FINAL TRANSCRIPT

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PRESENTATION

Operator

Good morning and welcome to Carpenter Technology's third-quarter 2010 earnings conference call.

My name is Glenn and I will be your coordinator for today. At this time, all participants will be in a listen-only mode. After the speakers' remarks, you will be invited to participate in the question-and-answer session towards the end of this call. At this time, we will review the procedures for asking a question. (Operator Instructions)

I would now like to turn the call over to your host for today, Mr. Mike Hajost, Vice President and Treasurer. Please proceed.

Mike Hajost - *Carpenter Technology - VP, Treasurer*

Thank you, Glenn. Good morning, everyone, and welcome to Carpenter's earnings conference call for the third fiscal quarter ended March 31, 2010. This call is also being broadcast over the Internet.

With us today are Greg Pratt, Chairman and Interim president and Chief Executive Officer; Mike Shor, Executive Vice President, AMO and PAO operations; Doug Ralph, Senior Vice President and Chief Financial Officer; as well as other members of the management team.

Statements made by management during this conference call that are forward-looking statements are based on current expectations. Risk factors that could cause actual results to differ materially from these forward-looking statements can be found in Carpenter's most recent SEC filings, including the Company's June 30, 2009 10-K and its September 30, 2009 and December 31, 2009 10-Qs, and the exhibits attached to those filings.

I will now turn the call over to Greg.

Greg Pratt - *Carpenter Technology - Chairman, Interim President & CEO*

Thank you, Mike. Thank you, everyone, for joining us today on our third-quarter call.

Similar in sequence to our last call, I will start off this morning by updating you on our view of the business today and where we see it heading. Mike Shor will then walk you through our end markets and the steps we are taking to position ourselves operationally as our markets return. Doug Ralph will then review our financial results and outlook. After that, we will be happy to take your questions.

As you can tell from our news release this morning, we are continuing to benefit from strengthening end markets and the expansion of our customer base and product portfolio. The momentum in our business is reflected in further sequential improvement in our quarterly financial results. We expect this trend to continue into the fourth quarter, allowing us to achieve our full-year financial goals of positive earnings per share and free cash flow. But, this is really just a start for us. We have made solid progress towards our goal of emerging from the recession a stronger and better-positioned company operationally, financially and strategically. Moving forward, we are well-positioned with our customers in attractive end markets. We have strong R&D capability and world-class premium meld capacity to meet ever-increasing demand for higher-value products. Our balance sheet remains strong, and we continue to make progress on operating efficiency and cost reduction.

Finally, let me finish by providing an update on the CEO search. As stated last October, we believe it would take six to nine months to find the most fit person to lead our company in the future. The search committee of the Board of Directors is in the final stage of the search process, and we expect to have an announcement by the end of our fiscal year. In the meantime, the business continues to execute seamlessly and the operation has proven nimble in reacting to surges in market demand as they occur.

Now, let me turn the call over to Mike Shor, who will review our end markets and operations. Mike?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Thank you, Greg, and good morning. I will review the markets in the order of their contribution to net sales this quarter.

Our Aerospace sales were $149 million in the third quarter. Excluding surcharge revenue, Aerospace sales were down 4% on 2% lower volume. On a sequential basis, overall Aerospace volumes increased 36% between the second and third quarters. The sequential improvement mainly relates to increases in demand in our engine business. Current ordering trends reflect increased market demand, better position with customers, the ramp up of new engine programs, and some inventory restocking.

On the fasteners side of Aerospace, third-quarter shipments were down versus a year ago due to supply-chain destocking. Fastener volumes were up sequentially, as there are some signs of inventory depletion in distributor channels. Typically, we see fastener demand lag engines by six months. Since we still believe there is excess inventory in the fastener supply chain, demand for fasteners may be several quarters away.

Overall, the Aerospace market is beginning to stabilize as traffic volumes increase for both passenger and freight. Recent communication on production rate increases by Boeing and Airbus reinforce this improving trend in [fastener] miles.

We're also encouraged by the shift in mix to more advanced material intensive planes, the result of which should grow usage of our types of materials at a rate that is 1.5 times the plane build rate. We expect these improving factors to generate a stronger sustained demand for our materials.

Sales to the industrial market of $74 million were flat year-over-year in the third quarter. Excluding surcharge, industrial sales decreased 6% on 25% higher volume. The year-over-year result reflects a temporary mix shift to lower-value products, including stainless redraw rod and stainless bars sold to distributors. It is typical that our general stainless portfolio recovers before the higher-value niche segments.

Sequentially, industrial volume increased 37% as Carpenter benefited from shorter lead time orders on lower-value products and, to a lesser extent, some return in demand for higher-margin products. As we begin the fourth quarter, we are seeing solid evidence of the follow-on recovery in the higher-value portions of this portfolio.

As we mentioned in our last call, industrial markets are showing signs of steady improvement. The US industrial production index increased 7% year-over-year during the first three months of this year and is forecasted to grow 11% year-over-year next quarter.

Consumer market sales were $33 million. Excluding surcharge revenue, consumer sales increased 40% over a year earlier on 53% higher volume. The year-over-year increases reflect inventory restocking to support broader global discretionary spending on household-related products.

Volumes increased sequentially 35%, which had as much to do with rebuilding depleted supply-chain inventories as it did with gradually increasing demand in housing, construction and electronics. Although supply-chain levels are certainly improved over recessionary lows, they still reflect some market caution.

Medical market sales were $30 million in the third quarter, which was flat compared with a year ago. Excluding surcharge revenues, medical market sales were down 1% on 12% higher volume. The increase in volume reflects share gain in cobalt-based implant products and initial restocking of inventory. The revenue decline continues to be attributable to lower titanium raw material costs.

Medical volumes increased 59% sequentially in the third quarter. We've previously described our lower second-quarter volume as a blip associated with supply-chain adjustments. The pickup in our third quarter gets us back on track to our view of steady growth and continued share gain. The longer-term outlook remains positive with a projected 5% growth rate in the medical procedures that use Carpenter materials.

Automotive market sales were $28 million in the third quarter. Excluding surcharge revenue, automotive sales increased 24% on a 90% increase in volume compared with a year earlier. The year-over-year volume increase reflects greater share in lower-value automotive intake valves along with increased demand for stainless steel fuel system components. Sequentially, automotive volumes increased 30% over the second quarter, reflecting share gain on lower-value business as well as higher volumes of more strategic fuel injectors and turbocharger engine components. We continue to believe our efforts with long-standing customers will create additional opportunities to increase our participation in higher-end automotive engine applications.

The automotive market is continuing its steady upswing. Off its lows last year of 930,000 units, Big Three powertrain builds are holding at about 1.5 million units for the first three months of 2010. This build rate is expected to stay stable over the next few quarters.

Energy market sales were $23 million in the third quarter. Excluding surcharge revenue, energy market sales decreased 42% on 34% lower volumes. The year-over-year decline in energy sales reflect sharply lower volumes for oil and gas applications as excess supply chain inventory reductions continue, along with sluggish demand for high-capacity industrial gas turbines.

Energy volumes grew 21% sequentially, driven by increased oil and gas rig activity. While the increase in directional drilling rigs has depleted some excess drill collar inventory, it is likely to be several more quarters before overall inventory gets back in balance.

On the power generation side of our business, many projects remain delayed and sales are likely to be sporadic and variable for the foreseeable future. As we have stated previously, our expectations for power generation are set more in terms of years, not quarters.

We are continuing to focus on diversifying our customer base, our market segments served, and our product offerings in a broader energy market. This is a major growth focus for Carpenter long-term.

With respect to international, Carpenter sales outside the United States in the third quarter were $105 million, a decrease of 6% compared with the third quarter of 2009. Our European revenue was down 13% compared with unusually strong sales to the power generation market a year earlier. Asia-Pacific was flat year-over-year, despite a significant increase in volume within the automotive and consumer markets. Sequentially, sales outside the United States increased 23%. International sales represented 31% of total company sales in the 2010 third quarter, compared to 34% in the prior year.

China continues to achieve encouraging growth. Third-quarter volume was up 59% over a year ago. We expect rapid growth to continue in China, aided in part by the recent AS 9100 certification of our new distribution center. One of the leading opportunities for long-term international growth lies in the diversification of our global energy business.

Now, I would like to turn your focus to our overall operating performance. Through a series of daily, weekly and monthly meetings, we are tracking our key metrics and areas of focus. The highlights of our recent performance are as follows. On safety, we've improved our OSHA recordable rate by 25% versus 2009. Our on-time delivery performance continues to improve. We have just received our AS 9100 aerospace quality certification for our new warehouse in China. Our production cost per ton has declined, and we are exceeding our year-to-date plan on this key measure.

In addition, overall inventory levels are at or below our monthly plans, and we have worked to position or stage specific inventory that will result in shorter lead times to our customers on our major items. We're now bringing manpower back to our facilities to handle our increasing volumes while obviously keeping an eye on our cost per ton. Our mills are getting busier, and our new VIM-VAR and ESR premium melding facilities are now in production.

We are definitely experiencing a transition period as the economy recovers and volumes improve. During this transition, we are seeing varied growth rates in our end markets along with surges in demand for certain products. The surge in aerospace engine demand is a welcome event, and we expect a pickup in fastener demand sometime within our fiscal '11. We have also seen volume increases in some of our lower-value products, using markets such as automotive, industrial and consumer.

We currently have the capacity, and since this business is profitable, we have made conscious decisions to temporarily adjust our mix accordingly and benefit from the increased volumes through our mill. As markets return to more normalized growth rates, we will see improvements in the overall value of our product mix.

We also continue to work on maintaining and improving our customer relationships with a focus on share growth. Looking out further, we continue to view aerospace, energy and medical as our long-term growth markets. These all utilize our increased premium mill capacity.

We view the robust airplane build schedule with added enthusiasm when considering the growth in certain types of planes. Models like the 787, A350 and A380 use significantly more of the specialty metals that we produce. Our added VIM capacity also allows us to broaden our participation in the energy market -- again, a major growth focus area for us.

Let me now provide some perspective on what all this means to us with respect to revenue growth in fiscal '11. From a pure market perspective, based on leading indicators and discussions with many of our key customers, we believe our end markets are going to grow on average by 5% to 7% year-over-year. On top of this, we are growing market share in Aerospace even despite the expected PCC Carlton impact as well as growing energy, medical and automotive. Along with benefits from our new product and new market initiatives in these areas, we expect the total topline growth rate in fiscal '11 to be low double digits.

Finally, want to thank all of our employees for their hard work in handling the increased volumes of this past quarter. This great effort has led to increased customer satisfaction.

I will now turn the discussion over to Doug, who will walk us through the financial results.

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

Thanks, Mike.

As you've just heard, the business has encouraging topline momentum right now. This is also beginning to show up in our bottom-line results. Driven by returning volumes and lower costs, our operating income, operating margin, and base earnings per share before one-time charges were all higher in the third quarter versus our second quarter. Our operating margin, excluding surcharge and pension impacts, was nearly 9% in the quarter, so we're well on our way to the 10% we told you we would be at by the end of the fiscal.

We expect to report further improvement in our financial metrics between the third and fourth quarters. This is despite some negative impact from nickel prices, which have risen about 50% in the last three months. This creates a negative short-term profit impact from the lag in our pricing surcharge mechanism. Nevertheless, we remain on track to comfortably achieve our financial targets for the year.

With that, let me now take you through our income statement and other results for the quarter. We reported net income this quarter of $2.1 million, or $0.05 per diluted share, which includes a one-time $0.13 non-cash charge associated with the new healthcare reform law and $0.21 of non-cash pension expense.

Net sales in the quarter were $337 million, or 2% above a year ago. Excluding raw material surcharge, sales were down 4% but up 24% sequentially from the second quarter.

Overall pounds shipped increased 20% from a year ago with special alloy products up 17%, titanium products up 8%, and stainless steel products up 22%. Sequentially, volumes were up 35% from our second quarter.

Gross profit was $46.3 million compared with $49.2 million in the 2009 third quarter. The impact of higher volumes on this quarter's gross profit was more than offset by a weaker product mix and higher net pension expense. Note that last year's third-quarter gross profit was also negatively impacted by $11 million of costs from the LIFO effect of reducing inventory in a period of declining nickel prices.

Reported SG&A expenses in the third quarter increased 8% year-over-year. If you adjust for the impact of non-cash pension expense in both years, SG&A was up 1%. There was an increase in variable compensation accruals, as we predicted on last quarter's call, offset by continued reductions in most other areas of our spending. Through nine months, our SG&A spending, excluding pension, is down 8%, with base salary and benefit costs down 13% and discretionary costs like outside services and travel 14% lower.

Looking ahead to the fourth quarter, we will see an additional year-over-year difference in variable compensation accruals as profits increase further compared to no performance bonuses earned last year. Overall, though, our SG&A costs for the full year should still be about flat with last year and down about 7%, excluding pension impacts. As we continue into the recovery, we will need to begin investing in some additional resource capabilities to drive our growth strategy, but plan to add these costs below the rate of topline revenue growth.

Returning to the income statement, we had operating income of $12.8 million for the quarter, compared with $16.1 million in last year's third quarter. Note that last year's results included $2.1 million in restructuring charges related to the closure of our Crawley, UK strip facility.

Our operating margin, excluding both surcharge and pension expense, interest and deferrals, or "EID" as we always quote it, was 8.7%, up from 6.8% in last year's third quarter, excluding the restructuring charge. As expected, our operating margin has improved each quarter this year and is already pretty close to the 10% target we expect to be at by the end of the fiscal. We also remain on track to achieve our goal of a 6% operating margin for the full year, which is in line with last year's level. This is despite lower overall revenue and a temporary weaker product mix, which we have been able to offset with our cost improvements.

Finishing up the income statement, other income of $1.6 million was down from $2.7 million last year, driven mainly by lower foreign exchange gains. The income tax provision for the third quarter was $7.8 million, or 79% of pretax income, compared with an income tax provision of $1.8 million or 12% a year ago. The increase in the provision mainly reflects the one-time non-cash reduction in the value of Carpenter's deferred tax asset previously established for anticipated retiree healthcare liabilities. We expect our effective tax rate for the fourth quarter to be about 26%.

Our cash flow and balance sheet remain strong. As expected, free cash flow for the third quarter was a negative $7.7 million as accounts receivable rose due to strong sales performance and the impact of higher raw material costs, and inventories rose somewhat to support increased volumes. We ended the quarter with $370 million of cash on the balance sheet and a net cash position of $91 million. We will pay down $20 million of debt in the fourth quarter and do not have any other meaningful debt maturities until August of 2011, when a $100 million unsecured note is due.

Through nine months, we have generated positive free cash flow of $17 million. We continue to do a good job of managing inventory levels through robust processes that balance our cash objectives with the need to put more inventory on the ground to respond to customer demand.

Our accounts receivable level will likely further increase in the fourth quarter due to continued volume growth and rising raw material costs. We also expect to spend higher CapEx in the fourth quarter. Nonetheless, we remain on track to comfortably achieve our target of positive free cash flow for the year.

Another item that I will call your attention to is a recent decision in an environmental civil lawsuit that is described in our SEC filings as Boarhead Farms. It is public record that, as of a few weeks ago, the Court of Appeals for the Third Circuit vacated the previous decision by the District Court and remanded the case for further proceedings. While this development is positive, we are not yet able to predict any revised outcome at this time. As a result, we have maintained the $21 million reserve on our balance sheet, pending further developments.

Finally, I want to provide some perspective on fiscal 2011. As Mike has already covered, we see low double-digit revenue growth next fiscal as our markets continue to rebound and we realize the benefits from our growth strategies. At this point, we expect our non-cash pension expense to be about $0.65 per share, compared to this year's $0.84. Note, for your modeling, that we are not expecting to receive any further CD SOA payments, as that program has ended, so that will take about $6 million out of the comparison to this fiscal. We forecast our full-year effective tax rate to be about 30%, and we have a capital spending plan of about $70 million heading into next year.

With that, I will turn it back to the operator so we can open the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Edward Marshall, Sidoti & Co.

Edward Marshall - *Sidoti & Co. - Analyst*

Good morning, guys. My first question is surrounding the topline guidance that you provided for us for fiscal '11. Does that include the impact or exclude the impact of surcharges?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

Any revenue that we would quote excludes surcharges.

Edward Marshall - *Sidoti & Co. - Analyst*

The PAO margins were, again, relatively strong. Last quarter, there was some hedging activity. Did that reoccur in this quarter?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

We had a small amount of hedging activity -- hedging timing effects as we would call them -- this quarter as well.

Edward Marshall - *Sidoti & Co. - Analyst*

What was the benefit to the operating -- the margin there, or operating line?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

In the order of $1 million to $1.5 million.

Edward Marshall - *Sidoti & Co. - Analyst*

How important is the Aerospace aftermarket, with passenger traffic miles picking up, to the overall engine demand? Is there -- I don't know if you can break it out since all of your business kind of goes OE, but is the aerospace aftermarket important to your business in any way?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

We look at about 30% -- and this is a rough number -- of our engine market being aftermarket activity, and much less than that on the fastener side. We would say probably 10% or less.

Edward Marshall - *Sidoti & Co. - Analyst*

Thank you guys very much.

Operator

Chris Olin, Cleveland Research.

Chris Olin - *Cleveland Research Co. - Analyst*

Good morning. I'm just wondering. Back to the guidance on a topline, could you provide thoughts on what you're thinking volumes will look like?

Unidentified Participant

We prefer to express it in revenue terms. There is not any material difference, I would say, in terms of volume growth that we would expect next year. They drive that.

Chris Olin - *Cleveland Research Co. - Analyst*

Can you give us maybe an update on where your utilization levels are for the meld and then fasteners?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Sure. Chris, this is Mike Shor. Utilization rates -- and you know we are part stainless, part high-temperature alloy mills, so I will go back and forth between the two. Our air meld and continuous caster facilities, which are mainly used for stainless steel, are about 70%. Our VIM -- and now we are including the full impact of the new 25-ton VIM furnace, so we are at about 60%. We talked about the fact that VIM was going to add about 40%, so the old capacity is pretty well filled right now.

Re-melding, that being ESR and VAR, about 75%. Hot working of the big stuff about 75% to 80%, hot working of the bar and wire, about 50%; and finishing so many facilities throughout the plant but in the general range of 60% to 80%.

Chris Olin - *Cleveland Research Co. - Analyst*

The third question I have is you had to deal with Titanium Metals a while back in terms of the fabrication and then with the ingots. Are you fabricating any volumes yet for the titanium side?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Sure, we have had an ongoing joint venture with them, with TiMet, and the exchanges, we processed through our hot working facility some of their titanium product. Then our Dynamet titanium facilities purchases ingot. So that has been going on and continues.

Chris Olin - *Cleveland Research Co. - Analyst*

Any kind of numbers we could put on it or --?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

No, typically they are not the types of numbers that we release.

Chris Olin - *Cleveland Research Co. - Analyst*

Okay, thanks a lot.

Operator

Steve Levenson, Stifel Nicolaus.

Steve Levenson - *Stifel Nicolaus - Analyst*

Good morning, everybody. This is a question I guess for Mike. You alluded to trying to keep the leadtimes short on some items. Can you give us an idea of what the leadtimes are on some of the popular aerospace alloys like 6-4 titanium and 7-18 nickel?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

I will talk mainly about the nickel-based super alloys for aerospace. What we are doing, Steve, is we are working off of forecasts which we review on a monthly basis. Based on that forecast, we are stocking what is called ingot, which is the product of our melding operations, or billet, which is the product that goes in our hot working operations. With those types of buffer stocks in there, we are able, depending on the product, to achieve somewhere between 6 and 12-week leadtimes on those products.

As we have seen the increase in demand, then some of that intermediate stock has been used up and we are quickly going back in and re-melting it so it can maintain those leadtimes. It's not been easy but we're working through that and trying to work hard to get those back so we are consistently at those numbers.

Steve Levenson - *Stifel Nicolaus - Analyst*

Thank you. Then just curious, how much of the revenue do you project is covered under long-term agreements? How much would you sell on spot prices?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

In general terms, about 40% of our business is long-term agreements, about 60% is transactional. I will tell you, though, on the aerospace side, much higher percentage is long-term agreement on the stainless-less.

Steve Levenson - *Stifel Nicolaus - Analyst*

Okay, thank you. Last item -- are you subject to any of the special duties that China has been imposing recently?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

No, we are not.

Steve Levenson - *Stifel Nicolaus - Analyst*

Thanks very much.

Operator

John Tumazos, private investor.

John Tumazos - *Independent Research, LLC - Analyst*

It's John Tumazos, Very Independent Research. Thank you. With the prospects for the A380, 787, A350, each have very good volumes two, three years from now.

Are the capacity expansions you undertook a couple of years ago enough to foresee being able to make enough of the titanium and special alloy products for those product lines, those airplanes? If you were to drop valve, steel, stainless bar, low-value products, are they essentially using the same facilities that the aerospace materials would use?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

John, it is Mike again. On the titanium side, our involvement in titanium is on the fastener side of the business. No issue at all with capacity there. We acquire the product that we then hot roll at our Dynamet facility and finish, and they will bring on the volume. We will love that all the way, so that's not an issue at all.

On the nickel side, the vacuum induction melding furnace we added again is about a 40% addition. We expect that to last us for many, many years, be that five or ten, I am not sure, but right now it provides us long-term capacity.

On the remelding side, we size those to be able to handle the next year or two versus demand. They are much smaller amounts of capital and they are, in essence, plug-ins so we can move very well on that as capacity increases.

In hot-working, we have a piece of machinery called a rotary forge. We are in the process; we are only working two crews. We are in the process of adding a third crew right now to expand our capacity there.

Finally, typically these products go through different sets of equipment than does the stainless steel and the "lower-value product", so there is no competition between the two for capacity.

John Tumazos - *Independent Research, LLC - Analyst*

So which product lines, if they recovered, would push out the stainless bar, valve, steel, etc.?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Higher-end stainless steel, and you can look at stainless steel through a gradient. There is the more distributor-oriented stainless steel and then there is the more what I will call higher-value stainless steel. They are typically going through the same set of assets.

John Tumazos - *Independent Research, LLC - Analyst*

Where are examples of the higher-value stainless products in end markets?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

I would say they are across the board. I'll give you some examples. Fuel inject -- material, small diameter bar for stainless for fuel injectors; stainless steel for fittings applications; even some aerospace applications where we use the same stainless. They would be typical applications. Semiconductor quality stainless steel is another. So there's a variety of the what I will call the higher-end stainless that we believe, as I said in my comments, are beginning to come back.

The other one that I did not mention that I should is oil and gas also utilizing a fair amount of stainless. We hope, as we grow that business, for more of that capacity to be used there.

John Tumazos - *Independent Research, LLC - Analyst*

Thank you.

Operator

Brian Yu, Citi.

Brian Yu - *Citigroup - Analyst*

Good morning. You mentioned earlier that average pricing is down, it looks like largely because of mix. Can you discuss if like pricing or specific products or end markets outside of mix, has that stabilized and given the volume improvement, are you seeing any pricing power?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Yes. On the pricing side, I would say pricing for our premium products has held up well through the downturn, since much of that was covered by long-term agreements. Pricing for the lower end of the stainless mix, the more transactional type business, as we've talked about in the past, has been competitive, but we believe that has stabilized.

Our goal here and our job here is to focus the customers on the value that we provide, so price isn't number one on our list. But also bottom line for us is, as we continue to see demand increases, we will evaluate price increases where we believe we have the opportunity.

Brian Yu - *Citigroup - Analyst*

So for now, it looks like prices in general have bottomed out but not much pricing power has of yet? Hopefully, you'll get it but --.

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Yes, I would say, if demand begins to come back, we will work to recover what we had lost in the downturn.

Brian Yu - *Citigroup - Analyst*

Okay. Is there any particular end market that's closer to the point where you think you might be able to get incremental margin improvement outside of operating leverage?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Where we are getting busier now and where we look at opportunities is on both the low-end products, which have suffered through some significant price decreases, and also on some of the higher-end premium products as we see some significant demand coming at us on the engine side. So we will look pretty much across the board.

Brian Yu - *Citigroup - Analyst*

Okay, thank you.

Operator

Phil Gibbs, KeyBanc Capital Markets.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

I just had some questions here on the mix shift that we saw in the third quarter. Has this been a change in your marketing strategy or just reflective of end market demands?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

It has been reflective of end market demands. As we moved into the downturn and we saw an awful lot of open capacity, one of our jobs was to keep our employees operating. So we looked at some business which we hadn't looked at in the past, which was historically lower-margin business for Carpenter, so we went after that. But as I said in the previous question, in no way does that impact compete with anything on the high end that we've got.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. On the 10% EBIT margin that we are looking at here for the fourth quarter, did you achieve that in the month of March, or was that more or less achieved into April?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

Yes, we don't report any specific monthly results. There is some volatility to our monthly results, but we finished at 8.7% for the quarter. That's an operating margin, excluding our pension effects, and expect to still be at the 10% in our fourth quarter.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. Then the 2011 outlook, does that assume a similar mix to this year, or does that assume a richer mix of product in the higher end?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

We would assume that we will see some improvements in our product mix year-to-year.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Perfect. Thanks, guys.

Operator

Luke Folta, Longbow Research.

Luke Folta - *Longbow Research - Analyst*

I had a question. First off, as far as the restocking that we are seeing in the engine channel, do you think -- can you give us a feel for what inning we might be as far as the restocking process is concerned?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

I didn't hear the question.

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

Luke, could you repeat the question? We broke up on this end.

Luke Folta - *Longbow Research - Analyst*

Do you think -- when you think about the restocking in the engine channel, is this something that's just starting to get moving or something that you think is halfway through or mostly complete?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

I would say we have seen, for the last couple of months, significant demand coming our way, and so I would say that we are started and well into it now.

Luke Folta - *Longbow Research - Analyst*

So, do you think you'll see a couple more quarters of benefit from further restocking in the engine channel?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

What's interesting is there certainly is some restocking taking place, but we think it's relatively small after talking to our customers. What we are seeing is a real pull now for some of the programs that have been on the sidelines for a while. We are also seeing, because there's been such a lack of inventory based on '09 being so light, that we are seeing more requests for short lead times; things are pulled through. So yes, we believe we've got a couple of more quarters of this type of demand.

Luke Folta - *Longbow Research - Analyst*

Okay, great. Then on the titanium side, can you give us some color as far as what the environment is regarding availability, and maybe also what you're seeing as far as spot pricing trends on grade 5 ingot and scrap?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

I will talk about availability. Availability for us is in very good shape. We have long-term agreements. I mentioned the TiMet joint venture. We also have long-term agreements on titanium, so we feel very good as far as where we are as far as supply of that, both short-term and long-term. Our pricing mechanism works in essence with a pass-through in pricing, so we are pretty much whatever the price is, we will pass that along to our customers.

Luke Folta - *Longbow Research - Analyst*

Okay, thanks a lot.

Operator

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

Gautam Khanna - *Cowen & Co. - Analyst*

Yes, even if you exclude the hedging gain at PAO this quarter, margin was above your estimate of -- I think, last quarter, you were talking about 20% for the third quarter. As volumes continue to rise for the year, do you expect -- kind of what do you expect to see the upper limit of PAO margins reaching?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

I think our fiscal year-to-date margin is in the high 20s%, 29% if I'm not mistaken. I think our year would end up right about at that level.

Gautam Khanna - *Cowen & Co. - Analyst*

Also, can you help us understand how pension expense will be allocated next year? I know you've mentioned a $0.19 year-to-year improvement. Will it all be -- will that difference all be at the EID line or will some of it come through the segments, the variance?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

There's, yes, some of that that would come through the segments. Our annual service costs would come through the segments. Most of it would be in EID.

Gautam Khanna - *Cowen & Co. - Analyst*

Got it.

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

Some would go through the segments.

Gautam Khanna - *Cowen & Co. - Analyst*

Also at AMO, just looking back, I think it was -- I don't remember exactly what, a couple of years -- it was last year actually when you had similar sales in the third quarter, much higher margins. That was despite high-cost inventory and utilization dropping through the quarters. So the operating profit at AMO, given the current rate of sales -- I mean, should we just expect to not get towards double digits, given the mix, anytime soon, or how should we think about incrementals off these low levels?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

I think certainly the third-quarter level of 3.5% is reflective of our product mix there. I would also say that -- and we've had the discussion before -- that, as long as our volume is at the lower levels that it still is running at right now, that the AMO business, because it has more of our finishing operations and assets, is disproportionately affected by lower overall volumes than the PAO business would be, and so you still have that impact on our AMO business.

Gautam Khanna - *Cowen & Co. - Analyst*

Lastly, CapEx you mentioned would be roughly $70 million next year, which is up a bit. Are there any new big projects that you guys are pursuing, or is that purely a maintenance CapEx number that we should think about as an ongoing recurring number?

Doug Ralph - *Carpenter Technology - SVP Finance, CFO*

You know, it's maintenance level plus some smart investments in technology upgrades on certain pieces of equipment. We've gone through a thorough process as part of our annual planning process of looking at all of the capital spending priorities and projects that we have for next year and going through to get to the $70 million number. So it's large part maintenance level but also includes projects that are technology upgrades or that we expect a good financial return on.

Operator

Chris Olin, Cleveland Research.

Chris Olin - *Cleveland Research Co. - Analyst*

I wanted to get your thoughts on the jet engine market. I've been hearing some discussion that maybe the OEMs are not producing fast enough, given kind of the new delivery outlook. Do you have any feel for maybe them increasing production over the next couple of months or anything similar to that?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Chris, it's Mike. We certainly are seeing pull-ins, certainly some spares. I think also the new airframe schedules that are out, the 747, 787 plus the increase A320 firming up will help. You know, when you look through all of the planes out there, they've either announced increases or increases are about to come, as you know, including 787 as the new plant is built for that one.

So we are seeing our customers getting busier. We are seeing them pull significant amounts from us right now. They are saying they are not building stocks, so my view is they are keeping up. It's just we are seeing a lot more volume from them.

Chris Olin - *Cleveland Research Co. - Analyst*

What are you thinking on the 737?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

737 -- I read the same articles you do. You know, they are at 31.5% a month.

What everyone keeps talking about, although it is the one that hasn't been published yet, is they are going to move that up to about 34%. We have not heard that officially, but with everything else moving up, it makes some sense.

Chris Olin - *Cleveland Research Co. - Analyst*

If you looked out the next two to three years, do you feel most confident about aerospace, oil, or the power generation in terms of incremental volumes?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Well, it's pretty much -- the three markets we talked about, which are growth markets, we feel pretty good about the growth rates in all of them. We've talked about air traffic growing at about 5% a year and us growing faster than that. We talked about energy with a weighted average between PowerGen and our nonmagnetic (inaudible) collars 5% a year. Don't forget we have talked about how this is truly a growth market as we move into other segments beyond the segments we are in.

In medical, we've seen, even through the downturn, good, steady, 5% growth. So we look at all of them positively. We believe we can grow faster than the market in those key markets for us, based on the capacity we've put in and the focus on the additional market segments. So we like them all.

Chris Olin - *Cleveland Research Co. - Analyst*

Just lastly, on this whole marketshare gaining within nickel alloy and auto, is there anything you can help me in understanding how you've been so successful lately?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Key is customer satisfaction. We've worked very hard. Te PCC and Carlton, the acquisition, we certainly didn't know that was coming, but we anticipated it. We've been working hard around that and we've been working hard in areas that, quite frankly, we have not had strong share positions. And we've worked to achieve those. So it's an everyday battle. Everything in aerospace revolves around quality, and we've done our best there to be -- to make sure that we have continued to do that.

On the automotive side, the number one issue is what we've talked about. We had a customer, a very good customer of ours, that had a significant issue with source of supply because of market dynamics and changes in the supply side of the industry. So we stepped in and helped out there. That's one of our lower-margin products, but they also purchase higher-margin products. We're going to be working with them to make sure that we secure that higher-margin product also.

Chris Olin - *Cleveland Research Co. - Analyst*

Okay, I think you guys are doing a great job. Keep it up.

Operator

Gautam Khanna, Cowen & Company.

Gautam Khanna - *Cowen & Co. - Analyst*

I just wanted to square a comment you just made with comments made by some of your competitors. Everyone alleges to be gaining share in the (multiple speakers) --

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Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

I know.

Gautam Khanna - *Cowen & Co. - Analyst*

-- alloy market, whether it is ATI, PCP, you name it.

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Right.

Gautam Khanna - *Cowen & Co. - Analyst*

So can you give us some specifics of who specifically you are gaining share? We know ATI got the Rolls contract. Here, PCP on their conference call is talking about continued gains with their existing customers. Where are you guys picking up share?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

Well, where we obviously long-term will lose some share is at the PCC Carlton side, so we've looked -- and that's ring -- so we've looked on the ring side there. And beyond that, really prefer not to get into details, but we have ongoing discussions throughout the supply chain.

THOMSON REUTERS

I think the bottom line is we are going to continue to focus on -- I know everyone is saying the same thing. I think what you need to hold us all accountable for is the results we show quarter after quarter related to volume.

Gautam Khanna - *Cowen & Co. - Analyst*

Your point, though, is on the ring rolling side. That's where you're going to see some share gains?

Mike Shor - *Carpenter Technology - EVP - Advanced Metals Operations & Premium Alloys Operations*

In part, yes.

Gautam Khanna - *Cowen & Co. - Analyst*

Got it. Thank you.

Operator

There are no further questions at this time. I would now like to turn the call over to Greg Pratt for closing remarks.

Greg Pratt - *Carpenter Technology - Chairman, Interim President & CEO*

Okay, thank you very much. I would just like to take this opportunity to thank everyone for joining us today, and thank you for your continued interest in Carpenter. We look forward to speaking to you next quarter. Good-bye.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.
