CIRCOR International, Inc.

First-Quarter 2014 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to CIRCOR International’s first-quarter 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 Mr. David Calusdian from Sharon Merrill for opening remarks and introductions. Please go ahead, sir.

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, April 22, 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 recoveries and 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 David and good morning everyone.

We had a strong start to the year with adjusted EPS up 50% to $0.78, including 3 cents of favorable FX. Our margin improvement initiatives continue to yield positive results. We increased our adjusted operating margins year-over-year by 230 basis points to 9.4%.

Revenues were up 3% over last year to $211 million. Our upstream large international project business showed strength in the quarter. Offshore platforms and FPSOs drove solid growth in our instrumentation and sampling business.

We generated strong free cash flow of $14 million, or 98% of net income, primarily resulting from margin improvement.

As we've discussed in the past, a key driver of our margin expansion efforts is our ongoing simplification program.

Restructuring programs in 2013 are largely complete and on track to deliver annualized savings of $9 million with the full run-rate to begin in the second half of this year.

We are also focused on transforming CIRCOR into a growth company. As part of that transformation, we are investing approximately $7 million into accelerating organic growth. We are increasing the size of our sales force in growing markets, opening international sales offices in Brazil and Malaysia, and increasing our investment in new products. This investment in growth will be entirely funded by another restructuring program focused on reducing G&A, as well as closing three small facilities: one in North America and two in Europe.

Finally, last month, we named Vince Sandoval as Group President—CIRCOR Aerospace & Defense. Vince joins us from TransDigm Group where he was most recently the President of Semco, a division focused on the sale of electrical harnesses and sensors into the aerospace commercial and defense markets. Prior to Transdigm, Vince spent more than 20 years at Parker Hannifin in roles of increasing responsibility. Vince brings a wealth of experience in improving operational performance and growing global Aerospace businesses. We welcome Vince to the leadership team.

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

Rajeev Bhalla:

Thank you Scott and good morning everyone.

We've reviewed the results overall so let's move right to the segment results starting with Energy on **Slide 4**.

Energy revenues of $163 million for the first quarter increased 3% year over year. As Scott mentioned, this was driven by growth in our upstream large international project business with continued strength in the North Sea as well as growth in our instrumentation & sampling business. This growth was partially offset by a modest decline in the upstream North American short-cycle business as distributors continued to reduce inventory levels early in the quarter. However, order rates did improve through the quarter further supported by higher rig counts and more boots on the ground as we increase the size of our sales force.

Energy's adjusted operating margin was up 300 basis points to 13.8% primarily due to increased volume, favorable product mix, productivity, as well as savings from restructuring.

As I noted during our last earnings call, based on our backlog and booking expectations, we anticipate higher volume and improving margins in the second half of this year.

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

Aerospace and Defense revenues increased 1% to $49 million from the prior year due to favorable foreign currency fluctuations. Organically revenues were down 2% year over year in large part due to a decline in our French actuation business, partially offset by higher revenue from our defense businesses. The decline in France was a result of our decision to exit certain low margin build-to-print products as well as a slower ramp-up of new programs which were expected to replace declining legacy programs.

Aerospace & Defense adjusted operating margin improved to 9.1% compared with 5.9% in the first quarter of last year primarily due to restructuring savings. In addition, margins were up this quarter compared with the 8.4% in the fourth quarter last year as we put the incremental costs due the supplier fire behind us. However, we continue to work through some operational inefficiencies after the factory consolidations and in launching our new landing gear programs, which will continue to put downward pressure on margins in the near term.

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

Our all-in tax rate for Q1 was 28.5%. Excluding the impact of special charges, the comparable tax rate was slightly lower at 27.9%. We expect our second-quarter adjusted tax rate to be in the range of 26% to 27% as we continue to profitably grow our businesses in emerging markets, which helps to drive down our overall effective tax rate.

Including the favorable FX impact, Q1 2014 adjusted earnings per diluted share were 78 cents. This is a 50% increase compared with 52 cents in the prior year.

Slide 7 shows the special adjustments that we recorded during the first quarter. These include a recovery of $2.2 million from a legal settlement, a net charge for $300,000 also related to a legal settlement, and $800,000 in costs related to restructuring actions announced in 2013.

For Q2, we anticipate charges related to restructuring actions to be in the range of $5 million to $6 million. As Scott mentioned earlier, we expect the actions announced today will result in approximately $7 million of additional annualized savings to be offset entirely by the investments in accelerating growth.

Turning to our cash flow and debt position on **Slide 8**.

Q1 was a good first quarter for cash flow. We continue to focus on working capital reduction to drive incremental cash into our business.

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

Scott:

Thank you, Rajeev.

Before I get into our guidance, let me start by providing you with an overview of our first-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. And it is important to point out that approximately half of our revenue is project related, which can lead to significant variation in order intake from one quarter to the next.

For Q1, incoming orders were $160 million, down 8% versus last year. While activity and quoting remains strong, particularly in upstream and power, we had a number of large project orders in the North Sea and Brazil slide out of the quarter. We still expect to close on these orders. Market demand and pricing remain positive.

We saw improving demand in our upstream North American short-cycle business with orders up double digits sequentially, although slightly down year-over-year. This trend is consistent with increasing rig counts in North America. As we discussed in our February call, we expect bookings in this business to improve in the second half of this year. Our first quarter performance gives us further confidence in this outlook.

Our instrumentation and sampling business continues to experience strong orders from upstream projects in Australia and the North Sea as well as downstream petrochem in the Middle East.

Quoting activity in our power business, particularly for projects in emerging markets, remains strong. In addition, we believe our global MRO market share is increasing, driven by shorter lead times, better on-time-delivery, and a more effective mix of distribution partners.

In Aerospace & Defense, orders were down year-over-year to $40 million due primarily to our landing gear business, which included the loss of the CH-47 program, and the exit of certain unprofitable build-to-print product lines. Our French businesses saw lower year over year orders primarily driven by weak Asian demand from Airbus Helicopter.

We expect a moderate increase in orders for the remainder of the year driven by a broad mix of aerospace products in the commercial markets. Domestic and foreign military orders including the Joint Strike Fighter Program and certain missile systems such as the Hellfire and SM3, are also expected to grow.

That brings us to our guidance. We expect that second-quarter revenue will be in the range of $220 to $230 million. We expect to report adjusted EPS in the range of $0.88 to $0.94, which represents year-over-year growth of 9% to 16%.

Going forward, we will continue to focus on our top three priorities: growth, margin expansion, and strong free cash flow.

We're looking forward to meeting many of you at our upcoming investor day on May 15 in New York City, where we will discuss 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. We look forward to seeing you at our upcoming investor day and speaking with you on next quarter's call.