CIRCOR International, Inc.

First-Quarter 2015 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to CIRCOR International's first-quarter 2015 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 Ms. Jamie Bernard from Sharon Merrill for opening remarks and introductions. Please go ahead, Ms. Bernard.

Jamie Bernard: *Sharon Merrill*

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 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, April 28, 2015. 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 non-GAAP metrics exclude any pre-tax special charges and recoveries.

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 Jamie and good morning everyone.

CIRCOR today reported revenue of $166 million and adjusted earnings per share of 60 cents. On the top line, after adjusting for currencies, revenue from our international project businesses was up year-over-year, however; as expected, we saw a decline in our North American short-cycle business. Our Aerospace & Defense Group experienced lower sales driven in large part by the exit of our structural landing gear products last year.

From an orders perspective, we recorded strong bookings in our long-cycle international projects business, driven by new customers and an improving win rate in the Middle East. Large project strength, adjusting for currencies, more than offset the significant decline in upstream short-cycle orders in North America. Our Aerospace & Defense Group reported higher orders year-over-year due in large part to bookings for fluid control products on commercial platforms.

On our last call, we discussed the restructuring actions we're taking to mitigate the impact of market dynamics on our earnings, and to align our businesses with lower near-term demand. These actions are on track to be completed by the end of the second quarter, and we expect them to generate approximately $8 million of annualized savings. In addition, today, we are announcing further actions to generate an additional $5 million of annualized savings. These new actions are primarily volume-related and should be largely completed by the end of the second quarter.

Please turn to **Slide 4**. A couple of weeks ago we announced the acquisition of Schroedahl, a Germany-based, privately held manufacturer of safety and control valves. This acquisition is aligned with the capital deployment strategy that we presented at our Investor Day last September.

Schroedahl accelerates our penetration into the high-growth power generation market, including a strong presence in Asia. The company has strong engineering capability and an excellent reputation for severe service products. Schroedahl has a leading position in the niche market for auto-recirculation valves, which protect pumps against overheating, collapse, or destruction. This business carries sustainable high margins because of its differentiated technology, its reputation for consistent high-quality products, and its severe service applications where the cost of failure is extremely high. Strategically, Schroedahl fits nicely into CIRCOR, where we have the opportunity to leverage our global sales and operations footprint.

As we look at the financial metrics for this acquisition, we paid net consideration of 76 million Euros representing about 8 times 2014 EBITDA. The return on invested capital exceeds our cost of capital in the first year. In addition, Schroedahl is expected to be EPS accretive in year one. We funded the deal with existing international cash and about $20 million of debt. We are excited to welcome the Schroedahl team to CIRCOR.

During the quarter, we initiated our $75 million share repurchase program. To date, we have purchased 648,000 shares for about $36 million. As we initially communicated, we expect to complete the full program this year.

I should note that with the share repurchase program and the acquisition of Schroedahl, our leverage ratio is expected to be less than one.

Our simplification plan and operational excellence initiatives remain on track. We are making progress on many fronts, including customer on-time delivery, supplier delivery and quality, material savings, and factory productivity.

In line with our focus in these areas, we are excited to welcome our new Vice President of Global Operations, Jay Lapointe. Jay has a wealth of experience in operations and comes to us from DRS Technologies, where he was responsible for their global operations. Prior to DRS, Jay was a senior operations leader at United Technologies. In his role at CIRCOR, Jay will be responsible for our operational excellence initiatives, including everything from production planning through product delivery.

Jay’s near-term priorities are to drive on-time delivery across CIRCOR, improve productivity in Aerospace and Defense, and accelerate our simplification plan through the market downturn in Energy. From there, he’ll be driving continuous improvement through the expansion of the CIRCOR Business System across our global operations network.

After Rajeev discusses our Q1 financial results, I’ll provide more context to our expectations with a review of our markets.

Now, I’ll turn the call over to Rajeev.

Rajeev Bhalla:

Thanks Scott. Before I get into the Energy results, you will note that we have excluded last year’s divestitures in our year-over-year comparisons for both segments.

Starting with Energy on **Slide 5**.

Energy sales of $128 million decreased 16% over the prior year and 9% organically. This was primarily due to lower sales in our short cycle, North American, distributed valves business, offset in part by higher sales in our large project businesses.

Energy's adjusted operating margin decreased 110 basis points to 13.8% as a result of lower volumes, currency headwind and pricing pressure. Restructuring savings helped mitigate the bottom line impact.

For Aerospace & Defense, please turn to **Slide 6**.

Aerospace & Defense sales of $38 million decreased 17% over the prior year and 11% organically. This was primarily due to the exit of the structural landing gear product lines and the completion of certain UK Navy projects last year.

Aerospace & Defense adjusted operating margin of 8.0% was down 150 basis points year-over-year due in large part to unfavorable mix from the UK Navy and the loss of the CH47 program. This was partially offset by ongoing operational improvements including the exit of certain structural landing gear product lines. Operationally we are making good progress in Aerospace and Defense as our adjusted operating margins improved sequentially by 300 basis points.

Turn to **Slide 7** for selected P/L items.

Our tax rate for the first quarter was 25.4%. We expect our second quarter tax rate to be in the range of 28% to 29%.

Corporate expenses decreased by $1.1 million in Q1 as we continue our cost reduction efforts across CIRCOR.

In the quarter we recorded a $1.5 million charge for restructuring actions, a charge of $500 thousand related to the costs associated with the Schroedahl acquisition, and a charge of $400 thousand related to additional equity compensation for the retirement of a senior officer of the company. These charges were offset by a special gain of $1 million associated with the completion of the previously announced divestiture of Cambridge Fluid Systems.

Adjusted earnings per diluted share were 60 cents compared with 79 cents in the prior year, primarily as a result of lower volume and currency headwinds.

Turning to our cash flow and debt position on **Slide 8**. During the first quarter, we used $18.4 million in free cash flow. Our net working capital build drove a significant portion of the cash outflow especially on the inventory side. The increase in inventory was due, in part, to the faster-than-expected decline in the distributed valves business in the quarter as well as the impact of the strike at the Port of Los Angeles. Much of our distributed valves product comes from our factory in China and enters the US through LA. We expect our inventory situation to normalize in the second quarter.

During the quarter, we spent $16.7 million under our share repurchase program. That equates to about 302,000 shares. Given the timing and amount of the buy back, there was no impact to our Q1 EPS.

That brings us to our guidance. Given the number of moving pieces, let me provide you with a baseline for comparison purposes shown on **Slide 9**. For the second quarter of 2014, the divested businesses generated $13.5 million of sales and 3 cents of EPS. In addition, if you take the current exchange rates, especially for the Euro, the year-over-year impact is a headwind of about $15 million on the top line and 9 cents of EPS. So, adjusting for the divestitures and currency headwind, Q2 2014 would reflect revenues of $178.9 million and adjusted EPS of 79 cents.

Slide 10 summarizes the annualized impact of restructuring actions as well as the savings in 2015 of $10 million. For Q2, we anticipate special charges relating to restructuring actions to be in the range of $3.1 million to $3.4 million, or 13 to 14 cents per share including the actions we announced today.

Now for the second quarter of 2015, please turn to **Slide 11**. We expect revenue to be in the range of $145 million to $160 million, primarily due to lower volumes from our upstream short cycle businesses in North America. We expect adjusted EPS in the range of 45 to 55 cents reflecting the earnings impact from lower revenue and pricing pressure offset in part by savings from restructuring and productivity. This guidance includes revenue of approximately $6 million and adjusted EPS of 8 cents from the Schroedahl acquisition. The adjusted EPS does not include amortization related to acquired intangible assets as that will be treated as a special charge in our reported results. Going forward, we will not break out Schroedahl from our guidance.

With that, let me turn it back over to Scott.

Scott:

Thank you, Rajeev.

Let me start by providing an overview of our first-quarter order intake as well as current market trends.

Let's start with Energy.

As a reminder, about 37% of our consolidated revenue was in the upstream oil and gas segment last year. This includes most of our distributed valve and international projects businesses, as well as part of our instrumentation and sampling business.

In our short-cycle distributed valves business, we expect continued pressure as a result of the significant drop in

North American rig counts since the beginning of December. As we look at the remainder of the year, we're expecting this business to be down 40 to 50% year-over-year, in line with market expectations. This includes lower end-customer demand as well as distributor de-stocking. In addition to the volume related impact on earnings, not surprisingly, we are seeing price pressure as customers attempt to take advantage of excess capacity in the market.

Within our long-cycle project businesses, we saw strong order intake in Q1 that should translate into a sequential increase in revenue towards the end of this year. We're seeing strength in the Middle East, especially for gas projects; and decent activity in engineered projects in North America for LNG and downstream Oil and Gas. Asia Pacific is weak as a result of capex reductions and project delays.

Looking at Instrumentation and Sampling, we see good activity in the downstream market for sampling products in North America, while upstream oil and gas markets continue to be weak, especially offshore.

In power, we continue to see good activity in Asia and the combined cycle segment of the North American market. Other markets are weak. We expect our Schroedahl acquisition to be a positive contributor to our future growth in this market since it has a stronger foothold in Asia than our legacy businesses.

In Aerospace and Defense, we see growth from increasing production rates on commercial platforms, certain military fixed wing platforms, like the Joint Strike Fighter, and in missile production. However, we do not expect this growth to offset the headwind from the exit of structural landing gear product lines.

Let me sum up by leaving you with three important points.

First, given the downturn in our upstream Oil & Gas end markets, we are focused on those things that we control. We’re managing our cost base and executing on our operational excellence and simplification initiatives. Our restructuring actions are on track, and we will be implementing further cost-reduction actions, as necessary. The top priority is to take advantage of the downturn to remove as much structural cost as possible so that when the cycle inevitably turns up, we emerge as a leaner company with better operational performance and margins.

Second, even as we focus on managing costs, we continue to carefully invest in growth. We are investing in areas where we see relatively short horizons to generate results. We've moderated, without stopping, some of our longer-term investments to align with market activity. Our growth investments are primarily focused on building out our commercial team in high impact areas, developing new products, and making CIRCOR easier to do business with.

We plan to continue to leverage our strong balance sheet to capitalize on attractive M&A opportunities, as we did with Schroedahl. We remain active in the market.

Third, we're starting to turn the corner operationally in our Aerospace and Defense business. During the past few quarters, all the work we've done to improve our operations is starting to show up in our results. As Rajeev discussed, we've gone from mid-single digit adjusted operating margins in the second half of last year, to an 8% margin in Q1. We expect to see ongoing operational improvements through the remainder of this year and we remain on track to exit the year with double digit margins.

And finally, regardless of the headwinds we're seeing in our markets, we remain focused on creating long-term shareholder value by investing in growth, expanding margins, generating strong free cash flow, and remaining disciplined with capital deployment.

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

After Q&A

Scott:

Thank you for your joining us this morning.