KAYDON CORPORATION

Moderator: Rick Mosteller
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Rick Mosteller: Welcome to the Kaydon Corporation Third 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 requirements, 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, I would like to turn the call over to Mr. Jim O'Leary, Chairman and Chief Executive Officer of Kaydon Corporation. Mr. O'Leary, please go ahead.

James O’Leary: Great. Thank you, Rick and good morning and thank you all for joining us today to review our third quarter results.

Bottom line is we're pleased with our execution and what continues to be an extremely operating environment. The cost reduction and containment measures that we initiated early and aggressively in the downtown, together with the solid performance from our wind energy business, yielded results that are relatively stronger than those experienced earlier this year.

We're especially pleased with our cash flow performance this quarter and year to date, which reflected both these measures and our disciplined approach to manage capital expenditures during this downturn.

Overall, our industrial end markets appear to have stabilized, albeit at the relatively lower levels noted last quarter. Certain markets, notably wind energy and medical, were stronger as they benefited from the strategic positioning and the capital investments we've made in prior periods.

Also noteworthy, our military end market, while below last year's level, due to the timing of certain program ramp-ups, was solid sequentially in the current quarter, so are higher orders and solid shipments of military vehicle products.

This was attributable largely to the MATV program, which ramped up, essentially replacing the MRAP program, which benefited prior years.

On the industrial side of each of our businesses, conditions remain challenging. While there continue to be anecdotes of improved sentiment, as noted last quarter, I think we need more time and sustained strength to conclude an enduring recovery is underway.

On the wind side, we were pleased with our sales growth, due in large part to improved trade credit conditions, notably with customers' ability to obtain letters of credit as noted in the past.

The medium and longer-term outlook, however, will be heavily influenced by government policy that's currently a work in progress.

On a positive note, again anecdotally, there was greater clarity on the tax issues and the mechanisms for obtaining cash grants for qualified projects in the renewable energy space. This came out towards the end of last quarter, so any impact on the general turbine inventory buildup in the pipeline is a bit further down the road, but to overstate the obvious, more clarity is better than less.

The more important issue continues to be the need for clarity in the renewable electricity standard. This was passed by the House 4 months ago, and we continue to wait for Senate to act. From a macro perspective, when we look at our results, they have clearly been impacted by this industrial recession. However, when we look at our performance relative to past cycles, the actions taken to date to impact future cash flows in our general position, we and our board clearly have a great deal of confidence in our positions and our cash-generating ability, as evidence by a recent dividend increase.

When we look at EBITDA, EBIT and free cash flow, there were two important data points worth reviewing again. First, the disproportionate impact of depreciation from the largest capital expenditure program over any 10-year period in the company's history undertaken over a 24-month period. The annual run rate of depreciation in 2009 is approximately $20 million, as compared to $11.2 million in 2006.

Also, with the spending complete, and with the capital discipline introduced early in this downturn, our CapEx for the year will drop under $20 million for the year.

Second, the impact of pensions, with a GAAP costs on (what), after our second quarter's funding is again a fully funded pension plan, was about $4 million higher than the comparable trough in the previous recession, largely due to the interest rate and actuarial rate of return assumptions.

When we stand back and look at these items, the business performance and the margin comparisons are more reassuring unless the next major move in volume is down, as volume and capacity are the biggest issues on decremental or incremental margins.

Now we'll go through the details in our normal fashion. Sales in the third quarter were $123.6 million, as compared to $126.8 million in the third quarter of 2008. So roughly comparable.

Operating income was $24.6 million in the third quarter of 2009, as compared to $24.8 million in the third quarter of last year, while EBITDA, a non-GAAP measure, was $32.1 million in the third quarter of 2009, as compared to $31.8 million in the prior year's third quarter.

Net income for the third quarter was $16.1 million in the or 48 cents per share on a diluted basis, as compared to $16.3 million, or 50 cents per share, on a fully diluted basis in the prior year.

Business conditions worldwide remain extremely challenging, with lower sales volumes in the third quarter as compared to the prior year's third quarter for most of our businesses.

We have seen sequential sales stability in most of our businesses even though the comparisons to prior year remain unfavorable.

Wind energy was a positive story in sales in the third quarter, with wind energy sales of $41 million, an increase of $19.4 million, or 90% as compared to the prior year's third quarter.

The wind energy volume partially offset the combination of lower volume in our other businesses, lower pricing, and the adverse effects of foreign exchange sales, which, while becoming a tailwind, was still a bit of a headwind year over year.

Operating income in total, and in varying degrees in each segment, was adversely affected by the lower volume, higher pensions costs, product mix issues, and increased year-over-year depreciation, associated with the new wind energy capacity expansion.

With the reduced volume, we continue to be impacted by lost volume in most of our plants, as we continue to operate below last year's levels.

Operating income was positively impacted by the cost reduction and containment measures initiated early and aggressively in this downturn. In particular, we initiated several changes to certain post-retirement benefit plans, which will impact future cash flows and earnings.

The curtailment to these benefits resulted in a pre-tax gain of $5.4 million, or 10 cents on a fully diluted basis, in the third quarter of 2009. These curtailment gains were recorded as a reduction to SG&A in our P&L.

Interest income also continued to remain at negligible levels. We continue to review opportunities to further reduce structural capacity in the event that business remains at this low level for a protracted period of time.

Now let's review our segment operating performance and give some color on how our principal end markets were at this stage.

Friction control sales totaled $87.1 million, as compared to $79.3 million in the third quarter of 2008, as sales of wind energy and medical products exceeded prior year's level, offsetting declines in our other end markets, principally in industrial.

Our sales to industrial end markets, principally to and through distribution and semi-conductor were down, year over year, due to continued weak business conditions, while year-over-year third quarter sales to these markets were stable, or improved sequentially as compared to second quarter or 2009.

Sales to the defense market were below prior year for the quarter and year to date, as the prior year's MRAP production and shipments have thus far not been fully replaced by this year's combined MRAP and MATV shipments.

Recent awards for the MATV program have resulted in orders and will result in shipments in the fourth quarter of 2009, with additional potential orders as the program continues to ramp up.

Wind energy sales were $41 million in the third quarter, an increase of $19.4 million as compared to last year, reflecting principally the benefits of improved trade finance being available to our customers.

Third quarter 2009 friction control products' operating income totaled $15.4 million, as compared to $16.4 million last year. The decrease was attributable, again, to lower sales and adverse product mix, as lower sales of higher-margin industrial products were offset by growth in relatively lower margin wind product sales.

These adverse items were also partially offset by the net benefit of cost containment.

In velocity controls, third quarter sales totaled $12.2 million, as compared to $17.1 million in the prior year's third quarter, due to lower volume across the board.

Operating income declined to $2.1 million in the third quarter of 2009, from $4.5 million in the prior year's third quarter, due again principally to the effects of lower sales volume.

Our velocity control business, both in the U.S. and Europe, is highly correlated with the level of industrial activity, and is closely tied to the general industrial cycle. So obviously, this business dropped fastest and most severely as the economic crisis set in and spread.

That said, the direction is comparable to that experienced in the last turn, but now on a bigger and much more international business. So if the past is an indicator of future trends, as industrial activity begins to improve, this business should be one of the first to see the benefit.

Sales of sealing products were $8.8 million, as compared to $10.8 million in the third quarter of 2008, principally due to lower volume in our industrial markets, particularly the railroad and hydrocarbon processing markets.

Operating income declined to $800,000 from $1 million in last year's third quarter, due to lower volume and additional pensions costs, partially offset by cost containment efforts.

Finally, sales in the company's remaining businesses equaled $15.5 million during the third quarter of 2009, as compared to $19.7 million in the 2008 quarter, due to lower volume in each of the businesses. Operating income decreased from $1.8 million to $1.4 million in the third quarter, as lower volume was only partially offset by cost containment measures.

Most of the businesses were adversely affected again by the general slowdown in the industrial environment. The one-time $5.4 million curtailment gain was not allocated to any of the businesses and is an SG&A resident at corporate.

Backlog at quarter end was $250 million, as compared to $242.8 million at July 4, 2009, at the end of our second fiscal quarter, and $354.5 million at September 27, 2008.

Wind backlog was $129.6 million at the end of the quarter, as compared to $124.1 million at the end of last quarter, and $181.6 million at the end of last year's comparable quarter.

The drop in backlog from the third quarter of 2008 is attributable to shipments in excess of gross new orders, as the effect of the globally weak economy translated into lower orders and continued deferrals in our longer-cycle markets, in addition to pricing adjustments and contractual pass-throughs.

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

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

During the third quarter of 2009, interest income totaled $190,000 on our average investment balances of $223 million. This compares to $1.5 million of interest income in last year's third quarter, when we earned approximately 2.2% on average investment balances at $269.2 million.

The interest income reduction of $1.3 million quarter over quarter was equivalent to approximately 3 cents per share on a diluted basis. The lower average investment balances this year resulted from our capital expenditure program, increased working capital, stock repurchase activities, pension plan contributions and enhanced dividend in the year.

We continue to focus on security in our short-term investments, and accordingly, our cash and cash equivalents remain principally invested in money market funds invested solely in short-term Treasury securities. We expect interest income in the fourth quarter of 2009 to again be negligible.

Interest expense during the quarter was $62,000, representing the amortization of fees on our credit facility, as we completed the conversion of our long-term debt into equity during the third quarter of last year, during which interest expense was $1.4 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 instrument.

The effective tax rate during the third quarter of 2009 equaled 35.1%, compared with 34.4% in the prior third quarter. The effective tax rate for the full year of 2009 is expected to be approximately 35.4%. That income for the third quarter was $16.1 million or 48 cents per share on a diluted basis, as compared to third quarter 2008 net income of 16.3 million or 50 cents per share on a diluted basis. As Jim, noted this quarter’s earnings include approximately 10 cents per share benefit, resulting from the curtailment of certain post retirement benefits during the quarter.

Third quarter 2008 results have been adjusted to reflect the required retrospective application of new FASB guidance, which requires the use of a two-class method of earnings per share. These required adjustments reduce previously reported third quarter 2008 basic earnings per share by 1 cent and had no effect on diluted earnings per share.

During the quarter, EBITDA was $32.1 million compared to third quarter 2008 EBITDA of 31.8 million. Third quarter 2009 EBITDA margins were 25.9%, as compared to 25.1% in the prior third quarter. Again, EBITDA benefited by the 5.4 million curtailment gain.

Free cash flow during the third quarter was $40.5 million compared to 7.8 million in the prior third quarter. The year-over-year improvement is due principally to the $19.7 million reduction in inventory in this year's third quarter, as we made significant progress on our plans to reduce inventories from their increased levels earlier this year in both our wind energy business and across our other businesses.

We currently expect 2009 capital expenditures to be below $20 million, substantially lower than our original plan, 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. We've included in our earnings release reconciliations of these metrics to the most comparable GAAP measure.

Cash and cash equivalents increased $37 million during the quarter and totaled 247.8 million at the end of the third 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. All right. Thanks, Peter.

While the current economic environment remains challenging, we have taken several steps to improve our results and position us for the longer term. Having taken these steps, our strong balance sheet and leadership positions in fundamentally sound end markets should allow us to emerge from the current period stronger than when we entered. With unrestricted cash totaling 247.8 million, 295.1 million in available credit, and no debt outstanding, we're exceptionally well positioned for the longer term.

During the third quarter of 2009, we paid common stock dividends of 17 cents per share or 5.7 million. For the third quarter of 2009, we declared a dividend of 18 cents per share paid on October 5, 2009. The 5.9 increase in quarterly dividends 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 shares management's confidence in the fundamental strength of our businesses, its demonstrated cash generating ability and, together with our fortress balance sheet, is reflected in this enhanced return to our shareholders.

Finally, I'd like to thank each of our shareholders and our – and our employees for their efforts and their commitment during this extremely tough period and we'd like to thank them prospectively for their efforts ahead in what's likely to be a challenging remainder of 2009.

That concludes the formal presentation of the conference call. Operator, we'll now take questions.

Operator: Thank you. The question and answer session will be conducted electronically. If you would like to ask a question, please do so by pressing the star key followed by the digit 1 on your touchtone telephone. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. We will proceed in the order that you signal us and we'll take as many questions as time permits. Once again, please press star 1 on your touchtone telephone to ask a question.

We'll take our first question from Steve Barger of KeyBanc Capital Markets.

Steve Barger: Hi, good morning.

James O'Leary: Hi, Steve.

Steve Barger: Really impressive wind order in the quarter and I agree. I mean the lack of legislative clarity's a problem for wind build out it seems, even with the ITC and loan guarantee programs. Were the orders really driven as a result of state standards or to take advantage of the tax credit? And can you talk about what kind of customer's out shopping for turbines right now?

James O'Leary: Steve, I'd say probably neither and I'm glad you started with the wind question. And while normally we don't comment on – and we're not going to start giving guidance now, but we usually don't comment on how we stand relative to consensus and expectations. Yes, it is worth mentioning that we had a big beat this quarter. And part of the reason we had a big beat I think reflects something that is new about Kaydon now, as opposed to prior quarters and prior periods, which is we have a business with wind energy that has a lot of potential to surprise positively.

And you know going forward you know it certainly can cut the other way, but while we're executing the strategy that we've been articulating to you guys for at least the past 2 or 3 years; while we're executing the strategy of building out the business around our lead horse customer and working with secondary and tertiary customers to add up margin, we're in a position of taking market share around one of the stronger players in the industry.

So it's – where we are in the supply chain, it's almost impossible to say the tax credit impacted this order, the potential for an RES or a particular wind project impacted that order. I mean this performance this quarter is reflective of two things; successful execution of our strategy around a leading customer and pretty much the leader in North America, and the surprise you know that came in better as expected really was catch up from last quarter's shipments.

If you remember last quarter, we talked about how shipments slipped from Q2 into Q3; how previously quarter shipped from Q1 into Q2. That was all because of letters of credit, customer issues, individual things associated with more trade financing than anything else. What happened this quarter is trade financing got better, we caught up on last quarter shipments, and we didn't have misses this quarter.

So you know the grease in the wheels of the global industrial machine was starting to work better. So while I can't point to a particular order and trace it back to a particular – a particular legislative impact you know it really was execution and improved credit conditions, where our secondary and tertiary customers for the most part got healthier and were able to get letters of credit. The banks started working a little bit more effectively. People took shipments that they delayed last quarter and took the shipments that they expected.

I went through that long – that long speech because you know it doesn't mean we're in a position where we'll be able to continue to beat and we're doing more than catching up. But we are executing better than we expected. Trade finance has improved I'd say a little bit faster than I might have thought last quarter. We – again, while we don't issue guidance, we have talked in the past about the wind business.

We said we'd be at least equal to last year, so it'd be kind of silly to keep saying that since we've already beaten last year in the quarter. You know I think this is at least – we're probably on track for about 100 million or so and you know the potential to surprise will come from what people's confidence is and in RES and when people start placing orders.

And that really comes down to how fast Senate gets something through that's good for the industry. And I had really hoped you know this is much as a citizen and taxpayer as a person who's got a lot of capital invested in a business we believe in, but we really would hope that happens before the Copenhagen summit, because it's important for the United States as the leader in the world to go there as the leader with their house in order on a very important legislative issue.

Steve Barger: OK. And I want to follow up on something you said during that, which I thought you said that you strengthened a relationship with your non-primary customer and I guess, from a broader standpoint, have you been able to strengthen relationships with turbine manufactures in this slowdown and are you seeing that they're getting more confident, whether it's about an RES or about the future in general right now?

James O'Leary: Yes and a very selective no and let me give you the full detail.

You know, we have great relationships, pretty much with most everybody in the industry. As we've always said you know the size of our facility and the size of this product means you really can't service all of the major guys for most of their production in any single facility. So we have picked our lead horse in the Mexican facility and you know that's who our primary business is with.

We have always had pretty good relationships with a lot of secondary and tertiary and we can't name them because of confidentiality, but we've always had good relationships with them. With a lot of the other majors who are coming here to the United States, we're doing prototypes and working hard to do their work, but obviously the uncertainty is meaning they're a little bit slower on their supply chain build-out than maybe they would have been a year-and-a-half ago.

And you know where they've gotten stronger; I think the customer's ability to get trade financed, to get letters of credit, to be able to get their banks to issue them on a timely basis at quarter end; that's the part that got stronger. But with most of our customers, we've got great relationships and they continue to be great. We've worked with them during this downturn and they're still positioned pretty well.

The selective no is something I've talked about in the past. You know if this downturn were to continue and broader financial issues don't get better you know we do have at least a customer, but there are one or two guys in the top ten that are not as fiscally strong. And while we had a, you know, think really is a spectacularly good working capital performance this quarter, there are still some guys that are slow payers.

We're still working through inventory challenges, as you'd expect with the number. And you know I will share with you at some point, we run out of patience and we have to do something. And that's something we're monitoring closely and have worked with both the customer and talked to – talked to outside advisors as how to kind of kick them into action a bit sooner.

So across the board I'd say better and they got better because of trade finance. You know we do have a customer issue or two where it's largely driven by the financial conditions and those haven't gotten better. But for the most part business got better and it got better because of trade finance.

Steve Barger: Excellent. I'm going to shift gears and ask one more broader question, then I'll get back in line.

James O'Leary: All right.

Steve Barger: Can you talk directionally about your ability to hold price through the downturn so far for all your businesses? And with volume still pretty weak in a lot of your segments, do you expect pricing pressure to increase on programs where you might not be sole source?

James O'Leary: Actually pretty much pricing has been stable. We're getting inflation. Where we talk about price decreases, we have a couple of selective places where we've adjusted price to maybe more inventory or give the distribution a reason to pick something up. And the really – the principal price thing we talk about and that we may have mentioned it in the press release, that's the raw material pass-throughs, which are contractual.

Remember we – our business is more direct to OE, program specific; I can't think of an anecdote where we've had someone come back to us where we're not sole source, but it may be happening. It's just not of huge significance.

Steve Barger: So, just to follow up real quick, are customers coming forward with preliminary forecast plans for 2010? And are they pressuring you – they're not necessarily pressuring you on any price-downs going forward?

James O'Leary: Not of huge significance right now.

Steve Barger: OK, great.

James O'Leary: The big one that we've always talked about is a price-down, but that's a material pass-through on the – on the wind business.

Steve Barger: Right, right.

James O'Leary: Which it helps us on the way up, because our customers want to protect us. It hurts us on the way down because we have a commitment to our customers.

Steve Barger: Right. All right, thanks; I'll get back in line.

James O'Leary: OK. Thank you, Steve.

Operator: We'll take our next question from Eli Lustgarten of Longbow Securities.

Eli Lustgarten: Good morning. Nice …

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

Eli Lustgarten: Fine. Nice quarter.

James O'Leary: Thank you.

Eli Lustgarten: Impressive. Just one clarification; are we finished with the extraordinary 10 cents from the post retirement curtailment? Is there anymore coming or is that it?

James O'Leary: There may be another one of much less significance and it may be in – much less. It would be not half of what we've incurred to date, but we're still working on a couple that could come in the second – excuse me; in the last quarter, but it's nowhere as significant as this.

Male: (About 13 pennies; in there). Most of us – most of us (X) it out in the numbers.

James O'Leary: Yes. And we'll flag it very carefully if there is something in the – in the fourth quarter.

Eli Lustgarten: Now I guess the orders for wind were you know like $5.4 million, 5-1/2 million dollars higher than the shipment, so it was a $46 million quarter. From your general commentary, it sounds like virtually all of that orders were for shipments in 2010 at this point.

James O'Leary: Yes. They're for 2010 requirements.

Eli Lustgarten: Yes. And your indication from what you were saying is that the fourth quarter shipment in wind would be back towards the $20 million range that we've seen in the first part of the year.

James O'Leary: We will do at least that if trade finance continues to be on the mend.

Eli Lustgarten: Yes.

James O'Leary: And our principal customer is you know the timing of their line of balance continues to be what it is. Yes, we'll do at least – at least that and for the year we'll top out at about 100. There is the potential to do better but, again, this is a different Kaydon than maybe we'd experienced before. One week of good or bad shipments, 1 week good or bad commercial bank performance on letters of credit …

Male: Make a big difference.

Male: … is a huge potential number, with (the big) bearings.

Eli Lustgarten: And how much of you know we've talked – we know (today) we talk about there've been delays first quarter to second quarter, second quarter to third quarter. Do you have the rough magnitude of how much that's been delayed that hasn't been shipped that should have been shipped so far this year ((inaudible))?

James O'Leary: I think – yes, I think we're caught potentially where letters of credit impacted, I think we're caught up.

Eli Lustgarten: OK, so …

James O'Leary: Yes.

Eli Lustgarten: This will be just more normal kind of shipment. And was there profit – was there a profitability kick in the third quarter from catching up with delayed shipments, because of the way the accounts were? I mean you had most of the cost absorbed earlier, so would you have a somewhat better profitability on the catch up than you would have on the standard?

James O'Leary: Absolutely. Not better on the catch up, because these would have been inventoried and absorbed previously.

Eli Lustgarten: Yes.

James O'Leary: But you're getting a 15 to 20% pickup on the normal margin on the product, which is about what we suggested previously the wind product would be in this downturn.

Eli Lustgarten: But there was no extra – you didn't get a little better help because of the timing change and (kick).

James O'Leary: No. And, Eli, we probably – we wouldn't see that you know we won't see that leg up until we're a bit further along and you would – you're in a point where it's not a question of shipping and working down inventory, but we're producing a little bit more aggressively. And I don't think that comes until we've cleared the inventory at the turbine manufacturer level and they've got the visibility to start ordering more, which would be for the end of '10 and into '11, and we're producing then for that – for those periods.

Eli Lustgarten: And do you have any measure of how much inventory is sitting out at the OEM level or, (gee), at this point that has to still be absorbed? Or has that – most of that been taken care of in the last quarter (also).

James O'Leary: Eli, anything I'd give you would be anecdotal. I mean I listen to the – our customers' calls. I listen to the other turbine manufacturers and read what they come out with. Nobody has quantified sufficiently where it's a good enough tangible data point for me to be comfortable with, but we know anecdotally there's still a fair bit out there.

Eli Lustgarten: But we've gotten to a process of working it down.

James O'Leary: Absolutely. Oh yes, absolutely. And last week, they're not a customer, but we do you know we'd love to someday be and the people we've worked with, Siemens had a very you know large order they announced in North America the week before last. You have seen – again, they're all anecdotal, but wind developers are now saying that they've been able to access cash grants through the American Recovery Act.

Those are anecdotes, but they're all anecdotes in the right direction. They're all things that will start chipping away with inventory. But again, the longer, more important thing for you know people to plan very big you know these big, capital-intensive, supply chain-intensive business, and I'm talking about our customers now; the more important thing is clarity on years out and that comes in the form of an RES.

Eli Lustgarten: And a final, can we shift to the military – the defense? Can you give us some idea of what the ramp up of MATV looks like, compared to the downturn in MRAP and how that proceeds over the next quarter and into next year?

James O'Leary: Sure. I'm going to have Peter handle that one.

Peter DeChants: If you – looking at what MRAP was last year, without putting specific numbers on it, but you know from a bookings basis, say between 15 in 20 and MATV will be somewhat less than that; say between 10 and 15. And a portion of that will roll into 2010. We'll ship as much as we can in the fourth quarter.

Eli Lustgarten: But I mean for the year, the MRAP; the defense business is in the 70s you know somewhere between 70 and 80 million typically that – do we have sufficient orders to be at that level for 2010 at this point or we still have to wait for the government to let the orders to get to that level for next year?

James O'Leary: We have – we have to wait for the orders and way too early to talk about 2010, not because of MATV, by the way. The uncertainty really, in my mind, is around funding for other – funding and timing for other programs. MATV is pretty solid.

Eli Lustgarten: Yes.

Male: It'll be close to, but may not be as robust as MRAP, but close. This year we've talked about being in the 70 to 75 range, compared to about 80 last year. And the difference is the ramp down and then subsequent ramp up of MRAP and MAT, respectively.

Eli Lustgarten: All right. Thank you very much.

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

Operator: We'll take our next question from Peter Lisnic of Robert W. Baird.

Peter Lisnic: Good morning, everyone.

James O'Leary: Hello, Pete.

Peter Lisnic: I guess first question on the wind side, Jim, if you could clarify or maybe give us a little bit more color on some of these what I'll call, I guess you know customer issues that you have on the wind side, can you maybe give us a sense of – as to level of materiality in terms of what that might mean, either you know from a balance sheet perspective, cash perspective, however you want to look at it?

James O'Leary: We'll break it into two. We had – and you guys were gracious and aggressive in commenting on the working capital buildup in previous quarters. You know a lot of that translated into improved cash flow. I think inventories came down 20 this quarter. And that was largely, again, stuff that could have shipped, had backed up, we were holding while customers got letters of credit. Some of that's normal flow through, but the inventory reduction is largely the improvement in those customers' individual positions.

The one where you know in the one where you know it's just getting payment and we're holding a little bit of inventory, it's less than 10 million; I think it might be 7 or 8.

Peter Lisnic: OK, all right.

James O'Leary: And you know it's one – this is one of those things that happens during recessions, but it's a big deal for us and we've got to keep on it.

Peter Lisnic: OK.

James O'Leary: But it's not a – it's – the positive from this quarter was about 20, but the thing that we're still working on is about – I think it's about eight.

Peter Lisnic: All right. All right, that's good. And then in terms of – I know we're talking about renewable energy standard and how that needs to kind of flow through for the wind business to really you know get to that 160 run rate I guess, but you must have some insight into 2010 at this point. We've got customers talking about potentially booking some large orders in the fourth quarter on the wind side.

So can you give us any feel or sense as to what sort of the run rate could look like in 2010, given where we're at now and without an RES standard?

James O'Leary: Yes. It's too early, but I suspect again this year we'll probably close at around 100, maybe a little bit north of that and I think next year would be comparable, unless you have a big pickup due to – due to an RES that not only, by the way, not only improves the orders, but in combination with the American Recovery Act and improved financing, gets people shipping, building a lot faster. Because there still may be a disconnect between when you see orders come, driven by improved clarity with the RES, and as they clear the inventory, because stuff can only get done so fast.

So I think that actually could be a – somewhat of a bottleneck between seeing a big improvement in 2010, even if you have an RES and business gets better, cause you can just only do so much.

Peter Lisnic: OK.

James O'Leary: Does that make sense?

Peter Lisnic: Yes. Yes, it does. And then just shifting gears, really strong free cash flow in the quarter as you've talked about, so you know 7-1/2 bucks on the balance sheet; any change in thinking on what you might do in terms of putting that cash to use? Maybe talk about the acquisition environment and what that might look like relative to potentially using the cash for you know share buybacks or you know special dividend, any sorts of cash uses or changes in strategy there.

James O'Leary: Listen, a very robust discussion we have, not just with our investors, but with our board on capital allocation in general. And (we) have – I don't want to go too far down memory lane, but a couple years ago we said we don't subscribe to any single way to deliver value to our shareholders, but we had a lot of cash and we needed to do everything.

We did an acquisition that's been reasonably successful. We upped the repurchase program in a way that I think our shareholders thanks us for. Our average price is around where we are or a bit less today. We've upped the dividend twice. We expanded the cap ex program. We're continuing; we have dialog with our board on all of those things.

There's no big you know let's start with the last two components you mentioned. There's no consideration to dramatically up the repurchase program or a special dividend today, because you know after waiting a couple of years with cash for the acquisition market to improve, it feels like the potential for things to happen is stronger.

Now is there anything in the pipeline that's imminent? No. But you know dialog, conversations, at the end of economic cycle like this is when you see things start to happen. But I would tell you that challenges I've talked about on previous calls and I've talked about anecdotally with a number of you you know the biggest challenge continues to be the fact that banks are in a position where they would rather extend, amend, push things off.

That creates a challenge for strategic buyers like us and the properties just don't come to market. That's still going on. Although you know the owners of some of these businesses are willing to engage in conversations. People who have good businesses and are thinking about IPO or strategic sale obviously think it's worth investing time talking to people like Kaydon because we're well financed.

But I wouldn't say it's thawed enough where anything is imminent. And again, there are a lot of very unique things about this M&A market that, when I compare it to the next closest analogy, which would have been 2000 and 2002, the big difference is just some of the things that the commercial banks did covenant packages and the behavior of banks as far as amending, push out, extending, further extending not credit, but time.

And you know for the M&A market to change a lot, those things have to kind of hit the wall where people stop extending and the flip side is start really extending credit. A lot of people won't bring properties to market now, cause it's very hard to put leverage on a business, so the only real potential buyers you have are guys like us, which is good, but they still have to be in a position to sell them, which they're not quite yet.

Peter Lisnic: OK. All righty, thank you for the insights. I appreciate it.

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

Operator: Once again, press star 1 if you would like to ask a question. We'll take our next question from Mike Hamilton of RBC.

Mike Hamilton: Morning. Nice to hear you guys having fun.

James O'Leary: Good morning, Mike.

Mike Hamilton: A couple things; in the past you've tried where you could to flag when wind has had lumpy order pattern just on the inherent nature of timing. Is there anything you want us to think about at this stage on what we're seeing now?

James O'Leary: No. It's pretty – the – what Eli just went through is pretty much the book to build relative to the quarter. And orders are lumpy; will continue to be lumpy cause they're much bigger in nature, but nothing special to flag.

Mike Hamilton: OK, thanks. Could you walk through kind of your feeling on timing of backlog as you see things now, within the usual range that you'd discuss it?

Peter DeChants: Yes. As – I think as we've talked on the last couple calls, it sometimes shifts a bit within – because of the wind, from what it was traditionally, I think backlog ships about 40% in the next quarter and then fairly equally out over the next several, trailing down when you get out to the fifth and sixth quarters.

Mike Hamilton: Thanks. Then could you comment on some of the traditionally seasonally strong businesses in the third quarter and how they kind of performed in this cycle; filtration, et cetera?

James O'Leary: None of them saw the seasonal pop that they usually do. As I mentioned, industrial, which historically was a large part of our business; industrial is still, I'd say stable, but at a – the relatively low level that we discusses last quarter. And industrial really hasn't shown a real sustained improvement, where I'd say you've got a sustainable recovery.

You know for Kaydon, the two principal drivers of performance was wind, cost reduction and cost containment across the company, and while sequentially better, still year-over-year down, the military business. So it's the three factors; wind, MATV, cost reduction and containment.

Mike Hamilton: Thanks for the help.

James O'Leary: You're welcome.

Operator: That concludes the question and answer session for today. At this time, Mr. O'Leary, did you have any closing remarks?

James O'Leary: I'd say usually I like to do these things in the middle of the afternoon, but when you – and we usually do our call a little bit later, but I guess when you do it in the heart of the release season and you do it earlier in the morning, you tend to lose a few people, which is either good or bad. But we appreciate your time this morning. We appreciate your attention and particularly our shareholders sticking with you know sticking with the companies they've been in for a while during a very tough economic period, and we look forward to talking to you next quarter. So, Mindy, thank you very much.

Operator: That does conclude today's conference call. Thank you for your participation.

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