CIRCOR International, Inc.

Fourth-Quarter 2014 Conference Call Prepared Remarks

Operator:

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

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, February 18, 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 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 Jamie and good morning everyone.

We ended the year by growing the fourth quarter top line by 6% organically, and delivering adjusted EPS of $1.08, up 14%. On the top line, we saw growth in most of our Energy segments. Our fourth quarter adjusted operating margin came in at 9.6%. We dealt with a difficult situation in Brazil, resulting from the impact of the Brazilian government's on-going corruption investigation at Petrobras. Two of our larger Brazilian engineering and construction customers filed for bankruptcy, resulting in a charge for overdue receivables of $6.5 million -- a 300 basis point margin impact in the quarter. Adjusting for this charge, CIRCOR's operating margin would have been 12.6%, a 100 basis point increase over the prior year's fourth quarter. This charge also reduced Adjusted EPS by approximately 34 cents in the quarter. Rajeev will provide more detail on the drivers of our GAAP and adjusted numbers in just a few minutes.

For the full year, revenues were $841 million down slightly versus prior year, with adjusted operating margin at 10.2%, up 30 basis points. Adjusted EPS grew 16% to $3.72 and full year free cash flow was 115% of net income.

As we've previously discussed, two of the pillars in our strategy include: positioning CIRCOR in markets that offer the best opportunities for growth, and simplifying the Company to remove complexity and cost. In line with this strategy, at the end of last year, we divested two businesses: Sagebrush Pipeline Equipment Company, from our Energy Group, and Cambridge Fluid Systems, from our Aerospace & Defense group. Neither business fit our strategy of playing in attractive markets with differentiated products. The divestitures will simplify CIRCOR, and allow us to focus on areas of the business that offer the most growth, and margin opportunity going forward.

Now, I'd like to take a few minutes to discuss our Energy end markets, given the dramatic drop in oil prices during the past few months.

As background, about 37% of our consolidated revenue is in the upstream oil and gas segment. 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 valve business, bookings were up double digits in the fourth quarter; however, we started to see quoting activity and orders decline as we entered 2015. A significant portion of this business is tied to North American rig counts, which have dropped by about 30% since the beginning of December. Consistent with what we experienced in past down-cycles, we expect to see a revenue impact from lower end-customer demand, and distributor de-stocking.

With our long-cycle project business, we expect orders to be affected by lower global capex spending, which is anticipated to be down approximately 20% in 2015. Depending on our first quarter order intake, there could be a drag on our revenue in the back half of this year, after we ship our current backlog.

While we expect revenue from our upstream oil and gas businesses to be negatively impacted by oil prices, we anticipate differing levels of growth in the other 63% of our portfolio.

For the large projects business, some regions are more sensitive to oil prices than others. We are seeing good quoting activity for upstream projects in Asia and midstream projects in the Middle East, where schedules are currently staying on track. We continue to see good quoting activity for LNG projects. Power generation in Asia is showing strength. In North America, our sales team is spending a larger share of its time developing mid and down-stream opportunities, where market trends are more favorable.

In Aerospace and Defense we see increased production rates on both commercial and military fixed wing platforms. However, we don’t expect this growth to offset the headwind from the exit of the structural landing gear product lines last year.

Given the expected headwinds we are facing from the oil price decline, weakness in Europe, and turmoil in Brazil, we are implementing a broad-based cost-reduction program. This program will include restructuring actions to mitigate the impact of market dynamics on our earnings, and to align our businesses with lower near-term demand. Accordingly, earlier this quarter, we started taking actions expected to generate approximately $8 million of annualized savings. We expect to complete these actions before the end of the second quarter.

In addition to our restructuring actions, we will continue to implement our simplification strategy and operational excellence initiatives. We are making progress on many fronts, including customer on-time delivery, supplier delivery and quality, material savings, and factory productivity.

Before I turn the call over to Rajeev, I'd like to note that we're excited to welcome a new Group President for CIRCOR Energy. Erik Wiik was formerly the Executive Vice President and Regional President of Aker Solutions North America. During Erik's 24 years at the company, he demonstrated a strong commercial orientation, consistently driving organic growth across multiple product platforms. Erik will join us on March 5th and we look forward to his contributions during this important time for our Energy Group.

I'd also like to take a moment to thank Wayne Robbins for his nine years of dedicated service to CIRCOR, and wish him well in his retirement. Wayne's industry knowledge and business advice were invaluable to me as I transitioned into CIRCOR in 2013. We all appreciate his many contributions.

With that, I'll turn the call over to Rajeev.

Rajeev Bhalla:

Thanks Scott. Let's move right to the segment results starting with Energy on **Slide 5**.

Energy sales of $172 million increased 6% over the prior year, or 10% organically. This was primarily driven by double digit growth in our North American, short-cycle businesses and high single digit growth in our large international projects business. Foreign exchange reduced revenues by about $7 million in the quarter.

Energy's adjusted operating margin decreased 280 basis points to 14.3% primarily due to the $6.5 million charge associated with the financially troubled Brazilian engineering and construction customers. Absent this adjustment, Energy's adjusted operating margin would have been 18%, up 90 basis points over the prior year, driven in large part by better pricing and the benefits from restructuring and productivity actions taken earlier in the year.

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

Aerospace & Defense revenues decreased 10%, or 7% organically, from the prior year to $46 million. This was primarily due to lower sales as we exited the structural landing gear product lines, partially offset by higher volume from our UK navy business.

Aerospace & Defense adjusted operating margin of 5.3% was in line with the expectations we outlined on our third quarter call, and was 310 basis points lower than Q4 last year as we continue to manage the operational challenges in our California and French businesses. The savings from our restructuring actions helped mitigate the costs associated with the exit of the structural landing gear product lines. We expect margins to improve as we put these issues behind us.

The impact from foreign currency was less than $2 million on the top line and not significant on the bottom line.

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

Let me discuss the tax rate for a moment. During the year, we have been working to make operational changes to help increase our foreign source income and utilize foreign tax credits that had accumulated on our balance sheet. We were successful in the fourth quarter, resulting in a net benefit to our tax rate and a benefit to EPS of 21 cents. This benefit took our all in tax rate to negative 8.2% for the quarter and 20% for the full year. We have utilized all of our existing foreign tax credits in the quarter. Further tax rate reductions would require that we generate new foreign tax credits in the future. So as a result, our first quarter 2015 tax rate is expected to be in the range of 26% to 27%.

Corporate expenses were $1.4 million lower due in large part to lower compensation costs as well as cost control actions.

In the quarter we took $12.9 million of special and impairment charges including restructuring charges of $2.6 million, a loss on divestitures of $4.1 million and a legal settlement of $6.2 million.

For Q1, we anticipate special charges related to restructuring actions, to be in the range of $3.0 million to $3.3 million, or 12 to 14 cents per share.

Adjusted earnings per diluted share were a dollar eight compared with 95 cents in the prior year. If you further adjust for the two significant items – the Brazilian accounts receivable adjustment and the foreign tax credit benefit, our Q4 2014 adjusted EPS would have been 13 cents higher at $1.21 which is 27% higher than the prior year, reflecting the strong operational performance from our Energy segment.

Turning to our cash flow and debt position on **Slide _8_**. During the fourth quarter we generated $22.3 million in free cash flow, which brings us to $58 million for full year 2014, or 115% of net income.

In December our Board of Directors authorized a share repurchase program of up to $75 million of outstanding common stock. Depending on market conditions, we will initiate the buyback when permitted under SEC rules and expect to complete the program this year.

That brings us to our guidance. Given a number of moving pieces, let me provide you with a baseline for comparison purposes shown on Slide 9. For the first quarter of 2014, the divested businesses generated $13 million of revenue and breakeven operating profit. In addition, if you take the current exchange rates, especially for the Euro, the year-over-year impact on the top line is an additional $12 million or 10 cents per share of headwind. So on a pro forma basis, Q1 2014 would reflect revenues of $186.2 million and adjusted EPS of 68 cents per share.

Now for the first quarter of 2015, we expect revenue to be in the range of $155 to $170 million, reflecting the impact on our short cycle businesses of the current market conditions we discussed earlier. We expect adjusted EPS in the range of 60 to 70 cents reflecting the earnings impact from lower revenue offset by margin expansion from simplification and productivity.

With that, I'll turn it back over to Scott for a summary.

Scott:

Thank you, Rajeev.

Let me sum up by leaving you with a few key thoughts.

First, as we proceed into 2015 during a time of high volatility in some of our Energy end markets, we are focused on those things that we control. We're focused on managing our cost base and executing on our operational excellence and simplification initiatives. We expect that these efforts, which are transforming CIRCOR from a holding company to a world-class operating company, will yield better-than-peer organic growth and further margin expansion, both now and when we come out of the cycle.

Second, we are managing the business for the long term. We will continue to invest in organic growth initiatives throughout the cycle. We remain committed to the go-to-market initiatives launched last year, including regional expansion and making CIRCOR "easier to do business with".

In addition, we will continue to invest in new product development in line with our long term strategy.

Our strong balance sheet and available financing facility could allow us to capitalize on attractive M&A opportunities in this market as well. The senior leadership team is spending more time exploring potential M&A opportunities.

Overall, we will be striving to outperform our peers, and effectively manage the business through the cycle. We view the current downturn as an opportunity to structurally address our cost profile, and take share from our competitors. We fully expect to exit the cycle as a more competitive and better positioned company.

And finally, we have a strong and experienced team that is committed to delivering on our objectives regardless of where we are in the cycle. We remain focused on creating shareholder value through growth, margin expansion, strong cash flow and disciplined 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.