

TWIN DISC INC
Form 10-Q
November 09, 2011

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 September 30, 2011

Commission File Number 1-7635

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

Wisconsin
(State or other jurisdiction of
Incorporation or organization)

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

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

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

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

Yes No

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

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

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

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

Yes No

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At October 28, 2011, the registrant had 11,429,487 shares of its common stock outstanding.

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWIN DISC, INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands)

(Unaudited)

| | September 30, 2011 | June 30, 2011 |
|---|--------------------------|------------------|
| Assets | | |
| Current assets: | | |
| Cash | \$24,698 | \$20,167 |
| Trade accounts receivable, net | 60,216 | 61,007 |
| Inventories, net | 104,976 | 99,139 |
| Deferred income taxes | 5,097 | 5,765 |
| Other | 8,536 | 9,090 |
| Total current assets | 203,523 | 195,168 |
| Property, plant and equipment, net | 66,940 | 65,791 |
| Goodwill, net | 18,063 | 17,871 |
| Deferred income taxes | 13,642 | 16,480 |
| Intangible assets, net | 6,336 | 6,439 |
| Other assets | 7,926 | 7,371 |
| Total assets | \$316,430 | \$309,120 |
| Liabilities and Equity | | |
| Current liabilities: | | |
| Short-term borrowings and current maturities of long-term debt | \$3,867 | \$3,915 |
| Accounts payable | 34,997 | 38,372 |
| Accrued liabilities | 38,301 | 41,673 |
| Total current liabilities | 77,165 | 83,960 |
| Long-term debt | 36,940 | 25,784 |
| Accrued retirement benefits | 47,981 | 50,063 |
| Deferred income taxes | 4,170 | 4,170 |
| Other long-term liabilities | 4,363 | 7,089 |
| Total liabilities | 170,619 | 171,066 |
| Equity | | |
| Twin Disc shareholders' equity: | | |
| Common shares authorized: 30,000,000; issued: 13,099,468; no par value | 11,079 | 10,863 |
| Retained earnings | 171,524 | 162,857 |
| Accumulated other comprehensive loss | (13,200) | (11,383) |
| Less treasury stock, at cost (1,679,767 and 1,739,574 shares, respectively) | 169,403 | 162,337 |
| | 24,499 | 25,252 |

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| | | |
|--------------------------------------|-----------|-----------|
| Total Twin Disc shareholders' equity | 144,904 | 137,085 |
| Noncontrolling interest | 907 | 969 |
| Total equity | 145,811 | 138,054 |
| Total liabilities and equity | \$316,430 | \$309,120 |

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

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

| | Three Months Ended | |
|--|--------------------------|--------------------------|
| | September 30, 2011 | September 24, 2010 |
| Net sales | \$81,330 | \$61,395 |
| Cost of goods sold | 50,562 | 41,372 |
| Gross profit | 30,768 | 20,023 |
| Marketing, engineering and administrative expenses | 15,909 | 14,777 |
| Earnings from operations | 14,859 | 5,246 |
| Interest expense | 359 | 439 |
| Other (income) expense, net | (394) | 554 |
| | (35) | 993 |
| Earnings before income taxes and noncontrolling interest | 14,894 | 4,253 |
| Income taxes | 5,259 | 1,556 |
| Net earnings | 9,635 | 2,697 |
| Less: Net earnings attributable to noncontrolling interest, net of tax | (54) | (41) |
| Net earnings attributable to Twin Disc | \$9,581 | \$2,656 |
| Dividends per share | \$0.08 | \$0.07 |
| Earnings per share data: | | |
| Basic earnings per share attributable to Twin Disc common shareholders | \$0.84 | \$0.24 |
| Diluted earnings per share attributable to Twin Disc common shareholders | \$0.83 | \$0.24 |
| Weighted average shares outstanding data: | | |
| Basic shares outstanding | 11,396 | 10,882 |
| Dilutive stock awards | 145 | 218 |
| Diluted shares outstanding | 11,541 | 11,100 |
| Comprehensive income: | | |
| Net earnings | \$9,635 | \$2,697 |
| Benefit plan adjustments, net | 474 | 553 |
| Foreign currency translation adjustment | (2,275) | 7,395 |
| Comprehensive income | 7,834 | 10,645 |

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| | | |
|--|---------|----------|
| Comprehensive income attributable to noncontrolling interest | (54) | (41) |
| Comprehensive income attributable to Twin Disc | \$7,780 | \$10,604 |

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)

| | Three Months Ended | |
|---|--------------------|-----------|
| | September | September |
| | 30, | 24, |
| | 2011 | 2010 |
| Cash flows from operating activities: | | |
| Net earnings | \$9,635 | \$2,697 |
| Adjustments to reconcile net earnings to net cash (used) provided by operating activities: | | |
| Depreciation and amortization | 2,573 | 2,272 |
| Other non-cash changes, net | 2,950 | 1,713 |
| Net change in working capital, excluding cash | (16,354) | (2,601) |
| Net cash (used) provided by operating activities | (1,196) | 4,081 |
| Cash flows from investing activities: | | |
| Acquisitions of fixed assets | (3,587) | (1,247) |
| Proceeds from sale of fixed assets | - | 49 |
| Other, net | (293) | (293) |
| Net cash used by investing activities | (3,880) | (1,491) |
| Cash flows from financing activities: | | |
| Proceeds from notes payable | - | 18 |
| Payments of notes payable | (53) | (42) |
| Proceeds from long-term debt, net | 11,164 | 1,695 |
| Proceeds from exercise of stock options | 169 | 71 |
| Dividends paid to shareholders | (914) | (792) |
| Dividends paid to noncontrolling interest | (132) | (138) |
| Other | (183) | 132 |
| Net cash provided by financing activities | 10,051 | 944 |
| Effect of exchange rate changes on cash | (444) | 558 |
| Net change in cash | 4,531 | 4,092 |
| Cash: | | |

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| | | |
|---------------------|----------|----------|
| Beginning of period | 20,167 | 19,022 |
| End of period | \$24,698 | \$23,114 |

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.

New Accounting Releases

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

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

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

In April 2010, the FASB issued a standards update providing guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. This update was effective for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010 (July 1, 2010 for the Company) and has not had a material impact on the Company’s financial statements to date.

B. Inventory

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

| | September 30, 2011 | June 30, 2011 |
|-----------------|--------------------------|------------------|
| Inventories: | | |
| Finished parts | \$56,825 | \$56,074 |
| Work in process | 21,391 | 18,561 |
| Raw materials | 26,760 | 24,504 |
| | \$104,976 | \$99,139 |

C. Warranty

The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers. However, its warranty obligation is affected by product failure rates, the number of units affected by the failure and the expense involved in satisfactorily addressing the situation. The warranty reserve is established based on our best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. When evaluating the adequacy of the reserve for warranty costs, management takes into consideration the term of the warranty coverage, historical claim rates and costs of repair, knowledge of the type and volume of new products and economic trends. While we believe the warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable in the future could differ materially from what actually transpires. The following is a listing of the activity in the warranty reserve during the three month periods ended September 30, 2011 and September 24, 2010 (in thousands):

| | Three Months Ended | |
|--------------------------------------|--------------------|------------------|
| | Sep. 30, 2011 | Sep. 24, 2010 |
| Reserve balance, beginning of period | \$6,022 | \$6,061 |
| Current period expense | 1,464 | 1,707 |
| Payments or credits to customers | (773) | (1,474) |
| Translation | (130) | 488 |
| Reserve balance, end of period | \$6,583 | \$6,782 |

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 | |
|--|--------------------|------------------|
| | Sep. 30, 2011 | Sep. 24, 2010 |
| Manufacturing segment sales | \$70,983 | \$50,802 |
| Distribution segment sales | 34,094 | 28,544 |
| Inter/Intra segment elimination - manufacturing | (19,670) | (14,468) |
| Inter/Intra segment elimination - distribution | (4,077) | (3,483) |
| Net sales | \$81,330 | \$61,395 |
| Manufacturing segment net earnings | \$8,802 | \$4,155 |
| Distribution segment net earnings | 2,006 | 1,230 |
| Corporate and eliminations | (1,227) | (2,729) |
| Earnings (loss) before income taxes and noncontrolling interest | \$9,581 | \$2,656 |
| | Sep. 30, 2011 | June 30, 2011 |
| Assets | | |
| Manufacturing segment assets | \$281,638 | \$271,454 |
| Distribution segment assets | 55,886 | 54,028 |
| Corporate assets and elimination of inter-company assets | (21,094) | (16,362) |
| | \$316,430 | \$309,120 |

F. Stock-Based Compensation

In the first quarter of fiscal 2012 and 2011, the Company granted a target number of 15,449 and 98,358 performance stock unit awards, respectively, to various employees of the Company, including executive officers. The performance stock unit awards granted in fiscal 2012 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2014. The performance stock unit awards granted in fiscal 2012 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is

18,539. Based upon actual results to date and the probability of achieving the targeted performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2012 at the target level. The performance stock unit awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock unit awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 118,030. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2011 at the maximum level. There were 243,647 and 278,665 unvested performance stock unit awards outstanding at September 30, 2011 and September 24, 2010, respectively. The performance stock unit awards are remeasured at fair-value based upon the Company's stock price at the end of each reporting period. The fair-value of the stock unit awards are expensed over the performance period for the shares that are expected to ultimately vest. The compensation (income) expense for the three months ended September 30, 2011 and September 24, 2010, related to the performance stock unit award grants, approximated \$(965,000) and \$461,000, respectively.

In the first quarter of fiscal 2012 and 2011, the Company granted a target number of 15,335 and 72,546 performance stock awards, respectively, to various employees of the Company, including executive officers. The performance stock awards granted in fiscal 2012 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2014. The performance stock awards granted in fiscal 2012 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 18,402. Based upon actual results to date and the probability of achieving the targeted performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2012 at the target level. The performance stock awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 87,055. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock awards granted in fiscal 2011 at the maximum level. There were 191,398 and 213,219 unvested performance stock awards outstanding at September 30, 2011 and September 24, 2010, respectively. The fair value of the stock awards (on the date of grant) is expensed over the performance period for the shares that are expected to ultimately vest. The compensation expense for the three months ended September 30, 2011 and September 24, 2010, related to performance stock awards, approximated \$197,000 and \$265,000, respectively.

In addition to the performance shares mentioned above, the Company has unvested restricted stock outstanding that will vest if certain service conditions are fulfilled. The fair value of the restricted stock grants is recorded as compensation over the vesting period, which is generally 1 to 4 years. During the first quarter of fiscal 2012 and 2011, the Company granted 33,834 and 98,780 service based restricted shares, respectively, to employees in each year. There were 261,025 and 225,203 unvested shares outstanding at September 30, 2011 and September 24, 2010, respectively. Compensation expense of \$342,000 and \$193,000 was recognized for the three months ended September 30, 2011 and September 24, 2010, respectively, related to these service-based awards.

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
Sep. 30, Sep. 24,
2011 2010

Pension Benefits:

| | | |
|---------------------------------------|---------|---------|
| Service cost | \$46 | \$38 |
| Interest cost | 1,510 | 1,556 |
| Expected return on plan assets | (1,919) | (1,513) |
| Amortization of prior service cost | - | - |
| Amortization of transition obligation | - | - |
| Amortization of net loss | 580 | 784 |
| Net periodic benefit cost | \$217 | \$865 |

Postretirement Benefits:

| | | |
|------------------------------------|-------|-------|
| Service cost | \$11 | \$8 |
| Interest cost | 246 | 274 |
| Amortization of net actuarial loss | 105 | 111 |
| Net periodic benefit cost | \$362 | \$393 |

The Company expects to contribute approximately \$3,728,000 to its pension plans in fiscal 2012. As of September 30, 2011, \$1,365,000 in contributions have been made.

H. Income Taxes

The effective tax rate for the first three months of fiscal 2012 is 35.3%, which is slightly lower than the prior year's 36.6%. The fiscal 2012 rate benefited from an increased Section 199 (domestic production activities) deduction due to increased activity at the Company's Racine operation driven by increased demand in the oil and gas market. The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. Due to recent operating losses in certain foreign jurisdictions, the Company has evaluated the realizability of the net deferred tax assets related to these jurisdictions. This evaluation concluded that, based primarily upon recent losses in this jurisdiction and failure to achieve targeted levels of improvement, a full valuation allowance continues to be necessary.

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 discretely based upon year-to-date results as these operations anticipate net operating losses for the year for which no tax benefit can be recognized.

The Company has approximately \$874,000 of unrecognized tax benefits, excluding related interest and penalties, as of September 30, 2011, which, if recognized, would favorably impact the effective tax rate. The Company has negotiated a proposed settlement in the U.S. for fiscal years 2003 through 2007. The Company does anticipate that upon final settlement, the net amount of unrecognized tax benefits will decrease by approximately \$350,000 during the next twelve months.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. For the quarter ended September 30, 2011, total accrued interest and penalties with respect to income taxes was approximately \$139,000 that would favorably affect the effective tax rate if recognized.

There was no significant change in the total unrecognized tax benefits due to the settlement of audits, the expiration of statutes of limitations or for other items during the quarter ended September 30, 2011.

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

I. Goodwill and Other Intangibles

The changes in the carrying amount of goodwill, substantially all of which is allocated to the manufacturing segment, for the three months ended September 30, 2011 were as follows (in thousands):

| | |
|--------------------------|----------|
| Balance at June 30, 2011 | \$17,871 |
| Translation adjustment | 192 |

| | |
|-------------------------------|----------|
| Balance at September 30, 2011 | \$18,063 |
|-------------------------------|----------|

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

| | September 30, 2011 | June 30, 2011 |
|--------------------------------------|--------------------------|------------------|
| Intangible assets with finite lives: | | |
| Licensing agreements | \$3,015 | \$3,015 |
| Non-compete agreements | 2,050 | 2,050 |
| Other | 5,991 | 5,991 |
| | 11,056 | 11,056 |
| Accumulated amortization | (7,990) | (7,774) |
| Translation adjustment | 885 | 817 |
| Total | \$3,951 | \$4,099 |

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

Intangible amortization expense was \$216,000 and \$199,000 the three months ended September 30, 2011 and September 24, 2010, respectively. Estimated intangible amortization expense for the remainder of fiscal 2012 and each of the next five fiscal years is as follows (in thousands):

| | |
|-------------|-------|
| Fiscal Year | |
| 2012 | \$648 |

| | |
|------|-----|
| 2013 | 802 |
| 2014 | 802 |
| 2015 | 461 |
| 2016 | 305 |
| 2017 | 301 |

The gross carrying amount of the Company's intangible assets that have indefinite lives and are not subject to amortization as of September 30, 2011 and June 30, 2011 are \$2,385,000 and \$2,340,000, respectively. These assets are comprised of acquired tradenames.

J. Long-term Debt

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

| | September 30, 2011 | June 30, 2011 |
|--|--------------------------|------------------|
| Revolving loan | \$22,500 | \$11,300 |
| 10-year unsecured senior notes | 17,857 | 17,857 |
| Other | 450 | 542 |
| Subtotal | 40,807 | 29,699 |
| Less: current maturities and short-term borrowings | (3,867) | (3,915) |
| Total long-term debt | \$36,940 | \$25,784 |

The revolving loan and unsecured senior notes listed above are subject to certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants, as defined, include a minimum consolidated net worth a minimum EBITDA for the most recent four fiscal quarters, and a maximum total funded debt to EBITDA ratio. As of September 30, 2011, the Company was in compliance with these covenants.

The fair value of the Company's 10-year unsecured senior notes due April 10, 2016 was approximately \$19,639,000 and \$19,589,000 at September 30, 2011 and June 30, 2011, respectively. The Company's revolving loan agreement approximates fair value at September 30, 2011 and June 30, 2011. 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 (0.42% and 0.81% for September 30, 2011 and June 30, 2011, respectively), plus the current add-on related to the revolving loan agreement (2.00% for September 30, 2011 and June 30, 2011, respectively).

K. Shareholders' Equity

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

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

| Twin Disc, Inc. Shareholders' Equity | | | | | | |
|--------------------------------------|----------|---------------|---------------|----------|-------------|--------|
| | | | Accumulated | | | |
| Common | Retained | Other | Comprehensive | Treasury | Non- | Total |
| Stock | Earnings | Income (Loss) | Income (Loss) | Stock | Controlling | Equity |
| | | | | | Interest | |
| | | | | | | |

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| | | | | | | |
|--|----------|-----------|------------|------------|-------|----------|
| Balance –June 30, 2010 | \$10,667 | \$147,438 | (\$42,048) | (\$27,597) | \$859 | \$89,319 |
| Net income | | 2,656 | | | 41 | 2,697 |
| Translation adjustments | | | 7,355 | | 40 | 7,395 |
| Benefit plan adjustments, net of tax | | | 553 | | | 553 |
| Cash dividends | | (792) | | | (138) | (930) |
| Compensation expense and windfall tax benefits | 590 | | | | | 590 |
| Shares (acquired) issued, net | (1,593) | | | 1,664 | | 71 |
| Balance-September 24, 2010 | \$9,664 | \$149,302 | (\$34,140) | (\$25,933) | \$802 | \$99,695 |

Twin Disc, Inc. Shareholders' Equity
Accumulated

| | Common Stock | Retained Earnings | Other Comprehensive Income (Loss) | Treasury Stock | Non-Controlling Interest | Total Equity |
|--|--------------|-------------------|-----------------------------------|----------------|--------------------------|--------------|
| Balance-June 30, 2011 | \$10,863 | \$162,857 | (\$11,383) | (\$25,252) | \$969 | \$138,054 |
| Net income | | 9,581 | | | 54 | 9,635 |
| Translation adjustments | | | (2,291) | | 16 | (2,275) |
| Benefit plan adjustments, net of tax | | | 474 | | | 474 |
| Cash dividends | | (914) | | | (132) | (1,046) |
| Compensation expense and windfall tax benefits | 985 | | | | | 985 |
| Shares (acquired) issued, net | (769) | | | 753 | | (16) |
| Balance-September 30, 2011 | \$11,079 | \$171,524 | (\$13,200) | (\$24,499) | \$907 | \$145,811 |

Item 2. Management Discussion and Analysis

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

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

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

Results of Operations

(In thousands)

| | Three Months Ended | | | |
|---|-----------------------|-------|-----------------------|-------|
| | September 30, 2011 | | September 24, 2010 | |
| | | % | | % |
| Net sales | \$81,330 | | \$61,395 | |
| Cost of goods sold | 50,562 | | 41,372 | |
| Gross profit | 30,768 | 37.8% | 20,023 | 32.6% |
| Marketing, engineering and administrative expenses | 15,909 | 19.6% | 14,777 | 24.1% |
| Earnings from operations | \$14,859 | 18.3% | \$5,246 | 8.5% |

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

Net sales for the first quarter increased 32.5%, or \$19.9 million, to \$81.3 million from \$61.4 million in the same period a year ago. Compared to the first quarter of fiscal 2011, on average, the Euro and Asian currencies strengthened against the U.S. Dollar. The net translation effect of this on foreign operations was to increase revenues by approximately \$2.8 million versus the prior year, before eliminations. The improvement in sales was the result of strong demand from customers in the oil and gas markets as well as growing demand in our aftermarket, industrial and airport rescue and fire fighting (ARFF) markets. Stable demand continues from the land- and marine-based military markets. While overall demand from commercial marine markets continued to improve, sales for the quarter were down slightly as a result of the timing of shipments to customers. The mega yacht and pleasure craft marine markets showed modest improvements in shipments and order activity in the first quarter versus the same period a year ago, albeit off of depressed levels.

Sales at our manufacturing segment were up 39.7% versus the same period last year. Compared to the first quarter of fiscal 2011, on average, the Euro strengthened against the U.S. Dollar. The net translation effect of this on foreign manufacturing operations was to increase revenues for the manufacturing segment by approximately \$1.8 million versus the prior year, before eliminations. In the current fiscal year's first quarter, our domestic manufacturing operation saw the largest growth, with an over 45% increase in sales versus the first fiscal quarter of 2011. The primary driver for this increase was the sale of transmissions and related products for the oil and gas markets as well as increased aftermarket shipments. The Company's Italian manufacturing operations, which have been adversely impacted by the softness in the European mega yacht and industrial markets, experienced a nearly 39% increase in sales compared to the prior fiscal year's first quarter. The Company's Belgian manufacturing operation, which also continued to be adversely impacted by the softness in the global mega yacht market, saw a 21% increase in sales versus the prior fiscal year's first quarter. The Company's Swiss manufacturing operation, which supplies customized propellers for the global mega yacht and patrol boat markets, experienced an over 18% increase in sales.

Our distribution segment, buoyed by continued growth in the North American oil and gas markets, experienced an increase of 19% in sales compared to the first quarter of fiscal 2011. Compared to the first quarter of fiscal 2011, on average, the Asian currencies strengthened against the U.S. Dollar. The net translation effect of this on foreign distribution operations was to increase revenues for the distribution segment by approximately \$2.0 million versus the prior year, before eliminations. The Company's distribution operation in Singapore continues to experience strong demand for marine transmission products for use in various commercial applications, with a six month backlog that

increased over 24% in the first fiscal quarter. However, due to the delay in shipments to some customers, this operation saw a 30% decrease in sales versus the prior fiscal year's first quarter record levels. The Company's distribution operation in the Northwest of the United States and Southwest of Canada experienced nearly a doubling of its sales due to continued strength in the Canadian oil and gas market. The Company's distribution operation in Italy, which provides boat accessories and propulsion systems for the pleasure craft market, saw an over 15% decrease in sales due to continued weakness in the global mega yacht market. The Company's distribution operation in Australia, which provides boat accessories, propulsion and marine transmission systems for the pleasure craft market, saw an increase in sales of over 60%, due to improved market conditions, including sales of component parts for the Company's new Express Joystick System®.

The elimination for net inter/intra segment sales increased \$5.8 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 520 basis points to 37.8% of sales, compared to 32.6% of sales for the same period last year. Gross profit for fiscal 2012's first quarter was significantly impacted by higher sales volumes (approximately \$9.2 million), a more profitable mix related to the Company's oil and gas transmission business (approximately \$1.1 million), and improved manufacturing efficiency and absorption. The Company also continues to benefit from the cost reduction and avoidance programs announced in the fourth fiscal quarter of 2009. As noted above, the majority of the sales volume increase came at the Company's domestic manufacturing operation, where the Company's 8500 series transmission for the oil and gas markets is produced. The growth in sales of this product was the primary driver of the favorable volume and mix benefits experienced in the quarter. Also favorably impacting gross profit as a percentage of sales, total warranty expense decreased over \$0.2 million in fiscal 2012's first quarter to \$1.5 million, despite a 32.5% increase in sales year-over-year.

For the fiscal 2012 first quarter, marketing, engineering and administrative (ME&A) expenses, as a percentage of sales, were 19.6 percent, compared to 24.1 percent for the fiscal 2011 first quarter. ME&A expenses increased \$1,132,000 versus the same period last fiscal year. Stock-based compensation expense decreased \$1,107,000 versus the prior year's first fiscal quarter, primarily driven by the decrease in the Company's stock price in the first quarter of fiscal 2012. Partially offsetting this were movements in foreign exchange rates, which increased ME&A expenses by \$792,000 in the first quarter of fiscal 2012 versus the comparable period a year ago. The net remaining increase of \$1,447,000 primarily relates to increased research and development activities, and higher salaries and wages.

Interest expense of \$0.4 million for the quarter was down 18.2% versus last year's first fiscal quarter. Total interest on the Company's \$40 million revolving credit facility ("revolver") decreased 22% to \$0.1 million in fiscal 2012's first quarter. This decrease can be attributed to an overall decrease in the interest rate on the revolver, partially offset by an increase in the average borrowings year-over-year. The average borrowing on the revolver, computed monthly, increased to \$15.0 million in fiscal 2012's first quarter, compared to \$9.6 million in the same period a year ago. The interest rate on the revolver decreased from a flat 4.00% in the prior fiscal year's first quarter to a range of 2.09% to 2.12% in the current year. The interest expense on the Company's \$25 million Senior Note decreased 17%, at a fixed rate of 6.05%, to \$0.3 million, due to a lower remaining principal balance.

Other income of \$0.4 million for the quarter ended September 30, 2011 improved from other expense of \$0.6 million for the comparable period a year ago. This improvement is due primarily to favorable foreign currency movements relative to the Euro, Canadian Dollar and Swiss Franc.

The effective tax rate for the fiscal 2012 first quarter was 35.3 percent, compared to the prior year's tax rate of 36.6 percent. The current year rate benefits from a higher estimated Section 199 (domestic production activities) deduction. Management anticipates the tax rate for the remainder of the year will remain consistent with the rate experienced in the fiscal 2012 first quarter. In the third fiscal quarter of 2011, the Company recorded a valuation allowance of approximately \$2,400,000 at one of the Company's foreign jurisdictions. The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In

determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. Due to recent operating losses in certain foreign jurisdictions, the Company evaluated the realizability of the net deferred tax assets related to these jurisdictions. This evaluation concluded that, based primarily upon recent losses in this jurisdiction and failure to achieve targeted levels of improvement, a full valuation allowance continues to be necessary.

Financial Condition, Liquidity and Capital Resources

Comparison between September 30, 2011 and June 30, 2011

As of September 30, 2011, the Company had net working capital of \$126.4 million, which represents an increase of \$15.2 million, or 13.7%, from the net working capital of \$111.2 million as of June 30, 2011.

Cash increased \$4.5 million to \$24.7 million as of September 30, 2011, versus \$20.2 million as of June 30, 2011. The majority of the cash as of September 30, 2011 is at our overseas operations in Europe and Asia-Pacific.

Trade receivables of \$60.2 million were down \$0.8 million, or just over 1%, when compared to last fiscal year-end. The impact of foreign currency translation was to decrease accounts receivable by \$1.3 million versus June 30, 2011. The net remaining increase is consistent with the sales volume increase experienced at the end of the quarter at our domestic manufacturing location, as shipping and order activity increased.

Net inventory increased by \$5.8 million versus June 30, 2011 to \$105.0 million. The impact of foreign currency translation was to decrease net inventory by \$3.0 million versus June 30, 2011. After adjusting for the impact of foreign currency translation, the net increase of \$8.8 million primarily came at the Company's domestic manufacturing location and was driven by increased production volume and order activity. On a consolidated basis, as of September 30, 2011, the Company's backlog of orders to be shipped over the next six months approximates \$164.5 million, compared to \$146.9 million at June 30, 2011 and \$100.0 million at September 24, 2010. The majority of the increase is being experienced at the Company's domestic manufacturing location. As a percentage of six month backlog, inventory has declined slightly from 67% at June 30, 2011 to 64% at September 30, 2011, indicating that the overall increase in inventory continues to be consistent with the growth in near-term demand.

Net property, plant and equipment (PP&E) increased \$1.1 million versus June 30, 2011. This includes the addition of \$3.6 million in capital expenditures, primarily at the Company's Racine-based manufacturing operation, which was partially offset by depreciation of \$2.4 million. The net remaining increase is due to foreign currency translation effects. In total, the Company expects to invest between \$15 and \$20 million in capital assets in fiscal 2012. The Company continues to review its capital plans based on overall market conditions and availability of capital, and may make changes to its capital plans accordingly. In addition, the quoted lead times on certain manufacturing equipment purchases may push some of the capital expenditures into the next fiscal year. In fiscal 2011, the Company spent \$12.0 million for capital expenditures, up from \$4.5 million and \$8.9 million in fiscal years 2010 and 2009, respectively. The Company's capital program is focused on modernizing key core manufacturing, assembly and testing processes and expanding capacity at its facilities around the world.

Accounts payable as of September 30, 2011 of \$35.0 million were down \$3.4 million, or 8.8%, from June 30, 2011. The impact of foreign currency translation was to decrease accounts payable by \$0.6 million versus June 30, 2011. The net remaining decrease in accounts payable was primarily driven by the payment of invoices for capital items acquired in the fourth fiscal quarter of fiscal 2011.

Total borrowings and long-term debt as of September 30, 2011 increased by \$11.1 million, or roughly 37%, to \$40.8 million versus June 30, 2011. This increase was driven by the overall increase in working capital levels, primarily driven by an increase in inventory and a net decrease in accounts payable. In addition, the Company made payments

for its annual incentive program in the first fiscal quarter of 2012 based on the achievement of fiscal 2011 targets.

Total equity increased \$7.8 million, or 6%, to \$145.9 million as of September 30, 2011. Retained earnings increased by \$8.7 million. The net increase in retained earnings included \$9.6 million in net earnings for the first fiscal quarter offset by \$0.9 million in dividend payments. Net unfavorable foreign currency translation of \$2.3 million was reported. The remaining movement of \$0.5 million represents an adjustment for the amortization of net actuarial loss and prior service cost on the Company's defined benefit pension plans.

In December 2002, the Company entered into a \$20,000,000 revolving loan agreement with M&I Marshall & Ilsley Bank ("M&I"), which had an original expiration date of October 31, 2005. Through a series of amendments, the last of which was agreed to during the fourth quarter of fiscal 2011, the total commitment was increased to \$40,000,000 and the term was extended to May 31, 2015. This agreement contains certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants include a minimum consolidated net worth, minimum EBITDA for the most recent four fiscal quarters of \$11,000,000 at September 30, 2011, and a maximum total funded debt to EBITDA ratio of 3.0 at September 30, 2011. As of September 30, 2011, the Company was in compliance with these covenants with a four quarter EBITDA total of \$54,366,000 and a funded debt to EBITDA ratio of 0.75. The minimum net worth covenant fluctuates based upon actual earnings and is subject to adjustment for certain pension accounting adjustments to equity. As of September 30, 2011 the minimum equity requirement was \$111,780,000 compared to an actual result of \$178,904,000 after all required adjustments. The outstanding balance of \$22,500,000 and \$11,300,000 at September 30, 2011 and June 30, 2011, respectively, is classified as long-term debt. In accordance with the loan agreement as amended, the Company can borrow at LIBOR plus an additional "Add-On," between 1.5% and 2.5%, depending on the Company's Total Funded Debt to EBITDA ratio. The rate was 2.12% and 2.09% at September 30, 2011 and June 30, 2011, respectively.

On April 10, 2006, the Company entered into a Note Agreement (the "Note Agreement") with The Prudential Insurance Company of America and certain other entities (collectively, "Purchasers"). Pursuant to the Note Agreement, Purchasers acquired, in the aggregate, \$25,000,000 in 6.05% Senior Notes due April 10, 2016 (the "Notes"). The Notes mature and become due and payable in full on April 10, 2016 (the "Payment Date"). Prior to the Payment Date, the Company is obligated to make quarterly payments of interest during the term of the Notes, plus prepayments of principal of \$3,571,429 on April 10 of each year from 2010 to 2015, inclusive. The outstanding balance was \$17,857,143 at September 30, 2011 and June 30, 2011, respectively. Of the outstanding balance, \$3,571,429 was classified as a current maturity of long-term debt at September 30, 2011 and June 30, 2011, respectively. The remaining \$14,287,714 is classified as long-term debt. The Company also has the option of making additional prepayments subject to certain limitations, including the payment of a Yield-Maintenance Amount as defined in the Note Agreement. In addition, the Company will be required to make an offer to purchase the Notes upon a Change of Control, and any such offer must include the payment of a Yield-Maintenance Amount. The Note Agreement includes certain financial covenants which are identical to those associated with the revolving loan agreement discussed above. The Note Agreement also includes certain restrictive covenants that limit, among other things, the incurrence of additional indebtedness and the disposition of assets outside the ordinary course of business. The Note Agreement provides that it shall automatically include any covenants or events of default not previously included in the Note Agreement to the extent such covenants or events of default are granted to any other lender of an amount in excess of \$1,000,000. Following an Event of Default, each Purchaser may accelerate all amounts outstanding under the Notes held by such party.

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

- "Four quarter EBITDA" is defined as "the sum of (i) Net Income plus, to the extent deducted in the calculation of Net Income, (ii) interest expense, (iii) depreciation and amortization expense, and (iv) income tax expense;" and

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

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

Four Quarter EBITDA Reconciliation

| | |
|-----------------------------|--------------|
| Net Earnings | \$25,755,000 |
| Depreciation & Amortization | 10,205,000 |
| Interest Expense | 1,639,000 |
| Income Taxes | 16,767,000 |
| Four Quarter EBITDA | \$54,366,000 |

Total Funded Debt to Four Quarter EBITDA

| | |
|--|--------------|
| Total Debt | \$40,807,000 |
| Divided by: Four Quarter EBITDA | 54,366,000 |
| Total Funded Debt to Four Quarter EBITDA | 0.75 |

As of September 30, 2011, the Company was in compliance with all of the covenants described above. Based on its annual and long range financial plans as well as the recent, significant increase in the Company’s order backlog, the Company does not expect to violate any of its financial covenants in fiscal 2012. Please see the factors discussed under Item 1A, Risk Factors, of the Company’s Annual Report filed on Form 10-K for June 30, 2011 for further discussion of this topic.

The Company’s balance sheet remains very strong, there are no off-balance-sheet arrangements other than the operating leases listed below, and we continue to have sufficient liquidity for near-term needs. The Company had \$17.5 million of available borrowings on our \$40 million revolving loan agreement as of September 30, 2011, and expects to continue to generate enough cash from operations to meet our operating and investing needs. As of September 30, 2011, the Company also had cash of \$24.7 million, primarily at its overseas operations. These funds, with limited restrictions, are available for repatriation as deemed necessary by the Company. In fiscal 2012, the Company expects to contribute \$3,728,000 to its defined benefit pension plans, the minimum contributions required. However, if the Company elects to make voluntary contributions in fiscal 2012, it intends to do so using cash from operations and, if necessary, from available borrowings under existing credit facilities. As of September 30, 2011, \$1,365,000 in contributions have been made.

As of September 30, 2011, 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):

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| Contractual Obligations | Total | Less than 1 year | 1-3 Years | 3-5 Years | After 5 Years |
|-------------------------|----------|---------------------|--------------|--------------|------------------|
| Revolver borrowing | \$22,500 | | \$22,500 | | |
| Long-term debt | \$18,307 | \$3,867 | \$7,269 | \$7,143 | \$28 |
| Operating leases | \$5,954 | \$2,920 | \$2,666 | \$368 | |
| Total obligations | \$46,761 | \$6,787 | \$32,435 | \$7,511 | \$28 |

The table above does not include tax liabilities related to uncertain income tax positions totaling \$874,000, excluding related interest and penalties, as the timing of their resolution can not be estimated. See Note H of the Condensed Consolidated Financial Statements for disclosures surrounding uncertain income tax positions.

The Company maintains defined benefit pension plans for some of its operations in the United States and Europe. The Company has established the Pension Committee to manage the operations and administration of the defined benefit plans. The Company estimates that fiscal 2012 contributions to all defined benefit plans will total \$3,728,000. As of September 30, 2011, \$1,365,000 in contributions have been made.

New Accounting Releases

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

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

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

In April 2010, the FASB issued a standards update providing guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. This update was effective for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010 (July 1, 2010 for the Company) and did not have a material impact on the Company’s financial statements.

Critical Accounting Policies

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

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

Item 3. Quantitative and Qualitative Disclosure About Market Risk

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

Interest rate risk - The Company's earnings exposure related to adverse movements of interest rates is primarily derived from outstanding floating rate debt instruments that are indexed to the prime and LIBOR interest rates. In accordance with the \$40,000,000 revolving loan agreement expiring May 31, 2015, the Company has the option of borrowing at the prime interest rate or LIBOR plus an additional "Add-On", between 2% and 3.5%, 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 September 30, 2011 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 \$48,000.

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

Stock market risk - The Company's earnings are exposed to stock market risk relative to the Performance Stock Unit Awards. These are cash based awards which are revalued at the end of each reporting period based upon the Company's closing stock price as of the end of the period. A one dollar increase or decrease in the Company's stock price would result in a decrease or increase, respectively, in earnings from operations of approximately \$130,000 as of September 30, 2011. These awards were valued based upon the average of the high and low of the Company's September 30, 2011 stock price of \$27.08.

Currency risk - The Company has exposure to foreign currency exchange fluctuations. Approximately 20% of the Company's revenues in the three months ended September 30, 2011 were denominated in currencies other than the U.S. Dollar. Of that total, approximately 67% was denominated in Euros with the balance composed of Japanese Yen, the Swiss Franc and the Australian and Singapore Dollars. The Company does not hedge the translation exposure represented by the net assets of its foreign subsidiaries. Foreign currency translation adjustments are recorded as a component of shareholders' equity. Forward foreign exchange contracts are used to hedge the currency fluctuations on significant transactions denominated in foreign currencies.

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

The Company primarily enters into forward exchange contracts to reduce the earnings and cash flow impact of non-functional currency denominated receivables and payables. These contracts are highly effective in hedging the cash flows attributable to changes in currency exchange rates. Gains and losses resulting from these contracts offset the foreign exchange gains or losses on the underlying assets and liabilities being hedged. The maturities of the

forward exchange contracts generally coincide with the settlement dates of the related transactions. Gains and losses on these contracts are recorded in Other expense, net in the Condensed Consolidated Statement of Operations as the changes in the fair value of the contracts are recognized and generally offset the gains and losses on the hedged items in the same period. The primary currency to which the Company was exposed in fiscal 2012 and 2011 was the Euro. The Company had no outstanding forward exchange contracts at September 30, 2011 or June 30, 2011.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). During the period covered by this report, the Company implemented a new enterprise resource planning (ERP) system at its Belgian manufacturing operation. The new ERP system resulted in some modifications to the internal controls surrounding financial reporting at this operation, however, adequate disclosure controls and procedures remained in place during the quarter. The Company is currently reviewing and redesigning, as necessary, the controls impacted by the new ERP system. This process will be completed in the Company's second fiscal quarter.

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 2011 Annual Report on Form 10-K.

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

(a) Unregistered Sales of Equity Securities

There were no securities of the Company sold by the Company during the three months ended September 30, 2011, 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 |
|-------------------------------|--------------------------------------|----------------------------------|--|--|
| July. 1, 2011 – July 29, 2011 | 0 | NA | 0 | 250,000 |
| July 30, 2011 – Aug. 26, 2011 | 0 | NA | 0 | 250,000 |
| Aug. 27, 2011 – Sep. 30, 2011 | 0 | NA | 0 | 250,000 |
| Total | 0 | | 0 | |

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

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

Item 6. Exhibits

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

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

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

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

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: November 9, 2011

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