

## **KAYDON CORPORATION**

**Moderator: Rick Mosteller**  
**July 29, 2011**  
**10:00 am CT**

Rick Mosteller: Welcome to the Kaydon Corporation Second 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 10K 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'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 with Kaydon Corporation, Peter DeChants, our Chief Financial Officer, and Laura Kowalchik, our Chief Accounting Officer.

Today's conference is being recorded. Now I'd like to turn the call over to Jim O'Leary, Chairman and Chief Executive Officer. Mr. O'Leary please go ahead.

Jim O'Leary: Thanks Rick and good morning and thanks to all of you for joining us today. And before as we did in our last call before we go into the ceremonial and somewhat excruciating reading of the press release which we'll - we continue to shorten up so we leave more time for Q&A and such let me give you a more informal and somewhat anecdotal but I think it provides some important backdrop for the quarter, how we see it and how you guys should frame how you look at the results this quarter.

And I say we're very happy with what I would say is a solid performance and a good quarter. And I put it that way not to downplay all the hard work and what I think our results have pretty much have come in exactly as expected, but it's still facing challenging comparisons from what were record performances in the early part of last year.

Some of the results are still down overall but like any diversified industrial business -- and I've worked for a few conglomerates in my career -- not everything fires on all cylinders or it's rare for everything to fire on all cylinders.

So some businesses do well during core times. And if you looked at our performance during the "great recession" a couple of the businesses that are a little bit more challenged because of fiscal conditions in the macro environment performed spectacularly then and really carried the day with what was a almost boringly solid performance when a number of other businesses were unfortunately falling through the floor.

Those businesses today -- and I'm talking principally about wind and military are somewhat challenged. They have tougher comparisons to face.

But I do think we have some positive things to say about wind that would suggest at least anecdotally we've seen a bottoming there and hopefully better times are ahead.

Our industrial business and again to provide some context, I suggest it's probably doing better than it's done overall at any point in the last ten years.

If you strip out military which was an important component of our run-up for much of the early 2000s and really we performed a bit better than many. And this is a little pat on the back for ourselves.

The MATV and the MRAP programs helped us perform better in the what is now kind of the winding down of the big military spend in the last decade.

We hung in there a lot better than many because MATV and MRAP, were really very kind to us as late as the middle of last year.

So those two comparisons, wind and military, a little bit challenged still through this part of the year, industrial performing extremely well. We'll have record performances in a number of our businesses.

One you can see the Velocity Controls business because of things we've done in the last few years, adding people, spending more on marketing, trying to reinvigorate the North American distribution presence, adding offices overseas, and the recent acquisition of HAHN will lead to a record performance this year and we think the foundation for record performances going forward.

Some businesses you don't see but I think are worth mentioning within Other. The Sealing Products business will have the best performance it's had, since the Great Recession and, and a much, much better performance over last year as are many of the smaller businesses that we don't talk a lot about such as the Tridan Group, our Purafil business all doing much better.

And again with an economy that hopefully will hang in there for a few more quarters suggests we should have good comparisons and better year over year performance in the quarters ahead.

So with that as context let's jump into the, again the ceremonial and excruciating prepared remarks and we'll quickly get to questions for you.

Sales in the second quarter were \$122 million compared to sales of \$121.5 million in the second quarter of last year.

Strong industrial sales and the contribution from the recently acquired HAHN offset the anticipated declines in our military and wind businesses. And hopefully with the comparisons rolling off, we can stop talking about the anticipated declines.

We continue to see improved capacity utilization from the historic lows of the recession and higher global capital spending, benefiting our principle industrial end markets.

Sales to these markets rose more than 24% in the second quarter over last year's second quarter while orders from industrial end markets increased more than 25% over the prior year second quarter.

With increased order and quotation activity in these markets we should continue to see strengthening in shipments as the year progresses.

Comparisons against a historically strong wind and military comparisons roll off and the benefits of many actions taken over the last 12 months become increasingly evident.

Operating income totaled \$20.4 million in the second quarter of 2011 compared to \$26.3 million in the second quarter of 2010. These comparisons were affected by \$1.3 million of net nonrecurring costs in 2011 and approximately \$200,000 in 2010.

Adjusting for these items operating income was \$21.8 million in the second quarter of 2011 as compared to \$26.5 million in the second quarter of 2010.

Net income for the second quarter was \$14.2 million compared to net income of \$17.8 million in the second quarter of last year.

Diluted EPS in the second quarter equaled 43 cents compared to 53 cents in the prior year second quarter.

And adjusting for the items mentioned a moment ago net income was \$15.1 million or 46 cents per share in the second quarter as compared to \$18 million or 54 cents per share on a diluted basis in the second quarter of last year.

EBITDA, a non-GAAP measure was \$27.9 million or 22.8% of sales in the second quarter compared to \$33.6 million or 27.6% of sales in the prior year second quarter.

And again adjusting for the items mentioned a few minutes ago EBITDA was \$29.2 million or 23.9% of sales this quarter as compared to \$33.8 million or 27.8% of sales in the second quarter of last year.

Very quickly through the segments, in our Friction Control Products segment we had sales of \$65.8 million compared to \$79.7 million in the 2010 second quarter.

The decline compared to the prior year second quarter was attributable to lower wind and military as wind energy sales declined approximately \$12 million from the very strong second quarter of 2010. We still expect wind energy sales of between \$60 million and \$65 million for 2011.

Industrial sales increased almost 15% as compared to the second quarter of last year.

Second quarter 2011 Friction Control Products income totaled \$11.5 million compared to \$20.3 million in the prior year second quarter.

Costs related to our manufacturing consolidation program which is now basically in its final stages and we can cease discussing other than the benefits we'll get from it were approximately \$500,000 in the second quarter of 2011 and approximately \$700,000 in the second quarter of 2010.

So adjusting for these, operating income was \$12.1 million compared to \$21 million last year.

The reduction in operating income was solely attributable to the decline in wind energy and military off of last year's strong comparisons.

Turning to Velocity Controls, Velocity Control sales were \$25.3 million -- a 67.6% increase compared to \$15.1 million in the prior year's second quarter due to improved sales volumes across the globe and the addition of HAHN.

Velocity Control Products operating income increased to \$5.9 million in the second quarter of 2011 from \$4 million earned in the prior year's second quarter due principally to improved volume.

One time purchase accounting and acquisition costs were approximately \$500,000 in this year's second quarter. And adjusting for these costs operating income was \$6.4 million in the second quarter compared to \$4 million in the second quarter of 2010.

This quarter included an investment in sales and marketing of about \$800,000 to increase our global sales team and enhance our advertising program to take advantage of the strong momentum the segment's currently experiencing especially with the inclusion of HAHN into our product portfolio.

Within Other Industrial Products, Other Industrial Products sales in the second quarter were \$30.9 million compared to \$26.7 million last year with operating income equaling \$4.4 million compared to \$2.8 million last year due principally to higher sales across most of these diverse businesses.

Orders for the company were \$111.5 million in this year's second quarter exceeding last year's second quarter by more than 25% in the industrial end markets.

Non- wind orders exceeded shipments by approximately 4% while wind orders were negligible. We continue to expect more significant wind orders in the second half of the year as is historically the case. That's our normal ordering pattern from our major customers.

Our industrial end markets performed extremely well offsetting much of the expected slowdown in both wind energy and military

While the absence of a national renewable energy standard continues to be the biggest impediment to a sustained recovery in the wind market we've recently seen a pickup in both quotes and prototype activity as the wind market shows further signs of bottoming.

That coupled with increasing sentiment toward safe renewable sources as you've noticed recently with Germany turning away from nuclear totally. And that sentiment across other countries in Western Europe and Asia gives us some feeling anecdotally that better times will be ahead.

Backlog in the second quarter was \$196.4 million compared to \$186.5 million at the end of last year and \$203 million at the end of the first quarter of this year.

Now, I'll turn it over to Peter who will cover some additional finance items.

Peter DeChants: Thanks Jim and good morning everyone. Again during the second quarter of 2011, both interest income and interest expense were negligible as our cash was principally invested in highly liquid corporate money market funds.

The effective tax rate for the second quarter of 2011 was 30.8% compared to 32.2% for the 2010 second quarter.

The tax rate in 2011 decreased primarily as a result of increased permanently reinvested foreign earnings which are taxed at lower rates than earnings in the US. This shift is consistent with our strategy which we've discussed for a while but increasing our international operating presence. For the full year we continue to expect our effective tax rate to be approximately 31%.

Also as Jim mentioned in the second quarter we incurred approximately \$1.3 million of net nonrecurring costs compared to net \$200,000 last year.

In addition to the \$500,000 associated with our previously mentioned manufacturing program there are about \$400,000 in due diligence costs and \$500,000 in nonrecurring purchase accounting and acquisition costs and a small curtailment gain.

Capital expenditures in the second quarter were \$3.4 million compared to \$5.5 million in the prior second quarter. Year to date capital expenditures were \$7.7 million.

For the full year we expect capital expenditures to be between \$20 million and \$25 million, we'd say probably closer to the \$20 million number compared to \$15.4 million last year.

Free cash flow during the second quarter was \$10.1 million compared to \$17 million in the prior second quarter. The decline in free cash flow is due principally to the timing of payments to satisfy accounts payable and accrued liabilities compared to the prior year's second quarter.

During the quarter, we returned over \$20 million to shareholders in the form of share purchases and increased dividends.

We repurchased 385,000 shares of our common stock at an average price of \$36.81 for an aggregate of \$14.2 million during the quarter.

Additionally in the quarter we paid out cash dividends totaling \$6.2 million. Year to date for 2011 dividends paid and share repurchases have totaled over \$40 million.

And is a reminder EBITDA and free cash flow are not GAAP measures. And we've included in our earnings release a reconciliation of these metrics and metrics adjusted for the special items we noted to their GAAP counterparts.

Cash and cash equivalents totaled \$223.3 million at the end of the second quarter of 2011 compared to \$272 million at the end of the first quarter this year.

The decline in cash balances is primarily attributable to the acquisition of HAHN for approximately \$39 million during the second quarter. And to do that we used cash which had been invested by international locations.

Inventory turns equaled 3.0 turns in the second quarter of 2011 compared to 2.8 turns in the first quarter this year.

DSOs equaled 6.5 days in Q2 compared to 69 days at the end of Q1 of this year and 66 days at the end of the fourth quarter of 2010.

Our cash together with our \$250 million credit agreement give us the flexibility to take advantage of internal and external growth opportunities for the rest of 2011.

Now I'll turn it back to Jim.

Jim O'Leary: Thanks Peter. As I said at the top we're pleased with the second quarter and our current view of things going forward.

We're extremely well-positioned regardless of broader macroeconomic conditions. With strong market positions and financial flexibility we expect to continue to drive internal growth while selectively evaluating external opportunities.

The Board at Kaydon shares our confidence and the fundamental strength of the company as we announced this week declared a 5.3% increase in our regular quarterly dividend and 20 cents per share from 19 cents per share.

This represents the fifth consecutive year of dividend increases. Our businesses demonstrated cash generating ability together with our strong balance sheet are reflected by this enhanced return to our shareholders.

Finally I'd like to thank each of our employees for their efforts thus far and prospectively as we look forward to delivering stronger results in the quarters ahead.

(Jennifer), that's the end of prepared remarks and we'd be glad to take any questions that are out there.

Operator: Thank you. If you'd like to ask a question, please do so by pressing star 1 on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star 1 to ask a question.

We'll now take our first question from Peter Lisnic with Robert W Baird.

Peter Lisnic: Good morning everyone.

Jim O'Leary: Hello Pete.

Peter Lisnic: I guess first question if we could just talk about Friction and Motion Control, the margin there if you could give us a little insight into what price cost has looked like and what the trends are on that front that'd be great?

Jim O'Leary: Obviously cost pressure is in the industrial sector are a reality, largely because of the commodity pricing and the flow through to most of, certainly ourselves and most of our peers.

We've been able to pass through much of that or offset it with cost reduction activities. And other than again, as we talked about in the past, other than the wind segment where forgings represent a much more material part of cost of sales but we are typically quoting and pricing smaller batches of orders and we have the opportunity to pass that along as we are working on specific programs for customers, wind being the anomaly again because the cost of sales is a much more - material is a much greater percentage of cost of sales than the other products.

So it's essentially it's more of a wash across the business but there's no question that there is cost pressure. We've thus far been lucky enough to be able to remediate most of it.

Peter Lisnic: Okay perfect. And then if I look at the decremental I guess in that segment is there a way that maybe you can help us quantify or understand just kind of what the under absorption in wind or wind and military is doing to the EBIT margin in the Friction segment?

Jim O'Leary: Well it's mostly wind. It's under absorption. It's the increment in depreciation that we've talked about over the past couple of years, but I put it solely in the - part of it is - the downside of the great performance last year with MATV is you don't have not just absorption but the incremental profit on those sales.

In the case of wind you've got under absorption and incremental depreciation, don't have it readily available but I bet if you look at EBITDA margins on a segment basis you see a lot of that covered by depreciation on the wind investments over the last few years.

And as those comps get a little bit easier and as absorption in the industrial businesses picks up and we'll also have expect to do \$60 to \$65 million you'll have modestly stronger wind performance in the next few quarters. That should improve a bit.

Peter Lisnic: Okay. And that last question if I could on Velocity Control, very robust growth. And it sounds like you're investing in the business. Just wondering where you're at from a capacity perspective in that business, any possibility that we could see some more significant incremental investment in the business? And how should we think about second half costs that are related to growth for velocity?

Jim O'Leary: The SG&A run rate will continue for a bit. And I say if there's one thing about that business since we acquired it we had a strong market position.

We were probably less aggressive on the sales and marketing side than we could have been. And we're right now in the process of reinvesting in more hunters and gatherers than we've had in the past. And that holds true across, really across the globe.

You will - I don't think you'll need to see big investment in terms of capital. Right now we're working on adding incremental shifts in North America and that - I mean that really is adding heads that will immediately pay for themselves because we've got the backlog.

So other than maintaining the SG&A rate at a more elevated level than I think you've seen in that business and across the company in the past you really won't see big capital.

Peter Lisnic: Okay that is perfect. Thank you much for your time and your help.

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

Operator: We'll go next to Edward Marshall with Sidoti & Company.

Edward Marshall: Hey guys. The contribution from HAHN in the quarter, would you give that?

Jim O'Leary: We'll give you the sales. There really wasn't any, there wasn't much contribution on income because of purchase accounting. What were the sales?

Peter DeChants: The sales number was \$5.9 million.

Edward Marshall: \$5.9 million.

Peter DeChants: As you look at margins that has some impact. As we've said we had sales contributions but initially the purchase accounting and other things, the margin impact is significantly less.

Jim O'Leary: Yes, so and when you - and this is probably important for you and others in modeling it, because of the purchase accounting you get \$5.9 million of sales, you get \$1 million or so of SG&A. But purchase accounting takes away the selling profit and much of the contribution.

We've said that would be accretive within the first 12 or so months which means not necessarily this year.

But that's doing a bit better than we thought. So there's a chance it will be accretive this year. On a GAAP basis by the way. On a GAAP basis.

Edward Marshall: Right, right. Are there inventories that were written up and that's kind of what you're alluding to some of the purchase accounting and things like that?

Jim O'Leary: That's exactly it.

Edward Marshall: And it'll be a couple quarters that we'll see that drag and then it'll kind of disappear I'm assuming?

Peter DeChants: Inventory turns fairly quickly. That's largely going to be in the first quarter. That's part of the onetime things we talked about.

Edward Marshall: Okay perfect. And then your wind customer has some pretty good orders. You've had better commentary than we've had in the past quarters.

I'm assuming, this is - I know this is a menace for all of us, this wind energy business but expectations are getting better.

I mean can you add additional comments to what you've already which I thought were pretty positive?

Jim O'Leary: Well it's all relative. But I don't know if I'd call it a menace Ed. It's certainly not a menace, let's start with that.

Edward Marshall: Okay.

Jim O'Leary: Wind was - wind gave us and I don't think I should say take it away. Remember it provided important balance. It really provided a huge contribution during the worst of the recession.

We posted record years in our biggest vertical with the industrial business for us and our peers was absolutely falling through the floor.

So in a diversified business, wind did the job. It's not where we thought it would be. It's not where we want it to be. It's not where we expect it to be today or when we originally did the capital program.

But when you look at the dollars, let's not go into what the discount rate could or should be for an investment like this.

But when you look at the unadjusted dollars, wind is awfully close to having paid for itself by now on an EBITDA basis. So we don't have to put a lot of CAPEX into it.

So while I guess the tongue-in-cheek reference to it is a menace, I would say wind has done its job but it has absolutely been a drag on sequential and quarterly comparisons.

Now to your question, listen, I don't want to comment on, tragedies around the world because it's poor taste.

But the world politically is shifting towards - the sentiment of it seems to be shifting toward safer sources in a number of countries. The most obvious one is what's gone on in Germany recently.

And if you read the Financial Times, you see that European and the Asian newspapers, it certainly seems that sentiment is playing out in many countries and even in the United States.

While we have fiscal issues that are paramount especially today, all the fiscal issues are taking precedence, there has been a lot more discussion on safety factors and an ongoing shift to renewable energy.

It's absolutely not as euphoric as it was in 2006, 2007 and beginning of 2008. But it's further evidence that it's bottomed a bit.

Now the orders you were talking about from a particular customer those obviously play into how we came up with our 60 to 65. And when we've, in previous quarters I think people were skeptical that was attainable.

It's attainable because we talk to our customers all the time. We know what their needs are. We have to position ourselves to satisfy their needs.

So that will absolutely support the 60 to 65. Could you do a little bit better, sure. Might it benefit and bolster next year? We'll talk more specifically about that when we - when we're talking about the chunkier orders that come either in the third or fourth quarter.

But anecdotally, there are more positives to talk about today than there have been in a while. And I think that's evidence that it's bottomed.

The only cautionary note I'd throw in there and I don't want to throw cold water on it, but the spike you see and the spike not just that our customer's talking about, that a number of people are discussing is a little bit influenced by the PTC expiration.

I'd be very surprised if it's allowed to expire. But you always see a little bit of a run for the roses in advance of the PTC expiration.

It's a pretty steep drop off the year after which would be 2013. I doubt the PTC will expire but that's just an opinion and I am hopeful that by the time we're even talking about PTC expiration -- you and I have talked about this before, I think tax policy is intended to shift things forward, move things back and change the timing. It shouldn't change the economics.

And the thing we really need is a renewable standard and a further shift globally away from sources that may be perceived to be more dangerous when we have environmental considerations and concerns that renewables don't. And that's all we really need by the end of next year. And that would mute the impact of any tax issue.

Edward Marshall: Switching gears a little bit, it's refreshing to hear the positive commentary on the industrial side of the business. I didn't hear much conservatism that we've heard kind with some of the industrial companies that reported this quarter.

The backlog looks good. The order book looks good. Are you seeing kind of what we're reading in the newspapers and et cetera, et cetera in your business? It doesn't sound like it from your commentary?

Jim O'Leary: I listen to a lot of those calls and I read a lot of the pieces that you and some of your peers write.

I don't think I've heard people say that their order book was weaker or that there was backlog degradation.

I think they said something which I'll echo. And I don't want to be perceived, I think I gave a balanced view of our industrial business. And it's supported by the orders in the backlog.

So I don't know if I could throw cold water on that without being outright misleading. It is what it is.

But I do share the sentiment that I have heard from a lot of my peers and some of the people you follow which is when you look at today and when you talk to customers there's a fair bit more

trepidation today than there was a couple of quarters ago which might mean that the incremental growth or kind of that second derivative feature is harder to comment on today than it's been in a while.

It might just be the summer doldrums. It might just be the drumbeat of fiscal issues or the debt ceiling discussion of European banking.

It's yet to be reflected in order trends. I would not be shocked if some of the sentiment and some of the - whether it's the purchasing managers surveys.

I'd be surprised if some of the sentiment things aren't worse in the next couple of quarters. And again it's a drumbeat of CNBC and issues coming out of Washington.

And if that, I think if you had an accord there if something positive happened that might turn around very quickly. But there is no question the sentiment's softer but we haven't seen it in the order book yet.

Edward Marshall: Okay thanks guys.

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

Operator: We'll go next to Holden Lewis with BB&T.

Holden Lewis: Thank you. Good morning. Wanted to get a little bit of color I guess, when I think about how the gross margin has trended in Q1 you're about 35.8, in Q2 you're about 36 but, revenues are much higher generally and wind was lower in the mix specifically.

And so I guess I was kind of curious why there wasn't a little bit more of a sequential improvement in gross margin given the sequential improvements in both revenue and mix?

Peter DeChants: One thing is the impact of HAHN that we mentioned before which is coming in that particularly with regard to because of the purchase accounting with regard to Velocity Control different margins than the rest of the business.

We also within Friction Control had some pricing affects that affected the margin in the quarter. If you neutralize for those the - on the gross level the margins were about comparable to about a year ago.

Jim O'Leary: If you're looking for one base \$5.9 million of sales with no margin pickups because purchase accounting is, my guess is most of it Holden.

Holden Lewis: Okay and then on the pricing piece, I mean is that something which you're going to be getting back or is that just kind of in there?

Jim O'Leary: We'll be getting back. It's just in there. The biggest issue is the \$5.9 million of sales.

Holden Lewis: Okay. And then can you give us a sense of the noise that you're kind of hearing on wind? I mean if it persists when would you expect that noise to kind of lead to orders?

I mean that does that sort of imply a better 2012 kind of order rate or is it just too difficult to sort of talk about that at this point?

Jim O'Leary: I mean this is a business that you have to measure over quarters and years not weeks and a quarter, so I think we'll be better prepared to comment on that in the next quarter and possibly the fourth when we actually get the orders from our customers.

But it's not noise. I mean people are positioning themselves for the expiration of the PTC.

The things that - I wouldn't say this is noise. I mean enough people in Germany came out and voted and sentiment obviously shifted that away from nuclear.

But it will take a while for that to translate into utilities spending. And again capital budgets that are decade long capital budgets on next quarter's capital budgets.

These are all anecdotally positives but I mean there's no question that it takes a while for that to translate into orders.

And between now and then, I hate to say the black swan events because based on recent events the black swan does not appear to be an endangered species by any measure. I mean they seem to be everywhere.

But the fiscal issues in this country have had the biggest issue - had the biggest impact on wind.

And the fact that North America and electrical usage really isn't all that eye-poppingly good has had the second biggest.

Now anecdotally anything that happens to tighten up supply across the globe is a positive.

The PTC expiration acceleration is a positive at least for next year but we still need a clear consistent renewable energy standard and at least stable and modestly improving GDP number in North America which is still forthcoming.

Holden Lewis: Okay. And when you talk about maybe sentiment shifting in Europe, for instance you hear about Brazil being a pretty good wind market nowadays, I mean what is your capacity with what you're doing now to sort of access those markets?

Do you go over there with your customers or are you just hoping that those trends will then sort of come stateside eventually so you can take advantage of it?

Jim O'Leary: We go with our customers now. We still need those trends to continue for an incremental pop. There are some places, Brazil like China where local content rules created some impediments.

But for the most part we work with our customers. There are no plans much like with China, there's no plans to add a lot of capacity anywhere else.

I think over the next couple of quarters if you continue to see shifts away from nuclear, shifts towards renewables, anything that tightens up the supply chain is a positive.

There was a period in 2007 where we were shipping all over the world. We were getting inquiries from others. And the fact that the dollar is not a particularly strong currency today certainly has been a beneficiary for exporters and people who translate foreign results into dollars.

So eventually that will feed through but again that's quarters and years not next quarter.

Holden Lewis: Okay and then just last thing, one specific market that seems to be getting a bit of attention lately is semiconductor.

I know it's only maybe five-ish percent of what you do. But any comment on that one in particular because I know it can be pretty volatile so...?

Jim O'Leary: It's volatile but because of marketshare gains and some discrete selling efforts where we've had some success we'll probably have the best year in semiconductor we've had an nearly a decade.

We're seeing a lot of success in customer specific wins. But as you said it's volatile.

Some of our customers and our customer's customers have recently been a little bit more caution - cautionary than they've been in a while.

But we're seeing marketshare gains there. We're seeing specific customer wins there. Semiconductor will have its best year in again many moons.

We're likely to have the best year in medical that we've had ever this year. Our industry machinery business, our heavy equipment business.

It's a nice thing about Kaydon but there's no one market that moved the needle the way wind and military did over the past decade.

But when you look at heavy equipment, industrial machinery, semiconductor, medical, our distribution business, our export business all of them are doing as well as they've done in some cases nearly a decade.

So all these niche markets where we've had great positions are performing as expected. It's just tough to offset principally military which is the thing that drove growth for a fair part of the time.

But military is more stable than I thought and wind we just talked about it. I actually think wind's at the point now where if it bottoms and we get some of the things going right that we talked about, that could be a positive surprise going forward.

Holden Lewis: Okay then I'm right, the 5% type of number in your mix for semiconductors is about accurate? And what about MRIs?

Jim O'Leary: And has the potential to be a little bit better than 5%.

Holden Lewis: Okay.

Jim O'Leary: And MRIs, talking about medical?

Holden Lewis: Yes sorry.

Jim O'Leary: A little bit bigger than 5%.

Holden Lewis: Okay all right. Thank you.

Jim O'Leary: You're welcome.

Operator: We'll go next to Walt Liptak with Barrington Research.

Walt Liptak: Hi. Thanks. Good morning guys. Just wanted to - I think most of my questions been answered. But I do want to make sure I'm clear on the operating income in Friction and the add backs to get to kind of an operating profit number. I wonder if we could just run through that again, going from \$11.5 million and then adding back the consolidation purchase accounting and any of the due diligence cost?

Peter DeChants: Yes for Friction Products Walt the only add back is the consolidation costs. And we've also we've attached a pretty detailed reconciliation to the financials with the press release as well. And that's got it by reporting segment.

Walt Liptak: Okay I'm sorry so the...

Peter DeChants: Friction is \$0.5 million and that's the consolidation cost.

Walt Liptak: Okay and the purchase accounting's related to the Velocity?

Peter DeChants: That's correct.

Walt Liptak: Okay. Okay great thank you.

Peter DeChants: Yes.

Operator: We'll go next to Steve Barger with KeyBanc Capital Markets.

Steve Barger: Hey good morning guys.

Jim O'Leary: Hey Steve.

Steve Barger: I cover a company that makes the steel tower for wind turbines and they talked this quarter about seeing a shift to bigger towers. I think you guys have talked about that in the past. But are you seeing that trend or quotes coming through for larger bearings or can you just give us an update on how the product itself is evolving?

Jim O'Leary: Yes and GE's been very public because they're I think appropriately talking about a product that's meeting some commercial success with the 1.6.

They're in the process of introducing a larger model as well. The trend is to bigger. And as long as it's under three, 3.5 we have the capacity and are ready, willing, and right now meeting demand for that product.

So that's the - I'm assuming you're talking about Trinity and Broadwind. I mean the towers sizes that they're talking about are for terrestrial wind and the 3.5 and undersize and we are seeing that trend...

Steve Barger: Yes.

Jim O'Leary: Nothing yet with offshore wind in North America. And we're still very actively monitoring it in England, but I don't know if that's yet far enough along to translate it into real tangible efforts on the supply chain for us but we are watching that.

But on the terrestrial wind side yes, no question. The shift is to larger models which are being met with some success by our customers.

Steve Barger: But based on everything that you can see right now you're in the game for all sizes that we're talking about on land?

Jim O'Leary: Yes.

Steve Barger: Okay. Any room in - and I think you've talked about this in the past that little bit but is there any room to partner with anybody on when to increase your share of turbine or tower or however you want to think about that, if we truly are seeing a bottom here?

Jim O'Leary: Yes and we have looked at, had discussions with but partnerships like marriages are challenging.

Steve Barger: All right and shifting gears a little bit to the M&A market, your trepidation comment I think we're hearing that from some of the companies as well.

There are more concerns about global growth recently. Just thinking back through your M&A career, historically when people start to think about a slowdown or get concerned how long does it take for that to be reflected in the M&A markets in terms of multiples? Are you seeing any change in the market?

Jim O'Leary: No you're seeing more activity because - and it usually starts because people are concerned about the financing market or obviously, you've had a very impressive rebound off of horrifically bad performances during the recession.

So properties that have performed well in this rebound are out to market now. I think there are more things that are worth looking at and potentially actionable than there have been certainly in the last five years.

Whether or not they get done or not will depend on whether or not there is a faster onset of a slowdown than anyone anticipates today.

Steve Barger: Right.

Jim O'Leary: Specifically to your question I don't think price expectations have changed at all. And the comment I made, we had a pretty robust discussion about this with our board this week had the same discussion with many of - other of my peers and a lot of the same guys that I'm sure you and the other analysts talk about.

The really unique thing to me about economic downturn was not only did prices never really correct it, just absolutely nothing got sold.

So whereas in 2000 and 2002, a lot of really good properties got sold for five to six, six to eight times EBITDA, things that normally would have priced anywhere between eight and up.

You just had absolutely nothing get sold during a very long period of economic decline. And a lot of that had to do with banks willingness to roll covenants, push things out give the, give some of these companies that had a fair degree of leverage a chance to see if times got better which they did.

I'm not smart enough to know it but I don't think anybody is whether or not that was a deferral or a permanent feature of the market.

I will tell you the price expectations have not changed and good businesses are going to go for nine to ten times EBITDA or higher.

Businesses that are smaller and still high-quality businesses, I think seven to nine times EBITDA is not unreasonable.

In past downturns you see things like that go to five to six and six to eight for good businesses. That just didn't happen during this past economic downturn.

And the number of actual data points is so meager, it's almost laughable. You can't draw any conclusions from it because I can count the ten deals that got done.

Steve Barger: Right. All right that's good color, thanks.

Jim O'Leary: You're welcome.

Operator: We'll go next to Mike Hamilton with RBC.

Mike Hamilton: Thank you, good morning.

Jim O'Leary: Hello Mike.

Mike Hamilton: Jim, if you could as you move into the planning cycle here for '12 what areas do you see knowing there's limited visibility where you're expecting momentum and where you're planning on pushing resources as we go towards '12?

Jim O'Leary: Internationally and continuing to add salespeople in certain portions of our business where historically we've been, because of the strength of our products, because of our strength of our market positions, I don't want to say order takers in a derogatory form but we've had the luxury of being able to wait for business to come to us.

I think the Velocity Controls, performance, some the things we're saying within bearings that unfortunately is a bit overwhelmed by the growth of military and wind over the last few years. It's absolutely points to the successes there.

There's a commentary which is more about the success of our international efforts than it is about the tax rate but it's worth commenting on both.

We've been talking for three or four years about the need to expand internationally, grow our resources there.

We've changed our distribution. We've added people. We've done all the things including opening sales offices that have to be done if you want to have an international presence.

But I also have been saying for years that's missionary work. There is no Kaydon to acquire there and it'll take a while to reap the benefits from those activities. You're seeing it.

You got a greater share of export and indigenous international business than the company's ever had. That will continue.

And as we go in the planning cycle, this is the luxury of having great market positions, really strong free cash flow in good times and bad and a great balance sheet.

We were able to continue investing in those things even during the worst of the recession.

Even if things are uncertain, and there's no question it'll be a little bit more uncertain this business planning cycle than it was this time last year.

Even if it was uncertain, the long term appropriateness of furthering those initiatives particularly internationally, particularly on adding salespeople and marketing people where we've just been under resourced they may not be right next year but I know they'll be right in five and ten years. There's tremendous market potential there. It just takes a while.

So we still have a great balance sheet. We still have great market share. We still have great market positions and all of our businesses are free cash flow.

So even if next year is a little bit more uncertain than it might have been a few weeks ago we just continue with those things because we know they'll be right for the long term.

Mike Hamilton: Nice perspective, thanks. Just a couple details, one, I take it from what you said no anticipation of one-time charges here remainder of the year that are worth noting?

Jim O'Leary: Nothing worth noting now. In fact Rick Mosteller and I were commiserating and actually celebrating the fact that maybe we can stop talking about non-recurring relation costs.

Mike Hamilton: Right.

Jim O'Leary: So that will roll off. The only thing that we might call out if it's meaningful if they continue, if there's a due diligence project or two that's worth calling out. And nothing else you can call out because if we knew there was going to be a nonrecurring charge we'd be talking about it now.

Mike Hamilton: Yes right. Apologize for my slowness. Could you repeat the share repurchase data off the quarter?

Peter DeChants: Sure it was 385,000 shares, average price of \$36.81 for an aggregate of \$14.2 million.

Mike Hamilton: Thanks very much. And all the best on the remainder of the year.

Jim O'Leary: Thank you, Mike. You too.

Operator: And as a reminder to ask a question, that is star 1. We'll go next to Michael Corelli with Barry Vogel & Associates.

Michael Corelli: Hi, good morning.

Jim O'Leary: Hello Michael.

Michael Corelli: Just two questions, one on the share repurchase. You've been doing a little bit more the first two quarters of this year. Is that something possibly we might see continue in the back half of the year?

Jim O'Leary: Possibly. And as we've said, we have three levers that we have used consistently over the last few years.

We just increased our dividend which I think is a testament to our confidence and our board's confidence in our prospects.

We, absent material acquisition activity, the strong preference us share repurchase over building cash. If you look at last year, we pretty much returned every dollar of incremental cash to our shareholders in the form of dividend and share repurchases.

That would continue to be our modus operandi absent acquisition. But if you go back to I think the question Steve Barger asked a moment ago, there's a fair bit more M&A activity out there.

We might kind of hold our gunpowder for a while. But over the course of the year it's either going to be one of those three things. We're really not interested in building cash and being the bank of Kaydon any longer.

So it will be one of those three. And if an acquisition didn't happen, there's sufficient volume in our shares. And we have sufficient float where we can catch up and deliver on our promise of reinvesting in the business while returning cash to our shareholders.

Michael Corelli: Okay great and then maybe Peter could help me with this one. You did a nice job of breaking out the nonrecurring items on the last page. Could you help us with SG&A and cost of goods sold where those where those would fall?

Peter DeChants: The consolidation costs are in cost of goods sold.

Michael Corelli: Okay.

Peter DeChants: And about \$250,000 to \$300,000 of the acquisition costs are in costs of goods sold and the balance is SG&A.

Michael Corelli: All right, so the purchase accounting?

Peter DeChants: It that's about half and half, so between those two.

Michael Corelli: All right so the purchase accounting and the due diligence costs?

Peter DeChants: Half of the purchase accounting and about \$400,000 and all of the due diligence is SG&A,

Michael Corelli: Okay all right, so all the due diligence and 50% of the other one okay. And the curtailment gain?

Peter DeChants: SG&A.

Michael Corelli: Okay great. Thank you.

Jim O'Leary: Okay you're welcome.

Operator: We'll go next to Holden Lewis with BB&T.

Holden Lewis: Thanks. Just as a reminder now that sort of the restructuring...

Jim O'Leary: Didn't we hear from you before?

Holden Lewis: I'm sorry.

Jim O'Leary: Didn't we hear from you before?

Holden Lewis: Yes that was my first question.

Jim O'Leary: All right.

Holden Lewis: It's in several parts. This is my follow-up. Now that the restructuring is passed just remind us when would you start to - or expect to start seeing the benefits coming in - coming from that and when or how much should those benefits be going forward?

Jim O'Leary: It'll be end this quarter through the fourth quarter, so really commencing now and accelerating as that plant gets online as the new plant in Sumter gets online and I think we said it was a three year payback on \$6 million of capital and costs...

Peter DeChants: Approximately.

Jim O'Leary: So it adds about \$3 million per annum in a full year. So I mean next year you'll start to see the benefits of that absent any charges and any startup costs.

Michael Corelli: Okay great. Thanks.

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

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

Jim O'Leary: Jennifer thank you very much and again thank you to all our employees for their efforts this year and excuse, me this quarter and respectively. And thanks for taking your time with us this morning. That's it.

Operator: This does conclude today's conference call. We thank you for your participation.

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