

KAYDON CORP

**Fourth Quarter and Full Year 2010 Earnings Conference Call
February 25, 2011
10:00 am ET**

Rick Mosteller: Welcome to the Kaydon Corporation fourth quarter and full year 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 and the 2010 form 10-K to be filed today 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 Laura Kowalchik, our Chief Accounting Officer.

Today's conference is being recorded.

Now I would like to turn the call over to Jim O'Leary, Chairman and Chief Executive Officer. Jim, please go ahead.

Jim O'Leary: Thank you, Rick. Good morning and thanks for joining us today. And before we get into the prepared remarks, which will go into a fair amount of detail, because it's, you know, Kaydon for its size is a relatively, you know, a relatively complicated story and it's got a lot of diverse businesses and diverse end markets.

To kind of give you the summation of how I think the quarter and the year came out and how I think 2011 is starting, 2010, both the quarter and the year, came in about as expected but with mostly positives towards the end.

Wind came in about as expected as did military. And in both those end markets, we're managing to a macro environment which is challenging, has been well-publicized, is heavily influenced by

macroeconomic and political factors which we've talked about, you read about and we'll hint upon today.

But clearly those businesses both are in a moderating or modestly declining trend until the political regime gives a little bit more clarity on what the long-term is. But the quarter and the year really came out pretty much exactly as we've expected and exactly as we've talked to you about in the last few quarters.

The end of the year in industrial, which is still the majority of Kaydon, came out better than expected, both in terms of margins and order activity.

And as we mentioned in the press release, as I'll talk a little bit about in the prepared remarks, the year started off a little bit better in terms of order activity, which is tangible, anecdotal activity, in terms of quotations, and things we read in the press, things we hear from investor conferences from many of our customers and many of the people that are - historically have been later-cycle markets. In that, we mean principally heavy equipment, industrial machinery, semiconductors.

So both tangible and anecdotal evidence, so far it's been a good start to the year. Another good start to the year and I don't take exception to, but I noticed a few of the analysts said a small acquisition done today, not that significant.

I would point out that HAHN, which we announce today, is strategically a pretty important acquisition for us. If you look at every investor presentation for the last three or four years, we've talked about the importance of broadening into gas springs, which this does and does in a fashion that is completely complementary to ACE.

HAHN is in fact today a supplier to us, so it's complementary both in terms of manufacturing and marketing and broadening the product line. And also in terms of the size, interesting to point out that the size of this acquisition is exactly half of ACE in terms of price and sales back in 2001.

So we hope we have the same success with HAHN as part of ACE that we did with ACE originally. And we couldn't be more excited about it. And we think it's foreshadowing what will be a better and a more proactive year on the corporate development side.

We've gone through two of the last three years, which were about as tough an environment as most people can remember economically. Any investment banker who I know would tell you professionally it was about the most challenging two years in terms of deal activity in their career.

Outside of things that go across investment bankers' screens, you know, most private sellers, including the people who ultimately sold us - or are in the process of selling us HAHN, you know, were in a hunkered down and a retrenchment mode. So you just didn't see a lot of activity.

And I'd say this year is starting off with a lot more encouraging signs, both tangibly in processes - in terms of processes that are under way, and intangibly, in terms of conversations we're having that are realistic in terms of expectations and I think tangible as long as the economy holds together.

So that is the editorialization. And now we'll turn to the prepared remarks. And to kind of follow on it, we're pleased with 2010. We delivered solid results for both the full year and the most recent quarter.

And we're also extremely pleased that we're entering 2011 well-positioned to benefit from a still-strengthening industrial environment with an important strategic acquisition in hand and announced today.

2011 has started with capacity utilization, which is a really important metric to us, continuing to improve from the recent historic lows we saw during the Great Recession and capital spending; of course, now starting to pick up.

Through the fourth quarter and thus far into 2011, we see continued evidence, both tangible and anecdotal, of this industrial pickup in most of our businesses, notably heavy equipment, industrial machinery, medical and semiconductor, three of which are traditionally later-cycle businesses.

This equipment strength will help offset the well-publicized challenges in wind energy as we await the substantive Federal policy required to return wind to consistent growth and the long-expected decline of certain programs in our military business, principally MATV, which was formerly MRAP, which had been in a ramp-up mode for much of the last few years.

Both sales and orders from our industrial end markets rose over 20% in the fourth quarter of 2010 over last year's fourth quarter. With increased order and quotation activity in heavy equipment and industrial machinery, we should continue to see strengthening in shipments as the year progresses.

We'll discuss this in more detail, probably in Q&A, but the timing of these orders and tougher first-half comparisons in wind and military will shift a slightly higher percentage of revenue to the latter half of 2011 and it has been the case in at least the last two years.

And I think historically, we've seen about 55 - maybe a little bit north of 55% of our revenue in the second half of the year. So those of you who do have quarterly numbers out, you're a little bit more one quarter, one quarter, one quarter.

With wind diminishing and industrial orders picking up, principally in orders we're just getting now in heavy equipment and industrial machinery, you'll see the traditional shift, before wind really became dominant in the portfolio, back to something a little bit more like 55%, 56% in the back half of the year, with the balance in the first half. But we'll give you more color on that during the Q&A.

As we note in today's press release, there are a few discrete items in - which affect fourth quarter comparisons, which I'll note in a moment.

During the quarter, sales totaled \$105 million compared to \$108.9 million in the prior year. As noted in prior calls, sales to wind energy and military came in about as expected.

Total wind energy in the fourth quarter were \$12.5 million compared to \$21.3 million in the fourth quarter of 2009.

Total military sales in the fourth quarter of 2010 were \$16.2 million compared to \$26.5 million in the fourth quarter of 2009 as a major military program, MATV, wound down as expected.

Sales to customers in all other end markets in the fourth quarter increased 25% to \$76.3 million as compared to \$61.1 million in the fourth quarter of last year.

Operating income totaled \$17.1 million in the fourth quarter of 2010 compared to \$18 million in the fourth quarter of 2009.

These comparisons were affected by \$1.4 million of net costs associated with acquisition due diligence efforts, one of which is consummated, some of which we're still working on, some of which fell to the wayside, and our previously announced manufacturing consolidation program, partially offset by a small gain associated with the curtailment of certain post-retirement benefits.

In last year and the prior year's fourth quarter, we had gains of \$1.3 million associated with the curtailment of post-retirement benefits. Adjusting for these items, operating income was \$18.5 million in the fourth quarter of 2010 as compared to \$16.7 million in the fourth quarter of 2009.

Net income for the fourth quarter of 2010 was \$11.3 million as compared to net income of \$11.4 million last year. Diluted EPS in the fourth quarter of 2010 equaled 34 cents compared to 34 cents in last year's fourth quarter.

And again, adjusting for these items we just mentioned, net income was \$12.2 million, or 37 cents per diluted share, in the fourth quarter of 2010 compared to \$10.6 million, or 31 cents, last year.

And finally, EBITDA, an important non-GAAP measure, was \$24.6 million in the fourth quarter of 2010 compared to \$25.6 million in the fourth quarter of last year.

These comparisons were also affected by the items we mentioned and adjusting for these, EBITDA was \$25.7 million in the fourth quarter of 2010 as compared to \$24.3 million in the fourth quarter of 2009.

Friction control sales in the fourth quarter of 2010 were \$61.5 million compared to \$72.9 million in the fourth quarter of last year. The comparison to last year's fourth quarter was again affected by reduced wind energy and military sales.

Full-year wind energy sales were \$95.9 million compared to \$103 million in 2009. And longer-term, a clear, actionable, renewable energy policy on a Federal basis and further broader strengthening in economic conditions continue to be the prerequisites for meaningful and sustained growth in this segment.

Excluding wind, sales decreased to 49.9 - excuse me, \$49.1 million from \$51.6 million in the prior year's fourth quarter as sales to machinery, heavy equipment, medical and other industrial markets were offset by lower sales to military end markets as the MATV program wound down. Excluding military, this was solidly up.

Fourth quarter 2010 friction control products operating income totaled \$11.8 million compared to \$12.7 million in the prior year's fourth quarter. The reduction in operating income was due principally to the effect of lower sales in the two segments we've discussed and manufacturing consolidation costs of about \$700,000 incurred during the current quarter.

Velocity control products sold in the fourth quarter were \$14.9 million, an increase of 27% compared to \$11.8 million in the prior year as sales volume increased in both North America and Europe.

Velocity control's income increased to \$2.8 million in the fourth quarter of 2010, up from \$1.3 million earned in the prior year's fourth quarter.

Other industrial product sales in the fourth quarter of 2010 were \$28.5 million as compared to \$24.2 million in the prior year, with operating income equaling \$3.5 million compared to \$3.1 million in the prior year's fourth quarter.

Finally, orders were \$100.8 million in the fourth quarter of 2010 compared to \$77.2 million in the fourth quarter of 2009, a 30% increase. For the full year, non-wind orders exceeded last year by 26%, with a book-to-bill ratio of 1.02.

Wind energy orders were \$8.6 million in the fourth quarter of 2010 compared to \$900,000 in the fourth quarter of last year. And full-year 2010 wind orders were \$71.9 million compared to \$49.3 million last year.

We finished backlog with \$200.9 million as compared to \$205 million last year, with obviously a heavy mix shift towards industrial from wind and \$218.5 million last year, December 31, 2009.

Now I'll turn it over to Peter to cover some additional financial items and our balance sheet.

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

Fourth quarter 2010 results benefited from the lower effective tax rate of 34.1%, which compares to 36.7% in the 2009 fourth quarter. For the full year 2010, our tax rate was 31.5%, which compares to 35.8% in 2009.

The improvement in both instances is due to the full availability of the domestic manufacturing deduction and the planned permanent reinvestment of earnings of certain international operations, and additionally for the full year 2010 the energy tax credit, which was taken in the first quarter of this year, 2010.

Also in the fourth quarter we incurred, as Jim mentioned, \$700,000 in costs associated with our previously mentioned manufacturing consolidation program. And we expect to incur an additional \$1.4 million in 2011 related to start-up costs in our Sumter, South Carolina bearings operation.

We'll also expect to incur next year approximately \$200,000 in carrying costs for our closed Mocksville facility till its final disposition.

Capital expenditures in the fourth quarter were \$4.1 million compared to \$2.4 million in the prior fourth quarter. For the full year 2010, capital expenditures totaled \$15.4 million, which compares to \$12 million in 2009.

Free cash flow during the fourth quarter was \$23.4 million compared to \$19.7 million in the prior fourth quarter. For the full year 2010, net cash generated from operating activities was a record \$93.9 million, which compares to \$66.2 million last year.

Free cash flow for all of 2010 was also a record, \$78.6 million, which compares to \$55.4 million a year ago.

Our strong cash flow from operations net of capital expenditures contributed to our ability to complete the repurchase of 500,500 shares of common stock for \$18.3 million during the fourth quarter of 2010. For the full year, share repurchases totaled 742,000 shares for \$27 million.

In the fourth quarter we paid cash dividends totaling \$6.4 million and for the full year, dividend payments totaled \$24.5 million. And as a reminder, EBITDA and free cash flow are non-GAAP measures and we've included reconciliations for these two metrics, as well as metrics adjusted for special items, to the most comparable GAAP measure in the press release.

In summary, during 2010 our strong cash flows enabled us to return over \$50 million to shareholders in dividends and share repurchases, as well as invest almost \$20 million in capital expenditures and other growth programs while still increasing cash by more than \$24 million.

Cash and cash equivalents totaled 28 - \$286.6 million at the end of the fourth quarter 2010, compared to \$288.8 million at the end of the third quarter of 2010 and compared to \$262 million at the end of calendar 2009.

Inventory turns equaled 3 turns in the fourth quarter of 2010 compared to 3.2 turns in the fourth quarter of 2009. DSO equaled 66 days compared to 65 days in the prior fourth quarter and 67 days at the end of the third quarter 2010.

Both receivables and inventory were modest sources of cash over the year 2010. Our cash, together with our \$250 million credit agreement, provide us with additional financial flexibility to take advantage of internal and external growth opportunities during 2011.

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

Jim O'Leary: Thanks Peter. We're happy, as I said; to finish a 2010 that saw considerable improvement over the prior year and to begin 2011 with what appears to be a still-firming industrial economy.

During the fourth quarter, we increased our dividend to 19 cents per share, which was paid on the first day of the fourth quarter. This 5.6% increase, together with a recently stepped-up repurchase program, a recently completed bolt-on acquisition and an improved environment for, we believe, further acquisitions, reflects our confidence in the fundamental strength and cash-generating ability of our company.

This year demonstrated the benefits of the market leadership and well-diversified end markets. During 2010, we generated the highest annual operating cash flow in Kaydon's history.

Structural cost reductions made during the Great Recession, together with ongoing, proactive management of spending and strong positioning in attractive industrial end markets, produced consistent, solid results during both the worst recession in over a generation and a recovery that thus far has been below standard by many measures.

Our ability to maximize free cash flow, as recognized by this record performance during this period, allowed us to return cash to our shareholders in the form of enhanced dividends and increased share repurchases, while reinvesting in our business both organically and through acquisition.

Looking forward, we are pleased to announce that we've entered into a definitive agreement to purchase all the outstanding shares of HAHN. HAHN is located in Eichwald, Germany, and manufactures and sells high-quality gas springs, tension springs and dampers to diverse industrial end markets.

HAHN had sales of approximately \$20 million in 2010 and will operate within our velocity control segment as part of ACE Controls. We're delighted with the opportunity to expand our velocity control segment with this acquisition and it's a recognized leader, as is ACE, in the high-quality industrial segment.

HAHN has established a reputation as a critical supplier to a number of leading-edge customers. HAHN will now join ACE as part of our velocity control segment, where we look forward to significant collaboration on key areas of product development and design.

(Robert) that concludes our formal remarks; we'd like to turn it over to Q&A. And we will have a relatively hard stop at 12:00 so I'd ask some of our fans out there to try to limit it to one question if you can out of respect for your peers and hop back in the queue and we'll take as many as we can.

But with that, Operator, we will turn it over to you.

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. And if 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 for a question. We'll pause for just a moment.

We'll take our first question from Edward Marshall, Sidoti & Company.

Edward Marshall: Good morning. With the wind energy backlog that supports your outlook that you gave kind of last quarter, mid-80s for 2011. First, are you - looking at that, would you adjust that number that you gave us then?

And also I'm wondering if you could provide the color on the remaining business other than what you've already provided and how you see that, you know, considering the decent order and the trends in the quarter.

Jim O'Leary: Sure. I think we said low- to mid-80s and we would update that on the last quarter, Ed. And, you know, right - let me give you a qualitative color first.

The market is firming. Major customers are still adjusting their order books. They're still working on their own internal challenges on addressing the environment. We're still - whether it's the EPA or just general legislation, there's not a lot of clarity.

I think a safer estimate, and it's lower and wider - it's lower and wider because I think we'll come in probably at the high end or the middle, but we do have the possibility to beat it if things picked up.

And a lot of the unfortunately problematic things going on in the world today argue for an energy security policy which would be favorable to renewable sources, but you just can't tell when they're going to kick in.

You know, we believe we still have an attractive position and a very valuable option on a market that's going to be important long-term. But we're still dealing with - and I mean, it's kind of interesting, when we talked about capacity utilization before, you know, the North American industrial market, you know, the broader economy is still working its way back.

Utility usage is still a bit low. And the commitment to renewable sources is still going to need some policy help. You know, with that as the qualitative backdrop, you know, I view the range of \$70 million to \$80 million; I suspect we'll be at the higher end with the possibility to beat it. But a lot more has to go right than you can prognosticate in, you know, in the first or second month of the year.

So the range is a little bit lower. I suspect we'll be in the high end. But it's got to be wider just because, you know, you miss one order or somebody restructures or pushes out, and I would tell you, you know, our major customers are still looking at their book and restructuring, adjusting, pushing out, all of which has a big impact on that number.

Now longer-term, if the industrial economy still picks up and wind becomes, you know, roughly the same percentage of the overall book of business that it was in '06, '07, it - we will probably start giving you a little bit less detail on wind. But I think it was important when it was dominating the portfolio as it did in the last two years.

But if we're in a maintenance mode for, you know, a few more quarters, few more years, we'll probably deemphasize that a bit. We'll still give you a lot of detail. But we'll focus more on the second part of your question.

The industrial business, you know, particularly in things that are normally later-cycle, and that would be heavy equipment and capital-spending-driven industrial machinery, you know, order activity, both tangible and - as you pointed out, and inquiries, heads-up from important customers

that their order book is starting to pick up and they're expecting to wind down inventory, things like that should turn into tangible orders as the year progresses.

But we're almost uniformly positive towards the end of the fourth quarter and into the first. The markets affected, principally heavy equipment, industrial machinery, semiconductor, but medical continues to be strong as well.

And what we see, and I mentioned this on the - in the prepared remarks, but I think it's important to mention to you guys, that the last two years, you know, because wind was really an important and a stabilizing influence on the book of business, as was a spectacular program which we were thankful to have in terms of MATV and MRAP before it.

With those diminishing in the spikes that they brought, in the case of the renewable energy, you know, the quarterly comparisons, this quarter compared to the first quarter of last year, the MATV ramp-up as well, you know, we see a little bit less than the distribution from the last two years in the first and second quarter, a little bit more in the third and fourth.

Which again, is a little bit more what we were like in the beginning of '08, '07, '06, where you had about 55%, 56% of your revenue distribution in the back half of the year as opposed to the ebb and flow we had. When industrial went down, book and ship went down, but wind and military, particularly MATV, became a bigger part of the mix.

Edward Marshall: Okay, understood. Thank you.

Jim O'Leary: I don't think - I think I'm out of breath now (after all that). Okay, thank you, Ed.

Edward Marshall: Thank you.

Operator: We'll move to our next question from Nicole Deblase, Deutsche Bank.

Nicole Deblase: Yes, good morning, guys.

Jim O'Leary: Hey, Nicole.

Nicole Deblase: Hi. So if you could talk about wind a little bit, what you're hearing from your customers and specifically within that, are you seeing a lot of pricing pressure since volumes are down so sharply for the (OEs).

Jim O'Leary: Yes, we are dealing with the same thing they are. You know, you obviously follow a couple of them. They are all, you know, there's half a dozen public companies that provide a lot of detail on the price pressure they're getting, the management that they're doing.

And by the way, when we talk about price pressure, we collectively have to make the turbine more effective and in terms of effective, on a price per kilowatt generated basis, the price has to come down to be competitive with natural gas and other sources.

So as they work - their customers work with them on the supply chain, i.e., the cost of the turbine, we're working with them on low-cost country sourcing, taking costs out of our supply chain.

And yes, we are seeing price pressure. Yes, we should expect to see it going forward. But yes, if you look at the margins, which I think we have a pretty healthy beat against most estimates out there, yourselves included, you know, we think we've done a pretty effective job of managing, you know, a very, very tough environment for our customers and ourselves.

We expect that to continue. But we're ramping up our own low-cost country sourcing efforts. We have effectively managed the variable cost part of that. And if you look at EBITDA margins for this

part of the cycle over Kaydon's long history on a revenue base, it's about two times the size. You know, we think it's pretty good.

Nicole Deblase: That's helpful, thanks. Maybe you could talk a little bit about free cash flow allocation. I mean, this is a nice share repurchase that you guys did in the fourth quarter. What's your outlook for share repurchase activity in 2011?

Jim O'Leary: Highest priority would be further acquisitions. But that's, you know, that's the same sound bite we've been giving you for years. I think it's going to be more actionable this year.

We had a two-year period where, you know, we looked hard. We looked at a couple of big opportunistic things. And you see it in the numbers, you know, we take due diligence very seriously. So we looked hard, we worked hard. We just didn't get to the finish line on a couple. It would have been truly opportunistic.

But, you know, when you look at the overall environment, and a couple of you guys have published on this, you know, the investment bankers all have a different spin on it.

But what's striking about the two-year period from the onset of the Great Recession, you know, until about the middle of this year, was that there were very few deals, you know, probably the scarcest at any point in a period after a real economic calamity that I can remember. You know, 2001 and '02 range was great to be buying assets.

What happened this time is prices didn't go down at all. Almost no deals got consummated. And, you know, it was a pretty dry period for corporate development activity.

What we're seeing now is more real processes. But, you know, in real processes, we are, you know, we're obviously going to be competitive - but try not to overpay, but pay a fair price. There's a lot more of them out there now that are interesting and, by definition, have to be actionable because there's a willing seller.

There's a lot more conversations going on on smaller things, but things where the owners may be more amenable to selling. And, you know, the great example is HAHN.

This is, I think four years ago when I walked in the door here, you know, the one thing that our managing director at ACE Germany and the CEO of ACE in the U.S. said is, boy, we really could use (a new one or two or three) possible gas spring acquisitions to, you know, help us get along the way.

But in that two-year period, in a period where really nobody wanted to be a seller unless they had to, things like that just weren't actionable or really viable. You know, that stuff's starting to percolate again.

So, you know, long way to say the priority is corporate development activity, and it's corporate development activity that's sizable but maybe not, you know, totally transformational. But I think its stuff that people would appreciate as material to the company.

The second source would be share repurchases. We stepped it up this quarter for the first time and it's not calling the market, and no one should read anything into it other than it's the first time in about a year and a half we had a steady period where we weren't in a closed period because of acquisition discussions or other things.

So we stepped up the repurchase. I think you can assume that's continued at, you know, roughly the same pace and should continue through the year.

And, you know, at the very least, we'll maintain. And depending on other things that our shareholders might welcome more, you know, we'll always consider enhancing the dividend. But that's a board decision to be made later in the year.

Nicole Deblase: Okay, that was very helpful color. And if I could just squeeze one very quick modeling question in before I pass it on, tax rate and CAPEX color for 2011?

Jim O'Leary: Peter?

Peter DeChants: Yes, the tax rate for 2011, would say about 32-1/2%, plus or minus. And as we model in HAHN, that could change a bit. And CAPEX would be in the \$20 million to \$25 million range at the high end, probably.

Nicole Deblase: Excellent, thank you so much.

Peter DeChants: Thank you.

Operator: And we'll move to our next question from Peter Lisnic, Robert W. Baird.

Peter Lisnic: Good morning, everyone.

Peter DeChants: Morning.

Peter Lisnic: Jim, we've handled, I think, a lot of the revenue questions. But can you talk about what sort of leverage we should expect this year as the mix on the portfolio changes away from - or moves away from military and wind? What sort of leverage should we think about? And if you could incorporate what sort of the price costs or commodity pressure might do to that leverage number as well, that'd be great.

Peter DeChants: Sure, going into next year with the change in mix, we will see some improvement in margins. Not going to, you know, specify a specific amount. But you'll see our material cost as the mix changes improves, we saw that in Q4. And we saw improved overhead savings in Q4. So going forward, there will be leverage there.

Jim O'Leary: And, Pete, where absolutely we don't want to be Pollyannaish about anything. We're seeing the same price pressure that Nicole mentioned a couple of moments ago.

And I think the whole world is experiencing, you know, where, you know, I wouldn't say unique to Kaydon, but a little bit unique to us, you know, the impact of that price pressure because of mix, i.e., wind being modestly down or stable, everything else growing.

The mix impact of that price pressure on our most raw-material-intensive product gets dampened a bit by the fact that the growth in the other parts of the business that historically have been a little bit higher margin and where, again, we're producing smaller batches, high mix, more frequent orders where you've got the ability to pass along prices, you know, fairly, to your customers.

You know, we still have pressure. It's still a high priority to minimize the costs. But you don't have as big a potential detriment as you do in the much more raw-material-intensive product as the mix changes. So you should have some positive leverage, but I wouldn't suggest it's eye-popping. And we are absolutely experiencing the same challenges as everybody else.

Peter Lisnic: Okay, got it. And then, if I could switch gears to HAHN, I think you mentioned purchase price about half of ACE and revenue half of ACE. So a guess is \$35-ish million purchase price. Can you comment on profitability of the business at all?

Jim O'Leary: That would be a very good guess. If you guessed a million or two higher, your guess would be exactly right.

The, you know, as the press release says, we expect it to be accretive within the first 12 months. You know, a lot of that's driven by the timing in terms of ((inaudible)) because (we are not an interest payer), it's immediately accretive to cash flow, immediately accretive to EBITDA.

It should be immediately accretive to (ex-purchase) accounting, i.e., step-ups and write-ups. On the due diligence costs, it would be, on a normalized GAAP basis, immediately accretive. We expect it will add to earnings only if we close it really, really early in the fourth quarter and it would be by most a penny.

But over the full 12 months, it'll be much more accretive. And going forward - and it's hard to give you a price to EBITDA multiple on this because it's been a private company where, you know, we're going to have some synergies on the sales side. We'll have to add some costs on the Sarbanes-Oxley side.

Overall the margin structure will be very, very similar to historic ACE numbers. They'll take about 12 to 18 months to get there. But it'll be, you know, a solidly accretive and a solidly additive deal in terms of both cash flow and EBITDA.

Peter Lisnic: Okay, that is perfect. Thank you very much; I'll jump back in queue.

Jim O'Leary: Thank you, Pete.

Operator: We'll move to our next question from Eli Lustgarten, Longbow Research.

Eli Lustgarten: Good morning.

Jim O'Leary: Hello, Eli; how are you?

Eli Lustgarten: I'm multitasking today, it's kind of fun, (with the Eaton) meeting going on.

Jim O'Leary: Are you in a phone booth at your other conference?

Eli Lustgarten: Amazing what you can do if you figure it out, right. Quick question, on military was \$16 million in the quarter. Can you give us what the military forecast for 2011 - you were talking 60 to 70 - and both for military and wind, can you give us a rough idea of what the quarterly spreads will be? Are they equal for all quarters or is it front-end loaders. We try to model the quarters' numbers out.

Jim O'Leary: Peter'll give you the quarters in a second because I think it'll be helpful to you guys in kind of distributing your estimates for the year. In terms of military for the full year '11, we said 60 to 70 for the whole company and remember that includes a little bit in filtration, a little bit in other segments.

The segment that we've traditionally talked about extensively, because that's where MATV, MRAP have been, which is friction control, should be about 60 to 65. So 60 to 70 still good, probably a little bit higher than 70 but that's across the whole company, including areas that we haven't talked about, some which go through distribution. For friction controls it'll be in the 60 to 65 range.

Peter DeChants: Far as the spread is the quarters, it is wind and military that's driving the shift to the second half of the year. So you'll see within those two sectors also a greater balance to the second half, second quarter through fourth quarter, than the rest of the year.

Jim O'Leary: Last year, you know, you probably got your biggest drop off because MATV was shipping like crazy in the first quarter of last year. Wind was very - in fact I think wind was our strongest at about \$29 million in the first quarter of last year.

And I think military was probably the strongest or the second strongest. And if it's the second strongest, it's but by 100,000 or 200,000 in the first quarter of last year. So those two - and people hate to hear this but it's the real benefit of diversification. You know, as one business slows down a little bit the other ones are picking up.

Military and wind did spectacular things cushioning the blow for us during the industrial recession. Now as they dampen off a bit the other businesses are coming up. But that puts our distribution back a little bit more heavily towards the back end of the year as we've been, you know, before the, you know, before the 2007 periods.

Eli Lustgarten: You know, the implication of that is a very tough first quarter comparison. Typically you had a low tax rate, if I remember correctly, in the first quarter of 2010, at least well below 32-1/2%, I think it was 29-1/2%, something like that.

Peter DeChants: We had a discrete item in Q1 last year on the energy tax credit.

Eli Lustgarten: Yes. So I mean, are we talking a very tough comparison in this first quarter and then it gets easier for the rest of the year?

Jim O'Leary: It's a tougher comparison and a lot depends on how much higher margin stuff in the book and ship area which is, you know, historically the much higher margin. If a lot of that comes in in the first quarter, the comparison will be less tough but it's still the toughest comparison amongst the years.

Eli Lustgarten: All right. Thank you very much.

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

Operator: We'll take our next question. Question comes from Walt Liptak, Barrington Research.

Walt Liptak: Hi, thanks. Good morning. Most of my questions have been asked so...

Jim O'Leary: All right, have a nice day, Walt.

Walt Liptak: All right. Well, I'll give you a couple of easy ones - D&A for next year?

Jim O'Leary: Can you say again?

Walt Liptak: The D&A for next year?

Peter DeChants: In total it would be probably a little under \$30 million.

Walt Liptak: Okay. And the, you know, and the share repurchase program, was there a - you know, if you could refresh us on what's still available and, you know, I guess intentions on the share repurchase?

Peter DeChants: Well it's what's available at the end of last year, 12/31 we had about 2.3 million shares available out of the 5 million authorized a while back. And as Jim mentioned, the intention is that first priority acquisitions, second priority share repurchase, you know, in the interim about at the pace we had in Q4.

Walt Liptak: Okay, great. And I think you put out a number - or you mentioned a number - wind backlog in millions of dollars?

Peter DeChants: Wind backlog at the end of the year was \$85 million, 12/31.

Walt Liptak: Okay, got it. Okay, thanks very much.

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

Operator: And we'll move to our next question from Samuel Eisner, Sterne Agee.

Samuel Eisner: Good morning, everyone.

Jim O'Leary: Hello, Sam.

Samuel Eisner: Most of my questions have been answered, just a couple of housekeeping ones here.

For HAHN, I definitely appreciate the color. The growth rate that you guys are assuming for HAHN, is that something in line with what velocity is growing or is it slightly better, slightly worse? And what's the geographic makeup of it?

Jim O'Leary: Should be slightly better but it'll take a little while to get there as we integrate them into our sales efforts and a little bit more formally into our distribution efforts.

Right now, it is much more international, principally Western Europe. So it immediately will give us a little bit more geographic balance. But again it is only \$20 million, which is meaningful to the division, meaningful to the company, but it doesn't change the percentage international to domestic by but, you know, a percentage point or two.

Longer term, you know, the goal is broaden our stuff internationally and also put that through our distribution here in North America.

Samuel Eisner: Very good. On the CAPEX I think it's going up about \$10 million or so at the high end of your range from what you guys did this year. What is the additional, I guess, \$10 million going towards?

Jim O'Leary: Capital.

Samuel Eisner: Okay.

Jim O'Leary: Honestly, you know, nothing - no big discrete project - nothing other than in some cases ordinary repair, couple of payback projects, some testing equipment. It littered over, you know, littered over dozens, if not hundreds, of small capital projects, nothing big.

And what I think is kind of interesting about this quarter, you know, our wind, you know, our wind facilities are still pristine, state of the art. But now they're in a maintenance mode unless you're growing that business which obviously we're not in this environment.

And now you're going to go into a couple-year period where depreciation should exceed CAPEX, you know. If you look at our fourth quarter of last year, CAPEX estimate was a fair bit bigger than the \$16 million that we spent.

So, you know, the number Peter gave, you know, unless something really good that's a big payback project comes up, that's probably on the high side as well.

Samuel Eisner: Great. And then just on pension - just looking at your cash flow here - you put about \$2.2 million into the pension this year, about \$15 million in 2009. What is the current funding status of the pension and do you anticipate using some of your excess cash to put into the pension?

Jim O'Leary: We are, I'm happy to say, unique in the industrial space and in the state and municipality space. We're fully funded other than asset returns up and down, which we actively are looking at ways to (de-fee) certain retirement obligations.

You know, we're fully funded and, you know, right now it's neutral, neither positive nor negative. And we've, you know, we've shifted to a more contemporary mix of benefits for our longer-term new employees. So pension should, you know, forever be neutral to us.

Samuel Eisner: Very good, thank you.

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

Operator: We'll take our next question from Holden Lewis, BB&T.

Holden Lewis: Thank you, just a quick modeling question. The charges that you referenced - or I guess the sort of restructuring stuff, the \$1.6 million collectively. How do you expect that to fall during the year?

Peter DeChants: The lion's share of that's in the first part of the year.

Holden Lewis: Okay.

Peter DeChants: In fact the lion's share of it probably in Q1 - it's just the project moved a little bit to the right and we've always had a small amount in 2011 and just a little bit more.

Holden Lewis: Okay. And then the 8 cents in - that you had for sort of the due diligence costs for instance, I mean, I kind of view your M&A activity as being ongoing. It sounds like you have a pipeline that's going on there.

I mean, is that 8 cents that sort of comes back to the model in 2011 so it should be treated as sort of a one-time item? Or should we sort of view that as, look, we're always looking to acquire, so we're always going to have these costs and you shouldn't assume that comes back.

Jim O'Leary: As long as you, you know, trying to think of the right way to put this - as long as you guys are, you know, appropriately given a dispensation when they occur, I wouldn't put it in your model because I can't forecast it.

Of the 8 cents, some of it was related to HAHN, but not most of it because of the size of it - a couple that are related to things that are still ongoing and a couple that are related to much bigger things that didn't happen.

So I don't know any way to forecast it. I would say it's probably on the high side going forward because we did look at a couple of pretty big opportunistic things and just didn't get there this year.

So my suggestion would be don't model it but, you know, but please give it dispensation when it occurs because we try to, you know, give you guys as much transparency as possible on those things.

Holden Lewis: Okay. And then just, you know, you talked about the revenue side in terms of wind and sort of back-end loading those revenues and such. You have any color on how you - on how you kind of see the order pace in 2011?

I know in the past you kind of talked about maybe Q3 being stronger than sort of other years. I just wanted to know if you had any color about the amount or timing of orders in what you're seeing out there?

Jim O'Leary: For wind?

Holden Lewis: Yes.

Jim O'Leary: Okay. You know, I'm glad you asked because, you know, this is something I don't want you guys to be surprised at if it comes up in the next quarter or two.

We are still - our customers, you know, principally two or three guys that we talk to daily, one of which is the larger of the two - they're still working on restructuring their order book around some known projects, some things that could push into 2012.

And while the environment is - I'd say it's much better. And if you look at our full-year orders, our full-quarter orders compared to the great abyss of 2009, boy, I mean, I feel awful good leaving this year with a backlog over \$80 million.

It's supportive of our full-year forecast, maybe a little upside. But, you know, in the first quarter or two I would be surprised if we don't see some push-outs. You could see some cancellations. You'll see customers still refining their order book. So that could happen in the first or second quarter.

That's almost always, if you look at the last four years since we've been on this rollercoaster ride, that's almost always offset by the major orders that get placed in usually the third quarter or fourth quarter which would offset any, you know, de minimis or - any push-outs or cancellations in the first half of the year typically get offset by the refined estimates in usually the end of Q3 or beginning of Q4. And my guess is that's exactly what will happen this year.

The only thing I hope is, you know, if we get a policy, if there's a little bit more, you know, if the economy continues to firm up, if you see utility usage, capacity usage and, you know, a real recognition of energy security issues and we get anything through legislature.

Maybe that will be a little bit better because, you know, the missing part of the equation for our North American capacity is still, you know, the transplants coming - the transplants of major European companies coming here, building out their supply chain and making commitments, which, you know, we've done very well in the last two or three years without that.

But for us to be at full capacity and deliver on what we'd like to of this equipment, you know, that's the missing piece that we need.

Holden Lewis: And so along those lines, do you want to comment on the CES versus the RES, since that came up in the State of the Union?

Jim O'Leary: Well, I mean the State of the Union; the President said some enormously bullish things for this industry. I still believe you need a renewable energy standard on a Federal basis. The state, you know, the state initiatives are important. They're helpful. But I do think you need a Federal policy to, you know, to really give us the sustained growth that we need.

Holden Lewis: But if it includes natural gas and nuclear, so you're in that CES instead of a pure RES, is that considered more positive, less positive?

Jim O'Leary: We only have ten minutes, but I'll give you my 60-second global perspective on that. And, you know, not rooting for war or instability in, you know, in important parts of the world, but in our natural gas, we've got a lot of it now.

But you might have noticed there were a couple of not minor accidents recently. And there's still a lot of discussion on the environmental issues and the like. But natural gas is a really important resource that this country has to exploit to its fullest.

Natural gas also is a very obvious, easy, and used in a lot of places substitute for gasoline which I believe I saw a \$4.50 to \$5.00 estimate in the paper the other day. And, you know, as much as I respect Wall Street research, I don't believe it until I see it in the "USA Today." And in the "USA Today" it was there the other day.

The, you know, I honestly believe that longer-term natural gas will probably be directed towards clean gas vehicles, which is a trend you read a lot more about now. A number of the companies that have made very big bets on North American natural resources are talking about whether or not it's a good export.

And the highest and best use of our resources would be for export to some places that, you know, if you are a hostage to - and a hostage is the wrong word - but if you're dependent on Eastern European sources which have been shut off a number of times in the last year or two - if you are subject to resources that needs to be extracted from, you know, potentially unstable regimes I think it all defaults back to, you know, we need everything.

Thank God we've got more natural gas than we thought we had three or four years ago. Its highest and best use may be for export or for clean gas vehicles which is already a tried and true and improving technology.

Wind and solar are always and probably, unless something changes about the sun or the wind, are always going to be intermittent resources. So I think the balancing of natural gas relative to those two resources is important.

And again we're coming off a percentage of the overall portfolio. It's about 1%. So we don't need an RES that says wind and only wind of 20, you know, 20% by 25 to make a meaningful difference on our capacity utilization.

Holden Lewis: All right, thanks, guys.

Jim O'Leary: That was more than 60 seconds but I thought it was worth spending time on.

Holden Lewis: Sorry, there was more than one - it was more than two questions.

Jim O'Leary: Thank you.

Operator: And as a final reminder, it is star 1 for a question. We'll take our next question from Steve Barger, Keybank Capital Markets.

Steve Barger: Hey, good morning, guys.

Jim O'Leary: Hello, Steve.

Steve Barger: Jim, earlier in the call you talked about exploring low-cost country sourcing for the wind business to help out your customers. Does that mean you can find a cost advantage over manufacturing in Mexico using forgings from India? And just geographically, what would that look like?

Jim O'Leary: No, but there are Mexican sources, Indian sources, Korean sources. And a lot of that when it was straight pass-through from our customers to their customers, from us to our customers, it was an important thing.

I'm not saying people weren't being cost-sensitive. But it was less important than in a deflationary environment where everyone's trying to push the price down, you know, to be closer to natural gas or coal, quite frankly.

That, you know, we're expanding our efforts now because I think longer-term, our customers' customers will not let them pass through. And our customers are unlikely to let us pass through. So that'll be a much bigger part of what we do and the value we provide.

So, you know, we - I'd expect we'd be taking that capability on and taking that responsibility on going forward. So we'll be talking less about pass-throughs, my guess, at the end of this year and next, and more about what we're doing to either get some upside, you know, or minimize some downside.

And unfortunately, that's the case in any product where you've got a deflationary environment and right now we do. I hope that changes by next year.

Steve Barger: Right.

Jim O'Leary: And we've expanded, you know, we've absolutely expanded our efforts there and our capabilities.

But it's not just in wind, you know, we're recognizing that that's in a two-year period now where even in the, you know, the worst parts - towards the end of the recession it was interesting the commodity prices, you know, didn't really behave like they do in recessions, whether it's financial speculation, whether it's the emergence of ETFs, whether it's developing nations.

You know, we become a lot more sensitive as every, you know, every one of our peers that I'm aware of. So they need to have expanded low-cost country sourcing and not assume you can pass that along because you can't.

Steve Barger: Right. Well, in the past you had talked about potential opportunities from, you know, maybe manufacturing in India or China to exploit those markets. Are those basically off the table right now until you get a little more clarity in the - in your home market here?

Jim O'Leary: They are - and it's not just clarity in our home market, you know, see, we are continuing to work with and explore options to manufacture for the Chinese market.

But, you know, based on the research we've done so far, I'm not so sure our shareholders would thank us for a big expansion there. I'm not so sure I want to put capital in place where the margins are - appear to be as far off as they are. And again, this is based on the research we've done.

We've looked at JVs with customers who've slowed it down a bit. We've looked at taking over assets from other potential parties. We're going to continue to do so because, you know, sometimes you've got to kiss a frog more than once to see if it turns into a prince.

But, you know, I would say that's not off the table but it's certainly deferred until you've got a better macro environment on a number of fronts.

Steve Barger: Right, makes sense. And then just one more quick one - just going back to the leverage question, is it reasonable to think from an incremental standpoint you can get back into the mid-

20% range or better in 2011 given your mix, kind of like where you were in the industrial upcycles back in 2004, 2005?

Jim O'Leary: EBIT or EBITDA?

Steve Barger: EBIT.

Jim O'Leary: Probably not. EBITDA possibly, but that would be a stretch target to maintain that over the entire year. EBIT I'd say high teens, low twenties, more likely low twenties.

And Steve, you know, that's - I wouldn't say that's a shortcoming. It's a mix issue. If you look at the last cycle, I think that was done on a revenue base. It was about \$150 million lighter. And it's not just wind, you know, wind has been solidly accretive in terms of EBITDA, cash flow and EBIT.

It's the mix away from defense. It - last turn of the last cycle, you know, you had legacy programs on fully depreciated equipment and facilities where we were well above practical capacity.

You know, you could get back to those margins, but you'd have absolutely no growth in sales or income or cash flow.

Steve Barger: Got it. No, that's great color. Thanks.

Jim O'Leary: Okay, you're welcome. Thank you. (Robert), I think we've got time maybe for one more, if there is one more.

Operator: And there are no further questions at this moment.

Jim O'Leary: Oh, exactly as we planned it. It couldn't work out better. Anyway, thank you all for joining us this morning. We appreciate your time.

And something I was remiss in saying during the prepared remarks, I'd like to thank all our employees and our long-term shareholders for their hard work and patience, you know, particularly over this last year, but over the last few years.

Thank you very much and we'll talk to you next quarter.

Operator: And that concludes our conference for today and we thank you for your attendance.

END