CIRCOR International, Inc.

Second-Quarter 2013 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to CIRCOR International's second-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, CIRCOR’s Chief Operating Officer, 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, August 1, 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, we performed well in the second quarter. Revenue was up 2% organically to $224 million with adjusted EPS up 27% to $0.81. We are particularly pleased with our margin expansion in the quarter. Adjusted operating margin was up 160 basis points to 10% -- the highest level we have achieved in four years.

Revenue growth was driven by our Flow Technologies and Aerospace segments, offset slightly by lower sales at Energy. In Flow, sales growth was broad-based, with strength across most end markets. In Aerospace, we had strong revenue growth at the fluid control business in California and France attributed primarily to both OEM and aftermarket demand for commercial single aisle aircraft. At Energy, sales slightly declined due to ongoing moderation in the short-cycle North American market driven largely by rig counts, which are flat to prior quarter but down year over year. This dynamic was mostly offset by strong shipments at our large international project business.

During the quarter we successfully completed our previously announced restructuring initiatives under budget. We saved more than $1 million from these actions in the quarter and as planned, we expect to achieve an annualized run rate of savings of $7 million.

With those actions behind us, we are announcing the first step of an ongoing simplification process at CIRCOR by initiating three new restructuring actions that are designed to reduce complexity, expand our margins, and better align our organization with end markets. Unlike the restructuring recently completed, these restructuring actions are not designed to turn around a broken or struggling part of the business. The intent is to address some of the complexity and cost embedded into the way CIRCOR is structured and the way we've historically operated our businesses. These actions will be part of an ongoing process of reaching competitive margins in our segments. We will close two facilities in the U.S. and significantly downsize a third, which will allow us to:

- first, reduce the overhead and G&A linked to running and managing these facilities;
- second, increase the utilization of our low cost manufacturing and design capabilities in India;
- third, consume excess capacity available in other CIRCOR facilities; and

- last, better align our business unit structure with common end markets.

In addition, we intend to rationalize our product lines – we will divest or exit certain small non-strategic, unprofitable product lines currently sold by these businesses.

These actions offer an attractive return on invested capital and are directly in line with our strategy to simplify our somewhat fragmented structure and better align our businesses with common end markets.

After Fred provides more detail on our financial results for the quarter, I'll come back with a brief look at what we're seeing in our markets, and discuss our priorities going forward.

But before I turn the call over to Fred, this morning we announced that Fred will be retiring as CFO once a successor is named. Fred has built a strong finance organization. He has been an invaluable member of the CIRCOR leadership team during the past five years and has been a great help to me since I came on board earlier this year. I'd like to thank him and I look forward to working with Fred and the Board on transition and succession planning over the next few months.

Fred Burditt:

Thank you Scott and good morning everyone.

Please go to slide 3 which reviews our consolidated results. Scott already provided the high-level overview of our second-quarter revenue and EPS, so I’ll just reiterate that the highlight this quarter was our 160 basis point improvement in adjusted operating margin to 10.0%. In addition adjusted operating income was up 21% year over year to $22.3 million and backlog of $433.5 million was up 3%.

Now please turn to slide 4 for our Restructuring Related Charges. The Q2 charges are associated with the 2012 initiated activities in Brazil, California and India. During the quarter we incurred $2.0 million in restructuring charges, which was primarily cash. We anticipate an additional $0.5 million in Q3 which will complete the charges on these three programs. We continue to expect annualized savings of approximately $7 million from these actions with $1.1 million having already improved in the second quarter.

In addition, as Scott mentioned, we are now implementing three new restructuring actions as part of a simplification process at CIRCOR. Specifically, we are consolidating a Flow Technologies plant in Texas into our South Carolina facility and second we are consolidating our Ohio Aerospace operations into our California facility and finally, we are significantly downsizing a Flow Technologies plant in New York, which includes exiting about $4 million of non-strategic products. Expanding outsourcing and further utilizing our

India operations is a key component of all these moves to reduce complexity and cost.

We expect that the total charges relating to these actions will be in the range of $8.3 million to $9.1 million, with 20% being non-cash and 80% cash. About $1.0 to $1.1 million of this will be recorded in the current third quarter of 2013. The annualized savings are expected to 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.

Now I’ll turn to segment performance, beginning with Energy on slide 5.

Energy revenues of $110.8 million for Q2 decreased 2% year over year essentially all organic which Scott reviewed.

The segment's adjusted operating margin was 13.8%, up from 11.1% in the second quarter of 2012, primarily driven by improvements in Italy from favorable volume, mix and pricing and in Brazil including $0.6 million of restructuring savings. This was partially offset by a volume decline in short-cycle distributed valves.

I want to mention a 2013 third quarter item. In July we reached a settlement with the former owners of Brazil in our dispute over their breech of certain representations and warranties. As a final result we have received a partial refund of the purchase price which will result in a gain of approximately $3.1 million in our third quarter results as a special recovery.

Now, let's move to slide 6 and Flow Technologies.

Revenue came in at $74.6 million, up 6% year over year due to higher power generation, instrumentation and sampling demand.

Flow's second-quarter adjusted operating margins were a record 14.8%, up from 12.8% last year, primarily due to improved volume, associated leverage and productivity across the segment.

Now Aerospace on slide 7

Revenues of $38.2 million were up 6% from the prior year, primarily due to increased volume mentioned earlier. We also benefitted from 1% favorable foreign currency fluctuations.

Aerospace margins in Q2 were 8.6% compared with 8.8% in Q2 2012 and 3.5% in Q1 2013. The sequential improvement is key here as we delivered $0.6 million of restructuring savings or 160 basis points and had reduced unfavorable start-up production variances for large programs.

Slide 8 shows our consolidated P&L and I'll speak to our tax rate.

The tax rate for Q2 was 32.6%, lower than our rate of 35.6% for the same period of 2012. The lower 2013 tax rate is due to a smaller loss for one of our international subsidiaries, which was not tax-benefited in either period.

Looking forward, we anticipate our third-quarter tax rate to be approximately 24% benefiting from the tax impact of the Brazil settlement gain I mentioned. Excluding restructuring charges and the Brazil gain, the rate is anticipated to be approximately 29.3%.

Now turning to Slide 9. During the second quarter, we generated a positive $9.5 million in free cash flow, $4.5 million more than the second quarter of 2012, primarily due to improved margins and working capital.

Now I'll turn it back over to Scott.

Scott:

Thank you, Fred.

I'll provide an overview of our second quarter order intake as well as current market trends that we are seeing.

Let's start with Energy. Incoming orders were $107 million in the quarter, down 16% year-over-year. The largest driver was the orders in our large international projects business. It is worth noting that we had a difficult comparison to last year due to a $22 million order received in the quarter. In addition, there are several dynamics we are seeing in the marketplace that I would like to explain.

- First, project inquiries and quoting levels remain high. In fact we saw a slight pick-up in activity in the second quarter.
- Second, although quotation activity is strong we have seen an increase in the time it takes between when a quote is placed and when an order is awarded. This obviously suggests that projects are being delayed.
- Third, we believe we are maintaining share in the marketplace as our order win rate remains unchanged from recent history.

- Finally, in the short-cycle market, the U.S. recovery continues to be slow - rig counts are flat YTD and down 10% versus prior year. It appears there are some distributor inventory corrections negatively impacting the channel as well.

We have not seen and do not expect to see a meaningful inflection point on orders in Energy, either up or down, versus what we have been seeing YTD.

In Flow Technologies, orders were down 6% primarily due to maritime and sampling project orders which are both lumpy markets. This does not necessarily imply a trend.

In Aerospace, orders were off 6% year-over-year. This was primarily due to declines in our French business that were partially offset by order growth in our California fluid control business. In France, we are seeing weakness on rotor aircraft products due to soft Asian demand. In addition certain orders were impacted by our recent price increase to address a segment of unprofitable business.

Our Commercial OEM business continues to be very solid with significant Airbus & Boeing backlog. While we do not expect to be impacted by sequestration for the major programs in our military business, we are seeing some general softness in spares & repairs because budgets are tight.

That brings us to our guidance for the third quarter. Based on our end market assumptions, we expect that third quarter revenue will be in the range of $212 to $218 million. This would result in organic growth between 1% and 4% versus prior year.

We expect to report adjusted EPS in the range of $0.76 to $0.83. This compares favorably to Q3 2012 adjusted EPS of $0.68 if you use a comparable tax rate to our 2013 guidance.

Let me conclude with a few thoughts on the three priorities I mentioned in our last call: margin expansion, cash generation, and growth.

Let's start with margin expansion. One of our top priorities is to reach industry peer average margins. In addition to the operational opportunities for expanding margins, like price and productivity, we have a structural opportunity with all the complexity at CIRCOR. We'll be undertaking a number of initiatives over time that are designed to simplify CIRCOR, including reducing P&Ls, rooftops, suppliers, and management systems. We are taking a step in the right direction with the restructuring actions we announced today, but there will be more work ahead.

Second, we are going to focus on cash generation by putting in place initiatives that we expect will improve our working capital performance. For example, we are in the early stages of creating a global sourcing organization to replace the somewhat fragmented structure that operates at the plant level today. A global sourcing organization will be focused on strategic "make versus buy" decisions across CIRCOR, as well as tactical supply chain management: price and term negotiations, supplier qualification, as well as supplier delivery & quality performance. An effective global sourcing organization would not only expand our margins but would certainly improve our working capital performance.

Finally, we will focus on growth. We are in great end markets with Energy and Commercial Aerospace expected to grow at rates up to 2X global GDP growth rates. There are many positive activities going on today at CIRCOR and on future calls I will elaborate on some of these activities as well as what changes I see that we can take to accelerate results.

While I am spending the majority of my time on improving CIRCOR's operating performance today, there is clearly an opportunity to grow through acquisitions. We are focusing on companies in markets that we already understand very well. We like companies with good technology or companies that are positioned in parts of the market where we expect exceptional growth. In addition to strategic fit, the main criterion for an acquisition will be return on invested capital.

As I said on our last call, I joined CIRCOR because of the strong foundation that was in place here, and the opportunities that are in front of us. Our efforts to simplify the organization, improve the operations, and more aggressively drive organic growth will not happen overnight, but I feel good about where we are and what this company can become.

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.