

# FINAL TRANSCRIPT

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## CRS - Q2 2011 Carpenter Technology Earnings Conference Call

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**Bill Wulfsohn**

*Carpenter Technology Corporation - President and CEO*

**Doug Ralph**

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## CONFERENCE CALL PARTICIPANTS

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*Cleveland Research Company - Analyst*

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## PRESENTATION

**Operator**

Good morning, and welcome to Carpenter Technology's second-quarter earnings conference call. My name is Caitlin and I will be your coordinator for today. At this time, all participants will be in a listen-only mode. After the speakers' remarks, you will be invited to participate in the question-and-answer session towards the end of this call. (Operator Instructions).

I would now like to turn the call over to your host for today, to Mr. Mike Hajost, Vice President and Treasurer. Please proceed.

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**Mike Hajost** - *Carpenter Technology Corporation - VP and Treasurer*

Thank you, Caitlin. Good morning, everyone, and welcome to Carpenter's earnings conference call for the second quarter ended December 31, 2010. This call is also being broadcast over the Internet.

With us today are Bill Wulfsohn, President and Chief Executive Officer, and Doug Ralph, Senior Vice President and Chief Financial Officer, as well as other members of the management team.



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Statements made by management during this conference call that are forward looking statements are based on current expectations. Risk factors that could cause actual results to differ materially from these forward-looking statements can be found in Carpenter's most recent SEC filings, including the Company's June 30, 2010 10-K; its September 30, 2010 10-Q; and the exhibits attached to those filings.

I will now turn the call over to Bill.

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**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Thank you, Mike. Good morning, everyone, and thank you for joining us for our fiscal year 2011 second-quarter earnings call. During our last call, I outlined in some detail my initial priorities. These included -- one, enhancing operational excellence; two, improving product mix; and three, accelerating growth in the business. These priorities remain unchanged, and the Carpenter team is aligned and active in each of these areas.

From an operational perspective, we've made great strides as we've reduced the number of safety incidences and reduced variable costs per ton. However, demand has outpaced our ability to add production shifts and train workers. Overall, we are experiencing significant demand for our materials across all of our end markets. In particular, we're pleased with the strength of the aerospace engine market, where we have increased our share position, and in the oil and gas sector, where we recently announced a downstream acquisition and are seeing rapid growth.

In the short-term, this led to tight capacity across some of our critical operations. We are making progress reducing these bottlenecks, and we fully expect greater output in the second half of the fiscal year. Our actions in this area are critical to success, as increasing our capacity will help us to reduce lead-times and bring in more profitable transactional volume.

My second key priority is improving our product mix. Let me be very clear -- we are not yet achieving the profit margins we expect to see in this business. Stepping back, as we discussed last quarter, we took on lower-value business during the downturn. With demand recovering, our plan is to increase margins by improving our sales mix and increasing our prices. You don't yet see strong evidence of these actions in the second quarter due to our long lead-times. In fact, most of our second-quarter shipments were booked before pricing and mix management actions were taken.

In addition, due to capacity constraints, we have had to turn away profitable transaction volume in the quarter. With improving operational performance, and a fuller realization of the impact of our announced price increases and mix management decisions, our margins will steadily improve over the next few quarters. This issue has my full attention and it is also the management team's number one priority. Success in our margin improvement efforts will also allow us to build the same level of momentum on the bottom line as we are seeing on the top line.

With respect to accelerating Carpenter's growth, I am confident we are very well-positioned in a very exciting space. Aerospace is clearly one of the most exciting markets we participate in. From a demand perspective, we expect Airline Monitor to soon release an increased forecast for aircraft build rates. In addition, the 787 supply chain is beginning to gear up, as deliveries are scheduled for later this year. We also see significant opportunities to extend our recent share gains. As a result, our backlog in this market continues to increase.

We continue to believe that the energy market has the potential to be our fastest growing market. Directional drilling rigs are already above prior peak levels and projected build rates for power generation plants are increasing. We are well-positioned in these as well as other segments of the energy market.

As we look to the future, a consequence of this continued demand growth is the eventual need for us to expand our capacity. As a first step, we are focused on finalizing customer qualifications of our new premium melt assets. We are also engaging lean



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resources to squeeze more production out of our other existing production assets. Finally, considering the lead-time required to put in new capacity, we are beginning to evaluate our next capacity expansion investments.

To augment our organic growth, we continue to pursue acquisitions and joint ventures, where there is a strong strategic fit and a positive financial return. Our partnered joint ventures announced earlier this year with Sandvik serve as an example of this strategy. We are also extremely excited about our recent downstream purchase of Amega West in the oil and gas drilling sector. This acquisition reflects our commitment to grow our energy business. It also moves us closer to the end customer. This benefits the customer by creating a more responsive supply chain. It also benefits Carpenter by helping us to accelerate product development and expand the use of our high-value alloys. Looking forward, we plan to increase Amega West's capability and footprint with additional investments.

Lastly, in terms of growth, we are getting very excited about the projects being worked on within our R&D group. We have a couple of near-term opportunities that are progressing well. We also have some longer-term projects that have the potential to be technical breakthroughs. We will provide more color on our R&D opportunities, as well as a broader and more strategic view of where Carpenter is going in the future during our February 16 investor day in New York.

Now, switching gears, I will review the status of our end markets in the order of their contribution to net sales.

Aerospace sales were \$150 million in the second quarter. Excluding surcharge, aerospace sales were up 24% on 32% higher volume. Aerospace results reflect the fifth consecutive quarter of strong demand for engine components and the impact of our share gain. We recently extended long-term supply agreements with major customers, and some of these customers are expanding their capacity and position in the industry, which also helps our growth.

We are now seeing increased order activity for our titanium business, as demand for titanium fasteners is picking up in anticipation of significant 787 needs. Recall the 787 uses eight times more titanium fasteners by weight than the 737. To meet this increased demand on a long-term basis, we recently announced the expansion of our titanium manufacturing facility in Florida. Although slower in developing, we expect order activity to increase for nickel and stainless fasteners over the next two quarters. Demand signals vary by customer, but overall, channel checks and supplier readiness assessments are continuing.

Sales to the industrial market are \$88 million in the second quarter. Excluding surcharge revenue, industrial sales increased 42% on 48% higher volume. The year-over-year results reflects increased demand for industrial products well above market growth rates. We see continued strong demand for higher-value semiconductor applications. We expect strong growth for the rest of the fiscal year. Eventually, as stimulus effects dissipate and restocking comes to an end, we expect demand in this market to better match GDP growth rates.

Energy sales are \$42 million in the second quarter. Excluding surcharge revenue, energy market sales increased 90% on 104% higher volume. This year-over-year increase reflects sharply higher demand from materials used in oil and gas applications, and recovering demand for high-value materials used in industrial gas turbines.

Directional drilling activity continues to grow. We also are expanding our participation into completion applications that utilize higher-value products. Beyond our Amega West acquisition, we will continue to evaluate alternatives to grow our presence and footprints in this sector.

Low natural gas prices, newly available financing, growth in electricity consumption, and supply chain restocking were all contributing to demand recovery for materials used in industrial gas turbines. These developments increased our confidence that energy has the potential to be our fastest-growing market and will have a positive impact on our growth in our international business.

Consumer market sales were \$36 million in the second quarter. Excluding surcharge revenue, sales increased 33% on 30% higher volume. Increases in volumes and revenues are due to growing demand for fasteners and electronic components used



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within housing and appliance. Although the majority of our sales are made to US-based customers, they are distributed globally, reducing some of the impact from the slow US housing market. We expect continued improvement in our mix over the next few quarters as we substitute lower-value products with higher-value ones.

Automotive market sales were \$34 million in the second quarter. Excluding surcharge revenue, automotive sales rose 24% as volumes increased 36%. The year-over-year volume increase reflects continued growth in demand for our products. Our mix in this segment should improve as we reduce sales of lower-value materials used in valves, and demand continues to grow for high-value turbocharger products and fuel system components. Strong retail sales during the last quarter of 2010 corrected inventories downward. 2011 will support a modest recovery as the US industry expects to sell 13 million vehicles, an increase of 13% over 2010. Longer-term, Carpenter is well-positioned to participate in the broader transportation industry's continual push for fuel efficiency and lower emissions.

Sales to the medical market were \$26 million in the quarter. Excluding surcharge revenue, medical market sales increased 20% on 26% higher volume. Increased sales of high-end stainless products outpaced demand of higher-value titanium and cobalt materials. We are now seeing the supply chain restock select materials. This is in advance of expected near-term OEM reordering in the US and Europe. In addition, activity in China continues to gain momentum. Orthopedic procedures are projected to continue their 6% growth rate. Material demand fluctuates with stocking and destocking trends.

With respect to international, Carpenter sales outside the US in the second quarter were \$122 million, an increase of 42% over second quarter a year ago. Sales in Europe were up 47% on 61% higher volume. This was driven mainly by increased demand in aerospace, energy, and automotive. Sales to power generation customers were particularly strong in the second quarter. The sales backlog in Europe is currently at a three-year high.

We saw continued momentum related to our Asia-Pacific strategy, as revenues increased 39% in that region on 62% higher volume. This was driven by significant broad-based growth in most markets, with particular strength in the energy and automotive sectors. International sales in the second quarter of 2011 represented 32% of total sales, unchanged from the prior year. We continue to believe that international growth will outpace overall Company growth in the coming years.

I'll now turn the discussion over to Doug, who will walk us through the financial results.

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**Doug Ralph** - Carpenter Technology Corporation - SVP of Finance and CFO

Thanks, Bill. Before I review our second-quarter results, I'd like to make a few comments on our broader financial position and outlook.

We expect to see clear progress in our operating income and margin and EPS results over the next two quarters, and we remain on track to achieve our financial goals for the full fiscal year. This includes continued strong volume and revenue growth, which we now expect to be in excess of 20% from year-to-year and above our prior outlook, improving operating income and margin in the second half of the year behind higher volumes, mix improvement, pricing actions and lower costs, and overall free cash flow for the year that is about neutral, excluding the Amega West acquisition.

Our cash flow goal of about neutral excluding Amega West will be the most challenging for us. Much of our higher inventory position and value is a function of our current business strength and the need to support growth of premium products in the second half. However, in certain areas, we have built up excess inventory, which we are targeting to reduce over the second half. Our end-of-year cash flow result will also be influenced by other factors, like the impact that May/June nickel prices will have on our accounts receivable. Nonetheless, we expect our inventory and cash flow performance to improve over the second half.

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Moving beyond this fiscal, we expect to continue strong topline and bottom-line progress, and have an internal plan in place to return to and then exceed our previous peak EBITDA level. While higher volume is a key factor in our profit improvement plan, it is even more important that we improve our profitability per pound.

We have been taking pricing and mix improvement actions during the year, based on a full analysis of profit by item, especially in areas where we have tight capacity for premium products. These actions have taken a few quarters to impact the bottom line, due to our long order lead-times and the amount of current capacity devoted to customers with long-term agreements. We expect to see the evidence of these actions in our margin performance for the next two quarters and into next fiscal year. In addition, we are still not back to normal levels on certain high value products like aerospace fasteners, which will be a positive to product mix and margin in the future.

Let me now turn to our second-quarter results. Net sales in the quarter were \$376 million or 42% [above] a year ago. Excluding raw material surcharge, sales were up 34%. Overall pounds shipped increased 43% from year-ago. Stainless steel products increased 50%, which is a function of the lower-value products taken on during the downturn, while titanium products were up 33% and special alloys were up 28%.

Gross profit was \$49.1 million compared with \$35.6 million in last year's second quarter. The higher gross profit level is driven by significantly higher volumes and better overall cost performance, partially offset by weaker product mix.

SG&A expenses in the second quarter were \$37 million compared to \$33.6 million in the prior year. The increase is primarily in our variable compensation expense, which reflects a more normalized cost level and trend this fiscal year versus the base period where the expense was lower due to the downturn. Beyond this, we booked Amega West transaction costs in the quarter, and we are making some resource investments to drive our strategic growth initiatives, as we have been talking about for awhile. As a percentage of sales, excluding surcharge, SG&A expense is about 3 percentage points lower than last year's second quarter and we should continue to benefit from efficiencies as we grow revenue.

Returning to the income statement, we had operating income of \$12.1 million for the quarter compared with \$2 million in last year's second quarter. Our operating margin, excluding surcharge and pension, earnings, interest and deferrals, or EID, as we always quote it, was 7.5%. This is up from 5.5% in last year's second quarter. Margins decreased slightly from the first quarter level of 8.7%, as higher volume was more than offset by weaker mix and nickel price impacts, which are the result of building inventory during rising nickel prices and the related lag in our surcharge pricing mechanism. Again, we expect our operating margin performance to improve in the next two quarters.

Finishing up the income statement, other income of \$3 million was significantly down from last year's level of \$6.7 million. This was mainly due to the closeout of the [CDS-08] program, which contributed \$5.8 million in the second quarter of last year, but only \$400,000 in the current period. I think we had given plenty of advance notice that this was coming.

The income tax provision for the quarter was \$1.4 million, or 13% of pretax income, which reflects the recent retroactive extension of the R&D tax credit. This compares to a tax provision of \$700,000, or 17% of pretax income a year ago. For the full year, we now expect our tax rate to be about 24%.

Net income was \$9.3 million or \$0.21 per diluted share compared with second-quarter net income last year of \$3.5 million or \$0.08 per diluted share. As we outlined in the press release, while the R&D tax credit helped our result in the quarter, this was largely offset by other items, including Amega West transaction costs, unplanned equipment outages, and customer-requested volume shifts into the third quarter.

Speaking of the Amega West acquisition, which we closed on December 31, we expect this to add a few cents to earnings in the current fiscal year, including the transaction costs that we booked in the second quarter, and some deferral of PAO revenue and earnings, since our sales to Amega are now handled as a wholly-owned affiliate.



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Free cash flow for the quarter was a negative \$90 million, which reflects the Amega West acquisition and a further increase in inventory levels. Our higher inventory level in the first two quarters is primarily a function of higher volume and the need to support strong second-half shipments of richer mix products, which also impacts the inventory value. While our inventory turns are above last year's level, as they should be, we are running short of our internal targets in a few areas and have focus in place to reduce excess inventory in the second half of the year.

We currently expect our capital spending for the year to be closer to \$60 million than the previous estimate of \$70 million. Our balance sheet remains strong. The high inventory level has had a negative impact on our ending December cash balance of \$224 million, resulting in a net debt position of \$35 million. We expect to be back around \$300 million of cash and positive net cash by the end of the fiscal. We are committed to maintain strong liquidity and balance sheet position, which will give us the flexibility to fund planned growth initiatives. We are also well out front with plans to refinance our August 2011 debt maturity.

With that, I will now turn it back to the Operator so we can open the line for your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Chris Olin, Cleveland.

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### Chris Olin - Cleveland Research Company - Analyst

A lot of questions on this margin issue getting weaker in the second quarter, and I thought maybe it would be helpful if you got a little more clarity into the actual impact some of those issues had, like the nickel accounting impact; the issue with this customer; and also the outages. Can you break out what you thought that did to the margins or results during the quarter?

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### Doug Ralph - Carpenter Technology Corporation - SVP of Finance and CFO

The R&D tax credit effect for the quarter was worth about \$0.04 positive. Amega transaction cost, the total amount of those is around \$700,000 before tax, so that's a little bit more than \$0.01. The customer requested volume shifts into the third quarter and that was on the premium side of our business, so that was worth a little more than \$1 million or a little more than \$0.02 a pound.

And then a couple of unplanned equipment outages that we had was worth the other \$0.01. So in total, all of those were offsetting effects versus the first-quarter margin level -- while we had higher volume, that was offset by a weaker product mix. One example of that or illustration of that is if you look at stainless volume as a percentage of our total revenue, it actually went up in the second quarter, and we consider that a function of transition and the fact that the customer requested volume shifts were on the premium side of the business, which contributed to that as well. And then the balance of the difference was the additional business model effects from rising nickel prices that impacted us in the second quarter.

When we file our 10-Q, one of the things that we always do when we talk about operating margin is to dimensionalize the effects that we have from either the raw material surcharge lag in our pricing mechanism as well as the inventory effects, and are on an apples-and-apples adjusted basis. Our margin was approximately level versus the first quarter and the second quarter.



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**Chris Olin** - *Cleveland Research Company - Analyst*

Have you looked at timeline in terms of working off the commodity volumes you have in the backlog, in terms of when a 10% EBIT margin could be achievable, given where you're priced at now?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

First of all -- this is Bill -- I would say that we clearly do keep a very close focus on the materials that have been ordered and how they're working their way through our system. Lead-times were between four and six months. They continue more or less at that level. So it's taken a little while.

Also, the customers in the lower-value end were good customers to us, especially in the downturn. And so we've been working with them to find alternative supply, as we've been raising the price and exiting some, we'll say, less attractive portions of the business. So the types of targets that you're talking about, we view in our very near-term horizon because we're getting to the point now where this transition is, in fact, taking place in the mix we're realizing here in the quarter.

**Chris Olin** - *Cleveland Research Company - Analyst*

So if I'm reading you right, within six months, we could be back at that kind of profit level?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

Well, we would -- on an adjusted basis, we were higher than the reported 7.5% in the second quarter, and we do expect to show clear progress in the upcoming two quarters and into next fiscal year. So, that 10% level should not be a particularly great challenge for us as we look into our second quarter.

**Chris Olin** - *Cleveland Research Company - Analyst*

Understood. Then, lastly, was there any impact within the channel related to the latest announcements from -- regarding the 787? Have you seen any kind of pause or are you preparing for something to happen in terms of inventory correction?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Well, we have seen a pickup in our demand for titanium fasteners. In fact, we're seeing that pickup rapidly to the point where it's close to the previous peak demand right now. And I think our customers, who are ultimately consuming that material for the 787, are expanding their production. Two quarters in the aerospace industry is not really very far away for the supply chain.

**Chris Olin** - *Cleveland Research Company - Analyst*

Thank you.

**Operator**

Edward Marshall, Sidoti and Company.

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**Edward Marshall** - *Sidoti and Company - Analyst*

My question is kind of an extension of what was just asked about margins and timing of the margin improvement, et cetera. And maybe if we can't look at the core business as a whole and when you get back to certain level, can we kind of talk about the individual segments -- the AMO, the PAO? And both what you'd kind of expect percentage terms for those two businesses? And if you can't answer that, maybe the incremental benefit of the AMO business as it relates to the increase in the aerospace fasteners that you're seeing over the next coming quarters?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

Sure, Ed. So, our PAO margin has actually been reasonably steady for awhile, in the low 30% on an operating budget basis, excluding surcharge. It was a bit lower in the second quarter because we did have some of these impacts of customer requests that ships out of the quarter, and some of the business model lag effects that would affect that part of the business. But that one has been steady and we just see good growth at that steady margin level on PAO.

Our margins on AMO have been running consistently around 5% on the same basis -- operating margin, excluding the raw materials surcharge. And we would expect that the results of our pricing, our mix improvement actions, and then the pickup of aerospace fasteners, would have an upward effect on the margins of the AMO business going forward.

**Edward Marshall** - *Sidoti and Company - Analyst*

Do we have an idea of where you could see that margin progressing over the rest of the year?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

I think the toughest part of that call is the fastener business. And when that ticks up, we have seen the pickup of that on the titanium side. And on the nickel side sometime during the second half of our fiscal year, we would also expect to see that, all of the channel checks from customers and all are going on. Some customers look like they're a little bit ahead of other customers there, but I think that will largely be a function of when we see the pickup in the nickel-based fastener business.

**Edward Marshall** - *Sidoti and Company - Analyst*

Can you talk about the incremental benefit to the margin of the fastener business? I mean, what kind of margin will that flow through, to kind of get -- so we can kind of price that into our model somehow?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

Well, I think, ultimately, if you go back and look at the Company's reported results before the downturn, the AMO margins ran about half the level of the PAO margins. And that's not going to happen during the course of the second half of the fiscal year, but as you look into next fiscal year, we ought to be on that path.

**Edward Marshall** - *Sidoti and Company - Analyst*

Okay. And then on the -- just to be clear, on the energy segment, it was a pretty good quarter there as far as the topline was concerned. There was nothing from the acquisition -- and that was all organic growth, right?

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**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

That is correct. The acquisition was completed at the very end of the year. So we'll see those incremental sales in the first quarter.

**Edward Marshall** - *Sidoti and Company - Analyst*

Excellent. Any LIFO impact in the quarter?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

Small -- I mean, you had the effect of rising raw material prices on what was building inventory. And so that would have had some modest impact in the quarter.

**Edward Marshall** - *Sidoti and Company - Analyst*

Okay. Thank you very much.

**Operator**

Brian Yu, Citigroup.

**Brian Yu** - *Citigroup - Analyst*

I'm trying to reconcile a couple statements that were made. I think, Bill, you mentioned that you guys were pretty well booked and you're turning away orders. And then, Doug, as part of the press release, you mentioned that you built up excess inventories. And those two don't really seem to go together to me. Maybe you can drill down a little bit and discuss the particular end market -- perhaps it didn't meet expectations and that was the reason for the inventory build?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Well, there are a couple of areas that we focused on building up some additional inventory just to make sure that we can provide the kind of responsiveness that's required to the customer. The fastener area is one area where we're anticipating a greater pull from inventory, so we built up some stocking in advance of that.

And also, we have seen in other segments, like the aerospace energy -- excuse me, aerospace engine area that we built up some materials, and that was in the area where the customers had a small push-out into the third quarter as they were trying to -- our third quarter as they were trying to manage their working capital levels. And so those would be sales that we have already seen, but we would anticipate seeing, enabling us to bring down our inventory as the year progresses.

**Brian Yu** - *Citigroup - Analyst*

Okay, great. Thank you.

**Operator**

Steve Levenson, Stifel Nicolaus.



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**Steve Levenson** - *Stifel Nicolaus - Analyst*

You mentioned excess inventory. Can you give us an idea what sort of materials those are?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

It's primarily WIP, you know, work-in-process inventory. And so, as we've mentioned, our capacity is very tight in places. That's compounded by the fact that we brought a lot of new employees on. And so you have proficiency curve type of issues in the first half of the year. And so the primary area of inefficiencies that we see is just behind some of the work centers, what's built up in work-in-process, and that's where our focus is in terms of reducing those levels in the second half of the year.

**Steve Levenson** - *Stifel Nicolaus - Analyst*

Okay, thank you. With the increase in international business, what sort of -- the weaker dollar, what sort of hedging program are you using, if any?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

We do hedge raw material risk and we have minimized the volatility of -- I mean, I'm sorry -- foreign exchange risk, and have minimized the volatility of foreign exchange impacts on our bottom line, so that they are really negligible at the current -- in the current state.

**Steve Levenson** - *Stifel Nicolaus - Analyst*

Okay, thank you. And what percentage of your business is doing now under long-term agreements versus spot sales?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

It's still about 50/50.

**Steve Levenson** - *Stifel Nicolaus - Analyst*

Okay. And last, can you give us some information on what's going on in the powder metals area?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Well, we consider -- continue to see very strong demand for the powder metals business. We're very encouraged by our recent joint venture or ventures, which we established with Sandvik, and see a lot of growth and potential there.

The overall opportunity in the nuclear market continues to grow, as we've been able to pick up some business in the NeutroSorb area, which is important for us and important for our growth and profitability. Ultimately, we're in the position where -- this is one of those areas where we're looking at options to expand our capacity because of the emerging demand that we see.

**Steve Levenson** - *Stifel Nicolaus - Analyst*

And do you think powder metals will -- I mean, it may already be -- but do you see it as being your margin leader?

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**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

It certainly is in the premium margin category. And we see that there's a great opportunity to increase prices over time, as supply and demand really works to our favor.

**Steve Levenson** - *Stifel Nicolaus - Analyst*

Great, thank you very much.

**Operator**

Gautam Khanna, Cowen.

**Gautam Khanna** - *Cowen and Company - Analyst*

Bill, you mentioned in your opening comments that you've increased your share position in aerospace engines. Could you elaborate on that? And could you also elaborate on whether you've seen any sort of order slowdown out of Carlton Forge since the calendar year began?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Well, we typically don't speak specifically about individual customers, but we have signed several long-term agreements that have given us a greater share in the aerospace market. And from the Carlton perspective, we have seen continued strong demand on their part. We haven't seen a slowdown. We're still, I think, an important supplier to them. We value them as a customer.

As they move, over time, potentially to bring some of that supply in-house, if that's the ultimate direction they pursue, we have a backlog right now that supports, of course, our sustained, if you will, full operations. But I think that -- and they'll have to speak for themselves on this matter -- but I think the significant portion of their adjustment to internal supply has taken place over the last couple of years. And so we're not seeing a significant move away from our product at this time. And again, we view them as a good customer and think we have a good relationship with them.

**Gautam Khanna** - *Cowen and Company - Analyst*

Can you elaborate on when might we see that, if it were to occur? I mean, given your lead-times, your order book now, how long are you booked through? Last quarter, I think you said extending into April. Where do we stand now -- on your PAO?

**Dave Strobel** - *Carpenter Technology Corporation - SVP of Operations*

This is Dave Strobel -- I'm responsible for Operations. We're taking orders now for aerospace billet out in the July timeframe.

**Gautam Khanna** - *Cowen and Company - Analyst*

Okay. Can you talk about what you mentioned earlier, I think Doug mentioned this, that you're on the path to 15% margin at AMO in fiscal '12, and what does that mean? A path in -- you will actually get to that level if the fastener demand comes and

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the mix improves like you anticipate? Or on a path, meaning we're somewhere between where we are now, 5% x-surcharge and the like and 15% at peak?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

Yes, the way I would address that, Gautam, is that our objective is to return back to our previous peak level of profit and then ultimately beyond. I don't think we've ever characterized that as something that we would accomplish within fiscal year '12, but we would be showing good progress from where we are today through the second half of this fiscal year into next fiscal year. And that it's a multi-year process to get back to peak level of profit and then beyond.

And so the AMO component of that peak was half the PAO margins are in that 15% neighborhood. We've been at 5% for the last four quarters. And I think we'll see evidence -- steady progress in the second half of this fiscal year and into next fiscal year, back to peak in that part of the business and across our overall business.

**Gautam Khanna** - *Cowen and Company - Analyst*

And Doug, just to follow-up on that, I'm always perplexed when I look at consensus estimates in the first half of calendar '12, the second half of fiscal '12 implies something in the \$0.86 range, \$0.84 a quarter range, and exits the back half of calendar '11 in the \$0.55 range. Is there any contract renewals -- is there anything that you can point to that would have such a massive sequential uptick from calendar Q4 of this year through calendar Q1 of '012? Is there anything that we're just not mindful of, that I'm not mindful of?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

I think it all boils down to the four levers that we've been talking about. We would expect that our volume will continue to grow, grow into the second half of this year and then into fiscal year '12. Pricing and mix management or mix improvement efforts are the other two levers. And so that will have bottom-line impacts in the second half of this fiscal year and into fiscal year '12.

And then our ongoing cost savings program is the other element of that. And we've been successful over the last couple of years at reducing our variable cost per ton and we would expect to continue to be successful. And so those are really the four things that would continue to show improvement beyond the fourth quarter of this fiscal year.

**Gautam Khanna** - *Cowen and Company - Analyst*

But I would ask -- I guess what I'm asking, though, is all those things you mentioned are gradual, with the exception potentially of price, which can gap up at any given time. Is there something with respect to these large contract renewals in calendar Q1 of '12 that could offer that pricing leverage? Everything else is gradual -- production ramps, penetration, cost management -- things that you'd see bleed through over the course of the year, wouldn't explain a sequential uptick of that magnitude. Just help me -- is there anything on contracts, pricing, repricing, in calendar '12 that would drive such a --?

**Doug Ralph** - *Carpenter Technology Corporation - SVP of Finance and CFO*

Yes, there's nothing that we're anticipating in the way of a major contract that would kick-in in calendar year '12. Now, we do have some parts of our business, like the aerospace fasteners and the nickel and stainless part of the aerospace fasteners, that are clearly not back at their normal going levels. And so as that happens, that will help, to some extent, the power generation sales. And our energy segment is still not back to kind of its normal past levels, so that's another thing that will help.

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**Gautam Khanna** - *Cowen and Company - Analyst*

Understood. Thank you, guys. Appreciate it.

**Operator**

Tim Hayes, Davenport and Company.

**Tim Hayes** - *Davenport and Company - Analyst*

Just one question -- we've heard there's potentially going to be a third player in the titanium wire market. Is that starting to show? Or is that still a few quarters out from that third participant in that market?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Well, we would see the impact, if there is any, being actually even further out than several quarters out. I say that because, as you can imagine, there is a very high quality standard, a very long qualification cycle to ensure the kind of performance that's required in the industry. So we're always wary of competitors who are trying to make their way into our market space, but we don't view this as an imminent threat.

**Tim Hayes** - *Davenport and Company - Analyst*

Is it a potential threat if and when they do get qualified?

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Well, we have a very strong position in the marketplace. And the reason why we do is because we have very good quality, very good technology, and very cost-effective operations. And as long as we stay focused on those fundamentals, I think that we'll be strong. We're putting in extra capacity to support the market growth. And with that in mind, I think we'll be able to meet the needs.

And this is a multi-level supply chain, so there is an immediate customer who we sell materials to, but also directed by, coming from the OEMs. And we are sustaining what I think is a very healthy relationship with them as well. So, again, it's always something we need to be cognizant of, but we feel very, very strong and we believe our position is very sustainable.

**Tim Hayes** - *Davenport and Company - Analyst*

Okay. Thank you.

**Operator**

Mark Parr, KeyBanc Capital Markets.

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**Mark Parr** - KeyBanc Capital Markets - Analyst

I had a couple of questions. First of all, I thought your commentary about getting back to that, call it, round numbers, \$350 million in EBITDA level is certainly an important observation. And, I guess, part of the achievement of that will be kind of a shift from some of the lower-value shipments into some of the higher-value mix that you're currently putting into the backlog. And maybe instead of asking you about numbers per se, I mean, could you talk a little bit about this process and how you see it unfolding over the next, call it, six to 12 months?

**Bill Wulfohn** - Carpenter Technology Corporation - President and CEO

You're talking about the respective trade-up of the mix?

**Mark Parr** - KeyBanc Capital Markets - Analyst

Yes. How is that -- how should we think about that mix unfolding here over the next 12 months?

**Bill Wulfohn** - Carpenter Technology Corporation - President and CEO

Yes. Just to take a moment here, as you can appreciate, when the economy was so weak, what, a year/year-and-a-half ago, there was an effort to keep ourselves as fully deployed as we could. And so, as we've talked about, we've brought on some of that material which was at a lower margin.

Now as we've seen constrains build in different parts of our operations, we've been very specific about looking not only at de-bottlenecking those, but also at the materials going through those centers. And we actually go through a process where we look at the profit velocity based upon residence time in constrained pieces of equipment. We study those. Sometimes, even though it might not be what we're looking for, there's a strategic reason because we supply a broad package to a customer. But in many cases, on the -- what we call the tail or the lower end, we recognize that it's just not business we're likely to benefit from in the long runs, unless we get the pricing up, which is the first option with the customers; or the second option is to ultimately transition supply.

And so we've been working this process in a very coherent way over the last, we'll say, four months or so. And I say the last four months because up till that point, you really didn't have the need to make trade-offs between one customer and another, as we had excess capacity and the backlog built on us very, very quickly. So, we have very formalized action trackers and we walk through the specific actions of the timing of those. And it takes a little while because of the orders we've taken. But that's why we remain confident -- as the year rolls on here, we're going to see good benefit of these efforts.

**Mark Parr** - KeyBanc Capital Markets - Analyst

Alright. So this is a process that you -- that really began four months ago and now you're into it. And so we would expect to see the first evidence of real mix shift, call it back to your previous mix in the '06 to '08 timeframe over the March and June quarters. Is that what you're trying to suggest?

**Bill Wulfohn** - Carpenter Technology Corporation - President and CEO

Yes, it's absolutely our number one priority and we have a lot of action, a lot of focus. And we go through our process where we build up our projections from the inside from the ground up. And we believe that we'll be able to demonstrate evidence in this area.

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**Mark Parr** - KeyBanc Capital Markets - Analyst

Okay. I had another question just to kind of follow onto that. I do believe you made some formal commentary about your volume growth expectations for the fiscal '11 year. That was in a positive direction. I mean, is there anything that you can share from an EBIT perspective that would correspond to the increase in volume shipment expectations for fiscal '11? What I'm asking is, do you -- internally, are you looking for better earnings on the improved volume momentum?

**Bill Wulfsohn** - Carpenter Technology Corporation - President and CEO

Well, the answer is clearly yes on that. One, because we'll be getting some volume leverage on our sales as we get more tons or pounds out the door. And then the second is, we do see a better mix from within businesses as well as across businesses as we migrate from one mix to another. So, yes, we do expect to see EBIT leverage on the volume growth.

**Mark Parr** - KeyBanc Capital Markets - Analyst

Alright. And then just one last point of clarification. Would this increase exclude the Amega West acquisition? Or how does Amega West -- how should we think about Amega West from an EBITDA perspective, as you look at the prior peak levels of around \$350 million of EBITDA? I mean, what does this facility or this operation have the potential to contribute?

**Doug Ralph** - Carpenter Technology Corporation - SVP of Finance and CFO

We bought a business, Mark, that has EBITDA of a little under \$10 million. So it would just be a \$10 million-ish added to those previous peak levels.

**Mark Parr** - KeyBanc Capital Markets - Analyst

Okay, (multiple speakers) --

**Bill Wulfsohn** - Carpenter Technology Corporation - President and CEO

However, we purchased the business because we see significant potential to grow and expand. We hope that this is just one move of several that will allow us to, well, grow our scale and scope there, but also to introduce a better mix of products as we're close with the customers and can push forward some of our R&D efforts in that area.

**Mark Parr** - KeyBanc Capital Markets - Analyst

Okay. And then if I could just ask -- again, I hate to keep pushing on this bottom-line thing, but unfortunately, that's what I'm supposed to do. Is a record -- is a \$350 million EBITDA number conceivable for fiscal '13? I mean, is that in your planning horizon? I'm not asking you to give a forecast, but I mean, is that something that is -- that we should be actually thinking about?

**Bill Wulfsohn** - Carpenter Technology Corporation - President and CEO

Well, I can say that there's lots and lots of execution required to get there, but that that is the type of target that we are targeting for ourselves.

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**Mark Parr** - KeyBanc Capital Markets - Analyst

Okay. That's real -- I really appreciate the color on the bottom line and, yes, look, congratulations on the revenue recovery. That was really encouraging in the December quarter. I think the market is a little discouraged by the bottom-line result, but it certainly sounds like things should be looking better here in the March and June quarters. So, I'm looking forward to next quarter. Thank you very much.

**Operator**

Dan Whalen, CapStone Investments.

**Dan Whalen** - CapStone Investments - Analyst

You know, a lot of my questions have been answered, but just -- not to beat this down, but just the mix issue. Looking at your current inventory as work-in-progress and your current lead-times, is there a way -- not to oversimplify, if we could kind of break it down looking at standard value and high value -- any kind of incremental mix shift? Is it a 5% to 10% incremental shift in the next quarter or two? Or is it something much greater than that? Any color you can give from a more simplistic basis.

**Bill Wulfsohn** - Carpenter Technology Corporation - President and CEO

Well, there might have been more than one question there, so I want to make sure I address them, but -- we have seen the number of tons in inventory grow and we've also seen the value per ton grow. And they -- both of those components are major contributors to the increase thus far this year.

As we pick up our sales through the remainder of the year, we are not anticipating that we'll need to build further inventory in support of it. In fact, we're targeting opportunities to reduce inventory in that context. And, of course, when you have a more premium inventory value, you expect that you'll have a richer, more premium sales mix thereafter.

So I don't know if that answered your question. I hope it did.

**Dan Whalen** - CapStone Investments - Analyst

Okay. Alright. Yes, I was looking for anything, I guess, incrementally for the next quarter or so, just in terms of the mix improvement -- if it's 10% order of magnitude or maybe just too difficult to pin it down from that perspective.

**Doug Ralph** - Carpenter Technology Corporation - SVP of Finance and CFO

Yes, we report our results by product types, special alloys, titanium products and stainless products. And so you should certainly see evidence in the growth rates in those product lines of the improvement in mix over the second half of the year.

**Dan Whalen** - CapStone Investments - Analyst

Okay. Fair enough. And then just lastly, you mentioned revenue of 20-plus percent. Is that assuming relatively flat nickel price? Or how are you guys thinking about that?

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**Doug Ralph** - Carpenter Technology Corporation - SVP of Finance and CFO

We would always quote revenue excluding any effect of raw material surcharges, so that's independent of what happens with nickel prices -- our revenue excluding surcharge that we report.

**Dan Whalen** - CapStone Investments - Analyst

Okay. Great. Thank you.

**Operator**

(Operator Instructions). Brian Yu, Citigroup.

**Brian Yu** - Citigroup - Analyst

Just want to follow-up on the topline guidance. I think you said that you're expecting 20% volume growth for this year. And when I look at your pretty impressive numbers this quarter and annualize it, it seems like the volume numbers are already there. So is it fair to say that we're probably going to stay at this 52 million, maybe 53 million ton quarterly run rate for the rest of the fiscal year?

**Doug Ralph** - Carpenter Technology Corporation - SVP of Finance and CFO

No, we would expect our volume in the second half of the year and our revenue in the second half of the year to be in excess of what it was in the first half of the year.

**Brian Yu** - Citigroup - Analyst

Okay. And then to pound on this discussion on margins, I think last quarter, there was discussions about a couple of base price increases -- 5% and then [3% to 8%]. If we assume that these price increases are sticking and that impacts about 50% of your business, which tends to be transactional, is it reasonable to believe that your AMO margins could go up by roughly 500 basis points in the back half, just using those rough numbers?

**Doug Ralph** - Carpenter Technology Corporation - SVP of Finance and CFO

Without getting real familiar with your math, I wouldn't say that we would expect that, just based on pricing, but certainly, we would expect to see the results of the pricing actions that you mentioned, including the ones that we took -- have taken on the Talley business, reflect through to the bottom line in the second half of the fiscal year. And that will lead to margin improvement in the second half of the year, in addition to our mix management efforts, as well as the eventual recovery of businesses like the aerospace fastener business.

**Brian Yu** - Citigroup - Analyst

Okay. Thanks.

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**Operator**

You have an additional question from the line -- pardon the interruption. The caller has dropped out of the queue. I will now turn the call over to management for closing remarks.

**Bill Wulfsohn** - *Carpenter Technology Corporation - President and CEO*

Well, thanks for participating in our call this morning. As you can tell, we are very excited about the prospects for our business and the growth opportunities in front of us. In the short-term, however, we remain laser-focused on executing to achieve higher margins. The combination of these effects will enable us to achieve our goal of reaching and then exceeding prior peak earnings.

Thank you again for your continued interest in and support of Carpenter Technology Corporation. I hope many of you will be able to attend our Investor Day event in New York City on February 16. Regardless, we look forward to speaking with you again next quarter. Good bye.

**Operator**

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a great day.

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