KAYDON CORP

Moderator: Rick Mosteller
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Rick Mosteller: Welcome to the Kaydon Corporation first quarter 2010 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 including 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 expectation and are subject to risks and uncertainties beyond the control of the company.

Listeners are cautioned to refer to the company's 2009 Form 10K for a list of risk factors that could cause its results to differ from those anticipated in any forward-looking statements.

The company does not undertake and expressly disclaims any obligation to update to 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.

Participating in today's call are Mr. Jim O'Leary, Chairman and Chief Executive Officer of Kaydon Corporation; Peter DeChants, our Chief Financial Officer and Don Buzinkai, our Controller.

Today's conference is being recorded.

Now, I'd like to turn the call over to Jim O'Leary, Chairman and Chief Executive Officer.

Jim O'Leary: Thank you, Rick. Good morning and thanks for joining us today. To sum up, we're pleased but I would say not satisfied with our results this quarter and not satisfied only in that it'll be nice to have a few more quarters of sustained of order growth. I think we're in, our second year and year and third consecutive.

So, a few more quarters of sustained order growth -- it would be nice to see all cylinders firing. Obviously more is going right than not. But it would be nice to see all of our end markets performing well.

But it does feel like we're in the early stages of a sustained recovery. We talked about that three quarters ago. The last two quarters we've seen order growth year-over-year in our industrial business.

And I think a positive sign here is in addition to the order growth in our industrial business you're seeing across all our businesses the benefits of the cost discipline and the cash flow discipline that we've put in over the last two years.

You see it in the margin line and you see it in the operating cash flow line.

So we're going to touch on those general themes as we go through the prepared remarks. They will be short and a bit sweeter than the last few quarters. And then we'll turn it over to Q&A.

Our performance this quarter reflects continued improvement in many of our key industrial end markets.

In addition, the favorable affects of actions taken early in the downturn to reduce structural costs and improve operating leverage.

We're especially pleased with our margin and our cash flow performance which illustrate our ongoing discipline in managing expenses and capital as we hopefully, hopefully emerge from this challenging period.

As I noted on our last call, our industrial businesses appear to be improving based on incoming orders in the first two months of 2010.

The improved order intake continued through the balance of the first quarter and into the first month of this quarter.

While meaningful growth in 2010 remains dependent on continued improvements and economic conditions and the resulting increase in our customer's capital spending, we're encouraged by the sustained strength in incoming orders.

Meaningful growth this year becomes especially dependent on ongoing strength in the broad industrial sector as much of our order growth is coming in what we traditionally have defined as the book and ship or in and out business which has shorter lead time and great - and visibility but a greater positive impact on results.

During the first quarter, sales grew both compared to prior year's comparable quarter and sequentially. Sales in the first fiscal quarter of 2010 were $119.2 million -- an increase of 8.1% compared to $110.3 million in the first quarter of last year.

This represents the first year-over-year increase in sales activity since the fourth quarter of 2008 as both shipping and order activity improved in most of our industrial business, in particular the short lead time industrial, semiconductor and military markets performed well relative to prior year.

Net income rose 36.6% to $13.8 million in the first quarter of 2010 or 41 cents per share on a diluted basis compared to the $10.1 million earned in the first quarter of 2009 or 30 cents per share. This represents the first year-over-year increase in net income since the third quarter of 2008.

Operating income was $19.7 million in the first quarter of 2010 -- an increase of 26.8% compared to $15.5 million in the first quarter of 2009 while EBITDA was $27.1 million in the first quarter of 2010 compared to $22.6 million in the prior quarter of last year.

Operating income in total and in both operating segments improved disproportionately to sales due principally to operating leverage associated with cost reductions undertaken over the past two years and the increased volume which improved cost absorption in our plants.

Now I'll move through a brief review of our operating segments.

Friction Control sales totaled $79.8 million compared with $72.2 million in the first quarter of 2009.

Sales growth was achieved in the wind energy, semiconductor and military markets which more than offset a decline principally to heavy equipment markets.

First quarter 2010 Friction Control operating income totaled $16.5 million compared to $12.5 million in the 2009 first quarter. The increase is primarily attributable to the effects of higher sales and improved cost absorptions associated with greater production volume.

Wind energy sales in the first quarter of 2010 were $29.3 million compared to $20.8 million in the first quarter of 2009.

For the full year of 2010 while still subject to continued economic improvement and the potential impact of legislative activity, we continue to expect 2010 wind shipments to be comparable to the level attained in 2009.

In Velocity Control, first quarter 2010 sales totaled $14.2 million -- an increase of 17.1% as compared to the $12.2 million in the prior year's first quarter as sales volume in both North America and now in Europe picked up.

Velocity Control operating income increased to $3.4 million in the first quarter from $2.2 million last year due principally to the effects of increased sales volume, the resultant improved absorption and the benefit of earlier cost reduction activities.

In other industrial products, sales totaled $25.2 million during the first quarter of 2010 compared to $26 million in 2009 principally from lower shipments of sealing products which more than offset increased demand for air and liquid filtration products.

First quarter 2010 operating income for these businesses totaled $1.3 million compared to the 1.4 last year. And decreased volume was only partially offset by cost containment efforts.

Worth noting, both shipments and operating income were negatively impacted by disruptions associated with the record snowfall in the mid-Atlantic this year which resulted in six lost shipping days at our sealing products facility.

Orders were $100.5 million across the company in the first quarter of 2010 compared to $71.1 million in the first quarter of 2009 -- an increase of 41.5%.

Excluding the impact of discrete wind energy orders on prior years, this represents the largest dollar increase in orders in Kaydon history.

Backlog at quarter end was 199.8 million compared to 218.5 million at December 31, 2009. The decline was largely due to timing associated with large discrete wind orders anticipated later in 2010 partially offset by strong order rates in the industrial business.

Also impacting backlog is the increase of - the increased mix of orders made during the quarter for immediate shipment reflecting our customer's cautiousness on taking excess inventory.

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

Peter DeChants: Thanks Jim and good morning everyone. During the first quarter of 2010, both interest income and interest expense were negligible as our cash was principally invested in low-yielding treasury money-market funds and our balance sheet remains debt free.

The effective tax rate during the first quarter of 2010 equaled 29.6% compared to 35.1% in the prior first quarter due to some discrete items in the quarter as well as some steps we've taken to reduce our effective rate on an ongoing basis.

The first quarter 2010 effective tax rate decrease before discrete items in the quarter to 31-1/2% compared to 35.7% in 2009's first quarter due to the plan's permanent reinvestment of earnings of certain international operations as well as the full phase-in of the domestic manufacturing deduction.

Additionally first quarter 2010 results include a net benefit of 500,000 or 1 cent per share on a diluted basis for certain discrete tax items in this year's first quarter.

This net benefit included a portion of the qualifying advanced energy investment tax credit we received of $1.4 million partly offset by adjustments to deferred tax assets including an adjustment of approximately $300,000 for reduced deductibility of post-retirement prescription drug coverage related to Medicare Part D subsidies.

These items contributed to the first quarter's effective tax rate of 29.6%. The effective tax rate for the balance of 2010 is expected to be approximately 32% plus or minus.

During the first quarter 2010 EBITDA was $27.1 million compared to first quarter 2009 EBITDA of $22.6 million.

First quarter 2010 EBITDA margins increased to 22.7% as compared to 20.5% in prior first quarter.

Free cash flow during the quarter was $27.9 million compared to $1.3 million in last year's first quarter.

Year over year improvement is due principally to higher net income, improved working capital performance and reduced capital expenditures.

Capital expenditures in the first quarter were about $2 million this year which should not be considered reflective of our expenditure rate for the year.

We have additional projects planned in later quarters and still expect CapEx in 2010 to come in around 25 million.

Again, EBITDA and free cash flow are non-GAAP measures which should be viewed as supplemental data rather than as substitutes for alternatives to comparable GAAP measures.

We've included in our earnings release the reconciliation of these metrics and the most comparable GAAP measure for your reference.

Regarding reporting segments, as you may have noticed during Jim's discussion of operating segments, we have changed our segment reporting beginning in Q1 of this year.

We will now include in our financial reporting only two operating segments, Friction Controls and Velocity Controls.

The companies sealing products operating segment no longer meets the quantitative threshold for separate disclosure and is included in other industrial products caption in our segment schedule.

On the balance sheet, cash and cash equivalents increased 12.6 million during the quarter and totaled $275 million at the end of the first quarter 2010 compared to $262.4 million at the end of 2009.

Quarter end cash of $275 million also represents a $54.7 million increase from the end of last year's first quarter.

As we've discussed on earlier calls, improved working capital management particularly in inventories in the second half of 2009 and into the first quarter this year together with reduced capital expenditures contributed to positive cash generation.

Inventory turns increased to 3.6 turns in the first quarter of 2010 from 2.6 turns in the first quarter of 2009. This improvement was offset in part by an increase in DSOs to approximately 64 days from the 55 days in the first quarter of 2009 as we've selectively extended terms in certain instances.

In addition in the quarter we paid cash dividends totaling $6 million and repurchased 207,437 shares of our common stock for 7-1/2 million.

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

Jim O'Leary: Thanks Peter. As I noted at the start of the call, we're pleased with our performance in the first quarter.

Economic conditions reflected in both shipments and orders have been improving.

While business conditions in the last two years were no doubt tough, we're beginning to realize some of the benefits of the difficult cost containment efforts initiated during the recession.

Together with our rock solid balance sheet, we're well positioned to benefit as the industrial markets continue to improve.

Lastly, I'd like to thank each of our Kaydon employees for their efforts as hopefully we exit one of the toughest economic periods in any of our lifetimes. And again, hopefully we're entering a much better cycle.

That concludes the formal remarks. Anna, we would open it up to 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 touch-tone telephone. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again that is star 1 if you would like to ask a question.

And we'll take our first question from Edward Marshall with Sidoti & Company.

Edward Marshall: Good morning guys.

Jim O'Leary: Hey Ed; how are you?

Edward Marshall: Good. I - my first question's on the Friction Control segment. When I look at that business less the wind energy sales, I would have suspected that the margin would have come in a little bit lower.

But is that part of the cost improvements that you've made that, you know, looking at it relative to the fourth quarter and the first quarter of last year, sales were slightly down but margin improved by quite a bit.

Jim O'Leary: Yes, it's two things Ed. First, it's a better mix. Even though you've got 29 million of wind, you know the book and ship business in - in particular semiconductor which, you know, in the five years I've been associated with the company and, you know, really since 2000 and - I think 2000, this is probably the best contribution from the semiconductor which is a reasonably high margin business.

So its book and ship particularly in end markets like semiconductor. So even though you've got 29.8 million of wind sales, you're having a little bit of a favorable impact of wind.

I think the bigger contributor is probably the leverage we're getting from cost reductions, a host of initiatives we put in the last two years.

And even though in SG&A you see an absolute increase in SG&A as we saw putting in incentive comp in sales programs or mercifully paying our salespeople, that's more than being offset by other things we did during the downturn.

Edward Marshall: Okay. And then the contribution for military in the quarter, I'm not sure if you'll break that out but I'll ask.

Jim O'Leary: We prefer not to. It was a good quarter. It - you know, again, we talk to at MATV a lot because incrementally it's positive.

Military was strong but once we start breaking out individual segments we'd be here all day because...

Edward Marshall: Sure.

Jim O'Leary: ...it's a contributor but it's not an enormous percentage.

Edward Marshall: And do you still aim for 65 to 70 million for the year?

Jim O'Leary: Yes. And remember that's within Friction Control 65 to 70. But that's still what we expect.

Edward Marshall: Okay, thank you guys.

Jim O'Leary: You're welcome Ed. Thank you.

Operator: We'll now take our next question from Walt Liptak with Barrington Research.

Walt Liptak: Hi. Thanks. Good morning guys.

Jim O'Leary: Hey Walt. How are you?

Walt Liptak: Good. I wanted to ask on the military side too, I understand that you don't want to give the revenue. But, you know, production, you know, kind of bubbles up and then slows down in the second and the third quarter. Is that - at the truck makers. Is that what happens with your revenue as well or is there something else going on there?

Jim O'Leary: Well for the one program in particularly I'd assume you're talking about it, it's going to be very similar to Oshkosh. We'll get an enhanced contribution from MATV first quarter which is just behind us, still a pretty healthy contribution in two. And then it starts to tail off unless there's an additional wave of orders.

We may see and we're not expecting it yet, but at some point you're going to start to see refurbishment which, you know, will be in a modestly different position than VOE. And so Oshkosh would see their production tail off.

We could see some replacements, some refurbs and stuff that's been in service. But excluding that you'll see a very similar dynamic with a bit of a lag where you drop off in Q2, 3 and 4.

Yes, again, that's all absent in other blanket order.

Walt Liptak: Okay. And the 65 to 70 million of military you talked about, that's not all MATV is it?

Jim O'Leary: Oh no, no, no, no. No, that's a host of programs. MATV is only a portion of it.

Walt Liptak: Okay, have you talked about what portion MATV is?

Jim O'Leary: Well we don't give the military portion. We don't give the MATV portions, no. It's a - no, it's not 1/3 of it.

Walt Liptak: Okay. And I wanted to ask about the tax rate for next quarter. Should we use the 32% for the full year numbers or any, you know, discrete items in the second quarter as well?

Peter DeChants: It's approximately 32% in the next three quarters. That's not - the full year rate would be - then be approximately 31-1/2 give or take.

Walt Liptak: Oh I see. Okay. All right, thanks very much.

Jim O'Leary: Thank you Walt.

Operator: We'll now move on to Eli Lustgarten with Longbow Research.

Eli Lustgarten: Good morning.

Jim O'Leary: Hi.

Eli Lustgarten: I hope this is the beginning of a nice trend.

Jim O'Leary: We hope so too.

Eli Lustgarten: Very quickly, what's the backlog in wind at the end of the quarter?

Jim O'Leary: Do we have that for you?

Peter DeChants: Backlog in wind is about 81 million.

Eli Lustgarten: So, you know, and the same question in military. We're still flat shipment. Are we having a - still a stronger second quarter and then it bubbles - it phases down unless some orders come in or is it relatively evenly distributed for the rest of the year? How does that work out?

Jim O'Leary: Well let's - I'm glad you asked the question. Let's talk about wind in particular because we have some comments in the press release and we talked about a few. I want to make sure everybody understands them.

Wind, we're still expecting it to be about 100 million a year for shipments -- same as before.

The orders - you know, obviously orders are better year-over-year. But that's because we didn't have cancellations this quarter. And last year at this time obviously people were a lot more despondent than they are today.

So you had cancellations and modest order, you know, and order this quarter, so, about a million compared to cancellations last year.

We don’t expect and we haven’t expected major wind orders till the back half of this year. And that’s still the case.

So to replenish backlog and to have the 100 million not for this year but for next year you need to see orders in the back half of the year.

Based on our discussions with known customers looking at their order trends over the past few years there’s no reason not to think we’re going to get some meaningful orders in the back half of this year and probably more heavily weighted towards the third quarter and that’s subject to a bunch of things that seem to change every day in the newspaper.

Right now, that’s based on production schedules and known installations over the next two years or so. But it’s dependent on what the government’s going to do. I’d say it’s probably more so it’s dependent on what the utilities are going to do as far as increased electrical demand.

But, you know, we’d expect those orders in the back half of the year. That would have more of an impact on how next year unfolds and whether or not we’re at 100 million or more or less. And we’d see that probably in the third quarter.

For this year, you know, we’re still based on the 29 plus the 80 million in backlog. We’re still comfortable with 100 million in shipments. But obviously until you start to get orders and we rebuild the backlog which is, you know, really identical to the same situation our customers have, you know, there’s enough public turbine producers out there where you have pretty good visibility on the trends that they’re seeing. And we’re about a quarter or two lag from them.

So we’re still on a backlog replenishment mode. It happens in the back half of this year. And I hate to be here saying it’s policy and it’s the economy, but really it’s policy and the economy.

With $86 going higher, you know, a lot of stuff in the press recently about comfort level with production techniques and safety, you know, I suspect we'll see more of a push and more headlines pro wind energy in the weeks and months to come, you know, certainly approval of Cape Wind.

You know, even if it doesn't mean it's going to be installed in the next couple weeks, I think that'll still go on for a few years.

The fact that sentiment's shifted sufficiently to get that approved are all anecdotally positive. And, you know, I think, you know, the drumbeat of that coupled with high 80s oil gives us a greater comfort level that, you know, next year will be a positive one but it's a little too early to talk specifically until we get the shipments in hand which should be the back half of this year.

Eli Lustgarten: All right. And follow-up, with the wonderful margins in the quarter, can you talk about the sustainability of the profitability as we go through the rest of the year and what kind of headwinds?

You know, you do have some dropping of both wind and military business and there is material pressures I assume that is going to be building through the rest of the year. So can you talk about material costs and the headwinds of maintaining profitability at the current level?

Jim O'Leary: Right now, we'd expect the margins we've got to be flattish and sustainable through the year. We are starting to see some cost increases in the pipeline particularly on goods that we are buying in bulk, i.e. steel and some of the headline commodities that others have talked about there being risks.

Thus far we've been able to pass it along. But, you know, I do agree with you that could be a risk in the back half of the year. That's why I'd say it's reasonable, you know, if not a little aggressive to think our margins will stay where they are. That's our goal for the year.

Eli Lustgarten: And true in both divisions, not only Friction but in Velocity too?

Jim O'Leary: Yes, sir.

Eli Lustgarten: And one final question, can you talk about - you've got a lot of cash. We're still waiting for you to do something. We hear a lot about wind in China's up. Can we talk about acquisitions, joint ventures, what's going on because, you know, in your world at this point as you look out next - for the rest of the year?

Jim O'Leary: Sure. You know, in the acquisition market it is getting a lot better. We're having productive conversations with people. There's nothing that's going to happen right away. But there are a bunch of things where I think there's constructive conversations, businesses that make sense for us.

And, you know, right now you've got sellers that are a bit more or a bit less reticent to put businesses to market if they think there's a viable way for companies to close them, credit markets to be there and, you know, companies that are willing to take a - flyer's the wrong word, but are comfortable enough with not 2010 but the number's your buying business off which is 2011 and 2012.

So the M&A market is getting better but I don't forecast acquisitions. I'd say it's considerably better than a year ago. And, you know, I'm optimistic that'll continue as long as the credit markets remain strong.

And again, not credit markets for Kaydon, but sellers don't want to put out their businesses unless, you know, unless if you had any financing need or if you're selling to others that do have a financing need, the credit market's supportive of it. So that's all positive.

On the capital side, the CapEx side we've mentioned last quarter, we've got a couple of projects coming down the pike which, you know, we're optimistic in.

We've, you know, we spent the last two years looking for cost savings, not just cyclical cost savings but structural cost savings.

And there's a couple of things in the next few quarters it will - we'll be working on which will influence capital spending, not huge dollars but, you know, probably push you towards that 20 million plus CapEx spend for the year.

We have looked at and had a lot of discussions with people in China. You know, the local content requirements which have recently been relaxed but, you know, really did color a lot of people's approach and perception to entering that market.

And we're still having discussions with people but there's nothing imminent. And that market is strong. In fact it's the strongest wind energy market in the world right now. But there's nothing imminent.

I would point out though, while there's nothing imminent as far as a JV or the like, our second biggest customer is a Chinese wind manufacturer, a wind turbine manufacturer. So we are participating in the market, not as directly as we would like though.

Eli Lustgarten: And just one final. Could you quantify how much the weather cost you in the other sectors in the quarter?

Jim O'Leary: You know, six shipping days, is it $1 million of shipments, you know, probably, you know, if that and, you know, a 10% to 15% margin.

So there's a reason we put that in is because we got a lot of questions when, you know, it was snowing like crazy. And you saw the headlines in Baltimore. In particular that's where our facility is.

And if you look at how close the numbers were to being below prior year I'd say we would have been up both sales and profits year-over-year if not for those six days.

That's the main reason we put it in. We got a lot a questions about it. And that probably was a, you know, on the margin an important incremental factor as to being down year-over-year as opposed to being up year-over-year.

Eli Lustgarten: Thank you very much.

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

Operator: As a reminder, please press star 1 if you would like to ask a question. We'll now move on to Mike Hamilton with RBC.

Mike Hamilton: Good morning gentlemen.

Jim O'Leary: Hello Mike.

Mike Hamilton: Congratulations.

Jim O'Leary: Thank you.

Mike Hamilton: One just didn't hear. You mentioned 7-1/2 million in repurchase. What was the share amount again? I apologize?

Peter DeChants: Sure Mike. It was a little over 200,000.

Mike Hamilton: Thanks. How it did FX play out in the quarter?

Peter DeChants: FX was a bit favorable on the top line and about a push for gross profit. But with the euro and pound it was probably about 700,000 cost us year-over-year in the quarter.

Mike Hamilton: Thanks. And then last question, could you comment a little bit on tenor and tone of your European business at this stage?

Jim O'Leary: Improved, improved. The European business that has the highest impact on us and is most visible to you is Velocity Controls and, you know, the trends that we started to see kind of improving two quarters ago and sustained improvement last quarter are starting to play out in Germany now as well, so absolutely improved.

And I've focused specifically on Germany. You know, our - we have an English business, an English split roller bearing business. That has not improved as much. But I don't think it has to do with either Europe or currency or the like.

It is 100% to do with the markets they serve. That's a much more heavy industrial, much like the OE heavy equipment business and services, a couple end markets that are, you know, on a bit of a lag like the steel industry all of which is starting to improve. But I think that's a quarter behind because of the end markets, not because of the geography.

Mike Hamilton: Thanks Jim.

Jim O'Leary: Okay. You're welcome.

Operator: We'll now move onto Steve Barger with KeyBanc Capital Markets.

Steve Barger: Hi. Good morning.

Jim O'Leary: Hi Steve. How are you?

Steve Barger: I'm pretty good. How about you?

Jim O'Leary: Good thanks.

Steve Barger: I wanted the - looking at the non-wind business kind of flattish year-over-year. But you - I know the order rate's growing. I'm just trying to get an idea of what you're expecting for non-wind growth rates in terms of revenue in the back half. Do you expect that's going to trend back to high single digit or how are you thinking about that?

Jim O'Leary: It'll be mid-ish, you know, and right now based on when you talk about $30 million of orders most of which were concentrated in - all of which were in the non-wind industrial machinery, semiconductor, you know, kind of what we call the book and ship orders.

So when I say it's, you know, for the year, you know, in the single digits, mid-single digit range and whether or not it's better than that depends on whether or not that order rate continues because, you know, the good thing about the book and ship business is it's high margin. It's high value-added.

The tough thing is you have lower visibility. And that was the business that if you remember two years ago in June of ‘06 we were - excuse me, June of ‘08 we're talking about business falling off because of that. It drops off very quickly.

But so far, it's the same strength and it’s still, you know, through today it’s still doing well into this quarter.

Steve Barger: Right. So if we - if you get back to that mid-single digit growth rate and let's just assume that wind in the back half is a fairly level loaded or however that plays out, can you help us think about what the right incremental contribution margin is in the back half as the comps get a little bit tougher?

Jim O’Leary: Well I’ll let Peter cover the incremental contribution. But we did say for the year we expect it to be flattish. Because I do think you have the headwind of raw material increases.

And, you know, I think it's important with 100 million in wind, 29 million out the door and probably a declining, you know, modest decline, we over - I think we over performed, overachieved this quarter doing 29 as opposed to, you know, low to mid - mid 20s, low 20s which is what we’d expected previously.

You know, the mid-level, you know, the mid-single digits is an aggregation. So you're not going to see, you know, a great wind performance in the fourth quarter unless you get big orders. So that trails off a bit as does military.

So it's other things which have a higher margin offsetting what's likely to be slightly lower than first quarter wind and military, right?

Steve Barger: Right.

Jim O'Leary: Okay. So now Peter will cover incremental margins.

Peter DeChants: On the incremental margin Steve I - you know, we have said that we're looking for the margins, just the overall margin for the year to be fairly consistent with what we saw in Q1. So given the consistent mix level the contribution margin should be similar to what you'd seen in Q1 as well.

Steve Barger: Okay wow. And in terms of the wind, if you start to take big wind orders in the back half, what's the delivery schedule typically on those?

Do you - presume - we know you have open capacity right now. Is that stuff that would potentially ship in the same quarter or the next quarter or would you expect to be taking orders for delivery a year out?

Jim O'Leary: You know, Steve, I'm glad you asked because that - you know, one of - a lot of the comments after our last quarter as people kind of looked at the backlog drop and kind of the overall delivery in shipment and order performance, you know, there's a lot of discussion about the seasonality of wind orders, how things are going to unfold.

It's kind of hard to talk about seasonality of a business that really hasn't existed through a full cycle and certainly hasn't existed in the form that is now.

And if you remember it's worth looking at Kaydon history. The reason we kind of called out the $30 million increase in orders. That's the best in Kaydon history except for wind. It's the highest in the industrial business.

And when you go back before 2006 - in the 2006, you know, the dynamics of how we build backlog changed dramatically. From 2006 through, you know, pretty much the end of 2007 we were taking massive orders that couldn't ship.

And they couldn't ship because number one we didn't have the capacity. Number two, you know, people didn't even need them yet. They were trying to, I'm talking about the turbine manufacturers. They were trying to book up capacity in the supply chain for 18 months, 24 months, 36 months.

We, you know, we had orders that were outside of backlog that were very significant in those years and what happened in the last year is, you know, the world has obviously changed. Turbine manufacturers were working down their own inventory and their own supply and suppliers' inventory.

There's no need to point out orders right now until you have some clarity on the legislative front.

This is a long prologue to say, you know, I think it's a very good chance you could get if the market took off, you could get orders that would be booked and shipped in nature.

I don't think the dynamics have changed towards book and ship because a wind farm has a much longer lead time. But right now, there's no terrible incentive like there was two or three years ago or even four years ago to place orders to ramp up capacity. You know, there's just not that much known demand today.

If you've got a renewable energy bill and, you know, oil went back up to 100 or, you know, some of the other things that drove that behavior back then you could see big orders and you can see some orders for immediate shipment.

But right now, the OE, you know, the wind turbine producer they don't have terrible incentive to do anything other than order not quite on a just in time basis. \

But I think you move from where people were placing orders it would cover three years worth of requirements to something that's a little bit closer to just in time that existed over this past cycle.

So you absolutely could get orders that impact it. But I do think we need the backdrop of stronger economy, higher oil, and, you know, real clarity on the legislative front all of which could happen. But I think it's, you know, we're in a little early in the game to say that today.

Steve Barger: Right. No that's a color. Thanks.

Jim O'Leary: Yes.

Steve Barger: Now I think there were around 9900 megawatts installed in 2009. Do you have any idea of how much of that came from inventory as you think about bearings?

Jim O'Leary: There's a printout. The EER who is Emerging Energy Research is the - is the source that we subscribe to. It's reasonably reliable.

I thought it was half. I mean it was a pretty large number of orders from the prior year which you'd assume is not inventory sitting on somebody's parking lot, you know, were a work in process and production that was in process at the beginning of last year.

So it's a pretty significant number. And, you know, if you have subscription to the service I'm pretty sure you could just Google it. Because when it comes out it's usually picked up by the mainstream media pretty, you know, pretty thoroughly.

EER came out with their forecast. And, you know, an interesting observation about North America and the past forecast which came out last week, you know, in the past few years you'd see a base case which was meaningfully higher than the downside and close to and constantly trending up to the upside case.

This is the first time I remember that, you know, the base case is right on top of the downside case.

And you almost have enough headroom for a double if the optimistic case of renewable energy, higher natural gas, higher oil prices, you know, there's a huge gap.

In fact it's the largest gap I remember between the base case and the upside case which I think is reflective of the sentiment.

You know, everything kind of swings to extremes particularly when you've gone through a period like we've had.

You know, three years ago, you know, you saw always a narrowing between the base case and the upside. And there was a lot of headroom or a lot of downside room between base case and the low case.

Now you've got the base case right on top of the downside case with a lot of headroom for positive surprises which, you know, again I am hopeful that maybe we've swung to an extreme in pessimism and that leaves room - some room for positive surprises the most important being you need a renewable electricity standard. And that's...

Steve Barger: Right.

Jim O'Leary: ...that's the thing that our customers need to really plan. And that's the thing that our customers' customers utilities in particular, need to plan their requirements.

Steve Barger: Right. But given the commentary about the, you know, potentially heading back to a, more of a just in time dynamic and if you were to see those things play out, the high gas prices on RES, that would, you know, imply a pretty significant bump in production just to be able to supply anything, right?

Jim O'Leary: I think so. I think so. But if you had an RES and you had people now planning for, you know, more than the next quarters and the next year's requirements, you know, I think you would see the dynamic of blanket orders that go out multi quarters, so...

Steve Barger: Right.

Jim O'Leary: ...I think both, yes.

Steve Barger: So you'd see backlog growth in a big way?

Jim O'Leary: Yes.

Steve Barger: One last one and I'll get back in line. Are there any reliable forecast for Chinese or Asian turbine growth in general? And how are you thinking about the best way to serve that market since your second biggest customer is over there?

Jim O'Leary: Okay EER came out with their Asian forecast and their global forecast on the same days. So that was two Fridays ago and then again if you Google it if you don't have the service you'll certainly see it was picked up by most of the mainstream. And they're pretty good. And that's EER, Emerging Energy Research.

And, you know, we are continuing as I think I responded to your last question. We're working hard on JVs. We're looking at the right partners.

But, you know, it's - that stuff takes a long time to develop. We’re working actively and I think with a softer dollar relative to the Chinese currency. If it does get revalued it’s a positive.

But, you know, I think something that is worth mentioning, you know, right now they're having a little bit, I wouldn’t say a hiccup but they're working on transmission issues.

They've had an unbelievable period of growth. This is the Chinese market. And I think there’s a little bit of a digestion phase too. So we're working on all the long-term initiatives. They just take a while.

Steve Barger: Great. Thank you.

Jim O’Leary: Okay, thank you Steve.

Operator: Our next question comes from Peter Lisnic with Robert W. Baird.

Peter Lisnic: Good morning everyone.

Jim O’Leary: Good morning Pete.

Peter Lisnic: I guess first question on the cash flow statement, the $12 million contribution from other items. Can you just help identify what exactly that is?

Peter DeChants: That was principally accrued liabilities with some timing on some tax payments and other accruals.

We've got some accruals for sales commissions, incentive compensation assuming it's earned, which we didn't have in the last year.

Peter Lisnic: Okay all right. So that will presumably washout through the rest of the year. The - I guess Jim on the - you've talked about the book and ship business and the strength there.

But typically we've seen the industrial or the - I should say the longer cycle business follow that, you know, a quarter or two after.

What sorts of indications are you getting from your customers on that piece of the business and demand there?

Jim O'Leary: When you say the longer cycle I think, you know, I'm glad we - it's a good question right after that the monologue I gave you the development of the wind business.

You know, if you look back at Kaydon before 2006 we had almost a decade where my predecessor, his predecessor, I think even his predecessor's predecessor were talking about continued contraction in orders, you know, backlog getting shorter and a higher mix of business that was short lead time.

And, you know, that was the world, just in time, a lot of the Toyota manufacturing processes.

You know, quick shipments were becoming the norm and backlog lead times, you know, were becoming shorter and shorter.

When we started accepting wind orders and as you saw the growth in the heavy equipment space and the heavy industry space, those are typically longer lead time in nature.

So while you might say there’s a typical lag, you know, the biggest driver of our back log development just because of the absolute size of the orders that will be wind.

And, you know, we expect in the third quarter the back half of this year, and that's based on discussions with guys today that's when we expect they'll be putting in their needs for 2011 forward.

So, you know, that's kind of a discrete element where you can point to that specifically.

You know, the heavy equipment business I’m hopeful it'll start picking up. You know, we’re certainly seeing their sales improve. We're hearing from the mining companies and the crane companies, you know, that they're feeling better although I don't think we'll have meaningful orders until back half of the year and into next year.

Again and that's because of the lag that is - the traditional lag you were referring to.

But you've got to throw in the wind piece as well because that is our longest lead time business. And that's a very big discrete item that we can talk about.

Peter Lisnic: Okay, all right. And then I guess the last question I just want to get behind this flattish margin comment I guess.

If I look at the mix of the business, you know, more book and ship which in theory should be higher margin, a little bit less wind in the back half of the year which I always assume is a little bit lower than, you know, book and ship for example.

So is sort of that gap, is that really all just materials cost or is there just an element of conservatism in the forecast or maybe give me an understanding, what sort of the moving parts are to the sort of the flattish margin outlook?

Jim O’Leary: I think you could say conservatism but there’s a, you know, there is a fair amount of raw material price increases in the pipeline.

You know, for a quarter or two you'd have to have a much higher mix of book and ship to offset the wind.

Now that will turn around by the back half of the year. But, you know, I'm hopeful we don't have that dynamic of higher margins on a much lower revenue base because of wind.

So you can say it's a little bit of conservatism but I think it's reasonable conservatism. And if you had to point to one item I’d say it's raw material.

Peter Lisnic: Okay, all right. And then what's your feeling on - in terms of getting price on the commodity cost increases?

Jim O’Leary: We've been able to get that. And historically have been able to. But, you know, it gets tougher and tougher at some point.

And we, you know, we don't want our wind business to have, you know, gross margins of 46%. You know, we don't want to lose that, keep gross margins if we could go to 45% or 44%. So and there's a little element of pass through that you have to do at this point in the cycle.

Peter Lisnic: Okay, understandable. And then the last question just on cash. I know you mentioned the acquisition environment, just wondering what sort of the outlook is or the feeling for dividend in case there is, you know, nothing in the pipeline from an acquisition perspective?

Jim O'Leary: I mean we've, you know, we've always said that we're going to do with our free cash flow dynamics, our reinvestment needs and with the cash balance we have, we've been open to share repurchase which if you notice we started again and stepped up a bit this quarter.

We've been open to and receptive to dividend increases. We did our third dividend increase in consecutive years. You know, one of the few industrial companies that did them in the downturn.

So open to both, but want to be opportunistic because I do think things are improving. But I would say we're absolutely shareholder friendly as it relates to repurchase which again we started and, you know, not a huge way but I do say it's a meaningful way this past quarter.

And I think the last three years including this downturn, the two years in a downturn show, you know, we understand and we appreciate our - some of our constituent's desire to see dividend.

That was certainly one of the things that helped, you know, people produce returns when stock prices were plunging was a consistent dividend which we appreciate as well.

Peter Lisnic: Okay all right. That is very helpful. Thanks for your time.

Jim O'Leary: Thank you, Pete.

Operator: Our next question comes from Holden Lewis with BB&T.

Holden Lewis: Thank you. Good morning.

Jim O'Leary: Hey Holden, good morning.

Holden Lewis: On the non-wind side again can you give some color about what your book to bill is looking like?

And one of the reasons I ask is because I know that you indicated through February last year or February at your last conference call that, you know, orders were looking up in sort of the 50-ish range I think for non-wind.

And they sort of came in around that 34% range. So is that just a function of sort of timing or did that slow in March?

And just how - as we go into April are we still seeing, you know, orders outpacing your sales and shipments rates or have we sort of slipped back?

Jim O'Leary: You kind of confused me with the - you want - can you repeat? Can you repeat the question?

Holden Lewis: I'm basically trying to figure out if in non-wind you're still seeing your orders out pacing your sales and shipments. And the reason I ask...

Jim O'Leary: Yes. Our book to bill, I think our book to bill for the first quarter is 1.1. So...

Holden Lewis: Right.

Jim O'Leary: ...I think that's reflective of an aggregated quarter where you did have some orders exceed shipments -- not by a huge amount.

And since we don't have this month closed, you know, I don't - you know, other than order activity has been consistently strong you know, I don't know if we can really comment on shipments through the first - through this point in the quarter.

Holden Lewis: Okay. Okay.

Jim O'Leary: ((inaudible)) one thing. You know, the very first couple of months after year end, particularly year end when you had last year when people were still rebuilding, you know, I do think you have the most robust ordering at that point.

So, you know, the first couple of months particularly after a year like last year are not necessarily receptive of you can continue at that rate.

But we continued at a pretty high rate if you look at the orders we booked for the quarter.

Holden Lewis: Right. And I think that said when you talk to other companies that have more of an equipment type business whether it be, you know, welding machinery or, you know, packaging machinery or what have you, I mean a lot of folks seem to think that more capital spending began to perk up in March versus what they saw in January, February and that's why I was wondering if you were kind of seeing some of these same things in terms of trends around your customers?

Jim O'Leary: No we're seeing pretty strong orders in the first month of this year.

Holden Lewis: Okay. And what's the prospect for heavy-duty machinery?

Jim O'Leary: I think it's going to be back half of the year at the earliest, you know. Surely things are better but, you know, a couple of conference calls I've heard from manufacturers and the like they're giving forecasts for 2013.

So it's a longer nature business. And the pickup there is going to be a bit behind some of the short order businesses like industrial machinery, semi conductor, military business obviously benefiting from MRAP. But, you know, that's a - I think it's going to be a longer time until that comes back at the levels it was in 2007.

Holden Lewis: Okay. And then to the margin, the other element of the margin is obviously production. Your inventories really didn't go up at all this quarter. In fact there were down a little bit sequentially.

What is your - I assume production went up and just to sort of match the outflow. But are you anticipating ratcheting up production sort of further to start building inventories up a little bit now that the business seems to be shoring up?

Is that going to be an element of some leverage and absorption as we go forward?

Jim O'Leary: Well I think it's more likely the opposite where you may have to bring people back. That's why when we're talking about our conservative margin forecast.

You know, we're in the early stages of recovery. If business keeps going you start adding the people back gradually. We haven't had to do that yet, but, you know, it's certainly possible.

Again with our facilities we didn't shut a lot - we didn't have to shut anything down. It was more a variable cost that you let go that you bring back as things come online.

So, you know, I don't think you get much better absorption until you take a real step function up in volume that, you know, certainly is possible and we're certainly trending that way but I wouldn't forecast it today.

Holden Lewis: Okay, and what do you plan on for inventory as the year progresses? Do you think you can continue to keep it at this level as revenues get a little bit better or do you start to build it?

Jim O'Leary: You start to build it if things get good and that's a positive, right?

Holden Lewis: Yes, okay. And then I guess just lastly, the tax rate, the 32%, that's good for the year but are the items pushing that down, is that good as you go into '11 and '12 as well? Those are sort of permanent sustained changes to the tax rate?

Jim O'Leary: Well the 32-ish percent I think is our ongoing (ACR). The other things unless the government does something that impacts Medicare again or some big discrete item, the other ones were truly discrete in this quarter.

Holden Lewis: Okay. All right, thank you.

Jim O'Leary: Okay thank you.

Operator: As a final reminder, that is star 1 if you would like to ask a question. And our next question comes from Samuel Eisner with Sterne Agee.

Samuel Eisner: Good morning gentlemen.

Jim O'Leary: Hello Sam.

Samuel Eisner: Most of my questions have been answered. But I guess, you know, you put some comments around some of the, you know, the acquisition opportunities in the M&A pipeline. Is there anything, you know, internally that you might be looking at, you know, divesting or getting rid of given how, you know, sellers are as you commented, sellers are looking more to do it?

No we always listen to, you know, qualified offers but, you know, that really hasn't been the environment. There's nothing we've got for sale right now.

Samuel Eisner: All right. And then I guess on the pricing you mentioned in the release that pricing benefited you guys at Velocity. Is there any way to kind of, you know, quantify that?

Jim O'Leary: I don't know if said pricing benefits was in Velocity. What was the comment again?

Samuel Eisner: That changes in FX and price increases were a benefit I guess over year on year. I mean have you guys...

Jim O'Leary: Yes. It would be a small benefit. And we typically don't quantify, you know, on a small segment what the pricing benefit would be.

Samuel Eisner: All right, thank you very much.

Jim O'Leary: Okay thanks.

Operator: And it appears there are no further questions at this time. I'd like to turn the conference back over to Mr. O'Leary for any additional or closing remarks.

Jim O'Leary: Okay. Anna, thank you very much. Again lastly I'd like to one more time thank our employees. It's been a very difficult two years. And hopefully we are out of it collectively.

I'd also like to thank all of you, you know, your attention and patience sharing a difficult period that we've all suffered through is greatly appreciated. I'm hoping that we're in a second of many, many, many quarters of continued improvement and if we're that lucky we'll all reap the benefits. But I appreciate your time today and your patience over the last two years. So Anna with that we'll wrap it up and thank you very much.

Operator: Once again that does conclude today's conference. We thank you for your participation.

Jim O'Leary: Okay, thanks.

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