KAYDON CORPORATION

Moderator: Jim O'Leary
May 06, 2011
10:00 am CT

Rick Mosteller: Welcome to the Kaydon Corporation First Quarter 2011 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 2010 Form 10-K for a list of risk factors that could cause its results to differ from those anticipated in any forward-looking statement. The company does not undertake and expressly disclaims any obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise except as required by applicable law.

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

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. Mr. O'Leary, please go ahead.

Jim O'Leary: Good. Thanks, Rick. Good morning, and thanks for joining us today. And we are going to have shorter comments than usual in the prepared remarks, because this quarter really came out consistent with our expectations and I think consistent with everything you can read about in the macroenvironment that affects our three major, what I would call our three major end markets that being general industrial, military and wind.

But before I go on to the prepared remarks, which inevitably and regrettably for you guys as for myself, because it's less exciting to read the press release to you than it is to answer some of your questions, I thought I'd give you a little bit of context on how we see the quarter and the implications going forward.

And I think you have to start with, at the heart of Kaydon is the simple truth is that we're a diversified business. A small conglomerate with heavy concentrations in some really excellent niche industrial markets, and at the heart of every conglomerate model is some things do very well at times when others don't and they tend to balance themselves out over a cycle.

And if you look at this last few years which had one of the worst recessions in anybody's memory and a pretty sharp and aggressive bounceback, you know, I think the consistency, the stability and the, you know, the heart of the conglomerate model or the diversified business model really showed itself through.

And where we are today, our biggest end market, which is obviously a diverse set of subsegments itself, is industrial. And our industrial business probably has had - no, not probably. In our history as a company we have had the best order bookings that we have ever had across many segments. And within the segments I suspect this year when December rolls around we'll have had record performances in a number of them.

And a lot of that's attributable to what I've categorized as kind of the hard missionary work that gets done when you're a company like Kaydon, which is a very customer-centric, and you have to have engineers and salespeople touching and working with your customers for long periods of time in some cases.

You have to have people in the markets, principally international and some of the distribution markets where over the last few years and even during the worst of the recession, because we were cash flow positive, in the black in every segment and had a great balance sheet, we were adding salespeople in distribution. Internationally we were upgrading positions and broadening our reach. And you're starting to see that now.

You're seeing it in the orders. You're seeing it in the results. And, you know, if you say relative to what any reasonable expectations were, I'd say industrial came out a bit better than we expected, a bit better I think even than the general environment.

And I think it reflects, you know, the hard work we've been doing over the last few years. We've gotten operating leverage from some of the actions taken during the downturn and it's coming through now and I suspect it'll continue to come through, all things being constant, over the next few quarters.

Second biggest segment today or over the last few years and roughly the second or third biggest today is wind. And wind held up extraordinarily well during the downturn. We had positive comps and growth through much of it. And wind now, because electrical generation, the overall energy policy issue, is cloudier than it's been in awhile.

It's still going to be a very good business for us and we suspect it's going to be an excellent business going forward. And the going forward may be 2012 or '13. The principal issue there is we need a clear actionable national energy policy and we will have that someday.

But while wind was spectacular during the worst of the downturn and really stabilized the industrial business, you know, its performance is a bit muted now. The comps are very challenging for the next two or three quarters, but by the time we get to the end of the year it'll still be a solid contributor.

It'll be an option on a market that we think is going to be great in the longer term, but its performance will be a bit muted. Again, think about the heart of the industrial model, the conglomerate diversified industrial model.

And the third business actually had a very good quarter. It's a business that grew significantly from 2002 forward, carried the day for us in the early part and through much of the last cycle. And we actually held up I think considerably better than many in the defense space with a program that has been absolutely fantastic for us.

We were lucky and happy beneficiaries of MATV and MRAP as those two vehicle programs replaced Humvee. Pretty much the whole decrease quarter-over-quarter and again the tougher comparisons for the next two quarters in that end market are 100% as being victimized by our success last year.

Seven million of the drop this year is sell-through on MATV and we shift now to a repair replenishment mode and we're working off a very big base of business that's still $55 million to $60 million in one of our segments, about $70 million across the whole company and a good strong base business.

But one where that will be stable, you know, for the next few quarters, tougher comps for the next two and then shifting into repair replenishment mode, but a very good business but one where that will counterbalance, you know, the extremely good growth we'll see in industrial and, you know, a decline but a decline off of a very high base in wind.

And you look at the three together, I'd say the quarter came out better than we expected. One business doing a bit better, one business being a bit softer and military in an excellent business, stable, but one where growth will be a little bit tougher going forward largely because of the budget issues that I think we all read about every day in the paper.

And that's the context we'll go through very quickly. And I'll apologize, but like I said it's inevitable and regrettable that we end up reading a little bit of the press release in these exercises. And then we'll get to Q&A.

Sales in the first quarter were $108.3 million. That compared to $119.2 million last year. And strong industrial sales driven by improving global capital expenditures and capacity utilization that's still working its way back towards that 2008 level, largely offset the expected and much discussed decline in wind energy and the absence of that key military sales program that really benefited us in the early part of last year.

As I noted on our last call, 2011 started with capacity utilization continuing to improve from the historic lows during the Great Recession and capital spending is still picking up. We see continued evidence both tangible and anecdotal of this trend notably in heavy equipment and industrial machinery which are normally later cycle markets. Both of them had strong orders and look sound and positive going forward.

Sales to our industrial end markets rose almost 20% in the first quarter of 2011 and orders from our industrial end market increased more than 29% over the prior first quarter. With increased order and quotation activity in heavy equipment and industrial machinery, we should see continued strengthening in shipments as the year progresses.

During the quarter - excuse me. Total wind energy sales in the first quarter were $12.2 million compared to $29.3 million in the first quarter of 2010. And military sales in the first quarter of 2011 were down $7 million almost entirely due to the absence of the MATV program that benefited us last year.

Both wind and military comparisons become less challenging as the year progresses, a little bit and roughly the same in the second quarter, a little bit less in the third and then you're into much more normal comparisons as you get into the fourth quarter. But that's largely going to be offset by improvement in the industrial space.

Sales to customers in all other end markets in the first quarter increased by nearly 20% to almost $80 million compared to the first quarter of 2010. Operating income totaled $17.5 million in the first quarter of 2011 compared to $19.7 million in the first quarter of 2010.

And the comparisons were impacted by $1.5 million of net costs this quarter associated with the previously announced manufacturing consolidation program and some acquisition due diligence efforts. Adjusting for these two items, operating income was $19 million in the first quarter of 2011 as compared to $19.7 million in the first quarter of last year.

Net income was $12 million compared to net income of $13.8 million last year and diluted EPS in the first quarter equaled 36 cents compared to 41 cents last year. And again, adjusting for the two items I mentioned a moment ago, net income was $13 million or 40 cents per share in this first quarter compared to $13.8 million or 41 cents per share on a diluted basis in the first quarter of 2010.

And if you remember, the first quarter of 2010 included a net benefit of $500,000 or a penny per share on a diluted basis related to a one-time tax pick-up, so roughly EPS was flat compared to last year with industrial up a lot and the tougher comparisons within military.

EBITDA, a non-GAAP measure, was $24.2 million or 22.3% of sales in the first quarter of 2011 compared to $27.1 million or 22.7% in sales last year. Adjusting for the items mentioned a few moments ago, EBITDA was $25.8 million or 23.8% of sales this quarter as compared to $27.1 million or 22.7% of sales in about a point increase year-over-year at the EBITDA line.

Friction Control sales in the first quarter was $60.9 million compared to $79.8 million last year with the decline attributable almost exclusively to reduced wind energy sales and reduced military sales largely offset by increased industrial sales.

First quarter, Friction Control Products operating income totaled $9.9 million compared to $16.5 million last year with the reduction in operating income due principally to the effect of lower sales and the costs we mentioned in the manufacturing consolidation program.

In Velocity Control, Velocity Control Products sales in the first quarter of 2011 were $19.6 million, a 37.9% increase compared to the $14.2 million in the prior first quarter as sales volumes increased in all our markets and most significantly in our international locations.

Velocity Control's operating income increased to $5.8 million in the first quarter of 2011 from $3.4 million in last year's first quarter due primarily to increased volume and operating leverage.

Finally, other Industrial Products sales in the first quarter equal $27.8 million as compared to $25.2 million in the 2010 first quarter, with operating income equaling $2.5 million compared to $1.3 million in last year's first quarter again due to higher sales and improved operating leverage across most of the businesses in other.

Orders were $110.4 million in the first quarter of 2011 compared to $100.5 million in the first quarter of 2010, an increase of 9.8%. For the quarter, non-wind orders exceeded last year's first quarter by 18.9%.

Orders in the first quarter of 2011 included approximately $8 million of wind cancellations for an older generation turbine that's expected to be replaced with new orders later in the year when our customer requirements come in, so probably the third or fourth quarter.

The $118 million first quarter intake is the largest non-wind order intake since early 2008 and ex-military, the largest industrial order intake in our history resulting in a strong book-to-bill ratio in industrial of 1.23. Wind energy orders were a negative 8 reflecting the cancellations mentioned before, which again we expect will be replaced with newer generation turbines later in the year.

Our industrial end markets performed extremely well offsetting much of the expected slowdown in military and wind. Going forward, we're selectively reallocating capacity servicing the wind energy market to take advantage of opportunities in an improving heavy equipment market.

Longer term we remain confident that the wind energy market will be an important contributor but at the present, growth expectations are muted because of the absence of an actionable national renewable energy standard.

In the intervening period, the selective reallocation of capacity, principally to heavy equipment, proactive management to a variable cost and the continued strength of our broad industrial platform will enhance growth as the year progresses. Backlog at quarter end was $203 million compared to $200.9 million at the end of last year and $199.8 million at the end of last year's first quarter.

Now I'll turn it over to Peter to cover the balance sheet and some other key financial items.

Peter DeChants: Thanks, Jim, and good morning, everyone. Again during the first quarter of 2011, both interest income and interest expense were modest as our cash was principally invested in low yielding money market funds and our balance sheet remains debt free.

The effective tax rate for the first quarter of 2011 was 31.8% which compares to 29.6% for the 2010 first quarter. First quarter of last year included a net benefit as Jim mentioned of $500,000 for certain tax items, which included a qualifying advanced energy credit partially offset by adjustments to defer tax assets.

For the full year we expect our effective tax rate to be approximately 31% or to call it roughly between 31% and 31-1/2%. Also in the first quarter we incurred $1.1 million in costs associated with our previously mentioned manufacturing consolidation program.

We expect to incur an additional $600,000 over the next two quarters related to equipment moves and start up costs as this important project at our Sumter, South Carolina bearings operation nears completion. Following that we expect to incur only ongoing maintenance costs for the now closed Mocksville, North Carolina facility until its final sale.

Capital expenditures in the first quarter were $4.3 million which compares to $1.7 million in the prior first quarter. For the full year 2011 we expect capital expenditures to be approximately $25 million compared to about $15 million in the full year of 2010.

Free cash flow during the first quarter was $3 million compared to $27.9 million in the prior first quarter. The decline in free cash flow is largely attributable to working capital growth relative to last year, principally inventory, which is supporting anticipated improved business activity.

In addition, certain other assets and liabilities were sources of cash in last year's first quarter including prepaid assets and some accruals for salaries and wages largely related to incentive comp and other accruals. During the quarter we returned over $20 million to shareholders in the form of share repurchases and increased dividends.

We repurchased 357,000 shares of common stock for about $14 million during the first quarter of 2011. Additionally in the quarter we paid cash dividends totaling $6.3 million. As a reminder, EBITDA and free cash flow are non-GAAP measures and we've included in our earnings release a reconciliation of these metrics as well as metrics adjusted for special items to the most comparable GAAP measure.

Cash and cash equivalents total $271.9 million at the end of the first quarter 2011 compared to $286 million at the end of the fourth quarter of 2010. Following the end of the first quarter this year on April 8, we completed the acquisition of HAHN-Gasfedern for cash.

Inventory turns in the quarter equaled 2.8 turns in 2011 compared to 3.6 turns in the first quarter of 2010. DSOs equaled 69 days compared to 64 days in the prior first quarter and 66 days at the end of fourth quarter of 2010. We've selectively increased inventory at certain operations to satisfy what we expect to be anticipated demand and have more stock on hand for shipments.

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 the balance of 2011. Now I'll turn it back over to Jim.

Jim O'Leary: Thanks, Peter. As I said at the top of quarter - excuse me, the top of the call, we're extremely pleased with our first quarter and how we start out the second going into the remainder of the year. And in early April we closed the acquisition of HAHN as Peter mentioned a moment ago.

HAHN is located in Aichwald, Germany, and manufactures and sells high quality gas springs, tension springs and dampers for diverse end markets. HAHN had sales of approximately $20 million in 2010 and is now operating as an integrated and integral part of ACE Controls within our Velocity Controls segment.

We're delighted with the opportunity to expand what has been our most consistently and our highest profitable segment over the last few years. With the acquisition of HAHN, a recognized leader in the high quality gas spring segment, we now have a much broader diversified offering to bring to our customers. Together, HAHN and ACE Controls will collaborate on key areas of product development, design and sales for our world-class customers.

With that, David, we're going to wrap up the prepared remarks and turn it over to you to moderate Q&A.

Operator: Thank you very much. The question and answer session is conducted electronically. If you'd like to ask a question at this time, you may do so by pressing the star key followed by the digit 1 on your touch-tone telephone. If you are using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment.

And once again, that's star 1 if you'd like to ask a question at this time. We'll pause for a brief moment to let everyone's signal reach us. And our first question comes from Eli Lustgarten with Longbow Securities.

Eli Lustgarten: Good day, I guess it's still good morning, everyone.

Jim O'Leary: In half an hour you can say good afternoon at the last question if you want.

Eli Lustgarten: I hope I don't go that long.

Jim O'Leary: I hope so too.

Eli Lustgarten: Just, you know, give some detail, you know, the wind business is obviously, you know, the most interesting one. It looks like the backlog dropped in wind to about $65 million. Is that the right calculation?

Peter DeChants: Yes, that's correct, Eli.

Eli Lustgarten: And that basically says - and is most of that scheduled for shipping this year?

Jim O'Leary: A good part of it.

Eli Lustgarten: Well, so we're really talking, I mean the implication of the guidance that you had is that the second quarter wind shipments will be very similar to the first quarter? And then...

Jim O'Leary: So I think our guidance before we said low 70s to 80-ish. Realistically where we see the market absent orders that come in for, you know, or acceleration of orders that are in that $65 million for 2012, we think it's more likely to be in the 60s. So we've tempered that a bit.

We expect it'll be, you know, low to mid-60s and there's certainly the possibility for an upside surprise because - also the possibility or I think less of a possibility as we feel its bottom for a downside surprise. But, you know, our guidance now, mid-60s, low 60s, and going into 2012, you know, we'll talk about that when we see what the orders are in the third and fourth quarter.

Eli Lustgarten: Okay. And is that operation profitable at the moment...

Jim O'Leary: Yes.

Eli Lustgarten: ...with the drop, I'm sorry?

Jim O'Leary: Yes, absolutely. And I with you, is - and I'm glad, you know, I want to editorialize for a minute, but going forward we're going to talk a lot less about wind until the business comes back. I mean right now it's comparably sized to our military business. Military and wind together are half the size of our industrial business.

And we have a number of subsegments within the company including industrial machinery which are roughly the same size if you add up that business across the segments, and more profitable. So until, you know, until and unless we have things that are worth calling out, we'll probably start talking about wind in the same context that we do military.

We'll call out major orders when they come in, but we're not going to disclose the level of backlog and the level of granularity we've had. Good, because I don't think it's in our best interest in dealing with customers and other competitive reasons.

But, you know, to your question it's solidly profitable. We have shifted wind down to our lowest cost manufacturing in our state-of-the-art manufacturing facility in Monterrey, Mexico. We're using some of the capacity that's onshore for heavy equipment. There's that market. And you know, since you cover a number of the guys, the heavy equipment market in my experience has come back...

Eli Lustgarten: It's booming, yes.

Jim O'Leary: ...much stronger and faster than I recall. I used to be with a company that owned, a major crane company and it is kind of unique at how quick some of the crane guys have snapped back. And we're a beneficiary of that so we're reallocating some of the domestic capacity towards that business.

But it's solidly profitable. And if you look at and you think about what we said as where we thought peak margins would be with wind at well north of $100 million level, we said the EBITDA margins would be in the mid to high 20s. We're almost at mid 20s with wind, you know, in the $60 million to $70 million range.

So that not only tells you that the wind business is solidly profitable, it tells you that everything else is benefiting from the operating leverage from actions we took before. So given that you've got a sales base that's significantly higher than at this point in the last cycle, you've replaced much of - you know, I don't want to hope for a war but a lot of the excess profitability in the last cycle had to do with the run up in the Iraq occupation.

You've got to feel pretty good about where we are in terms of our margin standpoint for the company as a whole. I wish Friction Control was doing a bit better. I think that's timing and mix. I feel good the EBITDA margins relative to the EBIT margins compared to prior cycles.

A lot of it's depreciation, which again some of it will be absorbed by heavy equipment and some of it will have to wait for wind to come back. But I'm still a big believer in wind. I just think it's a timing issue.

And in an environment where despite a pretty steep run up in industrial activity so much of it is being driven by developing nations and kind of a resurgence in automotive, I think it would unrealistic for me to think that wind would doing much better given that electrical generation is really not close to the 2008 peaks.

And, you know, you still have unemployment and some of the macro factors in this country where, you know, we are a North American supplier in wind so we're going to go as electrical generation and employment goes in North America. So I'm not disappointed. In fact, I think our numbers are probably are a bit better than people should expect at this point.

Eli Lustgarten: Is there any, there's no revision in your outlook for the military business this year is there?

Jim O'Leary: Whatever we said last time, I thought we said 60-ish within Friction Controls. That's probably about right.

Eli Lustgarten: Yes, and that was the same. And at this point you're expecting the growth in the wind, in the non-military non-wind business to be able to more than fully offset the slowdown in those two businesses to give you some, you know, earnings growth across the board.

Jim O'Leary: Yes, but it'll come, because the comparisons are tougher for the next two quarters you'll see a little bit, the rate of improvement will increase as the year goes on. And if you think about how our backlog typically ships, you know, three to six months out, so some of the orders were taken principally for heavy equipment.

And if you listen to, and I'm sure you listened to the crane guys last couple of - released in the last couple of quarters, that'll come on in the back half of the year. And I think we had some pretty aggressive comps principally for wind in the second and third quarter. So as the year ages and as we get into the third and fourth quarter, you'll see the rate of improvement pick up.

Eli Lustgarten: Okay. That says that the second quarter is going to be a difficult comparison just like the first, is that fair?

Jim O'Leary: It'll be more challenging, yes. It'll be more challenging than the third and fourth.

Eli Lustgarten: Well, the third quarter will be easier. And with HAHN coming in at this point, will that be, you know, enhance both the profitability and the bottom line of Velocity Controls?

Jim O'Leary: It may in the fourth quarter. And I say that it's because the purchase accounting, principally on inventory that'll turn during the first two quarters of ownership. You know, if things continue to improve in the industrial space at the rate they are, it could be contributing to GAAP profitability by the fourth quarter.

But I think it's more safe to say it'll be solidly accretive by the first quarter of next year with the possibility of it contributing to the fourth quarter of this year.

Eli Lustgarten: All right. Thank you very much.

Jim O'Leary: Eli, you may not have left questions for anybody else. David, if there's nobody else we'll wrap the call up now. Just kidding, David.

Operator: And our next question comes from Nicole Deblase with Deutsche Bank.

Nicole Deblase: Yes, good morning, Jim.

Jim O'Leary: Hi, Nicole.

Nicole Deblase: Hi. So you guys gave some good color on your heavy equipment. It seems like it's doing very well. Could you talk a little bit about your other end markets where you're seeing strain, to where you're seeing weakness aside from wind of course?

Jim O'Leary: Medical, very strong, principally internationally. Semi-conductor, really strong, semi-conductor equipment is probably up within industrial and I'd probably say it's our third or fourth biggest business. And that's not getting to the 2000 levels when it was the biggest business within Kaydon, but it's having a really solid year we think.

Industrial machinery, very well, export, which goes across everything doing very well, you said not to comment on - well, heavy equipment as you mentioned, order rate very good which should benefit us in the back half of the year particularly and it should have a beneficial impact on absorption as some of that equipment is currently being reallocated from wind.

Distribution business extremely strong, you know, distribution is less important for us than other guys in the bearing space, goes more direct OE. But we have added a lot of resources over the last few years and it's absolutely paying off so, you know, more broadly across Friction Controls and principally in Velocity Control our distribution business is doing very well.

So there's nothing really that stands out as being negative, you know, other than the macro issues we talked about in both military and wind.

Nicole Deblase: Okay, got it. That's helpful. And then the velocity margins look very good this quarter. Is there anything to call out there or shall we expect that kind of strength to be sustainable?

Jim O'Leary: I mean that should be roughly the level. I mean it's just doing very well. We've got good operating leverage there. You won't see a big pickup. You're unlikely to see a big pickup off the level of that now because the incremental margins will be consistent with what I think are pretty close to peak margins right now.

You won't see a big contribution from HAHN I think until next year but, you know, if things continue improving it's possible we'll see a little bit of a pickup in the fourth quarter. But again, in terms of solid GAAP accretion I think it's more realistic to think first quarter of next year.

Nicole Deblase: Okay, thanks.

Jim O'Leary: You're welcome, Nicole.

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

Peter Lisnic: Yes, good morning, everyone.

Jim O'Leary: Hello, Pete.

Peter Lisnic: I guess first question on military. You talked about the $7 million MATV hit in the first quarter. And if I remember right, we were looking at around a $10 million hit for the year but then there was I think a comment where the second quarter impact was comparable to the first. I'm just trying to square away. Are we looking at a military business that's still down, call it $10-ish million in 2011?

Peter DeChants: No, the MATV impact in Q2 will be less than Q1.

Peter Lisnic: Okay, so call it low millions in the - okay, from MATV. All right, that's fine. And then if I look at profitability in the Friction business, you know, on an adjusted basis 18% EBIT margin, last year at 20.7%. It implies that mix was a significant I guess a pretty significant headwind.

Can you talk about mix and what the puts and takes were for profitability for Friction Control and then also maybe address price cost and what that has looked like for you given the commodity inflation we've seen?

Jim O'Leary: Well, as you pointed out mix, but mix in the drop off in volume principally MATV, had more to do with the profitability than, you know, the factors you mentioned which I will comment on. I think you mentioned EBIT margins. I suspect and we don't disclose it, but the EBITDA margins are probably closer to historic norms than the EBIT margins and that's because the depreciation, the depreciation on equipment.

You know, after two decades of roughly 2% to 3% CAPEX where most of the equipment was added not just for wind, but to upgrade some facilities and to address some bottlenecks and to some aged equipment we had. The heaviest impact across the company on depreciation is right in Friction Control. So I actually think the cash operating margin and the EBITDA margins are closer to norms but, you know, absolutely mix impact in it.

In terms of price relative to cost, you know, I mean the cost environment is challenging for anyone manufacturing. The inflationary impact of a lot of the inputs we have is more challenging than in awhile. I think it's been roughly neutralized. And if I'm wrong it's just by a couple hundred thousand here or there by either price pass-throughs or cost reduction efforts.

So I can't say it's had a significant impact yet, but it's been significant on the floor where we've been working hard to offset it and we've been working well with our customers to assist where appropriate. Going forward I still think it's going to be a very challenging environment and I hope we're as lucky in the quarters to come.

Peter Lisnic: Okay, fair enough on that. And then on the wind business, obviously no orders this quarter but can you give us a sense as to what your customers are telling you? And I'd be particularly interested in what sorts of comments you're hearing from international customers and what - how the order book could potentially shape up from an international basis as you look forward.

Jim O'Leary: Well, recently the ER forecast came out and it shows steady growth off of this year. It'll impact suppliers to the turbine guys a bit later because I suspect they're still shipping a bit out of inventory and they're still shipping off of backlog that they've been trying to hold in place for probably the last few quarters. But this will be the toughest and hopefully it is the bottom.

Next year we should see some improvement, and now all of this is anecdotal. But obviously the tragedy in Japan certainly prompted immediate action in Europe where the green parties in a couple of states and I think the general trend towards more renewables has been notable and headline worthy.

That happened the first week or two after the events in Japan. Anecdotally that is clearly a positive for both wind and solar. International gas is not, it's still at a price.

And with the supply I think that's still the principal competition for renewables, particularly as the bill was rewritten for the policy actions taken and hopefully eventually to be in a real energy policy, will impact us but still anecdotally what we hear from and what I see in the headlines on the foreign side suggests that there will be more business and more activity going forward, but it has yet to translate into real orders.

And I think it'll take a couple of quarters for that to do so. Our customers have to work through their existing backlog and their current inventories. And, you know, we will see orders in the back half of the year. I suspect they'll be consistent with what we saw last year with any real improvement coming as you get into 2012.

Peter Lisnic: Okay, perfect. And then just a last question on the switch in capacity from wind over to heavy, any incremental costs that we should think about in the second, third or fourth quarters from that change?

Jim O'Leary: No, no. And I'm glad you asked the question. I think we mentioned in the press release, it's getting towards de minimus but the manufacturing consolidation costs, they'll drop down to much lower levels over the next few quarters and certainly be down by the third.

Peter Lisnic: Okay, perfect. Thank you very much for all the information.

Jim O'Leary: You're welcome. Thanks, Pete.

Operator: Our next question is from Steve Barger with KeyBanc Capital.

Steve Barger: Hi, good morning.

Jim O'Leary: Hello, Steve.

Steve Barger: You know, Jim, as the comps get easier in the back half and you start to normalize on some of your end markets and benefit from this cyclical recovery, how should we think about full year incremental margins on the operating line? Is that still in the mid-20% range? Is that reasonable?

Peter DeChants: Mid-20% for the year as a whole, Steve, the...

Steve Barger: Yes, that's right.

Peter DeChants: We have - I think that's probably aggressive for the year as a whole for an EBIT margin.

Steve Barger: Okay. And what percentage of the total business is going to export now?

Jim O'Leary: Still less than 20% but it's picking up. And it's still less than 20% as a whole and some of that is intercompany that goes to, from ACE North America to ACE Germany. But within Friction Controls it's the highest level it's been I think in the company's history and hopefully that continues the pace.

Steve Barger: Right, okay. And so kind of taking a step back and I know you don't give guidance, but with the good strength you're seeing in some of industrial end markets and with exports looking like they might stay solid for the near term, as the comps normalize how should I think about growth in the non-wind non-defense business?

Can that get to, whether it's in the back half or, you know, in the out years, a low double digit kind of story or should we still think about the legacy business as kind of high single?

Peter DeChants: What was the question?

Steve Barger: The legacy business going forward given what you're seeing, should I think about that as a high single digit growth business or is it low double? And I'm just trying to get an idea of with the exports and some of the end market activity, exposure you have to some of these end markets is that - are you seeing higher growth rates going forward?

Jim O'Leary: I think it's still high single from what we see right now. But if the rate of improvement continues, you know, by the time we lap through the tough comparisons in Q2 and Q3, you know, the fourth quarter is where you could have a little bit of a positive surprise.

But that'll be based on the continued rate of improvement if that's the right way to put it, the second derivative of things continuing a pace particularly in Friction - excuse me, particularly in Velocity Controls.

Steve Barger: Got it. And I'll ask one more and this, you know, you'll have to see if you can do some math on the fly. But, you know, you said your neutralizing input cost inflation so far, just broadly speaking what percentage of your revenue exposure do you think you have pricing power on where you cannot only cover the cost but also protect margin? And what percent can you cover cost but you might see margin pressure just from the math of it?

Jim O'Leary: Well, let's say half the business because half - well, wind plus military, the two areas where because of budget issues on military, price increases are very tough. And on wind because, you know, and I think we mentioned on prior calls, you know, the cost of forgings and the cost of what is of most raw material intensive product in this type of environment, it is very tough to get price pressures to the term like that.

So on whatever that would be, 60 to 70 plus, or 140 divided by whatever you have for the base, it's very tough to get price increases. And we're working almost exclusively on the cost side because, you know, our customers including the government are - have made it clear that that's the new normal. Everything else, it's a mixed bag so maybe you could say 50/50 of the whole company.

Steve Barger: Great. That's helpful. Thanks, I'll get back in line.

Jim O'Leary: Okay.

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

Holden Lewis: Thank you. Good morning.

Jim O'Leary: Hello, Holden.

Holden Lewis: The - you know, your comment now that wind is difficult to get price increases through, I thought that raw material stuff on wind was largely contractual pass-through.

Jim O'Leary: As we told you on the last, we mentioned on the last call that that's a changing feature in contracts and POs going forward and, you know, with the pressure that our customers are under, you know, going to do business with them for the very long time which we do, you know, we have to accept the fact that we're going to have to cover that ourselves going forward.

Holden Lewis: Got it, okay. And then just you have a couple of sort of deadlines coming up with regards to the, I think it's the Treasury tax grants. You know, at the end of this year I think there needs to be, activity needs to be started to qualify. Are you anticipating any sort of burst in revenues in wind as people break ground, to qualify for that? Or how do you anticipate some of these regulatory elements playing in, in '11 and '12?

Jim O'Leary: I think we're far enough down the food chain and there's probably sufficient inventory out there where we're not expecting any major policy driven burst. And as, you know, I think I've said a couple of times on either calls or on presentations, you know, a tax policy whether it's in the wind space, in construction in general, in you pick a subsegment, that policy moves demand around. It doesn't, it largely doesn't create new demand.

What this space needs is a clear renewable energy standard so that our customers and their customer's utility can plan what our capital budgets spend, you know, five to ten years in the case of some of the ultimate customer, which is utilities and the consumer.

So what we need is a clear policy that focuses on both the security and the cost issues associated with energy. The tax credits, they move demand around but I don't think they create demand. And in this environment where you're operating off of the base that we are, I don't think we'll see any great burst attributable to that.

Holden Lewis: Okay. And then since you're kind of resetting the baseline for this year on wind revenues, what about the order side? I mean does this wind up being a year where you can actually begin to build up a little extra backlog or are we just sort of assuming that sales are coming down in line with orders and so you kind of run the fuel on the same trajectory?

Jim O'Leary: I think it's more likely that orders will be a little bit better than shipments, but not by $20 million or $30 million, you know, by millions in the single digits. If some of things that - an earlier question was asked, you know, if a weak dollar coupled with more stuff going on in foreign markets, if we do see it, you know, I don't think we're going to see the burst that you just referred to but if I'm wrong you might see a little bit better activity on the order front.

But again I don't think we're talking $20 million or $30 million which was the type of stuff we saw at the early part of this cycle. You might see millions better on orders than shipments.

Holden Lewis: Okay, and then with regards to HAHN as we build that back into our model...

Jim O'Leary: By the way, Holden, if we see it we're not going to tell you anymore. Remember, we're going to...

Holden Lewis: Yes, I understand.

Jim O'Leary: Okay, just want to be clear. Okay.

Holden Lewis: And then with regards to HAHN as we build that into our models, what kind of backlog does that typically carry in terms of dollars?

Peter DeChants: It's relatively low. They ship fairly quickly. You know, we had said their annual sales were about $20 million and they turn their orders very quickly as far as in and out.

Holden Lewis: Okay, can we just build in a couple of million for a kind of backlog on that one?

Peter DeChants: Yes, for now.

Jim O'Leary: And like the Velocity Control business, I mean that was, that's simply our lowest shortage backlog. It's the heaviest distribution business we have and you don't carry long-term backlogs there.

Holden Lewis: Okay, all right. Great, thanks, guys.

Jim O'Leary: Okay, you're welcome.

Operator: Next question is Michael Corelli with Barry Vogel & Associates.

Michael Corelli: Hi, good morning.

Jim O'Leary: Hi, Michael.

Michael Corelli: Just had a question about the share repurchase. Obviously you've been a little bit more active here in recent time. But I know you had mentioned on the fourth quarter call that you probably were going to continue to be more active. Should we make that assumption going forward?

Jim O'Leary: Yes, it's as good as any. You know, we - I wouldn't say we were less active last year, but there were a couple of periods where we were and we talked about it on one of the calls. We were looking at much bigger acquisitions where we thought it was the right thing to do to be in a quiet period and not buying back shares from the advice of counsel.

Until we're looking at something much bigger, I think you should assume we'll do what we've consistently done. And the objective is to neutralize build up in cash flow with return to our shareholders, which is repurchase at the right time and at least maintenance of the current dividend.

Michael Corelli: And what's going on with the M&A environment?

Jim O'Leary: A lot more stuff out there than I've seen in awhile. The price expectations are still - you know, again the one thing that really didn't happen in this downturn which is certainly unique in my experience, so I've been through three other downturns or two or three other downturns on the corporate acquisition front and what didn't happen this time is price expectations didn't get reset, largely due to how banks were able to manage their own exposures through extension, amendment, pushing out.

It's certainly still possible that, you know, you'll see some resetting and purging much like you saw in the 2000, 2002 area. But, you know, there's a lot of stuff out there. There's a lot of auctions going on. People are more aggressive about putting properties on the market.

But hand in hand with that there's a lot of private equity buyers. There's a lot of corporates. There's a lot of people with cash. So, you know, the price expectations are still pretty lofty. There are some interesting things that we're looking at but, you know, nothing I could tell you is as likely to happen as not.

Michael Corelli: All right. So considering the fact that it sounds like it's going to be difficult to buy things at the kind of price that you would like with that kind of competition, would that lead back to you maybe continuing to buy shares at the level you did in the first quarter?

Jim O'Leary: Yes, I think that is the default, and if we find the right business that fits and it's a good business, you know, we're going to pay what we think it's worth. So I wouldn't rule out big acquisitions going forward, but we're going to not stretch outside our comfort zone and we certainly have other ways to return value to our shareholders.

Michael Corelli: Thank you.

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

Operator: And as a reminder, star 1 if you have a question at this time, star and the number 1 on your telephone keypad. Our next question comes from Edward Marshall with Sidoti & Company.

Edward Marshall: Good morning.

Jim O'Leary: Hello, Ed.

Edward Marshall: I'm between two calls, so forgive me if you've responded to this already. But...

Jim O'Leary: Was there another call you thought was more important than ours?

Edward Marshall: I'm juggling both of them at the same time. So backlog and orders through April, did you give any kind of indication as to what you saw through April so far and if not, could you do that?

Jim O'Leary: We didn't, but it's continued at a reasonably healthy level.

Edward Marshall: Well, just - it followed the trend then?

Jim O'Leary: Yes.

Edward Marshall: And that's ex-anything from HAHN?

Jim O'Leary: Yes.

Edward Marshall: Okay, perfect. Thank you.

Jim O'Leary: Yes, thanks. Off back on his other call I guess.

Operator: We have no further questions in queue at this time. Again, star 1 if you have a question, star and the number 1 on your telephone keypad.

Jim O'Leary: David, if we don't have any other questions and I don't want to encourage people to hop back on for the second or third bite of the apple, so we may just let people get off to lunch early if we have no other questions.

Operator: We have no further questions in queue, sir.

Jim O'Leary: Okay, so for everyone except Ed, who had to jump off, thank you for your time today and for employees and the like who are listening, thanks for your hard work this quarter and we will talk to you in a few more months. Thank you, David.

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

END