CIRCOR International, Inc.

Third-Quarter 2013 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to CIRCOR International's third-quarter 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, Wayne Robbins, President of CIRCOR's Energy Group, and Fred Burditt, 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.

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 2012 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, October 31, 2013. 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 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 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.

Overall I am pleased with the financial results the CIRCOR team produced in the quarter.

As you know, margin expansion is one of our top priorities. In Q3, we delivered our second consecutive double-digit adjusted operating margin. AOI was 11.1%, up 230 basis points from last year and 110 basis points sequentially. We saw significant improvements in both the Energy and the Aerospace groups. The main factors driving the improved margins were better pricing, mix, and productivity; as well as the recently completed restructuring that was announced last year.

Another top priority for us is cash flow. Our focus on working capital, along with strong earnings, helped us deliver free cash flow of nearly $30 million in the quarter. This was up over $10 million from the same period in 2012 and puts our year-to-date free cash flow to Net Income ratio at 105%. This is a ratio we monitor closely.

On the top-line, revenues grew 2% with increases in our Flow Technologies and Aerospace businesses, which offset a slight decline in Energy. The main highlight in the quarter from a commercial perspective was order intake in our Flow Technologies business, which was up 22% versus prior year to a record $79 million. I will discuss orders across all of CIRCOR in more detail later in the call.

During the third quarter we initiated the first major step of our ongoing simplification process at CIRCOR. This included the three restructuring actions we announced on our last call. These actions are intended to reduce complexity, expand margins, and better align our businesses with common end markets.

We are on schedule with this initiative and expect to complete these actions by Q1 of next year, at which time we will begin to realize the previously announced annualized cost savings of about $4 million.

Finally, we recently completed an update of our 5-year strategic plan. Based on that work, we are changing our organizational structure to simplify the way we manage CIRCOR and, further align our businesses with end markets. As part of the organizational change, we will consolidate our group structure from three groups to two. Initially, these changes are focused on reducing management layers and combining back-office operations. Our commercial organization will remain unchanged; but over time we will incrementally align our customer facing organization by end market, rather than the existing internally focused business unit alignment we have today.

The first new group will be ‘Energy,’ which will include all of the businesses from the existing Energy group and most of the current ‘Flow Technologies’ businesses. The primary markets served in the new Energy group are oil & gas: upstream, midstream and downstream; as well as the global power market.

The second group will be ‘Aerospace and Defense,’ which will include all of the current Aerospace group plus a few primarily defense-oriented businesses currently in the Flow Technologies group.

Wayne Robbins will transition from his role as Executive Vice President & COO to Executive Vice President and Group President of the new CIRCOR Energy group. Michael Dill, will remain as Group Vice President of the CIRCOR Aerospace and Defense Group.

We expect to complete this reorganization in the fourth quarter and anticipate an annual expense reduction of approximately $5.0 million.

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

Fred Burditt:

Thank you Scott and good morning everyone.

I will begin with slide 3 which is a summary of our consolidated results.

Scott already provided the high-level overview of our third-quarter results, a 230 basis point improvement in adjusted operating margin to 11.1%. In addition, adjusted operating income was up 28% year over year to $23.7 million.

Adjusted earnings per diluted share, excluding the impact of the special charges, was $0.93, a 22% increase compared with $0.76 in the prior year. And backlog of $446.9 million was up 1%.

Now please turn to slide 4 which provides an update on the restructuring-related charges associated with our 2012 programs that are now complete. The charges in Q3 which wrap up this program were $1.0 million. We expect this program will generate $7.0 million of annual savings with approximately $1.6 million occurring in Q3.

Slide 5 outlines the impact of the programs launched last quarter. We expect that the total charges relating to this restructuring will be in the range of $8.3 million to $9.1 million, with 20% being non-cash and 80% cash. About $1.4 million was recorded in Q3, and about $2.7 to $3.0 million is expected to be recorded in the current fourth quarter of 2013. The anticipated annualized savings will be in the range of $4 million beginning in the first quarter of 2014 with a full run-rate beginning in the second half of 2014.

As Scott reviewed we are announcing new organizational changes that will benefit CIRCOR annually by approximately $5.0 million. The costs to achieve this will be approximately $2.6 to $3.0 million which will be recorded as special charges in the fourth quarter. Related to this we will also be moving to two reporting segments in the fourth quarter aligned with this new group structure. We will report our fourth quarter earnings and our 2013 10K in this new format early next year.

With that, let's move to the segments with Energy on slide 6.

Energy revenues of $108.4 million for Q3 decreased 1% year over year. This was driven by reductions in the North American distributed valve market as rig counts are down year over year, partially offset by growth in large international projects.

The segment's adjusted operating margin was a very strong 17.1%, up from 14.0% in the third quarter of 2012, primarily driven by improved pricing and favorable order mix within our large international project business, Brazil restructuring benefits and reduced operating expenses, partially offset by lower shipment volume and the associated leverage.

For Flow Technologies, turn to Slide 7.

Revenue was $69.8 million, up 3% year over year due to contributions from power and instrumentation, as well as favorable foreign currency fluctuations.

Flow’s third-quarter adjusted operating margin was 13.6%, up from 13.1% last year, primarily due to improved volume, associated margin and favorable pricing, partially offset by sales and marketing growth investments.

Now Aerospace on slide 8

Revenues of $36.4 million were up 15% from the prior year, with strength in most of our markets as well as favorable foreign currency fluctuations of 2%.

Aerospace margins in Q3 were 11.3% compared with 4.2% in Q3 2012 due primarily to increased volume and savings associated with the California restructuring.

Slide 9 shows our consolidated P&L. I'll comment on special charges and the tax rate.

In Q3 this year we recorded net Special Recoveries of $0.2 million. This is composed of Special charges of $2.9 million primarily associated with our restructurings discussed earlier offset by a gain of $3.1 million from the settlement of a prior acquisition purchase price dispute.

The tax rate for Q3 was 21.7% compared with our rate of negative 92.8% for the same period of 2012. Excluding the impact of restructuring charges, the comparable tax rate for last year would have been 20.9%. We anticipate our fourth-quarter tax rate to be approximately 29%.

Now turning to Slide 10. During the third quarter, we generated a positive $29.6 million in free cash flow which puts us at $40.2 million year to date.

With that, I'll turn it back over to Scott to provide an update on our orders and guidance for Q4 2013.

Scott:

Thank you, Fred.

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

Let's start with Energy. Incoming orders were $101 million in the quarter, down 14% year-over-year, primarily due to lower orders in our large international projects business. The trends we discussed last quarter in this business continued through the third quarter, including delayed decisions on large projects, despite strong quoting activity. Overall our win rate remains unchanged and we did not lose any major project proposals. As we enter Q4, we are not seeing a meaningful change to this trend; which is increasing price pressure on some of the larger project proposals. However, despite a somewhat stagnant environment today, we remain optimistic about an increase in activity in 2014. In our short-cycle business, the market demand has played out as expected. Orders were slightly down versus prior year driven largely by rig counts. As with our large project business, we do not anticipate a meaningful change in our order run rate before the end of the year. We expect modest growth to resume in 2014.

In Flow Technologies, orders were up 22% to a record high of over $79 million for the segment, with strong contributions from most end markets. Strength in Flow Technologies orders included a large project order for the Australian Ichthys LNG Project. Products include valves & instrumentation along with our proprietary GYROLOK fittings. In the offshore oil and gas segment served by our Flow Technologies businesses, we are seeing an ongoing shift to higher strength alloys to help improve service life. We expect this trend to support solid demand levels into 2014.

In Aerospace, orders were up 2% year-over-year to $44 million. This was due to modest growth in most end markets that we serve.

That brings us to our guidance for the fourth quarter. Based on our end market assumptions, we expect that fourth-quarter revenue will be in the range of $222 to $228 million, which represents organic growth between 10% and 13%.

We expect to report adjusted EPS in the range of $0.88 to $0.95, which represents YOY growth of 29% to 40%.

Overall we feel good about the quarter we just delivered as well as our outlook for the remainder of the year. We have a solid foundation in place at CIRCOR with exposure to good end markets and significant opportunity to improve our performance on our top three priorities: growth, margin expansion and free cash flow.

On May 15th of next year we will be hosting an investor day in New York City where we will elaborate on our vision for CIRCOR. Please save the date and watch for more details to follow.

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

After Q&A

Scott:

Thank you for your joining us this morning. We look forward to seeing many of you on the road in the weeks and months ahead. Thank you.