

**KAYDON CORPORATION**  
**Second Quarter 2010 Earnings Conference Call**  
**July 29, 2010**  
**11:00 am ET**

Rick Mosteller: Welcome to the Kaydon Corporation Second 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 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 2009 Form 10-K 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 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's 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 would like to turn the call over to Jim O'Leary, Chairman and Chief Executive Officer. Mr. O'Leary, please go ahead.

Jim O'Leary: Thank you, Rick and good morning everybody. Thanks for joining us today to review our results which we're extremely pleased with as they reflect not only much improved business conditions, thank God and knock on wood, but the lasting effect of some tough actions we took over the last two years to improve our cost structure and make us more competitive for the long term.

Our results this quarter are outstanding as sales increased over both the prior year second quarter and this year's first quarter. The results in the quarter and the first half of 2010 reflect the benefits of market leadership and sound end markets together with the impact of aggressive management of cost and spending - I should say ongoing aggressive management of cost and spending. That's part of our corporate culture but it's one that we notched up a bit over the past two years to our long term benefit.

During the current quarter, sales grew both compared to the prior year's comparable quarter and sequentially. Sales in the second fiscal quarter of 2010 were \$121.5 million, an increase of 23.6% compared to the \$98.3 million in the second quarter of 2009 as most of our major end markets experienced improved results both sequentially and relative to the second quarter of last year.

Net income rose 113.2% to \$17.8 million in the second quarter or 53 cents per share on a diluted basis, more than doubling when compared to the \$8.4 million earned last year or 25% per share in last year's prior quarter.

Operating income was \$26.3 million in the second quarter of 2010, almost double that of the \$13.2 million in the second quarter of 2009 while EBITDA, a non-GAAP measure, was \$33.6 million for the second quarter of 2010 as compared to \$20.6 million in the second quarter of last year.

Operating income and EBITDA benefited from increased volume and the positive impact of actions taken to reduce both the structural and cyclical costs in the company and improve our long term competitiveness.

Certain discrete items affected comparisons with the 2009 second quarter. In this year's quarter - excuse me, in this year's second quarter we incurred costs associated with the first phase of our previously announced manufacturing consolidation program and for unconsummated corporate development efforts primarily offset by gains associated with recent changes and certain post-retirement benefit programs. The net impact of these two items was to reduce operating income by about \$200,000 or about 1 cent per share.

Now moving into a brief review of our segment operating performance and some color on our principal operating markets. Within Friction Control, Friction Control sales in the second quarter of 2010 were \$79.7 million, an increase of 24.1% as compared with the \$64.2 million in the second quarter of last year.

Sales to most major end markets were higher in the second quarter of this year compared to the second quarter of last year. Notably our industrial machinery, semiconductor, medical, military, and wind energy markets all performed extremely well.

Second quarter 2010 Friction Control operating income totaled \$20.3 million as compared to \$9.8 million in last year's second quarter. The segment benefited from the increased volumes and the operating leverage provided by our improved cost structure.

Wind energy sales were \$25 million in the second quarter of 2010 which compared to \$19.8 million in the second quarter of 2009. Comparisons to the prior year will be more challenging in the second half of 2010 as the second half of 2009 had significant wind energy sales that were deferred from the second quarter of 2009 if you will remember due to severe adverse financial and economic conditions experienced then.

Year to date wind sales are \$54.4 million now as compared to \$40.7 million in the first half of last year, a year in which general economic turmoil made us much more back end loaded than really we would like to have been.

We continue to expect wind energy shipments for the full year of 2010 to be comparable to the \$103 million of wind energy shipments in 2009 but to put it more directly, this year we're seeing more even flow sales against our expectation for the full year while last year issues with customers securing letters of credit principally in the second quarter but really throughout the full first half pushed more shipments into the second half of last year.

So the comparisons, even flow this year versus much more back end loaded last year as credit conditions and economic conditions picked up as the year progressed.

Likewise I think it's important to mention military, we see a similar impact but for different reasons with military sales within Friction Control. At the first half of this year we'll book about 59% of our total expectation versus about 45% or 46% last year.

The reason for this being we were in the ramp up phase for the MATV program which will continue strong in about the middle of next quarter then tail off towards the end of the year. So we've got a more heavily weighted book of military shipments in 2010, about 59% compared to last year of about 46%. So two timing issues to keep in mind, wind energy and military.

Within Velocity Control, Velocity Control Product sales in the second quarter of 2010 were \$15.1 million, an increase of 47.6% as compared to the \$10.2 million in the prior year second quarter as sales volumes increased significantly both in North America and in Europe.

Operating income increased to \$4 million in the second quarter, up from \$.9 million earned in the prior year's second quarter due to the much improved volume and our improved operating leverage.

Within Other Industrial Product sales in the second quarter of 2010 equaled \$26.7 million and increased as compared to the \$23.9 million last year principally from higher demand for liquid filtration, air filtration, and metal alloy products. Operating income increased to \$2.8 million in the second quarter of 2010 as compared to \$1.9 million last year. Again, higher volumes, improved operating leverage, and generally lower spending across the board.

Orders were \$108.2 million in the second quarter of 2010 as compared to \$67.8 million in the second quarter of 2009, an increase of 59.5%. Wind orders were \$12.1 million in the second quarter of 2010, doubling as compared to the \$6.1 million in the second quarter of 2009 and there were no cancellations in this quarter.

We continue to expect more significant wind order sales in the second half of 2010 as our customers formalize their requirements for the upcoming year. Backlog at quarter end was \$186.5 million versus \$199.8 million on April 3, 2010. The decline in backlog reflects a timing of

strong year to date wind energy shipments in excess of orders we've received thus far. Year to date non-wind orders have exceeded sales with a book-to-bill ratio of about 1.05.

Also impacting backlog is the increased mix of orders in our industrial business typically booked and shipped within 90 days reflecting continued cautiousness on the part of our customers on taking excess inventory and issuing blanket commitments.

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

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

Second quarter 2010 results also benefited from the lower effective tax rate of 32.2% compared to 37% in the 2009 second quarter due to the full availability this quarter of the domestic manufacturing deduction and the planned permanent reinvestment of earnings of certain international operations. The effective tax rate for the full year 2010 is expected to be approximately 31.5% including the benefit of certain discrete items we discussed last quarter. For the second half of 2010 the effective tax rate is expected to be approximately 32%.

During the second quarter of this year EBITDA was \$33.6 million compared to second quarter 2009 EBITDA of \$20.6 million. Second quarter 2010 EBITDA margins increased to 27.6% as compared to 20.9% in the prior second quarter.

Free cash flow during the second quarter was \$17 million compared to a net use of \$6.1 million in the prior second quarter. The improvement over the second quarter of 2009 reflects higher second quarter 2010 net income and our voluntary additional contribution last year of \$14.1 million to our qualified pension plans.

Again, EBITDA and free cash flow are non-GAAP measures and we have included in our earnings release a reconciliation of these metrics to the most comparable GAAP measure.

Capital expenditures in the second quarter were \$5.5 million. During the second quarter we announced a plan to optimize our custom bearings manufacturing capacity by expanding our operations in Sumter, South Carolina. Including the expected investment of \$3.6 million in capital expenditures associated with this project, we expect total company CAPEX in 2010 to be approximately \$25 million.

Also in the second quarter we incurred approximately \$700,000 in costs associated with the Sumter consolidation program and expect to incur an additional \$3.6 million in the second half of 2010 related to this expansion and consolidation approximately \$1.1 million of which will be non-cash.

Cash and cash equivalents increased \$8.7 million during the quarter and totaled \$283.7 million at the end of the second quarter 2010 compared with \$262.4 million at the end of 2009.

Quarter end cash of \$283.7 million also represents a \$73 million increase from the end of the second quarter 2009. As we have discussed on earlier calls, improved working capital management particularly inventories in the second half of 2009 and into the second quarter of this year together with reduced capital expenditures contributed to our positive cash generation.

Inventory turns increased to 3.3 turns in the second quarter of 2010 from the 2.3 turns we had in the second quarter of last year. This improvement was offset in part by an increase in DSOs to approximately 64 days from the 61 days in the second quarter of 2009.

In addition, in the quarter we paid cash dividends totaling \$6.1 million and repurchased 33,817 shares of common stock for \$1.3 million.

Now I'll turn the call back over to Jim.

Jim O'Leary: Sure. Thank you, Peter. As I noted at the start of the call, we're extremely and we think appropriately pleased with our performance in the second quarter of 2010 but I would point out that extremely pleased doesn't mean complacent nor does it mean we're not respectful of how much uncertainty there is out in the general economy right now. In my career I don't recall ever seeing as many equally smart people on both sides of big important macroeconomic issues.

As I noted on our last call, we are encouraged by the sustained strength of incoming orders through the first half of 2010 relative to the same period of 2009. And while conditions in the first half of 2010 have improved considerably, we have taken a measured approach in reacting to the improved macroeconomic conditions because as Fed Chairman Bernanke noted last week, the economic outlook remains unusually uncertain.

That said, continued improvement in the second half of 2010 remains dependent on further strengthening of economic conditions. Notably continued improvement in our industrial business typically booked and shipped within 90 days so by definition a little bit less - excuse me, visibility than certain of our other businesses will be required to maintain a favorable comparison against prior year as we expect and we continue to expect moderation in our wind energy business because of the timing of incoming orders and military business in the second half of this year -- both items we talked about a few moments ago.

Our wind energy and military markets face more difficult comparisons respectively due to the timing of orders and shipments in the case of wind and the expected maturation of the large military program we referred to before.

Longer term, the enactment of a clear actionable renewable electricity standard and a sustained economic recovery is obviously a prerequisite for meaningful growth in future wind energy shipments.

Steps taken to reduce our cost base over the last two years contributed much to our strong results this quarter. Further, last quarter we announced and had begun our manufacturing consolidation program which includes the expansion of our Sumter, South Carolina operations while concurrently closing our Mocksville, North Carolina facility.

We expect to optimize our bearing manufacturing operations by effectively - by more effectively utilizing resources in technology, excuse me, improving plant processes, reducing redundant capacity between the two, and better aligning our capabilities with market expansion opportunities. These strategic actions will reduce costs, leverage overheads, increase productivity, and grow market share as we become more competitive. And we're looking forward to bringing on our new manufacturing facility early next year.

During the second quarter of 2010, we paid common stock dividends of 18 cents per share or \$6.1 million and today we declared our third quarter dividend of 19 cents per share payable on October 4, 2010. This reflects the company's confidence in the fundamental strength and cash generating ability of our businesses. Our cash generating ability together with our balance sheet are reflected in this enhanced return to our shareholders.

This quarter represented a significant improvement in performance over the prior year's second quarter. We're realizing the benefits of some of the difficult cost containment efforts initiated during the recession and these actions together with our robust free cash flow and strong balance sheet position us well going forward regardless of the broader macroeconomic uncertainty that

abounds today. With cash of \$284 million and no debt, we are exceptionally well positioned for the long term.

And Justin, other than to say thank you to the people on the call and to our employees who worked like crazy during the past quarter and over the past few years to bring us here, I'd like to turn it over to you to field questions.

Operator: Thank you very much, sir. Ladies and gentlemen, the question and answer session will be conducted electronically over the phone. If you'd like to ask a question, please do so by pressing the star key followed by the digit 1 on your touchtone telephone. If you're using a speakerphone today, please make sure your mute function is turned off to allow your signal to reach our equipment. We'll proceed in the order that you signal us and will take as many questions as time permits. Once again if you have a question at this time, please press star 1 on your touchtone telephone.

Also if you find that your question has been answered you may remove yourself from the questions queue by pressing star followed by the digit 2.

We'll go to our first question from Peter Lisnic from Robert W. Baird. Please go ahead.

Peter Lisnic: Good morning everyone.

Jim O'Leary: Hello Pete.

Peter Lisnic: Jim, I guess first question if I look at that - the Friction segment, margin is much higher. In the first quarter I think you saw some price headwind there on revenue and margin. Can you give us a sense as to what price and volume were and how that sort of worked margin in the second quarter, please?

Jim O'Leary: The margin surprise - good question and one that you guys should think about as you roll out third and fourth quarter. Most of the margin surprise and improvement this quarter relative to last year and the prior sequential quarter is improved mix and improved throughput.

Remember we've got much better even flow this year relative to last year in terms of wind, you know, which does dissipate a bit as the year goes off. And the math is pretty simple, \$103 million minus year to date last year -- \$103 million minus year to date last year means your production and your shipments are obviously much more weighted to the back half of last year than it is this year on the same annual forecast.

So that and the same issue with the military where, you know, this year we had great - particularly relative to last year, great industrial mix that's book and ship business within the second quarter combined with, you know, really tremendous military throughput which goes through the same factory so most of the surprise this quarter is due to improved throughput and leverage on some of the cost reduction efforts that we undertook over the past two years.

We haven't had to add back either as many of the hedge or as much of the costs. And we are getting leverage from a lot of the contractual changes we made either to union contracts, a couple of healthcare contracts impact the switching out the way we provide for pension benefits going forward.

So you're seeing all of that. And as always with us because we're a small, you know, we're typically a smaller mass producer, the cost increases typically get offset by price increase. Neither had a huge impact this year, excuse me, this quarter.

But going forward, you know, we are seeing a little bit of material cost headwind. We hope to recover it but it may be a little bit tougher going forward but I wouldn't say it's anywhere as big as the throughput impact and the timing principally of wind and military.

Peter Lisnic: Okay and then just so I'm clear on that second half margin for Friction, should we think about a mix benefit as you anniversary a relatively difficult comp on the wind side?

Jim O'Leary: We're going to have I wouldn't say more difficult anything other than last year we got the benefit of a \$40 million quarter in the third quarter and that was a lot of spillover from the second quarter when customers couldn't get letters of credit.

We were doing everything but standing in the way of shipments going out of Mexico because we were not shipping to people unless they had letters of credit last year. This year you've got a much more even flow, closer to 50/50 than last year where it was very heavily weighted to the back half of the year.

When you go through it, and I don't remember where and typically don't comment on analyst models but we did in the last quarter say we thought we'd be mid to high teens for the balance of the year. I think absent this surprise we were a little bit higher in the low 20s.

I still think for the balance of the year we're in the mid to high teens operating margin and I think most of you guys are pretty much on point there where continued improvement in mix will offset a little bit of loss throughput on wind and military.

Peter Lisnic: Okay, all right, and then last question if I could. Just on the Sumter/Mocksville changes that are being made, if I heard the number right, I thought I heard \$3.6 million in the second half. Is that right?

Peter DeChants: Capital expenditures are \$3.6 million. The total spending for the second half is \$4.1 million.

Peter Lisnic: Okay, all right. Thank you very much.

Jim O'Leary: Pete and others, when our 10-Q comes out there will be a footnote in there that kind of lays out what the cost and capital will be for the balance of the year to help you model that out.

Operator: We'll go next to Nicole Deblase with Deutsche Bank. Please go ahead.

Nicole Deblase: Yeah, good morning guys, nice quarter. So on the wind side, what are you guys hearing from wind OEMs right now? Have there been signs of improvement? What really gives you the confidence to say that wind orders are going to be up in the second half?

Jim O'Leary: Well if you look at our history, if you look at the - well it's actually not just the history. We have a few major customers that we work with day in and day out, you know, there are some contractual outlines that govern when they're going to place their next year order. So all that gives us confidence there will definitely be orders in the back half of the year. How significant they are, that will depend a lot on the macroeconomic environment and their confidence in whether or not there is going to be some policy action in the upcoming year.

So we will have orders, how significant they are is still being formulated by our customers. But for the most part if you look at the last few years and a lot of this is governed by long term agreements, we would expect orders in the back half of the year.

Anecdotally I would tell you, we're quoting more, working more actively with people besides our major customers now. And right now we have, you know, a customer book where obviously there's one major customer, there's close to half a dozen other not insignificant customers,

people we're shipping material volume to and have good relationships with. We're working with other people besides that now.

None of the transplants -- and transplants being the major European producers who are coming here -- have set up headquarters and are continuing to hire. You know, they're also working on supply chain strategies but it will be difficult for them to place LTAs and they're not going to want, you know, themselves or their trade partners to spend major capital until there's a little bit more certainty on what the requirements are going to be going forward.

Unfortunately we sound like broken records on this but you do need an RES, renewable electricity standard, for people to have that type of confidence because we're not talking about people planning a couple of million dollars in the upcoming quarters, we're talking tens of millions of dollars over multi-year periods to satisfy utility electricity needs.

So but that will still be needed to have very, very robust orders and get to where we want to be which is sold out on our existing capacity and thinking about building more. I think that won't happen until we have legislative action.

But anecdotally everybody's still out there committed to their moves in the case of the transplants, and all our customers still have business next year. But when you have your supply chain under capacity there's really no compelling reason for them to place orders early.

And if you think back two years ago there was such concern that with the current administration, a likely RES, and a very strong economy there was concern that you'd be sold out of key supply chain components like bearings. So two years ago you had people placing orders for two years out. Now there's really no tremendous incentive for people to do that.

Nicole Deblase: Okay thanks for the color, Jim, that was really helpful. Could you also remind us what or tell us what the wind backlog was in the second quarter?

Peter DeChants: Wind backlog is \$68 million.

Nicole Deblase: Okay thanks. And one more if I may, if you guys could just give some color around how the non-wind business trended in the three months of the quarter and then also how results are looking in July versus June.

Jim O'Leary: Yeah, it didn't - and obviously the sequential comparisons first quarter to second quarter are flattish, maybe a little bit favorable but it was sustained strength. Not another big pop up. You know, there's some timing issues and impact from week to week and it's been about the same through the beginning of this year. There's some timing issues where last year we had a couple of big orders at the last of the month.

But I'd say it's still the same strength. You haven't had another huge pop like you did going from the end of last year into the first quarter but we've stayed at that same elevated level.

You know, we would and what we specifically referred to, we not only need that strengthening, we need to get a bit better to offset some of the timing issues in the back half but right now there hasn't been any fall back and, you know, we're encouraged.

Nicole Deblase: Thanks.

Operator: Moving forward, our next question comes from Walt Liptak with Barrington Research. Please go ahead.

(Mike Bridger): Hello everyone, this is actually (Mike Bridger) in for Walt.

Jim O'Leary: Hello (Mike).

(Mike Bridger): Can I ask for an update on the MATV deliveries? Are you guys - what's the production schedule on that?

Jim O'Leary: Well I don't know if we ever give you guys production schedules for something that's - it's an important program but it's not material enough to break out on its own. Overall the military business as I said in the prepared remarks, within Friction Controls this year it will be weighted about 60% for the first half of the year and about 40% for the back half. That compares to about 46% in the first half of last year and about 54% in the back half of 2009.

And as you think about, you know, the published comments from guys like Oshkosh and what's out there in the public domain on MATV, you were ramping up last year, you're fulfilling a very strong book of business, and some pretty robust requirements through the midpoint and into the beginning of next quarter.

Then it starts to tail off a bit and you go into more of a maintenance mode. So that's reflected in the percentage you see where last year more weighted to the second half, this year more weighted to the first half.

(Mike Bridger): Okay I think that's it, great quarter guys.

Jim O'Leary: Okay thank you (Mike).

Operator: And our next question comes from Steve Barger with Keybank Capital Markets. Please go ahead.

Steve Barger: Hey good morning guys.

Jim O'Leary: Hey Steve.

Steve Barger: I missed the first couple of minutes; sorry if this has been asked. But if those wind orders that you're talking about in the release do drop in early 2Q or 2 half, I'm sorry, will the delivery cadence start in 1Q '11 or 2Q '11 or, you know, how are your customers talking about the cadence of those projects?

Jim O'Leary: I'll answer one question you didn't ask because a lot of people appreciate it. We'll get orders in the back half whether it's the third or fourth quarter, the difference between September or October is not something that we're going to freak out over nor should you.

But when those orders come, you know, the timing on ordering, forging, processing them. What we're talking about is orders in the next half of the year for next year's requirements. So, you know, there's really nothing you're going to get of significance in the end of this year or the third quarter that gets shipped.

You know, even in a best case scenario you never have book and ship type business within the wind business because you have to order forgings that are specific for the customer, it takes a while for them to be machined and delivered, and then you've got to do your own work on them to get them out the door. So the turn time doesn't lend itself influencing 2010.

Right now what we know what we have on the books possibly influenced by - again, letters of credit here and there, timing issues on customer's own inventory balancing. We feel comfortable it's going to be about \$100 million year but nothing on the order book will really influence that.

That's all for next year requirements.

Steve Barger: Right, just so I'm clear though, if you - if the orders drop more in your fourth quarter you're really talking about maybe back half '11 shipments versus first half '11?

Jim O'Leary: I think in any event it's back half of the year.

Steve Barger: Got it, okay. As I look at the margin structure of the legacy business, back in '07 before the big drop off, all your legacy businesses ran in - well combined low 20% out margin. If your regular stuff just gets back to normal mid to high single digit growth as end markets normalize, after all the puts and takes of the last few years from restructuring, price actions, raw materials, pension, what's the right consolidated margin for the legacy business now?

Jim O'Leary: It's still low 20s. If you remember '06 and '07, I'd actually say apples and apples, after we're done with the Sumter consolidation the margins in a lot of that business will be a little bit better because of the cost structure.

What you don't have which, you know, we talked about extensively probably in '08 when the comparisons became unfavorable. What you don't have absent another huge military undertaking is, you know, an 80 plus year within Friction Controls for military which was very heavily weighted toward a couple of legacy military programs.

What we've always talked about as far as, you know, the improvement on margins from legacy programs, it was specifically a couple of military programs that came out of one of our older facilities where, you know, the margins were well over 50% U.S. servicing or replacement program that had been on the books for 20-ish years. And absent another big military effort when military goes back over \$80 million, you couldn't get back to those types of numbers.

Steve Barger: Right.

Jim O'Leary: But still - high 20s is a margin we will hope for, it's not - excuse me, low 20s.

Steve Barger: Low 20s.

Jim O'Leary: EBITDA margins with wind we still think are going to be in the low 20s to mid 20s.

Steve Barger: Okay that's great. And if we think about wind as being potentially, you know, deliveries in general if they end up being back half loaded in 2011 or less than where we are for this year, are we talking low teen out margin at that absorption rate or where would you expect that to come in?

Jim O'Leary: Steve it's probably a better question for next quarter because then I think we'll be far enough along to say how close we think we'll be to kind of year on year comparison.

Again we originally said we're hoping it will be about \$100 million year next year as well influenced positively or negatively by if anything happens legislatively, if the economy continues to improve at the rate it has. If you're at about 100 or even a little bit north or south of 100, you're still talking high teens. But I think it's a better question when we have a little bit more visibility at the end of next quarter.

Steve Barger: Right, to be clear, the later those orders drop in 2 half '10 the tougher it gets to get to those numbers in '11, right?

Jim O'Leary: Without phasing it quarter by quarter right now anything I tell you will be speculation. Let's see when we get the orders over the next six months and then we'll be more articulate around that in the next call.

Steve Barger: Great, thanks.

Jim O'Leary: Okay thank you.

Operator: Going to our next question from Edward Marshall with Sidoti & Company. Please go ahead sir.

Edward Marshall: Morning guys.

Jim O'Leary: Hello Ed, how are you?

Edward Marshall: Good, good. The transactional business was strong last quarter. I'm assuming it was also strong in this quarter. I don't know if you commented to it but are you seeing kind of - it doesn't look it from your backlog but are you seeing a shift from customer order activity that's starting to enter into the backlog yet or do you foresee that coming in the coming quarters here?

Jim O'Leary: You mean a shift to longer term orders, blanket orders going to backlog and staying there for a bit?

Edward Marshall: Right, as opposed to the transactional business that you've been seeing over the last couple of quarters.

Jim O'Leary: I don't know if we've talked about this on other calls, I know I've talked about it conversationally with people. But, you know, before wind came along for Kaydon, if you look at releases, annual reports from not just my predecessor, his predecessor going back almost ten years.

There has been a pretty consistent shift to shorter turn orders, fewer blanket orders whether it was in the late 90s or early 2000s, big shift to Japanese production methods or just in time delivery methods.

You know, we've seen pretty much a consistent decline in longer term blanket orders because it's something customers really don't want to do. I'll tell you something customers really don't want to do, I'm kind of talking out of both sides of my mouth because for to be honest with you we don't want to do it either if we don't have to. I mean, nobody wants to make commitments longer than they're comfortable with. So that trend has been in place really for, you know, over a decade now.

You know, we're seeing probably a point or two higher in the last quarter or two but that's significant on that business and I'd expect that to be continuing. I mean, eventually you get to the point where - and the reason we refer to within 90 days is, you know, you book and ship, if it comes in on March 29 it doesn't go out until the following quarter.

When we talk about that we're talking about received and shipped within 90 days. And I think that's a trend that continues because that's the nature of the world.

The only reason it changed so dramatically with wind and in some cases military, is because the planning cycle is so much longer and the wind case is - I think Nicole asked the question before, you know, to get the forgings in that means they're coming in for a specific customer. They've already been machined to some extent. They're coming into us specific for that customer and then we work on them again. You know, the planning cycle and the supply chain challenges on these enormous bearings is very different than most of our other product offerings.

Edward Marshall: Now the function of the industrial business, the quicker lead times, the shift in the market, is that additional capacity in the market? Is it just quicker lead times or quicker cycle times that you guys are providing? Maybe a combination of both? Why the shift over the last decade or so?

Jim O'Leary: I think it's just the nature of customers don't want to take big inventory commitments because when things go south they get beat up by their analysts.

Edward Marshall: And acquisitions, I don't know if you commented on it but could you?

Jim O'Leary: Yeah, this past quarter we looked pretty hard at - harder at one than the other but we've been out looking at two things. We spent some money on one that, you know, not an extensive amount of due diligence ended up passing at the end for a variety of reasons. I would say the market is getting and got much better as the quarter progressed. And by that I mean there are now actually a number of options that are commencing that are of interest to us.

I think the narrowing of the gap between seller and buyer expectations has come a very long way from the end of last year where it was a Grand Canyon, now I would say it's still a canyon, it's just not that grand. And you're close enough where, you know, there are deals to be made. Right now we're probably looking at half a dozen things maybe, you know, some much more seriously than others. During the past quarter we devoted a lot of time to one in particular but we looked pretty hard at two things.

And, you know, I think as long as the financial markets stay stable and asset prices and the financing of them, you know, at least are less volatile than they were last year, I think that trend will continue. There are some things that are of interest but, you know, we - I would not say we're looking for cheap assets because we're not, we want high quality businesses but we are price sensitive.

Edward Marshall: Okay, well I mean, you do have quite a bit of cash on the balance sheet. I know you gave a little bit back today to shareholders with the dividend increase. You know, with the pricing narrowing and knowing that you want to go out and get something of quality, that means you're going to have to pay for it. I get the sense that you don't want to stretch to go after something unless it really fits the bill here for you. Am I hearing that correctly?

Jim O'Leary: Oh yeah, you heard it correctly; you've heard it correctly in the past. I think we've been consistent on that. And, you know, in the prepared remarks I hope we were clear enough.

You know, I respect the fact that there's a lot of uncertainty about the economy. The recent results have been very good but, you know, the leading indicators, there are a host of things out there that, you know, should give prudent people reasons for pause and we're respectful of that.

So the size of an asset also will probably impact our ability to stretch for it because we don't want to put all the good things we have going on within Kaydon, all the good things about where we are not just strategically but how we're executing on some of the tactical things which you're seeing in the numbers. We don't want to put our opposition with that risk because we stretched too far for something and that's both valuation and size.

Edward Marshall: Excellent, thank you guys.

Jim O'Leary: You're welcome, thank you.

Operator: Michael Corelli with Barry Vogel & Associates has our next question. Please go ahead.

Michael Corelli: Hi, good morning.

Jim O'Leary: Hello Michael.

Michael Corelli: Just a question about the dividend. I see you raised it a penny here again which seems to be I think mostly what the company has done in recent time. Obviously you have a pretty significant cash balance, over \$8 a share now.

I know you continue to look at acquisition potentially and, you know, there hasn't been that much activity really done on completing acquisitions anyhow over the last several years. So why not a little bit more of an increase in the dividend considering again the cash balance, cash generation, and all those factors?

Jim O'Leary: Sure. Well we're paying out about a 2% yield. The payout ratio is consistent with high grade industrial companies. So paying out a lot more and turning ourselves into a straight up dividend stock and stretching the payout ratio doesn't make a tremendous amount of sense to me.

But what you said before, we do have \$8 per share of cash. We're respectful of the fact that, you know, tax policy may change next year in a way that, you know, has important implications for a lot of you.

We are taking that under advisement, considering it as the year progresses, but back to the preceding question, you know, after sitting on it for really not just two or three years, you know, since early 2000s when we did the convert and we sold the business. The M&A market wasn't really conducive for much of that time for transactions. It feels like it's improving. It feels like there are more actionable things.

So, you know, we're kind of balancing the fact that we've been patient this long, and now that environment is starting to improve and I'd say measurably. We're balancing that against the fact that yes, could we afford to pay a bigger dividend on a one-time basis? Sure, but we want to buy ourselves as much time as possible as the year progresses and, you know, not ask, but I think should be mentioned.

We've been consistent buyers of our shares, you know, over the past 2 years or 2-1/2 years. We took a little bit of time off this quarter but that was largely because we were in a quiet period as

we were looking at things and, you know, a host of other reasons why you have to be in a quiet period.

So between dividends, share repurchases, and I do think as conditions are improving, we've shown that we're good custodians of your capital. We've shown that we give it back to our shareholders in a variety of ways. And being prudent about acquisitions after the way many of the things we could have bought performed in the last two or three years, I think that's something that you guys should appreciate. I'm really not too apologetic about that.

Michael Corelli: Okay thank you.

Jim O'Leary: You're welcome.

Operator: We'll take our next question from Mike Hamilton with RBC. Please go ahead.

Mike Hamilton: Good morning everyone.

Jim O'Leary: Hello Mike, how are you?

Mike Hamilton: Good, nice job in demonstrating the cost structuring of the recent years. Congratulations.

Jim O'Leary: Thank you.

Mike Hamilton: I was wondering if you could give any observations you've got, you mentioned some raw material cost increases there and notably with what's going on in steel, any thoughts both on timing and degree of stretch on pressure there?

Jim O'Leary: Really nothing huge. We do see some in the pipeline. Remember for our - in our case in particular in the wind business it's a timing issue because it gets passed along but at a lag. So whatever we buy where it's heavily impacted by steel pricing, think about forgings. We're passing that along or it's being passed back to us on a quarterly lag in accordance with our long term agreements.

In the pipeline you see little bits of, you know, anecdotally higher cash prices for some of the things that we buy but remember, we're not buying steel in enormous volumes. We're typically buying things after they have been machined already, after they've got some degree of value add. So while we are seeing some we're pretty confident it won't be a huge impact on the back half of the year.

And I think historically and, you know, it goes back over most of this company's history because we're producing in small batches and typically for customer OEM specific requirements, we're definitely successful in passing along most of that. So it's not like a big commodity producer where you've got big inventory risk and, you know, huge risk of a quarter being blown because of a big move in prices.

Mike Hamilton: Right, thanks. Now that we're normalizing a little bit off of this last cycle, are you seeing anything that's changing your thinking about seasonality in any of the businesses?

Jim O'Leary: I don't think we've been historically particularly seasonal, nothing is changing that.

Mike Hamilton: Okay thanks. Then last, I apologize because you've hit it a couple of times but can you repeat one more time the cost impact off of the South Carolina?

Jim O'Leary: Sure.

Peter DeChants: The cost in the quarter was \$700,000 in Q2.

Mike Hamilton: And outlook?

Peter DeChants: The outlook for the year we said was about \$4 million, \$4.1 million for the second half of the year.

Mike Hamilton: Very good, thanks a lot.

Jim O'Leary: You're welcome Mike, thank you.

Operator: And gentlemen, we'll go to our next question Longbow Research's Derek Jose. Please go ahead.

Derek Jose: Hi guys, can you talk about, you know, upcoming legislation, what you've been hearing in terms of I guess the wind business given that, you know, a lot of people get excited and, you know, sometimes the business isn't there but it kind of seems to fluctuate. Are you guys seeing anything positive?

Jim O'Leary: Well I think the legislative notes in the last few weeks is that cap and trade does not seem to be carrying the day. There are still well intentioned people on both sides of the aisle that believe that something is needed. It's probably an RES because the price of carbon is an important part of any legislative action they take. But it does seem like cap and trade for at least this year will not carry the day.

I still think something will get done. Everything that's come up and I believe it's from either side of the aisle has had an RES feature to it. You know, the question is, you know, how are you going to

tax carbon and pass it through in a way that's acceptable to the principal users who are often utilities?

The - what I would say is I'm sure something is going to get done. I'm sure it won't be this year, I doubt it will be this year, hopefully it will be next year. You have an administration that's still very committed to it but practicality, healthcare, financial reform, and some issues whether it's Gulf shore issues or military, there have been a lot of other issues that they have had to deal with. But the commitment is there.

And, you know, this is not talked about a lot but I don't think either side of the aisle really wants this to be legislated by the EPA which right now is a reality. I think the preference is for it to be addressed by selected officials in a way that everyone notably their constituents are happy with.

So I think something will happen, it won't be this year, it will certainly include or it will likely include an RES and what that percentage is I've said a number of times, it's 20 by 20, 15 by 20, 15 by 25, if it's 15 it's still 15 times what people are using today in terms of renewable electricity which almost always pushes itself towards wind because as defined, natural gas is not one of the renewables as the bill is laid out.

So nothing that's going to be this year. Longer term I do think there will be something because really nobody wants EPA to be the sole guardian of this issue.

Derek Jose: Okay and you talked earlier about your different wind customers and how you guys kind of have been diversifying and expanding that. Can you talk about, you know, how the growth has been over the past - from the beginning of the year?

Jim O'Leary: We have added significant - not significant to the 100 but, you know, we've got a customer or two that are now \$10 million or so annually and they've always been customers that we are

cultivating to be secondary or tertiary customers. With our fixed capacity we'll say it's about 150-ish now, 140 to 150 depending on the pricing.

You know, we have a lead horse. They are, you know, one of our most - our most important relationship. That will always absorb the lion's share of the capacity so, you know, the rest of your customer base is always going to be in the 10 million to 20 million and you can only accommodate so many of them without capacity expansion. And we have a couple that we've cultivated this year, relationships are going well, we've been through prototype, we're dealing with all the important issues on functionality that they want to see.

You know, we've passed all the tests before it hits the field and we've booked some significant orders. As I mentioned, the \$12 million this quarter, most of that was not our principal customer. So we have cultivated a number of the important secondary and tertiary customers that we've been talking about as part of the overall wind strategy.

Derek Jose: Okay and kind of lastly, I may have missed this. You know, obviously a lot of cash usage or sorry, a lot of cash on the books. And people talk about acquisitions and, you know, share buybacks but I'm kind of curious, do you see, you know, CAPEX expenditures, you know, being a, you know, reality in the second half of the year or, you know, maybe in the beginning of 2011?

Jim O'Leary: They're going to be reality because we are going to have CAPEX, it just won't be that big. There's nothing really significantly different about our prior comments.

And looking forward, until - coming back to someone's earlier wind question, until you have an RES and until we're at full capacity or close to full capacity with our existing plants, you really don't have any compelling need for an enormous capital spending program.

In the company's history the only time we broke in I think \$30 million was the two years when we were spending for wind. So until you've got another major facility like that, there's nothing significant coming down the pike.

Derek Jose: Thank you.

Jim O'Leary: You're welcome, thank you.

Operator: We have a question from Holden Lewis with BB&T Capital Markets. Please go ahead.

Holden Lewis: Thank you, good morning.

Jim O'Leary: Hey Holden.

Holden Lewis: SG&A, you know, for the past six quarters you've been running pretty well sort of in that call it \$19 million to \$20 million range. You did so again this quarter although it looks like this quarter the revenue is up a little bit. It looks like your SG&A actually came off a touch and I would, you know, imagine some of those charges are in there.

Can you just talk about, you know, what - at what point do we need to see SG&A starting to come up? Are there costs that have to go in or is your model so fixed that frankly, you know, you think and certainly for the balance of the year and into next year you're thinking to sort of maintain this \$20 million level of SG&A?

Jim O'Leary: Well the reason it ticked down a bit on a percentage basis is probably because, you know, in terms of the variable comp, you know, think principally bonuses and incentive comp, we've been at pretty much the full level which it is fixed. It's not open ended where it can continue on an open ended fashion.

So if revenues keep going up, incentive comp won't go up. The only thing that will, and I always think this is spectacularly good news, SG&A will pay up if we're paying more sales commissions and we'll pay more sales commissions if we get higher revenues.

But that will continue to tick down as a percentage because the fixed portion of executive comp, think the people in this room, think the bonuses for division presidents and some of their key staff, that's at fixed level. So revenues will go up, the SG&A will go up a little bit but at a slower rate because it will only be sales commission then.

Holden Lewis: Okay but with revenues presumably coming off in the second half, the throughput you mentioned, you know, SG&A, no reason for SG&A to move much from this level at this point.

Jim O'Leary: It will look - as I said, it will look a lot more like the first quarter and, you know, when you guys think about kind of the percentage income statement you're looking at for the third and fourth quarter, you know, I think the - and I thought the second quarter was still be, you know, mid to high teens operating margin.

I think we'll drop back to that because both wind and military are back off a bit. SG&A won't change materially because the wind piece doesn't have a big sales commission, it's an OEM business so we don't have big sales commissions associated with that.

Holden Lewis: Okay, and then are most those - I'm still trying to get my arms around the big step up I guess in the gross margin. You know, inventories certainly didn't look like they went crazy, I don't know where production was sequentially but in revenues you were only up a couple of million dollars. It just seems like the 280 basis point sequential step up is a pretty big increase considering, you know, not a huge increase in revenues or production.

Is it really just a function of the wind mix coming down? And if that's true, shouldn't the wind fall in the mix in second half and really sustain the gross margin at sort of Q2 type of levels?

Peter DeChants: Gross margin in Q2 Holden was affected by a couple of things, mix being one of them, mix was in Friction Control and the second being some resetting the material cost standards during the quarter where we got a benefit in Q2 that won't roll forward.

Holden Lewis: Are you comfortable with how much of the increase is a function of that?

Peter DeChants: If you look at just the gross profit increase where we went from 35% in Q1 to almost 38%, about half of that.

Holden Lewis: About half of that increase, okay. So that half kind of is one-time in nature and kind of comes off it?

Peter DeChants: Yep.

Holden Lewis: Okay so that's sort of your starting point. And then mix gets somewhat better as you go forward but throughput falls off is sort of the way to look at it.

Peter DeChants: That's right.

Holden Lewis: All right, thank you.

Jim O'Leary: Thanks Holden.

Operator: And gentlemen, our final question comes from Tim Curro with Value Holdings. Please go ahead.

Tim Curro: Hi, do you have an update on the arbitration process with the customer that owes \$8-1/2 million?

Jim O'Leary: Moving along at a slow pace and I think our Q will have a little bit of color but really nothing material.

Tim Curro: Can you describe what the performance issue is that they're blaming on the bearing?

Peter DeChants: They're claiming that the bearings were not functioning properly with regard to lubrication and as a result the turbines weren't functioning. The fact is and our view is that the bearings were designed to their spec and that it's a complicated part of a much larger component, many of which pieces have to work together and as we've tested the bearings in question they have been to spec and performed to spec.

Jim O'Leary: Yeah, this was a customer who had been accepting these same bearings for well over the warranty period and continued to accept them until we started pursuing the receivables and inventory plans. It's pretty well laid out in the footnote so really no change.

Tim Curro: Is it Kaydon's primary wind customer?

Jim O'Leary: No.

Peter DeChants: No.

Tim Curro: Okay. Also can you provide an update on China? Is the plant shipping yet? It feels kind of like (Timkin) is establishing share there with that joint venture earlier in the month and then the \$26 million order yesterday.

Jim O'Leary: Is what plant shipping?

Tim Curro: Is your plant in China, has it begun shipping yet?

Jim O'Leary: We don't have a - in Friction Controls we don't and never have had a plant in China. I'm not sure what...

Tim Curro: I was just looking at the transcript from last quarter.

Jim O'Leary: That's Velocity Controls and it is shipping, but that's not for the wind energy market, that's for the industrial shock absorber business.

Tim Curro: ((Inaudible))?

Jim O'Leary: Pardon me?

Tim Curro: It says - you said we continue to expand in Asia, our new wind energy bearing plant in China will begin shipments this year.

Jim O'Leary: Absolutely, definitely not.

Tim Curro: Okay, all right.

Jim O'Leary: You must be taking the wrong note, because that's absolutely nothing we've ever talked about. We have a shock absorber facility which we have referred to, and more directly to your question, the type of product that (Timkin) was referring to with their first bridge venture

announced yesterday is not the type of product we make. It's not turntable bearings and it's really more for the gear box and not what we're shipping out of Mexico.

Tim Curro: Okay, all right.

Jim O'Leary: I'll check and go through transcripts, but that's a pretty egregious mistake.

Tim Curro: That was my mistake, it was a (Timkin) transcript, I'm sorry.

Jim O'Leary: Ah yeah, you've got to make sure - you should check the other as well, because nothing has changed and if you're mixing up your transcripts that could be a little bit embarrassing.

Tim Curro: All right.

Operator: Gentlemen, we have a follow-up question from Holden Lewis.

Holden Lewis: Talk a little bit about - now that we're seeing maybe the first offshore kind of activity taking place in the States, can you talk a little bit about is offshore something you'll participate in if that starts to take off in the Great Lakes or Massachusetts or is offshore a different animal from onshore?

Jim O'Leary: There's nothing technically different about it. The capacitization would require additional capital because of the size of the bearings. It is something where we are in discussions but I think these are discussions that will take years not quarters in Europe on, you know, certainly the stuff going on for the North Sea.

We are in discussions and have talked with some of our customers about their needs elsewhere. But some of the products I think you're probably referring to whether it's Cape Wind, the stuff off

of Long Island, terrestrial windmills have a long way to go in the United States before it needs to be as important part of the mix it is in Europe.

And in particular the countries that you're talking about, Europe because of the land use and how mature that market is, you know, the real growth in the European wind market is going to come from offshore.

In the United States the transmission issue still does need to be addressed but there's plenty of land that is fit, has good wind, and you think about the stuff that was going on two years ago in Texas and other parts of the southwest, there's plenty of land that has no better use than for windmills.

Holden Lewis: Okay. And then the \$4.1 million you have for, you know, expenses regarding or related to Sumter, how is that going to fall into, you know, Q3 and Q4? Should we just sort of assume that that's equally in there? And is it cost of goods or SG&A?

Peter DeChants: It's - it will be approximately equal in the next few quarters and the bulk of it is cost of goods sold.

Holden Lewis: Okay and there won't be any of that in 2011 or it will just carry over into that?

Peter DeChants: There will be some additional spending to what we mentioned, under \$1 million in Q1 of 2011.

Holden Lewis: ((Inaudible)).

Peter DeChants: Right, the numbers we called out were for this year 2010 but there will be some spending in first quarter of '11 in less than \$1 million, between \$1/2 million and \$1 million.

Holden Lewis: Okay so the gross margin or the cost of goods in Q2 had that \$.7 million, then it will have the \$4.1 million for the second half roughly equally split?

Peter DeChants: About 500 in cost of goods sold and 200 in SG&A.

Holden Lewis: Okay, all right, thank you.

Jim O'Leary: Thanks.

Operator: And gentlemen, we have some other questions in the queue. Would you like to continue?

Jim O'Leary: Why don't we take one more?

Operator: We'll take our next question, a follow-up from Peter Lisnic with Robert W. Baird.

Peter Lisnic: I just wanted to follow up on Sumter really quick. I know a lot of it is capacity addition, but you're also, you know, closing Mocksville. What sorts of cost benefits should we think about as we go forward?

Jim O'Leary: I wouldn't say it's capacity, well it is capacity addition in that it's replacing a facility where, you know, we have similar overhead structure, redundant costs, redundant discretionary spending in Mocksville. Mocksville has historically been well under capacity so we're adding a little bit of capacity in Sumter to take out a lot of capacity in Mocksville. And you'll see benefits in both gross margins and interest from overhead leverage.

In addition, we are adding some capacity for a business that we've pretty much not participated in the last decade which is aerospace. We've gotten certifications in Sumter that will allow us to do

flight critical parts, we've gotten quality certifications that will allow us to continue to be more competitive and more aggressive on aerospace business that historically was all done out of one of our higher cost facilities in Michigan. Now we'll have the option of quoting that out of a much lower cost facility.

Peter Lisnic: Okay, all right, that is good enough. Thank you.

Jim O'Leary: You're welcome, thank you.

Operator: Gentlemen, no further questions.

Jim O'Leary: Okay Justin, thank you very much and for those of you who hung in with us past 12:00 thank you very much as well and I'll look forward to talking to you next quarter.

Operator: Ladies and gentlemen, that concludes our presentation. We thank you very much for your participation. Have a great day.

END