CIRCOR International, Inc.

Fourth-Quarter 2013 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to CIRCOR International's fourth-quarter and full year 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, 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, February 27, 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, restructuring inventory reserves and intangible impairments.

The reconciliation of CIRCOR's non-GAAP adjusted operating income, adjusted operating margins, 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 good morning everyone.

We closed 2013 with solid order intake and strong bottom-line performance. Orders for CIRCOR overall were up 14%. The backlog ended the year at $463 million, up 3% from a year ago. We reported a 6% increase in revenue compared with Q4 2012. While revenue at $214 million came in below our expectations, margins were strong, helping us deliver adjusted EPS of $0.95.

We posted adjusted operating income at 11.6%, an increase of 380 basis points over last year. Our focus on growth, coupled with strong margin expansion, resulted in free cash flow of nearly $15 million in the quarter. For the year, our free cash flow to net income ratio was 116%.

During the fourth quarter we announced our plan to change CIRCOR's organizational structure to simplify the way we manage the company and better align our businesses with end markets. As part of the organizational change, we consolidated our group structure from three groups to two. Operating as two segments should enable us to accelerate organic growth, further expand margins, and more effectively deploy capital. We completed this realignment in Q4, and we now operate as CIRCOR Energy and CIRCOR Aerospace & Defense. This reorganization has reduced our annual expenses by approximately $5.0 million. The other three restructuring actions announced in the first half of 2013 are either complete or on schedule for completion in early 2014.

As we’ve discussed in the past, a key driver of our margin expansion efforts is our ongoing simplification process. We continue to see cost reduction opportunities from simplifying the organization. We operate with significant complexity at CIRCOR. We will continue to reduce rooftops, P&Ls, IT systems, backoffice organizations, and suppliers.

In addition to simplification, we’re focused on driving operational excellence at CIRCOR. Part of that effort is to create a Global Sourcing and a Global Operations organization. I am pleased to report that we have had a global sourcing leader in place at CIRCOR for several months now, and we are in the process of realigning the organization. We source a significant amount of material from high cost parts of the world, including locally near our 20 manufacturing locations. Much of this spend will be consolidated into fewer suppliers in lower cost parts of the world. We are currently recruiting for a head of operations at CIRCOR. This leader will accelerate improvements in delivery, quality, cost, safety, and inventory performance across all of our businesses. We are expanding the CIRCOR business system to drive sustainable results in all these areas. We are focused on building a more robust system that reaches well beyond the four walls of our existing manufacturing facilities. This program will include strong leadership at the top of CIRCOR, more effective training and standardization across the organization, robust processes and metrics, and clear lines of accountability. Achieving operational excellence will be one of the main driving forces behind our future growth, margin expansion, and improved working capital.

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

Rajeev Bhalla:

Thank you Scott and good morning everyone.

We've reviewed the overall results so let's move right to the segments starting with Energy on **Slide 5**.

Energy revenues of $163 million for the fourth quarter increased 4% year over year. This was driven by our international projects business, especially in the upstream Oil & Gas market with particular strength in support of offshore production. In addition, we saw moderate growth in our global downstream markets. On the other hand, we experienced lower sales from our distributed valves business and from our Brazil operation.

Energy's adjusted operating margin was a very strong 17.1%, up from 11.9% in the fourth quarter last year, driven in large part by pricing in our large international projects business as well as restructuring and productivity benefits. As a reminder, the orders we booked during 2012 had favorable pricing and product mix. We saw that favorable impact coming through the fourth quarter results. However, due to the competitive pricing environment in 2013, coupled with lower order volume, we do not expect a repeat of these favorable Q4 margins in the first half of this year. But, based on our current backlog, we do expect higher volume and improved margins in the second half of this year.

For the Aerospace & Defense segment, please turn to Slide 6.

Aerospace and Defense revenues of $51 million were up 13% from the prior year largely driven by strength in our defense OEM programs.

Aerospace & Defense adjusted operating margin in Q4 was 8.4% compared with 5.1% in the fourth quarter last year. As we take a look at this fourth quarter performance, we did see a deterioration in margin sequentially. Some of you may recall that we have been working through start-up issues after the factory consolidations and in launching our new landing gear programs. A number of these issues continued to impact our operations in Q4. This was exacerbated by a fire at a critical sole source supplier that burned their factory to the ground. As we worked through the recovery plan and qualified a new supplier, we saw incremental costs. While we anticipate some ongoing headwind in the near term, we expect margins to improve as we look ahead.

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

Our all-in tax rate for Q4 was 20.7%. Excluding the impact of restructuring and impairment charges, the comparable tax rate was 29.5%, in line with our expectations. We anticipate our first-quarter tax rate to be approximately 29%.

Q4 2013 adjusted earnings per diluted share was 95 cents, excluding the impact of restructuring, impairment and special charges. This is a 38% increase compared with the 69 cents in the prior year.

Slide 8 shows the adjustments we recorded during the fourth quarter for a non-cash intangible impairment of $6.9 million and a $5.8 million charge related to our restructuring actions. For Q1, we anticipate charges related to restructuring actions to be in the range of $1.5 million to $1.7 million. The anticipated annualized savings of the actions announced in 2013 will be approximately $9 million with a full run-rate beginning in the second half of this year.

Turning to our cash flow and debt position on **Slide 9**, during the fourth quarter, we generated a positive $14.7 million in free cash flow, which brings us to $54.9 million for 2013, or 116% of net income.

For the full year 2013, revenues were up 1%, adjusted operating margin increased 210 basis points to 9.9%, and adjusted EPS grew 25% to $3.21.

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

Scott:

Thank you, Rajeev.

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

Let's start with Energy. As a reminder, we compete in the upstream, midstream and downstream oil and gas markets as well as power generation. Most of our revenue is in the upstream market today. Incoming orders were $187 million in the quarter, up 20% year-over-year. In our large project business, we received a record number of orders for offshore production facilities in the North Sea. We expect these orders to begin to ship in the back half of 2014 and early 2015. We anticipate ongoing order strength in this part of our business. On the other hand, market demand remains rather soft in our North American distributed valves business due to rig count levels and destocking at distributors, in some cases resulting from consolidation of our distribution channel. We are optimistic that orders will pick up in the second half of this year due to strength in unconventional drilling and moderation of destocking activities in our customer base. Our instrumentation business continues to experience strong orders from international upstream projects in Australia and the North Sea. In our downstream markets, while we are experiencing some softness in Europe, we are seeing moderate growth globally. We also have experienced recent success in further penetrating the downstream markets in China. Finally, regarding power generation, we are experiencing a significant increase in quote activity globally.

In Aerospace & Defense, orders were down 4% year-over-year to $44 million as we booked relatively high UK defense orders in Q4 2012. Going forward we expect to see low to moderate growth in our defense programs overall with particular strength in missile related platforms. On the commercial side, we expect to see moderate growth in fluid controls with softness in our landing gear business.

That brings us to our guidance. We expect that first-quarter revenue will be in the range of $200 to $210 million.

We expect to report adjusted EPS in the range of $0.68 to $0.73, which represents year-over-year growth of 31% to 40%.

Our focus in 2014 will continue to be on growth, margin expansion, and strong free cash flow.

Before we go to Q&A, let me remind you about our upcoming investor day on May 15 in New York City. Invitations will be sent out shortly for this event where we will discuss our longer-term targets for CIRCOR.

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

After Q&A

Scott:

Thank you for your joining us this morning.