

TWIN DISC INC
Form 10-Q
May 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended March 30, 2012

Commission File Number 1-7635

TWIN DISC, INCORPORATED
(Exact name of registrant as specified in its charter)

Wisconsin
(State or other jurisdiction of
Incorporation or organization)

39-0667110
(I.R.S. Employer
Identification No.)

1328 Racine Street, Racine, Wisconsin 53403
(Address of principal executive offices)

(262) 638-4000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer
Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

At April 27, 2012, the registrant had 11,429,487 shares of its common stock outstanding.

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands)

(Unaudited)

| | March 30, 2012 | June 30, 2011 |
|---|-------------------|------------------|
| Assets | | |
| Current assets: | | |
| Cash | \$ 17,628 | \$ 20,167 |
| Trade accounts receivable, net | 67,675 | 61,007 |
| Inventories, net | 117,749 | 99,139 |
| Deferred income taxes | 5,942 | 5,765 |
| Other | 9,523 | 9,090 |
| Total current assets | 218,517 | 195,168 |
| Property, plant and equipment, net | 67,161 | 65,791 |
| Goodwill, net | 17,332 | 17,871 |
| Deferred income taxes | 9,159 | 16,480 |
| Intangible assets, net | 5,514 | 6,439 |
| Other assets | 7,678 | 7,371 |
| Total assets | \$ 325,361 | \$ 309,120 |
| Liabilities and Equity | | |
| Current liabilities: | | |
| Short-term borrowings and current maturities of long-term debt | \$ 3,789 | \$ 3,915 |
| Accounts payable | 30,986 | 38,372 |
| Accrued liabilities | 38,637 | 41,673 |
| Total current liabilities | 73,412 | 83,960 |
| Long-term debt | 41,319 | 25,784 |
| Accrued retirement benefits | 45,261 | 50,063 |
| Deferred income taxes | 3,660 | 4,170 |
| Other long-term liabilities | 4,478 | 7,089 |
| Total liabilities | 168,130 | 171,066 |
| Equity | | |
| Twin Disc shareholders' equity: | | |
| Common shares authorized: 30,000,000; issued: 13,099,468; no par value | 12,181 | 10,863 |
| Retained earnings | 184,831 | 162,857 |
| Accumulated other comprehensive loss | (16,430) | (11,383) |
| | 180,582 | 162,337 |
| Less treasury stock, at cost (1,669,981 and 1,739,574 shares, respectively) | 24,356 | 25,252 |
| Total Twin Disc shareholders' equity | 156,226 | 137,085 |

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| | | |
|------------------------------|------------|------------|
| Noncontrolling interest | 1,005 | 969 |
| Total equity | 157,231 | 138,054 |
| Total liabilities and equity | \$ 325,361 | \$ 309,120 |

The notes to condensed consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(In Thousands, Except Per Share Data)
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|------------------|-------------------|------------------|
| | Mar. 30, 2012 | Mar. 25, 2011 | Mar. 30, 2012 | Mar. 25, 2011 |
| Net sales | \$95,490 | \$76,471 | \$259,761 | \$213,026 |
| Cost of goods sold | 62,434 | 48,689 | 166,375 | 141,464 |
| Gross profit | 33,056 | 27,782 | 93,386 | 71,562 |
| Marketing, engineering and administrative expenses | 17,746 | 17,054 | 53,752 | 50,470 |
| Earnings from operations | 15,310 | 10,728 | 39,634 | 21,092 |
| Interest expense | 389 | 430 | 1,129 | 1,309 |
| Other expense (income), net | 71 | 193 | (473) | 836 |
| | 460 | 623 | 656 | 2,145 |
| Earnings before income taxes and noncontrolling interest | 14,850 | 10,105 | 38,978 | 18,947 |
| Income taxes | 5,412 | 5,563 | 14,039 | 7,648 |
| Net earnings | 9,438 | 4,542 | 24,939 | 11,299 |
| Less: Net (earnings) loss attributable to noncontrolling interest, net of tax | (45) | 6 | (108) | (61) |
| Net earnings attributable to Twin Disc | \$9,393 | \$4,548 | \$24,831 | \$11,238 |
| Dividends per share | \$0.09 | \$0.08 | \$0.25 | \$0.22 |
| Earnings per share data: | | | | |
| Basic earnings per share attributable to Twin Disc common shareholders | \$0.82 | \$0.40 | \$2.18 | \$0.99 |
| Diluted earnings per share attributable to Twin Disc common shareholders | \$0.81 | \$0.40 | \$2.15 | \$0.98 |
| Weighted average shares outstanding data: | | | | |
| Basic shares outstanding | 11,426 | 11,344 | 11,410 | 11,308 |
| Dilutive stock awards | 146 | 130 | 145 | 117 |
| Diluted shares outstanding | 11,572 | 11,474 | 11,555 | 11,425 |
| Comprehensive income: | | | | |

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| | | | | |
|---|----------|---------|----------|----------|
| Net earnings | \$9,438 | \$4,542 | \$24,939 | \$11,299 |
| Foreign currency translation adjustment | 2,241 | 4,551 | (6,292) | 14,776 |
| Prior service credit, net | (80) | (107) | (240) | (321) |
| Net actuarial loss, net | 498 | 652 | 1,543 | 1,986 |
| Comprehensive income | 12,097 | 9,638 | 19,950 | 27,740 |
| Comprehensive (income) loss attributable to noncontrolling interest | (45) | 6 | (108) | (61) |
| Comprehensive income attributable to Twin Disc | \$12,052 | \$9,644 | \$19,842 | \$27,679 |

The notes to condensed consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

| | Nine Months Ended | |
|--|-------------------|-------------------|
| | March 30, 2012 | March 25, 2011 |
| Cash flows from operating activities: | | |
| Net earnings | \$24,939 | \$11,299 |
| Adjustments to reconcile net earnings to net cash (used) provided by operating activities: | | |
| Depreciation and amortization | 8,010 | 6,983 |
| Other non-cash changes, net | 4,557 | 5,537 |
| Net change in working capital, excluding cash | (41,315) | (19,753) |
| Net cash (used) provided by operating activities | (3,809) | 4,066 |
| Cash flows from investing activities: | | |
| Capital expenditures | (10,560) | (4,099) |
| Proceeds from sale of fixed assets | 95 | 58 |
| Other, net | (293) | (293) |
| Net cash used by investing activities | (10,758) | (4,334) |
| Cash flows from financing activities: | | |
| Proceeds from notes payable | - | 19 |
| Payments of notes payable | (109) | (82) |
| Proceeds (payments) of long-term debt, net | 15,543 | (352) |
| Proceeds from exercise of stock options | 169 | 203 |
| Dividends paid to shareholders | (2,857) | (2,494) |
| Dividends paid to noncontrolling interest | (130) | (137) |
| Other | 350 | 223 |

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| | | |
|--|----------|----------|
| Net cash provided (used) by financing activities | 12,966 | (2,620) |
| Effect of exchange rate changes on cash | (938) | 2,365 |
| Net change in cash | (2,539) | (523) |
| Cash: | | |
| Beginning of period | 20,167 | 19,022 |
| End of period | \$17,628 | \$18,499 |

The notes to condensed consolidated financial statements are an integral part of these statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

A. Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and, in the opinion of the Company, include all adjustments, consisting only of normal recurring items, necessary for a fair presentation of results for each period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. The Company believes that the disclosures made are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company’s latest Annual Report. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Revision of Prior Period Financial Statements

In the third quarter of the fiscal 2012, the Company identified a prior period error in their first and second quarter 2012 condensed consolidated financial statements related to the cash flow statement classification of the windfall tax benefit related to stock-based compensation. The windfall tax benefit in the first and second quarter of fiscal 2012 was reflected in operating activities rather than financing activities in the condensed consolidated cash flow statement. There was no impact of the error on the statement of operations. In evaluating whether the Company’s previously issued condensed consolidated financial statements were materially misstated, the Company considered the guidance in Accounting Standard Codification (“ASC”) Topic 250, Accounting Changes and Error Corrections and ASC Topic 250-10-S99-1, Assessing Materiality. The Company concluded this error was not material individually or in the aggregate to any of the prior period reporting periods. The revision for the correction is reflected in the financial information herein and will be reflected in future filings containing affected financial information. The impact of these revisions on the Condensed Consolidated Statements of Cash Flows for previously filed 2012 Form 10-Q’s is as follows (in thousands):

| | Three Months Ended September 30, 2011 | | Six Months Ended December 30, 2011 | |
|---|--|------------|---------------------------------------|------------|
| | As Reported | As Revised | As Reported | As Revised |
| Cash flows from operating activities: | | | | |
| Other non-cash changes, net | \$2,950 | \$2,505 | \$4,291 | \$3,756 |
| Net cash used by operating activities | (1,196) | (1,641) | (3,054) | (3,589) |
| Cash flows from financing activities: | | | | |
| Other | (183) | 262 | (185) | 350 |
| Net cash provided by financing activities | 10,051 | 10,496 | 10,096 | 10,631 |

New Accounting Releases

In September 2011, the Financial Accounting Standards Board (“FASB”) issued a standards update that is intended to simplify how entities test goodwill for impairment. This update permits an entity to first assess qualitative factors to

determine whether it is “more likely than not” that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350 “Intangibles-Goodwill and Other.” This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 (the Company’s fiscal 2013). This standards update is not expected to have a material impact on the Company’s financial statements.

In June 2011, FASB issued a standards update that will allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This standards update eliminates the option of presenting the components of other comprehensive income as part of the statement of changes in stockholders’ equity. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 (the Company’s fiscal 2013). This standards update is not expected to have any impact on the Company’s financial statements, as the Company’s reporting is already compliant with this guidance.

In May 2011, the FASB issued a standards update which represents the converged guidance of the FASB and the International Accounting Standards Board (“IASB”) on fair value measurement. This collective effort has resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term “fair value.” This update is to be applied prospectively effective for interim and annual periods beginning after December 15, 2011 (the Company’s third fiscal quarter of 2012). This standards update did not have a material impact on the Company’s financial statements.

B. Inventory

The major classes of inventories were as follows (in thousands):

| | March 30, 2012 | June 30, 2011 |
|-----------------|-------------------|------------------|
| Inventories: | | |
| Finished parts | \$63,697 | \$56,074 |
| Work in process | 22,769 | 18,561 |
| Raw materials | 31,283 | 24,504 |
| | \$117,749 | \$99,139 |

C. Warranty

The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers. However, its warranty obligation is affected by product failure rates, the number of units affected by the failure and the expense involved in satisfactorily addressing the situation. The warranty reserve is established based on our best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. When evaluating the adequacy of the reserve for warranty costs, management takes into consideration the term of the warranty coverage, historical claim rates and costs of repair, knowledge of the type and volume of new products and economic trends. While we believe the warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable in the future could differ materially from what actually transpires. The following is a listing of the activity in the warranty reserve during the three and nine month periods ended March 30, 2012 and March 25, 2011 (in thousands):

| Three Months Ended | | Nine Months Ended | |
|--------------------|------------------|-------------------|------------------|
| Mar. 30, 2012 | Mar. 25, 2011 | Mar. 30, 2012 | Mar. 25, 2011 |

| | | | | |
|--------------------------------------|---------|---------|---------|---------|
| Reserve balance, beginning of period | \$5,883 | \$6,893 | \$6,022 | \$6,061 |
| Current period expense | 1,044 | 291 | 2,825 | 3,262 |
| Payments or credits to customers | (1,077) | (1,306) | (2,756) | (3,708) |
| Foreign currency translation | 52 | 130 | (189) | 393 |
| Reserve balance, end of period | \$5,902 | \$6,008 | \$5,902 | \$6,008 |

The current portion of the warranty accrual (\$4,016,000) is reflected in accrued liabilities, while the long-term portion (\$1,886,000) is included in other long-term liabilities on the Consolidated Balance Sheets.

D. Contingencies

The Company is involved in litigation of which the ultimate outcome and liability to the Company, if any, is not presently determinable. Management believes that final disposition of such litigation will not have a material impact on the Company's results of operations, financial position or cash flows.

E. Business Segments

The Company and its subsidiaries are engaged in the manufacture and sale of marine and heavy duty off-highway power transmission equipment. Principal products include marine transmissions, surface drives, propellers and boat management systems, as well as power-shift transmissions, hydraulic torque converters, power take-offs, industrial clutches and controls systems. The Company sells to both domestic and foreign customers in a variety of market areas, principally pleasure craft, commercial and military marine markets, as well as in the energy and natural resources, government and industrial markets.

The Company has two reportable segments: manufacturing and distribution. These segments are managed separately because each provides different services and requires different technology and marketing strategies. The accounting practices of the segments are the same as those described in the summary of significant accounting policies. Transfers among segments are at established inter-company selling prices. Management evaluates the performance of its segments based on net earnings.

Information about the Company's segments is summarized as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------------|-------------------|------------------|
| | Mar. 30, 2012 | Mar. 25, 2011 | Mar. 30, 2012 | Mar. 25, 2011 |
| Manufacturing segment sales | \$86,659 | \$67,253 | \$235,686 | \$181,582 |
| Distribution segment sales | 30,990 | 29,195 | 94,166 | 93,476 |
| Inter/Intra segment elimination - manufacturing | (20,068) | (17,179) | (62,017) | (49,024) |
| Inter/Intra segment elimination - distribution | (2,091) | (2,798) | (8,074) | (13,008) |
| Net sales | \$95,490 | \$76,471 | \$259,761 | \$213,026 |
| Manufacturing segment net earnings | \$9,441 | \$4,965 | \$26,360 | \$13,381 |
| Distribution segment net earnings | 2,058 | 1,567 | 5,287 | 4,763 |
| Corporate and eliminations | (2,106) | (1,984) | (6,816) | (6,906) |

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| | | | | |
|---|-----------|-----------|----------|----------|
| Net earnings attributable to Twin Disc | \$9,393 | \$4,548 | \$24,831 | \$11,238 |
| | Mar. 30, | June 30, | | |
| Assets | 2012 | 2011 | | |
| Manufacturing segment assets | \$292,905 | \$271,454 | | |
| Distribution segment assets | 57,826 | 54,028 | | |
| Corporate assets and elimination of inter-company assets | (25,370) | (16,362) | | |
| | \$325,361 | \$309,120 | | |

F. Stock-Based Compensation

In the first nine months of fiscal 2012 and 2011, the Company granted a target number of 15,449 and 98,358 performance stock unit awards, respectively, to various employees of the Company, including executive officers. The performance stock unit awards granted in fiscal 2012 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2014. The performance stock unit awards granted in fiscal 2012 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 18,539. Based upon actual results to date and the probability of achieving the targeted performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2012 at the target level. The performance stock unit awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock unit awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 118,030. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2011 at the maximum level. There were 243,647 and 278,665 unvested stock unit awards outstanding at March 30, 2012 and March 25, 2011, respectively. The performance stock unit awards are remeasured at fair-value based upon the Company's stock price at the end of each reporting period. The fair-value of the stock unit awards are expensed over the performance period for the shares that are expected to ultimately vest. The compensation (income) expense for the three and nine months ended March 30, 2012, related to the performance stock unit awards, approximated \$(963,000) and \$88,000 respectively. The compensation expense for the three and nine months ended March 25, 2011, related to the performance stock unit awards, approximated \$567,000 and \$2,030,000, respectively.

In the first nine months of fiscal 2012 and 2011, the Company granted a target number of 15,335 and 72,546 performance stock awards, respectively, to various employees of the Company, including executive officers. The performance stock awards granted in fiscal 2012 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2014. The performance stock awards granted in fiscal 2012 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 18,402. Based upon actual results to date and the probability of achieving the targeted performance levels, the Company is accruing the performance stock awards granted in fiscal 2012 at the target level. The performance stock awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum

number of performance shares that can be awarded if the target objective is exceeded is 87,055. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock awards granted in fiscal 2011 at the maximum level. There were 191,398 and 213,219 unvested stock awards outstanding at March 30, 2012 and March 25, 2011, respectively. The fair value of the stock awards (on the date of grant) is expensed over the performance period for the shares that are expected to ultimately vest. The compensation expense for the three and nine months ended March 30, 2012, related to performance stock awards, approximated \$214,000 and \$625,000, respectively. The compensation expense for the three and nine months ended March 25, 2011, related to performance stock awards, approximated \$126,000 and \$517,000, respectively.

In addition to the performance shares mentioned above, the Company has unvested restricted stock outstanding that will vest if certain service conditions are fulfilled. The fair value of the restricted stock grants is recorded as compensation over the vesting period, which is generally 1 to 4 years. During the first nine months of fiscal 2012 and 2011, the Company granted 43,620 and 119,268 service based restricted shares, respectively, to employees and non-employee directors in each year. There were 250,323 and 237,691 unvested shares outstanding at March 30, 2012 and March 25, 2011, respectively. The compensation expense for the three and nine months ended March 30, 2012, related to these service-based awards approximated \$364,000 and \$1,070,000, respectively. The compensation expense for the three and nine months ended March 25, 2011, related to these service-based awards approximated \$289,000 and \$741,000, respectively.

G. Pension and Other Postretirement Benefit Plans

The Company has non-contributory, qualified defined benefit plans covering substantially all domestic employees hired prior to October 1, 2003 and certain foreign employees. Additionally, the Company provides health care and life insurance benefits for certain domestic retirees. Components of net periodic benefit cost for the defined benefit pension plans and the other postretirement benefit plan are as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------|--------------------|------------------|-------------------|------------------|
| | Mar. 30, 2012 | Mar. 25, 2011 | Mar. 30, 2012 | Mar. 25, 2011 |
| Pension Benefits: | | | | |
| Service cost | \$53 | \$46 | \$152 | \$130 |
| Interest cost | 1,516 | 1,566 | 4,543 | 4,687 |
| Expected return on plan assets | (1,927) | (1,525) | (5,775) | (4,562) |
| Amortization of net loss | 580 | 783 | 1,740 | 2,350 |
| Net periodic benefit cost | \$222 | \$870 | \$660 | \$2,605 |
| Postretirement Benefits: | | | | |
| Service cost | \$10 | \$8 | \$31 | \$24 |
| Interest cost | 245 | 274 | 738 | 822 |
| Amortization of net actuarial loss | 106 | 111 | 316 | 334 |
| Net periodic benefit cost | \$361 | \$393 | \$1,085 | \$1,180 |

The Company expects to contribute approximately \$3,728,000 to its pension plans in fiscal 2012. As of March 30, 2012, \$2,722,000 in contributions have been made.

H. Income Taxes

The effective tax rate for the first nine months of fiscal 2012 is 36.0%, which is lower than the prior year's 40.5%. The effective tax rate for the fiscal 2012 third quarter was 36.5 %, compared to the prior year's tax rate of 55.0 %. The

fiscal 2011 rates included a \$794,000 benefit due to a favorable adjustment to the deferred tax asset in the prior year second quarter related to the pension liability resulting from the increase in the estimated tax rate from 34% to 35%. The fiscal 2011 rates included the recording of a valuation allowance against the net deferred tax assets of certain foreign jurisdictions in the prior year third quarter. The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. Due to recent operating losses in certain foreign jurisdictions, the Company has evaluated the realizability of the net deferred tax assets related to these jurisdictions. This evaluation concluded that, based primarily upon recent losses in this jurisdiction and failure to achieve targeted levels of improvement, a full valuation allowance continues to be necessary.

During the third quarter of fiscal 2012, the Company completed and filed its 2011 Federal and State income tax returns. Subsequently, the Company completed its return-to-provision reconciliation to determine differences between positions taken per the year-end fiscal 2011 book tax provision and the actual positions taken per the 2011 returns. This reconciliation identified an error in the fiscal 2011 tax provision, which resulted in overstating fiscal 2011 earnings by \$608,000. To correct this error, the Company increased tax expense by \$608,000 in the third quarter of fiscal 2012. This adjustment was effectively offset by normal provision to return adjustments in the quarter, resulting in a minimal impact on the effective tax rate.

Accounting policies for interim reporting require the Company to adjust its effective tax rate each quarter to be consistent with the estimated annual effective tax rate. Under this effective tax rate methodology, the Company applies an estimated annual income tax rate to its year-to-date ordinary earnings to derive its income tax provision each quarter. The impact of the Company's operations in certain foreign jurisdictions is removed from the overall effective tax rate methodology and recorded discretely based upon year-to-date results as these operations anticipate net operating losses for the year for which no tax benefit can be recognized.

The Company has approximately \$560,000 of unrecognized tax benefits, excluding related interest and penalties, as of March 30, 2012, which, if recognized, would favorably impact the effective tax rate. The Company finalized the settlement of a U.S. income tax audit for fiscal years 2006 and 2007 during the quarter, resulting in a decrease of \$89,000 in the net amount of unrecognized tax benefits. The Company does not anticipate any material changes to this amount during the next twelve months.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. For the quarter ended March 30, 2012, total accrued interest and penalties with respect to income taxes was approximately \$41,000 that would favorably affect the effective tax rate if recognized.

Annually, the Company files income tax returns in various taxing jurisdictions inside and outside the United States. In general, the tax years that remain subject to examination are 2006 through 2011 for the major operations in the Italy, Belgium, and Japan. The tax years open to examination in the U.S. are for years subsequent to fiscal 2007. Audits currently underway include fiscal 2010 through 2011 in Belgium, fiscal 2010 in the U.S. and fiscal 2002 through 2009 in Wisconsin for income tax. It is reasonably possible that at least one of these audit cycles will be completed during fiscal 2012.

I. Goodwill and Other Intangibles

The changes in the carrying amount of goodwill, substantially all of which is allocated to the manufacturing segment, for the nine months ended March 30, 2012 were as follows (in thousands):

| | |
|--------------------------|----------|
| Balance at June 30, 2011 | \$17,871 |
| Translation adjustment | (539) |

Balance at March 30, 2012 \$17,332

The gross carrying amount and accumulated amortization of the Company's intangible assets that have defined useful lives and are subject to amortization as of March 30, 2012 and June 30, 2011 were as follows (in thousands):

| | March 30, 2012 | June 30, 2011 |
|--------------------------------------|-------------------|------------------|
| Intangible assets with finite lives: | | |
| Licensing agreements | \$3,015 | \$3,015 |
| Non-compete agreements | 2,050 | 2,050 |
| Other | 5,991 | 5,991 |
| | 11,056 | 11,056 |
| Accumulated amortization | (8,388) | (7,774) |
| Foreign currency translation | 640 | 817 |
| Total | \$3,308 | \$4,099 |

The weighted average remaining useful life of the intangible assets included in the table above is approximately 6 years.

Intangible amortization expense was \$197,000 and \$614,000 for the three and nine months ended March 30, 2012, respectively, and \$182,000 and \$583,000 for the three and nine months ended March 25, 2011, respectively. Estimated intangible amortization expense for the remainder of fiscal 2012 and each of the next five fiscal years is as follows (in thousands):

| Fiscal Year | |
|-------------|-------|
| 2012 | \$200 |
| 2013 | 745 |
| 2014 | 745 |
| 2015 | 432 |
| 2016 | 288 |
| 2017 | 284 |

The gross carrying amount of the Company's intangible assets that have indefinite lives and are not subject to amortization as of March 30, 2012 and June 30, 2011 are \$2,206,000 and \$2,340,000, respectively. These assets are comprised of acquired tradenames.

J. Long-term Debt

Long-term debt at March 30, 2012 and June 30, 2011 consisted of the following (in thousands):

| | March 30, 2012 | June 30, 2011 |
|--------------------------------|-------------------|------------------|
| Revolving loan | \$26,950 | \$11,300 |
| 10-year unsecured senior notes | 17,857 | 17,857 |
| Other | 301 | 542 |
| Subtotal | 45,108 | 29,699 |

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| | | |
|--|----------|----------|
| Less: current maturities and short-term borrowings | (3,789) | (3,915) |
| Total long-term debt | \$41,319 | \$25,784 |

The revolving loan and unsecured senior notes listed above are subject to certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants, as defined, include a minimum consolidated net worth, a minimum EBITDA for the most recent four fiscal quarters, and a maximum total funded debt to EBITDA ratio. As of March 30, 2012, the Company was in compliance with these covenants.

The fair value of long-term debt is estimated by discounting the future cash flows at rates offered to the Company for similar debt instruments of comparable maturities. This rate was represented by the US Treasury Three-Year Yield Curve Rate (0.51% and 0.81% for March 30, 2012 and June 30, 2011, respectively), plus the current add-on related to the revolving loan agreement (1.50% for March 30, 2012 and 2.00% for June 30, 2011, respectively). The fair value of the Company's 10-year unsecured senior notes due April 10, 2016 was approximately \$19,299,000 and \$19,589,000 at March 30, 2012 and June 30, 2011, respectively. The Company's revolving loan agreement approximates fair value at March 30, 2012 and June 30, 2011.

K. Shareholders' Equity

On February 1, 2008, the Board of Directors authorized the purchase of 500,000 shares of Common Stock at market values. The Company purchased no shares of its outstanding Common Stock in fiscal 2011 or the first nine months of fiscal 2012.

The following is a reconciliation of the Company's equity balances for the first fiscal nine months of 2011 and 2012 (in thousands):

| | Twin Disc, Inc. Shareholders' Equity | | | | | |
|--|--------------------------------------|-------------------|---|----------------|--------------------------|--------------|
| | Common Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Non-Controlling Interest | Total Equity |
| Balance –June 30, 2010 | \$10,667 | \$147,438 | (\$42,048) | (\$27,597) | \$859 | \$89,319 |
| Net income | | 11,238 | | | 61 | 11,299 |
| Translation adjustments | | | 14,661 | | 115 | 14,776 |
| Benefit plan adjustments, net of tax | | | 1,665 | | | 1,665 |
| Cash dividends | | (2,494) | | | (137) | (2,631) |
| Compensation expense and windfall tax benefits | 1,482 | | | | | 1,482 |
| Shares (acquired) issued, net | (1,979) | | | 2,182 | | 203 |
| Balance-March 25, 2011 | \$10,170 | \$156,182 | (\$25,722) | (\$25,415) | \$898 | \$116,113 |

| | Twin Disc, Inc. Shareholders' Equity | | | | | |
|-------------------------|--------------------------------------|-------------------|---|----------------|--------------------------|--------------|
| | Common Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Non-Controlling Interest | Total Equity |
| Balance-June 30, 2011 | \$10,863 | \$162,857 | (\$11,383) | (\$25,252) | \$969 | \$138,054 |
| Net income | | 24,831 | | | 108 | 24,939 |
| Translation adjustments | | | (6,350) | | 58 | (6,292) |

| | | | | | | |
|--|----------|-----------|------------|------------|---------|-----------|
| Benefit plan adjustments, net of tax | | | 1,303 | | | 1,303 |
| Cash dividends | (2,857) | | | (130) | | (2,987) |
| Compensation expense and windfall tax benefits | 2,230 | | | | | 2,230 |
| Shares (acquired) issued, net | (912) | | 896 | | | (16) |
| Balance-March 30, 2012 | \$12,181 | \$184,831 | (\$16,430) | (\$24,356) | \$1,005 | \$157,231 |

Item 2. Management Discussion and Analysis

In the financial review that follows, we discuss our results of operations, financial condition and certain other information. This discussion should be read in conjunction with our consolidated fiscal 2011 financial statements and related notes.

Some of the statements in this Quarterly Report on Form 10-Q are “forward looking statements” as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements include the Company’s description of plans and objectives for future operations and assumptions behind those plans. The words “anticipates,” “believes,” “intends,” “estimates,” and “expects,” or similar anticipatory expressions, usually identify forward-looking statements. In addition, goals established by Twin Disc, Incorporated should not be viewed as guarantees or promises of future performance. There can be no assurance the Company will be successful in achieving its goals.

In addition to the assumptions and information referred to specifically in the forward-looking statements, other factors, including but not limited to those factors discussed under Item 1A, Risk Factors, of the Company’s Annual Report filed on Form 10-K for June 30, 2011 could cause actual results to be materially different from what is presented here.

Results of Operations

(In thousands)

| | Three Months Ended | | | | Nine Months Ended | | | |
|--|--------------------|-------|-------------------|-------|-------------------|-------|-------------------|-------|
| | March 30, 2012 | % | March 25, 2011 | % | March 30, 2012 | % | March 25, 2011 | % |
| Net sales | \$95,490 | | \$76,471 | | \$259,761 | | \$213,026 | |
| Cost of goods sold | 62,434 | | 48,689 | | 166,375 | | 141,464 | |
| Gross profit | 33,056 | 34.6% | 27,782 | 36.3% | 93,386 | 36.0% | 71,562 | 33.6% |
| Marketing, engineering and administrative expenses | 17,746 | 18.6 | 17,054 | 22.3 | 53,752 | 20.7 | 50,470 | 23.7 |
| Earnings from operations | \$15,310 | 16.0 | \$10,728 | 14.0 | \$39,634 | 15.3 | \$21,092 | 9.9 |

Comparison of the Third Quarter of FY 2012 with the Third Quarter of FY 2011

Net sales for the third quarter increased 24.9%, or \$19.0 million, to \$95.5 million from \$76.5 million in the same period a year ago. Compared to the third quarter of fiscal 2011, on average, the Euro and Asian currencies weakened against the U.S. Dollar. The net translation effect of this on foreign operations was to decrease revenues by approximately \$0.3 million versus the prior year, before eliminations. The improvement in sales was the result of strong demand from customers in the oil and gas markets. Stable to slightly increased sales continued in a majority of the Company's other markets, including aftermarket, industrial, airport rescue and fire fighting (ARFF), land- and marine-based military, and commercial marine. Pleasure craft markets continue at depressed levels, largely impacting the Company's European operations.

Sales at our manufacturing segment were up 28.9%, or \$19.4 million, versus the same period last year. Compared to the third quarter of fiscal 2011, on average, the Euro weakened against the U.S. Dollar. The net translation effect of this on foreign manufacturing operations was to decrease revenues for the manufacturing segment by approximately \$0.5 million versus the prior year, before eliminations. In the current fiscal year's third quarter, our domestic manufacturing operation saw the largest growth, with a nearly 39% increase in sales versus the third fiscal quarter of 2011. The primary drivers for this increase were the sale of transmissions and related products for the oil and gas market, and increased commercial marine transmission shipments. The Company's Italian manufacturing operations, which were adversely impacted by the softness in the European mega yacht market, experienced decreases, with a nearly 9% decrease in sales compared to the prior fiscal year's third quarter. The softness in the European mega yacht market was only partially offset by continued growth in the Company's industrial product shipments. The Company's Belgian manufacturing operation, which also continued to be adversely impacted by the softness in the global mega yacht market, saw a 25% increase in sales versus the prior fiscal year's third quarter, as this operation continued to improve on its past due backlog. The Company's Swiss manufacturing operation, which supplies customized propellers for the global mega yacht and patrol boat markets, experienced a nearly 30% decrease in sales, primarily due to the rescheduling of customer shipments.

Our distribution segment, buoyed by continued strength in Asian markets, experienced an increase of 6%, or \$1.8 million, in sales compared to the third quarter of fiscal 2011. Compared to the third quarter of fiscal 2011, on average, the Asian currencies strengthened against the U.S. Dollar. The net translation effect of this on foreign distribution operations was to increase revenues for the distribution segment by approximately \$0.3 million versus the prior year, before eliminations. The Company's distribution operation in Singapore experienced strength in demand for marine transmission products for use in various commercial applications, as well as growth in shipments for land-based transmission products. This operation saw a 43% increase in sales versus the prior fiscal year's third quarter record levels. Third quarter sales for the Singapore operation, which operates as the Company's master distributor for Asia, represented an all-time quarterly sales record. The Company's distribution operation in the Northwest of the United States and Southwest of Canada experienced a decrease of 23% in its sales, from the prior fiscal year's record third quarter, due to a slowdown in the Canadian oil and gas market. The Company's distribution operation in Italy, which provides boat accessories and propulsion systems for the pleasure craft market, saw a nearly 10% decrease in sales due to continued weakness in the global mega yacht market. The Company's distribution operation in Australia, which provides boat accessories, propulsion and marine transmission systems for the pleasure craft market, saw an increase in sales of 15%, due to improved market conditions, including sales of component parts for the Company's new Express Joystick System®.

The elimination for net inter/intra segment sales increased \$2.2 million accounting for the remainder of the net change in sales versus the same period last year. This increase represents an increase in shipments from the domestic manufacturing operation to the distribution operation in Singapore to support the growing oilfield market demand in Southeast Asia.

Gross profit as a percentage of sales decreased 170 basis points to 34.6% of sales, compared to 36.3% of sales for the same period last year. Gross profit for fiscal 2012's third quarter was significantly impacted by higher sales volumes (approximately \$9.6 million) partially offset by an unfavorable mix (\$4.3 million) driven by a higher concentration of lower-margin marine unit shipments in the quarter. The Company also continues to benefit from the cost reduction

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and avoidance programs announced in the fourth fiscal quarter of 2009. As noted above, the majority of the sales volume increase came at the Company's domestic manufacturing operation, where the Company's 8500 and 7500 series transmissions for the oil and gas markets are produced. The growth in sales of these products was the primary driver of the favorable volume and mix benefits experienced in the quarter. Unfavorably impacting gross profit as a percentage of sales was total warranty expense which increased almost \$0.8 million in fiscal 2012's third quarter to \$1.0 million.

For the fiscal 2012 third quarter, marketing, engineering and administrative (ME&A) expenses, as a percentage of sales, were 18.6 percent, compared to 22.3 percent for the fiscal 2011 third quarter. ME&A expenses increased \$0.7 million versus the same period last fiscal year. The table below summarizes significant changes in certain ME&A expenses for the quarter:

| \$ thousands – (Income)/Expense | Three Months Ended | | Increase/ (Decrease) |
|------------------------------------|------------------------------|-------------------|-------------------------|
| | March 30, 2012 | March 25, 2011 | |
| Stock-Based Compensation | \$ (385) | \$ 982 | \$ (1,367) |
| Severance Charges | 330 | 0 | 330 |
| | | | (1,037) |
| | Foreign Currency Translation | | (59) |
| | | | (1,096) |
| | | All Other, Net | 1,788 |
| | | | \$ 692 |

The net remaining increase in ME&A expenses of \$1.8 million was primarily driven by higher salary and benefit costs, increased travel, higher project related expenses and a continued emphasis on the Company's product development program.

Interest expense of \$0.4 million for the quarter was down nearly 10% versus last year's third fiscal quarter. Total interest on the Company's \$40 million revolving credit facility ("revolver") increased 23% to \$0.1 million in fiscal 2012's third quarter. This increase can be attributed to an increase in the average borrowings year-over-year, partially offset by an overall decrease in the interest rate on the revolver. The average borrowing on the revolver, computed monthly, increased to \$24.6 million in fiscal 2012's third quarter, compared to \$8.7 million in the same period a year ago. The interest rate on the revolver decreased from a flat 4.00% in the prior fiscal year's third quarter to a range of 1.74% to 1.80% in the current year. The interest expense on the Company's \$25 million Senior Note decreased 17%, at a fixed rate of 6.05%, to \$0.3 million, due to a lower remaining principal balance.

Other expense of \$0.1 million for the quarter ended March 30, 2012 improved from other expense of \$0.2 million for the comparable period a year ago. The improvement is due primarily to favorable foreign currency movements of the Euro, Canadian Dollar and Swiss Franc.

The effective tax rate for the first nine months of fiscal 2012 is 36.0%, which is lower than the prior year's 40.5%. The effective tax rate for the fiscal 2012 third quarter was 36.5 %, compared to the prior year's tax rate of 55.0 %. The fiscal 2011 rates included a \$794,000 benefit due to a favorable adjustment to the deferred tax asset in the prior year second quarter related to the pension liability resulting from the increase in the estimated tax rate from 34% to 35%. The fiscal 2011 rates included the recording of a valuation allowance against the net deferred tax assets of certain foreign jurisdictions in the prior year third quarter. The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. Due to recent operating losses in certain foreign jurisdictions, the Company has

evaluated the realizability of the net deferred tax assets related to these jurisdictions. This evaluation concluded that, based primarily upon recent losses in this jurisdiction and failure to achieve targeted levels of improvement, a full valuation allowance continues to be necessary.

Comparison of the First Nine Months of FY 2012 with the First Nine Months of FY 2011

Net sales for the first nine months of fiscal 2012 increased 21.9%, or \$46.7 million, to \$259.8 million from \$213.0 million in the same period a year ago. Compared to the first nine months of fiscal 2011, on average, the Euro and Asian currencies strengthened against the U.S. Dollar. The net translation effect of this on foreign operations was to increase revenues by approximately \$2.8 million versus the prior year, before eliminations. The improvement in sales was the result of strong demand from customers in the oil and gas markets. Stable to slightly increased sales continued in a majority of the Company's other markets, including aftermarket, industrial, airport rescue and fire fighting (ARFF), land- and marine-based military, and commercial marine. Pleasure craft markets continue at depressed levels largely impacting the Company's European operations.

Sales at our manufacturing segment were up nearly 30%, or \$54.1 million, versus the same period last year. Compared to the first nine months of fiscal 2011, on average, the Euro strengthened against the U.S. Dollar. The net translation effect of this on foreign manufacturing operations was to increase revenues for the manufacturing segment by approximately \$1.5 million versus the prior year, before eliminations. In the current fiscal year's first nine months, our domestic manufacturing operation saw the largest growth, with a 35.1% increase in sales versus the first nine months of fiscal 2011. The primary drivers for this increase were the sale of transmissions and related products for the oil and gas market as well as increased commercial marine transmission and industrial product shipments. The Company's Italian manufacturing operations, which were adversely impacted by the softness in the European mega yacht market, experienced increases, with a nearly 9% increase in sales compared to the prior fiscal year's first nine months. The softness in the European mega yacht market was more than offset by continued growth in the Company's industrial product shipments into European markets. The Company's Belgian manufacturing operation, which also continued to be adversely impacted by the softness in the global mega yacht market, saw a 27% increase in sales versus the prior fiscal year's first nine months, as this operation continued to improve on its past due backlog. The Company's Swiss manufacturing operation, which supplies customized propellers for the global mega yacht and patrol boat markets, experienced an increase of just over 3% compared to the prior fiscal year's first nine months.

Our distribution segment, buoyed by continued sales in Asia and the North American oil and gas markets, experienced a modest increase of 1% in sales compared to the first nine months of fiscal 2011. Compared to the first nine months of fiscal 2011, on average, the Asian currencies strengthened against the U.S. Dollar. The net translation effect of this on foreign distribution operations was to increase revenues for the distribution segment by approximately \$2.5 million versus the prior year, before eliminations. The Company's distribution operations in Singapore continued to experience strong demand for marine transmission products for use in various commercial applications as well as land-based transmissions for Asian oil and gas markets. This operation saw a 2% increase in sales versus the same period a year ago, and set a new sales record for its first nine months. The Company's distribution operation in the Northwest of the United States and Southwest of Canada experienced over a 14% increase in sales due to continued strength in the Canadian oil and gas market, and set a new sales record for its first nine months. The Company's distribution operation in Italy, which provides boat accessories and propulsion systems for the pleasure craft market, saw a decrease in sales of nearly 30% due to continued weakness in the global mega yacht market. The Company's distribution operation in Australia, which provides boat accessories, propulsion and marine transmission systems for the pleasure craft market, saw an increase in sales of nearly 15%, due to improving market conditions, including sales of components parts for the Company's new Express Joystick System® that were shipped in the second and third quarters of fiscal 2012.

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The elimination for net inter/intra segment sales increased \$8.1 million, including an unfavorable exchange movement of \$1.2 million, accounting for the remainder of the net change in sales versus the same period last year. This increase was primarily the result of increased shipments from the domestic manufacturing operation to the distribution operation in Singapore to support the growth in the oilfield market in Southeast Asia.

Gross profit as a percentage of sales increased 240 basis points to 36.0% of sales, compared to 33.6% of sales for the same period last year. Gross profit for fiscal 2012's first nine months was significantly impacted by higher sales volumes (approximately \$22.3 million) partially offset by a slightly unfavorable mix impact (\$0.5 million). The Company also continues to benefit from the cost reduction and avoidance programs announced in the fourth fiscal quarter of 2009. As noted above, the majority of the sales volume increase came at the Company's domestic manufacturing operation, where the Company's 8500 and 7500 series transmissions for the oil and gas markets are produced. The growth in sales of these products was the primary driver of the favorable volume and mix benefits experienced in the first nine months. Also favorably impacting gross profit as a percentage of sales, total warranty expense decreased \$0.4 million, or 13%, to \$2.8 million in the first nine months of fiscal 2012 compared to the same period a year ago, despite a 21.9% increase in sales year-over-year.

For the first nine months of fiscal 2012, marketing, engineering and administrative (ME&A) expenses, as a percentage of sales, were 20.7 percent, compared to 23.7 percent for the first nine months of fiscal 2011. ME&A expenses increased \$3.3 million versus the same period last fiscal year. The table below summarizes significant changes in certain ME&A expenses for the quarter:

| \$ thousands – (Income)/Expense | Nine Months Ended | | Increase/ (Decrease) |
|------------------------------------|------------------------------|-------------------|-------------------------|
| | March 30, 2012 | March 25, 2011 | |
| Stock-Based Compensation | \$ 2,022 | \$ 3,288 | \$ (1,266) |
| Severance Charges | 330 | 0 | 330 |
| | | | (936) |
| | Foreign Currency Translation | | 927 |
| | | | (9) |
| | All Other, Net | | 3,291 |
| | | | \$ 3,282 |

The net remaining increase in ME&A expenses of \$3.3 million was primarily driven by higher salary and benefit costs, increased travel, higher project related expenses and a continued emphasis on the Company's product development program.

Interest expense of \$1.1 million for the first nine months was down 13.8% versus last fiscal year's first nine months. Total interest on the Company's \$40 million revolving credit facility ("revolver") decreased 3% to \$0.3 million in fiscal 2012's first nine months versus the same period a year ago. This decrease can be attributed to an overall decrease in the interest rate on the revolver, partially offset by an increase in the average borrowings year-over-year. The average borrowing on the revolver, computed monthly, increased to \$20.0 million in fiscal 2012's first nine months, compared to \$8.8 million in the same period a year ago. The interest rate on the revolver decreased from a flat 4.00% in the prior fiscal year's first nine months to a range of 1.74% to 2.12% in the current year. The interest expense on the Company's \$25 million Senior Note decreased 17%, at a fixed rate of 6.05%, to \$0.8 million, due to a lower remaining principal balance.

For the first nine months of fiscal 2012, other income was \$0.5 million, compared to other expense of \$0.8 million for the same period last year. The improvement is due primarily to favorable foreign currency movements of the Euro, Canadian Dollar and Swiss Franc.

The effective tax rate for the first nine months of fiscal 2012 is 36.0%, which is lower than the prior year's 40.5%. The effective tax rate for the fiscal 2012 third quarter was 36.5 %, compared to the prior year's tax rate of 55.0 %. The fiscal 2011 rates included a \$794,000 benefit due to a favorable adjustment to the deferred tax asset in the prior year second quarter related to the pension liability resulting from the increase in the estimated tax rate from 34% to 35%. The fiscal 2011 rates included the recording of a valuation allowance against the net deferred tax assets of certain foreign jurisdictions in the prior year third quarter. The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. Due to recent operating losses in certain foreign jurisdictions, the Company has evaluated the realizability of the net deferred tax assets related to these jurisdictions. This evaluation concluded that, based primarily upon recent losses in this jurisdiction and failure to achieve targeted levels of improvement, a full valuation allowance continues to be necessary.

Financial Condition, Liquidity and Capital Resources

Comparison between March 30, 2012 and June 30, 2011

As of March 30, 2012, the Company had net working capital of \$145.1 million, which represents an increase of \$33.9 million, or 30.5%, from the net working capital of \$111.2 million as of June 30, 2011. The primary drivers of the net increase in net working capital were an \$18.6 million, or 18.8%, increase in inventories, a \$6.7 million, or 10.9%, increase in accounts receivables and a \$7.4 million, or a 19.2%, decrease in accounts payable.

Cash decreased \$2.6 million to \$17.6 million as of March 30, 2012, versus \$20.2 million as of June 30, 2011. The majority of the cash as of March 30, 2012 is at our overseas operations in Europe and Asia-Pacific.

Trade receivables of \$67.7 million were up \$6.7 million, or just under 11%, when compared to last fiscal year-end. The impact of foreign currency translation was to decrease accounts receivables by \$1.9 million versus June 30, 2011. Adjusted for the impact of foreign currency movements, the net remaining increase is consistent with the sales volume increase, particularly at the end of the third fiscal quarter, at the Company's domestic manufacturing operations, and management's continued focus on monitoring customer receivables.

Net inventory increased by \$18.6 million versus June 30, 2011 to \$117.7 million. The impact of foreign currency translation was to decrease net inventory by \$3.8 million versus June 30, 2011. After adjusting for the impact of foreign currency translation, the net increase of \$22.4 million primarily came at the Company's domestic manufacturing and Canadian distribution operations and was driven by increased production volume and order activity due to the increase in overall demand for the Company's oil and gas related products. On a consolidated basis, as of March 30, 2012, the Company's backlog of orders to be shipped over the next six months approximates \$131.4 million, compared to \$146.9 million at June 30, 2011 and \$140.2 million at March 25, 2011. As a percentage of six month backlog, inventory has increased from 67% at June 30, 2011 to 90% at March 30, 2012. The primary driver of the recent increase in inventory as a percentage of six month backlog is the growth in inventory to support the oil and gas markets, including ramping up production for the new 7500 series transmission released into production in the first half of the fiscal year. The Company expects inventory levels to come down in the fourth fiscal quarter.

Net property, plant and equipment (PP&E) increased \$1.4 million versus June 30, 2011. This includes the addition of \$10.6 million in capital expenditures, primarily at the Company's Racine-based manufacturing operation, which was partially offset by depreciation of \$7.4 million. The net remaining decrease of \$1.8 million is due to foreign currency translation effects and disposals. In total, the Company expects to invest between \$15 and \$20 million in capital assets in both fiscal 2012 and 2013. The Company continues to review its capital plans based on overall market conditions and availability of capital, and may make changes to its capital plans accordingly. In addition, the quoted

lead times on certain manufacturing equipment purchases may push some of the capital expenditures into the next fiscal year. In fiscal 2011, the Company spent \$12.0 million for capital expenditures, up from \$4.5 million and \$8.9 million in fiscal years 2010 and 2009, respectively. The Company's capital program is focused on modernizing key core manufacturing, assembly and testing processes and expanding capacity at its facilities around the world.

Accounts payable as of March 30, 2012 of \$31.0 million were down \$7.4 million, or 19.2%, from June 30, 2011. The impact of foreign currency translation was to decrease accounts payable by \$1.0 million versus June 30, 2011. The net remaining decrease in accounts payable was consistent with the overall decrease in inventory at the end of the third quarter, a \$2.3 million decrease from the end of January to the end of March, versus an increase inventory at the end of the prior fiscal year end, a \$3.5 million increase from the end of April 2011 to the end of June 2011.

Total borrowings and long-term debt as of March 30, 2012 increased by \$15.4 million, or 52%, to \$45.1 million versus June 30, 2011. This net increase was driven by the overall increase in working capital levels, primarily driven by an increase in inventory and accounts receivable and a reduction in accounts payable. In addition, the Company made payments for its annual incentive program in the first fiscal quarter of 2012 based on the achievement of fiscal 2011 targets.

Total equity increased \$19.2 million, or 14%, to \$157.2 million as of March 30, 2012. Retained earnings increased by \$22.0 million. The net increase in retained earnings included \$24.8 million in net earnings attributable to Twin Disc for the first nine months offset by \$2.9 million in dividend payments. Net unfavorable foreign currency translation of \$6.3 million was reported. The net remaining movement of \$3.6 million represents an adjustment for the amortization of net actuarial loss and prior service cost on the Company's defined benefit pension plans of \$1.3 million and the impact of stock based compensation programs on common and treasury stock.

In December 2002, the Company entered into a \$20,000,000 revolving loan agreement with M&I Marshall & Ilsley Bank ("M&I"), which had an original expiration date of October 31, 2005. Through a series of amendments, the last of which was agreed to during the fourth quarter of fiscal 2011, the total commitment was increased to \$40,000,000 and the term was extended to May 31, 2015. This agreement contains certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants include a minimum consolidated net worth, minimum EBITDA for the most recent four fiscal quarters of \$11,000,000 at March 30, 2012, and a maximum total funded debt to EBITDA ratio of 3.0 at March 30, 2012. As of March 30, 2012, the Company was in compliance with these covenants with a four quarter EBITDA total of \$64,348,000 and a funded debt to EBITDA ratio of 0.70. The minimum net worth covenant fluctuates based upon actual earnings and is subject to adjustment for certain pension accounting adjustments to equity. As of March 30, 2012 the minimum equity requirement was \$117,118,000 compared to an actual result of \$190,226,000 after all required adjustments. The outstanding balance of \$26,950,000 and \$11,300,000 at March 30, 2012 and June 30, 2011, respectively, is classified as long-term debt. In accordance with the loan agreement as amended, the Company can borrow at LIBOR plus an additional "Add-On," between 1.5% and 2.5%, depending on the Company's Total Funded Debt to EBITDA ratio. The rate was 1.74% and 2.09% at March 30, 2012 and June 30, 2011, respectively.

On April 10, 2006, the Company entered into a Note Agreement (the "Note Agreement") with The Prudential Insurance Company of America and certain other entities (collectively, "Purchasers"). Pursuant to the Note Agreement, Purchasers acquired, in the aggregate, \$25,000,000 in 6.05% Senior Notes due April 10, 2016 (the "Notes"). The Notes mature and become due and payable in full on April 10, 2016 (the "Payment Date"). Prior to the Payment Date, the Company is obligated to make quarterly payments of interest during the term of the Notes, plus prepayments of principal of \$3,571,429 on April 10 of each year from 2010 to 2015, inclusive. The outstanding balance was \$17,857,143 at March 30, 2012 and June 30, 2011, respectively. Of the outstanding balance, \$3,571,429 was classified as a current maturity of long-term debt at March 30, 2012 and June 30, 2011, respectively. The remaining \$14,287,714 is classified as long-term debt. The Company also has the option of making additional prepayments subject to certain limitations, including the payment of a Yield-Maintenance Amount as defined in the Note Agreement. In addition, the Company will be required to make an offer to purchase the Notes upon a Change of

Control, and any such offer must include the payment of a Yield-Maintenance Amount. The Note Agreement includes certain financial covenants which are identical to those associated with the revolving loan agreement discussed above. The Note Agreement also includes certain restrictive covenants that limit, among other things, the incurrence of additional indebtedness and the disposition of assets outside the ordinary course of business. The Note Agreement provides that it shall automatically include any covenants or events of default not previously included in the Note Agreement to the extent such covenants or events of default are granted to any other lender of an amount in excess of \$1,000,000. Following an Event of Default, each Purchaser may accelerate all amounts outstanding under the Notes held by such party.

Four quarter EBITDA and total funded debt are non-GAAP measures, and are included herein for the purpose of disclosing the status of the Company's compliance with the four quarter EBITDA covenant and the total funded debt to four quarter EBITDA ratio covenant described above. In accordance with the Company's revolving loan agreement with M&I and the Note Agreement:

- "Four quarter EBITDA" is defined as "the sum of (i) Net Income plus, to the extent deducted in the calculation of Net Income, (ii) interest expense, (iii) depreciation and amortization expense, and (iv) income tax expense;" and
- "Total funded debt" is defined as "(i) all Indebtedness for borrowed money (including without limitation, Indebtedness evidenced by promissory notes, bonds, debentures and similar interest-bearing instruments), plus (ii) all purchase money Indebtedness, plus (iii) the principal portion of capital lease obligations, plus (iv) the maximum amount which is available to be drawn under letters of credit then outstanding, all as determined for the Company and its consolidated Subsidiaries as of the date of determination, without duplication, and in accordance with generally accepted accounting principles applied on a consistent basis."
- "Total funded debt to four quarter EBITDA" is defined as the ratio of total funded debt to four quarter EBITDA calculated in accordance with the above definitions.

The Company's total funded debt as of March 30, 2012 and June 30, 2011 was equal to the total debt reported on the Company's March 30, 2012 and June 30, 2011 Condensed Consolidated Balance Sheet, and therefore no reconciliation is included herein. The following table sets forth the reconciliation of the Company's reported Net Earnings to the calculation of four quarter EBITDA for the four quarters ended March 30, 2012:

| | |
|-----------------------------|--------------|
| Four Quarter EBITDA | |
| Reconciliation | |
| Net Earnings | \$32,423,000 |
| Depreciation & Amortization | 10,931,000 |
| Interest Expense | 1,539,000 |
| Income Taxes | 19,455,000 |
| Four Quarter EBITDA | \$64,348,000 |

| | |
|--|--------------|
| Total Funded Debt to Four Quarter EBITDA | |
| Total Debt | \$45,108,000 |
| Divided by: Four Quarter EBITDA | 64,348,000 |
| Total Funded Debt to Four Quarter EBITDA | 0.70 |

As of March 30, 2012, the Company was in compliance with all of the covenants described above. Based on its annual and long range financial plans as well as in the historically high level of the Company's order backlog, the

Company does not expect to violate any of its financial covenants over the course of the next year. Please see the factors discussed under Item 1A, Risk Factors, of the Company's Annual Report filed on Form 10-K for June 30, 2011 for further discussion of this topic.

The Company's balance sheet remains very strong, there are no off-balance-sheet arrangements other than the operating leases listed below, and we continue to have sufficient liquidity for near-term needs. The Company had \$13.1 million of available borrowings on our \$40 million revolving loan agreement as of March 30, 2012, and expects to continue to generate enough cash from operations to meet our operating and investing needs. As of March 30, 2012, the Company also had cash of \$17.6 million, primarily at its overseas operations. These funds, with some restrictions, are available for repatriation as deemed necessary by the Company. In fiscal 2012, the Company expects to contribute \$3,728,000 to its defined benefit pension plans, the minimum contributions required. However, if the Company elects to make voluntary contributions in fiscal 2012, it intends to do so using cash from operations and, if necessary, from available borrowings under existing credit facilities. As of March 30, 2012, \$2,722,000 in contributions have been made.

As of March 30, 2012, the Company has obligations under non-cancelable operating lease contracts and loan and senior note agreements for certain future payments. A summary of those commitments follows (in thousands):

| | Total | Less than 1 year | 1-3 Years | 3-5 Years | After 5 Years |
|-------------------------|----------|---------------------|--------------|--------------|------------------|
| Contractual Obligations | | | | | |
| Revolver borrowing | \$26,950 | | \$26,950 | | |
| Long-term debt | \$18,158 | \$3,789 | \$7,198 | \$7,143 | \$28 |
| Operating leases | \$5,954 | \$2,920 | \$2,666 | \$368 | |
| Total obligations | \$51,062 | \$6,709 | \$36,814 | \$7,511 | \$28 |

The table above does not include tax liabilities related to uncertain income tax positions totaling \$560,000, excluding related interest and penalties, as the timing of their resolution can not be estimated. See Note H of the Condensed Consolidated Financial Statements for disclosures surrounding uncertain income tax positions.

The Company maintains defined benefit pension plans for some of its operations in the United States and Europe. The Company has established the Pension Committee to manage the operations and administration of the defined benefit plans. The Company estimates that fiscal 2012 contributions to all defined benefit plans will total \$3,728,000. As of March 30, 2012, \$2,722,000 in contributions have been made.

New Accounting Releases

In September 2011, the Financial Accounting Standards Board ("FASB") issued a standards update that is intended to simplify how entities test goodwill for impairment. This update permits an entity to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 (the Company's fiscal 2013). This standards update is not expected to have a material impact on the Company's financial statements.

In June 2011, FASB issued a standards update that will allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This standards update eliminates the option of presenting the components of other comprehensive income as part of the statement of changes in stockholders' equity. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 (the Company's fiscal 2013). This standards update is not expected to have any

impact on the Company's financial statements, as the Company's reporting is already compliant with this guidance.

In May 2011, the FASB issued a standards update which represents the converged guidance of the FASB and the International Accounting Standards Board ("IASB") on fair value measurement. This collective effort has resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." This update is to be applied prospectively effective for interim and annual periods beginning after December 15, 2011 (the Company's third fiscal quarter of 2012). This standards update did not have a material impact on the Company's financial statements.

Critical Accounting Policies

The preparation of this Quarterly Report requires management's judgment to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates.

Twin Disc's critical accounting policies are described in Item 7 of the Company's Annual Report filed on Form 10-K for June 30, 2011. There have been no significant changes to those accounting policies subsequent to June 30, 2011.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

The Company is exposed to market risks from changes in interest rates, commodities and foreign exchange. To reduce such risks, the Company selectively uses financial instruments and other pro-active management techniques. All hedging transactions are authorized and executed pursuant to clearly defined policies and procedures, which prohibit the use of financial instruments for trading or speculative purposes.

Interest rate risk - The Company's earnings exposure related to adverse movements of interest rates is primarily derived from outstanding floating rate debt instruments that are indexed to the prime and LIBOR interest rates. In accordance with the \$40,000,000 revolving loan agreement expiring May 31, 2015, the Company has the option of borrowing at the prime interest rate or LIBOR plus an additional "Add-On", between 1.5% and 2.5%, depending on the Company's Total Funded Debt to EBITDA ratio. Due to the relative stability of interest rates, the Company did not utilize any financial instruments at March 30, 2012 to manage interest rate risk exposure. A 10 percent increase or decrease in the applicable interest rate would result in a change in pretax interest expense of approximately \$47,000.

Commodity price risk - The Company is exposed to fluctuation in market prices for such commodities as steel and aluminum. The Company does not utilize commodity price hedges to manage commodity price risk exposure.

Stock market risk - The Company's earnings are exposed to stock market risk relative to the Performance Stock Unit Awards. These are cash based awards which are revalued at the end of each reporting period based upon the Company's closing stock price as of the end of the period. A one dollar increase or decrease in the Company's stock price would result in a decrease or increase, respectively, in earnings from operations of approximately \$172,000 as of March 30, 2012. These awards were valued based upon the average of the high and low of the Company's March 30, 2012 stock price of \$26.63.

Currency risk - The Company has exposure to foreign currency exchange fluctuations. Approximately 20% of the Company's revenues in the nine months ended March 30, 2012 were denominated in currencies other than the U.S. Dollar. Of that total, approximately 70% was denominated in Euros with the balance composed of Japanese Yen, the Swiss Franc and the Australian and Singapore Dollars. The Company does not hedge the translation exposure represented by the net assets of its foreign subsidiaries. Foreign currency translation adjustments are recorded as a component of shareholders' equity. Forward foreign exchange contracts are used to hedge the currency fluctuations on significant transactions denominated in foreign currencies.

Derivative financial instruments - The Company has written policies and procedures that place all financial instruments under the direction of the company corporate treasury and restrict derivative transactions to those intended for hedging purposes. The use of financial instruments for trading purposes is prohibited. The Company uses financial instruments to manage the market risk from changes in foreign exchange rates.

The Company primarily enters into forward exchange contracts to reduce the earnings and cash flow impact of non-functional currency denominated receivables and payables. These contracts are highly effective in hedging the cash flows attributable to changes in currency exchange rates. Gains and losses resulting from these contracts offset the foreign exchange gains or losses on the underlying assets and liabilities being hedged. The maturities of the forward exchange contracts generally coincide with the settlement dates of the related transactions. Gains and losses on these contracts are recorded in Other expense, net in the Condensed Consolidated Statement of Operations as the changes in the fair value of the contracts are recognized and generally offset the gains and losses on the hedged items in the same period. The primary currency to which the Company was exposed in fiscal 2012 and 2011 was the Euro. The Company had no outstanding forward exchange contracts at March 30, 2012 or June 30, 2011.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("the Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing, and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act, and that such information is accumulated and communicated to the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely discussions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). During the first quarter of fiscal 2012, the Company implemented a new enterprise resource planning (ERP) system at its Belgian manufacturing operation. As a result of the implementation, the Company initiated a process to review and redesign, as necessary, the controls impacted by the new ERP system, which was substantially completed by the end of the second fiscal quarter. Further testing and validation of the revised controls continued through the third quarter and will continue into the fourth quarter. Despite the process to review, redesign and test controls, as necessary, management believes adequate disclosure controls and procedures remained in place during the quarter covered by this report.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Twin Disc is a defendant in several product liability or related claims which are considered either adequately covered by appropriate liability insurance or involving amounts not deemed material to the business or financial condition of the Company.

Item 1A. Risk Factors

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There have been no material changes to the risk factors previously disclosed in response to Item 1A to Part I of our 2011 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Unregistered Sales of Equity Securities

There were no securities of the Company sold by the Company during the nine months ended March 30, 2012, which were not registered under the Securities Act of 1933, in reliance upon an exemption from registration provided by Section 4 (2) of the Act.

(b) Use of Proceeds

Not applicable.

(c) Issuer Purchases of Equity Securities

Issuer Purchases of Equity Securities

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|-------------------------------|--------------------------------------|----------------------------------|--|--|
| Dec. 31, 2011 – Jan. 27, 2012 | 0 | NA | 0 | 250,000 |
| Jan. 28, 2012 – Feb. 24, 2012 | 0 | NA | 0 | 250,000 |
| Feb. 25, 2012 – Mar. 30, 2012 | 0 | NA | 0 | 250,000 |
| Total | 0 | | 0 | |

On February 1, 2008, the Board of Directors authorized the purchase of up to 500,000 shares of Common Stock at market values, of which 250,000 shares were purchased during the second quarter of fiscal 2009.

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

Item 6. Exhibits

31a Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31b Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 32a Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
 - 32b Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TWIN DISC, INCORPORATED
(Registrant)

Date: May 9, 2012

/s/ JEFFREY S. KNUTSON
Jeffrey S. Knutson
Corporate Controller
Chief Accounting Officer
