

TWIN DISC INC
Form 10-K
September 13, 2012

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, 2012
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.

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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

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

YES [] NO []

At December 30, 2011, 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 \$313,655,596. 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 17, 2012, the registrant had 11,404,246 shares of its common stock outstanding.

As permitted by Securities and Exchange Commission regulations, the Interactive Data File for this Annual Report on Form 10-K will be filed within the 30-day grace period for the first financial statements required to include detailed tagging of notes to the financial statements and financial statement schedules.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held October 19, 2012, 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.

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FOR THE YEAR ENDED JUNE 30, 2012

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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 49% of the Company's consolidated net sales during the year ended June 30, 2012. There were no customers that accounted for 10% or more of consolidated net sales in fiscal 2012.

Unfilled open orders for the next six months of \$98,746,000 at June 30, 2012 compares to \$146,899,000 at June 30, 2011. The Company saw a decline in orders by oil and gas customers for its 8500 series transmission as current demand has softened for new high-horsepower rigs due to the North American natural gas supply overhang and lower prices. In addition, the Company has begun to accept orders and has shipped initial units of its new 7500 series transmission for the oil and gas market. 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 \$2,657,000, \$2,475,000 and \$2,347,000 in fiscal 2012, 2011 and 2010, respectively. Total engineering and development costs were \$9,508,000, \$8,776,000 and \$7,885,000 in

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fiscal 2012, 2011 and 2010, respectively.

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, 2012 was 1,029.

A summary of financial data by segment and geographic area for the years ended June 30, 2012, 2011 and 2010 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 fiscal 2009, 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 recovered to historically high levels in fiscal 2011 and 2012, the cyclical nature of the global oil and gas market presents the ongoing possibility of a severe cutback in demand, which would create a significant 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 could 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

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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 developing 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 2012, 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 53% of our consolidated net sales for fiscal 2012. We have international manufacturing operations in Belgium, Italy and Switzerland. In addition, we have international distribution operations in Singapore, China, Australia, Japan,

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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
 - ⇒ changes in tax law

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 2012'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 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. While some recovery has been seen in 2011 and 2012, these conditions made 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, 2012, 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 2013 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

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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 847,000 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 leased and are used for sales offices, warehousing and light assembly or product service:

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

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, are 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. Mine Safety Disclosures

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Not applicable.

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 19, 2012.

Name	Age	Position
Michael E. Batten	72	Chairman and Chief Executive Officer
John H. Batten	47	President and Chief Operating Officer
Christopher J. Eperjesy	44	Vice President – Finance, Chief Financial Officer and Treasurer
James E. Feiertag	55	Executive Vice President
Dean J. Bratel	48	Vice President - Engineering
Henri-Claude Fabry	66	Vice President - International Distribution
Denise L. Wilcox	55	Vice President - Human Resources
Jeffrey S. Knutson	47	Corporate Controller
Thomas E. Valentyn	53	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.

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.

Henri Claude Fabry, Vice President – International Distribution. 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.

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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, 2010 through June 30, 2012:

Quarter	Fiscal Year Ended 6/30/12			Fiscal Year Ended 6/30/11		
	High	Low	Dividend	High	Low	Dividend
First Quarter	\$42.82	\$25.72	\$0.08	\$13.95	\$10.52	\$0.07
Second Quarter	47.39	23.08	0.08	30.25	12.68	0.07
Third Quarter	40.51	26.00	0.09	35.10	25.24	0.08
Fourth Quarter	26.97	16.55	0.09	39.43	29.22	0.08

For information regarding the Company's equity-based compensation plans, see the discussion under Item 12 of this report. As of August 17, 2012, shareholders of record numbered 651. The closing price of Twin Disc common stock as of August 17, 2012 was \$19.95.

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 31, 2012 – April 27, 2012	0	NA	0	250,000
April 28, 2012 –	0	NA	0	250,000

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May 25, 2012

May 26, 2012 - June 30, 2012	125,000	19.40	125,000	125,000
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Total	125,000	19.40	125,000	125,000
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