TWIN DISC INC
Form 10-Q
November 03, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended September 24, 2010

Commission File Number 1-7635

TWIN DISC, INCORPORATED
(Exact name of registrant as specified in its charter)

Wisconsin	39-0667110
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

1328 Racine Street, Racine, Wisconsin 53403
(Address of principal executive offices)

(262) 638-4000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.
Yes √ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).Yes__No__

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer Accelerated Filer √
Non-accelerated Filer Smaller reporting company__

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No √

At October 29, 2010, the registrant had 11,338,694 shares of its common stock outstanding.

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Unaudited)

	September 24, 2010	June 30, 2010
Assets		
Current assets:		
Cash	$23,114	$19,022
Trade accounts receivable, net	46,918	43,014
Inventories, net	77,458	72,799
Deferred income taxes	5,597	5,224
Other	8,087	7,391
Total current assets	161,174	147,450
Property, plant and equipment, net	59,361	58,243
Goodwill, net	16,813	16,440
Deferred income taxes	22,633	24,029
Intangible assets, net	6,342	6,268
Other assets	6,845	6,626
Total assets	$273,168	$259,056
Liabilities and Equity		
Current liabilities:		
Short-term borrowings and current maturities of long-term debt	$3,987	$3,920
Accounts payable	26,894	23,842
Accrued liabilities	33,932	35,545
Total current liabilities	64,813	63,307
Long-term debt	28,852	27,211
Accrued retirement benefits	72,394	72,833
Deferred income taxes	3,914	3,914
Other long-term	3,500	2,472
Total liabilities	173,473	169,737
Equity		
Twin Disc shareholders’ equity:		
Common shares authorized: 30,000,000;		
issued: 13,099,468; no par value	9,664	10,667
Retained earnings	149,302	147,438
Accumulated other comprehensive loss	(34,140)	(42,048)
	124,826	116,057

Less treasury stock, at cost (1,786,462 and 1,901,242 shares, respectively)	25,933	27,597
Total Twin Disc shareholders' equity	98,893	88,460
Noncontrolling interest	802	859
Total equity	99,695	89,319
Total liabilities and equity	$273,168	$259,056

The notes to condensed consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(In Thousands Except Per Share Data, Unaudited)

	Three Months Ended	
	September 24, 2010	September 25, 2009
Net sales	$61,395	$47,057
Cost of goods sold	41,372	37,310
Gross Profit	20,023	9,747
Marketing, engineering and administrative expenses	14,777	12,778
Earnings (loss) from operations	5,246	(3,031)
Interest expense	439	619
Other expense, net	554	60
	993	679
Earnings (loss) before income taxes and noncontrolling interest	4,253	(3,710)
Income taxes	1,556	(1,398)
Net earnings (loss)	2,697	(2,312)
Less: Net earnings attributable to noncontrolling interest, net of tax	(41)	(92)
Net earnings (loss) attributable to Twin Disc	$2,656	$(2,404)
Dividends per share	$0.0700	$0.0700
Earnings per share data:		
Basic earnings (loss) per share attributable to Twin Disc common shareholders	$0.24	$(0.22)
Diluted earnings (loss) per share attributable to Twin Disc common shareholders	$0.24	$(0.22)
Weighted average shares outstanding data:		
Basic shares outstanding	10,882	11,137
Dilutive stock awards	218	-
Diluted shares outstanding	11,100	11,137
Comprehensive income:		
Net earnings (loss)	$2,697	$(2,312)
Adjustment for amortization of net actuarial loss and prior service cost, net of tax	553	447
Foreign currency translation adjustment	7,395	2,928
Comprehensive income	10,645	1,063
Comprehensive income attributable to noncontrolling interest	(41)	(92)
Comprehensive income attributable to Twin Disc	$10,604	$971

The notes to condensed consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands, Unaudited)

	Three Months Ended	
	September 24, 2010	September 25, 2009
Cash flows from operating activities:		
Net earnings (loss)	$2,697	$(2,312)
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,272	2,375
Other non-cash changes, net	1,713	277
Net change in working capital, excluding cash	(2,601)	8,203
Net cash provided by operating activities	4,081	8,543
Cash flows from investing activities:		
Acquisitions of fixed assets	(1,247)	(1,031)
Proceeds from sale of fixed assets	49	-
Other, net	(293)	(293)
Net cash used by investing activities	(1,491)	(1,324)
Cash flows from financing activities:		
Proceeds from notes payable	18	-
Payments of notes payable	(42)	(874)
Proceeds from (payments of) long-term debt	1,695	(1,394)
Proceeds from exercise of stock options	71	80
Dividends paid to shareholders	(792)	(784)
Dividends paid to noncontrolling interest	(138)	-
Other	132	(500)
Net cash provided (used) by financing activities	944	(3,472)
Effect of exchange rate changes on cash	558	128
Net change in cash	4,092	3,875
Cash:		
Beginning of period	19,022	13,266
End of period	$23,114	$17,141

The notes to condensed consolidated financial statements are an integral part of these statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

A. Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and, in the opinion of the Company, include all adjustments, consisting only of normal recurring items, necessary for a fair presentation of results for each period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. The Company believes that the disclosures made are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's latest Annual Report. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

New Accounting Releases

In April 2010, the Financial Accounting Standards Board (“FASB”) issued a standards update providing guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. This update is effective for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, with early adoption permitted. This standards update is not expected to have a material impact on the Company’s financial statements.

In June 2009, the FASB issued an amendment changing how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. New disclosures will be required regarding involvement with variable interest entities and any significant changes in risk exposure due to that involvement. This change was effective for the start of the first fiscal year beginning after November 15, 2009 (July 1, 2010 for the Company) and did not have a material impact on the Company’s financial statements.

In June 2009, the FASB issued a revision which requires more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a “qualifying special-purpose entity,” and changes the requirements for derecognizing financial assets, and requires additional disclosures. This change was effective for the start of the first fiscal year beginning after November 15, 2009 (July 1, 2010 for the Company) and did not have a material impact on the Company’s financial statements.

B. Inventory

The major classes of inventories were as follows (in thousands):

	September 24, 2010	June 30, 2010
Inventories:		

Finished parts	$48,241	$47,051
Work in process	10,146	8,998
Raw materials	19,071	16,750
	$77,458	$72,799

C. Warranty

The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers. However, its warranty obligation is affected by product failure rates, the extent of the market affected by the failure and the expense involved in satisfactorily addressing the situation. The warranty reserve is established based on our best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. When evaluating the adequacy of the reserve for warranty costs, management takes into consideration the term of the warranty coverage, historical claim rates and costs of repair, knowledge of the type and volume of new products and economic trends. While we believe the warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable in the future could differ materially from what actually transpires. The following is a listing of the activity in the warranty reserve during the three month periods ended September 24, 2010 and September 25, 2009 (in thousands):

	Three Months Ended	
	September 24, 2010	September 25, 2009
Reserve balance, beginning of period	$6,061	$8,028
Current period expense	1,707	1,197
Payments or credits to customers	(1,474)	(1,686)
Translation	488	128
Reserve balance, end of period	$6,782	$7,667

D. Contingencies

The Company is involved in litigation of which the ultimate outcome and liability to the Company, if any, is not presently determinable. Management believes that final disposition of such litigation will not have a material impact on the Company's results of operations, financial position or cash flows.

E. Business Segments

Information about the Company's segments is summarized as follows (in thousands):

	Three Months Ended	
	September 24, 2010	September 25, 2009
Manufacturing segment sales	$50,802	$32,738
Distribution segment sales	28,544	27,952
Inter/Intra segment elimination - manufacturing	(14,468)	(6,407)
Inter/Intra segment elimination - distribution	(3,483)	(7,226)

Net sales	$61,395	$47,057
Manufacturing segment earnings (loss)	$6,453	$(4,174)
Distribution segment earnings	2,033	2,267
Corporate and eliminations	(4,233)	(1,803)
Earnings (loss) before income taxes and noncontrolling interest	$4,253	$(3,710)

Assets	September 24, 2010	June 30, 2010
Manufacturing segment assets	$235,819	$217,656
Distribution segment assets	54,987	53,514
Corporate assets and elimination of inter-company assets	(17,638)	(12,114)
	$273,168	$259,056

F. Stock-Based Compensation

In the first quarter of fiscal 2011 and 2010, the Company granted a target number of 98,358 and 91,807 performance stock unit awards, respectively, to various employees of the Company, including executive officers. The performance stock unit awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock unit awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 118,030. Based upon actual results to date and the probability of achieving the targeted performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2011 at the target level. The performance stock unit awards granted in fiscal 2010 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2012. The performance stock unit awards granted in fiscal 2010 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 110,168. Based upon actual results to date and the probability of achieving the threshold performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2010 at the threshold level. Previous to the first quarter of fiscal 2011, the Company was not accruing for the performance stock unit awards granted in fiscal 2010 based upon the low probability of achieving the threshold performance levels. There were 278,665 and 233,065 unvested stock unit awards outstanding at September 24, 2010 and September 25, 2009, respectively. The performance stock unit awards are remeasured at fair-value based upon the Company's stock price at the end of each reporting period. The fair-value of the stock unit awards are expensed over the performance period for the shares that are expected to ultimately vest. The compensation expense for the three months ended September 24, 2010 and September 25, 2009, related to the performance stock unit award grants, approximated $461,000 and $0, respectively.

In the first quarter of fiscal 2011 and 2010, the Company granted a target number of 72,546 and 74,173 performance stock awards, respectively, to various employees of the Company, including executive officers. The performance stock awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 87,055. Based upon actual results to date and the probability of achieving the targeted performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2011 at the target level. The performance stock awards granted in fiscal 2010 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2012. The performance stock awards granted in fiscal 2010 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 89,008. Based upon actual results to date and the probability of achieving the threshold performance levels, the Company is accruing the performance stock awards granted in fiscal 2010 at the threshold level. Previous to the first quarter of fiscal 2011, the Company was not accruing for the performance stock awards granted in fiscal 2010 based upon the low probability of achieving the threshold performance levels. There were 213,219 and 177,983 unvested stock awards outstanding at September 24, 2010 and September 25, 2009, respectively. The fair value of the stock awards (on the date of grant) is expensed over the performance period for the shares that are expected to ultimately vest. The compensation expense for the three months ended September 24, 2010 and September 25, 2009, related to performance stock awards, approximated $265,000 and $0, respectively.

In addition to the performance shares mentioned above, the Company has unvested restricted stock outstanding that will vest if certain service conditions are fulfilled. The fair value of the restricted stock grants is recorded as compensation over the vesting period, which is generally 1 to 4 years. During the first quarter of fiscal 2011 and 2010, the Company granted 98,780 and 101,923 service based restricted shares, respectively, to employees in each year. There were 225,203 and 125,623 unvested shares outstanding at September 24, 2010 and September 25, 2009, respectively. Compensation expense of $193,000 and $96,000 was recognized for the three months ended September 24, 2010 and September 25, 2009, respectively, related to these service-based awards.

G. Pension and Other Postretirement Benefit Plans

The Company has non-contributory, qualified defined benefit plans covering substantially all domestic employees hired prior to October 1, 2003 and certain foreign employees. Additionally, the Company provides health care and life insurance benefits for certain domestic retirees. Components of net periodic benefit cost for the defined benefit pension plans and the other postretirement benefit plan are as follows (in thousands):

	Three Months Ended	
	September 24, 2010	September 25, 2009
Pension Benefits:		
Service cost	$38	$62
Interest cost	1,556	1,815
Expected return on plan assets	(1,513)	(1,507)
Amortization of prior service cost	-	2
Amortization of transition obligation	-	13
Amortization of net loss	784	656
Net periodic benefit cost	$865	$1,041

Postretirement Benefits:		
Service cost	$8	$7
Interest cost	274	337
Amortization of net actuarial loss	111	45
Net periodic benefit cost	$393	$389

The Company expects to contribute $2,206,000 to its pension plans in fiscal 2011. As of September 24, 2010, $599,000 in contributions have been made.

H. Income Taxes

The Company has approximately $808,000 of unrecognized tax benefits, excluding related interest and penalties, as of September 24, 2010, which, if recognized, would favorably impact the effective tax rate. The Company does not anticipate that the net amount of unrecognized tax benefits will change significantly during the next twelve months.

There was no change in the total unrecognized tax benefits due to the settlement of audits, the expiration of statutes of limitations, or for other items during the quarter ended September 24, 2010.

Annually, the Company files income tax returns in various taxing jurisdictions inside and outside the United States. In general, the tax years that remain subject to examination are 2006 through 2009 for the major operations in the U.S., Italy, Belgium, and Japan. The U.S. Internal Revenue Service is currently auditing the consolidated income tax return for fiscal 2003 through 2007. Other audits currently underway include those in Italy and Canada. It is reasonably possible that at least one of these audit cycles will be completed during fiscal 2011.

The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. Changes in valuation allowances from period to period are included in the tax provision in the period of change. In determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. Due to recent operating losses in certain foreign jurisdictions including the first quarter of the fiscal year, the Company has evaluated the realizability of the net deferred tax assets related to these jurisdictions (approximately $2,037,000 at September 24, 2010). This evaluation concluded that it continues to be more likely than not that the net deferred tax assets will be realized, and no valuation allowance is warranted. The Company will continue to evaluate the realizability of its net deferred tax assets in the future, and will establish a valuation allowance in the event that it becomes more likely than not that all or a portion of a net deferred tax asset will not be realized.

Due to current year operating income from domestic operations, the Company concluded that it is more likely than not that all state tax credits will be fully realized before they expire. Therefore the valuation allowance of $260,000 was reversed during the quarter ended September 24, 2010. The Company will continue to evaluate the realization of state tax credits before expiration.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of September 24, 2010, total accrued interest and penalties with respect to income taxes was approximately $112,000 that would favorably affect the effective tax rate if recognized.

I. Goodwill and Other Intangibles

The changes in the carrying amount of goodwill, substantially all of which is allocated to the manufacturing segment, for the three months ended September 24, 2010 were as follows (in thousands):

Balance at June 30, 2010	$16,440
Translation adjustment	373
Balance at September 24, 2010	$16,813

The gross carrying amount and accumulated amortization of the Company's intangible assets that have defined useful lives and are subject to amortization as of September 24, 2010 and June 30, 2010 were as follows (in thousands):

	September 24, 2010	June 30, 2010
Intangible assets with finite lives:		
Licensing agreements	$3,015	$3,015
Non-compete agreements	2,050	2,050
Other	5,991	5,991
	11,056	11,056
Accumulated amortization	(7,179)	(6,980)
Translation adjustment	394	211
Total	$4,271	$4,287

The weighted average remaining useful life of the intangible assets included in the table above is approximately 7 years.

Intangible amortization expense for the three months ended September 24, 2010 and September 25, 2009 was $199,000 and $199,000, respectively. Estimated intangible amortization expense for the remainder of fiscal 2011 and each of the next five fiscal years is as follows (in thousands):

Fiscal Year	
2011	$561
2012	748
2013	700
2014	700
2015	413
2016	276

The gross carrying amount of the Company's intangible assets that have indefinite lives and are not subject to amortization as of September 24, 2010 and June 30, 2010 are $2,071,000 and $1,981,000, respectively. These assets are comprised of acquired tradenames.

J. Long-term Debt

Long-term debt at September 24, 2010 and June 30, 2010 consisted of the following (in thousands):

	September 24, 2010	June 30, 2010
Revolving loan	$10,700	$9,000
10-year unsecured senior notes	21,429	21,429
Other	710	702
Subtotal	32,839	31,131
Less: current maturities and short-term borrowings	(3,987)	(3,920)
Total long-term debt	$28,852	$27,211

The revolving loan and unsecured senior notes listed above are subject to certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants include a minimum consolidated net worth, as defined, a minimum EBITDA for the most recent four fiscal quarters, and a maximum total funded debt to EBITDA ratio. As of September 24, 2010, the Company was in compliance with these covenants. Based on its current projections, including the Company's results in the first three months of fiscal 2011, the Company believes it will generate sufficient earnings EBITDA levels throughout fiscal 2011 in order to maintain compliance with the above covenants. However, as with all forward-looking information, there can be no assurance that the Company will achieve the planned results in future periods due to the uncertainties in certain of its markets.

The fair value of long-term debt is estimated by discounting the future cash flows at rates offered to the Company for similar debt instruments of comparable maturities. This rate was represented by the US Treasury Three-Year Yield Curve Rate (0.69% and 1.00% for September 24, 2010 and June 30, 2010, respectively), plus the current add-on related to the revolving loan agreement (2.50% and 3.00% for September 24, 2010 and June 30, 2010, respectively). The fair value of the Company's 10-year unsecured senior notes due April 10, 2016 was approximately $23,406,000 and $22,977,000 at September 24, 2010 and June 30, 2010, respectively. The Company's revolving loan agreement approximates fair value at September 24, 2010 and June 30, 2010.

K. Shareholders' Equity

On February 1, 2008, the Board of Directors authorized the purchase of 500,000 shares of Common Stock at market values. The Company purchased no shares of its outstanding Common Stock in fiscal 2010 or the first quarter of fiscal 2011. In the second quarter of fiscal 2009, the Company repurchased 250,000 shares of its outstanding Common Stock at an average price of $7.25 per share for a total cost of $1,812,500.

The following is a reconciliation of the Company's equity balances for the first fiscal three months of 2010 and 2011 (in thousands):

	Twin Disc, Inc. Shareholders' Equity					
	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Non-Controlling Interest	Total Equity
Balance –June 30, 2009	$13,205	$149,974	($25,935)	($30,256)	$837	$107,825
Net (loss) income		(2,404)			92	(2,312)
Translation adjustments			2,913		15	2,928
Benefit plan adjustments, net of tax			447			447
Cash dividends		(784)				(784)
Compensation expense and windfall tax benefits	(90)					(90)

Shares (acquired) issued, net	(2,699)			2,462		(237)
Balance-September 25, 2009	$10,416	$146,786	($22,575)	($27,794)	$944	$107,777

	Twin Disc, Inc. Shareholders' Equity					
	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Non-Controlling Interest	Total Equity
Balance-June 30, 2010	$10,667	$147,438	($42,048)	($27,597)	$859	$89,319
Net income		2,656			41	2,697