

**KAYDON CORP**

**Moderator: Rick Mosteller  
February 25, 2010  
10:00 am CT**

Operator: Good day everyone, and welcome to the Kaydon Corporation Fourth Quarter and Full Year 2009 Earnings Conference Call. Just a reminder that today's call is being recorded.

And at this time, I would like to turn the conference over to Mr. Rick Mosteller. Please go ahead, sir.

Rick Mosteller: Again, welcome to the Kaydon Corporation fourth quarter and full year 2009 earnings conference call.

Before the conference begins, the company would like to make the legal disclaimer that certain information in this formal discussion and that may be included in the question and answer session is forward-looking within the meaning of the federal securities laws.

These forward-looking statements are only predictions, based on the company's current expectations about future events. While the company believes that any forward-looking statements made are reasonable, actual results could differ materially, since the statements are based on the company's current expectations and are subject to risks and uncertainties beyond the control of the company.

Listeners are cautioned to refer to the company's 2008 Form 10-K for a list of risk factors, as updated in the company's first quarter 2009 Form 10-Q, that could cause its results to differ from those anticipated in any forward-looking statement. In addition, listeners should refer to risk factors which will be included in the company's 2009 Form 10-K, which we intend to file on February 26, 2010.

The company does not undertake and expressly disclaims any obligation to update or alter its forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.

During this conference call, Kaydon's spokespersons will refer to certain non-GAAP measures. To assist you in understanding these non-GAAP measures, as well as to comply with SEC requirements, the company has included in its press release a reconciliation of these non-GAAP measures to the most directly comparable GAAP measures.

Participating in today's call are Mr. Jim O'Leary, Chairman and Chief Executive Officer of Kaydon Corporation; Peter DeChants, our Chief Financial Officer; and Don Buzinkai, our Controller. Today's conference is being recorded.

Now, I would like to turn the call over to Jim O'Leary, Chairman and Chief Executive Officer. Mr. O'Leary, please go ahead.

Jim O'Leary: Thank you, Rick. And thank you all for joining us this morning. I am going to have some brief prepared remarks, and we'll try to get to Q&A and spend as much time on that as possible.

Before we start the prepared remarks, I want to kind of start off with what I'd said was a minor change from what we'd – we talked about on our last call. I think I said the prepared remarks

would be short, but unfortunately, they won't be very sweet, because there wasn't much of a change from the prior quarter.

And I think in our prior quarter, which would have been June, we saw things bottom. There wasn't a material change between quarters, going into our third quarter, and as we went into our fourth quarter, up until January I would say in terms of order entry, there wasn't much of a change.

As noted in our press release, we have seen a pretty significant rebound in orders since year-end. We've had the first cumulative basis the first 2 months of February the first positive order comps, not just sequentially, but year over year, that we've seen since the third quarter of 2008. So the order growth over the last 2 months on a cumulative quarter-to-date basis has been strong.

Overall it's over 35%, and on a non-wind versus wind basis, the wind orders obviously are driven by our scheduling with a few major customers. They come later in the year. But our non-wind orders have been particularly strong, running closer to 50% up year over year, running through today.

So the prepared remarks are still going to be short, because the year finished I think pretty much as we expected, except for some of the cost reduction initiatives having a little bit more impact that we'd expected. The margin was a bit better. You know all the end markets and most of the top line initiatives pretty much came in as we expected.

But since year-end, we have seen some pretty strong order growth. We're hoping it continues. While we'll be short and a bit sweeter, I still think we'd like to see a few more months, if not quarters, that say we're totally out of the woods as far as double-dip or the things I think people are appropriately concerned about.

But again, for the first time in pretty much close to a year and a half, we're seeing positive year over year comps and pretty good order entry and pretty good confidence on the part of our customers, non-wind. And I think when we get to Q&A, we can talk about the bigger end markets – notably wind, military – but in the general industrial space you know probably I'd say the best anecdotal evidence, the best feeling and supported by the best order entry that we've seen in over a year.

Now we'll go through the prepared remarks. We're satisfied with our performance in what has been a historically challenging period, not just for Kaydon, but for the industrial sector and the global economy – perhaps one of the greatest understatements we'll make on this call.

While 2009 was challenging, we believe we're exiting the recession far more competitive than when we entered it, due to actions taken over the past 2 years. The cost reduction and containment measures that we initiated early and aggressively have yielded improved results relative to both the start of this year and the cyclical trough of the previous recession.

We're especially pleased with our cash flow performance this quarter and the full year, which reflected both these measures and our disciplined approach to managing costs and capital during this difficult period.

The industrial portion of each of our businesses appears to be improving. As I mentioned, during the first 2 months of 2010, non-wind orders have improved both sequentially and relative to the prior year, as cumulative incoming orders exceeded prior year levels for the first time since the third quarter of 2008.

While we still need more time and sustained strength to conclude that an enduring industrial recovery is underway, the early indications are encouraging. While wind energy sales declined

sequentially, this was largely due to the timing of customer releases in the third quarter, when we shifted a significant amount of product that had previously been delayed due to the global credit conditions, notably for customers in need of letters of credit.

Regarding wind, while we're pleased with our sales performance for the 2009 year, improved wind energy orders and future growth will be driven by increased electricity demand from an improving economy and greater clarity which the renewable space needs on the public policy front.

While the U.S. wind industry – wind energy industry set a record for installing nearly 10,000 megawatts of new generating capacity in 2009, much of this growth came from inventories of turbines and components without a corresponding benefit down the supply chain to manufacturers like ourselves. This highlights our view that the more important issue for the longer-term growth of the industry continues to be the need for clarity on the renewable electricity standard and a steadily improving economy, which will drive electricity usage.

In reviewing the financial performance of our business through "the great recession" in aggregate, there are two important data points worth reviewing when looking at EBITDA, EBIT, and free cash flow. First, the disproportionate impact of depreciation on the largest capital program over any ten-year history in our company's history – depreciation in 2009 totaled almost \$20 million, compared to \$11.2 million in 2006, so nearly doubling. Now with the wind energy expansion complete, our 2009 CapEx dropped down to \$12 million.

Second, the impact of pension, where GAAP cost in our plans, is about \$4 million higher today than the comparable trough of the preceding recession, largely due to the interest rate and actuarial assumptions embedded within our pension costs. When we stand back and look at these items, the business performance and margin comparisons are considerably more reassuring, if indeed we're out of the woods as an economy.

Now we'll go through the details in our normal fashion. Sales for the fourth quarter of 2009 were \$108.9 million, as compared to \$132.4 in the fourth fiscal quarter of 2008. Operating income was \$18 million in the first quarter – excuse me – in the fourth quarter of 2009, as compared to \$22.4 in the fourth quarter of 2008, while EBITDA was \$25.6 for the fourth quarter, compared to \$29.6 in the prior year's fourth quarter.

Net income for the fourth quarter of 2009 was \$11.4 million, or 34 cents per share on a diluted basis, as compared to the fourth quarter of 2008 – net income of \$13.8 million, or 40 cents per share on a diluted basis.

Wind energy sales in the fourth quarter of 2009 totaled \$21.3 million, compared to \$24 million in the fourth quarter of 2008; full year 2009 wind energy sales of \$103 million, or 28% higher than the \$80.5 million in the full year of 2008.

Operating income in total, and to varying degrees in each segment, was adversely impacted obviously by the decreased volume, increased pension costs, product mix issues, which we've talked about in the past, and the previously mentioned increase in year-over-year depreciation. With the reduced volume, we were impacted by loss absorption, as most of our plants operated at below optimal capacity levels.

Operating income was positively impacted by the cost reduction and containment measures initiated early and aggressively in this downturn. In the fourth quarter of 2009, we recognized a \$900,000 cost – benefit – excuse me – related to changes in certain post-retirement employee benefits, which will benefit future cash flows and earnings. This gain was fully offset by one-time costs to the split roller bearing facility in England, which included inflated termination costs associated with the redundancy that we enacted during the fourth quarter.

We continue to review opportunities to reduce structural capacity, providing further downside protection, should business remain at this low level for a period of time, or more positively, greater operating leverage, if the recovery we've seen recently continues through the year.

Let's review our segment operating performance and give some color on our fourth quarter performance in our principal end markets. Friction control sales totaled \$72.9 million, as compared to \$85.8 million in the fourth quarter of 2008. The adverse impact of macroeconomic activity affected our core industrial businesses, with only semiconductor achieving growth, compared to the fourth quarter of the prior year.

Notably, sales to the heavy industrial markets declined, due to the much decreased level of global industrial activity. As mentioned, when energy sales decreased compared to the prior fourth quarter and also sequentially, following the record wind energy sales in the third quarter of 2009, as we caught up on some of the credit conditions we talked about previously.

The machinery and military markets were down, compared to the prior fourth quarter, with those markets along with the semiconductor market improved sequentially, compared to the third quarter of 2009.

Sales to the defense market were below prior year for the quarter and full year. The full year 2008 MRAP production and shipments were not fully replaced by this year's combined MRAP and MATV shipments. The awards for the MATV program have resulted in orders and will result in shipments and additional potential orders in 2010.

Fourth quarter 2009 friction control products operating income totaled \$12.7 million, as compared to \$11.7 million in the 2008 fourth quarter. The decrease was attributable to the decreased sales, higher depreciation and pension costs, and the one-time costs associated with the redundancy in our split roller bearing business.

Turning to velocity control, fourth quarter 2009 sales of velocity control products totaled \$11.8 million, compared to \$13.8 in the prior fourth quarter, due to decreased volume across the board. Operating income declined to \$1.3 million in the fourth quarter from \$1.8 million in the prior year's fourth quarter, due principally to the effects of lower volume, all associated with lower economic activity.

Our velocity control business, both in the U.S. and in Europe, is highly correlated with the level of industrial activity and is closely tied to the general industrial cycle. Obviously, this business dropped fastest and most severely early in this downturn.

That said, the direction is comparable to that experience in the last downturn, but now on a much bigger, more international business. During the fourth quarter, we saw a sequential increase in the daily order rate in domestic markets of this business, and we're starting to see improvements in our European markets, where the downturn began 4 to 6 months later than in the domestic markets. If the past is an indicator of future trends, and if industrial activity continues to improve, this business should be among the biggest and first beneficiaries of a sustained recovery.

Turning to sealing products, sales of sealing products were \$8.8 million, compared to \$11 million in the fourth quarter of 2008, principally due to decreased volume stemming from the general economic decline. Operating income increased to \$11.7 million, compared to \$900,000 in the last year's fourth quarter, due to the absence of an asset impairment charge recorded in the fourth quarter and reduced costs, including a favorable inventory adjustment, which partially offset the impact of decreased sales.

And finally, turning to other, sales of our company's other remaining businesses equaled \$15.3 million in the fourth quarter of 2009, compared to \$21.8 in the 2008 quarter, due largely to decreased volume in each of the businesses. Operating income decreased from \$3.1 million to

\$1.4 in the fourth quarter of 2009, as decreased volume was only partially offset by cost containment efforts.

Most of these businesses were adversely impacted by the general slowdown. The one – the one-time \$.9 million net curtailment gain was not allocated to any individual segment and is included in SG&A. Backlog at quarter end was 21 – excuse me – was \$218.5 million, compared to \$250.1 million at October 3, 2009, the end of our third fiscal quarter, and \$312.6 million at the end of the previous year.

Wind energy backlog was \$109.2 million at the end of the quarter, compared to \$129.6 million at October 3 and \$160.2 million at December 31, 2008. The drop in backlog from the – from the fourth quarter of 2008 is attributable to shipments in excess of gross orders; continued deferrals of push-outs in the longer cycle markets, principally wind; and some pricing adjustments to the wind energy backlog associated with contractual pass-throughs, which we've talked about previously.

Now I'll turn it over to Peter, to cover some financial items, and we'll wrap up and go to questions.

Peter DeChants: Thanks, Jim and good morning everyone. During the fourth quarter of 2009, interest and investment income was \$108,000. As our cash investments were principally in money market funds and short-term Treasury securities.

Also during the fourth quarter 2009, we were able to liquidate the remainder of our investment in an enhanced cash fund. In last year's fourth quarter, we recorded a loss of \$1 million related to that fund. The effective tax rate during the fourth quarter of 2009 equaled 36.7%, compared with 37.5% in the prior fourth quarter, with the decrease due principally to state taxes.

Net income for the fourth quarter was \$11.4 million, or 34 cents per share on a diluted basis, as compared to fourth quarter 2008 net income of \$13.8 million, or 40 cents per share on a diluted basis.

Fourth quarter 2008 results have been adjusted to reflect the required retrospective application of new FASB guidance, which reduced previously reported fourth fiscal quarter 2008 basic and diluted earnings per share by 1 cent. During the quarter, EBITDA was \$25.6 million, compared to fourth quarter 2008 EBITDA of \$29.6 million. Fourth quarter 2009 EBITDA margins increased to 23.5%, as compared to 22.4% in the prior fourth quarter.

Free cash flow during the fourth quarter was \$19.7 million, compared to a net use of \$5.5 million in the prior fourth quarter. The year-over-year improvement is due principally to improved working capital performance, reduced capital expenditures, and the absence of the fourth quarter 2008 contribution to our qualified pension plans, which we made a year ago.

Full year 2009 capital expenditures totaled \$12 million, a substantial reduction, compared to recent years, when we were heavily investing in our now complete wind energy expansion, and lower than our original budget for the year, as we reviewed all capital spending projects in light of the current economic environment.

For 2010, we're currently budgeting approximately \$30 million in CapEx, subject again to our ongoing review during the year. Again, EBITDA and free cash flow were non-GAAP measures, which should be viewed as supplemental data, rather than as substitutes or alternatives to the comparable GAAP measures. We've included in our earnings release a reconciliation of these metrics to the most comparable GAAP measure for your reference.

On the balance sheet, cash and cash equivalents increased \$14.6 million during the quarter and totaled \$262.4 million at the end of 2009, compared to \$233 million at the end of 2008. This year-

end cash balance of \$262 million also represents an over \$50 million increase from the end of this year's second quarter.

As we've discussed on earlier calls, improved working capital management, particularly inventories in the second half of the year, together with increased earnings in the second half, compared to this year's first half, reduced CapEx contributed to positive cash generation.

Inventory turns for the quarter increased from 2.6 in the first quarter of 2009 to 3.2 turns for the fourth quarter and the year. This improvement in working capital metrics was offset in part by an increase in DSOs related to accounts receivable to approximately 65 days, as we've selectively extended terms in certain instances.

And finally, the company continues to have no outstanding debt on the balance sheet. Now I'd like to turn the call back over to Jim.

Jim O'Leary: Thanks, Peter. While the past 2 years have been challenging, we've taken several steps to improve our results and position ourselves for the long term.

These actions, our strong balance sheet and leadership positions in fundamentally sound end markets should allow us to emerge from the current period considerably stronger than when we entered it. With unrestricted cash totaling \$262.4 million, \$300 million in available credit, and no debt outstanding, we're exceptionally well positioned for the long term.

During the fourth quarter of 2009, the company paid common stock dividends of 18 cents per share, or \$6 million. We've increased our annual dividend in each of the last 3 years, reflecting the company's confidence in the fundamental strength and cash generating ability of our businesses.

While business conditions in the last year were no doubt tough, the board shares management's confidence in the fundamental strength of our business, and I think within the industrial space, we're amongst the very few companies that raised their dividends this year.

Finally, I'd like to thank each of our employees for their efforts in a most challenging 2009, and we continue to work towards delivering our outstanding products and capabilities and servicing our customers in the future. With that, Lorie, prepared remarks are over, and we'd like to turn it to questions.

Operator: Thank you.

Jim O'Leary: Thank you.

Operator: The question and answer session will be conducted electronically today. And to our telephone audience, if you would like to ask a question, please press star 1 on your touch-tone telephone. Just a reminder, if you're joining us on a speakerphone today, make sure your mute function is disengaged, to allow your signal to reach our equipment. Once again, that is star 1.

Male: Yes. This is ...

Operator: We'll take our first question today from Eli Lustgarten with Longbow Securities.

Eli Lustgarten: Good morning, Jim.

Jim O'Leary: Hey, Eli. How are you?

Eli Lustgarten: (Not bad). Could you give us some help on how to think about 2010 – wind backlogged 109, and we're looking at relatively flat you know wind outlook for this year, military down, what's

going on – how to think about you know how do we forecast 2010 from your perspective, and what's going on in the various divisions?

Jim O'Leary: Sure. Wind in terms of units we would expect to be up a bit. In terms of revenue – dollar revenue – I'd look at flat, and maybe modestly up, for 2010. And part of that's due to the material cost pass-through, as forging costs have gone down. The revenue has gone down a bit. The units, despite going up, you'll see a bit of a tradeoff there.

You know where we are today, we're very comfortable with saying wind will at least be flat next year. I think the real challenge in forecasting that is it depends on what happens in Washington over the upcoming quarters.

Eli Lustgarten: Yes.

Jim O'Leary: The upside there, we have capacity but you know obviously the orders there, the impact on backlog, the impact of aggregate book to bill is pronounced on a company that really has about \$100 million run rate of revenue and orders over the past few quarters, as we entered a – entered this downturn. But we're comfortable today saying on a revenue basis, it'll at least be flat with next year, so about 100 to 105.

Eli Lustgarten: Yes.

Jim O'Leary: Military I think last year we said it'll come in between 70 and 75 in our last call, and it came in right at about 75. Next year, we think it'll be between 65 and 70, and I'd say in terms of units and overall activity, it's actually flattish. We have upside there. Right now, we're expecting it to be between, let's say high 60s towards 70.

Eli Lustgarten: Yes.

Jim O'Leary: The upside there is from MATV. We're one of two – we're not sole source. We are one of two suppliers for that program. In the past, we have gotten most of those orders. I think the thing that we're wary about in forecasting that is we do know there's a lot more pressure on government procurement programs. We expect some of that work to go to others, as has been discussed in the past.

There have always been two suppliers, but for delivery issues, we've gotten most of them. So right now for military you know we're comfortable saying 65 to 70 with some upside. And general industrial which you know really covers the rest of the waterfront – you know we'll kick it back to you you know for what your overall industrial outlook is, but we're seeing improved activity. The mix within Kaydon is shifting obviously to the more higher margin products.

We see a little bit of that in the fourth quarter and you know going into the year, most of the order activity that we talked about before – you know 37% up year over year. I mean, that means you're about 50% up year over year on general industrial orders, which is everything but wind and military.

Eli Lustgarten: I was looking at – so right now, if you were sitting there, we're not sure you would be looking at a modestly improved year in revenue and you know maybe a little bit more kick in earnings at this point at a favorable mix.

Jim O'Leary: You know I think modestly improved and, again, it all depends on how things accelerate during the year. You know the big impact for us could be if wind turns around – if there's something on the legislative front that gets the floodgates really opening – maybe floodgates would be more appropriate for hydroelectric, but ...

Eli Lustgarten: Yes.

Jim O'Leary: ... for the legislative things to start moving a little bit faster you know there's considerable upside there. We've got the capacity. We could do more, but we're cautiously – we're very cautious, and a – we're reluctant to forecast that now, because in a – it's been a lot slower than I think we or anybody else anticipated.

Eli Lustgarten: Yes.

Jim O'Leary: You know despite a lot of – they've well-intentioned and real enthusiasm on the part of the current administration. It's just that it hasn't happened, largely because of health care and other initiatives, but ...

Eli Lustgarten: Yes.

Jim O'Leary: ... that's one where, even though we're saying flat, it could be upside.

Eli Lustgarten: Yes. And you said capital spending is going to \$30 million. You've got the wind capacity. Where are you going to spend you know three – almost 2-1/2 times what you're spending this year?

Jim O'Leary: We've got a couple of projects we're working on which you know – that we'll discuss in future quarters, but there are a few things going on that in our budget could provide some longer-term cost reduction benefits. But you know we're working on them and you know we'll report back in future quarters.

Eli Lustgarten: But is it a capacity expansion? Is it modernization? How would we characterize a big step-up in spending?

Jim O'Leary: I characterize it as modernization, capacity improvement – not expansion – and you know we dropped down to 12. I think if you looked at our norm, I've said consistently we probably should be between 3 and 5% of sales, so ...

Eli Lustgarten: Yes.

Jim O'Leary: ... I'd say 12 is probably a little bit on the dear side, and 30 is closer to where our normal – our normal spend should be.

Eli Lustgarten: Yes, I like that. And there's one – it's the last thing – what was the inventory adjustment in the – was that a material number, or just a small thing that we don't worry about?

Jim O'Leary: Less than \$1 million, and it offset the ...

Eli Lustgarten: Yes.

Jim O'Leary: ... it offset some of the other costs within the ring and seal business ...

Eli Lustgarten: Yes.

Jim O'Leary: ... and it came from our annual go through of all our obsolete products, and we just really over-accrued for it in the past year.

Eli Lustgarten: And the tax rate stays the same in the – 2010 versus '09?

Jim O'Leary: Working on that right now. We're looking at a number of international initiatives, but since we don't give guidance – I think giving guidance on individual line items probably ((inaudible)) ...

Eli Lustgarten: All right. Thank you.

Jim O'Leary: You're welcome. Thank you.

Operator: Moving on, we'll take the next question from Steve Barger with KeyBanc Capital Markets.

Steve Barger: Good morning.

Jim O'Leary: Hi, Steve.

Steve Barger: Can you talk a little bit more about mix in the quarter – maybe give us some background on how much cost cutting contributed, just so we can understand the sustainability of gross margin, as we move into one half '10.

Jim O'Leary: Well, that – I think the – for the full year 2010, I think we're starting off at a good base, and there's opportunity for modest improvement. A lot will depend on volume – we're a pretty volume-sensitive business. Most of the upside relative to in – while we don't give guidance, we do look at the numbers you guys have out there. I'd say most of the fourth quarter surprise, relative to where you fellows thought we'd be on a gross margin basis, was cost reduction.

Steve Barger: And is that fixed or variable cost reduction or should – you know should we see some of that cost come back?

Jim O'Leary: It's a mix of both. I mean, some of the costs that we took out during the past 2 years really never comes out, and you'll get the benefit as we season, and by that I mean some of the health care programs we addressed in OPEB in particular. The defined benefit program – we have now capped the pension costs – you know while we have a higher pension cost relative to the past trough, I think it's \$8.8 million of pension costs, compared to \$4 million in 2002.

You know as the pension assumptions, as the interest rate assumptions change, and as we don't add new people – remember, we fixed the population now within a defined benefit plan and shifted to a defined contribution plan – you know you'll start to see those as permanent benefits as the company grows.

A lot of the heads we took out you know absolutely are variable, but they will come back slower, because it's you know it's like anything. You find that your efficiencies are a bit better. When we looked at what we took out in prior downturns compared to this you know there probably was some stuff that does not have to come back. But a lot of it is volume-dependent, and it'll come back a bit later in the cycle.

The permanent things, like the pension plan, the OPEB plan – you know as the years – as quarters go on, it was – they're absolutely permanent structural benefits, and they benefit you more as you expand the workforce on a margin basis.

Steve Barger: OK. So just conceptually speaking, if we think about the – kind of the full year end market walk you just gave us – you know leading to modest improvement – if we get that sequentially, it's reasonable to think that plus or minus, these gross margins are sustainable in the first half.

Jim O'Leary: Yes.

Steve Barger: And backlog – that you know is down sequentially, and certainly year over year. Can you talk about the mix in the backlog with respect to margin, as it stands right now?

Peter DeChants: The – well, the backlog, as you know – that's about half wind, half industrial ...

Steve Barger: Yes.

Peter DeChants: When he was talking about mix, you mean among the businesses?

Steve Barger: Yes, are you seeing – is the backlog full of – you know are you starting to get the higher margin book and ship stuff reflected in that? Or – on the industrial side.

Peter DeChants: Yes, bringing it out on the industrial side. The large portions of those business, when you're looking at velocity controls and at bearings, we are seeing some pickup in the – you know the improvements that Jim talked about in the first part of the year. The – portions of that are in the industrial businesses in bearings and in velocity controls, where we've had better margins than heavy equipment, for example, and wind.

Steve Barger: OK.

Jim O'Leary: Really, all of the order growth that we talked about at the top of the call – that's coming from non-wind sectors, because wind orders thus far up till February, we haven't had any. So I think you could assume that net of some pricing adjustments and the like, you've got well over 37% growth in non-wind orders.

Steve Barger: Right. OK. One more and I'll get back in line. Yes you know you're talking about increased CapEx for next year on plans that you'll talk about in the future, but just generally speaking, can you give us some thought about how you're thinking about operating cash flow relative to 2009? You know, what's the variance; up, down?

Jim O'Leary: Well, if business did go up like a scorched rabbit and you're building inventories again you know that'll be the caveat. But let's say the year is you know modest improvement or the same, you should take the operating cash flow you see in the GAAP statement there, add \$15 million,

because we made a pension contribution that you know – I want to highlight, we're happy with our operating cash flow performance.

It's a heck of a lot better than what you see there on the GAAP statement, because there's a \$15 million pension contribution that was totally discretionary and I think strategically a sensible thing to do you know unless you think the stock market's going to take another whopping leg down.

Steve Barger: Right.

Jim O'Leary: You know I think history has proven – and 2000 and 2002 is a good example – that those investments were smart things for companies that had to manage DB plans. So you could add \$15 million back to that, and let's say the CapEx comes in. You could have at least a comparable year in terms of operating cash flow.

Steve Barger: That's great. OK. Thanks a lot.

Jim O'Leary: OK. Thank you.

Operator: Our next question is from Nicole Deblase with Deutsche Bank.

Nicole Deblase: Yes. Hi, guys, how are you?

Jim O'Leary: Hey, Nicole. How are you?

Nicole Deblase: Good, thanks. So on the wind backlog, could you possibly quantify the impact of the price adjustments that you talked about? And then also, how you expect the total backlog to amortize as we progress through 2010?

Peter DeChants: On the second part is we look at the total backlog at the end of the year – this would be total wind and non-wind. There's about 40% of it that would come in Q1, and then 40% in the next two quarters, and the rest in the next three quarters. But as we say, over time that's been variable as wind and you know other components of the business are – go into the mix.

Jim O'Leary: And on the – on the pricing adjustment, there's a component of that – most of it was shipments on our price adjustment. We really – I don't think we want to get into the precedent of quantifying price adjustments from a quarter to quarter, because – you know it would be prognosticating and providing our material cost on a component basis, which I don't want to set a precedent for.

Nicole Deblase: OK. OK. That's helpful though. And then trends in Europe – you mentioned that in velocity it seems like things are starting to improve. What are you seeing across your other businesses?

Jim O'Leary: Well you know velocity – we're at 30% international, but it's really half our German velocity control business, and the balance in the split roller bearing business. The velocity control business – definitely firmed, doing a bit better.

The split roller bearing business, because its end markets are heavy industrial – a lot of steel mills you know heavy construction, which we do think is going to continue to have a tough 2010 and probably not rebound till 2011. You know I'd say it's half improving, half – you know still at a flat level. But that's more end market driven than international, relative to U.S.

You know international in our case, principally Germany – it's starting to pick up – that's resident solely in the velocity control business. We're seeing "improved activity" in quotations within orders for export from the U.S. within our traditional Kaydon bearings business. But yes, it's still

"expressions of interest" – it's quotations. You know I think that'll start to firm up, if the economy improves in Europe over the balance of the year, so ...

Nicole Deblase: OK. And do you expect to see any more gain come through really into benefit plans?

Or is that – is the \$900 million it?

Jim O'Leary: Well – \$9 million I think for the year, right?

Nicole Deblase: Sorry, sorry – \$9 million.

Peter DeChants: But it was \$900,000 for the quarter, right?

Jim O'Leary: Nine-hundred million would be a good number, but it's – that's ((inaudible)) – all the health plans that we have – current plans too. There should be nothing in 2010.

Nicole Deblase: OK. OK, great. That's all I have. Thanks.

Jim O'Leary: OK, you're welcome, Nicole.

Operator: Next we'll go to Sidoti & Company and Edward Marshall.

Edward Marshall: Hey, guys.

Peter DeChants: Hey.

Jim O'Leary: Hey, how are you?

Edward Marshall: Thanks for taking my call. I'm doing pretty well. The timing of the orders that are hitting in the first 2 – the first 2 months?

Peter DeChants: The timing for delivery? The timing for the delivery of the orders – it would be – these are total orders and – that would be consistent with what we see you know rolling forward – or what we've seen as our backlog rolls out – you know it's – we're not going to – we don't break that down as to what will hit in Q1 versus Q2 or Q3.

Edward Marshall: OK. But I mean, I guess we could just look at kind of the history of the way that – the way your backlog generally breaks out. So I mean, is it fair to say that the top line looks stronger in the second half of the year than it does in the first half of the year, based on the way the orders in the backlog are flowing at this point?

Jim O'Leary: Yes. Definitely, definitely.

Edward Marshall: OK. OK. And then just a point of observation – I guess the margin in the sealing products – and I know that's you know a small piece of the business overall, but – you know I know you've been putting some work in there to kind of change that business over the last couple of quarters or so. Did I hear you right? Was there an inventory gain in there? Or what caused the margin improvement?

Jim O'Leary: I think it was the timing between an impairment last year replaced by an inventory pickup this year. So you had a non-recurring hurt last fourth quarter, and a non-recurring benefit. So you know the sustainable benefit from some of the stuff we're working on there – that won't hit till, at the earliest, the end of this year, Ed, or probably next.

So you've got the absence of an impairment last year and an inventory pickup on our evaluation of our review of obsolescence this year. That is not what we've been working on, and you shouldn't expect that over the next two quarters.

Edward Marshall: OK. And then uses for cash – you're spending some on capital expansion next year, or modernization. What else are we – are you considering? What else could the board be considering as far as ...

Jim O'Leary: Yes.

Edward Marshall: ... or maybe a return of that cash to shareholders.

Jim O'Leary: Yes – and you know Ed, just to follow back to your question – Eli's as well – yes. I think somewhere between 30 is the normal capital spend. When we talk about modernization, it's not a – this is not a huge spend for a company with our free cash, so again, I'd add the \$15 million back to our operating cash flow and use that as what we expect to generate on top of the \$260 we have.

What are the uses for cash? We will probably step up repurchase a bit. We will continue to do dividend and probably look – it's obviously the board's decision, but we'll look to increase that in our normal fashion at year-end. And we are considering other things as well.

I would say – and this is probably you know a reasonable time to take 2 or 3 minutes to talk about corporate development. In the M&A market, it is getting considerably more active. We're not telling you that it's a pipeline of things that are going to happen any time soon, but sellers – you know I think the last year has brought in a little bit more reality to pricing expectations. No one's giving businesses away, but they're not waiting to see if ten times plus EBITDA comes back across the board.

With the financing markets particularly high yield a little bit better, sellers are a little bit more willing to go out and you know if not conduct broad auctions you know selectively talk to potential buyers – because they know – you can get a deal done now.

So while there's nothing happening tomorrow or you know imminently, I would say M&A activity is more active, and – you know it's really seller driven. There's more stuff that is interesting coming to market now or being discussed about coming to market in the next few quarters than there has been in a while, and it's largely driven by a healthier financing market and the fact that the seasoning that you know I think you need in any cycle like we've had – the seasoning of seller expectations off of very high entry prices in the 2007-ish time period through today. You know that's happened.

So now you're getting the chasm between buyer and seller is a lot narrower, and I think the possibility of things happening is a lot better than it's been in a while.

Edward Marshall: OK. Thank you. And the last question is – was there any push-outs in the wind or – backlog in the – in the quarter?

Jim O'Leary: A little bit, but nothing of great significance. You know the main push-outs we saw were earlier last year, and – earlier last year and you know very much tied to the letter of credit availability, so – nothing of note.

Edward Marshall: OK. So did you say that there were no orders through February on wind?

Jim O'Leary: There's nothing – there's not been anything significant yet.

Edward Marshall: OK.

Jim O'Leary: But that's not a – that would not be a shock. We expect you know based on our contract – the contractual orders come later in the year, and we are still shipping off of – you know \$100 million of backlog is nothing to sneeze at.

Edward Marshall: Right. OK. Thank you, guys, very much.

Jim O'Leary: You're welcome, Ed. Thank you.

Operator: Your next question is from Peter Lisnic with Robert W. Baird.

Peter Lisnic: Good morning, gentlemen.

Jim O'Leary: Hello, Pete.

Peter Lisnic: How are you?

Jim O'Leary: Good, Pete, how are you?

Peter Lisnic: Good. I guess the first question is just to clarify on the orders January and February – you said plus 50% or so, and that's excluding wind and military, is that – did I hear that right?

Peter DeChants: No, that would just be excluding wind. That's non-wind.

Peter Lisnic: OK, just excluding wind. Great. OK, when you look at that, is there a way that you can either talk about how much of that would – or how much of that improvement would be really what I classify as short cycle business versus longer cycle business, and what piece of it might just be pure inventory replenishment? Obviously, there's not a lot of inventory carried for some of these

specialty bearings, but I'm just wondering if there is an element of it that it is just simply restocking, if you will.

Jim O'Leary: Well, I mean – there's got to be some of that. It's kind of hard for us to quantify. Within our bearings business you know sure there's some, but again, we're not really a stock – SKU driven business. We're not a big catalog business. So my guess is most of it is in demand and had just been hammered down and tightened up so severely earlier last year that you know people have to let the purse strings go a bit, and they're starting to do projects where – you know where our products have applications.

But we talked a little bit about semiconductor, because it was one of the few markets that was up sequentially and year over year in the fourth quarter. But you know with semiconductor, it's going to a capital replacement cycle where you know not only are people probably inventorying a bit, those orders have been particularly good.

But I would say it's probably less inventory within the bearings business than real end demand, and a lot of our stuff, the book and ship that may go out – I think Ed asked the question – and a lot of it goes out end of this quarter and then over future quarters, so it's still a bit back end loaded. My guess is most of that's for real projects, real end demand – not for stock.

Within velocity control, it's a little bit more an SKU driven business, but it's usually in and out pretty quickly. They operate off a short backlog. So there's some inventory replenishment there, but that turns very quickly, so it's not like we're getting huge blanket orders, and I wouldn't say there's a massive inventory build going up at any of our customers, so – short answer is probably not a huge amount of inventory.

Some of it is, but just the nature of our business, I think you'd have to assume, without a lot of automotive, without a lot of things that have been driven by stimulus-driven spending over the last year you know not a lot of it is inventory building.

Peter Lisnic: OK. That is perfect. Thanks on that. And then as you look at 2010 in terms of the price and materials cost equation, what are you seeing right now on the – on the pricing side of the business, and then is that enough to cover potentially higher materials costs, heading into this year?

Jim O'Leary: I think pretty much a wash – I mean, so much of our stuff is custom for order – you know for specific customer orders. You have the ability to adjust pricing to costs, and obviously in the much bigger stuff like wind and the turntable bearings, you've got contractual pass-through, so it's pretty much a wash. I don't think there's any big surprise coming there.

Peter Lisnic: OK. Fair enough. And then last question, I guess, on capital allocation – you talked about stepping up, I guess, the dividend a little bit here again, as you've typically been doing. But with change in tax – tax law, tax rate – any consideration to potentially special dividend, given that M&A, although picking up doesn't sound like there's anything really on the – you know hot on the stove at this point.

Jim O'Leary: It's – I would say it's something we absolutely do keep in mind, and I don't think a special dividend of an enormous amount is in the cards, but it's something we absolutely do think about and whether or not it would be a – you know a meaningful, but not enormous bump up. It's absolutely something we consider.

And the board certainly takes a look at tax policy and what's going on in Washington when we make those decisions, and – but that's for future – I think that's for future board meetings, probably in the next quarter or two.

Peter Lisnic: OK. That was very helpful. Thank you very much.

Jim O'Leary: You're welcome, Pete. Thank you.

Operator: And as a reminder to our telephone audience, if you would like to ask a question, please press star 1 on your touchtone telephone. Our next question today is from Samuel Eisner with Sterne Agee.

Samuel Eisner: Good morning, everyone.

Jim O'Leary: Hey, Sam. How are you?

Samuel Eisner: Good. Good. Just had a couple of quick questions. Most of mine have been answered. I guess you mentioned there was some unabsorbed overhead. Can you guys, I guess, talk to – I guess what you're seeing and what's happening in your factories, your utilization rates and kind of where you guys are and where you think you might be going to, maybe in 2010?

Jim O'Leary: Well, I mean, it's a volume-sensitive business. We're – you know depending on how you define full capacity. If it's three shifts, or close to three shifts. You know we're anywhere between 60 and 80% across the nine businesses and the dozen plus factories we have. And it absolutely starts moving up as the year progresses, if the order rate we've seen continues, and if business continues to firm.

It would be better – you'd start to absorb some of that overhead, and you'd see that come through the margins, but right now – obviously, we – like everybody – I think the capacity utilization across the industrial space is still below 70 or close to 70. You know our factories, depending on which

business, are between 60 and – you know 60 and 75 to 80, so that would improve as the year goes on, but it's all going to be dependent on order rate and volume across the industrial space.

Samuel Eisner: And is there any way I guess to quantify the unabsorbed overhead, either in the quarter or for the year?

Jim O'Leary: No.

Samuel Eisner: OK.

Jim O'Leary: I mean – we could do it factory by factory, but that's not precedent – we'd have to go into overheads, variances by plant and sector, so that's not something we've done or going to choose to do today.

Samuel Eisner: OK. And then lastly, I guess book to bill – I guess in the fourth quarter and kind of what you guys have seen in the first and second months of the year. I would assume obviously in the back half of the year of the – you know in the fourth quarter that it was pretty weak. But is that obviously picking up pretty substantially?

Jim O'Leary: Well, yes. I mean, a couple of you guys have put out pieces this morning. You know there were some numerical mistakes in a few. Non-wind was .87 in the fourth quarter. We see that trending up towards 1 as you know if this current order pickup continues – I think something that you guys should appreciate on a small you know relatively small revenue base.

And a lot of it is at once order for a product that is not stocked – does not have a lot of things that were driven by stimulus you know the fact that some of our customers probably held back on orders at year end, waited until the new year kicked off – because you know they don't want to

have orders or big commitments out, going into 12/31. Many of them are public companies as well.

They're probably artificially impacted the book to bill at the end of the fourth quarter of 2009. You know we saw a big – and probably a burst, some of which was carryover from that in our first quarter. So I think you trend up to something between .9 and 1, closer to 1. And let us all keep our fingers crossed that that continues through the year.

You know we were careful in what we put in our press release. We have factually seen pretty good orders. It's the first year over year comps we've seen in you know well over – well, a year and a quarter. And you know we need that to continue and to accelerate to have the type of year we're hoping to have and you're hoping for us to have.

Samuel Eisner: All right. Thank you very much.

Jim O'Leary: OK. You're welcome, Sam. Thank you.

Operator: We'll go next to Mike Hamilton with RBC.

Mike Hamilton: Good morning, and congratulations on navigating 2009.

Jim O'Leary: Good – thank you, Mike.

Mike Hamilton: I was just wondering if you could give us the currency impact in the fourth quarter.

Peter DeChants: Currency was – on the top line I think about \$1 million of headwind, and it was just about a push on the operating income line. So that – a non-event in the quarter.

Mike Hamilton: OK. Thanks.

Jim O'Leary: That it, Mike?

Mike Hamilton: That is it for me. Thank you.

Jim O'Leary: OK. Thank you.

Operator: And next we'll take a follow-up from Eli Lustgarten.

Eli Lustgarten: Yes, just one quick clarification. I – during the conversation you said that 40% of the backlog would go in the first quarter. Is that also in wind that we're going to have a big shipment in – a quarter in wind like we had in the third quarter? Or do we look pretty much like you know the average for the year?

Peter DeChants: It's – the 40% number is overall, and it doesn't really tell you anything about a spike in wind.

Eli Lustgarten: Yes. So wouldn't it be relatively level for most of the year, as we expected it this morning?

Jim O'Leary: Yes. I mean, around the third quarter, we ((inaudible)) some of you guys thought there'd be a little bit more of a surprise in the fourth. The third quarter was all catch-up from letters of credit issues and the like. I think the best way to think of the – if it's a flattish year in terms of dollar revenue, it's pretty even through the year.

Eli Lustgarten: Yes. That – and the big step up in orders – you know the 50% gain that you looked at – is that mostly you know because the comparison's as easy as I suspect they are because of the

period last year that – but it's still a very impressive performance. But it's still a relatively versus relatively easy (comps)?

Jim O'Leary: Oh, absolutely. And it's ...

Eli Lustgarten: Yes.

Jim O'Leary: ... high 30s overall ...

Eli Lustgarten: Yes.

Jim O'Leary: ... ex wind, it's closer to 50, and yes, Eli, absolutely it's driven by – it's driven by the easier comps, but ...

Eli Lustgarten: Yes.

Jim O'Leary: ... you can roll that back. It's fourth – it's the first positive comparison in five quarters. You know the same way I said ...

Eli Lustgarten: And it's real money.

Jim O'Leary: ... ((inaudible)) quarters to go ...

Eli Lustgarten: And it's real money.

Jim O'Leary: ... got to stop declining at the bottom. You've got to be bottomed for a while till you start increasing – you know it's time to see the increase. So anecdotally, directionally you know it's a more positive feeling than we've had in five quarters.

Eli Lustgarten: OK. Thank you very much.

Jim O'Leary: You're welcome. Thank you.

Operator: Gentlemen, I have no further questions at this time. I'd like to turn the call back over to you for any additional or concluding remarks.

Jim O'Leary: OK. Lorie, thank you. And to analysts, investors, interested parties, we appreciate your time this morning. We're always available for follow-up questions, and we look forward to speaking to you next quarter. And you know keep our fingers crossed and hope that things continue to improve. But thank you and we will talk to you in a few months.

Operator: Once again, that does conclude today's conference. I'd like to thank everyone for your participation.

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