CIRCOR International, Inc.

Fourth-Quarter 2015 Conference Call Prepared Remarks

Operator:

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

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, 10-Q 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 19, 2016. 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. Please turn to **Slide 3**.

Scott Buckhout:

Thank you David and good morning everyone.

CIRCOR concluded 2015 with solid fourth-quarter performance as we demonstrated continued progress on our margin expansion and simplification strategy. We delivered revenue of $165 million, and adjusted earnings per share of 63 cents, consistent with our guidance.

We delivered solid year-over-year organic sales growth in our large projects business, as well as our control valves business. This growth was more than offset by the continued decline in our short-cycle distributed valves business, as well as softness in the upstream portion of our Instrumentation and Sampling business.

Aerospace and Defense sales were down year-over-year, primarily due to a difficult comparison with prior year, when we completed a large UK navy program. In the fourth quarter, we saw an increase in orders for fluid control products out of our California business, primarily on military platforms.

We improved our free cash flow to $28 million, driven by better working capital performance. Working capital and cash flow continue to be a top priority for us.

Our restructuring and simplification actions delivered the expected $12 million of savings during 2015. This contributed to year-over-year consolidated margin expansion of 50 basis points, to 10.2% in the fourth quarter.

Our Energy team has done an excellent job of aligning our cost structure to the lower Energy market, ultimately delivering 13.4% margins in the quarter.

In Aerospace & Defense, our margin expansion initiatives led to double-digit margins of 10.4% in the fourth quarter, up 560 basis points year over year.

Our efforts to simplify CIRCOR, which began in 2013, are progressing well. As a result of the current economic climate, we've been accelerating our simplification initiatives and the rationalization of our operational footprint. Let me give you an update on the major restructuring actions we announced last year.

Production at our manufacturing operation in Brazil has essentially ceased, and we are in the process of winding down the business. This closure permanently removes a high cost, negative margin business from the CIRCOR footprint, and puts us another step closer to achieving our long-term margin targets.

In July 2015, we announced the closure of one of our two California manufacturing facilities as an important part of our effort to improve Aerospace & Defense margins. The plan is on track, and we expect to exit this facility by the end of the third quarter.

I'd like to provide you with an update on our progress against the targets we set at our investor day conference back in September 2014. At the end of 2015:

- We’ve reduced the number of manufacturing facilities from 24 to 18; the Brazil and California closures will put us at 16 by the end of the third quarter.
- We’ve reduced the number of suppliers by 34% to 3,300.
- We’ve increased the level of sourcing spend on long-term contracts with our suppliers from 8% to over 30%.
- We’ve also decreased the number of P&Ls from 22 to 16 and reduced the number of ERP systems from 24 to 18.

In addition, we’ve maintained a strong focus on growth. We continue to carefully invest in sales & marketing, new product development, and engineering, while we improve our operations. Our fourth quarter customer on-time-delivery was 90% compared with 73% in 2014.

So overall, we delivered strong results in a difficult market, while we significantly improved our operations.

After Rajeev discusses our Q4 financial results, I will discuss our outlook for 2016 with a review of our end markets.

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

Rajeev Bhalla:

Thanks Scott. As a reminder, we have excluded the 2014 divestitures in our year-over-year comparisons for both segments.

Let's start with Energy on **Slide 4.**

Energy sales of $124.4 million decreased 24% from the prior year. We delivered strong organic sales growth in our engineered valves business as well as the control valves business, especially into the power generation market. But that was more than offset by the continued and significant decline in our short-cycle distributed valves business. Short-cycle distributed valve sales declined 65% from the prior year and over 20% sequentially as North America rig count and well completions continue to decline. We also saw year over year softness in the upstream portion of our Instrumentation and Sampling business.

Our restructuring and cost-cutting initiatives helped to mitigate the impact on margins from lower volumes. We achieved an operating margin of 13.4% -- a 120 basis point year-over-year decrease. Our ability to deliver double-digit margins in the face of a 24% revenue decline highlights the strong actions taken to mitigate the volume-driven margin erosion.

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

Aerospace & Defense sales of $39.8 million decreased by 6% organically, in part due to a difficult comparison with 2014, when we completed a large UK Navy program. The decline was also due to push outs of deliveries for certain large military programs, most notably the F35.

Aerospace & Defense adjusted operating margin of 10.4% increased 560 basis points year-over-year, and 130 basis points sequentially, achieving our goal of exiting the year with a double-digit margin. This was primarily driven by ongoing operational improvements and the benefit of exiting the structural landing gear product lines.

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

We recorded Q4 special and restructuring charges of $4.5 million. This primarily consisted of $2.2 million of acquisition-related amortization expense and $2.1 million related to the exit of our manufacturing operations in Brazil. With the end of production in Brazil, the remaining shut-down costs are expected to be about $1 million in the first quarter and $500 thousand for the rest of the year.

Our tax rate for the fourth quarter was 25.6% -- much higher than the fourth quarter last year. You may recall that we recorded a benefit of 21 cents per share in the fourth quarter of 2014 when we utilized our foreign tax credits, resulting in a much lower tax rate. For the first quarter of 2016, we expect our tax rate to be in the range of 28% to 29%.

Adjusted earnings per diluted share was 63 cents, in line with our guidance, and lower than the prior year given the impact on our bottom line from the decline in volume.

Turning to our cash flow and debt position on **Slide 7**. During the fourth quarter, we generated $28.4 million in free cash flow, which brings us to $16.6 million for the full year 2015. The improved cash flow is a result of better working capital management and we expect this trend to continue in

2016. In Q4, we also completed our $75 million share repurchase program.

This brings us to our guidance. Please turn to **Slide 8**.

We expect revenue to be in the range of $135 million to $145 million, based on:

- the backlog in our large projects business;
- growth in our control valves business;
- a continued decline in our short cycle distributed valves business of approximately 60% year over year;
- And flat revenues in our Instrumentation and Sampling as well as Aerospace and Defense businesses.

We expect adjusted EPS in the range of 38 to 48 cents per share, reflecting the benefits from cost reductions, restructuring actions and productivity.

For Q1, we anticipate special charges to be in the range of $2.5 million to $3.0 million, or 10 to 15 cents per share.

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

Scott Buckhout:

Thank you, Rajeev.

Let's start with an overview of current market trends for Energy and Aerospace & Defense.

First, Energy.

Energy segment orders were lower overall in the fourth quarter, primarily driven by the weakness in our upstream, North American, short-cycle business; where market dynamics have not changed, and demand is down significantly year over year. Rig count continues to decline with total US rig count at about 540, or 60% below last year and 35% lower than the end of Q3. Distributed valve orders in Q4 were down approximately 65% versus last year. Distributors continue to reduce inventory or, in some cases, hold inventory at very low levels, while expecting us to carry the inventory instead. We've adapted our operations to this new reality and we believe we are gaining share in this market. We recently signed two new distributors in the US, displacing the competition. In addition, we are quoting a number of North American pipeline projects, a relatively new market for us. Over the last year, our Milan and Oklahoma City operations have been accepted onto the Approved Manufacturers' List for eight pipeline companies. The quotation activity has picked up within this segment, especially for our fully-welded ball valves used in natural gas pipelines.

Our long-cycle engineered valves business saw an increase in orders year over year and sequentially, largely driven by strength in the Middle East. We're seeing good activity in the US and Canada for LNG. Elsewhere in the market, we are seeing increasing market headwinds as we enter 2016. We see very little activity in Asia, Europe, and Latin America. We expect modest growth in the first half based on our backlog; with the second half of the year to be determined by current order intake. Overall, we're quoting more projects, but the average value of the projects is lower and the sales cycle is longer. Pricing pressure continues to be strong, but this is partially mitigated by lower costs for raw materials that we buy.

In our Instrumentation and Sampling business we're seeing decent quoting activity in downstream oil and gas, and in LNG. There is also good activity in the Middle East. Most of the business is coming from ongoing MRO and safety upgrades, as opposed to large capital projects. Order intake seems to have bottomed out in the middle of last year but has remained relatively stable since then. We expect orders in this business to be flat to slightly down in 2016, with some potential upside driven by a number of large projects in the pipeline.

In our Control Valves business, we are seeing a healthy pipeline of Power projects and good quotation activity in Asia and North America. In addition, the Schroedahl acquisition is opening up new opportunities for sales growth of Schroedahl products, and legacy CIRCOR products, as we expected.

Aerospace & Defense bookings were slightly lower than the prior year. As we enter 2016, we expect to see growth from most of the commercial OEM platforms, especially the A350 program, and the expansion of our MRO business. Overall, we expect Aerospace and Defense orders to be about flat in Q1, with order growth increasing to low single digits as the year unfolds.

Going forward, we are focused on supporting higher OEM production rates, driving new product development for both commercial and military platforms, and growing our MRO business.

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

First, we are reaping the benefits of our margin expansion initiatives across CIRCOR. We have been taking advantage of low volumes in our Energy business to drive simplification at a much faster pace than we initially anticipated. We will continue to be aggressive with cost take out at CIRCOR. We are in the planning phase on a number of structural initiatives that we expect to announce later this year.

Second, we continue to invest in growth: geographic expansion, sales & marketing, and new products. For example, we're investing in the Middle East, where we are expanding our presence to be closer to our customers. We're investing in new products for power generation and LNG as well as certain Aerospace and Defense markets. And we are taking advantage of our competitors' instability to hire their best sales leaders and engineers.

Third, we have an active M&A pipeline and we're currently exploring a number of proprietary opportunities for our Energy group. We are still in the early phases of building a pipeline on the Aerospace & Defense side.

So in summary, we are focused on what we control. We are effectively managing our business through the market downturn in Energy, while we build the foundation for long term value creation. We are investing in growth, expanding margins, generating strong free cash flow, and being disciplined with capital deployment.

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

After Q&A

Scott Buckhout: Thank you for your joining us this morning.