TWIN DISC INC
Form 10-Q
February 05, 2014

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 December 27, 2013

Commission File Number 1-7635

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

Wisconsin	39-0667110
(State or other jurisdiction of Incorporation or organization)	(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 January 28, 2014, the registrant had 11,264,873 shares of its common stock outstanding.

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)
(UNAUDITED)

	December 27, 2013	June 30, 2013
Assets		
Current assets:		
Cash	$27,124	$20,724
Trade accounts receivable, net	34,907	46,331
Inventories, net	102,590	102,774
Deferred income taxes	5,283	5,280
Other	11,183	13,363
Total current assets	181,087	188,472
Property, plant and equipment, net	61,100	62,315
Goodwill	13,438	13,232
Deferred income taxes	6,782	7,614
Intangible assets, net	3,028	3,149
Other assets	9,094	10,676
Total assets	$274,529	$285,458
Liabilities and Equity		
Current liabilities:		
Short-term borrowings and current maturities of long-term debt	$3,643	$3,681
Accounts payable	19,890	20,651
Accrued liabilities	34,188	39,171
Total current liabilities	57,721	63,503
Long-term debt	17,422	23,472
Accrued retirement benefits	46,865	48,290
Deferred income taxes	2,666	2,925
Other long-term liabilities	3,923	3,706
Total liabilities	128,597	141,896
Commitments and contingencies (Note D)		
Equity		
Twin Disc shareholders’ equity:		
Preferred shares authorized: 200,000; issued: none; no par value	-	-
Common shares authorized: 30,000,000; issued: 13,099,468; no par value	11,368	13,183
Retained earnings	183,874	184,110
Accumulated other comprehensive loss	(21,882)	(25,899)

	173,360	171,394
Less treasury stock, at cost (1,834,595 and 1,886,516 shares, respectively)	28,095	28,890
Total Twin Disc shareholders' equity	145,265	142,504
Noncontrolling interest	667	1,058
Total equity	145,932	143,562
Total liabilities and equity	$274,529	$285,458

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

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	Dec. 27, 2013	Dec. 28, 2012	Dec. 27, 2013	Dec. 28, 2012
Net sales	$63,212	$72,325	$129,638	$141,118
Cost of goods sold	44,668	50,014	90,427	99,391
Gross profit	18,544	22,311	39,211	41,727
Marketing, engineering and administrative expenses	17,185	16,770	32,702	33,390
Restructuring of operations	-	-	1, 094	-
Earnings from operations	1,359	5,541	5,415	8,337
Interest expense	223	329	477	635
Other (income) expense, net	(119)	(22)	(153)	105
	104	307	324	740
Earnings before income taxes and noncontrolling interest	1,255	5,234	5,091	7,597
Income taxes	689	1,815	3,161	2,912
Net earnings	566	3,419	1,930	4,685
Less: Net earnings attributable to noncontrolling interest, net of tax	(48)	(59)	(135)	(94)
Net earnings attributable to Twin Disc	$518	$3,360	$1,795	$4,591
Dividends per share	$0.09	$0.09	$0.18	$0.18
Earnings per share data:				
Basic earnings per share attributable to Twin Disc common shareholders	$0.05	$0.30	$0.16	$0.41
Diluted earnings per share attributable to Twin Disc common shareholders	$0.05	$0.29	$0.16	$0.40
Weighted average shares outstanding data:				
Basic shares outstanding	11,264	11,366	11,251	11,368
Dilutive stock awards	6	68	6	73
Diluted shares outstanding	11,270	11,434	11,257	11,441
Comprehensive income:				

Net earnings	$566	$3,419	$1,930	$4,685
Benefit plan adjustments, net of income taxes of $354, $375, $706 and $759,respectively	528	652	978	1,320
Foreign currency translation adjustment	1,119	2,130	2,999	3,394
Comprehensive income	2,213	6,201	5,907	9,399
Less: comprehensive income attributable to noncontrolling interest	(48)	(59)	(135)	(94)
Comprehensive income attributable to Twin Disc	$2,165	$6,142	$5,772	$9,305

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)

	Six Months Ended	
	December 27, 2013	December 28, 2012
Cash flows from operating activities:		
Net earnings	$1,930	$4,685
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	5,198	5,345
Restructuring of operations	1,094	-
Other non-cash changes, net	(18)	1,599
Net change in working capital, excluding cash	11,413	463
Net cash provided by operating activities	19,617	12,092
Cash flows from investing activities:		
Acquisitions of fixed assets	(3,004)	(3,529)
Proceeds from sale of fixed assets	46	35
Other, net	(244)	(293)
Net cash used by investing activities	(3,202)	(3,787)
Cash flows from financing activities:		
Payments of notes payable	(39)	(51)
(Payments of) proceeds from long-term debt, net	(6,052)	1,892
Proceeds from exercise of stock options	-	189
Dividends paid to shareholders	(2,031)	(2,055)
Dividends paid to noncontrolling interest	(486)	(204)
Acquisition of treasury stock	-	(3,069)
Excess tax benefits from stock compensation	524	1,276
Payments of withholding taxes on stock compensation	(2,170)	(1,700)
Net cash used by financing activities	(10,254)	(3,722)
Effect of exchange rate changes on cash	239	286
Net change in cash	6,400	4,869
Cash:		
Beginning of period	20,724	15,701

End of period	$27,124	$20,570

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.

During the first quarter of fiscal 2014, the Company recorded out-of-period adjustments related to the correction of errors identified late in the year-end closing process of fiscal 2013 that were deemed immaterial for adjustment to the fiscal 2013 financial statements. The impact of these corrections to the fiscal 2014 first quarter and six month results was to increase earnings before income taxes and noncontrolling interest by $437,000 and increase net earnings attributable to Twin Disc by $69,000 (after considering applicable tax effects). The nature of these errors is as follows:

- The Company had over accrued for certain payroll related items totaling $337,000 as of June 30, 2013, resulting in an increase to earnings from operations.
- The Company had overstated its warranty accrual by $217,000 as of June 30, 2013, resulting in an increase to earnings from operations.
- The Company determined that work-in-process inventory had been overstated by $117,000 as of June 30, 2013. As a result, additional cost of goods sold was recorded in the first quarter of fiscal 2014, resulting in a decrease to earnings from operations.
- The Company's deferred tax liabilities were understated by $285,000 as of June 30, 2013, resulting in additional tax expense.

The Company does not believe these errors are material to its financial statements for any prior period, nor that the correction of these errors is material to the six months ended December 27, 2013 or its projected full year results for fiscal 2014.

New Accounting Releases

In July 2013, the Financial Accounting Standards Board ("FASB") issued guidance stating that, except in certain defined circumstances, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013 (the Company's fiscal 2015). The adoption of this guidance is not expected to have a material impact on the Company's financial disclosures.

In March 2013, the FASB issued guidance on the parent company's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. This guidance clarifies the circumstances under which the related cumulative translation adjustment should be released into net income. This guidance is effective for fiscal years, and interim periods within those fiscal

years, beginning after December 15, 2013 (the Company's fiscal 2015). The adoption of this guidance is not expected to have a material impact on the Company's financial results.

B. Inventory

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

	December 27, 2013	June 30, 2013
Inventories:		
Finished parts	$67,756	$68,594
Work in process	12,380	11,880
Raw materials	22,454	22,300
	$102,590	$102,774

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 six month periods ended December 27, 2013 and December 28, 2012 (in thousands):

	Three Months Ended		Six Months Ended	
	Dec. 27, 2013	Dec. 28, 2012	Dec. 27, 2013	Dec. 28, 2012
Reserve balance, beginning of period	$5,664	$5,462	$5,701	$5,745
Current period expense	771	1,086	1,142	1,967
Payments or credits to customers	(767)	(1,066)	(1,148)	(2,251)
Foreign currency translation	132	51	105	72
Reserve balance, end of period	$5,800	$5,533	$5,800	$5,533

The current portion of the warranty accrual ($3,876,000) is reflected in accrued liabilities, while the long-term portion ($1,924,000) is included in other long-term liabilities on the Consolidated Balance Sheets as of December 27, 2013.

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		Six Months Ended	
	Dec. 27, 2013	Dec. 28, 2012	Dec. 27, 2013	Dec. 28, 2012
Manufacturing segment sales	$57,010	$66,914	$110,268	$125,196
Distribution segment sales	30,563	33,742	61,577	64,745
Inter/Intra segment elimination - manufacturing	(21,088)	(23,522)	(36,220)	(39,080)
Inter/Intra segment elimination - distribution	(3,273)	(4,809)	(5,987)	(9,743)
Net sales	$63,212	$72,325	$129,638	$141,118
Manufacturing segment net earnings	$1,653	$5,055	$3,670	$7,889
Distribution segment net earnings	1,422	1,551	3,303	2,703
Corporate and eliminations	(2,557)	(3,246)	(5,178)	(6,001)
Net earnings attributable to Twin Disc	$518	$3,360	$1,795	$4,591

Assets	Dec. 27, 2013	June 30, 2013
Manufacturing segment assets	$263,324	$258,617
Distribution segment assets	53,146	56,965
Corporate assets and elimination of inter-company assets	(41,941)	(30,124)
Total assets	$274,529	$285,458

F. Stock-Based Compensation

In the first half of fiscal 2014 and 2013, the Company granted a target number of 43,154 and 28,255 performance stock unit awards, respectively, to various employees of the Company, including executive officers. The performance stock unit awards granted in fiscal 2014 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, 2016. The performance stock unit awards granted in fiscal 2014 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 25,943. Based upon actual results to date and the low probability of achieving the threshold performance levels, the Company is currently not accruing the performance stock unit awards granted in fiscal 2014. The performance stock unit awards granted in fiscal 2013 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, 2015. The performance stock unit awards granted in fiscal 2013 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 23,449. Based upon actual results to date and the low probability of achieving the threshold performance levels, the Company is currently not accruing the performance stock unit awards granted in fiscal 2013 and has reversed previously recognized expenses related to these awards during the second quarter of fiscal 2013. There were 54,874 and 161,734 unvested stock unit awards outstanding at December 27, 2013 and December 28, 2012, respectively. The weighted average grant date fair value of the unvested awards at December 27, 2013 was $26.65. 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 six months ended December 27, 2013, related to the performance stock unit awards were $0. The compensation (income) expense for the three and six months ended December 28, 2012, related to the performance stock unit awards, approximated $(58,000) and $120,000 respectively. At December 27, 2013, the Company had $1,436,000 of unrecognized compensation expense related to the unvested shares that would vest if the specified target objective was achieved for the fiscal 2014, 2013 and 2012 awards. The total fair value of performance stock unit awards vested as of December 27, 2013 and December 28, 2012 were $0. The performance stock unit awards are cash based, and are thus recorded as a liability on the Company's Consolidated Balance Sheets. As of December 27, 2013, these awards are $0. As of June 30, 2013, these awards are included in "Accrued liabilities" ($2,787,000) due to the awards having a performance period ending in less than one year.

In the first half of fiscal 2014 and 2013, the Company granted a target number of 17,312 and 28,535 performance stock awards, respectively, to various employees of the Company, including executive officers. The performance stock awards granted in fiscal 2014 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, 2016. The performance stock awards granted in fiscal 2014 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 20,774. Based upon actual results to date and the low probability of achieving the threshold performance levels, the Company is currently not accruing the performance stock awards granted in fiscal 2014. The performance stock awards granted in fiscal 2013 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, 2015. The performance stock awards granted in fiscal 2013 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 32,880. Based upon actual results to date and the low probability of achieving the threshold performance levels, the Company is currently not accruing the performance stock awards granted in fiscal 2013 and has reversed previously recognized expenses related to these awards during the second quarter of fiscal 2013. There were 59,453 and 130,926 unvested stock awards outstanding at December 27, 2013 and December 28, 2012, 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 (income) expense for the three and six months ended December 27, 2013, related to performance stock awards were $0. The compensation (income) expense for the three and six months ended December 28, 2012, related to performance stock awards, approximated $(164,000) and $15,000, respectively. The weighted average grant date fair value of the unvested awards at December 27, 2013 was $26.12. At December 27, 2013, the Company had $1,553,000 of unrecognized compensation expense related to the unvested shares that would vest if the specified target objective was achieved for the fiscal 2014, 2013 and 2012 awards. The total fair value of performance stock awards vested as of December 27,

2013 and December 28, 2012 were $0.

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 half of fiscal 2014 and 2013, the Company granted 51,004 and 83,729 service based restricted shares, respectively, to employees and non-employee directors in each year. There were 119,297 and 220,343 unvested shares outstanding at December 27, 2013 and December 28, 2012, respectively. The compensation expense for the three and six months ended December 27, 2013, related to these service-based awards approximated $308,000 and $626,000, respectively. The compensation expense for the three and six months ended December 28, 2012, related to these service-based awards approximated $400,000 and $788,000, respectively. The total fair value of restricted stock grants vested as of December 27, 2013 and December 28, 2012 was $3,053,000 and $2,177,000, respectively. As of December 27, 2013, the Company had $1,786,000 of unrecognized compensation expense related to restricted stock which will be recognized over the next three years.

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		Six Months Ended	
	Dec. 27, 2013	Dec. 28, 2012	Dec. 27, 2013	Dec. 28, 2012
Pension Benefits:				
Service cost	$135	$49	$267	$93
Interest cost	1,356	1,311	2,711	2,619
Expected return on plan assets	(1,648)	(1,580)	(3,294)	(3,151)
Amortization of transition obligation	19	(11)	38	(22)
Amortization of net loss	714	846	1,427	1,691
Net periodic benefit cost	$576	$615	$1,149	$1,230
Postretirement Benefits:				
Service cost	$9	$9	$19	$17
Interest cost	164	191	329	383
Amortization of net actuarial loss	151	197	301	395
Net periodic benefit cost	$324	$397	$649	$795

The Company expects to contribute approximately $2,643,000 to its pension plans in fiscal 2014. As of December 27, 2013, $1,281,000 in contributions have been made.

The Company has reclassified $528,000 (net of $354,000 in taxes) and $978,000 (net of $706,000 in taxes) of benefit plan adjustments from accumulated other comprehensive loss during the three and six months ended December 27, 2013. The Company has reclassified $652,000 (net of $375,000 in taxes) and $1,320,000 (net of $759,000 in taxes) of benefit plan adjustments from accumulated other comprehensive loss during the three and six months ended December 28, 2012. These reclassifications are included in the computation of net periodic benefit cost.

H. Income Taxes

For the six months ended December 27, 2013 and December 28, 2012, the Company's effective income tax rate was 62.1% and 38.3% respectively. The fiscal 2014 rate reflects the impact of the valuation allowance and a continued reduced domestic earnings base offset by a limited Section 199 credit and reduced research and development tax credit resulting from the expiration of the credit.

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. Changes in valuation allowances from period to period are included in the tax provision in the period of change. 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 a certain foreign jurisdiction, the Company has evaluated the realizability of the net deferred tax assets related to this jurisdiction. 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.

The Company has not provided additional U.S. income taxes on cumulative earnings of consolidated foreign subsidiaries that are considered to be reinvested indefinitely. The Company reaffirms its position that these earnings remain permanently invested, and has no plans to repatriate funds to the U.S. for the foreseeable future. Such earnings could become taxable upon the sale or liquidation of these foreign subsidiaries or upon dividend repatriation. It is not practicable to estimate the amount of unrecognized withholding taxes and deferred tax liability on such earnings. The Company's intent is for such earnings to be reinvested by the subsidiaries or to be repatriated only when it would be tax effective through the utilization of foreign tax credits.

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 locations is removed from the overall effective tax rate methodology and recorded directly 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 $1,900,000 of unrecognized tax benefits, including related interest and penalties, as of December 27, 2013, which, if recognized, would favorably impact the effective tax rate. There was no significant change in the total unrecognized tax benefits due to the settlement of audits or the expiration of statutes of limitations during the quarter ended December 27, 2013. It appears reasonably possible that the amount of unrecognized tax benefits could change in the next twelve months due to on-going audit activity.

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 2009 through 2013 for the major operations in Italy, Canada, Belgium, and Japan. The tax years open to examination in the U.S. are for years subsequent to fiscal 2011. The state of Wisconsin income tax audit remains ongoing for the fiscal years 2001 through 2009. The Company has not been notified of any other tax examinations covering open periods. It is reasonably possible that at least one of these audit cycles will be completed during fiscal 2014.

I. Goodwill and Other Intangibles

The changes in the carrying amount of goodwill, all of which is allocated to the manufacturing segment, for the six months ended December 27, 2013 were as follows (in thousands):

Balance at June 30, 2013	$13,232
Translation adjustment	206
Balance at December 27, 2013	$13,438

The gross carrying amount and accumulated amortization of the Company's intangible assets that have definite useful lives and are subject to amortization as of December 27, 2013 and June 30, 2013 were as follows (in thousands):

	December 27, 2013	June 30, 2013
Intangible assets with finite lives:		
Licensing agreements	$3,015	$3,015
Non-compete agreements	2,050	2,050
Trade name	2,596	-
Other	5,991	5,991
	13,652	11,056
Accumulated amortization	(9,536)	(9,301)
Impairment charge	(1,277)	(1,277)
Foreign currency translation	(32)	546
Total	$2,807	$1,024

The weighted average remaining useful life of the intangible assets included in the table above is approximately 16 years.

Intangible amortization expense was $119,000 and $235,000 for the three and six months ended December 27, 2013, and $166,000 and $354,000 for the three and six months ended December 28, 2012, respectively. Estimated intangible amortization expense for the remainder of fiscal 2014 and each of the next five fiscal years is as follows (in thousands):

Fiscal Year	
2014	$239
2015	251
2016	165
2017	160
2018	160
2019	160

The gross carrying amount of the Company's intangible assets that have indefinite lives and are not subject to amortization as of December 27, 2013 and June 30, 2013 are $221,000 and $2,125,000, respectively. These assets are comprised of acquired trade names. Based on the Company's reassessment of the useful lives assigned to intangible assets during the first quarter, it was determined that certain indefinite lived trade names should be reclassified to definite lived. As such, the Company assigned a 20-year useful life to the trade names.

J. Long-term Debt

Long-term debt at December 27, 2013 and June 30, 2013 consisted of the following (in thousands):

	December 27, 2013	June 30, 2013
Revolving loan	$10,250	$16,300

10-year unsecured senior notes	10,714	10,714
Other	101	139
Subtotal	21,065	27,153
Less: current maturities and short-term borrowings	(3,643)	(3,681)
Total long-term debt	$17,422	$23,472

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 December 27, 2013, 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 (0.79% and 0.66% for December 27, 2013 and June 30, 2013, respectively), plus the current add-on related to the revolving loan agreement (1.65% for December 27, 2013 and June 30, 2013) resulting in a total rate of 2.44% and 2.31% for December 27, 2013 and June 30, 2013, respectively. The fair value of the Company's 10-year unsecured senior notes due April 10, 2016 was approximately $11,324,000 and $11,536,000 at December 27, 2013 and June 30, 2013, respectively. The Company's revolving loan agreement approximates fair value at December 27, 2013 and June 30, 2013. If measured at fair value in the financial statements, long-term debt (including the current portion) would be classified as Level 2 in the fair value hierarchy.

K. Shareholders' Equity

On February 1, 2008, the Board of Directors authorized the purchase of 500,000 shares of Common Stock at market values. On July 27, 2012, the Board of Directors authorized the purchase of an additional 375,000 shares of Common Stock at market values. These authorizations have no expiration. The Company made open market purchases of 125,000 shares of its outstanding Common Stock during fiscal 2012 and 185,000 shares during fiscal 2013.

The following is a reconciliation of the Company's equity balances for the first fiscal six months of 2013 and 2014 (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, 2012	$12,759	$184,306	($34,797)	($26,781)	$1,022	$136,509
Net income		4,591			94	4,685
Translation adjustments			3,334		60	3,394
Benefit plan adjustments, net of tax			1,320			1,320
Cash dividends		(2,055)			(204)	(2,259)
Compensation expense and windfall tax benefits	2,079					2,079
Shares (acquired) issued, net	(2,937)			(1,642)		(4,579)
Balance-December 28, 2012	$11,901	$186,842	($30,143)	($28,423)	$972	$141,149

Twin Disc, Inc. Shareholders' Equity

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Non-Controlling Interest	Total Equity
Balance-June 30, 2013	$13,183	$184,110	($25,899)	($28,890)	$1,058	$143,562
Net income		1,795			135	1,930
Translation adjustments			3,039		(40)	2,999
Benefit plan adjustments, net of tax			978			978
Cash dividends		(2,031)			(486)	(2,517)
Compensation expense and windfall tax benefits	1,150					1,150
Shares (acquired) issued, net	(2,965)			795		(2,170)
Balance-December 27, 2013	$11,368	$183,874	($21,882)	($28,095)	$667	$145,932

L. Restructuring of Operations

During the first quarter of fiscal 2014, the Company recorded a pre-tax restructuring charge of $1,094,000 representing the incremental cost above the minimum legal indemnity for a targeted workforce reduction at its Belgian operation, following finalization of negotiations with the local labor union. The minimum legal indemnity of $548,000 was recorded in the fourth quarter of fiscal 2013, upon announcement of the intended restructuring action. During the first half of fiscal 2014, the Company made cash payments of $788,000, resulting in an accrual balance at December 27, 2013 of $900,000.

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 2013 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, 2013 could cause actual results to be materially different from what is presented here.

Results of Operations

(In thousands)

Three Months Ended	Six Months Ended

	December 27, 2013	%		December 28, 2012	%		December 27, 2013	%		December 28, 2012	%	
Net sales	$63,212			$72,325			$129,638			$141,118		
Cost of goods sold	44,668			50,014			90,427			99,391		
Gross profit	18,544	29.3	%	22,311	30.8	%	39,211	30.2	%	41,727	29.6	%
Marketing, engineering and administrative expenses	17,185	27.2	%	16,770	23.2	%	32,702	25.2	%	33,390	23.7	%
Restructuring of operations	0	0.0	%	0	0.0	%	1,094	0.8	%	0	0.0	%
Earnings from operations	$1,359	2.1	%	$5,541	7.7	%	$5,415	4.2	%	$8,337	5.9	%

Comparison of the Second Quarter of FY 2014 with the Second Quarter of FY 2013

Net sales for the second quarter decreased 12.6%, or $9.1 million, to $63.2 million from $72.3 million in the same period a year ago. Compared to the second quarter of fiscal 2013, on average, Asian currencies weakened against the U.S. dollar more than offsetting a strengthening euro against the U.S. dollar. The net translation effect of this on foreign operations was to decrease revenues by approximately $1.0 million versus the prior year, before eliminations. The decrease in sales was primarily the result of lower demand from the Company's customers in North America and Europe, while sales to customers in Asia Pacific remained strong. Coming off a record year in fiscal 2013, commercial marine transmission system shipments are down in the first half of fiscal 2014. However, the Company experienced strong order activity in the second fiscal quarter and the six-month backlog of orders for commercial marine transmission systems is up significantly both sequentially and versus the end of the prior fiscal year's second quarter. While demand for pressure pumping transmissions for the North American market remained depressed, shipments of these transmission systems to China in the current fiscal quarter exceeded shipments for fiscal 2013's second quarter. Sales to customers serving the global mega yacht market remained near historical lows in the quarter.

Sales at our manufacturing segment were down 14.8%, or $9.9 million, versus the same period last year. Compared to the second quarter of fiscal 2013, 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 $0.7 million versus the prior year, before eliminations. In the current fiscal year's second quarter, our domestic manufacturing operation, the largest, experienced a 20% decrease in sales versus the second fiscal quarter of 2013. The primary driver for this decrease was lower sales of pressure-pumping transmissions for the oil and gas market, and marine and propulsion systems for the global marine market. The Company's Italian manufacturing operations, which have been adversely impacted by the softness in the European mega yacht and industrial markets, experienced flat sales compared to the prior fiscal year's second quarter. The Company's Belgian manufacturing operation, which also continued to be adversely impacted by the softness in the global mega yacht market, experienced a brief strike at its facility in the first fiscal quarter. This operation saw an 18% decrease in sales versus the prior fiscal year's second quarter, primarily driven by the continued softness in its markets and the temporary disruption experienced as a result of the strike in the first fiscal quarter. The Company's Swiss manufacturing operation, which supplies customized propellers for the global mega yacht and patrol boat markets, experienced a 5% increase in sales, primarily due to the timing of shipments for the global patrol boat and Italian mega yacht markets.

Sales at our distribution segment were down just over 9%, or $3.2 million, compared to the second quarter of fiscal 2013. Compared to the second quarter of fiscal 2013, on average, the Asian currencies weakened against the U.S. dollar. The net translation effect of this on foreign distribution operations was to decrease revenues for the distribution segment by approximately $1.7 million versus the prior year, before eliminations. The Company's distribution operation in Singapore, its largest Company-owned distribution operation, which continues to experience strong demand for marine transmission products for use in various commercial applications and pressure-pumping transmissions for the Chinese oil and gas market, experienced flat sales compared to the prior fiscal year's second quarter. This operation acts as the Company's master distributor for Asia and continues to achieve record results as the Company's products gain greater acceptance in the market. The Company's distribution operation in the Northwest of the United States and Southwest of Canada experienced a decrease in sales of nearly 14%. In the prior fiscal year's second quarter this operation experienced a 40% decrease in sales versus fiscal 2012's second quarter due to weakness in the Canadian oil and gas market as rig operators continued to adjust to the North American natural gas supply overhang and lower prices. The Canadian oil and gas market remained at depressed levels in the first half of fiscal 2014. The Company's distribution operation in Italy, which provides boat accessories and propulsion systems for the pleasure craft market, saw sales decline over 25% due to continued weakness in the global mega yacht market. In fiscal 2013's fourth quarter, the Company committed to a plan to exit the distribution agreement of this operation and entered negotiations to sell the inventory back to the parent supplier. Those negotiations continue. The Company's distribution operation in Australia, which provides boat accessories, propulsion and marine transmission systems for the pleasure craft market, saw a decrease in sales of almost 8% from the prior year's second quarter, driven by both softness in the mega yacht and industrial markets in Australia.

The elimination for net inter/intra segment sales decreased $4.0 million, accounting for the remainder of the net change in sales versus the same period last year.

Gross profit as a percentage of sales decreased 150 basis points to 29.3% of sales, compared to 30.8% of sales for the same period last year. Gross profit for fiscal 2014's second quarter was unfavorably impacted by lower sales volume compared to the fiscal 2013 second quarter (approximately $4.3 million). The unfavorable volume impact was somewhat offset by a more profitable product mix (approximately $0.5 million) and reduced warranty expense ($0.3 million).

Marketing, engineering, and administrative (ME&A) expenses of $17.2 million were up $0.4 million compared to last year's second fiscal quarter. As a percentage of sales, ME&A expenses increased to 27.2% of sales versus 23.2% of sales in the second quarter of fiscal 2013. The increase in ME&A expenses for the quarter relates to increased spending in the Company's growing Asian operations, a slight increase in stock based compensation expense in the quarter and increased spending on corporate projects, partially offset by a continued focus on controlled spending at the Company's global operations.

Interest expense of $0.2 million for the quarter was down 32.2% versus last year's second fiscal quarter. Total interest on the Company's $40 million revolving credit facility ("revolver") decreased nearly 50% to $0.06 million in fiscal 2014's second quarter. The average borrowing on the revolver, computed monthly, decreased to $11.4 million in fiscal 2014's second quarter, compared to $22.5 million in the same period a year ago. The interest rate on the revolver increased slightly from a range of 1.71% to 1.73% in the prior fiscal year's second quarter to a range of 1.82% to 1.83% in the current year. The interest expense on the Company's $25 million Senior Note decreased 25%, at a fixed rate of 6.05%, to $0.2 million, due to a lower remaining principal balance.

The favorable movement in other expense (income) compared to the prior year is primarily due to the impact of currency movements related to the Euro, Japanese yen and Indian rupee.

The effective tax rate for the second quarter of fiscal 2014 was 54.9%, which is significantly higher than the prior year rate of 34.7%. Both years were significantly impacted by non-deductible losses in a certain foreign jurisdiction that are subject to a full valuation allowance. Adjusting for these non-deductible losses, the fiscal 2014 rate would have

been 29.8% compared to 31.2% for the fiscal 2013 second quarter. The increase in the fiscal 2014 adjusted rate was primarily driven by adjustments to tax on foreign earnings (Canada and Italy) recorded in the first quarter.

Comparison of the First Six Months of FY 2014 with the First Six Months of FY 2013

Net sales for the first six months decreased 8.1%, or $11.5 million, to $129.6 million from $141.1 million in the same period a year ago. Compared to the first six months of fiscal 2013, on average, Asian currencies weakened against the U.S. dollar more than offsetting a strengthening euro against the U.S. dollar. The net translation effect of this on foreign operations was to decrease revenues by approximately $1.9 million versus the prior year, before eliminations. The decrease in sales was primarily the result of lower demand from the Company's customers in North America and Europe, while sales to customers in Asia Pacific remained strong. Coming off a record year in fiscal 2013, commercial marine transmission system shipments are down in the first half of fiscal 2014. However, the Company experienced strong order activity in the second fiscal quarter and the six-month backlog of orders for commercial marine transmission systems is up significantly both sequentially and versus the end of the prior fiscal year's second quarter. While demand for pressure pumping transmissions for the North American market remained depressed, shipments of these transmission systems to China in the current fiscal years' first half exceeded shipments for fiscal 2013's first half. Sales to customers serving the global mega yacht market remained near historical lows.

Sales at our manufacturing segment were down 11.9%, or $14.9 million, versus the same period last year. Compared to the first half of fiscal 2013, 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 $1.3 million versus the prior year, before eliminations. In the current fiscal year's first half, our domestic manufacturing operation, the largest, experienced a 14% decrease in sales versus the first six months of 2013. The primary driver for this decrease was lower sales of pressure-pumping transmissions for the oil and gas market, and marine and propulsion systems for the global marine market. The Company's Italian manufacturing operations, which have been adversely impacted by the softness in the European mega yacht and industrial markets, experienced flat sales compared to the prior fiscal year's first six months. The Company's Belgian manufacturing operation, which also continued to be adversely impacted by the softness in the global mega yacht market, experienced a brief strike at its facility in the first fiscal quarter. This operation saw a nearly 24% decrease in sales versus the prior fiscal year's first six months, primarily driven by the continued softness in its markets and the temporary disruption experienced as a result of the strike in the first fiscal quarter. The Company's Swiss manufacturing operation, which supplies customized propellers for the global mega yacht and patrol boat markets, experienced a 13% decrease in sales, primarily due to the timing of shipments for the global patrol boat and Italian mega yacht markets.

Sales at our distribution segment were down nearly 5%, or $3.2 million, compared to the first half of fiscal 2013. Compared to the first six months of fiscal 2013, on average, the Asian currencies weakened against the U.S. dollar. The net translation effect of this on foreign distribution operations was to decrease revenues for the distribution segment by approximately $3.1 million versus the prior year, before eliminations. The Company's distribution operation in Singapore, its largest Company-owned distribution operation, which continues to experience strong demand for marine transmission products for use in various commercial applications and pressure-pumping transmissions for the Chinese oil and gas market, experienced an over 7% increase in sales compared to the prior fiscal year's first six months. This operation acts as the Company's master distributor for Asia and continues to achieve record results as the Company's products gain greater acceptance in the market. The Company's distribution operation in the Northwest of the United States and Southwest of Canada experienced a decrease in sales of nearly 7%. In the prior fiscal year's first six months, this operation experienced a 56% decrease in sales versus fiscal 2012's first six months due to weakness in the Canadian oil and gas market as rig operators continued to adjust to the North American natural gas supply overhang and lower prices. The Canadian oil and gas market remained at depressed levels in the first half of fiscal 2014. The Company's distribution operation in Italy, which provides boat accessories and propulsion systems for the pleasure craft market, saw sales decline over 34% due to continued weakness in the global mega yacht market. In fiscal 2013's fourth quarter, the Company committed to a plan to exit the distribution agreement of this operation and entered negotiations to sell the inventory back to the parent supplier. Those

negotiations continue. 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 just over 2% from the prior year's first six months, driven by strong shipments in the first fiscal quarter of 2014. This operation experienced weaker sales in both the mega yacht and industrial markets in Australia in the second fiscal quarter of 2014.

The elimination for net inter/intra segment sales decreased $6.6 million, accounting for the remainder of the net change in sales versus the same period last year.

Gross profit as a percentage of sales increased 60 basis points to 30.2% of sales, compared to 29.6% of sales for the same period last year. Gross profit for fiscal 2014's first six months was unfavorably impacted by lower sales volume compared to the fiscal 2013 first half (approximately $5.3 million). The unfavorable volume impact was only partially offset by a more profitable product mix (approximately $1.8 million) driven by higher sales of the Company's oil and gas transmission products (approximately $0.9 million) and reduced warranty expense ($0.8 million).

Marketing, engineering, and administrative (ME&A) expenses of $32.7 million were down $0.7 million compared to last year's first six months. As a percentage of sales, ME&A expenses increased to 25.2% of sales versus 23.7% of sales in the first six months of fiscal 2013. The decrease in ME&A expenses for the first half relates to increased spending in the Company's growing Asian operations and increased spending on corporate projects, more than offset by a continued focus on controlled spending at the Company's global operations and a decrease in stock based compensation expense for the first six months of this fiscal year compared to the same period in fiscal 2013.

Interest expense of $0.5 million for the quarter was down 24.9% versus the prior fiscal year's first six months. Total interest on the Company's $40 million revolving credit facility ("revolver") decreased 32% to $0.13 million in fiscal 2014's second quarter. The average borrowing on the revolver, computed monthly, decreased to $12.9 million in fiscal 2014's first half, compared to $19.7 million in the same period a year ago. The interest rate on the revolver increased slightly from a range of 1.71% to 1.75% in the prior fiscal year's first six months to a range of 1.82% to 1.85% in the current fiscal year. The interest expense on the Company's $25 million Senior Note decreased 25%, at a fixed rate of 6.05%, to $0.3 million, due to a lower remaining principal balance.

The favorable movement in other expense (income) compared to the prior year is primarily due to the impact of currency movements related to the Euro, Japanese yen and Indian rupee.

The effective tax rate for the first half of fiscal 2014 was 62.1%, which is significantly higher than the prior year rate of 38.3%. Both years were significantly impacted by non-deductible losses in a certain foreign jurisdiction that are subject to a full valuation allowance. Adjusting for these non-deductible losses, the fiscal 2014 rate would have been 37.0% compared to 33.1% for fiscal 2013. The increase in the fiscal 2014 adjusted rate was primarily driven by adjustments to tax on foreign earnings (Canada and Italy) recorded in the first quarter.

Financial Condition, Liquidity and Capital Resources

Comparison between December 27, 2013 and June 30, 2013

As of December 27, 2013, the Company had net working capital of $123.4 million, which represents a decrease of $1.6 million, or 1.3%, from the net working capital of $125.0 million as of June 30, 2013.

Cash increased $6.4 million, or 30.9%, to $27.1 million as of December 27, 2013, versus $20.7 million as of June 30, 2013. The majority of the cash as of December 27, 2013 is at our overseas operations in Europe ($15.5 million) and Asia-Pacific ($10.5 million). As of December 27, 2013, the Company was in a net cash position of $6.06 million (net cash is defined as total cash ($27.12 million) less total debt ($21.06 million)).

Trade receivables of $34.9 million were down $11.4 million, or nearly 25%, when compared to last fiscal year-end. The impact of foreign currency translation was to increase accounts receivable by $0.6 million versus June 30, 2013. The net remaining decrease is consistent with the sales volume decrease of just under 17% from the fourth quarter of fiscal 2013 compared to the second fiscal quarter of fiscal 2014.

Net inventory decreased slightly by $0.2 million versus June 30, 2013 to $102.6 million. The impact of foreign currency translation was to increase net inventory by $1.5 million versus June 30, 2013. After adjusting for the impact of foreign currency translation, the net decrease of $1.7 million primarily came at the Company's U.S. manufacturing location. On a consolidated basis, as of December 27, 2013, the Company's backlog of orders to be shipped over the next six months approximates $56.2 million, compared to $66.8 million at June 30, 2013 and $68.2 million at December 28, 2012. The majority of the decrease is being experienced at the Company's domestic manufacturing location due to lower demand from customers in the pressure pumping sector of the North American oil and gas, and commercial marine markets. As a percentage of six month backlog, inventory has increased from 154% at June 30, 2013 to 183% at December 27, 2013.

Net property, plant and equipment (PP&E) decreased $1.2 million versus June 30, 2013. This includes the addition of $3.0 million in capital expenditures, primarily at the Company's Racine-based manufacturing operation, which was more than offset by depreciation of $5.1 million. The net remaining increase is due to foreign currency translation effects. In total, the Company expects to invest between $10 and $15 million in capital assets in fiscal 2014. These anticipated expenditures reflect the Company's plans to continue investing in modern equipment and facilities, its global sourcing program and new products as well as expanding capacities at facilities around the world. 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 2013, the Company spent $6.6 million for capital expenditures, down from $13.7 million in fiscal 2012. 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 December 27, 2013 of $19.9 million were down $0.8 million, or 3.7%, from June 30, 2013. The impact of foreign currency translation was to increase accounts payable by $0.3 million versus June 30, 2013. This decrease is consistent with the Company's lower six month backlog levels, continued focus on lowering inventories and the timing of certain payments.

Total borrowings and long-term debt as of December 27, 2013 decreased by $6.1 million, or roughly 22%, to $21.1 million versus June 30, 2013. This decrease was driven by the strong operating cash flow in the first half of the fiscal year ($19.6 million). During the first six months of the fiscal year, the Company generated free cash flow (defined as operating cash flow less acquisitions of fixed assets) of $16.6 million and ended the quarter with total debt, net of cash, of $(6.1) million, compared to $6.4 million at June 30, 2013, for a net change of $12.5 million.

Total equity increased $2.4 million, or less than 2%, to $145.9 million as of December 27, 2013. Retained earnings decreased by $0.2 million. The net decrease in retained earnings included $1.8 million in net earnings for the first six months of the fiscal year offset by $2.0 million in dividend payments. Net favorable foreign currency translation of $3.0 million was reported. The net remaining decrease in equity of $0.4 million primarily represents the issuance and vesting of stock awards and noncontrolling interest dividends, partially offset by an adjustment for the amortization of net actuarial loss and prior service cost on the Company's defined benefit pension plans.

The Company has a $40,000,000 revolving loan agreement with BMO Harris Bank, N.A. ("BMO"). The Company originally entered into this revolving loan agreement in December 2002 with M&I Marshall & Ilsley Bank, predecessor to BMO. At that time, the revolving loan agreement was for $20,000,000 and had an 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 December 27, 2013, and a maximum total funded debt to EBITDA ratio of 3.0 at December 27, 2013. As of December 27, 2013, the Company was in compliance with these covenants with a four quarter EBITDA total of $18,289,000 and a funded debt to EBITDA ratio of 1.15. The minimum net worth covenant fluctuates based upon actual earnings and is subject to adjustment for certain pension accounting adjustments to equity. As of December 27, 2013 the minimum equity requirement was $120,018,000 compared to an actual result of $179,265,000 after all required adjustments. The outstanding balance of $10,250,000 and $16,330,000 at December 27, 2013 and June 30, 2013, 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 1.82% and 1.84% at December 27, 2013 and June 30, 2013, 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 $10,714,286 at December 27, 2013 and June 30, 2013, respectively. Of the outstanding balance, $3,571,429 was classified as a current maturity of long-term debt at December 27, 2013 and June 30, 2013, respectively. The remaining $7,142,857 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.

On November 19, 2012, the Company and its wholly-owned subsidiary Twin Disc International, S.A. entered into a multi-currency revolving Credit Agreement with Wells Fargo Bank, National Association. Pursuant to the Credit Agreement, the Company may, from time to time, enter into revolving credit loans in amounts not to exceed, in the aggregate, Wells Fargo's revolving credit commitment of $15,000,000. In general, outstanding revolving credit loans (other than foreign currency loans) will bear interest at one of the following rates, as selected by the Company: (1) a "Base Rate," which is equal to the highest of (i) the prime rate; (ii) the federal funds rate plus 0.50%; or (iii) LIBOR plus 1.00%; or (2) a "LIBOR Rate" (which is equal to LIBOR divided by the difference between 1.00 and the Eurodollar Reserve Percentage (as defined in the Credit Agreement)) plus 1.50%. Outstanding revolving credit loans that are foreign currency loans will bear interest at the LIBOR Rate plus 1.50%, plus an additional "Mandatory Cost," which is designed to compensate Wells Fargo for the cost of compliance with the requirements of the Bank of England and/or the Financial Services Authority, or the requirements of the European Central Bank. In addition to principal and interest payments, the Borrowers will be responsible for paying monthly commitment fees equal to .25% of the unused revolving credit commitment. The Company has the option of making additional prepayments subject to certain limitations. The Credit Agreement includes financial covenants regarding minimum net worth, minimum EBITDA for the most recent four fiscal quarters of $11,000,000, and a maximum total funded debt to EBITDA ratio of 3.0:1. The Credit Agreement also includes certain restrictive covenants that limit, among other things, certain investments, acquisitions and indebtedness. The Credit Agreement provides that it shall automatically include any

covenants or events of default not previously included in the Credit 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. The Credit Agreement also includes customary events of default, including events of default under the BMO agreement or the Prudential Note Agreement. Following an event of default, Wells Fargo may accelerate all amounts outstanding under any revolving credit notes or the Credit Agreement. The Credit Agreement is scheduled to expire on May 31, 2015. As of December 27, 2013 and June 30, 2013, respectively, there were no borrowings under the Credit Agreement.

Four quarter EBITDA, total funded debt, and adjusted net worth 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, total funded debt to four quarter EBITDA ratio, and adjusted net worth covenants described above. In accordance with the Company's revolving loan agreements 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.

- "Adjusted net worth" means the Company's reported shareholder equity, excluding adjustments that result from (i) changes to the assumptions used by the Company in determining its pension liabilities or (ii) changes in the market value of plan assets up to an aggregate amount of adjustments equal to $34,000,000 ("Permitted Benefit Plan Adjustments") for purposes of computing net worth at any time.

The Company's total funded debt as of December 27, 2013 and June 30, 2013 was equal to the total debt reported on the Company's December 27, 2013 and June 30, 2013 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 December 27, 2013:

Four Quarter EBITDA Reconciliation	
Net Earnings Attributable to Twin Disc	$1,086,000
Depreciation & Amortization	10,691,000
Interest Expense	1,277,000
Income Taxes	5,235,000
Four Quarter EBITDA	$18,289,000

Total Funded Debt to Four Quarter EBITDA	
Total Funded Debt	$21,065,000
Divided by: Four Quarter EBITDA	18,289,000
Total Funded Debt to Four Quarter EBITDA	1.15

The following table sets forth the reconciliation of the Company's reported shareholders' equity to the calculation of adjusted net worth for the quarter ended December 27, 2013:

Total Twin Disc Shareholders' Equity	$145,265,000

Permitted Benefit Plan Adjustments	34,000,000
Adjusted Net Worth	$179,265,000

As of December 27, 2013, the Company was in compliance with all of the covenants described above. As of December 27, 2013, the Company's backlog of orders scheduled for shipment during the next six months (six-month backlog) was $56.2 million, or approximately 15% lower than the six-month backlog of $66.8 million as of June 30, 2013. In spite of the decrease in order backlog driven primarily by the decline in the North American oil and gas market, as rig operators adjust to the natural gas supply overhang and lower prices, the Company does not expect to violate any of its financial covenants in fiscal 2014. The current margin surrounding ongoing compliance with the above covenants, in particular, minimum EBITDA for the most recent four fiscal quarters and total funded debt to EBITDA, are not expected to decrease significantly. Based on its annual financial plan, the Company believes it is well positioned to generate sufficient EBITDA levels throughout fiscal 2014 in order to maintain compliance with the above covenants. However, as with all forward-looking information, there can be no assurance that the Company will achieve the planned results in future periods due to the uncertainties in certain of its markets. Please see the factors discussed under Item 1A, Risk Factors, of this Form 10-K 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 $29.75 million of available borrowings on its $40 million revolving loan agreement as of December 27, 2013 as well as $15 million available under its multi-currency revolver agreement with Wells Fargo Bank. The Company expects to continue to generate enough cash from operations to meet our operating and investing needs. In the first half of fiscal 2014, the Company generated $19.6 million of cash from operating activities. As of December 27, 2013, the Company also had cash of $27.1 million, primarily at its overseas operations. These funds, with some restrictions and tax implications, are available for repatriation as deemed necessary by the Company. In fiscal 2014, the Company expects to contribute $2.6 million to its defined benefit pension plans, the minimum contributions required. However, if the Company elects to make voluntary contributions in fiscal 2014, it intends to do so using cash from operations and, if necessary, from available borrowings under existing credit facilities.

As of December 27, 2013, 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):

Contractual Obligations	Total	Less than 1 year	1-3 Years	3-5 Years	After 5 Years
Revolver borrowing	$10,250		$10,250		
Long-term debt	$10,815	$3,643	$7,142		$30
Operating leases	$8,409	$3,079	$3,293	$2,021	$16
Total obligations	$29,474	$6,722	$20,685	$2,021	$46

The table above does not include tax liabilities related to uncertain income tax positions totaling $1.9 million, 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 2014 contributions to all defined benefit plans will total $2.6 million. As of December 27, 2013, $1.3 million in contributions have been made.

New Accounting Releases

In July 2013, the Financial Accounting Standards Board ("FASB") issued guidance stating that, except in certain defined circumstances, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013 (the Company's fiscal 2015). The adoption of this guidance is not expected to have a material impact on the Company's financial disclosures.

In March 2013, the FASB issued guidance on the parent company's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. This guidance clarifies the circumstances under which the related cumulative translation adjustment should be released into net income. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013 (the Company's fiscal 2015). The adoption of this guidance is not expected to have a material impact on the Company's financial results.

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, 2013. There have been no significant changes to those accounting policies subsequent to June 30, 2013.

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 December 27, 2013 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 $19,000.

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.

Currency risk - The Company has exposure to foreign currency exchange fluctuations. Approximately 22% of the Company's revenues in the six months ended December 27, 2013 were denominated in currencies other than the U.S. dollar. Of that total, approximately 61% was denominated in euros with the balance composed of Japanese yen, the Swiss franc, Indian rupee 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 occasionally 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 occasionally 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 2014 and 2013 was the euro. The Company had no outstanding forward exchange contracts at December 27, 2013 or June 30, 2013.

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 period covered by this report, no changes were made which have materially affected, or which are reasonably likely to materially affect, our internal control over financial reporting.

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

There have been no material changes to the risk factors previously disclosed in response to Item 1A to Part I of our 2013 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 three months ended December 27, 2013, 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
Sep. 28, 2013 – Oct. 25, 2013	1,776	NA	0	315,000
Oct. 26, 2013 – Nov. 29, 2013	0	NA	0	315,000
Nov. 30, 2013 – Dec. 27, 2013	0	NA	0	315,000
Total	0	NA	0	315,000

The Company did not purchase any shares of Common Stock during the quarter ended December 27, 2013, pursuant to our publicly announced program (described below). The amounts shown in Column (a) above represent shares of Common Stock delivered to the Company as payment of withholding taxes due on the vesting of restricted stock issued under the Twin Disc, Incorporated 2010 Long-Term Incentive Compensation Plan.

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 fiscal 2009 and 125,000 shares were purchased during fiscal 2012. On July 27, 2012, the Board of Directors authorized the purchase of an additional 375,000 shares of Common Stock at market values. This authorization has no expiration. During the second quarter of fiscal 2013, the Company purchased 185,000 shares under this authorization.

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.

101.INS XBRL Instance Document

101.SCH XBRL Schema

101.CAL XBRL Calculation Linkbase

101.DEF XBRL Definition Linkbase

101.LAB XBRL Label Linkbase

101.PRE XBRL Presentation Linkbase

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: February 5, 2014

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