PREMCOR INC
Form 424B5
April 08, 2004
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The information in this Preliminary Prospectus Supplement is not complete and may be changed. This Preliminary Prospectus Supplement and accompanying Prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PROSPECTUS SUPPLEMENT *(Subject to Completion)* *Issued April 8, 2004*

(To prospectus dated January 7, 2004)

13,000,000 Shares

COMMON STOCK

Premcor Inc. is offering 13,000,000 shares of its common stock.

Our common stock is listed on the New York Stock Exchange under the symbol PCO. On April 7, 2004, the reported last sale price of our common stock on the New York Stock Exchange was $30.83 per share.

Concurrently with this offering, our subsidiary, The Premcor Refining Group Inc., or PRG, is offering by means of a separate prospectus supplement, $400 million aggregate principal amount of senior notes. Neither offering is contingent upon the other.

Investing in our common stock involves risks. See Risk Factors beginning on page S-10 of this prospectus supplement and on page 6 of the accompanying prospectus.

PRICE $ A SHARE

	Price to Public	*Underwriting Discounts and Commissions*	*Proceeds to Premcor Inc.*
Per Share	$	$	$
Total	$	$	$

We have granted the underwriters the right to purchase up to an additional 1,950,000 shares to cover over-allotments.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares of common stock to purchasers on , 2004.

Joint Book-Running Managers

MORGAN STANLEY *CREDIT SUISSE FIRST BOSTON*

CITIGROUP *UBS INVESTMENT BANK*

April , 2004

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Prospectus Supplement

Prospectus

You should rely only on the information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If

anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement and accompanying prospectus, including the documents that we incorporate by reference, contain both historical and forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements are not historical facts, but only predictions and generally can be identified by use of statements that include phrases such as believe, expect, anticipate, intend, plan, foresee or other words or phrases of similar import. Similarly, statements that describe our objectives, plans goals also are forward-looking statements. These forward-looking statements are subject to risks and uncertainties, which could cause actual results to differ materially from those currently anticipated. Factors that could materially affect these forward-looking statements can be found in our periodic reports filed with the SEC. Potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements, including the factors described under the heading Risk Factors, and are cautioned not to place undue reliance on these forward-looking statements. The forward-looking statements included in this prospectus supplement are made only as of the date of this prospectus supplement and we undertake no obligation to publicly update these forward-looking statements to reflect new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events might or might not occur. We cannot assure you that projected results or events will be achieved.

MARKET DATA

We obtained market and competitive position data including market forecasts used through this prospectus supplement and accompanying prospectus and incorporated by reference herein from market research, publicly available information and industry publications. Industry publications generally state that the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information is not guaranteed. Similarly, internal surveys, industry forecasts and market research, while believed to be reliable, have not been independently verified, and neither we nor the underwriters make any representation as to the accuracy of such information.

IMPORTANT NOTICE ABOUT INFORMATION PRESENTED IN THIS PROSPECTUS SUPPLEMENT

This document is in two parts. The first part is the prospectus supplement, which describes the specific terms of this offering and certain other matters relating to our business. The second part, the accompanying prospectus, gives more general information, some of which does not apply to this common stock offering. Generally, when we refer to the prospectus, we are referring to both parts combined. If the description of this offering varies between this prospectus supplement and the accompanying prospectus, you should rely on the information in this prospectus supplement.

SUMMARY

This summary highlights information contained elsewhere in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference. It is not complete and may not contain all the information that you consider important. We encourage you to read this prospectus supplement, the accompanying prospectus and the documents to which we have referred you in their entirety. As used in this prospectus supplement, the terms Premcor, we, our, or us refer to Premcor Inc. and its consolidated subsidiaries, taken as a whole, unless the context otherwise indicates. Premcor Inc. should be distinguished from its subsidiaries, including The Premcor Refining Group Inc. and Port Arthur Finance Corp., each of which has publicly traded debt outstanding.

Premcor Inc.

We are one of the largest independent petroleum refiners and suppliers of unbranded transportation fuels, heating oil, petrochemical feedstocks, petroleum coke and other petroleum products in the United States. Our wholly owned subsidiary, The Premcor Refining Group Inc., or PRG, currently owns and operates three refineries, which are located in Port Arthur, Texas, Memphis, Tennessee, and Lima, Ohio, with a combined crude oil volume processing capacity, known as throughput capacity, of approximately 610,000 barrels per day or bpd. We sell petroleum products in the Midwest, the Gulf Coast, Eastern and Southeastern United States. We sell our products on an unbranded basis to approximately 1,200 distributors and chain retailers through our own product distribution system and an extensive third-party owned product distribution system, as well as in the spot market.

For the year ended December 31, 2003, highly refined products, known as light products, such as transportation fuels, petrochemical feedstocks and heating oil, accounted for approximately 93% of our total product volume. For the same period, high-value, premium product grades, such as high octane and reformulated gasoline, low-sulfur diesel and jet fuel, which are the most valuable types of light products, accounted for approximately 42% of our total product volume.

We source our crude oil on a global basis through a combination of long-term crude oil purchase contracts, short-term purchase contracts and spot market purchases. The long-term contracts provide us with a steady supply of crude oil, while the short-term contracts and spot market purchases provide us with flexibility in obtaining crude oil. Since all of our refineries have access, either directly or though pipeline connections, to deepwater terminals, we have the flexibility to purchase foreign crude oils via waterborne delivery or domestic crude oils via pipeline delivery. Our Port Arthur refinery, which possesses one of the world s largest coking units, can process approximately 80% low cost, heavy sour crude oil, substantially all of which is crude oil from Mexico called Maya.

Delaware City Refinery Acquisition

On March 30, 2004, we executed an agreement with Motiva Enterprises LLC, or Motiva, to purchase its Delaware City refining assets located in Delaware City, Delaware. The purchase price is $800 million, plus the value of net working capital, currently estimated at $100 million, which we expect will be funded with available cash. We expect to finance the purchase of the refinery assets with approximately equal parts equity and debt, including the net proceeds from this offering and the proceeds from a $400 million offering of PRG s senior notes. In addition, Motiva will be entitled to receive from us earn-out payments of $25 million per year up to a total of $75 million over a three-year period depending on the amount of crude oil processed at the refinery and the level of industry refining margins during that period, and a $25 million payment per year up to a total of $50 million over a two-year period depending on the achievement of certain performance criteria at the gasification facility.

The Delaware City refinery is a high-conversion heavy crude oil refinery with a rated crude oil throughput capacity of 180,000 bpd. Also included in the acquisition is a petroleum coke gasification unit, a cogeneration

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facility, crude oil and product tankage, and a truck-loading rack. Major process units include a crude unit, a fluid coking unit, a fluid catalytic cracking unit, a hydrocracking unit with a hydrogen plant, a continuous catalytic reformer, an alkylation unit, and several hydrotreating units. Primary products include regular and premium conventional and reformulated gasoline, low-sulfur diesel, and home heating oil. The refinery s production is sold in the U.S. Northeast via pipeline, barge, and truck distribution. The refinery s petroleum coke production is sold to third parties or gasified to fuel the cogeneration facility, which is designed to supply electricity and steam to the refinery as well as electricity for sale to third parties.

We expect the acquisition to be completed by the end of the second quarter of 2004, subject to our obtaining the necessary financing and the satisfaction of customary conditions. There is no assurance we will consummate the transaction.

Market Trends

We believe that the longer-term outlook for the United States refining industry is attractive due to certain significant trends that we have identified. We believe that:

- *The supply and demand fundamentals for refined petroleum products have improved since the late 1990s and will continue to improve.* While the Department of Energy s Energy Information Administration, or EIA, expects refining capacity growth to be nominal over the next two decades and utilization to remain high relative to historical levels, the EIA expects demand for petroleum products to continue to grow steadily at 1.6% per year over the next two decades. Of this projected growth, approximately 96% is expected to come from the increased consumption of light petroleum products including gasoline, diesel, jet fuel and liquefied petroleum gas. We believe that impending regulatory requirements will result in the rationalization of non-competitive refineries, further reducing refining supply.

- *Increasing worldwide supplies of lower cost sour and heavy sour crude oil will provide an increasing cost advantage to those refineries with complex configurations that are able to process these crude oils.* Industry sources estimate that total worldwide heavy sour crude oil production will increase, which should result in a continuation of the downward price pressure on this type of crude oil relative to benchmark West Texas Intermediate crude oil, and that imports, primarily from Latin America and Canada, of sour and heavy sour crude oil are also expected to increase over the next several years.

- *Products meeting evolving fuel specifications will account for an increasing share of total fuel demand, which will benefit refiners possessing the capabilities to blend and process these fuels.* According to industry sources, the demand for reformulated gasoline and the oxygenates used in its production is expected to increase over the next several years, while the trend toward banning MTBE as a blendstock in reformulated gasoline is expected to result in a reduction of the gasoline supply by 3% to 4%.

- *The continuing consolidation in the refining industry will create attractive opportunities to acquire competitive refining capacity.* We believe that integrated oil companies may continue the trend of divesting refining assets rather than making costly investments to meet increasingly strict product specifications.

Competitive Strengths

We believe that we have the following strengths:

- As a pure-play refiner, which is a refiner without crude oil exploration and production or retail sales operations, we are free to acquire the most attractive crude supply and to supply our products to markets having the greatest profit potential and to focus our management attention and capital expenditures solely on refining.

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- Our refineries are logistically well-located modern facilities of significant size and scope with access to a wide variety of crude oils and product distribution systems.

- Our Port Arthur, Texas refinery and the Delaware City refinery we plan to acquire have significant heavy sour crude oil processing capacity, giving us a cost advantage over other refiners that are not able to process high volumes of these less expensive crude oils.

- We have a long-term crude oil supply agreement with an affiliate of Petroleos Mexicanos, or PEMEX, the Mexican state oil company, that provides a stable and secure supply of heavy sour Maya crude oil to our Port Arthur refinery.

- We have an experienced and committed management team led by Mr. Thomas D. O Malley, a refining industry veteran with a proven track record of growing businesses and shareholder value through acquisitions.

Business Strategies

Our goal is to be a premier independent refiner and supplier of unbranded petroleum products in the United States and to be an industry leader in growing shareholder value. We intend to accomplish this goal, grow our business, enhance earnings and improve our return on capital by executing the following strategies:

- Growing through timely and cost-effective acquisitions and by undertaking discretionary capital projects to improve, upgrade and potentially expand our refineries.

- Continuing to promote excellence in safety and reliability at our operations.

- Maintaining an organization in which employees are highly motivated to enhance earnings and improve return on capital.

Other Financing Transactions

Concurrently with this offering, our operating subsidiary, PRG, is offering $400 million aggregate principal amount of senior notes. This prospectus supplement shall not be deemed to be an offer to sell or a solicitation of an offer to buy the senior notes. Neither the offering made hereby nor the senior notes offering is contingent on the other or upon the closing of the Delaware City refinery acquisition.

We have signed a commitment letter to establish a new $1 billion senior secured revolving credit facility for PRG which would replace PRG s existing $785 million credit facility. This new facility will be secured by substantially the same assets as the existing facility, will extend the maturity date to April 2009 and will modify certain covenant requirements. There are no assurances that PRG will enter into this new facility. If PRG does not enter into this new facility, the senior notes offering is contingent upon us obtaining required waivers and approvals under PRG s existing credit facility.

* * * *

We are a Delaware corporation. Our principal executive offices are located at 1700 East Putnam Avenue, Suite 400, Old Greenwich, Connecticut 06870, and our telephone number is (203) 698-7500. Our website address is www.premcor.com. Information contained on our website is not incorporated by reference into this prospectus supplement and should not be considered to be a part of this prospectus supplement.

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THE OFFERING

Common stock offered	13,000,000 shares
Common stock to be outstanding after this offering	87,119,694 shares
Over-allotment option	1,950,000 shares
Use of proceeds	We expect to receive net proceeds from the sale of shares of our common stock in this offering of approximately $ million, or $ million if the underwriters exercise their over-allotment option in full. We intend to contribute the net proceeds from this offering and the other financing transactions to PRG to finance the Delaware City refinery acquisition and for general corporate purposes.
Dividend policy	We do not expect to pay dividends on our shares of common stock for the foreseeable future.
New York Stock Exchange symbol	PCO

The number of shares of common stock to be outstanding after this offering is based on 74,119,694 shares outstanding as of December 31, 2003 and, unless we indicate otherwise, excludes:

- 5,114,171 shares issuable upon the exercise of stock options held by our directors, employees and former employees, which were outstanding as of December 31, 2003, with exercise prices ranging from $9.90 to $24.53 per share;
- an additional 1,351,225 shares authorized and reserved for issuance to our directors or employees under our stock incentive plans and other agreements; and
- 1,950,000 shares that the underwriters have the option to purchase from us solely to cover over-allotments.

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SUMMARY SELECTED FINANCIAL DATA

The following table presents summary selected financial and other data about us. The summary statement of earnings and cash flows data for the years ended December 31, 2003, 2002 and 2001 and the selected balance sheet data as of December 31, 2003 and 2002 are derived from our audited consolidated financial statements including the notes thereto incorporated by reference in this prospectus supplement. The selected statement of earnings and cash flow data for the years ended December 31, 2000 and 1999, and the selected balance sheet data as of December 31, 2001, 2000, and 1999 have been derived from our audited consolidated financial statements, including the notes thereto, which are not incorporated by reference in this prospectus supplement. The data below reflects the closure of our Blue Island refinery in January 2001, the closure of our Hartford refinery in September 2002 and the acquisition of our Memphis refinery in March 2003. This table should be read in conjunction with the information contained in Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes incorporated by reference in this prospectus supplement.

	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(in millions, except per share data)				
Statement of earnings data:					
Net sales and operating revenues(1)	$ 8,803.9	$ 5,906.0	$ 5,985.0	$ 7,162.3	$ 4,245.7
Cost of sales(1)	7,719.2	5,235.0	4,818.9	6,423.1	3,825.0
Operating expenses	524.9	432.2	467.7	467.7	402.8
General and administrative expenses	67.1	51.8	63.3	53.0	51.5
Stock-based compensation	17.6	14.0			
Depreciation and amortization(2)	106.2	88.9	91.9	71.8	63.1
Refinery restructuring and other charges	38.5	172.9	176.2		
Inventory write-down (recovery) to market value					(105.8)
Operating income (loss)	330.4	(88.8)	367.0	146.7	9.1
Interest expense and finance income, net(3)	(115.1)	(101.8)	(139.5)	(82.2)	(91.5)
Gain (loss) on extinguishment of long-term debt(4)	(27.5)	(19.5)	8.7		
Income tax (provision) benefit	(64.0)	81.3	(52.4)	25.8	12.0
Minority interest in subsidiary		1.7	(12.8)	(0.6)	1.4
Income (loss) from continuing operations	123.8	(127.1)	171.0	89.7	(69.0)
Discontinued operations, net of taxes(5)	(7.2)		(18.0)		32.6
Net income (loss)	116.6	(127.1)	153.0	89.7	(36.4)
Preferred stock dividends		(2.5)	(10.4)	(9.6)	(8.6)
Net income (loss) available to common stockholders	$ 116.6	$ (129.6)	$ 142.6	$ 80.1	$ (45.0)
Net income (loss) from continuing operations per share:					
basic	$ 1.70	$ (2.65)	$ 5.05	$ 2.79	$ (3.59)
diluted	1.68	(2.65)	4.65	2.55	(3.59)
Weighted average number of common shares outstanding:					
basic	72.8	49.0	31.8	28.8	21.6
diluted	73.6	49.0	34.5	31.5	21.6
Cash flow data:					
Cash flows from operating activities	$ 182.4	$ 15.9	$ 439.2	$ 124.4	$ 85.5
Cash flows from investing activities	(710.3)	(144.5)	(152.9)	(375.3)	(321.3)

Cash flows from financing activities	787.2	(214.1)	(66.3)	234.8	393.9
Capital expenditures for property, plant and equipment	229.8	114.3	94.5	390.7	438.2
Capital expenditures for turnarounds	31.5	34.3	49.2	31.5	77.9
Refinery acquisition expenditures	476.0				
Earn-out payment on refinery acquisition	14.2				

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	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(in millions, except per share data)				
Key operating statistics:					
Production (barrels per day in thousands)	532.6	438.2	463.4	477.3	460.5
Crude oil throughput (barrels per day in thousands)	501.3	412.8	439.7	468.0	451.7
Total crude oil throughput (millions of barrels)	183.0	150.7	160.5	171.3	164.9
Per barrel of crude oil throughput:					
Gross margin	$ 5.93	$ 4.45	$ 7.27	$ 4.32	$ 2.55
Operating expenses	2.87	2.87	2.91	2.73	2.44

	As of December 31,				
	2003	2002	2001	2000	1999
	(in millions)				
Balance sheet data:					
Cash, cash equivalents and short-term investments(6)	$ 499.2	$ 234.0	$ 542.6	$ 291.8	$ 307.6
Working capital	860.1	320.9	482.6	325.0	305.8
Total assets	3,715.3	2,323.0	2,509.8	2,469.1	1,984.1
Long-term debt	1,452.1	924.9	1,472.8	1,516.0	1,340.4
Exchangeable preferred stock			94.8	90.6	81.1
Stockholders equity	1,145.2	704.0	294.7	152.1	14.7

(1) Cost of sales includes the net effect of the buying and selling of crude oil to supply our refineries. Operating revenue and cost of sales for 2002, 2001, 2000 and 1999 have been reclassified to conform to the fourth quarter 2003 application of EITF 03-11 *Reporting Gains and Losses on Derivative Instruments That Are Subject to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not Held for Trading Purposes*, effective as of January 1, 2003. The reclassification had no effect on previously reported operating income (loss) or net income (loss). See Management s Discussion and Analysis of Financial Condition and Results of Operations 2003 Compared to 2002 incorporated by reference in this prospectus supplement.

(2) Amortization includes amortization of turnaround costs. However, this may not be permitted under Generally Accepted Accounting Principles, or GAAP, in the future. See Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Judgments and Estimates incorporated by reference in this prospectus supplement.

(3) Interest expense and financing income, net, included amortization of debt issuance costs of $9.1 million, $12.3 million, $14.9 million, $12.4 million, and $7.9 million for the years ended December 31, 2003, 2002, 2001, 2000, and 1999, respectively. Interest expense and financing income, net, also included interest on all indebtedness, net of capitalized interest and interest income.

(4) In 2002, we elected the early adoption of Statement of Financial Accounting Standard No. 145 and, accordingly, have included the gain (loss) on extinguishment of long-term debt in Income (loss) from continuing operations as opposed to as an extraordinary item, net of taxes, in our statement of operations. We have accordingly restated our statement of operations and statement of cash flows for 2001.

(5) Discontinued operations is net of an income tax benefit of $4.4 million and $11.5 million for the years ended December 31, 2003 and 2001, respectively, and an income tax provision of $21.0 million for the year ended December 31, 1999.

(6) Cash, cash equivalents, and short-term investments includes $66.6 million, $61.7 million, and $30.8 million of cash and cash equivalents restricted for debt service as of December 31, 2003, 2002, and 2001, respectively.

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RISK FACTORS

An investment in our common stock involves risks. You should consider carefully, in addition to the other information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus, the following risk factors and the risk factors contained in the accompanying prospectus before deciding to purchase any common stock.

Risks Related to the Delaware City Refinery Acquisition and Future Acquisitions

We may not realize the anticipated benefits of the Delaware City refinery acquisition.

Our estimates regarding the earnings, operating cash flow, capital expenditures and liabilities resulting from our acquisition of the Delaware City refinery may prove to be incorrect. In addition, we may not realize any synergies and we may not be successful in integrating the acquired assets into our existing business.

If we do not consummate the Delaware City refinery acquisition, we will not realize the anticipated benefits from the acquisition.

Although the information in this prospectus supplement assumes the consummation of the Delaware City refinery acquisition, the consummation is subject to the satisfaction of certain conditions precedent. Our failure to acquire the Delaware City refinery would result in our asset base being smaller than as described in this prospectus supplement. Accordingly, we would not realize the anticipated benefits we discuss in this prospectus supplement which are based on our completion of this acquisition. Additionally, if the Delaware City refinery acquisition is not consummated for any reason, we would retain broad discretion as to the use of the net proceeds of this offering and the senior notes offering and we might not be able to effectively deploy them.

We may be liable for significant environmental costs relating to the Delaware City refinery acquisition or future acquisitions.

In connection with acquisitions of refineries, we may become responsible for certain environmental clean-up liabilities or costs. The Delaware City refinery acquisition agreement provides that, subject to certain limitations, the seller shall indemnify us against certain environmental liabilities and costs to the extent related to, arising out of, resulting from, or occurring during the ownership, operation or use of the refinery assets prior to the closing. Conversely, we have agreed to indemnify the seller against environmental liabilities and costs to the extent related to, arising out of, resulting from, or occurring during the period of time after the closing. These indemnities are generally subject to a cap of $50 million, with the exception of certain matters, including outstanding consent orders involving, and ongoing cleanup projects at, the refinery, which are subject to an aggregate cap of $800 million. In addition, we have agreed to be generally responsible for costs relating to existing consent orders relating to the refinery. In particular, we have agreed to assume responsibility under an existing consent order which requires the installation of air pollution control technology to the refinery s coker and fluid catalytic cracker by 2006. The seller estimates this project to cost approximately $175 million. There can be no assurances that the seller will satisfy its obligations under this agreement, or that significant liabilities will not arise with respect to the matters we have assumed or for which we are indemnifying the seller. In addition, we may agree to be responsible for these or other types of environmental liabilities in connection with future acquisitions. There can be no assurances that these environmental liabilities and/or costs or expenditures to comply with environmental laws will not have a material adverse effect on our current or future financial condition, results of operations and cash flow.

We may not be able to consummate future acquisitions or successfully integrate the Delaware City refinery or other future acquisitions into our business.

A substantial portion of our growth over the last several years has been attributed to acquisitions. A principal component of our strategy going forward is to continue to selectively acquire refining assets in order to increase cash flow and earnings. Our ability to do so will be dependent upon a number of factors, including our ability to identify acceptable acquisition candidates, consummate acquisitions on favorable terms, successfully integrate acquired assets and obtain financing to support our growth, and many other factors beyond our control. We may not be successful in implementing our acquisition strategy and, even if implemented, such strategy may not improve our operating results. In addition, the financing of future acquisitions may require us to incur additional indebtedness, which could limit our financial flexibility.

In connection with the Delaware City refinery acquisition or with future acquisitions, we may experience unforeseen operating difficulties as we integrate the acquired assets into our existing operations. These difficulties may require significant management attention and financial resources that would otherwise be available for the ongoing development or expansion of existing operations. The Delaware City refinery acquisition and any future acquisitions involve risks, including:

- unexpected losses of key employees, customers and suppliers of the acquired operations;
- difficulties in integrating the financial, technological and management standards, processes, procedures and controls of the acquired business with those of our existing operations;
- challenges in managing the increased scope, geographic diversity and complexity of our operations; and
- mitigating contingent and/or assumed liabilities.

Risks Related to this Offering

Our use of certain federal income tax attributes will be limited as a result of this offering because we will experience an ownership change as defined in the Internal Revenue Code.

As of December 31, 2003, our consolidated group had regular federal income tax net operating loss carryforwards of approximately $420 million and alternative minimum tax net operating loss carryforwards of approximately $192 million.

For federal income tax purposes, we will, as a result of this offering, experience a stock ownership change of more than 50%, determined over the preceding three-year period. Under federal tax law, the more than 50% stock ownership change will result in an annual limitation being placed on the amount of regular and alternative minimum tax net operating losses, and certain other losses and tax credits (collectively tax attributes) that may be utilized in any given year. Accordingly, depending upon the amount of the annual limitation, our ability to utilize our tax attributes could be affected in both timing and amount. For example, the annual limitation may cause the utilization of our tax attributes to be delayed or the tax attributes to expire unutilized. A delay in utilization of our tax attributes could cause us to pay taxes in a given year that we otherwise would not have to pay in that year, thereby adversely affecting our future cash flow, and the potential expiration of our tax attributes could cause us to record additional valuation allowance, thereby negatively affecting our future net income.

Our stock price may be volatile

The market price of our common stock has been in the past, and could be in the future, subject to significant fluctuations due to the following factors, some of which are beyond our control:

- fluctuations in the market prices of crude oil, other feedstocks and refined products, which are beyond our control and may be volatile, such as announcements by OPEC members that they may reduce crude oil output in order to increase prices;
- quarterly variations in our operating results such as those related to the summer and winter driving seasons and resulting demand for unleaded gasoline and heating oil;
- operating results that vary from the expectations of securities analysts and investors;
- operating results that vary from those of our competitors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

- announcements by us or our competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- announcements by third parties of significant claims or proceedings against us;
- future sales of our common stock, for example, when lock-up agreements expire 90 days following this offering; and
- general domestic and international economic conditions.

If we or our existing stockholders sell additional shares of our common stock after this offering, the market price of our common stock could decline.

The market price of our common stock could decline as a result of sales of a large number of shares of common stock in the market after this offering, or the perception that such sales could occur. These sales, or the possibility that these sales may occur, could make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

All of the shares we are selling in this offering, plus any shares issued upon the underwriters exercise of their option to purchase additional common stock, will be freely tradable without restriction under the United States securities laws, unless purchased by our affiliates.

We, our directors and executive officers, and Blackstone Capital Partners III Merchant Banking Fund L.P. (Blackstone) and Occidental Petroleum Corporation (Occidental), our principal stockholders, owning an aggregate of 39,262,150 shares, have agreed not to offer or sell, directly or indirectly, any common stock without the permission of Morgan Stanley & Co. Incorporated for a period of 90 days from the date of this prospectus supplement, subject to certain exceptions. Sales of a substantial number of shares of our common stock following the expiration of this lock-up period could cause our stock price to fall. We continually evaluate potential refinery acquisitions. Any other significant acquisition may require us to issue shares of our common stock or securities linked to shares of our common stock to finance all or a portion of such acquisition.

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THE ACQUISITION OF THE DELAWARE CITY REFINERY

Overview of the Acquisition

On March 30, 2004, we executed an agreement with Motiva Enterprises LLC, or Motiva, to purchase its Delaware City refining assets located in Delaware City, Delaware. The purchase price is $800 million, plus the value of net working capital which we expect will be funded with available cash. In addition, Motiva will be entitled to receive from us earn-out payments of $25 million per year up to a total of $75 million over a three-year period depending on the amount of crude oil processed at the refinery and the level of industry refining margins during that period, and a $25 million payment per year up to a total of $50 million over a two-year period depending on the achievement of certain performance criteria at the gasification facility.

The Delaware City refinery has a rated crude oil throughput capacity of 180,000 bpd. We expect to have an average crude oil run rate in the low to mid 170,000 bpd range. Also included in the acquisition is a 2,400 tons per day, or tpd, petroleum coke gasification unit, a 180 megawatt cogeneration facility, 8.5 million barrels of crude oil, intermediate and blendstock, and product tankage, and a 50,000 bpd truck-loading rack.

We intend to finance the acquisition with the proceeds from this offering, PRG s senior notes offering and available cash. See Use of Proceeds.

Consummation of the acquisition is conditioned upon our securing the requisite financing. If we are unable to secure this financing and have notified Motiva of our inability to obtain such financing, we will be excused by Motiva of our obligation to purchase the Delaware City refining assets. Notification to Motiva must be accompanied by a notice from our lead investment banker regarding its opinion as to the dollar amount of equity financing available to us at such time and the terms and conditions under which such equity financing is available.

In the event that the proceeds from this offering and PRG s senior notes offering exceed $800 million in the aggregate, due to the purchase of shares by the underwriters pursuant to the over-allotment option or otherwise, we may use the additional proceeds to fund the purchase of net working capital at closing or for general corporate purposes.

The Delaware City refinery acquisition agreement provides that, subject to certain limitations, the seller shall indemnify us against certain environmental liabilities and costs to the extent related to, arising out of, resulting from, or occurring during the ownership, operation or use of the refinery assets prior to the closing. Conversely, we have agreed to indemnify the seller against environmental liabilities and costs to the extent related to, arising out of, resulting from, or occurring during the period of time after the closing. These indemnities are generally subject to a cap of $50 million, with the exception of certain matters, including outstanding consent orders involving, and ongoing cleanup projects at, the refinery, which are subject to an aggregate cap of $800 million. In addition, we have agreed to be generally responsible for costs relating to existing consent orders relating to the refinery. In particular, we have agreed to assume responsibility under an existing consent order which requires the installation of air pollution control technology to the refinery s coker and fluid catalytic cracker by 2006. The seller estimates this project to cost approximately $175 million.

Completion of the acquisition is also subject to the satisfaction of customary conditions, including regulatory approvals. The waiting period pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, applicable to the Delaware City refinery acquisition expired on March 8, 2004. The acquisition is expected to close in the second quarter of 2004. There is no assurance we will consummate the transaction.

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Delaware City Refinery

The Delaware City refinery has the capacity to process 180,000 barrels of crude oil per day and is the only crude oil refinery in the state of Delaware. It is located 15 miles south of Wilmington, Delaware on approximately 4,000 acres along the Delaware River.

The Delaware City refinery began production in 1957 as part of the Tidewater Oil Company. In 1967, the Tidewater Oil Company merged into Getty Oil Company. The refinery became an important part of Texaco s domestic refining portfolio when Texaco acquired Getty in 1984. The Delaware City refinery was part of Star Enterprise, a joint venture between Texaco and Saudi Refining from 1989 until 1998, when it became one of Motiva s four refineries.

The Delaware City refinery is the only heavy coking refinery on the East Coast of the United States with coking capacity equal to 28% of crude capacity. Only one other East Coast refiner (Valero Paulsboro) is configured with a coker. A $400 million repowering project was constructed in 2001 to enable the refinery to produce electricity and steam from petroleum coke produced at the refinery. The gasifier associated with this project has two parallel trains with a nominal capacity of 1,300 tpd each, with a design capacity of 2,400 tpd.

Feedstocks. The refinery can process a variety of heavy crude oils typically ranging from 15 to 32 API with sulfur content up to 4 wt.%, with the refinery normally being constrained by the sulfur limit of the fluid coking unit, or FCU. All crude is received by water with cargo size generally limited by draft to some 550,000 barrels. The typical refinery crude oil slate is about 50% Arabian and 50% Latin American, with the flexibility to capture spot opportunities.

The refinery has large conversion capacity with its 82,000 bpd fluid catalytic cracking unit, or FCCU, 47,000 bpd FCU and 20,000 bpd high pressure hydrocracking unit with vacuum distillation. An average of 15,000 bpd of cat-cracker feed is imported to fully load the FCCU. Hydrogen is provided via the refinery s own steam methane reformer and continuous catalytic reformer. The refinery has two sulfur recovery units with 530 long tpd capacity. The following table sets forth capacity information regarding the refinery units.

Stream-Day Capacity for Refining Units

Unit Description	Units	Capacity (bpd)
Atmospheric Crude	1	180,000
Vacuum Distillation	1	102,000
Fluid Coking Unit (FCU)	1	47,000
Fluid Catalytic Cracking Unit (FCCU)	1	82,000
Continuous Catalytic Reformer (CCR)	1	43,000
Hydrocracking Unit	1	20,000
Alkylation (sulfuric)	2	12,000 total
Hydrotreating (5 trains + SHU)	6	140,000
Sulfur Recovery, LT/d	2	530 total
MTBE, product	1	2,500
TAME, product	1	2,600
Aromatic Solvent Extraction	1	15,000

Hydrogen (SMR), kSCF/d	1	40,000
Petroleum Coke Gasification (T/D)	2	2,400
GE Frame 6 Combustion Turbines (MW)	2	180
Steam Drive Turbo Generators (MW)	4	102

We will depreciate these assets in accordance with our policies related to property, plant and equipment, and the assets have estimated useful lives of approximately 25 to 30 years.

Product Offtake. The Delaware City refinery produces about 60% motor gasoline, 35% distillates and 5% coke. Clean products are shipped via the local truck rack, pipeline and water. Conventional gasoline is shipped to markets in western Pennsylvania via the Shell pipeline to the Sun pipeline, which connects to the Laurel and

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Buckeye pipelines. Reformulated gasoline is sold into region 1 (south Delaware, Maryland, Virginia) and region 2 (north New Jersey, Pennsylvania, New York) via pipeline and/or barge.

The refinery produces 100,000 bpd of motor gasoline, of which approximately 65% is reformulated gasoline. Premium gasoline production is about 35% of the total refined product pool. The refinery produces approximately 60,000 bpd of distillates roughly split between low sulfur diesel and home heating oil. Ultra low sulfur diesel production of up to 10,000 bpd can be produced from the hydrocracker. No aviation fuel is produced, but kerosene is produced on a spot opportunity basis.

Energy. The seller recently constructed and is in the startup phase of a repowering project that includes two combined cycle combustion turbines with a maximum gross electrical output of 180 megawatts. This power production is sufficient to supply the refinery with all its electrical needs and could also sell electricity into the Pennsylvania New Jersey Maryland, or PJM, grid. The refinery also has four turbo generators that can produce 120 megawatts of electricity depending on steam production available from the refinery boilers.

Tankage Capacity. The following table sets forth certain information regarding tank capacity at the Delaware City refinery:

	Capacity in barrels (in thousands)	Number of tanks
Crude Oil	2,072	12
Intermediates and Blendstock	4,790	63
Gasoline	956	12
Distillate	648	6
Other	59	16
Total	8,525	109

Employees. The seller has indicated that the refinery employs approximately 650 employees, of whom approximately 60% are represented by a union. We have agreed to recognize and enter into a contract with the union and intend to offer employment to qualified union-represented personnel and intend to consider the non-union-represented employees as candidates for employment.

Impact of the Acquisition

We believe Delaware City refinery s historical operating performance is not indicative of the results that can be expected under our ownership of the assets. Premcor expects to run the 180,000 bpd crude oil refinery in the low to mid 170,000 bpd range, which is greater than Motiva s historical rates. The revenues and costs associated with this production level will also be significantly different as Motiva purchased crude oil and marketed refined products through its parent company relationships and contractual arrangements. We will establish new supply activities to purchase all crude oil and intermediate feedstocks for the refinery, and market products from the refinery in the wholesale and spot markets while developing our own customer base. In addition, the petroleum coke gasification unit of the refinery, which is designed to process 2,400 tpd of petroleum coke, has not been in full operation under Motiva. Motiva has only recently transitioned from the start-up phase into the operational phase for this unit during the fourth quarter of 2003 and is currently operating at approximately 450 tpd with no third party electricity sales. We intend to run this unit from 1,600 to 1,880 tpd and the refinery s petroleum coke production will be gasified to fuel the cogeneration facility, which can supply electricity and steam to the refinery. There can be no assurances that the unit will operate at our intended rate, or at all, which could cause us to seek alternative energy sources. As a result of this and various other factors, we believe we have purchased an asset, rather than a business, from the seller. Accordingly, we are not providing historical or pro forma financial statements for this acquisition. We intend to optimize the refinery s operations as part of our existing refining system.

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We believe that our acquisition of the Delaware City refinery will benefit us in the following ways:

We believe the acquisition will be accretive to our earnings per share and will generate positive cash flow from operations. The Delaware City refinery is capable of processing more than 180,000 bpd of crude oil, thus increasing our capacity base by approximately 30%. We intend to utilize the New York harbor reformulated gasoline 3/2/1, or NYH RFG 3/2/1, crack spread as a benchmark for the Delaware City refinery operations. See Management s Discussion and Analysis of Financial Condition and Results of Operations Outlook incorporated by reference in this prospectus supplement. Our ability to achieve these results depends on various factors, many of which are beyond our control, including market prices for refined products and crude oil, economic conditions, regulatory environment and unanticipated changes in the Delaware City refinery s operations. There can be no assurances that we will achieve our expected results.

Motiva and its predecessors have invested $800 million in the Delaware City refining complex over the past five years. Approximately $400 million has been spent for the petroleum coke gasification unit and cogeneration facility to convert low-value coke into electricity, steam, and commercial gases for refinery use. The gasification unit should reduce our reliance on natural gas. The remaining approximately $400 million was spent to complete the Tier II gasoline upgrade and other capital investments. The refinery is configured to meet current Tier II gasoline requirements and has demonstrated the capability to produce 10,000 bpd of ultra low sulfur diesel.

The acquisition should enhance and diversify our asset base. The acquisition of the Delaware City refinery will give us a broader more diversified asset base and increase the number of our operating refineries from three to four and our combined crude oil throughput capacity from 610,000 bpd to 790,000 bpd. The acquisition provides us with a presence in the attractive PADD I market. The Delaware City refinery has a high clean product yield with excellent conversion capabilities and increases our ability to process low cost heavy sour and high acid crude oils.

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USE OF PROCEEDS

We estimate that the net proceeds from the sale of the shares of our common stock in this offering, after deducting underwriting discounts and commissions and our estimated expenses, will be approximately $ million, or $ million if the underwriters exercise their over-allotment option in full. We expect PRG to receive gross proceeds of $400.0 million from the separate issuance of its senior notes.

We intend to contribute the net proceeds from this equity offering to PRG to finance the Delaware City refinery acquisition or for general corporate purposes. However, neither the consummation of this offering nor the consummation of the senior notes offering is contingent on the other or on the completion of the Delaware City refinery acquisition. We will retain broad discretion as to the use of the net proceeds currently allocated to the Delaware City refinery acquisition if it is not completed.

Consummation of the acquisition of the Delaware City Refinery is conditioned upon our receiving adequate financing. If we do not consummate this offering, or if the gross proceeds of this offering are less than $400.0 million, we will evaluate our financing alternatives to complete the Delaware City Refinery acquisition, including whether we will incur additional debt to finance the purchase price.

In the event that the proceeds from this offering and PRG s senior notes offering exceed $800 million in the aggregate, due to the purchase of shares by the underwriters pursuant to the underwriters exercise of their over-allotment option or otherwise, we may use the additional proceeds to fund the purchase of the Delaware City refinery net working capital or for general corporate purposes.

Pending the uses described above, we intend to invest the net proceeds in direct or guaranteed obligations of the United States, interest-bearing, investment-grade investments or certificates of deposit.

The following table sets forth the expected sources and uses of the gross proceeds of this offering and the debt offering:

	Amount
	(in millions)
Sources:	
Proceeds from this offering (contributed to PRG)	$ 400.0
Proceeds from the PRG senior notes offering	400.0
Cash	119.0
Total sources	$ 919.0
Uses:	
Purchase of Delaware City refinery and related assets	$ 800.0
Purchase of Delaware City refinery net working capital	100.0
Fees and expenses of financing transactions	19.0
Total uses	$ 919.0

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CAPITALIZATION

The following table sets forth our cash, cash equivalents and short-term investments, and capitalization as of December 31, 2003:

- on an actual basis; and
- on an as adjusted basis to reflect:
  - our receipt of the net proceeds from the sale of our common stock in this offering;
  - our receipt of the net proceeds from the senior notes offering; and
  - the use of the net proceeds from this offering and the senior notes offering as described under Use of Proceeds.

The table below should be read in conjunction with Summary Selected Financial Data in this prospectus supplement and Selected Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes to those statements incorporated by reference in this prospectus supplement.

	As of December 31, 2003	
	Actual	**As Adjusted**
	(in millions)	
Cash, cash equivalents and short term investments(1)	$ 499.2	$
Debt(2):		
Port Arthur Finance Corp.:		
12 1/2% Senior Secured Notes due 2009	$ 221.8	$ 221.8
The Premcor Refining Group Inc.:		
9 1/4% Senior Notes due 2010	175.0	175.0
6 3/4% Senior Notes due 2011	210.0	210.0
% Senior Notes due 2011 and % Senior Notes due 2014 offered separately(3)		400.0
9 1/2% Senior Notes due 2013	350.0	350.0
7 1/2% Senior Notes due 2015	300.0	300.0
7 3/4% Senior Subordinated Notes due 2012	175.0	175.0
Ohio Water Development Authority Environmental and Facilities Revenue Bonds	10.0	10.0
Obligations under capital leases	10.3	10.3
Total debt	1,452.1	1,852.1
Common stockholders equity:		

Common Stock, $0.01 par value (74,119,694 shares issued and outstanding; 87,119,694 shares issued and outstanding, as adjusted)	0.7	
Paid-in capital	1,186.8	
Retained earnings (deficit)	(42.3)	(42.3)
Total common stockholders equity	1,145.2	
Total capitalization	$ 2,597.3	$

(1) Includes $66.6 million of cash restricted for debt service.

(2) In addition, PRG has a credit facility that provides for the issuance of letters of credit and revolving loan borrowings of up to the lesser of $785 million or the amount available under a borrowing base calculation. As of December 31, 2003, $602.1 million of the line of credit was utilized for the issuance of letters of credit primarily to secure purchases of crude oil. Direct cash borrowings under the credit facility are limited to $75 million. There were no direct borrowings under the facility as of December 31, 2003. In connection with the senior notes offering and the Delaware City refinery acquisition, we must obtain various waivers and approvals under this credit facility. We have signed a commitment letter to establish a new $1 billion senior secured revolving credit facility for PRG which would replace PRG s existing $785 million credit facility. This new facility will be secured by substantially the same assets as the existing facility, will extend the maturity date to April 2009 and will modify certain covenant requirements. There are no assurances that PRG will enter into this new facility or be able to obtain the necessary waivers and approvals under its existing facility.

(3) Guaranteed by Premcor Inc.

PRICE RANGE OF COMMON STOCK AND DIVIDEND POLICY

Our common stock began trading on the NYSE on April 30, 2002 under the symbol PCO. Before that date, no public market for our common stock existed. Set forth below are the high and low closing sales prices per share of our common stock as reported on the NYSE Composite Tape.

	High	Low
Fiscal Year 2002		
Second Quarter (commencing April 30, 2002)	$ 28.25	$ 24.52
Third Quarter	24.95	15.65
Fourth Quarter	22.93	13.40
Fiscal Year 2003		
First Quarter	$ 26.00	$ 19.28
Second Quarter	25.70	20.84
Third Quarter	24.50	21.30
Fourth Quarter	26.00	22.06
Fiscal Year 2004		
First Quarter	$ 31.75	$ 25.55
Second Quarter (through April 7, 2004)	31.08	29.71

We do not anticipate paying cash dividends on our common stock in the foreseeable future. We currently intend to retain our future earnings to finance the improvement and expansion of our business. In addition, our ability to pay dividends is effectively limited by the terms of the debt instruments of our subsidiaries, which significantly restrict their ability to pay dividends directly or indirectly to us. Future dividends on our common stock, if any, will be at the discretion of our board of directors and will depend on, among other things, our results of operations, cash requirements and surplus, financial condition, contractual restrictions and other factors that our board of directors may deem relevant.

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CERTAIN U.S. TAX CONSEQUENCES TO NON-U.S. HOLDERS

General

The following summary describes the material U.S. federal income and estate tax consequences of the ownership and disposition of common stock by a Non-U.S. Holder (as defined below) as of the date hereof. This discussion does not address all aspects of U.S. federal income and estate taxes and does not deal with foreign, state and local tax consequences that may be relevant to Non-U.S. Holders in light of their personal circumstances. Special rules may apply to certain Non-U.S. Holders that are subject to special treatment under the Internal Revenue Code of 1986, as amended, or the Code, such as controlled foreign corporations, passive foreign investment companies, foreign personal holding companies, individuals who are U.S. expatriates and corporations that accumulate earnings to avoid U.S. federal income tax. Those individuals or entities should consult their own tax advisors to determine the U.S. federal, state, local and other tax consequences that may be relevant to them. Furthermore, all Non-U.S. Holders should consult their U.S. tax advisors regarding the appropriate documentation and certifications described below. The discussion below is based upon the provisions of the Code and regulations, rulings and judicial decisions thereunder as of the date hereof, and such authorities may be repealed, revoked or modified, possibly with retroactive effect, so as to result in U.S. federal income tax consequences different from those discussed below. If a partnership holds common stock, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. A holder that is a partner in a partnership holding the common stock should consult its own tax advisor. Persons considering the purchase, ownership or disposition of common stock should consult their own tax advisors concerning the U.S. federal income tax consequences in light of their particular situations as well as any consequences arising under the laws of any other taxing jurisdiction.

As used herein, a Non-U.S. Holder of common stock means a beneficial owner that is an individual or entity other than (1) a citizen or resident of the United States, (2) a corporation or partnership (or other entity properly classified as a corporation or partnership for U.S. federal income tax purposes) created or organized in or under the laws of the United States or any state thereof (including the District of Columbia), (3) an estate the income of which is subject to U.S. federal income taxation regardless of its source or (4) a trust (A) that is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons as described in section 7701(a)(30) of the Code or (B) that has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

Dividends

Dividends paid to a Non-U.S. Holder of common stock generally will be subject to withholding of U.S. federal income tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. However, dividends that are effectively connected with the conduct of a trade or business by the Non-U.S. Holder within the United States and, where a tax treaty applies, are attributable to United States permanent establishment of the Non-U.S. Holder, are not subject to the withholding tax, but instead are subject to U.S. federal income tax on a net income basis at applicable graduated individual or corporate rates as if the Non-U.S. Holder were a U.S. resident. Certain certification and disclosure requirements must be complied with in order for effectively connected income to be exempt from withholding. Any such effectively connected dividends received by a foreign corporation may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or a lower rate as may be specified by an applicable income tax treaty.

A Non-U.S. Holder of common stock who wishes to claim an exemption from, or reduction in, withholding under the benefit of an applicable treaty rate (and avoid backup withholding as discussed below) for dividends, will be required to provide us or their paying agent with an Internal Revenue Service Form W-8BEN (generally required for persons that are not partnerships or trusts) and satisfy certain certification requirements of applicable U.S. Treasury regulations. Where dividends are paid to a Non-U.S. Holder that is a partnership or other pass-through entity, persons holding an interest in the entity may also be required to provide the certification.

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A Non-U.S. Holder of common stock eligible for a reduced rate of U.S. withholding tax under an income tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the Internal Revenue Service, or the IRS.

Gain on Disposition of Common Stock

A Non-U.S. Holder generally will not be subject to U.S. federal income tax with respect to gain recognized on a sale or other disposition of common stock unless (1) the gain is effectively connected with a trade or business in the United States of the Non-U.S. Hol 10pt; FONT-FAMILY: times new roman"> 11,152

Cash flows from investing activities:		
Acquisitions of fixed assets	(6,631)	(10,605)
Proceeds from sale of fixed assets	56	263
Other, net	1,111	(337)
Net cash used by investing activities	(5,464)	(10,679)
Cash flows from financing activities:		
Increase (decrease) in notes payable, net	898	(98)
Proceeds from long-term debt	7,939	12,880
Proceeds from exercise of stock options	110	133
Purchase of treasury stock	(1,813)	(15,643)
Dividends paid	(2,333)	(2,220)
Other	(252)	19
Net cash provided (used) by financing activities	4,549	(4,929)
Effect of exchange rate changes on cash	(1,729)	1,888
Net change in cash	(2,144)	(2,568)
Cash balance:		
Beginning of period	14,447	19,508
End of period	$12,303	$16,940

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

A. Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of the Company, include all adjustments, consisting only of normal recurring items, necessary for a fair presentation of results for each period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. The Company believes that the disclosures made are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's latest Annual Report. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Certain balances in the prior fiscal year have been reclassified to conform to the presentation adopted in the current year. This reclassification impacted the Company's Condensed Consolidated Statements of Cash Flow, resulting in a transfer of $337,000 from operating activities to investing activities.

New Accounting Releases

In April 2009, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." This FSP provides additional clarification on the determination of fair value, including illustrative examples. FSP FAS 157-4 is effective for interim and annual periods beginning after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and is not expected to have a material impact on the Company's financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." This FSP provides guidance on determining whether an impairment is other than temporary, provides examples to be considered and identifies reporting requirements related to such impairments. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods beginning after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and is not expected to have a material impact on the Company's financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." This FSP 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. FSP FAS 107-1 and APB 28-1 is effective for interim periods beginning after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and is not expected to have a material impact on the Company's financial statements ..

In April 2009, the FASB issued FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies." This FSP requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated, and eliminates the requirement to disclose an estimate of the range of outcomes of recognized contingencies at the acquisition date. This FSP is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Adoption of this FSP is not expected to have a material impact on the

Company’s financial statements.

In December 2008, the FASB issued FSP 132(R)-1, “Employers’ Disclosure about Postretirement Benefit Plan Assets.” This FSP provides 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 FSP are to provide users of financial statements with an understanding of:

a) How investment allocation decisions are made;

b) The major categories of plan assets;

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c) The inputs and valuation techniques used to measure the fair value of plan assets;
d) The effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period; and
e) Significant concentrations of risk within plan assets.

The disclosures about plan assets required by this FSP are required for fiscal years ending after December 15, 2009, and earlier application is permitted. This FSP is not expected to have a material impact on the Company's financial statements.

In April 2008, the FASB issued FSP 142-3, "Determination of the Useful Life of Intangible Assets." This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of Financial Accounting Standard ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," and other U.S. generally accepted accounting principles. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. This FSP is not expected to have a material impact on the Company's financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – An Amendment of FASB Statement No. 133." This statement enhances the disclosures regarding derivatives and hedging activities by requiring:

- Disclosure of the objectives for using derivative instruments in terms of underlying risk and accounting designation;
- Disclosure of the fair values of derivative instruments and their gains and losses in a tabular format;
- Disclosure of information about credit-risk-related contingent features; and
- Cross-reference from the derivative footnote to other footnotes in which derivative-related information is disclosed.

SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company has adopted SFAS No. 161 in its fiscal third quarter, however these disclosures were considered immaterial due to the nature and fair value of the derivatives held by the Company at March 27, 2009.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." This statement will significantly change the accounting for business combinations, requiring the acquiring entity to recognize the acquired assets and liabilities at the acquisition date fair value with limited exceptions. The statement also includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual report period beginning on or after December 15, 2008. Earlier adoption is prohibited. Accordingly, the Company will be subject to SFAS No. 141(R) beginning on July 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51." SFAS No. 160 establishes 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. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. Adoption of SFAS No. 160 is not expected to have a material impact on the financial statements of the Company.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115." This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company adopted SFAS No. 159 in the first quarter of fiscal 2009 with no material impact to the financial statements. The Company has currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with accounting principles generally accepted in the United States.

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. On February 12, 2008, the FASB issued FSP 157-2 which delays the effective date of SFAS No. 157 for one year, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS No. 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 157 in the first quarter of fiscal 2009 for those assets and liabilities not subject to the one year deferral granted in FSP 157-2, with no material impact to the financial statements. The Company is currently evaluating the impact of adopting SFAS No. 157 for the assets and liabilities subject to the one year deferral granted under FSP 157-2, for which SFAS No. 157 will become effective for fiscal years beginning after November 15, 2008.

In September 2006 and March 2007, respectively, the FASB ratified Emerging Issues Task Force ("EITF") Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" and Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements." These EITF's address the possible recognition of a liability and related compensation costs for split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. EITF 06-4 and 06-10 are effective for fiscal years beginning after December 15, 2007, including interim periods within those years. The Company adopted these EITF's in the first quarter of fiscal 2009 with no material impact to the financial statements.

During June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements by standardizing the level of confidence needed to recognize uncertain tax benefits and the process for measuring the amount of benefit to recognize. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 as of July 1, 2007, with no material impact to the Company's financial statements.

B. Inventory

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

	March 27, 2009	June 30, 2008
Inventories:		
Finished parts	$ 61,793	$ 53,697
Work in process	12,174	20,725
Raw materials	23,939	23,269
	$ 97,906	$ 97,691

The year end fiscal 2008 figures were revised to reflect subcomponents in raw materials rather than finished parts. Finished parts now more properly reflects goods in a saleable state.

C. Warranty

The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers. However, its warranty obligation is affected by product failure rates, the 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. The following is a listing of the activity in the warranty reserve during the three and nine month periods ended March 27, 2009 and March 28, 2008 (in thousands).

	Three Months Ended				Nine Months Ended			
	Mar. 27, 2009		Mar. 28, 2008		Mar. 27, 2009		Mar. 28, 2008	
Reserve balance, beginning of period	$	8,231	$	7,802	$	8,125	$	7,266
Current period expense		2,068		1,191		4,175		3,333
Payments or credits to customers		(2,372)		(1,151)		(3,928)		(3,089)
Translation		(161)		279		(606)		611
Reserve balance, end of period	$	7,766	$	8,121	$	7,766	$	8,121

D. Contingencies

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

E. Business Segments

Information about the Company's segments is summarized as follows (in thousands):

	Three Months Ended				Nine Months Ended			
	Mar. 27, 2009		Mar. 28, 2008		Mar. 27, 2009		Mar. 28, 2008	
Manufacturing segment sales	$	65,931	$	78,689	$	201,308	$	214,881
Distribution segment sales		25,741		28,702		83,712		84,328
Inter/Intra segment elimination - manufacturing		(16,738)		(16,014)		(45,973)		(44,469)
Inter/Intra segment elimination - distribution		(5,642)		(5,539)		(15,485)		(13,395)
Net sales	$	69,292	$	85,838	$	223,562	$	241,345
Manufacturing segment earnings	$	3,165	$	9,033	$	11,608	$	25,849
Distribution segment earnings		1,531		2,011		7,026		7,251
Corporate and eliminations		(1,637)		(337)		(6,175)		(7,011)
Earnings before income taxes and minority interest	$	3,059	$	10,707	$	12,459	$	26,089

Assets	Mar. 27, 2009		June 30, 2008	
Manufacturing segment assets	$	351,988	$	369,842
Distribution segment assets		66,268		67,223
Corporate assets and elimination of inter-company assets		(139,251)		(132,437)
	$	279,005	$	304,628

F. Stock-Based Compensation

In fiscal 2009 and 2008, the Company granted a target number of 88,500 and 52,758 performance stock unit awards, respectively, to various employees of the Company, including executive officers. The performance stock unit awards granted in fiscal 2009 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2011. The performance stock unit awards granted in fiscal 2009 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 106,200. Based upon actual results to

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date, the Company is accruing the performance stock unit awards granted in fiscal 2009 at the target payout level. The performance stock unit awards granted in fiscal 2008 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2010. The performance stock unit awards granted in fiscal 2008 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 63,310. Based upon actual results to date, the Company is accruing the performance stock unit awards granted in fiscal 2008 at the targeted payout level. There were 214,300 and 202,178 unvested stock unit awards outstanding at March 27, 2009 and March 28, 2008, respectively. The performance stock unit awards are remeasured at fair-value (based upon the Company's stock price) at the end of each reporting period. The fair-value of the stock unit awards are expensed over the performance period for the shares that are expected to ultimately vest. Compensation expense (income) for the three and nine months ended March 27, 2009, related to the performance stock unit awards, approximated $64,000 and $(607,000), respectively. Compensation (income) for the three and nine months ended March 28, 2008, related to the performance stock unit awards, approximated $(1,888,000) and $(638,000), respectively.

In fiscal 2009 and 2008, the Company granted a target number of 66,500 and 37,310 performance stock awards, respectively, to various employees of the Company, including executive officers. The performance stock awards granted in fiscal 2009 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2011. The performance stock awards granted in fiscal 2009 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 79,800. Based upon actual results to date, the Company is accruing the performance stock awards granted in 2009 at the targeted payout level. The performance stock awards granted in fiscal 2008 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2010. The performance stock awards granted in fiscal 2008 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 44,772. Based upon actual results to date, the Company is accruing the performance stock awards granted in fiscal 2008 at the target payout level. There were 176,868 and 218,558 unvested stock awards outstanding at March 27, 2009 and March 28, 2008, respectively. The fair value of the stock awards (on the date of grant) is expensed over the performance period for the shares that are expected to ultimately vest. Compensation expense for the three and nine months ended March 27, 2009, related to performance stock awards, approximated $320,000 and $920,000, respectively. Compensation expense for the three and nine months ended March 28, 2008, related to performance stock awards, approximated $244,000 and $695,000, respectively.

In addition to the performance shares mentioned above, the Company has unvested restricted stock outstanding that will vest if certain service conditions are fulfilled. The fair value of the restricted stock grants is recorded as compensation expense over the vesting period, which is generally 1 to 4 years. During fiscal 2009 and 2008, the Company granted 17,700 and 7,200 service based restricted shares, respectively, to employees and non-employee directors in each year. There were 23,700 and 20,000 unvested shares outstanding March 27, 2009 and March 28, 2008, respectively. Compensation expense for the three and nine months ended March 27, 2009, related to restricted stock grants, approximated $43,000 and $164,000, respectively. Compensation expense for the three and nine months ended March 28, 2008, related to restricted stock grants, approximated $43,000 and $111,000, respectively.

G. Pension and Other Postretirement Benefit Plans

The Company has non-contributory, qualified defined benefit plans covering substantially all domestic employees hired prior to October 1, 2003 and certain foreign employees. Additionally, the Company provides health care and life insurance benefits for certain domestic retirees. Components of net periodic benefit cost for the defined benefit pension plans and other postretirement benefit plan are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	Mar. 27, 2009	Mar. 28, 2008	Mar. 27, 2009	Mar. 28, 2008
Pension Benefits:				
Service cost	$ 298	$ 305	$ 885	$ 896
Interest cost	1,769	1,738	5,296	5,190
Expected return on plan assets	(2,237)	(2,411)	(6,698)	(7,206)
Amortization of prior service cost	(180)	(180)	(539)	(539)
Amortization of transition obligation	17	21	48	52
Amortization of net loss	801	428	2,402	1,282
Net periodic benefit cost (income)	$ 468	$ (99)	$ 1,394	$ (325)
Postretirement Benefits:				
Service cost	$ 9	$ 9	$ 28	$ 28
Interest cost	325	341	973	1,025
Amortization of net loss	137	133	412	399
Net periodic benefit cost	$ 471	$ 483	$ 1,413	$ 1,452

The Company previously disclosed in its financial statements for the year ended June 30, 2008, that it expected to contribute $302,000 to its pension plan in fiscal 2009. As of March 27, 2009, $227,000 in contributions have been made.

H. Income Taxes

The Company has approximately $797,000 of unrecognized tax benefits as of March 27, 2009 which, if recognized, would favorably impact the effective tax rate. We anticipate the decline of approximately $90,000 of unrecognized tax benefits during the next twelve months.

During the three months ended March 27, 2009, unrecognized tax benefits increased approximately $172,000 due mainly to a change in the estimated realization of research and development credits.

Annually, we file income tax returns in various taxing jurisdictions inside and outside the United States. In general, the tax years that remain subject to examination are 2003 through 2008 for our major operations in the U.S., Italy, Belgium, and Japan. The U.S. Internal Revenue Service is currently auditing our consolidated income tax return for fiscal 2006. Other audits currently underway include those in Singapore and Italy. It is reasonably possible that at least one of these audit cycles will be completed during fiscal 2009.

We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of March 27, 2009, total accrued interest and penalties with respect to income taxes was approximately $102,000 that would favorably affect the effective tax rate if recognized.

I. Goodwill and Other Intangibles

The changes in the carrying amount of goodwill, substantially all of which is allocated to the manufacturing segment, for the nine months ended March 27, 2009 were as follows (in thousands):

Balance at June 30, 2008	$	18,479
Translation adjustment		(1,828)
Balance at March 27, 2009	$	16,651

The gross carrying amount and accumulated amortization of the Company's intangible assets that have defined useful lives and are subject to amortization as of March 27, 2009 and June 30, 2008 are as follows (in thousands):

	March 27, 2009	June 30, 2008
Intangible assets with finite lives:		
Licensing agreements	$ 3,015	$ 3,015
Non-compete agreements	2,050	2,050
Other	5,991	5,991
	11,056	11,056
Accumulated amortization	(5,936)	(5,176)
Translation adjustment	207	1,235
Total	$ 5,327	$ 7,115

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The weighted average remaining useful life of the intangible assets included in the table above is approximately 8 years.

Intangible amortization expense was $244,000 and $760,000 for the three and nine months ended March 27, 2009, respectively, and $242,000 and $712,000 for the three and nine months ended March 28, 2008, respectively. Estimated intangible amortization expense for the remainder of fiscal 2009 and each of the next five fiscal years is as follows (in thousands):

Fiscal Year		
2009	$	232
2010		724
2011		724
2012		724
2013		682
2014		682

The gross carrying amount of the Company's intangible assets that have indefinite lives and are not subject to amortization as of March 27, 2009 and June 30, 2008 are $2,039,000 and $2,474,000, respectively. These assets are comprised of acquired tradenames.

J. Long-term Debt

Notes payable and long-term debt at March 27, 2009 and June 30, 2008 consisted of the following (in thousands):

		March 27, 2009		June 30, 2008
Revolving loan	$	28,300	$	19,700
10-year unsecured senior notes		25,000		25,000
Notes payable		-		1,010
Other		4,708		4,247
Subtotal		58,008		49,957
Less: current maturities and short-term borrowings		(2,313)		(1,730)
Total long-term debt	$	55,695	$	48,227

At March 27, 2009, the Company is in compliance with all covenants and other requirements set forth in its revolving loan and note agreements.

K. Shareholders' Equity

In October 2007, the Board of Directors approved a two-for-one stock split of the Company's outstanding common stock. The split was issued on December 31, 2007 to shareholders of record at the close of business on December 10, 2007. The split increased the number of shares outstanding to approximately 11.4 million from approximately 5.7 million. The Condensed Consolidated Financial Statements and Notes thereto, including all share and per share data, have been restated as if the stock split had occurred as of the earliest period presented.

On July 27, 2007, the Board of Directors authorized the purchase of up to 200,000 shares of Common Stock at market values. This resolution superseded the resolution previously adopted by the Board in January 2002. On August 14, 2007, the Board of Directors authorized the purchase of an additional 200,000 shares of Common Stock at market values. On February 1, 2008, the Board of Directors authorized the purchase of an additional 500,000 shares of Common Stock at market values. The Company purchased 250,000 shares of its outstanding Common Stock in the second quarter of fiscal 2009 at an average price of $7.25 per share for a total cost of $1,813,000. In fiscal 2008, the Company repurchased 660,000 shares of its outstanding Common Stock at an average price of $23.70 per share at a total cost of $15,643,000.

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Item 2. Management Discussion and Analysis

In the financial review that follows, we discuss our results of operations, financial condition and certain other information. This discussion should be read in conjunction with our consolidated fiscal 2008 financial statements and related notes.

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

In addition to the assumptions and information referred to specifically in the forward-looking statements, other factors, including but not limited to those factors discussed under Item 1A, Risk Factors, of the Company's Annual Report filed on Form 10-K for June 30, 2008 could cause actual results to be materially different from what is presented here.

Results of Operations

(In thousands)

	Three Months Ended				Nine Months Ended			
	March 27, 2009	%	March 28, 2008	%	March 27, 2009	%	March 28, 2008	%
Net sales	$ 69,292		$ 85,838		$ 223,562		$ 241,345	
Cost of goods sold	50,141		59,211		161,386		165,522	
Gross profit	19,151	27.6%	26,627	31.0%	62,176	27.8%	75,823	31.4%
Marketing, engineering and administrative expenses	14,517	21.0	14,969	17.4	47,843	21.4	47,041	19.5
Earnings from operations	$ 4,634	6.7	$ 11,658	13.6	$ 14,333	6.4	$ 28,782	11.9

Comparison of the Third Quarter of FY 2009 with the Third Quarter of FY 2008

Net sales for the third quarter decreased 19.3%, or $16.5 million, to $69.3 million from $85.8 million in the same period a year ago. Compared to the third quarter of fiscal 2008, the U.S. Dollar strengthened against the Euro and Asian currencies. The translation effect of this strengthening on foreign operations was to decrease revenues by approximately $2.9 million versus the prior year, before eliminations. Adjusting for the impact of foreign currency translation on the third fiscal quarter, sales would have been down just under 16% versus the same period last fiscal year. The decline in sales for the fiscal 2009 third quarter was primarily due to lower sales of products to customers in the mega yacht, oil and gas, and industrial markets. This was partially offset by higher sales to customers in the commercial marine, land-based military and airport rescue fire fighting (ARFF) markets.

Sales at our manufacturing segment were down 16.2%, or $12.8 million, to $65.9 million from $78.7 million in the same period last year. Compared to the third quarter of fiscal 2008, the U.S. Dollar strengthened against the Euro and Asian currencies. The translation effect of this strengthening on foreign manufacturing operations was to decrease revenues by approximately $3.0 million versus the prior year, before eliminations. Sales at our U.S. domestic manufacturing locations were down just under 7%. Continued softening in transmission sales for the land-based oil and gas market, and lower propulsion system and industrial product shipments were only partially offset by improved shipments for the commercial marine product markets. Sales at our Belgian manufacturing location were down approximately 12% over the same period last year. Adjusting for the negative translation effect of a weakening Euro versus the U.S. Dollar, sales were down just over 2%. Our Italian manufacturing operations saw a nearly 46% decrease in sales compared to fiscal 2008's third quarter. The majority of this decrease is due to decreased sales of low horsepower marine transmissions and propulsion systems for the Italian and European pleasure craft and mega yacht markets. In addition, there was a softening in industrial product markets in the Italian and European market. Just under one-fifth of the decrease can be attributed to the translation effect of a strengthening U.S. Dollar versus the third quarter of last fiscal year. The Company's Swiss manufacturing operation, which manufactures propellers for high-end pleasure craft and military patrol boat applications, experienced a 38% decrease in sales versus the prior year's third fiscal quarter. The Company continued to experience a decrease in order activity, cancellations and retiming of orders for pleasure craft marine transmission, boat management and propulsion systems for the global mega yacht market.

Our distribution segment experienced a decrease of 10.3% in sales, or $3.0 million, to $25.7 million from $28.7 million in the same period a year ago. Compared to the third quarter of fiscal 2008, the U.S. Dollar strengthened against the Euro and Asian currencies. The translation effect of this strengthening on foreign distribution operations was to decrease revenues by approximately $1.5 million versus the prior year, before eliminations. The Company's distribution operations in Italy and Australia saw double digit decreases in pleasure craft marine transmission and boat management system product sales. This was partially offset by continued strength in commercial marine transmission sales at the Company's distribution operations in Asia.

The elimination for net inter/intra segment sales increased $0.8 million, accounting for the remainder of the net change in sales versus the same period last year. This change is primarily due to an increase in shipments from our Japanese joint venture to our distributor in Singapore, due to strong demand in the Asia Pacific region for the high horsepower marine transmissions produced in Japan.

Gross profit as a percentage of sales decreased to 27.6% of sales, compared to 31.0% of sales for the same period last year. This 340 basis point deterioration can be attributed to reduced sales of higher margin products, higher sales of lower margin products, increased warranty costs ($0.9 million), and an increase in domestic pension expense ($0.4 million). In addition, the Company's Belgian operation's gross profit was favorably affected by the continued relative strength of the U.S. Dollar versus the Euro, 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. It is estimated that the year-over-year effect of the stronger U.S. Dollar was to improve margins at our Belgian subsidiary by over $0.8 million in the third fiscal quarter versus the same period a year ago. Compared to the third quarter of fiscal 2008, the U.S. Dollar strengthened against the Euro and Asian currencies. The translation effect of this strengthening on foreign operations was to decrease gross margin by approximately $0.9 million versus the prior year, before eliminations.

Marketing, engineering, and administrative (ME&A) expenses were 3.0% lower compared to last year's third fiscal quarter. However, due to lower sales volume, ME&A expenses as a percentage of sales were up 3.6 percentage points to 21.0% of sales versus 17.4% of sales in the third quarter of fiscal 2008. For the third quarter of fiscal 2009, stock based compensation expense totaled $0.4 million compared to income of $1.6 million for the third quarter of fiscal 2008, for a net year-over-year increase of $2.0 million. Fiscal 2008's third quarter included a $2.3 million reversal of stock based compensation expense, which reflected the decline of the Company's stock price during that quarter a year ago. In addition, expenses related to the Company's corporate and domestic incentive programs decreased $1.5 million versus the third quarter of fiscal 2008, due to the overall decline in financial performance year-over-year. This was partially offset by increased IT costs of $0.3 million, primarily depreciation expense, associated with the Company's new ERP system and higher domestic pension expenses of $0.2 million. The net impact of foreign currency translation from overseas operations reduced ME&A expenses by approximately $0.8 million when compared to the same period of the prior fiscal year.

Interest expense of $0.5 million was down over 30% compared to fiscal 2008's third quarter. In the third quarter of fiscal 2009 and 2008, the Company incurred interest of $0.4 million on the $25 million of Senior Notes that were entered into in April 2006. In addition, for the third quarter of fiscal 2008, the interest rate on the Company's revolving credit facility was in the range of 4.36% to 5.85%, whereas for the third quarter of fiscal 2009 the range was 1.67% to 1.75%. At the same time, the average balance of the Company's revolving credit facility increased slightly versus the prior year. However, as a result of the lower interest rate, total interest on the revolver decreased just over $0.2 million.

Other expense of $1.0 million for the quarter was up approximately $0.9 million from the prior year primarily due to exchange losses caused by the strengthening of the U.S. Dollar versus the Japanese Yen.

The effective tax rate for 2009's third fiscal quarter of 11.8 percent improved over the prior year rate of 25.4 percent due primarily to a 5.9 percent reduction in the Italian corporate tax rate effective with the start of fiscal 2009, a shift in earnings to lower tax subsidiaries, the impact of foreign tax credits on the domestic tax rate and provision to return adjustments recorded in the third quarter based on changes in estimates. These favorable items were partially offset by an additional reserve recorded due to a change in the estimate of realization of research and development tax credits during the fiscal 2009 third quarter.

Comparison of the First Nine Months of FY 2009 with the First Nine Months of FY 2008

Net sales for the first nine months of fiscal 2009 decreased 7.4%, or $17.8 million, to $223.6 million from $241.3 million in the same period a year ago. Compared to the first nine months of fiscal 2008, the Euro and Asian currencies weakened, on average, against the U.S. Dollar. The translation effect of this weakening on foreign operations was to decrease revenues by approximately $1.4 million versus the prior year. The Company's North American manufacturing operations saw a continued softening in demand for the Company's oil and gas transmission products and saw continued weakness in its marine propulsion system shipments for the mega yacht segment of the marine pleasure craft market. This was partially offset by year-over-year increases in the Company's industrial product and commercial marine transmission sales. In addition, vehicular transmission sales for the airport rescue and fire fighting (ARFF) and military markets remained steady. Overseas, the Company experienced particularly strong increases in sales at our distribution operations in Asia, which serve commercial marine markets. However, significant softening was experienced in the third fiscal quarter for propulsion and boat management systems for the global mega yacht segment of the pleasure craft market. As a result, through nine months these product markets are now experiencing a year-over-year decline.

Sales at our manufacturing segment were down 6.3%, or $13.6 million, to $201.3 million from $214.9 million in the same period last year. Year-to-date, sales at our U.S. domestic manufacturing locations were down almost 8%. This was primarily due to the continued slow down in sales of land based transmissions for the oil and gas markets and lower sales of propulsion systems for the European mega yacht. This was partially offset by improved year-over-year sales of commercial marine transmissions. On a year-to-date basis, sales of industrial products as well as vehicular transmissions for the ARFF and military markets remained steady. Sales at the Company's Belgian manufacturing operation are up nearly 4% through the first nine months. The prior fiscal year's first nine months was unfavorably affected by material shortages and equipment downtime, as progress continued on the plant re-layout associated with the June 2007 restructuring program. Our Italian manufacturing operations saw a significant decrease in sales in the third fiscal quarter compared to the prior fiscal year, as noted above. As a result, sales for the first nine months are down over 17% versus the first nine months of fiscal 2008. The decrease can be primarily attributed to decreased sales of low horsepower marine transmissions for the Italian and European pleasure craft as well as lower sales of boat management systems for the Italian mega yacht market. The Company's Swiss manufacturing operation, which manufactures propellers for high end pleasure craft and military patrol boat applications, experienced a 9.0% increase in sales versus the prior year's first nine months. However, as noted above there was a significant fall off in third quarter shipments versus the prior fiscal year's third quarter. As noted above, the Company did experience a decrease in order activity, cancellations and retiming of orders for pleasure craft marine transmission, boat management and propulsion systems for the global mega yacht market starting late in the second fiscal quarter of 2009, which accelerated in the third fiscal quarter of 2009.

Our distribution segment experienced a slight decrease of 0.7% in sales, or $0.6 million, to $83.7 million from $84.3 million in the same period a year ago. The Company's Asian distribution operations in Singapore and joint venture in Japan saw significant growth in the commercial marine transmission markets. Partially offsetting these increases, the Company's distribution operations in Italy and Australia saw double digit decreases in pleasure craft marine transmission and boat management system product sales. Compared to the first nine months of fiscal 2008, the Euro and Asian currencies weakened, on average, against the U.S. Dollar. The translation effect of this weakening on foreign distribution operations was to decrease revenues by approximately $0.7 million versus the prior year, before eliminations.

The elimination for net inter/intra segment sales increased $3.6 million, accounting for the remainder of the net change in sales versus the same period last year. This change is primarily due to an increase in shipments from our Japanese joint venture to our distributor in Singapore, due to strong demand in the Asia Pacific region for the high horsepower marine transmissions produced in Japan.

Gross profit as a percentage of sales decreased to 27.8% of sales, compared to 31.4% of sales for the same period last year. This 360 basis point deterioration can be attributed to reduced sales of higher margin products, higher sales of lower margin products, increased warranty costs ($0.8 million), and an increase in domestic pension expense ($1.2 million) partially offset by higher pricing and expanded outsourcing. In addition, the Company's Belgian operation's gross profit was favorably affected by the continued relative strength of the U.S. Dollar versus the Euro, 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. It is estimated that the year-over-year effect of the stronger U.S. Dollar was to improve margins at our Belgian subsidiary by over $1.0 million in the first nine months of fiscal 2009 versus the same period a year ago. Compared to the first nine months of fiscal 2008, the U.S. Dollar strengthened against the Euro and Asian currencies. The translation effect of this strengthening on foreign operations was to decrease gross margin by approximately $1.8 million versus the prior year, before eliminations.

Marketing, engineering, and administrative (ME&A) expenses were 1.7% higher compared to last year's first nine months. ME&A expenses as a percentage of sales were up 1.9 percentage points to 21.4% of sales versus 19.5% of sales in the first nine months of fiscal 2008. On a year-to-date basis, expenses related to the Company's corporate and domestic incentive programs decreased $2.3 million versus the first nine months of fiscal 2008, due to the overall decline in financial performance year-over-year. This was offset by increased IT costs of $1.4 million, primarily depreciation expense, associated with the Company's new ERP system and higher domestic pension expenses of $0.5 million. In addition, there were severance costs of $1.3 million booked in the second fiscal quarter of 2009. For the first nine months of fiscal 2009, stock based compensation expense totaled $0.5 million compared to $0.2 million for the first nine months of fiscal 2008. As noted above, fiscal 2008's third quarter included a $2.3 million reversal of stock based compensation expense, which reflected the decline of the Company's stock price during that quarter a year ago. The net impact of foreign currency translation from overseas operations reduced ME&A expenses by approximately $0.8 million when compared to the same period of the prior fiscal year.

Interest expense of $1.8 million was down 21% compared to fiscal 2008's first nine months. In the first nine months of fiscal 2009 and 2008, the Company incurred interest of $1.1 million on the $25 million of Senior Notes that were entered into in April 2006. In addition, for the first nine months of fiscal 2008, the interest rate on the Company's revolving credit facility was in the range of 4.36% to 6.97%, whereas for the first nine months of fiscal 2009 the range was 1.67% to 4.00%. At the same time, the average balance of the Company's revolving credit facility increased slightly versus the prior year. However, as a result of the lower interest rate, total interest on the revolver decreased just over $0.5 million.

Year-to-date, the effective tax rate of 29.2 percent improved over the prior year rate of 33.3 percent due primarily to a 5.9 percent reduction in the Italian corporate tax rate effective with the start of fiscal 2009, a shift in earnings to lower tax subsidiaries and the impact of foreign tax credits on the domestic tax rate.

Financial Condition, Liquidity and Capital Resources

Comparison between March 27, 2009 and June 30, 2008

As of March 27, 2009, the Company had net working capital of $108.6 million, which represents an increase of $2.5 million, or 2%, from the net working capital of $106.1 million as of June 30, 2008.

Cash decreased 14.8% to $12.3 million as of March 27, 2009. The majority of the cash as of March 27, 2009 is at the Company's overseas operations in Europe and Asia-Pacific. Of the nearly $2.1 million decrease since the start of the fiscal year, roughly $1.7 million can be attributed to effect of exchange rate changes on cash.

Trade receivables of $55.1 million were down $12.5 million from last fiscal year-end. The effect of foreign currency translation due to the strengthening U.S. Dollar versus the Euro and Asian currencies was to decrease trade accounts receivables by just under $7.2 million versus the end of the prior fiscal year. The overall decrease in accounts receivable was consistent with the lower sales volume experienced in the last two fiscal quarters. Due to the global economic slowdown, the Company began to see an increase in requests for extended payment terms beyond its customary practice in the second fiscal quarter and into the third fiscal quarter. Management continues to actively monitor accounts receivables and work with customers on a global basis.

Net inventory increased by $0.2 million, or 0.2%, versus June 30, 2008 to $97.9 million. The effect of foreign currency translation due to the strengthening U.S. Dollar versus the Euro and Asian currencies was to decrease net inventories by just under $12 million versus the end of the prior fiscal year. The majority of the net increase in inventory, after the effect of foreign exchange, came at the Company's domestic manufacturing location and Asian distribution operation. The increase at the Company's domestic manufacturing operation is the result of customer reschedules and the impact of dual sourcing of component parts as we transition to low-cost suppliers. The increase at the Asian distribution operation can be attributed to the timing of shipments to customers. On a consolidated basis, as of March 27, 2009, the Company's backlog of orders to be shipped over the next six months approximates

$81.5 million, down 33% since the year began and 35% compared with the same period a year ago. Of the $39.2 million decrease experienced since the beginning of the fiscal year, approximately $4.7 million can be attributed to the effect of foreign currency translation. The reduction of inventory levels at both the Company's manufacturing and distribution operations around the world continues to be a priority for the balance of fiscal 2009 and beyond.

Net property, plant and equipment (PP&E) decreased $4.3 million versus June 30, 2008. This includes the addition of $6.6 million in capital expenditures, primarily at the Company's domestic and Belgian manufacturing operations, which was offset by depreciation of $6.5 million. The net remaining decrease of $4.4 million is due to the effects of foreign currency translation. As a result of current external business factors, the Company has revised its capital expenditure projection for the year and now expects to invest between $10 and $12 million in capital assets in fiscal 2009, compared to its prior estimate of between $15 and $17 million. The quoted lead times on certain manufacturing equipment purchases may push some of the capital expenditures into the next fiscal year. This compares to $15.0 million in capital expenditures in fiscal 2008, $15.7 million in fiscal 2007 and $8.4 million in fiscal 2006. The Company's capital program is focusing on modernizing key core manufacturing, assembly and testing processes at its facilities around the world as well as the implementation of the global ERP system.

Accounts payable as of March 27, 2009 of $31.8 million were down $6.1 million, or 16.1%, from June 30, 2008. The effect of foreign currency translation due to the strengthening U.S. Dollar versus the Euro and Asian currencies was to decrease accounts payable by just under $2.7 million versus the end of the prior fiscal year. The net remaining decrease after adjusting for the impact of foreign currency translation is primarily the result of the overall downturn in business, decrease in the order backlog and the focus on reducing inventory levels.

Total borrowings, notes payable and long-term debt, as of March 27, 2009 increased by $8.1 million, or 16%, to $58.0 million versus June 30, 2008. This increase was driven by the increase in working capital, primarily inventory, the payment of annual incentive and bonus awards for fiscal 2008 performance in the first fiscal quarter of 2009 and a $1.8 million stock repurchase in the fiscal second quarter, partially offset by net cash provided by operating activities. In the second fiscal quarter, the Company repurchased 250,000 shares of its outstanding common stock at an average price of $7.25 per share. For the balance of fiscal 2009, the Company is not required to make any additional contributions to its domestic defined benefit plans. However, based on overall financial performance and cash flows, the Company may elect to make further contributions beyond those required. At March 27, 2009, the Company is in compliance with all covenants and other requirements set forth in its revolving loan and note agreements. The first installment of $3.6 million on the Company's unsecured $25 million 6.05% Senior Notes is due in April 2010.

Total shareholders' equity decreased by $12.7 million to a total of $117.0 million. Retained earnings increased by $6.4 million. The net increase in retained earnings included $8.7 million in net earnings reported year-to-date, offset by $2.3 million in dividend payments. Net unfavorable foreign currency translation of $19.6 million was reported as the U.S. Dollar strengthened against the Euro and Asian currencies during the first nine months of fiscal 2009. The remaining movement of $1.4 million represents an adjustment for the amortization of net actuarial loss and prior service cost on the Company's pension plans.

The Company's balance sheet remains strong, there are no off-balance-sheet arrangements, and we continue to have sufficient liquidity for near-term needs. As of March 27, 2009, the Company had available borrowings under its $35 million revolving line of credit of nearly $7 million. Furthermore, the Company has over $12 million in cash at its subsidiaries around the world, approximately 45% of which is considered permanently reinvested. Management believes that available cash, our revolver facility, cash generated from operations, existing lines of credit and access to debt markets will be adequate to fund our capital requirements for the foreseeable future.

As of March 27, 2009, the Company has obligations under non-cancelable operating lease contracts and a senior note agreement 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
Short-term borrowing	$1,652	$1,652			
Revolver borrowing	$28,300		$28,300		
Long-term debt	$28,056	$661	$4,421	$8,584	$14,390
Operating leases	$12,992	$3,250	$5,812	$3,637	$293
Total obligations	$71,000	$5,563	$38,533	$12,221	$14,683

New Accounting Releases

In April 2009, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." This FSP provides additional clarification on the determination of fair value, including illustrative examples. FSP FAS 157-4 is effective for interim and annual periods beginning after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and is not expected to have a material impact on the Company's financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." This FSP provides guidance on determining whether an impairment is other than temporary, provides examples to be considered and identifies reporting requirements related to such impairments. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods beginning after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and is not expected to have a material impact on the Company's financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." This FSP 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. FSP FAS 107-1 and APB 28-1 is effective for interim periods beginning after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and is not expected to have a material impact on the Company's financial statements ..

In April 2009, the FASB issued FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies." This FSP requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated, and eliminates the requirement to disclose an estimate of the range of outcomes of recognized contingencies at the acquisition date. This FSP is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Adoption of this FSP is not expected to have a material impact on the Company's financial statements.

In December 2008, the FASB issued FSP 132(R)-1, "Employers' Disclosure about Postretirement Benefit Plan Assets." This FSP provides 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 FSP are to provide users of financial statements with an understanding of:

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

The disclosures about plan assets required by this FSP are required for fiscal years ending after December 15, 2009, and earlier application is permitted. This FSP is not expected to have a material impact on the Company's financial statements.

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In April 2008, the FASB issued FSP 142-3, "Determination of the Useful Life of Intangible Assets." This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of Financial Accounting Standard ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," and other U.S. generally accepted accounting principles. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. This FSP is not expected to have a material impact on the Company's financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – An Amendment of FASB Statement No. 133." This statement enhances the disclosures regarding derivatives and hedging activities by requiring:

- Disclosure of the objectives for using derivative instruments in terms of underlying risk and accounting designation;
- Disclosure of the fair values of derivative instruments and their gains and losses in a tabular format;
- Disclosure of information about credit-risk-related contingent features; and
- Cross-reference from the derivative footnote to other footnotes in which derivative-related information is disclosed.

SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company has adopted SFAS No. 161 in its fiscal third quarter, however these disclosures were considered immaterial due to the nature and fair value of the derivatives held by the Company at March 27, 2009.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." This statement will significantly change the accounting for business combinations, requiring the acquiring entity to recognize the acquired assets and liabilities at the acquisition date fair value with limited exceptions. The statement also includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual report period beginning on or after December 15, 2008. Earlier adoption is prohibited. Accordingly, the Company will be subject to SFAS No. 141(R) beginning on July 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51." SFAS No. 160 establishes 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. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. Adoption of SFAS No. 160 is not expected to have a material impact on the financial statements of the Company.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115." This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company adopted SFAS No. 159 in the first quarter of fiscal 2009 with no material impact to the financial statements. The Company has currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with accounting principles generally accepted in the United States.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. On February 12, 2008, the FASB issued FSP 157-2 which delays the effective date of SFAS No. 157 for one year, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS No. 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 157 in the first quarter of fiscal 2009 for those assets and liabilities not subject to the one year deferral granted in FSP 157-2, with no material impact to the financial statements. The Company is currently evaluating the impact of adopting SFAS No. 157 for the assets and liabilities subject to the

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one year deferral granted under FSP 157-2, for which SFAS No. 157 will become effective for fiscal years beginning after November 15, 2008.

In September 2006 and March 2007, respectively, the FASB ratified Emerging Issues Task Force ("EITF") Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" and Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements." These EITF's address the possible recognition of a liability and related compensation costs for split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. EITF 06-4 and 06-10 are effective for fiscal years beginning after December 15, 2007, including interim periods within those years. The Company adopted these EITF's in the first quarter of fiscal 2009 with no material impact to the financial statements.

During June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements by standardizing the level of confidence needed to recognize uncertain tax benefits and the process for measuring the amount of benefit to recognize. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 as of July 1, 2007, with no material impact to the Company's financial statements.

Critical Accounting Policies

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

The Company's significant accounting policies are described in Note A of the Company's Annual Report filed on Form 10-K for June 30, 2008. 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:

Revenue Recognition

Twin Disc recognizes revenue from product sales at the time of shipment and passage of title. While we respect the customer's right to return products that were shipped in error, historical experience shows those types of adjustments have been immaterial and thus no provision is made. With respect to other revenue recognition issues, management has concluded that its policies are appropriate and in accordance with the guidance provided by the Securities and Exchange Commissions' Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition."

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

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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, 2008 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.

As indicated above, the Company tests for goodwill impairment between annual tests if an event occurs or circumstances change that would "more likely than not" reduce the fair value of the reporting unit below the unit's carrying amount. In our evaluation of interim triggering events, we considered, among others, the decline in the Company's stock price since June 30, 2008. The Company concluded that these events did not constitute triggering events as it would be more likely than not that the fair value of the reporting unit would still exceed its carrying amount as of March 27, 2009.

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 Moody's AA Corporate Bond rate, with appropriate consideration of pension plans' participants' demographics and benefit payment terms.
- 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 and the UP 1994 Mortality Table for all prior years presented.
- 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;

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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 SFAS No. 109, "Accounting for 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 foreign subsidiaries.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

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

Interest rate risk - The Company's earnings exposure related to adverse movements of interest rates is primarily derived from outstanding floating rate debt instruments that are indexed to the prime and LIBOR interest rates. In accordance with the $35,000,000 revolving loan agreement expiring October 31, 2010, the Company has the option of borrowing at the prime interest rate or LIBOR plus an additional "Add-On", between 1% and 2.75%, depending on the Company's Total Funded Debt to EBITDA ratio. Due to the relative stability of interest rates, the Company did not utilize any financial instruments at March 27, 2009 to manage interest rate risk exposure. A 10 percent increase or decrease in the applicable interest rate would result in a change in annual pretax interest expense of approximately $50,000.

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

Stock market risk – The Company's earnings are exposed to stock market risk relative to the Performance Stock Unit Awards. These are cash based awards which are revalued at the end of each reporting period based upon the Company's closing stock price as of the end of the period. A one dollar increase or decrease in the Company's stock price would result in a decrease or increase, respectively, in earnings from operations of approximately $117,000. These awards were valued at the Company's March 27, 2009 closing stock price of $6.46.

Currency risk - The Company has exposure to foreign currency exchange fluctuations. Approximately 33% of the Company's revenues in the nine months ended March 27, 2009 were denominated in currencies other than the U.S. Dollar. Of that total, approximately 87% was denominated in Euro with the balance composed of Japanese Yen, the Swiss Franc and the Australian and Singapore Dollars. The Company does not hedge the translation exposure represented by the net assets of its foreign subsidiaries. Foreign currency translation adjustments are recorded as a component of shareholders' equity. Forward foreign exchange contracts are used to hedge the currency fluctuations on significant transactions denominated in foreign currencies.

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

The Company primarily enters into forward exchange contracts to reduce the earnings and cash flow impact of non-functional currency denominated receivables and payables. These contracts are highly effective in hedging the cash flows attributable to changes in currency exchange rates. Gains and losses resulting from these contracts offset the foreign exchange gains or losses on the underlying assets and liabilities being hedged. The maturities of the forward exchange contracts generally coincide with the settlement dates of the related transactions. Gains and losses on these contracts are recorded in Other income (expense), net in the Consolidated Statement of Operations as the

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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 2009 and 2008 was the Euro. At March 27, 2009, the Company had net outstanding forward exchange contracts to purchase Euros in the value of $150,000 with a weighted average maturity of 57 days. The fair value of the Company's contracts was a gain of approximately $4,000 at March 27, 2009. At June 30, 2008, the Company had net outstanding forward exchange contracts to purchase Euros in the value of $752,000 with a weighted average maturity of 34 days. The fair value of the Company's contracts was a minimal gain at June 30, 2008.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). During the first quarter of fiscal 2009, the Company implemented a new enterprise resource planning (ERP) system at its North American manufacturing operation. As a result of the implementation, the Company initiated a process to review and redesign, as necessary, the controls impacted by the new ERP system, which was substantially completed by the end of the second fiscal quarter. Further testing and validation of the revised controls continued through the third quarter, with final testing to be completed in the fourth quarter. Despite the process to review, redesign and test controls, as necessary, management believes adequate disclosure controls and procedures remained in place during the quarter covered by this report.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Twin Disc is a defendant in several product liability or related claims considered either adequately covered by appropriate liability insurance or involving amounts not deemed material to the business or financial condition of the Company.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in response to Item 1A to Part I of our 2008 Annual Report on Form 10-K.

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

There were no securities of the Company sold by the Company during the nine months ended March 27, 2009, which were not registered under the Securities Act of 1933, in reliance upon an exemption from registration provided by Section 4 (2) of the Act.

During the period covered by this report, the Company offered participants in the Twin Disc, Incorporated - The Accelerator 401(k) Savings Plan (the "Plan") the option to invest their Plan accounts in a fund comprised of Company stock. Participation interests of Plan participants in the Plan, which may be considered securities, were not registered with the SEC. Participant accounts in the Plan consist of a combination of employee deferrals, Company matching contributions, and, in some cases, additional Company profit-sharing contributions. No underwriters were involved in these transactions. On September 6, 2002, the Company filed a Form S-8 to register

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200,000 shares of Company common stock offered through the Plan, as well as an indeterminate amount of Plan participation interests.

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
December 27, 2008 – January 30, 2009	0	NA	0	250,000
January 31, 2009 – February 27, 2009	0	NA	0	250,000
February 28, 2009 – March 27, 2009	0	NA	0	250,000
Total	0		0	

On February 1, 2008, the Board of Directors authorized the purchase of up to 500,000 shares of Common Stock at market values.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

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

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

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

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

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	TWIN DISC, INCORPORATED (Registrant)
Date: May 6, 2009	/s/ JEFFREY S. KNUTSON Jeffrey S. Knutson Corporate Controller Chief Accounting Officer