

**KAYDON CORP.**

**Moderator: Rick Mosteller  
October 28, 2011  
10:00 am CT**

Operator: Good day everyone and welcome to today's Kaydon Corporation Third Quarter 2011 Earnings conference call. Today's conference is being recorded.

At this time, I'd like to turn the call over to Rick Mosteller. Please go ahead, sir.

Rick Mosteller: Welcome to the Kaydon Corporation third 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.

James O'Leary: Thank you, Rick, and thanks everybody for joining us this morning.

Now before I go through the necessary and almost ritualistic reading of the press release, I thought it might be helpful to give you a couple bigger picture comments, as we've done the last couple of calls to give you some context, not just for this quarter and the next quarter, but kind of the early part of our impressions for what next year is going to be like. And we'll focus on our three principal markets, and we use that really as the framework in which we want you to look about the business, on how we look at the business, which is wind, defense, and general industrial.

And wind being probably the easiest of the market to allow - there's a lot of big macro drivers, it's a defined set of customers, it's a defined set of geographies, and that's one where we'll give you an indication of what we think next year looks like, and our next call we'll give you a specific revenue number. But, that's one of the easier of the two to analyze -- excuse me -- of the three to analyze.

Defense is the second big bucket of revenues and profits, but that in itself is in some respects as complex as industrial, largely because while it's a large business within Kaydon and the end customer and the end market, ultimately are for military applications it's a very diversified set of programs, much like our industrial business. It's a small lot, typically a large mix for a host of programs, so there's a fair degree of diversification.

Now, all that said it's still impacted by the macro trends that we're seeing today. Withdrawal of troops, government spending under fire, particularly in the U.S., but we'll talk a little bit about internationally where the picture is a bit brighter. But, it's a more complex business than wind, but it does have some macro factors that drive it one way or the other. So we'll give you some idea as to directionally what we think next year will look like.

And the last big, and it's arguably the biggest, but it's the most diversified, set of end markets is general industrial. General industrial is a business that broken up between medical, semiconductor, machinery, heavy equipment, a lot of end markets, some of which are behaving differently today. Much of that is what we call book-and-ship business, meaning it's our shortest lead time, and much of it's impacted by things that are, for lack of a better term, (animal spirits)-driven.

So where we talk in our press release about late August and September, clearly we're referring to budget issues in the U.S., some of the European turmoil, which we hope - I don't think it is

completely taken off the table yesterday, but hopefully dispelled, or the worst of it dispelled while policy makers around the world sort out some of the challenges that we're all facing.

Now on wind, wind really is performing about as we expected. I'd say almost exactly as we expected throughout this year. There's little bits of business that moved in and out from quarter-to-quarter, but we still expect it'll be in the low 60s for the full-year.

We mentioned in our press release, and I'll talk a little bit more granularly when we go through the prepared remarks and then Q&A, next year there's an upward bias to - an unquestionable upward bias. Some of it is the PTC's potential expiration, which has significant implications for 2012, but also for 2013. And as I said before, the biggest thing we need is an RES and some clear consistent policy.

But on the margin, the fact that tax policy pushes things forward or pushes them back, the tax policy expiration of the PTC is likely to push things into 2012, which gives next year a clear upward bias from the 60-ish or so we think we'll do this year.

You know we are doing, and I think it's important to mention, while the wind market has been down, largely because of global economic concerns and the absence of policy, we've done a lot of things that set the table for us to take advantage of what we think now is a very valuable option on a big business, which we still believe in for the long-term.

We have positioned ourselves with a number of other customers. We've positioned ourselves with a lot of the global transplants where we've gotten qualifications. We've done a lot of the hard work to be involved with them as a key partner, but none of that will pay off until you have clearer policy and a better economic backdrop. But, that work's done and hopefully it'll pay off a bit next year.

On the military front, I'd say military is performing exactly as we expected, maybe a little bit better. On the ground vehicles, which we've talked about and were a very fortunate recipient of good business the last two or three years while defense had already begun to decline, that business ran its course and we shipped the final parts of the MATV program. It will go into a replacement mode where we'll be the beneficiary of some of that going forward.

That is year or years off when some of the vehicles out in service are refurbished after they're withdrawn from the field. But for this year, you know I'd say military across the board is performing about where we expect. The pressure long-term, I think the bias going into next year and future years is negative because of government spending and fiscal issues around the world.

I think we are somewhat insulated because of the diversity of the number of programs, and there is an opportunity for it internationally, which we're starting to see pay off. None of it is as large as a MATV program that benefits you the way we saw in 2009 and '10, but we're positioned in the way, and I think somewhat insulated by the diversity.

So next year military flatish with a negative bias, but it's not a huge negative bias. It's impacted by pricing and the fact that we do have, and this is the only caveat I put on the overall picture for next year, you know if we have a huge budget issue with the Special Committee.

If we are unable to get to some of the things that we're talking about, and you know really discuss when we had the August freeze-up on Washington and the debt was downgraded, if there's not a lot of movement there and you end up with the mandatory cuts in defense a lot of what I said has to be discounted, because I don't think anyone really knows what would happen if you had that type of cuts to military spending. And really automatic cuts, which I don't think will happen, I don't think anyone wants to happen, but you do have to leave that out there as an outlier possibly impacting some of the comments I'm making today.

Finally, in general industrial, business through the year has generally been strong and stable. That business got a little, I wouldn't say shaky, it (buzzed). We had choppiness, two good weeks, one bad week, three good weeks, one bad week, and then in August and September we had more bad weeks than good weeks. And a lot of that was on what I'd almost categorize as to discretionary at-once business, things that come in and out in a 90-day window. We call it book-and-ship in and out. I mean a bunch of different nomenclatures the company's used.

But, that's the business that is more the discretionary, higher end, higher margin CAPEX. It typically isn't for inventory, but it is easily impacted by (animal spirits) and we saw that get particularly choppy in August and September heavily impacted, in my estimation, by what happened in Europe.

And as we mentioned in our press release, those orders on an absolute basis stabilized at around last year's levels through today. This week they were a bit better and you know one day doesn't make a pattern, but hopefully with the news of yesterday and maybe more stable economic environment we'll see the resumption to the trends we experienced earlier in the year.

But in August and September the general industrial business, particularly what we refer to as book-and-ship, got choppy and, you know we had more bad weeks than good weeks that recovered in the early part of October to a level about where we were last year. And we're hopeful that what happened yesterday in a more stable economic backdrop will get us back to the levels we saw earlier this year.

Now, with all that as backdrop we'll go through the ritualistic reading of the press release.

Sales in the third fiscal quarter of 2011 were \$121.6 million as compared to \$118.3 in the third quarter of last year, reflecting an industrial environment. Again, it's been generally strong and

stable for most of the year, but got a bit choppier, a bit more volatile towards the end of the third quarter.

Operating income totaled \$20.3 million in the third quarter compared to \$18.6 last year, and the comparisons were affected by \$900,000 of costs associated with the now completed, and I've been waiting several quarters to say the words now completed, manufacturing consolidation program and some due diligence costs in the third quarter of 2011. That compared to \$2.6 of likewise costs in the prior year's third quarter.

Adjusting for these items, operating income was \$21.3 in this year's third quarter, compared to \$21.2 in the third quarter of 2010.

Net income for the third quarter of 2011 was \$14.5 million, as compared to \$13.1 million in last year's third quarter. Diluted EPS equaled 45 cents compared to 39 cents in the prior year's third quarter. And again, adjusting for the items I just mentioned, net income was \$15.2 or 47 cents per share in this year's third quarter, compared to \$14.9 million or 44 cents last year.

EBITDA, a non-GAAP measure, was \$27.7 million or 22.8% of sales in the third quarter of 2011. That compared to \$26.2 million or 22% of sales in the prior year's third quarter.

And finally, adjusting for the items I mentioned, EBITDA this year was \$28.6 million or 23.5% of sales, as compared to \$28 million with 23.7% of sales last year.

Going through the segments, Friction Control sales in the third quarter of 2011 was \$69.9, almost \$70 million, as compared to \$78 million in the 2010 third quarter. The decline, which was largely expected, is almost exclusively attributable to wind as wind energy sales were \$10 million lower than last year.

We continue to expect wind energy sales (from) approximately \$60 million for 2011, and we expect wind energy sales to be at least equal to that next year. And as I mentioned at the top, we think there's a clear upward bias because of the expiration of the PTC in 2012. Third quarter sales to industrial markets increased almost 7% compared to the third quarter, despite the choppiness we talked about towards the end of the third quarter.

Third quarter Friction Control Products operating income totaled \$11.1 million compared to \$12.7 million in the prior year's third quarter, with the reduction attributable exclusively to wind energy sales.

Turning to Velocity Control, Velocity Control sales in the third quarter of 2011 were \$24.4 million, an increase of 53% compared to \$15.9 million in the prior year's third quarter, due to improved sales volumes and the addition of Hahn, which was acquired in the second quarter of 2011.

Velocity Controls operating income increased to \$6.1 million in the third quarter of 2011 from \$4.1 million earned in the prior year's third quarter, due exclusively to sales volume. The segment benefited from both the Hahn acquisition and the renewed emphasis on reinvigorating our sales efforts in North America and expanding our reach abroad.

Other Industrial Product sales in the third quarter of 2011 equaled \$27.4 million, compared to \$24.3 million in the prior year's third quarter. Operating income equaled \$2.9 million in the third quarter compared to \$1.4 million in the prior year's third quarter, due primarily to improved volume and better product mix. The segment benefited from the successful cost reduction efforts in Sealing Products and strong aerospace sales -- excuse me -- aerospace sales of those Sealing Products.

Orders were \$130.4 million in the third quarter of 2011 and the third quarter saw lower industrial orders, particularly those placed for immediate shipment, than experienced earlier in the year due to the economic uncertainty that persisted through much of August and September, principally in

Europe. While order rates remain more volatile than earlier in the year, the absolute level of orders in the first few weeks is relatively stable as compared to last year.

Backlog at the quarter-end was \$205 million, compared to \$205 million at the end of the third quarter of 2010, and \$196.4 million at the end of the second quarter of 2011.

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

Peter DeChants: Thank you, Jim and good morning everybody. Again, during the third quarter of 2011, both our interest income and interest expense were negligible, reflecting low interest rates earned on cash around the world and the fact our balance sheet remains debt-free.

The effective tax rate for the third quarter of 2011 was 28.7%, compared to 30.2% for the 2010 third 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 U.S. This shift is consistent with the strategy we've discussed of increasing our international operating presence.

The Q3 rate of 28.7% also compares to 30.8% in Q2 of this year. The lower rate in Q3 reflects an R&D tax credit program, which was implemented during the quarter. For the full-year we expect our effective tax rate to be a little over 30%.

Also, as Jim mentioned, in the third quarter we incurred approximately \$900,000 in consolidation and due diligence costs, compared to \$2.6 million last year. The costs in this quarter included about \$700,000 that was associated with the manufacturing consolidation program. And the rest of the \$900,000, \$200,000 was the due diligence costs.

Capital expenditures were \$4.1 million in both this year's third quarter and last year's third quarter. Year-to-date, CAPEX is about \$11.9 million. For the full-year we expect capital expenditures to be between \$18 and \$20 million, compared to \$15.4 million last year.

Free cash flow during the third quarter was \$10.5 million, compared to \$10.3 in the prior third quarter.

During the quarter, we returned over \$12 million to shareholders in the form of share repurchases and increased dividends. We repurchased 205,000 shares of the common stock at an average price of \$32.05 or \$6.6 million total during the third quarter. Additionally in the quarter, we paid cash dividends totaling \$6.1 million. Year-to-date for 2011 dividends paid and cash repurchases have totaled over \$53 million.

As a reminder, EBITDA and cash flow are non-GAAP measures and our earnings release includes a reconciliation of these metrics to the most comparable GAAP measure.

Cash and cash equivalents totaled \$219.1 million at the end of the third quarter of 2011, compared to \$223 million at the end of the second quarter.

Inventory turns equaled 2.9 in the third quarter of 2011, accounts receivable with DSOs equaled 70 days, which compares to 67 days in the prior third quarter.

Our cash, together with our \$250 million credit agreement, continue to provide us a great deal of additional financial flexibility to take advantage of internal and external growth opportunities.

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

James O'Leary: Thank you, Peter. Looking at the past quarter, I would say we were satisfied, but not happy with the results achieved in an environment that was much more volatile than either expected or experienced earlier in the year.

Our wind energy and military businesses continue to perform, generally in line with the expectations that reflect the fiscal issues affecting both of these end markets. And while we currently expect these end markets to be stable in the near-term, as I've mentioned the potential expiration of the PTC in 2012 could provide upset to those - upside to those expectations in the upcoming year.

Our performance for the rest of 2011 and into 2012 remains dependent on renewed strengthening in the economic and industrial conditions we experienced earlier in 2011.

Regardless of the economic backdrop, however, our strategy of proactively managing costs and maximizing cash flow while identifying and pursuing new opportunities will continue to serve us well.

Notably, we continue to make progress in expanding our footprint globally, better positioning us to serve faster growing industrial markets around the world. For the year thus far, we have record international sales both in absolute dollars and as a percentage of overall sales as we broaden our business's global reach and better balance our overall portfolio.

We're pleased with the significant progress on this important long-term growth initiative. In the future, as in the recent past, we expect to be both able to - we expect to be able to prudently return capital to our shareholders in the form of both share repurchases and increased dividends, while driving profitable organic growth.

As a testament to our confidence, our Board of Directors declared a quarterly dividend of 20 cents per share in the fourth quarter, and the indicated annual dividend is 80 cents per share per year.

Finally, I'd like to thank each of our Kaydon employees for their efforts thus far in 2011, and thank you for participating on this call.

And now, Ann, we'll gladly take questions from any of our listeners.

Operator: Thank you very much. If you would like to ask a question, please signal by pressing the star key followed by the digit 1 on your touch-tone 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 if you have a question at this time, please press star 1.

We'll take our first question from Eli Lustgarten with Longbow Securities.

Eli Lustgarten: Good morning, everyone.

James O'Leary: Eli, how are you?

Eli Lustgarten: Not too bad. Just some clarifications, what were wind orders in the third quarter. You know you indicated that shipments were about \$19 million. I guess - I think last year it was \$29, so you know what were orders in the quarter for wind?

Peter DeChants: Wind orders in the quarter were about \$38 million, Eli.

Eli Lustgarten: Thirty-eight?

Peter DeChants: Yes.

Eli Lustgarten: So you had a big quarter for orders?

Peter DeChants: Yes, that's - Q3 is the - typically the largest order - or largest quarter for wind orders.

Eli Lustgarten: Okay. On that - so - and you're sort of indicating, you know, something in the vicinity of \$16 million in the fourth quarter, is that sort of what you're - to get to that \$16...

James O'Leary: No. Eli, and you know this is - I said this on the last two quarters and we've continued to break our policy of what we've immediately said, but given wind orders, and I think the importance that we're attaching to them on a longer-term basis, - these things are moving close to being - they're not going to be book-and-ship coming in and out on a quarter, but we work off not just orders, we work off a line of balance that we go through with each one of our customers.

Not having all the orders for next year's backlog has a lot less significant - a lot less significance today than it did in 2008 when people were placing orders for two and three years worth of requirements. We've got a very big set of orders from one of our major customers this quarter. We do expect more in the next two quarters, but we know what their line of balance is for planning.

So when we say that we know we're going to do at least what we did this year in next year, and there's a likely upward bias, you know the fact that we don't have the orders by the third quarter means a lot less than it did two years ago, because this free capacity, we're working on qualifications with people, and we know what their line of balance is.

So the cutting of a PO has a lot more symbolism today than it did of significance two years ago.

Eli Lustgarten: And can you also give - very good. Could you give us some indication what happened in the defense business in the third quarter, both you know shipments and orders (or so), and are we still looking...

James O'Leary: It's generally stable. ((inaudible))...

Eli Lustgarten: That's - are we still looking in the low 60s for the defense side, similar to the wind business this year?

James O'Leary: Low 70s and low 60s in the Friction Control segment, which is where most of the uplift from military vehicles came the last two years, so 70s across the company, 60s in Friction Controls.

Eli Lustgarten: And, you know you sort of indicated - is there any change in pricing going on in the industrial businesses that should give us any concern for the fourth quarter as we look out? (Like you said), we - it - with the instability there are things - pricing's generally stable at this point given the ((inaudible))?

James O'Leary: Pricing's generally stable, but we are, you know like a lot of people in the industrial space, we are playing catch-up with commodity prices. We've been successful thus far, but if I had to say looming outward I don't know if it's going to be as easy to catch-up with prices it has been, because it's - you know the commodity prices has been a concern we have kept up with, for the most part, but it's a real challenge, particularly in the wind business.

Eli Lustgarten: And then plus, like are we - is it probable given with the stability in October that the fourth quarter volume for the company will be somewhat better than the third quarter if you go up a little bit at this point? Is that a fair assumption?

Peter DeChants: Yes. It - we - Q4 is looking consistent with Q3 overall and...

Eli Lustgarten: Okay ((inaudible))...

Peter DeChants: ...possibly a little better.

Eli Lustgarten: All right. Thank you.

James O'Leary: There was silence because we looked at each other on our policy about not giving guidance.

Eli Lustgarten: Well, we got ((inaudible)), yes, but we're sitting here trying to figure it out. (You...

James O'Leary: Yes, I understand totally...

Eli Lustgarten: ...missed the end of the quarter).

James O'Leary: ...and we - you know as you guys know, we try to give you as much visibility and clarity without outright guidance, but your assumption would be fair.

Eli Lustgarten: All right. Thank you.

James O'Leary: Okay, thank you, Eli.

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

Edward Marshall: Hey, guys. Good morning.

James O'Leary: Morning, Ed.

Edward Marshall: So you know you talked about wind and we saw the orders come in and we're looking at 12, et cetera. But, as I think about pricing and I think, you know one of your key customers had something to say about pricing down at 11, we know that and it's been flowing through, but that tends to ease up in 2012. Is that kind of what you're seeing on a pricing side, so volume's up and potentially pricing slightly up?

James O'Leary: I'm not sure what you mean that's what you see in 2012.

Edward Marshall: For wind energy, the orders coming through on wind energy, are they - are you getting any price increasing on those orders?

James O'Leary: No.

Edward Marshall: Because I - you know, my understanding is that the - your main customer there is seeing some price improvement in 2012 over 2011. That's not flowing through to you?

James O'Leary: You think that they raised the prices for their supplies in lockstep with what they get, which by the way...

Edward Marshall: That would be nice.

James O'Leary: ...it's (still basically) down from a few years ago. They don't.

Edward Marshall: Right. Right. Okay. Thanks.

James O'Leary: No, listen, it's - the turbine guys who are our customers, and much of their supply base, are - listen, it will be better than next year - next year will be better than this year, it will not be as good as a few years ago, and 2013 looms as a challenge if there's no long-term policy.

So we are not back to the pricing levels and no one in the supply chain from the turbine manufacturers down have the - you know have the latitude to push price the way they did in 2008.

Edward Marshall: Excellent. Thanks, guys.

James O'Leary: You're welcome.

Operator: We'll take our next question from Steve Barger with Keybanc Capital Markets.

Steve Barger: Hey, good morning, guys.

James O'Leary: Hi, Steve.

Steve Barger: Hey, I hear what you're saying about knowing the line of balance on wind and in your comments you said there was a clear upward bias, but can you help us quantify that? Is that like 10% or is that more like 40%? You know just trying to help us think about the opportunity.

James O'Leary: More than 10%, but nowhere near 40%.

Steve Barger: Okay.

James O'Leary: The best case is high 60s, low 70s.

Steve Barger: Got it. Okay.

James O'Leary: And, you know that - and that - you know I think there would be an upward bias as well from that if suddenly the global - you know the global economy was clearly on firm footing, not kind of one stability pact to another, which is kind of the way it's been the last few periods.

And if it was a little less rancor over some of the policies issues that we need, not to be talking about a PTC, but to be talking about our longer-term RES that would change all that and it would be with an upward bias.

Steve Barger: Sure, of course. And in the quarter itself, operating leverage pretty light, is that really because of the mix of the book-and-ship business coming off a little bit that you talked about?

James O'Leary: Yes, absolutely. And, you know I'm glad you asked the question and you were not set up to be a straight man. You know, over the last, I'd say it's almost four or five years, I've been here as CEO for about five years, but you know when you look back at our history over a longer period there's been a pretty steady trend in our company.

And I think it's in a lot of industrial businesses across the board where shorter backlog, quicker delivery, and a lot of it's Kaizen and Kanban and the - you know the things that most better performing industrial companies hold their suppliers to. Our percentage of the basic industrial business that has moved to book-and-ship or shorter turn has, you know pretty much steadily increased over the very longer-term. Let's say the longer-term is a ten-year period.

Within Kaydon that got diluted a bit from, you know maybe as early as 2003, 2002 forward, first because of military, but then largely because of wind. And you know back to Eli's questions a few minute ago - a few minutes ago, you know we were taking orders in 2007 and '08 before we even

had capacity. There were orders that went out in some cases longer than we could include them in backlog because of the window we keep on backlog.

So now as wind, because of the overall capacity, and because military is becoming a smaller percentage as a whole, and - both those businesses as a percentage have less of an impact the percentage of book-and-ship increases a lot as well. So right now it's over 50%, it's been as high 60% of overall industrial the last few quarters. So the volatility of that component of our business and the impact that can have, particularly on operating leverage, it's pretty significant.

So I don't know if that helps you all to think that, you know there's a healthy impact, both positive and negative that can have, not just on sales in any period, but on leverage.

Steve Barger: Yes. No, that's good color and I guess - I mean, you commented that 4Q revenue might be in line plus or minus with 3Q. If I look at the last couple of years, 4Q's been down 11% or 12% from 3Q sequentially, so if that pattern holds should I be thinking that it's because of the book-and-ship business your expectation is it holds up a little better, and that would give you that better incremental?

James O'Leary: Yes, and it also has to recover a little bit. Remember, we're talking about it stabilized. I'm hopeful that with - you know again, I don't want to put too much significance on events of this week, but there needs to be a little bit more of an upward bias.

You know remember, most of August and September people were holding their breath. With a little bit more stability we'd like to see the book-and-ship, and we need to see the book-and-ship come back a little bit more strongly than it has thus far, but thus far it's still impacted somewhat by the events of late August and September.

Steve Barger: Right. Okay, last question from me. Buyback, I - maybe I missed it in the prepared comments, but I don't think you talked about it. It looked like it was about half, in terms of shares from the first half run rate, why not step up in 3Q with the market volatility and increase the buyback given where the shares were trading at one point?

James O'Leary: Would and will, if, and the if no one's asked yet, but we are looking at a number of properties. The corporate development endeavors we've got has been more active in the last few months than it's been in a while. Some of them are relatively large things.

I couldn't handicap the possibility of any of them happening, but if it was something that would put leverage up to return it to as time -- excuse me -- a turn or two of EBITDA I'd rather slow down the repurchase program now, because you know I don't see - that's going to be an opportunity available to us no matter what happens. Our priority is still acquisitions first and foremost.

As I said, a number of times I'd love to have ten acquisitions like Hahn, but the nature of our markets isn't that we've got a lot of obvious bolt-on candidates. We're typically looking at some bigger things in complimentary or similar businesses, but not things that are obvious roll-ups.

And as long as a couple of those are on the table or out there we'd rather hold on to the resources and see what happens with those. Because the repurchase program, and you didn't mention dividends, but when you look at our return -total return to shareholders, while the share price has been flattish or down for a few years, as many have been, dividends have been a pretty important return to shareholders over that period, pushing up the total return to shareholders at a much more respectable level.

Steve Barger: Okay, so there was a conscious decision in this quarter related to a potential deal that caused you to hold back on the buyback a bit?

James O'Leary: Absolutely. Absolutely...

Steve Barger: Okay.

James O'Leary: ...and you know with the volume we trade at, we can catch up that volume pretty easily at any time. So being half of last year's pace doesn't mean you couldn't easily recover to the full-year pace if we chose to.

Steve Barger: All right. I'll get back in line. Thanks.

James O'Leary: Okay, Steve. You're welcome.

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

Walter Liptak: Hi, thanks. Good morning.

James O'Leary: Hello, Walt.

Walter Liptak: Wanted to ask about, you know you mention Hahn and the velocity margin continues to look really good, so obviously that acquisition's going well, but I wonder about the revenue contribution this quarter and the kind of growth that you're getting out of it.

James O'Leary: Well, it's - we haven't provided that because to some extent it's not fully integrated and never will be because the brand is going to remain separate, but we have sold their products. They've private labeled for us in the past. We're doing a lot more of that now, so we're not running it as a separate unit. It's been a contribution of...

Peter DeChants: It's - in the quarter it was about \$5.1 million.

James O'Leary: It's about \$5.1 million, but a lot of it is stuff - or some of it is stuff that we may have been selling anyway. It really has begun to lose its identity as a homogeneous entity. And we certainly could tell you what the sales out of that plant were, but it doesn't make it any different than any plant in bearings as a contribution to friction control, if you follow?

Walter Liptak: Okay, yes. Yes. Okay, good. And you know as you've owned this longer, you know the - I think there was some kind of - some of those consolidation opportunities. Do you have a better idea of the kind of, you know annual cost out that you're going to get between ACE Controls and Hahn?

James O'Leary: It's insignificant. If it were a couple hundred thousand the real opportunity there is broadening our international reach, expanding our efforts in gas springs, which was a product they private labeled for us, and really broadening the revenue opportunity.

It's most, if not all, of the synergies that I think are significant, you know besides maybe a couple hundred thousand on the sourcing side, all those opportunities are top line. And you know you will see some overall cost improvement there, but it's volume from the incremental leverage.

Walter Liptak: Okay. All right, good. Yes, I hope you find another deal like that one.

James O'Leary: We hope we find ten, but again we have to be realistic.

Walter Liptak: Okay, and if could ask one about the wind business, you know, and I apologize because I know you've talked about this in the past, but I wonder about where you are now with customer diversity, if you've been able to add customers and if that's part of the reason for the - you know the positive outlook you know for the 2012 period?

James O'Leary: Well, that's part of it, but it's not the main reason. The main reason across the board is our customers, plural, but our principal customer do have a positive outlook for volume next year, partially driven by the PTC's potential expiration. I think the wind market, even ex the PTC, stabilized from the plunge we saw, you know, right after the 2008 into 2009 time table.

If you remember, our business performed better than many in the supply chain and many of the customers because we were picking up share in what was then a declining market. That has stabilized now for us as well as for, you know, the broader population of turbine manufacturers.

Now specifically to us, we have added a couple of customers. We have added customers who will contribute volume next year. They are not customers that are going to contribute the type of volume we were talking about in 2008, you know as far back as 2008, just because the opportunity for them here as transplants coming to the United States is still a bit muted.

You know, the North American market will still be a large market, but you know when you smooth out what's expected to be a big pop from PTC over what the EER forecasts are at least for 2013 and '14, it's still not a big enough market for some of these customers whom we're now either qualified with or in prototype phase with, it's not big enough for them to come and want to have a primary North American supplier that they'll do long-term agreements with.

Walter Liptak: Okay.

James O'Leary: You still need an RES for people who want to do that.

Walter Liptak: Okay. Okay, thanks very much for the color.

James O'Leary: But, you know more briefly, you know, the addition of new customers is part of our upward bias for next year.

Walter Liptak: Okay, got it.

James O'Leary: Okay, thank you, Walt.

Operator: We'll go next to Peter Lisnic with Robert Baird.

(Josh Hinsun): Morning, this is (Josh Hinsun) in for Pete. You guys had talked about the bias looking to 2012 for wind and military, but if I look at, I guess, your general industrial business you said orders, you know, have stabilized to be sort of flat compared to last year. I mean, is that the sort of run rate that we should go in to 2012 with?

James O'Leary: No, absolutely not. I think, and this is one I would - I'll hold off on making comment, I think until our next call, but we just went through that dissertation, (Josh), a couple of minutes ago on, you know, how much of our industrial business is short order, in and out in 90 days. A lot of it depends on the - you know the general trajectory of the economy. It feels a lot better today than it did last week, but I do think we need a few more - you know a few more data points and, you know continued improvement in some of the economic indicators.

Obviously, GDP was better, factory orders were better. This comes on the heels of a lot of consternation during August and September, so I wouldn't assume flat for next year, I would wait until we have a couple more weeks and we'll specifically address that on our next conference call. But, I think it's too early to draw conclusions about that, and that's just really talking about early October behavior relative to what was a shaky August and September.

(Josh Hinsun): Okay, I - that's - I understand. If you look at your Friction and Motion Control business, sequentially you had \$4 million of higher sales, but you had a decline in operating income even

adjusting for the consolidation. Is that solely attributable to the book-and-ship businesses? It seems like a relatively large impact for mix.

James O'Leary: Well, you said Friction and Motion, which are you talking about?

(Josh Hinsun): Yes, Friction and Motion Control this quarter compared to last quarter.

Peter DeChants: On a sequential basis, part of the effect on the margins this quarter is the higher amount of wind. I think last quarter we had about \$13 million versus \$19 this year. That can affect the margins in Friction.

(Josh Hinsun): Okay. And then the last question, the implied ramp in CAPEX for the fourth quarter, is there anything special going on there?

Peter DeChants: No, and nothing special, just projects that have been worked on over the course of the year and we're hoping to bring them home in Q4.

James O'Leary: But, the implied ramp, I would bet if you looked at our history the implied ramp doesn't come to fruition because you can't just spend the money fast enough. So there's a bias to that number being lower in the fourth quarter because you just can't spend it fast enough.

(Josh Hinsun): Okay. Thank you for your time.

James O'Leary: You're welcome, (Josh). Thank you.

Operator: And once again if you have a question at this time, please press star 1.

We'll go next to Holden Lewis with BB&T Capital Markets.

Holden Lewis: Thank you. Good morning.

James O'Leary: Hello, Holden.

Holden Lewis: The - just a little bit more color, and I know you only have 2012 (as a stretch, so) 2013 is a real one, but when you think about the wind orders that are coming in, I mean do you feel like the market is getting reenergized because of the PTC expiration, or do you feel like in effect projects that might have happened in 2013 are getting pulled forward to get in under the wire? And therefore, this isn't necessarily a statement about the market it's just a statement about regulatory timing.

James O'Leary: I think it's more of a statement about regulatory timing.

Holden Lewis: Okay, so you're not actually seeing like industry backlogs and all that stuff perking up, it's just the timing?

James O'Leary: Well, I think it's largely timing, but - and if you look at the EER stuff, which we subscribe to, it's largely attributable to timing. But, I think if you go beyond that, you know, a lot of the - you know despite the continued fall in solar I think solar is still not really close enough to parity to say it's ahead of wind or even close to wind.

The issues on nuclear around the world are still - you know are - we're further away from the tragedy in Japan, but I think nuclear is not really a likely competitor for our renewable dollars and natural gas is still absolutely, you know, the biggest differentiated item from the 2000, 2008 - 2007, 2008 period than it's been. But, I still think wind is positioned extremely well to be a healthy mix of anyone's renewable energy portfolio, and you know what we still need is some clarity from the government on what their expectations for utilities will be.

So I think there are a lot of anecdotal positives on wind, relative to other possible parts of that portfolio. Natural gas is still the biggest change from, you know, 2007 when we started talking about this, but you know it's - I don't think any of those have factored - can be factored in explicitly yet because the biggest driver for our outlook for next year really does have to be the PTC.

Holden Lewis: Okay. And then, you know when you talk about the industrial markets are you able to get a little bit more granular and give us a sense of, you know the semiconductor, the medical and MRI machines? Any other categories where you're seeing - you know where you might have seen the drop-off or where you're seeing some strengthening? Is there any granularity in the group?

James O'Leary: I'd say across the portfolio, except for semiconductor, I'd say it's a generally, but modestly positive bias. You know there is nothing that happened, other than a lot of uncertainty and angst, and I would say there were some push-outs. There were some you know, "Hey, we don't want to take inventory just in case, you know, Europe collapses." You know, I mean let's use that as an extreme statement, and that would be across most of our businesses.

If you look at what happened from the end of the second quarter to the end of third quarter, and a lot of it was manifested in some recent press releases by heavy equipment people, people in the mining business, people in the crane business, there seems to be a generally positive bias relative to a few weeks ago, or even a quarter ago within heavy equipment.

So I'd say across the board it's choppy, it's still volatile, it's very impacted by (animal spirits), but there's a generally positive - modestly positive bias upwards for most of our industrial businesses. And the only caveat is semiconductor where I think it's more of a downward bias. There's a lot of

discussion about fabs, you know whether or not they're going into - whether or not they're going to be in shutdown and whether it's a hot or a cold shutdown in the next couple of quarters.

That's the one that's more uncertain and I think has more of a negative bias than the rest of general industrial.

Holden Lewis: Okay. And then I guess last question, you've sort of been running in - on gross margin this year, sort of in this 35 to 36-type level. You've also, I think, each quarter had, you know, ballpark 100 basis point drag from gross margin - or from the restructuring. As you go into Q4 with that restructuring past, I mean would we expect to see the gross margin step-up because of that or - you know or is some of the message you're giving about pricing and, you know things like that, could that be a drag? Should we kind of stick with this 35, 36? Just trying to get a sense of when we might start to (inflect) on the margin.

James O'Leary: I would - I'd like to exit this year - I think you should assume the 35 to 36 for the balance of this year, but going into next year if the general industrial space, you know still has a positive bias, we don't have the drag, and we should have the payback from that consolidation, I think that would be a safer time to start factoring in upside to the gross margin forecast, which we do expect to have at some point and I'm hoping that point is next year.

Holden Lewis: Okay. All right, thank you, guys.

James O'Leary: Hey, you're welcome, Holden. Thank you.

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

Michael Hamilton: Good morning.

James O'Leary: Hello, Mike.

Michael Hamilton: Wondering if you could give any comments on military orders that are out there that you're working on that are worth discussing, or is it just a diverse enough mix that it's not worth going into?

James O'Leary: Well, I mean they're all worth going into internally because everyone's important, but none of them are significant enough, like MATV and MRAP before to call out, so we'll probably defer on that.

Michael Hamilton: Okay. Thanks and congratulations.

James O'Leary: No, thank you, Mike.

Operator: And we'll take a follow-up question from Eli Lustgarten with Longbow Securities.

James O'Leary: No, no, no, no, we have a...

Eli Lustgarten: No, no, no, huh?

James O'Leary: ...very strict policy about Eli coming on with a follow-up question. When you ask ten questions on your first question you don't get a follow-up question.

Eli Lustgarten: Oh, shucks.

James O'Leary: All right, go ahead.

Eli Lustgarten: I just had a question, you had a big step-up in profitability in Friction and Motion Controls between the third and fourth quarter last year. Now, when it down is it fair to expect that we'll see the fourth quarter to be the best margin profitability for Friction and Motion of the year - Motion (for) year? I mean, how about...

Peter DeChants: So we talk about the gross margin expectations, Eli, as being consistent, and so would not expect something - that to recur this Q4.

James O'Leary: And I don't have it right in front of me. I assume if it was a big step-up it was probably wind absorption and the EBITDA margins probably weren't materially different, but let me look into that for you and we'll follow-up later.

Eli Lustgarten: Okay. Thank you.

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

Operator: And we'll take a follow-up from Holden Lewis of BB&T Capital Markets.

Holden Lewis: You opened the flood gates on the multiple questions.

James O'Leary: And you're a repeat offender too.

Holden Lewis: It's all right. You're going to be able to not answer this one, so - but I thought I should ask in any event. On the M&A side, you know when you talked about having some stuff that you're looking at, obviously there's - you know (we can a little message), I guess, in the fact that you slowed down the share buybacks. But, you know every quarter seems that you have some due diligence stuff in there, so obviously you're always looking.

And, you know is there - when you look at the opportunities on the table do you feel like the potential to get some of them done and some of the bigger ones done is greater than perhaps what you've seen in the past for any reason, or is kind of the same dynamic you know, or - just trying to get a sense that - if you're more confident, less confident, or sort of the same that some of these things get done on a timely basis.

James O'Leary: Well, you know you're right, I'm not really going to answer the question, but I will say that I'm more positive and confident that something will happen today than I was at the same time in that 2008 timeframe. And a lot of it has to do with - you know I think there's a general feeling amongst corporate America, owners of businesses, whether they're sponsors, or private holders, that at some point taxes are going up.

When we - you know when there were bigger things, and if you looked at when we - probably my comments on where we were most active and spent a fair amount of money on due diligence back in the 2008 timeframe, you know at that point, largely because of the outright plunge in economic indicators, even though you had a new President coming in who I thought the perception would have been you're going to likely have higher taxes, nobody thought taxes were going to be increased at that point.

I think right now the general feeling is that at some point capital gains and the tax regime will change where it may be better to be a seller of the businesses sooner than later if you've got a good gain, a good return, and you get a fair price. So I'm modestly more positive now than I've been at the last time we were looking at this many things.

Holden Lewis: Okay. Thank you.

James O'Leary: You're welcome.

Operator: And at this time we have no further questions in the queue.

James O'Leary: Okay. Ann, thank you very much for a very nice job, and thank you all for spending the last hour with us and we will talk to you in a couple of months.

Thank you.

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

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