CIRCOR International, Inc.

First-Quarter 2013 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to CIRCOR International's first-quarter 2013 financial results conference call. Today's call will be recorded. At this time, all participants have been placed in a listen-only mode. There will be an opportunity for questions and comments after the prepared remarks. (Operator Instructions). I'll now turn the call over to Mr. Dennis Walsh from Sharon Merrill for opening remarks and introductions. Please go ahead, sir.

Dennis Walsh: *Sharon Merrill*

Thank you and good morning everyone. On the call today is Scott Buckhout, CIRCOR's President and CEO, Wayne Robbins, CIRCOR's Chief Operating Officer, and Fred Burditt, the Company's Chief Financial Officer. The slides we'll be referring to today are available on CIRCOR's website at www.CIRCOR.com, on the "Webcast and Presentations" section of the "Investors" link.

Today's discussion contains forward-looking statements that identify future expectations. These expectations are subject to known and unknown risks, uncertainties and other factors.

For a full discussion of these factors, the Company advises you to review CIRCOR's Form 10-K for 2012 and other SEC filings. The Company's filings are available on its website at CIRCOR.com. Actual results could differ materially from those anticipated or implied by today's remarks. Any forward-looking statements only represent the Company's views as of today, May 2, 2013. While CIRCOR may choose to update these forward-looking statements at a later date, the Company specifically disclaims any duty to do so.

On today's call, management will often refer to adjusted operating income, adjusted operating margins, adjusted EPS and free cash flow. These metrics exclude any pre-tax special charges, repositioning inventory reserves, intangible impairments, as well as historical asbestos and bankruptcy charges related to the company's Leslie Controls subsidiary.

The reconciliation of CIRCOR's non-GAAP adjusted operating income, adjusted net income, adjusted EPS and free cash flow to the comparable GAAP measures are available in the financial tables of the earnings press release on CIRCOR's website.

I will now turn the call over to Mr. Buckhout.

Scott Buckhout:

Thank you Dennis and hello everyone.

It's my pleasure to be here today as CIRCOR's President and CEO. I'd like to take this opportunity to briefly introduce myself and to share with you my excitement about joining the CIRCOR team and the opportunities that lie ahead.

Most recently, I served as President of United Technologies' $7B Fire and Security division. Fire and security sold highly engineered products and systems into many of the same markets as CIRCOR: oil & gas and power generation to name a couple. Before that, I served in other roles at UTC, including President of the Global Fire Products business and President of the Systems and Firefighting business based in Europe. I also spent six years at Honeywell running their Friction Materials Americas business and their Friction Materials & Consumer Products businesses in Europe.

In my new role as CEO of CIRCOR, I will be focused on driving earnings per share and cash flow by delivering results in three areas: margin expansion, growth - both organic and through acquisitions - and improved working capital. I would like to share some of my initial thoughts and impressions after three weeks on the ground. But before I do that lets turn the call over to Fred to discuss our Q1 results.

Fred Burditt:

Thanks Scott and good morning everyone.

Please go to slide 3 and I will touch on the consolidated results, then give you more color by segment and markets.

We had a solid start to the year achieving both revenue and adjusted EPS at the high end of our guidance. Revenue for the first quarter was $205.4 million. As expected, this was down 4% from Q1 of 2012 primarily due to softer short-cycle energy volume, which declined in line with the North American reduction in rig count and large international projects where some shipments shifted to the second quarter. Backlog of $457.3 million was up 6% year over year and 2% sequentially from the fourth quarter. Adjusted operating income was $14.5 million, up 6% from the first quarter of last year and AOI margins expanded to 7.1% compared with 6.4% in the same quarter last year.

Net income for the quarter was $7.9 million, or $0.45 per diluted share, compared with net income of $8.6 million, or $0.49 per diluted share, for the same quarter last year. Excluding repositioning charges, we achieved adjusted EPS of $0.52 for the quarter, an increase of 6% from the first quarter of 2012.

Please turn to slide 4 for our Q1 Repositioning Related Charges which are associated with the activities in Brazil, California and India. These actions include consolidating facilities, shifting expenses to lower cost regions and exiting certain non-strategic product lines.

During the quarter we incurred $1.6 million in repositioning charges, which was primarily cash. On a year over year basis these projects have already contributed approximately $1.0 million of savings, primarily from Brazil. We expect to realize annualized savings of approximately $7 million from these actions in the second half of 2013.

Now I'll turn to segment performance, beginning with Energy on slide 5.

Energy bookings were down 19% year over year as a result of lower North American short-cycle orders and large international projects. North American short-cycle business was negatively impacted by the 10% year over year rig count reduction. In addition, last year's first quarter had unusually high bookings. International project quoting remains healthy; however, actual releases of contracts were pushed out. We do anticipate though that Q2 will be stronger, which has been confirmed so far in the first month of the quarter. In Brazil, we received our first large oil and gas valve order since entering that market a couple of years ago. Ending Energy backlog of $217.8 million was up 12% year over year, primarily due to higher order levels within our large international projects business, especially in the Middle East.

Energy revenues of $96.7 million for Q1 decreased 11% year over year due to factors I mentioned earlier. In addition unfavorable foreign currency fluctuations reduced revenues by 1%.

The segment's adjusted operating margin was 11.1%, up from 8.2% in the first quarter of 2012. This increase was primarily driven by improved large international project pricing, partially offset by lower volume and associated leverage.

Now, let’s move to slide 6 and Flow Technologies.

Year over year Segment bookings were up 2%, primarily driven by sampling and instrumentation orders, partially offset by lower HVAC orders. Revenue came in at $71.4 million, up 7% year over year – from higher power generation, instrumentation and sampling demand, partially offset by 1% unfavorable foreign currency fluctuations.

Flow's first-quarter adjusted operating margins were strong at 12.7% and up from 11.3% last year, primarily due to higher volume and associated leverage.

Now Aerospace on slide 7.

Bookings were up 5% year over year due primarily to higher landing gear orders led by A330. Ending backlog of $162.7 million was up 1% year-over-year.

Revenues of $37.3 million were down 2% from the prior year, primarily due to a decline in landing gear shipments associated with the exit of the unprofitable overhaul product line as part of the repositioning actions.

Aerospace margins in Q1 were 3.5% compared with 10.8% in Q1 2012 and 3.5% in Q4 2012. Year-over-year margins were affected by approximately 500 bps as a result of development and start up expenses on new programs including the A350, A330 and Blackhawk. In addition, we had unfavorable mix related to a favorable engineering project from last year. We anticipate margin improvement on

Blackhawk and A330 during the second half of this year as they reach full production and we will get the full benefit of the repositioning.

The Aerospace business is a major focus of our margin improvement initiatives. We are consolidating two of our California landing-gear facilities and exiting some small non-strategic product lines.

Slide 8 includes highlights from our consolidated P&L.

Corporate, general and administrative expenses for the first quarter of 2013 were $6.6 million compared with $6.9 million for the same period in 2012.

The tax rate was 31.2%, lower than our anticipated 36% rate due a shift of Brazil repositioning expenses from Q1 to Q2. The adjusted effective tax rate in the quarter without repositioning charges was 30.3%, slightly lower than our anticipated rate of 31%.

Looking ahead, we anticipate our second-quarter tax rate to be approximately 31%. Excluding repositioning charges, the rate is anticipated to be approximately 29.5%. For the full year 2013 we expect our tax rate to be approximately 31%. Excluding repositioning charges, the full year tax rate is anticipated to be approximately 31%.

Now turning to Slide 9. During the first quarter, we generated a positive $1.1 million in free cash flow, $8.2 million more than the first quarter of 2012, primarily due to improved working capital.

Now, let me give you with an update on the markets we serve. Please turn to slide 10.

Let's start with oil & gas markets that impact our Energy segment, as well as more than 25% of the Flow segment.

We continue to see rig counts essentially flat for Q2 in North America however this is still at good levels. We are cautious, but currently believe rig counts may improve in the second half of the year. We're continuing to see inventory consolidation in the distribution channel.

To minimize the impact of reduced rig counts, we continue to expand our relationships with international distribution outlets, especially in the oil and gas hot spots of the Middle East, South East Asia and Brazil.

At our large international projects business, we're seeing strong offshore project activity. The oil price environment is providing support for a wave of new offshore projects and quote activity in the Middle East is improving. There is some delay, however, in project finalization but we do expect Q2 to improve.

Our pipeline business, which is primarily driven by capital spending, is up in North America with international markets flat. There is an increased opportunity in pipeline integrity due to aging infrastructure and spills, particularly in North America.

Now let's move on to Flow Technologies, which also derives a significant amount of revenue from energy-related markets. Flow Technologies accounts for about 35% of our business and serves oil & gas, power generation, process and other markets. I'll focus my remarks on the oil & gas and power generation markets. The commentary on our smaller end markets can be found on slide 10.

In the oil and gas market, off-shore platforms continue to provide good growth opportunities, especially internationally. We plan to grow share in this market through our ability to deliver products with exotic materials and with short lead-times.

The long-term outlook for the power generation market is positive and is a key target market for us. New construction in emerging markets presents CIRCOR with excellent near-term and long-term growth potential.

While the power generation market in India still remains somewhat slow, we expect policy actions in 2013 to drive growth. Although growth in China has also slowed, the region is still investing heavily in large power projects. In Europe, new power investments are primarily coming from Russia and Eastern Europe. We are also participating, on an increasing basis, in the MRO business in North America with significant growth opportunities for both efficiency upgrades and for the conversion to natural gas power plants.

Finally, let’s move to our Aerospace segment, which makes up about 17% of our overall business and primarily serves the commercial and military aerospace end markets.

On the commercial side, production from OEMs such as Boeing and Airbus continues to be strong and commercial traffic is up.   On the flip side, commercial aftermarket orders are soft due to maintenance deferrals and aircraft cannibalization. The business jet market remains flat.

On the military side, there continues to be uncertainty related to defense budgets, however our business is well positioned through 2013 as the Blackhawk program ramp up offsets weakness in military spares.

And now for our guidance for the second quarter of 2013… We expect revenues to be in the range of $214 to $220 million. During the second quarter, we expect to incur pre-tax repositioning related charges of between $4.2 and $4.8 million. Excluding those charges, we anticipate adjusted earnings to be in the range of $0.64 to $0.70 per diluted share.

This guidance assumes that exchange rates remain at present levels.

I'll now turn it back over to Scott for some final thoughts.

Scott:

Thank you, Fred.

I'd like to close out the call by discussing what appealed to me about CIRCOR before I joined the company, and what I now see as some of the key opportunities going forward.

The principal reason I was attracted to the Company is its significant earnings growth potential. To reach this potential, we are going to capitalize on several key strengths.

First, we have a broad range of premier brands in the energy and aerospace markets around the world.

Second, we have a diverse product line of highly engineered products. Many of our product lines have leading positions in their respective niche markets.

Third, we sell into strong end markets with good long-term growth potential: energy - both oil & gas and power generation - and aerospace. In addition, we have an early presence in several important emerging markets, including India, China, and Brazil.

Finally, we have a strong continuous improvement culture, particularly in our factories.

Those key strengths attracted me to CIRCOR. Now that I've been here a few weeks, let me share my initial impressions of the Company.

Looking first at our top-line opportunities, we plan to place a higher priority on organic growth. As I mentioned, our products are a key strength of the Company, and there are certainly pockets of excellence in our new product development efforts across this Company. Having said that, I see an opportunity to improve the rigor and discipline around new product development and to become a more innovative, customer-focused company.

In addition, we also have the opportunity to enhance CIRCOR's marketing function and expand our presence in higher growth parts of our industry. Accelerating our organic growth through thoughtful go-to-market initiatives will be a high priority for us.

Acquisitions will remain an important component of our growth strategy. Going forward, we'll be re-focusing the organization on in-market acquisitions - businesses we already understand very well - where we can generate a double digit return on invested capital. We have a strong balance sheet and serve excellent end markets with many opportunities for consolidation.

Finally, one of the most striking observations after arriving at CIRCOR is the complexity of our business. As everyone knows, complexity drives cost. We have more than our share of complexity: we have a lot of P&Ls, factories, SKUs, suppliers and ERP systems to name some of the more apparent opportunities. We also have an opportunity to streamline our sourcing and supply chain organization, which is somewhat fragmented and managed locally in most parts of our business. Simplifying CIRCOR and aligning the business with our customers and channels will be a top priority for us. All of this won't be accomplished overnight, but we look forward to reporting our progress to you in the quarters ahead.

I'm excited about the strong foundation that is in place at CIRCOR, and even more so by the opportunities in front of us. With that, Fred, Wayne and I are available to take your questions.

After Q&A

Scott:

Thank you for your joining us this morning. I've enjoyed speaking with many of you already, and look forward to meeting many more of you in the coming weeks and months.   Thank you.