TWIN DISC INC
Form 10-Q
February 06, 2008

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 December 28, 2007

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 _ x_ No__

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer __ Accelerated Filer _x_

Non-accelerated filer

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

At January 31, 2008, the registrant had 11,274,114 shares of its common stock outstanding.

1

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

TWIN DISC, INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands, Unaudited)

	December 28, 2007	June 30, 2007
Assets		
Current assets:		
Cash and cash equivalents	$22,117	$ 19,508
Trade accounts receivable, net	59,797	63,277
Inventories, net	87,615	76,253
Deferred income taxes	6,360	6,046
Other	10,245	8,156
Total current assets	186,134	173,240
Property, plant and equipment, net	61,858	56,810
Goodwill, net	17,889	17,171
Deferred income taxes	2,322	3,956
Intangible assets, net	9,567	9,352
Other assets	6,928	6,655
	$284,698	**$267,184**
Liabilities and Shareholders' Equity		
Current liabilities:		
Current maturities of long-term debt	$ 1,933	$ 1,768
Accounts payable	35,133	28,896
Accrued liabilities	47,347	49,254
Total current liabilities	84,413	79,918
Long-term debt	53,613	42,152
Accrued retirement benefits	23,861	26,392
Other long-term	3,890	2,640
	165,777	151,102
Minority interest	655	645
Shareholders' equity:		
Common shares authorized: 30,000,000; issued: 13,099,468; no par value	14,204	13,304
Retained earnings	128,986	121,109
Accumulated other comprehensive income (loss)	3,055	(4,493)
	146,245	129,920
Less treasury stock, at cost		

(1,815,354 and 1,384,272 shares, respectively)	27,979	14,483
Total shareholders' equity	118,266	115,437
	$284,698	**$267,184**

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

2

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

	Three Months Ended		Six Months Ended	
	Dec 28, 2007	Dec 31, 2006	Dec 28, 2007	Dec 31, 2006
Net sales	$81,894	$74,239	$155,507	$140,013
Cost of goods sold	56,548	49,850	106,311	95,311
Gross profit	25,346	24,389	49,196	44,702
Marketing, engineering and administrative expenses	17,378	14,528	32,072	28,180
Earnings from operations	7,968	9,861	17,124	16,522
Interest expense	825	824	1,568	1,467
Other expense (income), net	179	(248)	174	(328)
	1,004	576	1,742	1,139
Earnings before income taxes and minority interest	6,964	9,285	15,382	15,383
Income taxes	2,729	3,573	5,967	5,950
Earnings before minority interest	4,235	5,712	9,415	9,433
Minority interest	(26)	(42)	(101)	(91)
Net earnings	**$ 4,209**	**$ 5,670**	**$ 9,314**	**$ 9,342**
Dividends per share	$0.0700	$0.0475	$0.1250	$0.0950
Earnings per share data:				
Basic earnings per share	$ 0.37	$ 0.49	$ 0.82	$ 0.80
Diluted earnings per share	$ 0.37	$ 0.48	$ 0.81	$ 0.79
Shares outstanding data:				
Average shares outstanding	11,261	11,618	11,378	11,610
Dilutive stock options	138	194	137	192
Diluted shares outstanding	**11,399**	**11,812**	**11,515**	**11,802**
Comprehensive income:				
Net earnings	$ 4,209	$ 5,670	$ 9,314	$ 9,342
Adjustment for amortization of net actuarial loss and prior service cost	463	-	463	-
Foreign currency translation adjustment	4,377	2,469	7,085	2,528
Comprehensive income	**$ 9,049**	**$ 8,139**	**$16,862**	**$11,870**

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

3

TWIN DISC, INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands, Unaudited)

	Six Months Ended December 28, 2007	December 31, 2006
Cash flows from operating activities:		
Net earnings	$ 9,314	$ 9,342
Adjustments to reconcile net earnings to		
net cash provided (used) by operating activities:		
Depreciation and amortization	3,560	3,368
Other non-cash changes, net	1,982	869
Net change in working capital,		
excluding cash	(3,844)	(19,987)
	11,012	(6,408)
Cash flows from investing activities:		
Acquisitions of fixed assets	(6,820)	(8,011)
Proceeds from sale of fixed assets	200	101
	(6,620)	(7,910)
Cash flows from financing activities:		
Bank overdraft	-	(3,194)
Increase (decrease) in notes payable, net	29	(396)
Proceeds from long-term debt	11,393	16,255
Proceeds from exercise of stock options	100	56
Purchase of treasury stock	(13,367)	(51)
Dividends paid	(1,437)	(1,109)
Other	19	(47)
	(3,263)	11,514
Effect of exchange rate changes on cash	1,480	1,118
Net change in cash and cash equivalents	2,609	(1,686)
Cash and cash equivalents:		
Beginning of period	19,508	16,427
End of period	**$22,117**	**$14,741**

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 December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 141 (Revised), Business Combinations . This statement will significantly change the accounting for business combinations, requiring the acquiring entity to recognize the acquired assets and liabilities at the acquisition date fair value with limited exceptions. The statement also includes a substantial number of new disclosure requirements. SFAS No. 141 (R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual report period beginning on or after December 15, 2008. Earlier adoption is prohibited. Accordingly, the Company will be subject to SFAS No. 141(R) beginning on July 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 . SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary, and includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. Adoption of SFAS No. 160 is not expected to have a material impact on the financial statements of the Company.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 . This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007 and is not expected to have a material impact on the Company s financial statements.

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements . This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this statement are effective for financial statements issued for fiscal years beginning after November 15, 2007 and are not expected to have a material impact on the financial statements of the Company.

B. Inventory

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

		December 28, 2007	June 30, 2007
Inventories:			
	Finished parts	$54,723	$49,594
	Work in process	16,107	13,011
	Raw materials	16,785	13,648
		$87,615	**$76,253**

Finished goods inventory includes both fully assembled units and finished components that may be sold as replacement parts or assembled into complete units.

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 and six month periods ended December 28, 2007 and December 31, 2006 (in thousands).

	Three Months Ended		Six Months Ended	
	Dec. 28, 2007	Dec. 31, 2006	Dec. 28, 2007	Dec. 31, 2006
Reserve balance, beginning of period	$7,527	$7,129	$7,266	$6,948
Current period expense	1,248	1,475	2,142	2,374
Payments or credits to customers	(1,108)	(1,314)	(1,938)	(2,209)
Acquisition accounting	-	-	-	210
Translation	135	161	332	128
Reserve balance, end of period	**$7,802**	**$7,451**	**$7,802**	**$7,451**

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		Six Months Ended	
	Dec. 28, 2007	Dec. 31, 2006	Dec. 28, 2007	Dec. 31, 2006
Manufacturing segment sales	$71,645	$71,131	$136,192	$128,797
Distribution segment sales	29,862	20,433	55,626	43,195
Inter/Intra segment elimination	(19,613)	(17,325)	(36,311)	(31,979)
Net sales	**$81,894**	**$74,239**	**$155,507**	**$140,013**

6

Manufacturing segment earnings	$ 8,026	$11,253	$16,816	$ 16,939
Distribution segment earnings	2,723	1,254	5,240	3,553
Inter/Intra segment elimination	(3,785)	(3,222)	(6,674)	(5,109)

Earnings before income taxes and minority interest	**$ 6,964**	**$ 9,285**	**$15,382**	**$ 15,383**

Assets	Dec. 28, 2007	June 30, 2007
Manufacturing segment assets	$337,625	$318,983
Distribution segment assets	61,043	58,501
Corporate assets and elimination of inter-company assets	(113,970)	(110,300)
	$284,698	**$267,184**

F. Stock-Based Compensation

In fiscal 2008 and 2007, the Company granted 52,758 and 60,868 performance stock unit awards, respectively, to various employees of the Company, including executive officers. The performance stock unit awards granted in fiscal 2008 will vest if the Company achieves a specified target objective relating to consolidated net operating profit after tax (NOPAT) in the cumulative three fiscal year period ending June 30, 2010. The performance stock unit awards granted in fiscal 2008 are subject to adjustment if the Company s NOPAT 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 61,840. The performance stock unit awards granted in fiscal 2007 will vest if the Company achieves a specified target objective relating to consolidated NOPAT in the cumulative three fiscal year period ending June 30, 2009. The performance stock unit awards granted in fiscal 2007 are subject to adjustment if the Company s NOPAT 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 73,042. There were 202,178 and 149,420 unvested performance stock unit awards outstanding at December 28, 2007 and December 31, 2006, respectively. As these awards are ultimately settled in cash, they are recorded as a liability and are subject to stock market volatility. As such, the performance stock unit awards are remeasured at fair-value at the end of each reporting period. The fair-value of the performance stock unit awards is expensed over the performance period for the shares that are expected to ultimately vest. The compensation expense for the three and six months ended December 28, 2007, related to the performance stock unit awards, approximated $1,262,000 and $1,250,000, respectively. The compensation expense for the three and six months ended December 31, 2006, related to the performance stock unit awards, approximated $292,000 and $534,000, respectively.

In fiscal 2008 and 2007, the Company granted 37,310 and 60,882 performance stock awards (equity classified awards), respectively, to various employees of the Company, including executive officers. The performance stock awards granted in fiscal 2008 will vest if the Company achieves a specified target objective relating to consolidated NOPAT in the cumulative three fiscal year period ending June 30, 2010. The performance stock awards granted in fiscal 2008 are subject to adjustment if the Company s NOPAT 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 42,040. The performance stock awards granted in fiscal 2007 will vest if the Company achieves a specified target objective relating to consolidated NOPAT in the cumulative three fiscal year period ending June 30, 2009. The performance stock awards granted in fiscal 2007 are subject to adjustment if the Company s NOPAT 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 73,058. There were 218,558 and 298,914 unvested performance stock awards outstanding at December 28, 2007 and December 31, 2006, respectively. The fair value of the performance 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 and six months ended December 28, 2007, related to performance stock awards, approximated $240,000 and $445,000, respectively. The compensation expense for the three and six months ended December 31, 2006, related to performance stock awards, approximated $223,000 and $445,000, respectively.

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 other postretirement benefit plan are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	Dec. 28,	Dec. 31,	Dec. 28,	Dec. 31,

	2007	2006	2007	2006
Pension Benefits:				
Service cost	$303	$ 307	$ 591	$601
Interest cost	1,736	1,760	3,452	3,503
Expected return on plan assets	(2,407)	(2,226)	(4,795)	(4,355)
Amortization of prior service cost	(179)	(179)	(359)	(359)
Amortization of transition obligation	19	18	31	29
Amortization of net loss	427	674	854	1,348
Net periodic benefit (income) cost	**$ (101)**	**$354**	**$ (226)**	**$767**
Postretirement Benefits:				
Service cost	$10	$19	$ 19	$38
Interest cost	342	334	684	667
Amortization of net actuarial loss	133	52	266	105
Net periodic benefit cost	**$485**	**$ 405**	**$ 969**	**$810**

The Company previously disclosed in its financial statements for the year ended June 30, 2007, that it expected to contribute $1,823,000 to its pension plan in fiscal 2008. As of December 28, 2007, $1,725,000 of contributions have been made.

H. Income Taxes

During June 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 . FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements by standardizing the level of confidence needed to recognize uncertain tax benefits and the process for measuring the amount of benefit to recognize. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

We adopted the provisions of FIN 48 as of July 1, 2007. We did not recognize an increase or decrease in the net liability for unrecognized tax benefits at July 1, 2007. As of the date of adoption, we had total unrecognized tax benefits of approximately $325,000 that would favorably affect the effective tax rate if recognized. We do not anticipate that the net amount of unrecognized tax benefits will change significantly during the next twelve months.

There was no significant change in the total unrecognized tax benefits due to the settlement of audits, the expiration of statute of limitations, or for other items during the quarter or six months ended December 28, 2007.

Annually, we file income tax returns in various taxing jurisdictions inside and outside the United States. In general, the tax years that remain subject to examination are 2003 through 2007 for our major operations in the U.S., Italy, Belgium, and Japan. The U.S. Internal Revenue Service is currently auditing our consolidated income tax return for fiscal 2006. Other audits currently underway include those in Singapore and Italy. It is reasonably possible that at least one of these audit cycles will be completed during fiscal 2008.

We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of July 1, 2007, total accrued penalties and net accrued interest with respect to income taxes was approximately $27,000, 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 six months ended December 28, 2007 were as follows (in thousands):

Balance at June 30, 2007	$17,171
Translation adjustment	718
Balance at December 28, 2007	**$17,889**

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 December 28, 2007 and June 30, 2007 are as follows (in thousands):

	December 28, 2007	June 30, 2007
Intangible assets with finite lives:		
Licensing agreements	$ 3,015	$ 3,015
Non-compete agreements	2,050	2,050
Other	6,078	6,078
	11,143	11,143
Accumulated amortization	(4,773)	(4,303)
Translation adjustment	869	368
Total	**$ 7,239**	**$ 7,208**

The weighted average remaining useful life of the intangible assets included in the table above is approximately 10 years.

Intangible amortization expense was $237,000 and $470,000 for the three and six months ended December 28, 2007, respectively, and $283,000 and $563,000 for the three and six months ended December 31, 2006, respectively. Estimated intangible amortization expense for the remainder of fiscal 2008 and each of the next five fiscal years is as follows (in thousands):

Fiscal Year	
2008	$ 485
2009	950
2010	734
2011	734
2012	734
2013	689

The gross carrying amount of the Company s intangible assets that have indefinite lives and are not subject to amortization as of December 28, 2007 and June 30, 2007 are $2,328,000 and $2,144,000, respectively. These assets are comprised of acquired tradenames.

J. Long-term Debt

Long-term debt at December 28, 2007 and June 30, 2007 consisted of the following (in thousands):

	December 28, 2007	June 30, 2007

Revolving Loan	$26,400	$14,525
10-year unsecured senior notes	25,000	25,000
Other	4,146	4,395
Subtotal	55,546	43,920
Less: current maturities	(1,933)	(1,768)
Total long-term debt	**$53,613**	**$42,152**

K. Shareholders Equity

In October 2007, the Board of Directors approved a two-for-one stock split of the Company s outstanding common stock. The split was issued on December 31, 2007 to shareholders of record at the close of business on December 10, 2007, The split increased the number of shares outstanding to approximately 11.4 million from approximately 5.7 million. The Consolidated Financial Statements and Notes thereto, including all share and per share data, have been restated as if the stock split had occurred as of the earliest period presented.

On July 27, 2007, the Board of Directors authorized the purchase of up to 200,000 shares (pre-split) of Common Stock at market values. This resolution supersedes the resolution previously adopted by the Board in January 2002. On August 14, 2007, the Board of Directors authorized the purchase of an additional 200,000 shares (pre-split) of Common Stock at market values. In the first half of fiscal 2008, the Company repurchased 520,000 shares (260,000 pre-split) of its outstanding common stock at an average price of $25.71 ($51.41 pre-split) per share at a total cost of $13,367,000. On February 1, 2008 the Board of Directors authorized the purchase of an additional 500,000 shares of Common Stock at market values.

Item 2. Management Discussion and Analysis

In the financial review that follows, we discuss our results of operations, financial condition and certain other information. This discussion should be read in conjunction with our consolidated 2007 financial statements and related notes.

Some of the statements in this Quarterly Report on Form 10-Q are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements include the Company s description of plans and objectives for future operations and assumptions behind those plans. The words anticipates, believes, intends, estimates, and expects, or similar anticipatory expressions, usually identify forward-looking statements. In addition, goals established by Twin Disc, Incorporated should not be viewed as guarantees or promises of future performance. There can be no assurance the Company will be successful in achieving its goals.

In addition to the assumptions and information referred to specifically in the forward-looking statements, other factors, including but not limited to those factors discussed under Item 1A, Risk Factors, of the Company s Annual Report filed on Form 10-K for June 30, 2007 could cause actual results to be materially different from what is presented here.

Results of Operations