TWIN DISC INC
Form 10-K
September 13, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended June 30, 2010
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 Number)
1328 Racine Street, Racine, Wisconsin (Address of Principal Executive Office)	53403 (Zip Code)
Registrant's Telephone Number, including area code:	(262) 638-4000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered:
Common stock, no par	The NASDAQ Stock Market LLC
Preferred stock purchase rights	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES [ ] NO [√]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES [ ] NO [√]

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 Web site, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [√].

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).
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 Act).
YES [ ] NO [√]

At December 25, 2009, the last business day of the registrant’s second fiscal quarter, the aggregate market value of the common stock held by non-affiliates of the registrant was $83,250,798. Determination of stock ownership by affiliates was made solely for the purpose of responding to this requirement and registrant is not bound by this determination for any other purpose.

At August 18, 2010, the registrant had 11,313,006 shares of its common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which will be filed pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report, are incorporated by reference into Part III.

PART I

Item 1. Business

Twin Disc was incorporated under the laws of the state of Wisconsin in 1918. Twin Disc designs, manufactures and sells marine and heavy duty off-highway power transmission equipment. Products offered 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 its products to customers primarily in the pleasure craft, commercial and military marine markets as well as in the energy and natural resources, government and industrial markets. The Company's worldwide sales to both domestic and foreign customers are transacted through a direct sales force and a distributor network. The products described above have accounted for more than 90% of revenues in each of the last three fiscal years.

Most of the Company's products are machined from cast iron, forgings, cast aluminum and bar steel which generally are available from multiple sources and which are believed to be in adequate supply.

The Company has pursued a policy of applying for patents in both the United States and certain foreign countries on inventions made in the course of its development work for which commercial applications are considered probable. The Company regards its patents collectively as important but does not consider its business dependent upon any one of such patents.

The business is not considered to be seasonal except to the extent that employee vacations are taken mainly in the months of July and August, curtailing production during that period.

The Company's products receive direct widespread competition, including from divisions of other larger independent manufacturers. The Company also competes for business with parts manufacturing divisions of some of its major customers. Primary competitive factors for the Company’s products are performance, price, service and availability. The Company’s top ten customers accounted for approximately 31% of the Company's consolidated net sales during the year ended June 30, 2010. There were no customers that accounted for 10% or more of consolidated net sales in fiscal 2010.

Unfilled open orders for the next six months of $84,419,000 at June 30, 2010 compares to $60,583,000 at June 30, 2009. The Company saw an increase in orders by oil and gas customers for the 8500 transmission as stable oil and gas prices have driven demand for new high-horsepower rigs. Since orders are subject to cancellation and rescheduling by the customer, the six-month order backlog is considered more representative of operating conditions than total backlog. However, as procurement and manufacturing "lead times" change, the backlog will increase or decrease; and thus it does not necessarily provide a valid indicator of the shipping rate. Cancellations are generally the result of rescheduling activity and do not represent a material change in backlog.

Management recognizes that there are attendant risks that foreign governments may place restrictions on dividend payments and other movements of money, but these risks are considered minimal due to the political relations the United States maintains with the countries in which the Company operates or the relatively low investment within individual countries. No material portion of the Company’s business is subject to renegotiation of profits or termination of contracts at the election of the Government.

Engineering and development costs include research and development expenses for new product development and major improvements to existing products, and other costs for ongoing efforts to refine existing products. Research and development costs charged to operations totaled $2,347,000, $2,636,000 and $2,788,000 in fiscal 2010, 2009 and 2008, respectively. Total engineering and development costs were $7,885,000, $9,142,000 and $9,025,000 in fiscal

2010, 2009 and 2008, respectively.

The Company's development of its 7500 series transmission has entered its field test phase, and the Company expects to start production in the second half of fiscal 2011. The 7500 series transmission is specifically designed for oil and gas high-pressure pumping applications, and is expected to offer significant advantages in those applications over the Company's current product mix. For example, the 7500 series transmission will be considerably lighter than the Company's 8500 series transmission, and will be able to fit within the frame rails of on-road fracturing rigs so that the rigs that don't need special permits to move from one field to another. It is also designed to work in a range of 1500 to 2500 horsepower, which is a larger market than the 2500 to 3000 horsepower application market for the Company's 8500 series transmission.

Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, is not anticipated to have a material effect on capital expenditures, earnings or the competitive position of the Company.

The number of persons employed by the Company at June 30, 2010 was 925.

A summary of financial data by segment and geographic area for the years ended June 30, 2010, 2009 and 2008 appears in Note J to the consolidated financial statements.

The Company's internet website address is www.twindisc.com. The Company makes available free of charge (other than an investor's own internet access charges) through its website the Company's Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after it electronically files such material with, or furnishes such material to, the United States Securities and Exchange Commission. In addition, the Company makes available, through its website, important corporate governance materials. This information is also available from the Company upon request. The Company is not including the information contained on or available through its website as a part of, or incorporating such information by reference into, this Annual Report on Form 10-K.

Item 1A. Risk Factors

The Company's business involves risk. The following information about these risks should be considered carefully together with other information contained in this report. The risks described below are not the only risks the Company faces. Additional risks not currently known, deemed immaterial or that could apply to any issuer may also result in adverse results for the Company's business.

As a global company, we are subject to currency fluctuations and any significant movement between the U.S. Dollar and the Euro, in particular, could have an adverse effect on our profitability. Although the Company's financial results are reported in U.S. Dollars, a significant portion of our sales and operating costs are realized in Euros and other foreign currencies. The Company's profitability is affected by movements of the U.S. Dollar against the Euro and the other currencies in which we generate revenues and incur expenses. Significant long-term fluctuations in relative currency values, in particular a significant change in the relative values of the U.S. Dollar or Euro, could have an adverse effect on our profitability and financial condition.

Certain of the Company's products are directly or indirectly used in oil exploration and oil drilling, and are thus dependent upon the strength of those markets and oil prices. In recent years, the Company has seen a significant growth in the sales of its products that are used in oil and energy related markets. The growth in these markets has been spurred by the rise in oil prices and the global demand for oil. In addition, there has been a substantial increase in capital investment by companies in these markets. In the prior fiscal year, a significant decrease in oil prices, the demand for oil and capital investment in the oil and energy markets had an adverse effect on the sales of these products and ultimately on the Company's profitability. While this market has shown signs of recovery in fiscal 2010, a continued softening or further deterioration in global oil and gas markets could have a further adverse effect on the sales of these products and ultimately on the Company's profitability.

Many of the Company's product markets are cyclical in nature or are otherwise sensitive to volatile or variable factors. A downturn or weakness in overall economic activity or fluctuations in those other factors can have a material adverse effect on the Company's overall financial performance. Historically, sales of many of the products that the Company manufactures and sells have been subject to cyclical variations caused by changes in general economic conditions and other factors. In particular, the Company sells its products to customers primarily in the pleasure craft, commercial and military marine markets, as well as in the energy and natural resources, government and industrial markets. The demand for the products may be impacted by the strength of the economy generally, governmental spending and appropriations, including security and defense outlays, fuel prices, interest rates, as well as many other factors. Adverse economic and other conditions may cause the Company's customers to forego or otherwise postpone purchases in favor of repairing existing equipment.

In the event of an increase in the global demand for steel, the Company could be adversely affected if it experiences shortages of raw castings and forgings used in the manufacturing of its products. With the continued development of certain third world economies, in particular China and India, the global demand for steel has risen significantly in recent years. The Company selects its suppliers based on a number of criteria, and we expect that they will be able to support our growing needs. However, there can be no assurance that a significant increase in demand, capacity constraints or other issues experienced by the Company's suppliers will not result in shortages or delays in their supply of raw materials to the Company. If the Company were to experience a significant or prolonged shortage of critical components from any of its suppliers, particularly those who are sole sources, and could not procure the components from other sources, the Company would be unable to meet its production schedules for some of its key products and would miss product delivery dates which would adversely affect our sales, profitability and relationships with our customers.

If the Company were to lose business with any key customers, the Company's business would be adversely affected. Although there were no customers that accounted for 10% or more of consolidated net sales in fiscal 2010, deterioration of a business relationship with one or more of the Company's significant customers would cause its sales and profitability to be adversely affected.

The Company continues to face the prospect of increasing commodity costs, including steel, other raw materials and energy that could have an adverse effect on future profitability. To date, the Company has been successful with offsetting the effects of increased commodity costs through cost reduction programs and pricing actions. However, if material prices were to continue to increase at a rate that could not be recouped through product pricing, it could potentially have an adverse effect on our future profitability.

The termination of relationships with the Company's suppliers, or the inability of such suppliers to perform, could disrupt its business and have an adverse effect on its ability to manufacture and deliver products. The Company relies on raw materials, component parts, and services supplied by outside third parties. If a supplier of significant raw materials, component parts or services were to terminate its relationship with the Company, or otherwise cease supplying raw materials, component parts, or services consistent with past practice, the Company's ability to meet its obligations to its customers may be affected. Such a disruption with respect to numerous products, or with respect to a few significant products, could have an adverse effect on the Company's profitability and financial condition.

A significant design, manufacturing or supplier quality issue could result in recalls or other actions by the Company that could adversely affect profitability. As a manufacturer of highly engineered products, the performance, reliability and productivity of the Company's products is one of its competitive advantages. While the Company prides itself on putting in place procedures to ensure the quality and performance of its products and suppliers, a significant quality or product issue, whether due to design, performance, manufacturing or supplier quality issue, could lead to warranty actions, scrapping of raw materials, finished goods or returned products, the deterioration in a customer relation, or other action that could adversely affect warranty and quality costs, future sales and profitability.

The Company faces risks associated with its international sales and operations that could adversely affect its business, results of operations or financial condition. Sales to customers outside the United States approximated 65% of our consolidated net sales for fiscal 2010. We have international manufacturing operations in Belgium, Italy and Switzerland. In addition, we have international distribution operations in Singapore, China, Australia, Japan, Italy and Canada. Our international sales and operations are subject to a number of risks, including:

⇒ currency exchange rate fluctuations
⇒ export and import duties, changes to import and export regulations, and restrictions on the transfer of funds
⇒ problems with the transportation or delivery of our products
⇒ issues arising from cultural or language differences and labor unrest
⇒ longer payment cycles and greater difficulty in collecting accounts receivables
⇒ compliance with trade and other laws in a variety of jurisdictions

These factors could adversely affect our business, results of operations or financial condition.

A material disruption at the Company's manufacturing facilities in Racine, Wisconsin could adversely affect its ability to generate sales and meet customer demand. The majority of the Company's manufacturing, based on fiscal 2010's sales, came from its two facilities in Racine, Wisconsin. If operations at these facilities were to be disrupted as a result of significant equipment failures, natural disasters, power outages, fires, explosions, adverse weather conditions or other reasons, the Company's business and results of operations could be adversely affected. Interruptions in production would increase costs and reduce sales. Any interruption in production capability could require the Company to make substantial capital expenditures to remedy the situation, which could negatively affect its profitability and financial condition. The Company maintains property damage insurance which it believes to be adequate to provide for reconstruction of its facilities and equipment, as well as business interruption insurance to mitigate losses resulting from any production interruption or shutdown caused by an insured loss. However, any recovery under this insurance policy may not offset the lost sales or increased costs that may be experienced during the disruption of operations. Lost sales may not be recoverable under the policy and long-term business disruptions could result in a loss of customers. If this were to occur, future sales levels and costs of doing business, and therefore profitability, could be adversely affected.

Any failure to meet our debt obligations and satisfy financial covenants could adversely affect our business and financial condition. Beginning in 2008 and continuing into 2010, general worldwide economic conditions have experienced a downturn due to the combined effects of the subprime lending crisis, general credit market crisis, collateral effects on the finance and banking industries, slower economic activity, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. These conditions make it difficult for customers, vendors and the Company to accurately forecast and plan future business activities, and cause U.S. and foreign businesses to slow spending on products, which delay and lengthen sales cycles. These conditions led to declining revenues in several of the Company's divisions in fiscal 2009 and 2010. The Company's amended revolving credit facility and senior notes agreements require it to maintain specified quarterly financial covenants such as a minimum consolidated net worth amount, a minimum EBITDA, as defined, for the most recent four fiscal quarters of $11,000,000 and a funded debt to EBITDA ratio of 3.0 or less. At June 30, 2010, the Company was in compliance with these financial covenants. Based on its annual financial plan, the Company believes that it will generate sufficient EBITDA levels throughout fiscal 2011 in order to maintain compliance with its financial covenants. However, as with all forward-looking information, there can be no assurance that the Company will achieve the planned results in future periods especially due to the significant uncertainties flowing from the current economic environment. If the Company is not able to achieve these objectives and to meet the required covenants under the agreements, the Company may require forbearance from its existing lenders in the form of waivers and/or amendments of its credit facilities or be required to arrange alternative financing. Failure to obtain relief from covenant violations or to obtain alternative financing, if necessary, would have a material adverse impact on the Company.

The Company may experience negative or unforeseen tax consequences. The Company reviews the probability of the realization of our net deferred tax assets each period based on forecasts of taxable income in both the U.S. and foreign jurisdictions. This review uses historical results, projected future operating results based upon approved business plans, eligible carryforward periods, tax planning opportunities and other relevant considerations. Adverse changes in the profitability and financial outlook in the U.S. or foreign jurisdictions may require the creation of a valuation allowance to reduce our net deferred tax assets. Such changes could result in material non-cash expenses in the period in which the changes are made and could have a material adverse impact on the Company's results of operations and financial condition.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Manufacturing Segment
The Company owns two manufacturing, assembly and office facilities in Racine, Wisconsin, U.S.A., one in Nivelles, Belgium, two in Decima, Italy and one in Novazzano, Switzerland. The aggregate floor space of these six plants approximates 724,000 square feet. One of the Racine facilities includes office space, which includes the Company's corporate headquarters. The Company leases additional manufacturing, assembly and office facilities in Italy (Limite sull'Arno) and India (outsourcing office in Chennai).

Distribution Segment
The Company also has operations in the following locations, all of which are used for sales offices, warehousing and light assembly or product service. The following properties are leased:

Jacksonville, Florida, U.S.A.	Limite sull'Arno, Italy
Medley, Florida, U.S.A.	Brisbane, Queensland, Australia
Coburg, Oregon, U.S.A.	Perth, Western Australia, Australia
Kent, Washington, U.S.A.	Singapore
Edmonton, Alberta, Canada	Shanghai, China
Burnaby, British Columbia, Canada	Guangzhou, China

The Company believes its properties are well maintained and adequate for its present and anticipated needs.

Item 3. Legal Proceedings

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

Item 4. Reserved

Executive Officers of the Registrant

Pursuant to General Instruction G(3) of Form 10-K, the following list is included as an unnumbered Item in Part I of this Report in lieu of being included in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 15, 2010.

Name	Age	Position
Michael E. Batten	70	Chairman and Chief Executive Officer
John H. Batten	45	President and Chief Operating Officer
Christopher J. Eperjesy	42	Vice President – Finance, Chief Financial Officer and Treasurer
James E. Feiertag	53	Executive Vice President
Henri-Claude Fabry	64	Vice President - International Distribution and Managing Director, Twin Disc International S.A.
Dean J. Bratel	46	Vice President - Engineering
Denise L. Wilcox	53	Vice President - Human Resources
Jeffrey S. Knutson	45	Corporate Controller
Thomas E. Valentyn	51	General Counsel and Secretary

Officers are elected annually by the Board of Directors at the Board meeting held in conjunction with each Annual Meeting of the Shareholders. Each officer holds office until a successor is duly elected, or until he/she resigns or is removed from office.

Michael E. Batten, Chairman and Chief Executive Officer. Mr. Batten has been employed with the Company since 1970, and was named Chairman and Chief Executive Officer in 1991.

John H. Batten, President and Chief Operating Officer. Effective July 1, 2008, Mr. Batten was named President and Chief Operating Officer. Prior to this promotion, Mr. Batten served as Executive Vice President since November 2004, Vice President and General Manager – Marine and Propulsion since October 2001 and Commercial Manager – Marine and Propulsion since 1998. Mr. Batten joined Twin Disc in 1996 as an Application Engineer. Mr. Batten is the son of Mr. Michael Batten.

Christopher J. Eperjesy, Vice President – Finance, Chief Financial Officer and Treasurer. Mr. Eperjesy joined the Company in his current role in November 2002. Prior to joining Twin Disc, Mr. Eperjesy was Divisional Vice President – Financial Planning & Analysis for Kmart Corporation since 2001, and Senior Manager – Corporate Finance with DaimlerChrysler AG since 1999.

James E. Feiertag, Executive Vice President. Mr. Feiertag was appointed to his present position in October 2001. Prior to being promoted, he served as Vice President – Manufacturing since joining the Company in November 2000. Prior to joining Twin Disc, Mr. Feiertag was the Vice President of Manufacturing for the Drives and Systems Group of Rockwell Automation since 1999.

Henri Claude Fabry, Vice President – International Distribution and Managing Director, Twin Disc International S.A. Mr. Fabry was appointed to his current position in January 2009, after serving as Vice President – Global Distribution since 2001. Mr. Fabry joined Twin Disc in 1997 as Director, Marketing and Sales of the Belgian subsidiary.

Dean J. Bratel, Vice President - Engineering. Mr. Bratel was promoted to his current role in November 2004 after serving as Director of Corporate Engineering (since January 2003), Chief Engineer (since October 2001) and Engineering Manager (since December 1999). Mr. Bratel joined Twin Disc in 1987.

Denise L. Wilcox, Vice President - Human Resources. After joining the Company as Manager Compensation & Benefits in September 1998, Ms. Wilcox was promoted to Director Corporate Human Resources in March 2002 and to her current role in November 2004. Prior to joining Twin Disc, Ms. Wilcox held positions with Johnson International and Runzheimer International.

Jeffrey S. Knutson, Corporate Controller. Mr. Knutson was appointed to his current role in October 2005 after joining the Company in February 2005 as Controller of North American Operations. Prior to joining Twin Disc, Mr. Knutson held Operational Controller positions with Tower Automotive (since August 2002) and Rexnord Corporation (since November 1998).

Thomas E. Valentyn, General Counsel and Secretary. Mr. Valentyn joined the Company in his current role in September 2007. Prior to joining Twin Disc, Mr. Valentyn served as Vice President and General Counsel at Norlight Telecommunications, Inc. since July 2000.

PART II

Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters

The Company's common stock is traded on the NASDAQ Global Select Market under the symbol TWIN. The price information below represents the high and low sales prices from July 1, 2008 through June 30, 2010:

	Fiscal Year Ended 6/30/10			Fiscal Year Ended 6/30/09		
Quarter	High	Low	Dividend	High	Low	Dividend
First Quarter	$15.23	$6.21	$0.07	$22.94	$12.92	$0.07
Second Quarter	14.77	9.12	0.07	15.38	4.02	0.07
Third Quarter	13.17	8.77	0.07	8.12	4.54	0.07
Fourth Quarter	14.92	11.35	0.07	9.72	6.06	0.07

For information regarding the Company’s equity-based compensation plans, see the discussion under Item 12 of this report. As of August 18, 2010, shareholders of record numbered 736. The closing price of Twin Disc common stock as of August 18, 2010 was $12.47.

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
March 27, 2010 – April 30, 2010	0	NA	0	250,000
May 1, 2010 – May 28, 2010	0	NA	0	250,000
May 29, 2010 - June 30, 2010	0	NA	0	250,000
Total	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 were purchased during the second quarter of fiscal 2009.

Performance Graph

The following table compares total shareholder return over the last 5 fiscal years to the Standard & Poor's 500 Machinery (Industrial) Index and the Russell 2000 index. The S&P 500 Machinery (Industrial) Index consists of a broad range of manufacturers. The Russell 2000 Index consists of a broad range of 2,000 companies. The Company believes, because of the similarity of its business with those companies contained in the S&P 500 Machinery (Industrial) Index, that comparison of shareholder return with this index is appropriate. Total return values for the Corporation's common stock, the S&P 500 Machinery (Industrial) Index and the Russell 2000 Index were calculated based upon an assumption of a $100 investment on June 30, 2005 and based upon cumulative total return values assuming reinvestment of dividends on a quarterly basis.

Item 6. Selected Financial Data

Financial Highlights
(in thousands, except per share amounts)

	Fiscal Years Ended June 30,				
Statement of Operations Data:	2010	2009	2008	2007	2006
Net sales	$227,534	$295,618	$331,694	$317,200	$243,287
Net earnings attributable to Twin Disc	597	11,502	24,252	21,852	14,453
Basic earnings per share attributable to Twin Disc common shareholders	0.05	1.04	2.15	1.88	1.26
Diluted earnings per share attributable to Twin Disc common shareholders	0.05	1.03	2.13	1.84	1.22
Dividends per share	0.28	0.28	0.265	0.205	0.1825

Balance Sheet Data (at end of period):					
Total assets	$259,056	$290,008	$304,628	$267,184	$236,172
Total long-term debt	27,211	46,348	48,227	42,152	38,369

Effective May 31, 2006, the Company acquired four related foreign entities: B.C.S. S.r.l., an Italian limited liability company; B.C.S. Service S.r.l., an Italian limited liability company; Boat Equipment Limited, a Maltese limited liability company; and Vetus Italia S.r.l., an Italian limited liability company. All four entities have a fiscal year ending May 31. Since the acquisition was also effective May 31, no results of operations for these four acquired entities are included in the consolidated results for the year ended June 30, 2006. A full year's results are included in the consolidated results for the years ended June 30, 2007, 2008, 2009 and 2010.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Note on Forward-Looking Statements

Statements in this report (including but not limited to certain statements in Items 1, 3 and 7) and in other Company communications that are not historical facts are forward-looking statements, which are based on management's current expectations. These statements involve risks and uncertainties that could cause actual results to differ materially from what appears here.

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 the Company 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, could cause actual results to be materially different from what is presented in any forward looking statements.

Results of Operations

(In thousands)

	2010	%	2009	%	2008	%
Net sales	$227,534		$295,618		$331,694	
Cost of goods sold	167,069		214,175		226,826	
Gross profit	60,465	26.6	81,443	27.6	104,868	31.6
Marketing, engineering and administrative expenses	56,886	25.0	60,470	20.5	66,349	20.0
Restructuring of operations	494	0.2	1,188	0.4	(373)	(0.1)
Earnings from operations	$3,085	1.4	$19,785	6.7	$38,892	11.7

Fiscal 2010 Compared to Fiscal 2009

Net Sales

Net sales decreased $68.1 million, or 23.0%, in fiscal 2010. The year-over-year movement in foreign exchange rates resulted in a net favorable translation effect on sales of $3.3 million in fiscal 2010, compared to fiscal 2009.
In fiscal 2010, sales for our worldwide manufacturing operations, before eliminating intra-segment and inter-segment sales, were lower by $82.5 million, or 31.0%, than in the prior fiscal year. Year-over-year changes in foreign exchange rates had a net favorable impact on sales of $1.0 million. Sales at the Company's domestic manufacturing location were down $37.1 million, primarily driven by lower sales of marine transmissions, industrial products and aftermarket parts, partially offset by higher sales of land-based oil and gas transmissions and surface drives for the global patrol boat market. The net remaining decrease came at the Company's European manufacturing operations and was primarily due to the impact of the continued softening experienced in the global mega yacht, European commercial marine and industrial markets.

Net sales for distribution operations were down a more modest $11.0 million, or 9.8%, in fiscal 2010. Year-over-year changes in foreign exchange rates had a net favorable impact on sales of $4.9 million. The Company's distribution operation in Singapore, which serves the Asian market, saw a 3.9% year-over-year decrease in sales, off of fiscal 2009's record level. This slight decrease was primarily driven by decreased shipments in the fourth fiscal quarter of commercial marine transmissions for Asian markets. The Company's distribution operations in Europe, Australia and the Southeastern United States experienced sharper declines versus the prior fiscal year due to the continued softening of the global mega yacht and industrial markets. The Company provides marine transmissions, and propulsion and boat management systems to serve the global mega yacht market.

Net sales for the Company's largest product market, marine transmission and propulsion systems, were down 22.7% compared to the prior fiscal year. Increased sales of propulsion and transmission systems for the military patrol boat market were up significantly, but were more than offset by continued weakness in the European mega yacht market as well as some softening off of record levels in the commercial marine market. Sales of the Company's boat management systems manufactured at our Italian operation and servicing the global mega yacht market, were off approximately 40% versus the prior fiscal year. This was primarily driven by continued weakening in sales to builders of mega yachts. In the off-highway transmission market, the year-over-year decrease of just over 10% can be attributed primarily to decreased sales of the Company's vehicular transmissions for the airport, rescue and fire fighting (ARFF) and agricultural tractor markets, only partially offset by increased transmission sales in land-based oil field markets. Sales of transmission systems for the military market were relatively flat year-over-year. The decrease experienced in the Company's industrial products of roughly 29% was due to decreased sales into the agriculture, mining and general industrial markets, primarily in the North American and Italian markets, partially offset by increased activity related to oil field markets.

The elimination for net intra-segment and inter-segment sales decreased $25.4 million, or 30.7%, from $82.6 million in fiscal 2009 to $57.2 million in fiscal 2010. Year-over-year changes in foreign exchange rates had a net unfavorable impact of $2.6 million on net intra-segment and inter-segment sales.

Gross Profit

In fiscal 2010, gross profit decreased $21.0 million, or 25.8%, to $60.5 million. Gross profit as a percentage of sales decreased 100 basis points in fiscal 2010 to 26.6%, compared to 27.6% in fiscal 2009. The table below summarizes the gross profit trend by quarter for fiscal years 2010 and 2009:

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Year
Gross Profit: ($ millions)					
2010	$ 9.7	$14.8	$16.5	$19.5	$60.5
2009	$20.1	$22.9	$19.2	$19.2	$81.4
% of Sales:					
2010	20.7%	26.8%	27.1%	30.2%	26.6%
2009	27.6%	28.1%	27.6%	26.7%	27.6%

There were a number of factors that impacted the Company's overall gross margin rate in fiscal 2010. Gross margin for the year was unfavorably impacted by lower volumes, extended shutdowns in the first half of the fiscal year at the Company's domestic and European manufacturing operations, and an increase in expenses related to the Company's defined benefit plans. The Company estimates the net unfavorable impact of lower volumes on gross margin in fiscal

2010 was approximately $27 million. On June 3, 2009 the Company announced it would freeze future accruals under the domestic defined benefit pension plans effective August 1, 2009. This resulted in a curtailment gain of $1.7 million recorded in the fourth quarter of fiscal 2009. Of this amount, $1.2 million was recorded as income in cost of goods sold, with the remainder recorded in ME&A expenses. As a result, there was a net increase in the defined benefit pension expense recorded in cost of goods sold of $2.8 million, from a net benefit of $(0.5) million in fiscal 2009 to a net expense of $2.3 million in fiscal 2010 (see Note M of the Notes to the Consolidated Financial Statements). The net impact of this change was to decrease gross profit as a percentage of sales by nearly 120 basis points. The above were partially offset by a favorable shift in product mix, primarily related to oilfield product in the second half of the fiscal year (estimated impact was $0.7 million), selective pricing actions, and lower warranty expenses. Total warranty expense decreased over $2.7 million in the current fiscal year, from $6.4 million in fiscal 2009 to $3.7 million in fiscal 2010 (see Note F of the Notes to the Consolidated Financial Statements). The decrease in warranty expense can be attributed to a decrease in volume and an overall reduction in specific warranty campaigns that were experienced in fiscal 2009. The net impact of this change was to increase gross profit as a percentage of sales by nearly 50 basis points. In addition, the year-over-year movement in foreign exchange rates, primarily driven by movements in the Euro and Asian currencies, resulted in a net favorable translation effect on gross profit of $1.2 million in fiscal 2010, compared to fiscal 2009.

Marketing, Engineering and Administrative (ME&A) Expenses

Marketing, engineering, and administrative (ME&A) expenses decreased $3.6 million, or 5.9%, in fiscal 2010 versus fiscal 2009. As a percentage of sales, ME&A expenses increased by 450 basis points to 25.0% in fiscal 2010, compared to 20.5% in fiscal 2009. The table below summarizes significant changes in certain ME&A expenses for the fiscal year:

	Fiscal Year Ended		Increase/
$ thousands – (Income)/Expense	June 30, 2010	June 30, 2009	(Decrease)
Pension	$ 2,044	$ 413	$ 1,631
Stock Based Compensation	505	(581)	1,086
Severance	-	1,308	(1,308)
Domestic/Corporate IT Expenses	4,847	5,740	(893)
			516
	Foreign Currency Translation		924
			1,440
		All Other, Net	(5,024)
			$ (3,584)

The net remaining decrease in ME&A expenses for the year of $5,024,000 primarily relates to the global cost reduction initiatives implemented by the Company at the end of fiscal 2009. As announced in June 2009, the actions included a reduction of annual base salaries of the Company’s salaried employees including all executive officers, removal of the fiscal 2010 bonus/incentive plan, changes to several benefit programs, an across-the-board reduction of marketing, advertising, travel and entertainment expenses, and staff reductions and layoffs. In fiscal 2009, the decrease in stock based compensation expense for executive officers was primarily driven by the reversal of accruals for long-term incentive compensation awards for fiscal years 2010 and 2011, due to the low probability of achieving the threshold performance levels (see Note K of the Notes to the Consolidated Financial Statements). The severance charge in fiscal 2009 related to actions announced in the second quarter at the Company’s Belgian operation. In fiscal 2009, domestic and corporate IT expenses included a higher level of spending related to the implementation of the Company’s new global ERP system.

Restructuring of Operations

During the fourth quarter of fiscal 2009, the Company recorded a pre-tax restructuring charge of $948,000 related to a workforce reduction at its Racine, Canadian and Australian operations. The charge consisted of severance costs for 22 salaried employees and voluntary early retirement charges for an additional 16 manufacturing employees. During fiscal 2009, the Company made cash payments of $180,000, resulting in an accrual balance at June 30, 2009 of $767,000. The remainder of this balance was paid during fiscal 2010, resulting in no accrual balance at June 30, 2010.

During the fourth quarter of fiscal 2007, the Company recorded a pre-tax restructuring charge of $2,652,000 related to a workforce reduction at its Belgian operation to improve profitability through targeted outsourcing savings and additional focus on core manufacturing processes. The charge consisted of prepension costs for 32 employees: 29 manufacturing employees and 3 salaried employees. An adjustment was made in the fourth quarter of fiscal 2009, resulting in a pre-tax expense of $240,000 related to legally required inflationary adjustments to benefits. An additional adjustment was made in the fourth quarter of fiscal 2010, resulting in a pre-tax expense of $342,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments. During fiscal 2010 and 2009, the Company made cash payments of $152,000 and $120,000, respectively. The exchange impact in fiscal 2010 was to reduce the accrual by $292,000. Accrued restructuring costs were $2,315,000 and $2,417,000 at June 30, 2010 and 2009, respectively.

The Company recorded a restructuring charge of $2,076,000 in the fourth quarter of fiscal 2005 as the Company restructured its Belgian operation to improve future profitability. The charge consists of prepension costs for 37 employees: 33 manufacturing employees and 4 salaried employees. An adjustment was made in the fourth quarter of fiscal 2010, resulting in a pre-tax expense of $138,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments. During fiscal 2010 and 2009, the Company made cash payments of $192,000 and $200,000, respectively. The exchange impact in fiscal 2010 was to reduce the accrual by $122,000. Accrued restructuring costs were $945,000 and $1,121,000 at June 30, 2010 and 2009, respectively.

Interest Expense

Interest expense decreased by $0.2 million, or 8.2%, in fiscal 2010. Total interest on the Company's $35 million revolving credit facility ("revolver") decreased $0.2 million from $0.8 million in fiscal 2009 to $0.6 million in fiscal 2010. This decrease can be attributed to an overall decrease in the average borrowings year-over-year partially offset by an increase in the interest rate on the revolver year-over-year. The average borrowing on the revolver, computed monthly, decreased to $14.4 million in fiscal 2010, compared to $24.0 million in fiscal 2009. Partially offsetting the average decreased borrowing, the interest rate on the revolver increased from a range of 1.69% to 4.00% in fiscal 2009 to 4.00%, the rate floor, for all of fiscal 2010. Interest expense for the Company's $25 million Senior Notes, which carry a fixed interest rate of 6.05%, remained flat at $1.5 million. The net remaining interest expense of $0.2 million was from various borrowings at the Company's foreign subsidiaries.

Income Taxes

For 2010, the effective tax rate was 57.6 percent, compared to 34.7 percent last fiscal year. The increased rate for 2010 was primarily due to the impact of permanent items, which remained relatively constant with the prior year, but had a greater impact on the tax rate due to the low base of earnings. In addition, the prior fiscal year included a 3.0 percentage point benefit (rate reduction) related to an increase in foreign tax credits, which resulted in the relatively low rate for fiscal 2009.

Order Rates

As of June 30, 2010, the Company's backlog of orders scheduled for shipment during the next six months (six-month backlog) was $84.4 million, or approximately 40% higher than the six-month backlog of $60.6 million as of June 30, 2009. The improvement in backlog is a result of increased orders by oil and gas customers for the Company's 8500 series transmission as stable oil and gas prices have driven demand for new high-horsepower rigs. With oil and gas prices remaining firm, the Company is optimistic demand for these transmissions will continue. In addition, the Company continues to work on the development of its 7500 series transmission and expects to start production in the second half of fiscal 2011.

Fiscal 2009 Compared to Fiscal 2008

Net Sales

Net sales decreased $36.1 million, or 10.9%, in fiscal 2009. The year-over-year movement in foreign exchange rates resulted in a net unfavorable translation effect on sales of $4.8 million in fiscal 2009, compared to fiscal 2008.

In fiscal 2009, sales for our worldwide manufacturing operations, before eliminating intra-segment and inter-segment sales, were $33.1 million, or 11.1%, lower than in the prior fiscal year. Year-over-year changes in foreign exchange rates had a net unfavorable impact on sales of $5.9 million. Sales at the Company's domestic manufacturing location were down $19.8 million, primarily driven by lower sales of land-based oil and gas transmissions, and surface drives for the global mega yacht market. The net remaining decrease came at the Company's European manufacturing operations and was primarily due to the impact of the softening experienced in the second half of the fiscal year in the mega yacht market. Softening demand as a result of the global economic slowdown unfavorably impacted shipments and order rates in the third and fourth fiscal quarters.

Net sales for distribution operations were down $3.3 million, or 2.9%, in fiscal 2009. Year-over-year changes in foreign exchange rates had a net unfavorable impact on sales of $2.2 million. The Company's distribution operation in Singapore, which serves the Asian market, saw a 35% year-over-year increase in sales. This increase was primarily driven by increased shipments of commercial marine transmissions for Asian markets. Offsetting the increase experienced in Asia, the Company's distribution operations in Europe, Australia and the Southeastern United States experienced declines versus the prior fiscal year due to the continued softening of the global mega yacht market. The Company provides marine transmissions, and propulsion and boat management systems to serve this market.

Net sales for the Company's largest product market, marine transmission and propulsion systems, were roughly flat compared to the prior fiscal year. Sales of the Company's boat management systems manufactured at our Italian operation and servicing the global mega yacht market, were off approximately 30% versus the prior fiscal year. This was primarily driven by second half fall-off in sales to builders of mega yachts. In the off-highway transmission market, the year-over-year decrease of nearly 19% can be attributed primarily to decreased transmission sales in land-based oil field markets, only partially offset by increased sales of the Company's transmissions for the agricultural tractor market. Sales of the Company's vehicular transmissions for the airport rescue and fire fighting and military markets remained at or slightly above year ago levels. The decrease experienced in the Company's industrial products of roughly 10% was also due in part to the decreased activity related to oil field markets as well as decreased sales into the agriculture, mining and general industrial markets, primarily in the North American and Italian markets.

The elimination for net intra-segment and inter-segment sales decreased $0.4 million, or 0.4%, from $82.9 million in fiscal 2008 to $82.5 million in fiscal 2009. Year-over-year changes in foreign exchange rates had a net favorable impact of $3.2 million on net intra-segment and inter-segment sales.

Gross Profit

In fiscal 2009, gross profit decreased $23.4 million, or 22.3%, to $81.4 million. Gross profit as a percentage of sales decreased 400 basis points in fiscal 2009 to 27.6%, compared to 31.6% in fiscal 2008. There were a number of factors that impacted the Company's overall gross margin rate in fiscal 2009. Gross margin for the year was unfavorably impacted by lower volumes (estimated impact of $15 million), an unfavorable shift in product mix, and an increase in warranty expenses ($1.7 million). In addition, the year-over-year movement in foreign exchange rates, primarily driven by movements in the Euro, resulted in a net unfavorable translation effect on gross profit of $3.3 million in fiscal 2009, compared to fiscal 2008. These adverse effects were partially offset by selective pricing actions, improvements achieved through the Company's outsourcing and cost reduction programs and lower domestic bonus expense. On June 3, 2009 the Company announced it would freeze future accruals under the domestic defined benefit pension plans effective August 1, 2009. This resulted in a curtailment gain of $1.7 million recorded in the fourth quarter of fiscal 2009. Of this amount, $1.2 million was recorded as income in cost of goods sold, with the remainder recorded in ME&A expenses. In addition, the Company's Belgian operation's gross margin was favorably affected by the continued relative strength of the Euro versus the U.S. Dollar, when compared to the average rate in fiscal 2008. This operation manufactures with Euro-based costs and sells more than a third of its production into the U.S. market at U.S. Dollar prices. The average Euro to U.S. Dollar exchange rate, computed monthly, in fiscal 2009 was $1.37, which was 7.3% lower than in fiscal 2008. It is estimated that the year-over-year effect of a weaker Euro, on average, was to improve margins at our Belgian subsidiary by nearly $1.4 million.

Marketing, Engineering and Administrative (ME&A) Expenses

Marketing, engineering, and administrative (ME&A) expenses decreased $5.9 million, or 8.9%, in fiscal 2009 versus fiscal 2008. As a percentage of sales, ME&A expenses increased by 50 basis points to 20.5% in fiscal 2009, compared to 20.0% in fiscal 2008. The table below summarizes significant changes in certain ME&A Expenses for the fiscal year:

	Fiscal Year Ended		Increase/
$ thousands – (Income)/Expense	June 30, 2009	June 30, 2008	(Decrease)
Domestic Bonus	$ -	$ 3,100	$ (3,100)
Stock Based Compensation	(581)	1,879	(2,460)
Pension	(88)	261	(349)
Severance	1,308	-	1,308
Domestic/Corporate IT Expenses	5,740	4,419	1,321
			(3,280)
	Foreign Currency Translation		(1,544)
			(4,824)
		All Other, Net	(1,055)
			$ (5,879)

The decrease in domestic bonus compensation is due to the fact that the annual incentive targets for fiscal year 2009 were not achieved and as a result no bonuses were accrued. The decrease in stock based compensation expense for executive officers is primarily driven by the reversal of accruals for long-term incentive compensation awards for fiscal years 2010 and 2011, due to the low probability of achieving the threshold performance levels (see Note K of the Notes to the Consolidated Financial Statements). The severance charge related to actions announced in the second quarter of fiscal 2009 at the Company's Belgian operation. The increase in domestic and corporate IT expenses primarily represents increased depreciation expense related to the implementation of the Company's new global ERP system. The net remaining decrease in ME&A expenses primarily relates to global cost reduction initiatives implemented by the Company in the second half of fiscal 2009.

Restructuring of Operations

During the fourth quarter of fiscal 2009, the Company recorded a pre-tax restructuring charge of $948,000 related to a workforce reduction at its Racine, Canadian and Australian operations. The charge consisted of severance costs for 22 salaried employees and voluntary early retirement charges for an additional 16 manufacturing employees. During fiscal 2009, the Company made cash payments of $180,000, resulting in an accrual balance at June 30, 2009 of $767,000.

During the fourth quarter of fiscal 2007, the Company recorded a pre-tax restructuring charge of $2,652,000 related to a workforce reduction at its Belgian operation that will allow for improved profitability through targeted outsourcing savings and additional focus on core manufacturing processes. The charge consists of prepension costs for 32 employees: 29 manufacturing employees and 3 salaried employees. This charge was adjusted in the fourth quarter of fiscal 2008, resulting in a pre-tax benefit of $373,000, due to final negotiations primarily related to notice period pay. A further adjustment was made in the fourth quarter of fiscal 2009, resulting in a pre-tax expense of $240,000 related to legally required inflationary adjustments to benefits. During fiscal 2009 and 2008, the Company made cash payments of $120,000 and $103,000, respectively. The exchange impact in fiscal 2009 was to reduce the accrual by $296,000. Accrued restructuring costs were $2,417,000 and $2,603,000 at June 30, 2009 and 2008, respectively.

The Company recorded a restructuring charge of $2,076,000 in the fourth quarter of fiscal 2005 as the Company restructured its Belgian operation to improve future profitability. The charge consists of prepension costs for 37 employees: 33 manufacturing employees and 4 salaried employees. During fiscal 2009 and 2008, the Company made cash payments of $200,000 and $262,000, respectively. The exchange impact in fiscal 2009 was to reduce the accrual by $137,000. Accrued restructuring costs were $1,121,000 and $1,465,000 at June 30, 2009 and 2008, respectively.

Interest Expense

Interest expense decreased by $0.6 million, or 18.1%, in fiscal 2009. Total interest on the Company’s $35 million revolving credit facility (“revolver”) decreased $0.6 million from $1.3 million in fiscal 2008 to $0.7 million in fiscal 2009. This decrease can be attributed to a decrease in the interest rate on the revolver year-over-year which more than offset an overall increase in the average borrowings year-over-year. The average borrowing on the revolver, computed monthly, increased to $24.0 million in fiscal 2009, compared to $22.8 million in fiscal 2008. More than offsetting the average increased borrowing, the interest rate on the revolver decreased from a range of 3.71% to 6.97% in fiscal 2008 to a range of 1.69% to 4.00% in fiscal 2009. Interest expense for the Company’s $25 million Senior Notes, which carry a fixed interest rate of 6.05%, remained flat at $1.5 million. The net remaining interest expense of $0.2 million was from various borrowings at the Company’s foreign subsidiaries.

Income Taxes

In fiscal 2009 and 2008, the Company’s effective tax rate approximated 34.7% and 30.9%, respectively. The primary cause for the increase is the one-time benefit recorded in fiscal 2008 related to adjusting the Italian deferred tax balance for the new reduced Italian tax rate (see Note N of the Notes to the Consolidated Financial Statements).

Order Rates

As of June 30, 2009, the Company's backlog of orders scheduled for shipment during the next six months (six-month backlog) was $60.6 million, or approximately 50% lower than the six-month backlog of $120.8 million as of June 30, 2008. The Company's domestic manufacturing operation saw an increase in backlog for airport rescue and fire fighting and military vehicular transmissions. This was more than offset by decreases in the six-month backlogs for marine and oil and gas transmissions, industrial products and propulsion systems, due to continued softening in the end markets for these products. The Company's European manufacturing operations saw a net decrease in their six-month backlogs, primarily for products serving the Italian and global mega yacht markets.

Liquidity and Capital Resources

Fiscal Years 2010, 2009 and 2008

The net cash provided by operating activities in fiscal 2010 totaled $35.1 million, an increase of $23.5 million, or 203%, versus fiscal 2009. The net increase was driven by a net decrease in working capital, primarily due to decreases in net inventories and trade accounts receivable balances, partially offset by a net decrease in net earnings of $11.1 million. The net decrease in inventory came primarily at the Company's European manufacturing locations and its distribution operation in Singapore. The decrease in trade accounts receivable was a result of lower sales in the second half of fiscal 2010 compared to the same period in fiscal 2009 as well as a continued effort to collect outstanding receivables balances globally.

The net cash provided by operating activities in fiscal 2009 totaled $11.6 million, a decrease of $8.3 million, or 42%, versus fiscal 2008. The net decrease was driven primarily by a net decrease in net earnings of $12.6 million, partially offset by decreases in working capital, primarily accounts payable and accrued liabilities. The decrease in accounts payable can primarily be attributed to the general volume decline in the fourth fiscal quarter as well as reduced inventories at the Company's manufacturing locations. The decrease in accrued liabilities primarily relates to the reduction in bonus and stock-based compensation accruals versus the end of the prior fiscal year. The net increase in inventory came primarily at the Company's distribution operation in Singapore, which saw double-digit sales growth throughout fiscal 2009 when compared to the same period in fiscal 2008.

The net cash provided by operating activities in fiscal 2008 totaled $19.9 million, an increase of $2.2 million, or 13%, versus fiscal 2007. The net increase was driven primarily by a net increase in earnings of $2.3 million partially offset by increases in working capital, primarily inventories, and a decrease in accrued retirement benefits. The increase in inventory came primarily at the Company's European manufacturing operations and distribution operations in the Pacific Basin.

The net cash used for investing activities in fiscal 2010 of $4.6 million consisted primarily of capital expenditures for machinery and equipment at our domestic and Belgian manufacturing operations, and the continuation of the global implementation of a new ERP system started in fiscal 2007. In fiscal 2010, the Company spent $4.5 million for capital expenditures, down from $8.9 million and $15.0 million in fiscal years 2009 and 2008, respectively. The software costs associated with the new ERP have been substantially paid for and were capitalized as appropriate in fiscal years 2007 and 2008.

The net cash used for investing activities in fiscal 2009 of $7.8 million consisted primarily of capital expenditures for machinery and equipment at our domestic and Belgian manufacturing operations, and the continuation of the global implementation of a new ERP system started in fiscal 2007. In fiscal 2010, the Company expects to complete the majority of the remaining ERP implementation work for its foreign manufacturing and distribution operations. The software costs associated with the new ERP have been substantially paid for and capitalized as appropriate in fiscal years 2007 and 2008.

The net cash used for investing activities in fiscal 2008 of $14.7 million consisted primarily of capital expenditures for machinery and equipment at our domestic and Belgian manufacturing operations, and the continuation of the implementation of a new ERP system started in fiscal 2007 at our domestic manufacturing location in Racine. The software costs associated with the new ERP have been substantially paid for and capitalized as appropriate in fiscal years 2007 and 2008.

In fiscal 2010, the net cash used by financing activities of $23.2 million consisted primarily of payments on long-term debt and dividends paid to shareholders of the Company.

In fiscal 2009, the net cash used by financing activities of $4.2 million consisted primarily of dividends paid to shareholders of the Company and the purchase of shares of the Company's outstanding common stock under a Board authorized stock repurchase program, offset by net borrowings on the Company's revolving credit facility. In the second fiscal quarter of 2009, the Company repurchased a total of 250,000 shares of its outstanding common stock at an average price of $7.25 per share, for a total of $1.8 million. In addition, the Company paid $3.1 million in dividends to its shareholders, a 3.5% increase over fiscal 2008. These were offset by over $2.8 million in additional borrowings under the Company's revolving credit facility.

In fiscal 2008, the net cash used by financing activities of $12.6 million consisted primarily of the purchase of shares of the Company's outstanding common stock under a Board authorized stock repurchase program. In the first and third fiscal quarters of 2008, the Company repurchased a total of 660,000 shares of its outstanding common stock at an average price of $23.70 per share, for a total of $15.6 million. In addition, the Company paid $3.0 million in dividends to its shareholders, a 25% increase over fiscal 2007. These were offset by over $5 million in additional borrowings under the Company's revolving credit facility.

Future Liquidity and Capital Resources

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. In September 2004, the revolving loan agreement was amended to increase the commitment to $35,000,000 and the termination date of the agreement was extended to October 31, 2007. During the first quarter of fiscal 2007, the term was extended by an additional two years to October 31, 2009. An additional amendment was agreed to in the first quarter of fiscal 2008 to extend the term by an additional year to October 31, 2010, and eliminate the covenants limiting capital expenditures and restricted payments (dividend payments and stock repurchases). During the fourth quarter of fiscal 2009, the term was further extended to May 31, 2012 and the funded debt to four quarter EBITDA maximum was increased from 2.5 to 3.0. This agreement contains certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants include a minimum consolidated net worth amount, a minimum EBITDA for the most recent four fiscal quarters of $11,000,000 at June 30, 2010, and a maximum total funded debt to EBITDA ratio of 3.0 at June 30, 2010. As of June 30, 2010, the Company was in compliance with these covenants with a four quarter EBITDA total of $13,688,000 and a funded debt to EBITDA ratio of 2.27. The minimum net worth covenant fluctuates based upon actual earnings and is subject to adjustment for certain pension accounting adjustments to equity. As of June 30, 2010, the minimum equity requirement was $101,836,000 compared to an actual result of $122,460,000 after all required adjustments. The outstanding balance under the revolving loan agreement of $9,000,000 and $22,450,000 at June 30, 2010 and June 30, 2009, respectively, is classified as long-term debt. In accordance with the loan agreement as amended, 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, subject to a minimum interest rate of 4%. The rate was 4.0% at June 30, 2010 and 2009, 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 $21,428,571 and $25,000,000 at June 30, 2010 and 2009, respectively. Of the outstanding balance, $3,571,429 was classified as a current maturity of long-term debt at June 30, 2010 and 2009, respectively. The remaining $21,428,571 and $17,857,142 is classified as long-term debt as of June 30, 2010 and 2009, respectively. 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 June 30, 2010 and June 30, 2009 was equal to the total debt reported on the Company's June 30, 2010 and June 30, 2009 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 June 30, 2010:

Four Quarter EBITDA Reconciliation	
Net Earnings	$ 597,000
Depreciation & Amortization	9,817,000
Interest Expense	2,282,000
Income Taxes	992,000
Four Quarter EBITDA	$13,688,000
Total Funded Debt to Four Quarter EBITDA	
Total Debt	$31,131,000
Divided by: Four Quarter EBITDA	13,688,000

Total Funded Debt to Four Quarter EBITDA	2.27

As of June 30, 2010, the Company was in compliance with all of the covenants described above. As of June 30, 2010, the Company's backlog of orders scheduled for shipment during the next six months (six-month backlog) was $84.4 million, or approximately 40% higher than the six-month backlog of $60.6 million as of June 30, 2009. In light of the increasing order backlog and overall improving business trends in some of the Company's key product markets, in particular the global land-based oil & gas transmission market, the Company does not expect to violate any of its financial covenants in fiscal 2011. 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 expected to improve beginning in the first quarter of fiscal 2011 and continuing thereafter. 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 $26.0 million of available borrowings on our $35 million revolving loan agreement as of June 30, 2010, and continues to generate enough cash from operations to meet our operating and investing needs. For the year ended June 30, 2010, the Company generated net cash from operating activities of $35.1 million. As of June 30, 2010, the Company also had cash of $19.0 million, primarily at its overseas operations. These funds, with limited restrictions, are available for repatriation as deemed necessary by the Company. In the third fiscal quarter, the Company used roughly $2 million of cash at its European operations to pay down some of its local debt. In fiscal 2011, the Company expects to contribute $2,206,000 to its defined benefit plans, the minimum contributions required. However, if the Company elects to make voluntary contributions in fiscal 2011, it intends to do so using cash from operations and, if necessary, from available borrowings under existing credit facilities.

Net working capital decreased approximately $19.5 million, or 18.8%, in fiscal 2010, and the current ratio decreased to 2.3 at June 30, 2010 from 2.5 at June 30, 2009. The decrease in net working capital was primarily driven by a decrease in accounts receivable and inventories.

Twin Disc expects capital expenditures to be between $10 and $15 million in fiscal 2011. These anticipated expenditures reflect the Company's plans to continue investing in modern equipment and facilities, its global sourcing program and new products.

Management believes that available cash, the credit facility, cash generated from future operations, existing lines of credit and potential access to debt markets will be adequate to fund Twin Disc's capital requirements for the foreseeable future.

Off Balance Sheet Arrangements and Contractual Obligations

The Company had no off-balance sheet arrangements, other than operating leases, as of June 30, 2010 and 2009.

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
Revolving loan borrowing	$ 9,000	$ -	$ 9,000	$ -	$ -

Long-term debt	$22,131	$ 3,920	$ 7,470	$ 7,142	$ 3,599
Operating leases	$ 5,573	$ 2,694	$ 2,549	$ 154	$ 176

The table above does not include tax liabilities for unrecognized tax benefits totaling $808,000, excluding related interest and penalties, as the timing of their resolution cannot be estimated. See Note N of the 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 2011 contributions to all defined benefit plans will total $2,206,000.

Other Matters

Critical Accounting Policies

The preparation of this Annual 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.

The Company's significant accounting policies are described in Note A to the consolidated financial statements. Not all of these significant accounting policies require management to make difficult, subjective, or complex judgments or estimates. However, the policies management considers most critical to understanding and evaluating our reported financial results are the following:

Accounts Receivable

Twin Disc performs ongoing credit evaluations of our customers and adjusts credit limits based on payment history and the customer's credit-worthiness as determined by review of current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer-collection issues. In addition, senior management reviews the accounts receivable aging on a monthly basis to determine if any receivable balances may be uncollectible. Although our accounts receivable are dispersed among a large customer base, a significant change in the liquidity or financial position of any one of our largest customers could have a material adverse impact on the collectibility of our accounts receivable and future operating results.

Inventory

Inventories are valued at the lower of cost or market. Cost has been determined by the last-in, first-out (LIFO) method for the majority of the inventories located in the United States, and by the first-in, first-out (FIFO) method for all other inventories. Management specifically identifies obsolete products and analyzes historical usage, forecasted production based on future orders, demand forecasts, and economic trends when evaluating the adequacy of the reserve for excess and obsolete inventory. The adjustments to the reserve are estimates that could vary significantly, either favorably or unfavorably, from the actual requirements if future economic conditions, customer demand or competitive conditions differ from expectations.

Goodwill

In conformity with U.S. GAAP, goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that an impairment might exist. The Company performs impairment reviews for its reporting units using a fair-value method based on management's judgments and assumptions or third party valuations. The Company is subject to financial statement risk to the extent the carrying amount of a reporting unit exceeds its fair value. The impairment testing performed by the Company at June 30, 2010 indicated that the estimated fair value of each reporting unit exceeded its corresponding carrying value, including goodwill and as such, no impairment existed at that time. While the Company believes its judgments and assumptions were reasonable, different assumptions, economic factors and/or market indicators could change the estimated fair values of the Company's reporting units and, therefore, impairment charges could be required in the future.

Warranty

Twin Disc 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 extent of the market 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.

Pension and Other Postretirement Benefit Plans

The Company provides a wide range of benefits to employees and retired employees, including pensions and postretirement health care coverage. Plan assets and obligations are recorded annually based on the Company's measurement date utilizing various actuarial assumptions such as discount rates, expected return on plan assets, compensation increases, retirement and mortality tables, and health care cost trend rates as of that date. The approach used to determine the annual assumptions are as follows:

- Discount rate – based on the Hewitt Top Quartile Yield Curve at June 30, 2010 as applied to the expected payouts from the pension plans. This yield curve is made up of Corporate Bonds rated AA or better.
- Expected Return on Plan Assets – based on the expected long-term average rate of return on assets in the pension funds, which is reflective of the current and projected asset mix of the funds and considers historical returns earned on the funds.
- Compensation Increase – reflect the long-term actual experience, the near-term outlook and assumed inflation.
- Retirement and Mortality Rates – based upon the Generational Mortality Table for fiscal 2008, 2009 and 2010.
- Health Care Cost Trend Rates – developed based upon historical cost data, near-term outlook and an assessment of likely long-term trends.

Measurements of net periodic benefit cost are based on the assumptions used for the previous year-end measurements of assets and obligations. The Company reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions when appropriate. As required by U.S. GAAP, the effects of the modifications are recorded currently or amortized over future periods. Based on information provided by its independent actuaries and other relevant sources, the Company believes that the assumptions used are reasonable; however, changes in these assumptions could impact the Company's financial position, results of operations or cash flows.

Income Taxes

The Company accounts for income taxes in accordance with ASC Topic 740, “Income Taxes.” Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company’s policy is to remit earnings from foreign subsidiaries only to the extent any resultant foreign taxes are creditable in the United States. Accordingly, the Company does not currently provide for additional United States and foreign income taxes which would become payable upon repatriation of undistributed earnings of certain foreign subsidiaries. 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.

Recently Issued Accounting Standards

In April 2010, the Financial Accounting Standards Board (“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 is effective for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, with early adoption permitted. This standards update is not expected to have a material impact on the Company’s financial statements.

In February 2010, the FASB issued a standards update removing the requirement for an SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. This update was effective upon issuance, and has been incorporated in this report.

In August 2009, the FASB issued a clarification on fair value measurements. This clarification provides that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the techniques provided for in this update. This clarification was effective in the first reporting period following issuance (the Company’s first quarter of fiscal 2010), and did not have a material impact on the Company’s financial statements.

In June 2009, the FASB issued the FASB Accounting Standards Codification (“Codification”). The Codification is the single source of authoritative US generally accepted accounting principles recognized by the FASB, and is to be applied for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification is not intended to change GAAP and did not have an effect on our financial position, results or liquidity.

In June 2009, the FASB issued an amendment changing how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. New disclosures will be required regarding involvement with variable interest entities and any significant changes in risk exposure due to that involvement. This change will be effective for the start of the first fiscal year beginning after November 15, 2009 (July 1, 2010 for the Company) and is not expected to have a material impact on the Company’s financial statements.

In June 2009, the FASB issued a revision which will require more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a "qualifying special-purpose entity," and changes the requirements for derecognizing financial assets, and requires additional disclosures. This change will be effective for the start of the first fiscal year beginning after November 15, 2009 (July 1, 2010 for the Company) and is not expected to have a material impact on the Company's financial statements.

In April 2009, the FASB issued an update that requires disclosure about the fair value of financial instruments whenever summarized financial information for interim periods is issued, and requires disclosure of the fair value of all financial instruments (where practicable) in the body or accompanying notes of interim and annual financial statements. This update was effective for the Company's first quarter of fiscal 2010, and appropriate disclosures have been included herein.

In March 2009, the FASB concluded that vested share-based payment awards that entitle holders to receive nonforfeitable dividends declared on common stock are participating securities. Accordingly, those awards should be considered in the calculation of earnings per share using the two class method. This guidance is effective for fiscal years beginning after December 15, 2008. The Company implemented this provision in the first fiscal quarter of 2010, with no material impact to the financial statements.

In December 2008, the FASB issued additional guidance on an employer's disclosures regarding plan assets of a defined benefit pension or other postretirement plan. The objectives of the disclosures required under this guidance are to provide users of financial statements with an understanding of:

- How investment allocation decisions are made;
- The major categories of plan assets;
- The inputs and valuation techniques used to measure the fair value of plan assets;
- The effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period; and
- Significant concentrations of risk within plan assets.

These disclosures about plan assets are required for fiscal years ending after December 15, 2009. The Company has adopted these new disclosure requirements with this report (See Note M – Pension and Other Postretirement Benefit Plans).

In April 2008, the FASB issued an update that amends the factors to be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of this update is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. This change was effective for the Company's first quarter of fiscal 2010, and had no material impact on the Company's financial statements.

In December 2007, the FASB established new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary, and includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. This new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company implemented this new standard in the first fiscal quarter of 2010, with minimal impact to the presentation of the financial statements.

In September 2006, the FASB issued guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The final phase of this guidance was adopted by the Company in fiscal 2010, with no material impact to the financial statements.

Item 7(a). Quantitative and Qualitative Disclosure About Market Risk

The Company is exposed to market risks from changes in interest rates, commodities and foreign currency exchange rates. To reduce such risks, the Company selectively uses financial instruments and other proactive 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. Discussion of the Company's accounting policies and further disclosure relating to financial instruments is included in Note A to the consolidated financial statements.

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. The Company currently has a $35 million revolving loan agreement, which is due to expire on May 31, 2012. In accordance with the loan agreement as amended, 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, subject to a minimum interest rate of 4%. Due to the relative stability of interest rates, the Company did not utilize any financial instruments at June 30, 2010 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 $36,000.

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. Direct material cost as a percent of total cost of goods sold was 56.2% for fiscal 2010.

Currency risk - The Company has exposure to foreign currency exchange fluctuations. Approximately thirty percent of the Company's revenues in the year ended June 30, 2010 were denominated in currencies other than the U.S. Dollar. Of that total, approximately eighty two percent was denominated in Euros with the balance comprised of Japanese Yen, 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 department 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 Income (Expense), net in the Consolidated Statement of Operations and Comprehensive (Loss) Income 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 2010 and 2009 was the Euro. At June 30, 2010, the Company had no outstanding forward exchange contracts. At June 30, 2009, the Company had net outstanding forward exchange contracts to purchase U.S. Dollars in the value of $156,000 with a weighted average maturity of 74 days. The fair value of the Company's contracts was a gain of $3,000 at June 30, 2009.

Item 8. Financial Statements and Supplementary Data

See Consolidated Financial Statements and Financial Statement Schedule.

Sales and Earnings by Quarter - Unaudited (in thousands, except per share amounts)

2010	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Year
Net sales	$47,057	$55,186	$60,977	$64,314	$227,534
Gross profit	9,747	14,786	16,505	19,427	60,465
Net (loss) earnings attributable to Twin Disc	(2,404)	(490)	1,451	2,040	597
Basic (loss) earnings per share attributable to Twin Disc common shareholders	(0.22)	(0.04)	0.13	0.18	0.05
Diluted (loss) earnings per share attributable to Twin Disc common shareholders	(0.22)	(0.04)	0.13	0.18	0.05
Dividends per share	0.07	0.07	0.07	0.07	0.28

2009	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Year
Net sales	$72,671	$81,598	$69,292	$72,057	$295,618
Gross profit	20,072	22,953	19,151	19,267	81,443
Net earnings attributable to Twin Disc	2,465	3,433	2,850	2,754	11,502
Basic earnings per share attributable to Twin Disc common shareholders	0.22	0.31	0.26	0.25	1.04
Diluted earnings per share attributable to Twin Disc common shareholders	0.22	0.31	0.26	0.25	1.03
Dividends per share	0.07	0.07	0.07	0.07	0.28

Item 9. Change in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9(a). Controls and Procedures

Conclusion Regarding Disclosure Controls and Procedures

As required by Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934, as of the end of the period covered by this report and under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that such disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and to provide reasonable assurance that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding disclosure.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company,
(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company, and
(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures included in such controls may deteriorate.

The Company conducted an evaluation of the effectiveness of our internal control over financial reporting based upon the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based upon such evaluation, our management concluded that our internal control over financial reporting was effective as of June 30, 2010.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the Company's consolidated financial statements and the effectiveness of internal control over financial reporting as of June 30, 2010, as stated in their report which is included herein.

Changes in Internal Control Over Financial Reporting

During the fourth quarter of fiscal 2010, there have not been any changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9(b). Other Information

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

For information with respect to the executive officers of the Registrant, see "Executive Officers of the Registrant" at the end of Part I of this report.

For information with respect to the Directors of the Registrant, see "Election of Directors" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference.

For information with respect to compliance with Section 16(a) of the Securities Exchange Act of 1934, see "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference.

For information with respect to the Company's Code of Ethics, see "Guidelines for Business Conduct and Ethics" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference. The Company's Code of Ethics, entitled, "Guidelines for Business Conduct and Ethics," is included on the Company's website, www.twindisc.com.

For information with respect to procedures by which shareholders may recommend nominees to the Company's Board of Directors, see "Selection of Nominees for the Board" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference. There were no changes to these procedures since the Company's last disclosure relating to these procedures.

For information with respect to the Audit Committee Financial Expert, see "Director Committee Functions: Audit Committee" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference.

For information with respect to the Audit Committee Disclosure, see "Director Committee Functions: Audit Committee" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference.

For information with respect to the Audit Committee Membership, see "Director Committee Functions: Committee Membership" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference.

Item 11. Executive Compensation

The information set forth under the captions "Executive Compensation," "Director Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report," in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 15, 2010, is incorporated into this report by reference. Discussion in the Proxy Statement under the captions "Compensation Committee Report" is incorporated by reference but shall not be deemed "soliciting material" or to be "filed" as part of this report.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Security ownership of certain beneficial owners and management is set forth in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 15, 2010 under the captions "Principal Shareholders" and "Directors and Executive Officers" and incorporated into this report by reference.

For information regarding securities authorized for issuance under equity compensation plans of the Company, see "Equity Compensation Plan Information" in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 15, 2010, which incorporated into this report by reference.

There are no arrangements known to the Registrant, the operation of which may at a subsequent date result in a change in control of the Registrant.

Item 13. Certain Relationships and Related Transactions, Director Independence

For information with respect to transactions with related persons and policies for the review, approval or ratification of such transactions, see "Corporate Governance – Review, Approval or Ratification of Transactions with Related

Persons" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference.

For information with respect to director independence, see "Corporate Governance – Board Independence" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010, which is incorporated into this report by reference.

Item 14. Principal Accounting Fees and Services

The Company incorporates by reference the information contained in the Proxy Statement for the Annual Meeting of Shareholders to be held October 15, 2010 under the heading "Fees to Independent Registered Public Accounting Firm."

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Consolidated Financial Statements

See "Index to Consolidated Financial Statements and Financial Statement Schedule", the Report of Independent Registered Public Accounting Firm and the Consolidated Financial Statements, all of which are incorporated by reference.

(a)(2) Consolidated Financial Statement Schedule

See "Index to Consolidated Financial Statements and Financial Statement Schedule", and the Consolidated Financial Statement Schedule, all of which are incorporated by reference.

(a)(3) Exhibits. See Exhibit Index included as the last page of this form, which is incorporated by reference.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND
FINANCIAL STATEMENT SCHEDULE

Schedules, other than those listed, are omitted for the reason that they are inapplicable, are not required, or the information required is shown in the financial statements or the related notes.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Twin Disc, Incorporated:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Twin Disc, Incorporated and its subsidiaries at June 30, 2010 and June 30, 2009, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2010 in conformity with accounting principles generally accepted in the United Sates of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under item 9(a). Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Milwaukee, Wisconsin
September 13, 2010

TWIN DISC, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
June 30, 2010 and 2009
(In thousands, except share amounts)

	2010	2009
ASSETS		
Current assets:		
Cash	$19,022	$13,266
Trade accounts receivable, net	43,014	53,367
Inventories, net	72,799	92,331
Deferred income taxes	5,224	6,280
Other	7,391	8,677
Total current assets	147,450	173,921
Property, plant and equipment, net	58,243	65,799
Goodwill, net	16,440	17,509
Deferred income taxes	24,029	18,829
Intangible assets, net	6,268	7,855
Other assets	6,626	6,095
	$259,056	$290,008
LIABILITIES and EQUITY		
Current liabilities:		
Short-term borrowings and current maturities of long-term debt	$3,920	$4,421
Accounts payable	23,842	24,864
Accrued liabilities	35,545	40,967
Total current liabilities	63,307	70,252
Long-term debt	27,211	46,348
Accrued retirement benefits	72,833	60,241
Deferred income taxes	3,914	4,443
Other long-term liabilities	2,472	899
	169,737	182,183
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	10,667	13,205
Retained earnings	147,438	149,974
Accumulated other comprehensive loss	(42,048)	(25,935)
	116,057	137,244
Less treasury stock, at cost (1,901,242 and 2,070,124 shares, respectively)	27,597	30,256

Total Twin Disc shareholders' equity	88,460	106,988
Noncontrolling interest	859	837
Total Equity	89,319	107,825
	$259,056	$290,008

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

TWIN DISC, INCORPORATED and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS and COMPREHENSIVE INCOME (LOSS)
For the years ended June 30, 2010, 2009 and 2008
(In thousands, except per share data)

	2010	2009	2008
Net sales	$227,534	$295,618	$331,694
Cost of goods sold	167,069	214,175	226,826
Gross profit	60,465	81,443	104,868
Marketing, engineering and administrative expenses	56,886	60,470	66,349
Restructuring of operations	494	1,188	(373)
Earnings from operations	3,085	19,785	38,892
Other income (expense):			
Interest income	84	207	501
Interest expense	(2,282)	(2,487)	(3,038)
Other, net	835	540	(1,107)
	(1,363)	(1,740)	(3,644)
Earnings before income taxes and noncontrolling interest	1,722	18,045	35,248
Income taxes	992	6,257	10,904
Net earnings	730	11,788	24,344
Less: Net earnings attributable to noncontrolling interest, net of tax	(133)	(286)	(92)
Net earnings attributable to Twin Disc	$597	$11,502	$24,252
Earnings per share data:			
Basic earnings per share attributable to Twin Disc common shareholders	$0.05	$1.04	$2.15
Diluted earnings per share attributable to Twin Disc common shareholders	0.05	1.03	2.13
Weighted average shares outstanding data:			
Basic shares outstanding	1,063	11,097	11,279
Dilutive stock awards	96	97	133
Diluted shares outstanding	11,159	11,194	11,412
Comprehensive (loss) income:			
Net earnings	$730	$11,788	$24,344
Foreign currency translation adjustment	(9,650		