CIRCOR International, Inc.

Second-Quarter 2014 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to CIRCOR International's second-quarter 2014 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. David Calusdian from Sharon Merrill for opening remarks and introductions. Please go ahead, sir.

Thank you and good morning everyone. On the call today is Scott Buckhout, CIRCOR’s President and CEO, and Rajeev Bhalla, 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.

Please turn to Slide 2.

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 2013 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, August 1, 2014. 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 net income, adjusted EPS and free cash flow. These metrics exclude any pre-tax special charges and recoveries, restructuring inventory reserves and intangible impairments.

The reconciliation of CIRCOR's non-GAAP metrics 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 David and good morning everyone.

Our adjusted EPS in the quarter was strong at $0.91 per share, representing a 12% increase over last year. We increased operating margin by 70 basis points to 10.7%. This was primarily driven by restructuring, productivity, and cost control initiatives, which more than offset the margin impact of lower sales year-over-year. Sales came in at $208 million, lower than our expectations due to shipment delays in our upstream large project business and relatively low volumes out of our power businesses.

As a result of our bottom-line performance, we continue to generate strong free cash flow. During the first half of the year we generated $22 million of free cash flow, or 82% of net income.

With respect to restructuring, we now have completed the actions announced in 2013. In April, we announced that we are investing $7 million of savings from new restructuring actions into accelerating organic growth. We've completed approximately 50% of these restructuring actions including the closure of 2 of the 3 facilities.

As of today, we've opened two new international sales offices; one in Brazil and one in Malaysia. With respect to new products, we've started receiving orders for our new zero-leak turbine bypass valve for the power market and will begin shipping later this year.

Finally, during the second quarter we made the strategic decision to exit certain landing gear product lines. As part of this decision, we reached a mutual agreement with Sikorsky to exit the Blackhawk program. This will enable our Aerospace and Defense leadership team to focus on our profitable actuation and fluid controls businesses, where we have more intellectual property, higher margins, and more growth opportunities. Exiting these landing gear product lines will improve our margins and profitability going forward. Rajeev will provide more color on the impact of this decision in the quarter.

With that, I'll turn the call over to Rajeev. I'll come back later to provide more detail on recent order trends and our guidance for the third quarter.

Rajeev Bhalla:

Thank you Scott and good morning everyone.

Let's move right to the segment results starting with Energy on **Slide 4**.

Energy sales of $161 million for the second quarter decreased 7% over the prior year. This was primarily driven by lower shipments of upstream, large international projects. The decrease was partially offset by higher volumes in the upstream North American short-cycle business, and our downstream instrumentation and sampling business.

Energy's adjusted operating margin was up 130 basis points to 14.6% as the savings from our restructuring actions, productivity, and lower discretionary spend more than offset the impact on margins from lower volumes.

For the Aerospace & Defense segment, please turn to **Slide 5**.

Aerospace & Defense revenues decreased 6% from the prior year to $47 million primarily due to lower landing gear sales, partially offset by higher actuation product shipments in the US.

Aerospace & Defense adjusted operating margin decreased to 7.1% compared with 11.4% in the second quarter of last year primarily due to operational inefficiencies in our California business, offset in part by restructuring savings as well as improved productivity in our US defense business. We mentioned on last quarter's call that we expected the operational issues to continue to put downward pressure on margins through the third quarter of this year.

Turn to **Slide 6** for selected P/L items.

Our all-in tax rate for Q2 was 22.2%. Excluding the impact of special and restructuring charges, the comparable tax rate was 25.9%. We expect our third-quarter adjusted rate to be between 26% and 27%.

Q2 2014 adjusted earnings per diluted share were 91 cents. This is a 12% increase compared with 81 cents in the prior year.

Slide 7 shows the special adjustments that we recorded during the second quarter. These include special and restructuring charges of $1.3 million primarily related to actions announced earlier in 2014.

As a result of our decision to exit certain landing gear product lines, we recorded a backlog reduction of $28.6 million during the quarter and a $5.1 million Inventory Restructuring charge, both primarily related to the Blackhawk Program. We will complete the exit of these landing gear product lines by the end of this year.

For Q3, we anticipate special charges related to restructuring actions to be in the range of $1.6 million to $2 million.

Turning to our cash flow and debt position on **Slide 8**.

We continued to generate strong cash flow and ended the first half of the year with $22 million of free cash flow which is 82% of net income.

And finally, today we are announcing our new $400 million revolving credit facility that will support our future growth initiatives. This new facility expands our current borrowing capacity and locks in the favorable terms that exist in the current credit markets.

With that, I'll turn it back over to Scott to provide an update on our orders and guidance for the third quarter of 2014.

Scott:

Thank you, Rajeev.

Before I get into our guidance, let me start by providing an overview of our second-quarter order intake as well as current market trends.

Let's start with Energy where we compete in the up, mid and downstream oil and gas markets; as well as power generation. Most of our revenue is in the upstream market today. As a reminder, approximately half of our Energy revenue is project related, which can lead to significant variation in order intake and revenue from one quarter to the next.

For Q2, Energy bookings were $160 million, down 2% versus last year. The inherent lumpiness in our upstream project businesses did have an effect in the quarter with orders coming in below our previous four quarter average. However, overall quoting activity remains strong globally, our win rate for orders decided in the quarter hasn't changed, and pricing remains positive.

Turning to our upstream short-cycle businesses, as expected, we are seeing improving run rates in North America. This trend improved through the second quarter and has continued into July. We're also seeing good activity in downstream oil and gas, particularly petrochem, which resulted in a nice sequential increase in our instrumentation and sampling orders in Q2.

In our power business, quoting activity remains strong in emerging markets, but bookings are taking longer than anticipated. We remain bullish on this business in the medium-term but expect bookings to continue to be modest in the third quarter.

In Aerospace & Defense, orders were up 20% year-over-year to $44 million due to strong demand for actuation products in the US, and improving order intake in France for products sold into the A350 and KC390 programs. This was partially offset by the close out of the CH47 landing gear program.

That brings us to our guidance. As you may recall, we've been anticipating improved revenue in the second half of this year. Built into this expectation was that upstream short cycle in North America was going to pick up and that upstream large projects booked in Q4 last year would start shipping as scheduled in Q3 this year.

For our upstream short cycle business in North America, higher rig counts are driving the expected improvements in orders and revenue. In addition, downstream short cycle is expected to remain positive globally, driving solid growth in our instrumentation and sampling businesses.

With respect to our large project backlog, we have experienced unusual delays on three large North Sea projects. These delays are a direct result of customer driven design changes. Longer term, as you know, design changes tend to result in higher revenue and margins. But of course in the short term, design changes typically result in later delivery dates, which we are experiencing here in the third quarter. As a result of these changes, we expect our large project sales to be lower in the third quarter versus last year.

In Aerospace & Defense, we expect revenue to be more or less in line with last year, with lower landing gear sales offset by growth in our defense businesses.

Overall, we expect that third-quarter revenue will be in the range of $200 to $215 million.

Looking at the bottom line, we expect to report adjusted EPS in the range of $0.87 to $0.94. We expect Energy margins to be flat sequentially, with savings from restructuring and productivity, offsetting volume-related, lower margins in our large project business. We expect to see slightly higher margins in Aerospace & Defense sequentially as we continue to work through operational issues in California.

Overall I'm pleased with the traction we are getting on our margin expansion initiatives. I'm optimistic about the level of activity that we are seeing in our end markets and excited about the investments we are putting in place to accelerate growth at CIRCOR. As we continue to change CIRCOR's organization and culture, we remain focused on our top priorities: growth, margin expansion, and strong free cash flow.

With that, Rajeev and I are available to take your questions.

After Q&A

Scott:

Thank you for your joining us this morning. We’re looking forward to seeing many of you at our investor day on September 10 in New York, where we will discuss longer-term targets for CIRCOR.