THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

CRS - Q2 2012 CARPENTER TECHNOLOGY EARNINGS CONFERENCE CALL

EVENT DATE/TIME: JANUARY 26, 2012 / 4:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Michael Hajost *Carpenter Technology Corp. - VP Treasury & IR*

Bill Wulfsohn *Carpenter Technology Corp. - President, CEO*

Doug Ralph *Carpenter Technology Corp. - SVP, CFO*

Dave Strobel *Carpenter Technology Corp. - SVP Global Operations*

Mark Kamon *Carpenter Technology Corp. - SVP Specialty Alloys Commercial Operations*

CONFERENCE CALL PARTICIPANTS

Gautam Khanna *Cowen & Co. - Analyst*

Dan Whalen *Auriga USA - Analyst*

Mark Parr *KeyBanc Capital Markets - Analyst*

Sunil Gaptadar *Centennial Investments - Analyst*

Steve Levenson *Stifel Nicolaus - Analyst*

Tim Hayes *Davenport & Co. - Analyst*

PRESENTATION

Operator

Good morning and welcome to Carpenter Technology second-quarter earnings teleconference. My name is Candace, and I will be your coordinator for today.

At this time all, participants will be in a listen-only mode. After the speakers' remarks, you will be invited to participate in the question-and-answer session towards the end of this call. (Operator Instructions).

I would now like to turn the call over to your host for today, Mr. Michael Hajost, Vice President of Investor Relations and Treasury. Sir, you may proceed.

Michael Hajost - *Carpenter Technology Corp. - VP Treasury & IR*

Thank you Candace. Good morning, everyone, and welcome to Carpenter's earnings conference call for the second quarter ended December 31, 2011. This call is also being broadcast over the Internet.

With us today are Bill Wulfsohn, President and Chief Executive Officer, and Doug Ralph, Senior Vice President and Chief Financial Officer. Also participating on the call are Dave Strobel, Senior Vice President of Global Operations, Mark Kamon, Senior Vice President of Specialty Alloys Commercial Operations, as well as other members of the management team.

Statements made by management during this conference call that are forward-looking statements are based on current expectations. Risks factors that could cause actual results to differ materially from these forward-looking statements can be found in Carpenter's most recent SEC filings, including the Company's June 30, 2011 10-K, September 30, 2011 10-Q, and the exhibits attached to those filings.

I will now turn the call over to Bill.

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Thank you Mike. Good morning everyone. Thank you for joining us for our fiscal year 2012 second-quarter earnings call.

Last February, we hosted an investor day in New York City. During that event, we outlined our forward strategy. It consisted of four components. One, optimize the core business; two, seek accretive acquisitions and joint ventures to accelerate our growth; three, commercialized new R&D technologies; and four, strengthen our corporate foundation. At that time, given that we were just exiting the recent recession, I explained that our initial and primary focus would be to optimize the core business by returning to our historical peak EBITDA by fiscal year '14. Since then, we have taken extensive actions in this area to expand our premium product output and improve our profit per pound through mixed management and pricing actions.

As we announce our Q2 earnings today, I am pleased to report that we had another good quarter. Versus last year, we more than doubled our profit per pound. Premium product revenues, including sales of special alloys, titanium, and powder metals, grew by 12% on 4% higher volume, while stainless steel revenues grew by 31% on 12% lower volume.

In total, our earnings per share were $0.52, or $0.57 excluding Latrobe transaction costs. This compares to $0.21 in last year's second quarter. We also saw positive cash flow in the context of making unprecedented investment back into our business.

Looking forward, we feel we are well on track to achieve our previously communicated financial targets of achieving a 50% increase in our operating income versus a year ago, and ultimately returning to peak EBITDA at or before fiscal year '14. Our confidence in a bright future is bolstered by strong end market demand signals, especially in Aerospace and Energy. These markets are less exposed to the risks of a short-term economic downturn and our customer backlog remains at historically high levels.

Within Aerospace, engine demand remains strong, driven by high aircraft build rates. Titanium fasteners demand is near record levels and is projected to hit new highs this fiscal year, and demand for our nickel and stainless fastener material has shown significant growth over the last year.

We are also seeing increased use of our materials in Aerospace structural components. As you will recall, this is a focus area for Carpenter and we are pleased with our progress in getting some of our high-value proprietary materials spec-ed into these applications. These include wind components, tail rudder and actuator applications, and certainly landing gear components. One example of success in this area is that 39,000 pounds of our proprietary Custom 465 alloy are used on the wing flap tracks of the 747-8.

Our energy business has also been strong. In the quarter, we realized revenue growth ex-surcharge of 58%. In addition, we are extremely pleased with the results of our acquisition last year of Amega West in the oil and gas space. Roughly 60% our growth and the Energy segment is attributable to the acquisition of Amega West.

In addition, our annual EBITDA level on this business is approaching $20 million. Looking forward, we continue to grow this business as directional drilling continues to grow, as is evidenced by the record rig count last quarter.

In addition, we intend to accelerate our growth in this important strategic area through bolt-on acquisitions similar to our recent purchase of Oilfield Alloys and Arwin Machining.

Beyond our Amega West business, Carpenter is focused on growing its participation in the oil and gas market with expanded sales of high value materials used for completions. We continue to make good inroads into this area. Our growth at this time is only limited by ability to expand our capacity to support demand. Completing the Latrobe acquisition, along with our other capacity expansion projects, should enable us to accelerate our growth in this strategic area.

Finally, also in the area of energy, we are seeing signs that the industrial gas turbine market growth is accelerating. This growth is being driven by low natural gas prices, and the trend of utilities replacing coal fired power plants with gas turbine power plants. Note our impending capacity additions should also enable our growth in this arena. Looking forward, we continue to expect that energy will remain our fastest growing market.

While I am pleased by the progress we have made to optimize our core business, I am equally excited by progress we have made setting the foundation for our business to grow well beyond our prior earnings peak.

We have made substantial progress toward obtaining regulatory approval for the Latrobe transaction and thus are confident we can close the transaction this quarter. More specifically, we have fully cooperated with the FTC allowing them to complete their review process. We believe we will achieve an acceptable and timely resolution on all issues with the FTC. We do not anticipate that the completion of this process will have any material negative impact on our business. In the meantime, we have developed our integration plan and we are ready to execute with synergies at or higher than originally planned.

In addition, our work up to this point has only strengthened our confidence in the Latrobe team and the synergies the business combination will bring. We remain confident that the deal will be accretive in the first full year and strongly accretive with at least $25 million of net pre-tax synergies by year three. Most of these synergies will result from our ability to expand our capacity for producing premium products.

We are also making good progress and are on-schedule with the construction of our new premium products facility in Alabama. More specifically, we have placed order for the hydraulic radial forge, which will be the largest in the world. We have also selected and hired the general contractor to build the facility

We are also in the final stages of completing our other previously announced capacity additions. More specifically, we are expanding the titanium wire facility in Clearwater, Florida, and we are expanding capacity in our Reading operations.

Lastly, during the quarter, we made an important change to our operating model that led to a change in our reporting segments. More specifically, we announced that we would report our results this quarter in two segments. First will be our Specialty Alloys Operations, or SAO segment. This segment will consist of our mill operations in Reading and Shalmet Pennsylvania (technical difficulty) in Alabama once completed. It will be managed as one integrated business to optimize efficiency and profitability. It will focus on maximizing asset output, driving cost and productivity gains, and maximizing our sales mix.

Our second reporting unit will be the Performance Engineered Products, or PEP segment. This segment will initially consist of our Dynamet titanium business, our Carpenter Powder Products, or CPP business, and our Amega West business in oil and gas. These businesses will be managed collectively to promote speed and flexibility to drive overall revenue and profit growth. We have targeted this as an area for strategic growth and hope to support with not only organic but also acquisition-driven investment. Note once we close on Latrobe, that business will become a third reported segment.

In summary, we feel good about the results we have achieved and the strategic growth path we are on. Carpenter is a great company. It's built on a proud history and the progress we have made as a result of the skills and dedication of the entire team. We still have much work ahead of us, but we remain confident our future is bright.

I'll now turn over the call to Doug who will cover the financial results.

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

Thank you Bill.

We had a good earnings result for Q2, which is the fourth quarter in a row that we saw a strong positive spread between our revenue growth rate and volume growth rate, and an improvement in our average mill profit per pound. As Bill has said, this reflects good execution of our strategies to drive premium volume growth and improve our pricing and product mix.

Overall, revenue, excluding surcharge, increased 19% on 7% lower volume. However, within these numbers, revenues for our premium products increased 12% on 4% higher volume while revenues for our stainless products increased 31%, or 19% if you exclude the Amega West impact on 12% lower volume.

In addition, the average profit per pound for our SAO segment, or mill operations, increased another $0.03 from last quarter and has doubled versus the year-ago period.

As we look at the second half of the year, we expect to see higher volume, revenue, and operating income levels on the Carpenter business compared to the first half, and we are still on track to achieve our full-year target of a 50% increase in operating income excluding non-cash pension EID expense. Our second-half margins will likely remain around the current levels as the benefits from higher volume are offset by some negative LIFO impacts from reducing inventory at current nickel prices.

As Bill said, we are optimistic about closing the Latrobe acquisition this quarter, and we remain confident that we will achieve our previously stated financial goals. We still expect positive EPS accretion in the first full year of ownership, although there will be some initial costs immediately following closing which will cause a small negative EPS impact in the remainder of fiscal year '12. This includes the balance of the investment banker success fee, the writeup of inventory value which gets amortized over one turn or the first six months, and final legal fees and other costs associated with the Hart-Scott-Rodino process. Most of these costs, excluding the inventory amortization, would be recorded in the third quarter at closing. We expect a positive EPS impact in fiscal year '13 and continue to forecast strong accretion with a minimum $25 million of pretax synergies by year three.

A year ago, we stated a goal to return to our prior peak EBITDA level of about $360 million in two to three years or by fiscal year 2014. This excludes the impact of Latrobe, of course. As a reminder, we define EBITDA for this purpose as operating income plus depreciation and amortization expense, plus total non-cash pension expense, both service costs and EID. All of these measures can be found on our income or cash flow statements to make it easy to follow. We're making very good progress on this target. On a trailing 12-month basis, we are at $282 million of EBITDA, so we have good momentum to meet or exceed this target. To close the remaining gap will require continued premium volume growth, further improvement in our profit per pound, and continued strong focus on cost management.

In terms of pension expense, based on current assets values and interest rates, we are likely looking at an increase in our pension expense from $39.4 million this fiscal year to about $48 million next fiscal year. This can of course change based on market changes over the balance of the year.

Now, with all that as background, let me take you through our second-quarter results. Net sales in the quarter were $431 million, or 15% above a year ago. Excluding raw material surcharge, sales were up 19%. The Amega West acquisition accounted for 4 percentage points of the year-to-year growth.

Our overall pounds shipped decreased 7% from a year ago. However, as I described earlier, our premium products volume grew, including a 17% increase in titanium products, 15% increase in powder metal products, and a slight increase in special alloys, which is still constrained by available capacity.

Continuing down the income statement, gross profit was $84.3 million compared with $49.1 million in last year's second quarter. The higher gross profit level was driven by a significantly higher profit per pound due to an improved product mix and higher prices, plus increased profit contributions from all of our PEP segment businesses.

SG&A expenses for the quarter were $38 million, or 11.5% of revenue excluding surcharge, compared to $36.3 million, or 13.1%, last year. The 1.6% reduction in SG&A as a percentage of revenues is consistent with our strategy to control overhead cost growth to well below the rate of revenue growth.

We had $2.4 million of acquisition related costs in the quarter related to the Latrobe transaction, which we are showing as a separate line item on the income statement. Last year, we had $700,000 on that line for the Amega West transaction.

Operating income for the quarter was $43.9 million compared with $12.1 million in last year's second quarter. Our operating margin, excluding surcharge and pension EID as we always quote it, was 14.4% or 15.1% excluding the Latrobe costs compared to 7.5% in last year's second quarter.

Interest expense in the quarter was $5.8 million compared to $4.3 million in the year-ago period. This reflects the net impact of an incremental $150 million of debt from our June financing actions at a lower overall average interest rate. For the full year, we continue to expect interest expense will be about $7 million higher than last year.

Finishing up the income statement, other income of $400,000 for the quarter compared to $3 million last year. The difference was primarily due to lower profit from our Sweden Powder joint venture as well as a reduction in the market value of assets supporting certain non-qualified retirement plans and the closeout of the CDSOA anti-dumping program credits.

The provision for income tax was $14.7 million, or 38% of pretax income. This compares to $1.4 million or 13% of pretax income in last year's second quarter. The higher tax rate this quarter reflects the non-deductibility of Latrobe transaction costs and an unfavorable state tax item, while the year-ago rate benefited from the retroactive extension of the R&D tax credit at that time. We expect our full-year book tax rate will be about 35%. Our cash tax rate, on the other hand, is only 18%.

Overall, reported net income was $23.6 million or $0.52 per share and would've been $0.57 per share excluding the impact of the Latrobe transaction costs. This compares with second-quarter net income last year of $9.3 million or $0.21 per share.

Free cash flow for the quarter was a positive $3.7 million. Within this, we built about $15 million of additional inventory versus where we ended the first quarter, which is different than we expected going into the quarter. This is driven by the need to support our strong second-half shipment forecast, a higher average inventory value due to the better product mix as overall pounds of inventory were down quarter-to-quarter, and some customer volume push-outs over the year-end holidays.

While much of the inventory increase is explainable, we continue to put strong focus on addressing areas of opportunity within inventory. We expect positive free cash flow with reduced inventory levels in each of the next two quarters. For the full year, we still expect overall free cash flow to be modestly negative with expected CapEx spend of between $175 million and $185 million.

We continue to have a strong balance sheet and plenty of liquidity. Our ending December cash balance was $319 million, and we have full revolver availability of about $350 million. Our cash balance will enable us to pay off the Latrobe debt at closing with sufficient cash remaining and no need to draw down on the revolver. The annual interest expense energy related to the Latrobe debt payoff will be about $7.5 million.

Finally, we changed our external reporting segments this quarter in line with the way we are looking at our business results. We put all of the historical data out a couple of weeks ahead of our call, which was hopefully helpful in recasting your models.

In the Specialty Alloys Operations segment, or mill operations, we reported total revenue of $360 million, with segment operating income of $50.9 million and a 19.7% segment operating margin, excluding surcharge.

For the Performance Engineered Products segment, we reported revenue of $82 million with operating income of $10.4 million and a 12.8% segment operating margin. We also made modest changes to our end market and product form supplemental reporting which we think make sense with how we are looking at the business.

With that, let me now turn it back to the operator so we can open the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Gautam Khanna, Cowen & Co.

Gautam Khanna - *Cowen & Co. - Analyst*

Yes, thanks. By the way, I think the call went dark for a minute or two during Bill's comments.

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

Okay.

Gautam Khanna - *Cowen & Co. - Analyst*

But anyway, just quickly, the PEP margins sequentially were down a bit. I just wondered what -- I know you are saying that margins will be kind of stable with the current level going forward, what'd explain that?

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

Nothing that we are concerned with. I think that's reflective just of some of the volume decisions that were made at year-end, where volume got pushed into the next quarter and impacted the mix that we had in that quarter.

Gautam Khanna - *Cowen & Co. - Analyst*

You mentioned some destocking I guess -- or customer management of inventory at the year-end. Has that recovered in the March quarter already?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

We've certainly -- this is Bill. We've certainly seen a strong demand kind of coming out of the chute as we've begun the fiscal year.

Gautam Khanna - *Cowen & Co. - Analyst*

Can you comment on leadtimes just generally in your various fastener metals, and on the nickel engine alloy side? Perhaps by metal type?

Dave Strobel - *Carpenter Technology Corp. - SVP Global Operations*

This is Dave Strobel. Our leadtimes for our premium products, which includes the aerospace fastener stock, is currently at about six to nine months for new orders coming in.

Gautam Khanna - *Cowen & Co. - Analyst*

What about for large customers who already have a relationship with you guys? The PCPs of the world and --?

Dave Strobel - *Carpenter Technology Corp. - SVP Global Operations*

We have stocking programs in finished goods and also as part of our WIP program we'll stock ingot and billet to help support that program as well.

Gautam Khanna - *Cowen & Co. - Analyst*

Could you describe the change in leadtimes? Have leadtimes stretched out of late or is that a pretty consistent number, the six to nine months?

Dave Strobel - *Carpenter Technology Corp. - SVP Global Operations*

It's been relatively flat.

Gautam Khanna - *Cowen & Co. - Analyst*

And on the engine billet side?

Dave Strobel - *Carpenter Technology Corp. - SVP Global Operations*

Same.

Gautam Khanna - *Cowen & Co. - Analyst*

Thank you, I'll get back in queue.

Operator

Dan Whalen, Auriga USA.

Dan Whalen - *Auriga USA - Analyst*

It's Dan Whalen from Auriga USA. A couple of quite questions here. It seems like you guys have made some pretty great progress in terms of working through some of that lower value-added inventory. Is that pretty much through the supply -- through your inventory levels now, or is there a little bit more to go?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Certainly, we continue to work to optimize our mix. We began this process roughly a year ago, giving customers either price increases or a notice where we were migrating our mix away from the business. We worked in a very constructive fashion with the customers and I think a lot of that inventory has worked its way through the system. You see that reflected in our sales. Also our inventory has gone up in terms of value per pound consistently over the last several quarters, which is another indication.

Dan Whalen - *Auriga USA - Analyst*

Great. Then it sounds like for the Specialty Alloys side of the business you are at 90%-plus utilization rates. What about on the performed -- performance engineered side?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

That is another area where we are very well -- our assets are well utilized, and ultimately we are in the process and looking at further expansions. We've announced the expansion of our titanium fine wire business, and that is to support additional output in that area. We have announced also expansion of our powder business and are looking at even further expansions to support what we anticipate will be a robust demand in the years to come. So we are in good shape. I would say we probably have a little bit more headroom in those businesses, especially with some of the advanced investments that were made.

Dan Whalen - *Auriga USA - Analyst*

Great. One more question if I may. If -- just framing the way we look at Europe, is most of your European exposure aerospace and energy focused, or how should we be thinking about that?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Yes. In fact, if you take aerospace, energy, and medical, you would be up over 80% of our overall European sales mix.

Dan Whalen - *Auriga USA - Analyst*

Great. Okay. Thanks for that color. Congratulations on the quarter.

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Thank you.

Operator

Mark Parr, KeyBanc.

Mark Parr - *KeyBanc Capital Markets - Analyst*

Thanks very much. Good morning. Congratulations on the numbers. I was curious in terms of pricing. I don't know, Bill, and I think, at least on my line, it was dark, silent for almost at least five or six minutes at the top of the hour. But if you haven't, I was wondering if you could give us an update, color on base price momentum, and how you expect that to impact results over the next couple of quarters?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Sure. Obviously, as we've said that we are going to drive back to peak EBITDA plus, a significant portion of that gain is related to we'll say mix management. The environment out there based upon supply/demand is certainly in favor of price increases, but I also want to continue to express that one fairly good portion of our business is under long-term agreement.

Secondly, we are trying to strategically develop and grow our business, which means that, even though there may be a supply/demand in favor of us, we are really trying to make sure we are pricing our products so that we can sustain long-term supply relationships and a trust-based relationship at that. That means that we expect we'll stay on track and continue to see improvements, but the majority of the gains will come through mix management and what we are running through our facilities as opposed to simply raising prices.

Mark Parr - *KeyBanc Capital Markets - Analyst*

Is there -- if you as you look at the March and June periods, will there be any meaningful difference in the relationship between volume and pricing compared to what you had in the September and December time frames?

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

I don't believe so, Mark, no.

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Nothing jumps out to mind.

Mark Parr - *KeyBanc Capital Markets - Analyst*

Okay, terrific. Thanks very much.

Operator

[Sunil Gaptadar], Centennial Investments.

Sunil Gaptadar - *Centennial Investments - Analyst*

Yes, thanks. When I looked on the different end markets that you'd participated, which end markets do you think are going to be a headwind for the rest of the year going into the second half of calendar 2012?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

I would say without question it would be probably more in the consumer market, which is at this point a pretty small portion of our overall sales mix. So, we have somewhat deemphasized that as we've traded our mix up. Fortunately, based upon high demand levels that exist in many other areas, as you saw in the results today, we are able to offset any weakness in demand with an offset of that capacity utilization in other areas which we think are more strategic and profitable.

Sunil Gaptadar - *Centennial Investments - Analyst*

Okay. You think that the profit per pound increase is from that better mix and better prices. Do you think that can continue, sustainment self over the next two years to your goal of 2014, or do you think that you need more than that to go to your goal of 2014?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

That is certainly a primary driver. I would be -- that's focused primarily on our SAO operations. When you look at the PEP businesses, there is strong growth which we are seeing in the CPP, the Dynamet and the Amega West businesses, and those are also very important to our success, both in the near term and long run. They have been a major contributor to the growth that we have realized in terms of profit growth to date, so we expect that they will also be an engine, and fortunately they are firing on their cylinders as well.

Operator

Steve Levenson, Stifel Nicolaus.

Steve Levenson - *Stifel Nicolaus - Analyst*

Good morning everybody. I've just been on a call from one of your other customers who indicated that their demand for nickel alloys is rising but they don't intend to add melt. What do you see as the outlook for nickel, and do you think the pricing will be more stable this year, or do you think there's going to be added volatility as the year goes on? Thanks.

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Nickel prices themselves have recently been trending upward, and so that's reflected in the surcharge that we have or otherwise is hedged. We are proactively investing in capacity to support the demand growth in the marketplace. This is one of the reasons we are very pleased with the opportunity to be purchasing Latrobe. They have a great team of people and a great business.

At the same time, we really believe the synergies of the know-how from the two companies will enable us to ultimately get more capacity by using the best assets and techniques for the primary mix that's going through really both companies' sales, and that should help us in the short run. Then the major investments we are making in the focus facility in the long run will make sure that we can provide good support to our customers from a capacity standpoint. So that I hope answers your question.

Steve Levenson - *Stifel Nicolaus - Analyst*

That's [going back to] capacity. Do you think -- I know they are rising now. Do you think they're going to get back to where they were last year and can that affect demand, or do you think they are going to stay in a tighter range close to where they are today?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

You're talking about nickel itself?

Steve Levenson - *Stifel Nicolaus - Analyst*

Yes.

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Dave Strobel may want to make a quick comment on the price, but we typically don't have a -- other than a very short-term affect -- a major impact based upon the price of nickel itself in terms of our sales volume. Sometimes, when nickel is rising or is expected to rise, some of the distributors may choose to stock up. Sometimes, when nickel prices are falling, they may hold off to see if they can buy at a lower price. But again, that's a relatively smaller portion of our overall sales mix.

Dave, do you want to speak to nickel prices?

Dave Strobel - *Carpenter Technology Corp. - SVP Global Operations*

Nickel, just over the last few days, has had a really nice bump up. A lot of that is projections, commodity trading, and comes back to the value of the dollar versus the euro and where people want to invest some money. But I mean -- at the levels that it's at, it's bumping back up to levels that we saw about six to nine months ago. We think it's in a pretty stable range.

Steve Levenson - *Stifel Nicolaus - Analyst*

Okay, thanks very much.

Operator

Tim Hayes, Davenport & Co.

Tim Hayes - *Davenport & Co. - Analyst*

Good morning. Can you provide the sequential volume increases for the new categories, end market categories please?

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

Sure Tim. So our aerospace and defense business in volume terms was up 6% from the first quarter, energy business up 18%, medical business down 1%, our transportation business up 3%, and the industrial and consumer business up 1%. So overall sequentially we were up 4%.

Tim Hayes - *Davenport & Co. - Analyst*

Very good. Thank you.

Operator

Gautam Khanna, Cowen & Co.

Gautam Khanna - *Cowen & Co. - Analyst*

I just wanted to follow-up on the two points that were brought up on the PCC call earlier. One was they mentioned Carlton Forge insourcing more. Could you talk about how that relationship has changed, if at all, since it's been owned by PCC? If I recall, you guys were -- did not see any erosion in volume there.

Then secondly, their fastener sales were relatively flat sequentially into the aerospace market. They are talking about kind of four quarters before we really get cooking. Can you talk about what you are seeing maybe outside of PCC, not at that customer but maybe at your other major buyers in that market, Alcoa and LISI, what the trends are there, and if they are different than what PCC is (technical difficulty)? Thanks.

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Sure. As it relates to PCC, again they are a very important customer to us. We value the relationship we have with them. We understand that they have internal capabilities which are very capable and supply a significant portion of their needs.

I think that, over time, and this would go back. Gautam, as you know, I've only been here myself 1.5 years. But if you go back several years ago, Carpenter did have some more business with Carlton Forge which I believe has been insourced. That being said, our impression and my understanding is that we have a good working relationship at all levels with PCC and that ultimately they're a winner in their industry. They continue to grow and grow. As their demand grows, it gives an opportunity if we can provide the right quality, the right delivery and the right pricing package, for us to be a more major supplier to them. That's our objective. So that's how I would leave that one. Right now, we feel like our business base with PCC is strong, and we appreciate their business.

As it relates to your second part of your question was about faster demand, titanium. This is probably during the period where I went dark or the system went dark. Maybe it's the sunspots they are talking about, all the radiation that's coming out from the sun at this point in time. But anyway, we have seen a strong uptick primarily in our titanium fastener business. We are already at record levels and expect to exceed prior-peak record levels this fiscal year. We are seeing a pick-up overall in our nickel and stainless fastener demand. It's not as large as what we are seeing in the titanium fastener area, but we are seeing a general uptick.

Gautam Khanna - *Cowen & Co. - Analyst*

May I just ask if that is outside of the PCC relationship? Are you seeing it with the other major customers there or --?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

I can't -- I would say it's pretty broad. PCC is an important part of that equation, and so I would say it's a combination of all.

Gautam Khanna - *Cowen & Co. - Analyst*

Okay. Maybe just to pick up on something that you may have said that we didn't hear, on the landing gear side, a couple quarters back, you mentioned the pursuit of a big opportunity there. What is the update? Is what we saw in the quarter part of that and the results?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

Actually, that's a project which is continuing to progress well through the developmental phase and approval phase with the OEMs. We feel very good about the future of that program. Ultimately, though, it's not reflected in our current sales mix. It would be used in retrofits and future aircraft construction. I would say, though, that what may not have been communicated because we went dark was that we have seen increased demand related to structural components on aircraft, another strategically targeted area. Specifically, we called out or I tried to call out that we have seemed increased demand, for example, on the 747-8. We see about 39,000 pounds on the flap tracks that are associated with that new aircraft construction. So we are seeing general growth.

Finally, I would highlight that, when we bring Latrobe into the fold, they have a strong aerospace landing gear program, and so we'll be providing the landing gear collectively that they provide today, whether it be in the technology they are selling today or in some of the new technologies that we are marketing and working with the OEMs on.

Gautam Khanna - *Cowen & Co. - Analyst*

Forgive me for one more -- I think it was yesterday, on ATI's call, Allegheny's call, they talked about how the acquisition of Ladish has not resulted in any sort of share loss or share shift from engine forgers for their engine billet material. I just wanted to get your perspective on that. Have you seen any share opportunities open up for Carpenter, given some of the consolidation (technical difficulty)?

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

We continue to be aggressive, working closely with our customers to gain business. We're trying to do it through kind of the old-fashioned way of developing trust-based relationships and providing what we think it is a very good quality product. We've had some successes. What we could attribute those successes to, I'd rather just leave it at the comments I've made, and also just state that, from our perspective, we prefer to be in the position where we can be a true supplier to our customers without the entanglements and conflict that would come from and integration further downstream. That's our decision strategically. It's not to say that ATI's is a good one or a bad one or it's working or it's not. Just that's our position and we are trying to take the business.

Gautam Khanna - *Cowen & Co. - Analyst*

Thank you.

Operator

(Operator Instructions). Mark Parr, KeyBanc.

Mark Parr - *KeyBanc Capital Markets - Analyst*

Thanks. It's with KeyBanc. The LIFO situation, Doug, I was wondering if you could maybe give us some numeric guidance on what you would expect for the second half compared to the first half.

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

Sure. It's good that you didn't change employers, so we are happy to hear that. But for the first half of the year, all the LIFO related impacts created a positive $4 million in the first half of the year, most of that in our first quarter, as we talked about last time. For the second half, based on current projections of the inventory declines, as well as raw material prices, we are estimating that would be a negative $5 million impact. So as it usually does, it kind of balances out on the year but we did benefit in the first half of the year, and we will see some of that come off in the second half of the year, which is why we feel overall second-half margins will be pretty similar to what we've been running at.

Mark Parr - *KeyBanc Capital Markets - Analyst*

Terrific, thanks. I hope on the next call I won't be from F Bank or G Bank.

Operator

Gautam Khanna.

Gautam Khanna - *Cowen & Co. - Analyst*

Sorry to keep asking, but the automotive business, the market anyway, appears a little bit healthier. We haven't talked about it in a while as you blended your mix down. But are there any opportunities to start moving that market segment up, both from a profitability and a volume standpoint?

Mark Kamon - *Carpenter Technology Corp. - SVP Specialty Alloys Commercial Operations*

This is Mark Kamon. Auto is high-performance automotive, and I say high-performance to distinguish, for example, our applications like turbochargers and high-efficiency engines. Our focus on that is very significant. We have, while we have kind of pushed away from some of the more simple structural hangers and things like that, our involvement in gasketing high tensile fasteners, turbochargers and things like that is a target area of growth. I would offer, for example, in Europe, where things are fairly flat, we have seen some very nice growth year-over-year and quarter-over-quarter in those high-performance segments.

Bill Wulfsohn - *Carpenter Technology Corp. - President, CEO*

By the way, this is Bill. Because we had an issue it appears technically, we are going to post on our website the script from this call. We'll try to do that this morning so that, if there were portions that didn't come through, you'd have a chance to reflect upon those words.

Gautam Khanna - *Cowen & Co. - Analyst*

Appreciate it. Doug, could you give us some color on fiscal '13 organic CapEx?

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

Yes. Fiscal year '1 -- and we are -- recognize that we are in the beginning stages of our annual planning process -- but as part of our long-range financial planning and especially with the announcement of the major facility down in Alabama, we would expect the CapEx levels to be above what we are forecasting for this year, and so closer to, I would say, $300 million than the slightly under $200 million level that we have been spending. But that's all been anticipated as part of our growth strategy and investments and actions we took on our capital structure at the end of last year.

Gautam Khanna - *Cowen & Co. - Analyst*

Doug, maybe directionally, since we are new to the Specialty -- the SAO segment, where do you -- I mean where is this thing going to trend over time? I know this year we are at the just under 20% range. But what is the right -- what are kind of the incrementals through the cycle? Are we going to trend up to mid-20% range, or how should we think about that?

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

I think that will be reflective of overall progress that we are making against our goal to return to our prior peak level of EBITDA. So on a run-rate basis and reflecting in the margins that you're looking at, we are at $282 million of EBITDA trailing 12 months, so there is still room to go to get back to our prior peak of $360 million.

On the PEP businesses, while it will have a positive effect on margins as we grow, we are looking at those businesses, as Bill had said, more as overall growth businesses, growth in revenue, growth in overall profitability and not as much focused on the margin or the profit per pound as we will be on the SAO or mill side of the business.

Gautam Khanna - *Cowen & Co. - Analyst*

Okay, so you're saying that there is more margin leverage in SAO from here than there is at PEP? I just want to be clear.

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

I'm not comparing one to the other. I would say that both have some additional margin leverage focusing on the strategies that we've outlined for our mill operations will have some positive impact on forward margins to get back our prior peak of EBITDA. As we grow the PEP part of the businesses, that would also have some positive impacts on our margin, although we are less focused on that as the metric.

Gautam Khanna - *Cowen & Co. - Analyst*

And tax rate going forward, 35% fiscal '13? Is that reasonable? What should we think?

Doug Ralph - *Carpenter Technology Corp. - SVP, CFO*

It's a reasonable estimate, yes.

Gautam Khanna - *Cowen & Co. - Analyst*

Okay. Thanks guys.

Operator

This concludes the question-and-answer portion of today's call. I will now turn the call back to Mr. Hajost for closing remarks.

Michael Hajost - *Carpenter Technology Corp. - VP Treasury & IR*

Thank you, again, for participating today on today's call. We do apologize for the technical problems during Bill's comments, and we will post the entire transcript to our website so that you can have those full comments. We look forward to speaking with you again next quarter. Thank you. Good-bye.

Operator

Thank you sir, and thank you for your participation in today's conference. You may now disconnect. Have a great day.
