Allison Transmission Holdings Inc
Form 10-Q
October 28, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2014

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File No. 001-35456

ALLISON TRANSMISSION HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**26-0414014**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
One Allison Way Indianapolis, IN	**46222**
(Address of Principal Executive Offices)	**(Zip Code)**

(317) 242-5000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of October 15, 2014, there were 177,527,712 shares of Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

Allison Transmission Holdings, Inc.

Condensed Consolidated Balance Sheets

(unaudited, dollars in millions, except share data)

	September 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	$ 208.1	$ 184.7
Accounts receivables net of allowance for doubtful accounts of $0.4 and $0.4, respectively	240.0	175.1
Inventories	161.5	160.4
Deferred income taxes, net	103.8	58.1
Other current assets	29.5	28.6
Total Current Assets	742.9	606.9
Property, plant and equipment, net	526.7	563.4
Intangible assets, net	1,536.7	1,610.8
Goodwill	1,941.0	1,941.0
Deferred income taxes, net	1.0	1.1
Other non-current assets	75.9	89.4
TOTAL ASSETS	$ 4,824.2	$ 4,812.6
LIABILITIES		
Current Liabilities		
Accounts payable	$ 182.9	$ 150.4
Product warranty liability	23.2	37.4
Current portion of long-term debt	17.9	17.9
Deferred revenue	21.2	29.2
Other current liabilities	141.6	152.3
Total Current Liabilities	386.8	387.2
Product warranty liability	62.2	53.1
Deferred revenue	47.9	43.2
Long-term debt	2,572.0	2,660.4
Deferred income taxes	212.1	76.2
Other non-current liabilities	189.7	153.7

TOTAL LIABILITIES		**3,470.7**		3,373.8
Commitments and contingencies (see NOTE O)				
STOCKHOLDERS EQUITY				
Common stock, $0.01 par value, 1,880,000,000 shares authorized, 177,524,277 shares issued and outstanding and 183,375,436 shares issued and outstanding, respectively		**1.8**		1.8
Non-voting common stock, $0.01 par value, 20,000,000 shares authorized, none issued and outstanding and 1,185 shares issued and outstanding, respectively				0.0
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding				
Paid in capital		**1,618.1**		1,631.8
Accumulated deficit		**(239.1)**		(173.8)
Accumulated other comprehensive loss, net of tax		**(27.3)**		(21.0)
TOTAL STOCKHOLDERS EQUITY		**1,353.5**		1,438.8
TOTAL LIABILITIES & STOCKHOLDERS EQUITY	**$**	**4,824.2**	$	4,812.6

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Allison Transmission Holdings, Inc.

Condensed Consolidated Statements of Comprehensive Income

(unaudited, dollars in millions, except share data)

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Net sales	**$ 553.3**	$ 466.3	**$ 1,583.0**	$ 1,435.8
Cost of sales	**294.0**	260.2	**862.7**	805.3
Gross profit	**259.3**	206.1	**720.3**	630.5
Selling, general and administrative expenses	**87.5**	74.0	**255.8**	247.5
Engineering research and development	**24.5**	20.9	**70.2**	72.7
Operating income	**147.3**	111.2	**394.3**	310.3
Interest income	**0.3**	0.2	**0.7**	0.6
Interest expense	**(29.6)**	(37.5)	**(101.7)**	(105.1)
Other expense, net	**(1.7)**	(1.5)	**(3.0)**	(7.2)
Income before income taxes	**116.3**	72.4	**290.3**	198.6
Income tax expense	**(47.5)**	(27.9)	**(112.2)**	(76.1)
Net income	**$ 68.8**	$ 44.5	**$ 178.1**	$ 122.5
Basic earnings per share attributable to common stockholders	**$ 0.38**	$ 0.24	**$ 0.99**	$ 0.66
Diluted earnings per share attributable to common stockholders	**$ 0.38**	$ 0.24	**$ 0.97**	$ 0.65
Dividends declared per common share	**$ 0.12**	$ 0.12	**$ 0.36**	$ 0.30
Comprehensive income, net of tax	**$ 60.6**	$ 47.0	**$ 171.8**	$ 115.9

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Allison Transmission Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited, dollars in millions)

	Nine months ended September 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 178.1**	$ 122.5
Add (deduct) items included in net income not using (providing) cash:		
Deferred income taxes	**105.2**	77.8
Amortization of intangible assets	**74.1**	80.1
Depreciation of property, plant and equipment	**71.0**	74.1
Unrealized gain on derivatives	**(12.8)**	(22.2)
Excess tax benefit from stock-based compensation	**(12.8)**	(9.3)
Stock-based compensation	**11.1**	10.7
Amortization of deferred financing costs	**6.2**	8.4
Other	**5.8**	5.2
Changes in assets and liabilities:		
Accounts receivable	**(67.4)**	(33.6)
Inventories	**(3.7)**	(10.0)
Accounts payable	**33.0**	31.0
Other assets and liabilities	**28.2**	(19.3)
Net cash provided by operating activities	**416.0**	315.4
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions of long-lived assets	**(37.6)**	(41.2)
Investments in technology-related initiatives	**(5.8)**	(6.3)
Collateral for interest rate derivatives	**1.7**	1.3
Proceeds from disposal of assets	**0.3**	0.4
Net cash used for investing activities	**(41.4)**	(45.8)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase of common stock	**(249.8)**	(99.5)
Dividend payments	**(64.7)**	(55.2)
Proceeds from exercise of stock options	**34.6**	33.5
Payments on long-term debt	**(88.4)**	(89.6)
Excess tax benefit from stock-based compensation	**12.8**	9.3
Taxes paid related to net share settlement of equity awards	**(1.1)**	(3.6)
Debt financing fees	**(1.0)**	(2.6)
Net cash used for financing activities	**(357.6)**	(207.7)
Effect of exchange rate changes on cash	**6.4**	10.2
Net increase in cash and cash equivalents	**23.4**	72.1
Cash and cash equivalents at beginning of period	**184.7**	80.2
Cash and cash equivalents at end of period	**$ 208.1**	$ 152.3
Supplemental disclosures:		
Interest paid	**$ 103.3**	$ 112.9
Income taxes paid	**$ 3.5**	$ 3.5

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Allison Transmission Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

NOTE A. OVERVIEW

Overview

Allison Transmission Holdings, Inc. and its subsidiaries (the Company or Allison), design and manufacture commercial and defense fully-automatic transmissions.

The business was founded in 1915 and has been headquartered in Indianapolis, Indiana since inception. The Company has 13 different transmission product lines. Although approximately 77% of revenues were generated in North America in 2013, the Company has a global presence by serving customers in Europe, Asia, South America and Africa. The Company serves customers through an independent network of approximately 1,400 independent distributor and dealer locations worldwide.

Since the introduction of the Company s first fully-automatic transmission over 60 years ago, the Company s products have gained acceptance in a wide variety of applications, including on-highway trucks (distribution, refuse, construction, fire and emergency), buses (primarily school, transit and hybrid-transit), motorhomes, off-highway vehicles and equipment (primarily energy, mining and construction) and defense vehicles (wheeled and tracked). The Company has developed over 100 different product models that are used in more than 2,500 different vehicle configurations, which are compatible with more than 500 combinations of engine brands, models and ratings. The Company also sells support equipment and Allison-branded replacement parts for the Company s transmissions and remanufactured transmissions for use in the vehicle aftermarket.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements as of and for the three and nine months ended September 30, 2014 and 2013 have been prepared in accordance with accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the condensed consolidated financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. The information herein reflects all normal recurring material adjustments, which are, in the opinion of management, necessary for the fair statement of the results for the periods presented. The condensed consolidated financial statements herein consist of all wholly-owned domestic and foreign subsidiaries with all significant intercompany transactions eliminated.

These condensed consolidated financial statements present the financial position, results of operations and cash flows of the Company. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission (SEC) on February 24, 2014. Certain immaterial reclassifications have been made in the condensed consolidated financial statements of prior periods to conform to the current period presentation. These reclassifications have no impact on previously reported net income, total stockholders equity or cash flows. The interim period financial results for the three and nine month periods presented are not necessarily indicative of results to be expected for any other interim period or for the entire year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Significant estimates include, but are not limited to, allowance for doubtful accounts, sales allowances, government price adjustments, fair market values and future cash flows associated with goodwill, indefinite life intangibles, long-lived asset impairment tests, useful lives for depreciation and amortization, warranty liability, determination of discount and other assumptions for pension and other postretirement benefit expense, income taxes and deferred tax valuation allowances, derivative valuation, and contingencies. The Company s accounting policies involve the application of judgments and assumptions made by management that include inherent risks and uncertainties. Actual results could differ materially from these estimates. Changes in estimates are recorded in results of operations in the period that the events or circumstances giving rise to such changes occur.

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Recently Issued Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (FASB) issued authoritative accounting guidance on the disclosure of uncertainties about an entity s ability to continue as a going concern. The guidance requires management to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that financial statements are available to be issued when applicable) and to provide related footnote disclosures. The guidance is effective prospectively for fiscal years beginning after December 15, 2016, but can be early-adopted. While the adoption of this guidance is not expected to have an effect on the Company s consolidated financial statements, it could affect the disclosure applied under these circumstances in the future.

In May 2014, the FASB issued authoritative accounting guidance on a company s accounting for revenue from contracts with customers. The guidance applies to all companies that enter into contracts with customers to transfer goods, service or nonfinancial assets. The guidance requires these companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires improved disclosures regarding the nature, timing, amount and uncertainty of revenue that is recognized. The guidance is effective prospectively for fiscal years beginning after December 15, 2016. Management is currently assessing the potential impact of the adoption of this guidance on the Company s consolidated financial statements.

NOTE C. INVENTORIES

Inventories consisted of the following components (dollars in millions):

	September 30, 2014	December 31, 2013
Purchased parts and raw materials	**$ 84.2**	$ 79.7
Work in progress	**6.1**	5.7
Service parts	**44.9**	45.8
Finished goods	**26.3**	29.2
Total inventories	**$ 161.5**	$ 160.4

Inventory components shipped to third parties, primarily cores, parts to re-manufacturers, and parts to contract manufacturers, in which the Company has an obligation to buy back, are included in purchased parts and raw materials, with an offsetting liability in Other current liabilities.

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NOTE D. GOODWILL AND OTHER INTANGIBLE ASSETS

As of September 30, 2014 and December 31, 2013, the carrying amount of the Company s Goodwill was $1,941.0 million. The following presents a summary of other intangible assets (dollars in millions):

		September 30, 2014			**December 31, 2013**	
	Intangible assets, gross	**Accumulated amortization**	**Intangible assets, net**	**Intangible assets, gross**	**Accumulated amortization**	**Intangible assets, net**
Other intangible assets:						
Trade name	**$ 870.0**	**$**	**$ 870.0**	$ 870.0	$	$ 870.0
Customer relationships defense	**62.3**	**(27.0)**	**35.3**	62.3	(24.4)	37.9
Customer relationships commercial	**831.8**	**(413.8)**	**418.0**	831.8	(374.9)	456.9
Proprietary technology	**476.3**	**(272.5)**	**203.8**	476.3	(243.9)	232.4
Non-compete agreement	**17.3**	**(12.4)**	**4.9**	17.3	(11.1)	6.2
Patented technology defense	**28.2**	**(23.7)**	**4.5**	28.2	(21.2)	7.0
Tooling rights	**4.5**	**(4.3)**	**0.2**	4.5	(4.1)	0.4
Patented technology commercial	**260.6**	**(260.6)**		260.6	(260.6)	
Total	**$ 2,551.0**	**$ (1,014.3)**	**$ 1,536.7**	$ 2,551.0	$ (940.2)	$1, 610.8

As of September 30, 2014 and December 31, 2013, the net carrying value of our Goodwill and other intangibles was $3,477.7 million and $3,551.8 million, respectively.

Amortization expense related to other intangible assets for the next five years and thereafter is expected to be (dollars in millions):

	2015	**2016**	**2017**	**2018**	**2019**	**Thereafter**
Amortization expense	$ 97.1	$ 92.4	$ 89.7	$ 87.2	$ 85.7	$ 189.9

NOTE E. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with the FASB s authoritative accounting guidance on fair value measurements, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements and utilizes the best available information that maximizes the use of observable inputs and minimizes the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs. The accounting guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by the relevant guidance are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, listed equities and publicly traded bonds.

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value. At each balance sheet date, the Company performs an analysis of all instruments subject to authoritative accounting guidance and includes, in Level 3, all of those whose fair value is based on significant unobservable inputs. As of September 30, 2014 and December 31, 2013, the Company did not have any Level 3 financial assets or liabilities.

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The Company s assets and liabilities that are measured at fair value include cash and cash equivalents, available-for-sale securities, derivative instruments, assets held in a rabbi trust and a deferred compensation obligation. The Company s cash equivalents consist of short-term U.S. government backed securities. The Company s available-for-sale securities consist of ordinary shares of Torotrak plc (Torotrak) associated with a license and exclusivity agreement with Torotrak. Torotrak s listed shares are traded on the London Stock Exchange under the ticker symbol TRK. The Company s derivative instruments consist of interest rate swaps, foreign currency forward contracts and commodity swaps. The Company s assets held in the rabbi trust consist principally of publicly available mutual funds and target date retirement funds. The Company s deferred compensation obligation is directly related to the fair value of assets held in the rabbi trust.

The Company s valuation techniques used to calculate the fair value of cash and cash equivalents, available-for-sale securities, assets held in the rabbi trust and the deferred compensation obligation represent a market approach in active markets for identical assets that qualifies as Level 1 in the fair value hierarchy. The Company s valuation techniques used to calculate the fair value of derivative instruments represent a market approach with observable inputs that qualify as Level 2 in the fair value hierarchy.

The foreign currency contracts consist of forward rate contracts which are intended to hedge exposure of transactions denominated in certain currencies and reduce the impact of currency price volatility on the Company s financial results. The commodity contracts consist of forward rate contracts which are intended to hedge exposure of transactions involving purchases of component parts and energy to power our facilities, reducing the impact of commodity price volatility on the Company s financial results.

For the fair value measurement of foreign currency derivatives, the Company uses forward foreign exchange rates received from the issuing financial institution. These rates are periodically corroborated by comparing to third-party broker quotes. The foreign currency hedges are accounted for within the authoritative accounting guidance set forth on accounting for derivative instruments and hedging activities and have been recorded at fair value based upon quoted market rates. The fair values are included in Other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company generally does not elect to apply hedge accounting for these foreign currency contracts, and as a result, unrealized fair value adjustments and realized gains and losses are recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

For the fair value measurement of commodity derivatives, the Company uses forward prices received from the issuing financial institution. These rates are periodically corroborated by comparing to third-party broker quotes. The commodity derivatives are accounted for within the authoritative accounting guidance set forth on accounting for derivative instruments and hedging activities and have been recorded at fair value based upon quoted market rates. The fair values are included in Other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company has either not qualified for or not elected hedge accounting treatment for these commodity contracts, and as a result, unrealized fair value adjustments and realized gains and losses are recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.

For the fair value measurement of interest rate derivatives, the Company uses valuations from the issuing financial institution. The Company corroborates the valuation through the use of third-party valuation services using a standard replacement valuation model. The floating-to-fixed interest rate swaps are based on the London Interbank Offered Rate (LIBOR) which is observable at commonly quoted intervals. The fair values are included in other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company has not qualified for hedge accounting treatment for the interest rate swaps and, as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income.

The following table summarizes the fair value of the Company s financial assets and (liabilities) as of September 30, 2014 and December 31, 2013 (dollars in millions):

	Fair Value Measurements Using					
	Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		TOTAL	
	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
Cash and cash equivalents	**$ 208.1**	$ 184.7	**$**	$	**$ 208.1**	$ 184.7
Available-for-sale securities	**9.7**	8.2			**9.7**	8.2
Rabbi trust assets	**2.8**	1.3			**2.8**	1.3
Deferred compensation obligation	**(2.8)**	(1.3)			**(2.8)**	(1.3)
Derivative assets			**0.8**	1.6	**0.8**	1.6

Derivative liabilities			**(7.8)**	(21.4)	**(7.8)**	(21.4)
Total	**$ 217.8**	$ 192.9	**$ (7.0)**	$ (19.8)	**$ 210.8**	$ 173.1

Of the available Cash and cash equivalents, approximately $203.1 million and $179.7 million was deposited in operating accounts while approximately $5.0 million and $5.0 million was invested in U.S. government backed securities as of September 30, 2014 and December 31, 2013, respectively.

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NOTE F. DEBT

Long-term debt and maturities are as follows (dollars in millions):

	September 30, 2014	December 31, 2013
Long-term debt:		
Senior Secured Credit Facility Term B-2 Loan, variable, due 2017	**$ 348.4**	$ 423.5
Senior Secured Credit Facility Term B-3 Loan, variable, due 2019	**1,770.2**	1,783.5
Senior Notes, fixed 7.125%, due 2019	**471.3**	471.3
Total long-term debt	**$ 2,589.9**	$ 2,678.3
Less: current maturities of long-term debt	**17.9**	17.9
Total long-term debt less current portion	**$ 2,572.0**	$ 2,660.4

As of September 30, 2014, the Company had $348.4 million of indebtedness associated with Allison Transmission, Inc. s (ATI), the Company s wholly-owned subsidiary, Senior Secured Credit Facility Term B-2 Loan due 2017 (Term B-2 Loan) and $1,770.2 million of indebtedness associated with ATI s Senior Secured Credit Facility Term B-3 Loan due 2019 (Term B-3 Loan) (together the Term B-2 Loan, Term B-3 Loan and revolving credit facility defined as the Senior Secured Credit Facility). The Company also had indebtedness of $471.3 million of ATI s 7.125% senior cash pay notes due May 2019 (7.125% Senior Notes).

The fair value of the Company s long-term debt obligations as of September 30, 2014 was $2,588.5 million. The fair value is based on quoted Level 1 market prices of the Company s debt as of September 30, 2014. It is not expected that the Company would be able to repurchase a significant amount of its debt at these levels. The difference between the fair value and carrying value of the long-term debt is driven primarily by trends in the financial markets.

Senior Secured Credit Facility

The Senior Secured Credit Facility is collateralized by a lien on substantially all assets of the Company including all of ATI s capital stock and all of the capital stock or other equity interest held by the Company, ATI and each of the Company s existing and future U.S. subsidiary guarantors (subject to certain limitations for equity interests of foreign subsidiaries and other exceptions set forth in the terms of the Senior Secured Credit Facility). In the second quarter of 2014, ATI entered into an amendment with the term loan lenders under its Senior Secured Credit Facility to refinance Term B-2 Loan. The interest rate margin applicable to such refinanced loan is at the Company s option, either (a) 2.75% over the LIBOR or (b) 1.75% over the greater of the prime lending rate provided by the British Banking Association or the federal funds effective rate published by the Federal Reserve Bank of New York plus 0.50%. The Company recorded $0.3 million of new deferred financing fees in the condensed consolidated financial statements. Interest on the Term B-3 Loan, as of September 30, 2014, is equal to the LIBOR (which may not be less than 1.00%) plus 2.75% based on the Company s total leverage ratio. As of September 30, 2014, these rates were approximately 2.91% and 3.75% on the Term B-2 Loan and Term B-3 Loan, respectively, and the weighted average rate on the Senior Secured Credit Facility was approximately 3.61%. The Senior Secured Credit Facility requires minimum quarterly principal payments on the Term B-2 Loan and Term B-3 Loan as well as prepayments from certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events and from a percentage of excess cash flow, if applicable. Due to voluntary prepayments, the Company has fulfilled all Term B-2 Loan required quarterly payments through its maturity date of 2017. During the third quarter of 2014, the Company made a principal payment of $75.0 million on the Term B-2 Loan, resulting in a loss of $0.3 million associated with the write off of related deferred debt issuance costs. The minimum required quarterly principal payment on the Term B-3 Loan is $4.5 million and remains through its maturity date of 2019. As of September 30, 2014, there had been no payments required for certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events. The remaining principal balance on each loan is due upon maturity.

The Senior Secured Credit Facility also provides for revolving credit borrowings. In the first quarter of 2014, ATI increased the revolving commitments available under the revolving portion of the Senior Secured Credit Facility to $465.0 million, net of an allowance for up to $75.0 million in outstanding letters of credit commitments. The increase was treated as a modification of debt under GAAP, and thus the Company recorded $0.6 million of new deferred financing fees in the condensed consolidated financial statements. For the nine months ended September 30, 2014, the Company made one withdrawal and payment on the revolving credit facility as part of its debt management plans. The maximum amount outstanding at any time on the revolving credit facility was $40.0 million, and the entire balance was repaid within the quarter it was borrowed. As of September 30, 2014, the Company had $455.1 million available under the revolving credit facility, net of $9.9 million in letters of credit. Revolving credit borrowings bear interest at a variable base rate plus an applicable margin based on the Company s total leverage ratio. As of September 30, 2014, this rate would have been between approximately 2.16% and 4.25%. In addition, there is an annual commitment fee, based on the Company s total leverage ratio, which as of September 30, 2014, was equal to 0.375% of the average unused revolving credit borrowings available under the Senior Secured Credit Facility. Revolving credit borrowings are payable at the option of the Company throughout the term of the Senior Secured Credit Facility with the balance due in January 2019.

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The revolving portion of the Senior Secured Credit Facility requires the Company to maintain a specified maximum total senior secured leverage ratio of 5.50x when revolving loan commitments remain outstanding at the end of a fiscal quarter. On March 12, 2014, however, the revolving lenders holding a majority of the revolving loan commitments permanently waived and agreed that no event of default would result from any non-compliance so long as there were no revolving loans outstanding as of the last day of any fiscal quarter. As of September 30, 2014, the Company had no revolving loans outstanding, however the Company would have been in compliance with the maximum total senior secured leverage ratio, achieving a 2.70x ratio. Additionally within the terms of the Senior Secured Credit Facility, a senior secured leverage ratio at or below 3.50x results in the elimination of excess cash flow payments on the Senior Secured Credit Facility for the applicable year. The Senior Secured Credit Facility also provides certain financial incentives based on our total leverage ratio. A total leverage ratio at or below 4.00x results in a 25 basis point reduction to the applicable margin on the revolving credit facility, and a total leverage ratio at or below 3.50x results in a 12.5 basis point reduction to the revolving credit facility commitment fee and an additional 25 basis point reduction to the applicable margin on the revolving credit facility. A total leverage ratio at or below 3.25x results in a 25 basis point reduction to the applicable margin on our Term B-3 Loan. These reductions would remain in effect as long as the Company achieves a total leverage ratio at or below the related threshold. As of September 30, 2014, the total leverage ratio was 3.37x.

In addition, the Senior Secured Credit Facility, among other things, includes customary restrictions (subject to certain exceptions) on the Company s ability to incur certain indebtedness, grant certain liens, make certain investments or declare or pay certain dividends. As of September 30, 2014, the Company is in compliance with all covenants under the Senior Secured Credit Facility.

NOTE G. DERIVATIVES

The Company is exposed to certain financial risk from volatility in interest rates, foreign exchange rates and commodity prices. The risk is managed through the use of financial derivative instruments including interest rate swaps, foreign currency forward contracts and commodity swaps. The Company s current derivative instruments are used strictly as an economic hedge and not for speculative purposes. As necessary, the Company adjusts the values of the derivative instruments for counter-party or credit risk.

Interest Rate

The Company is subject to interest rate risk related to the Senior Secured Credit Facility and enters into interest rate swap contracts that are based on the LIBOR to manage a portion of this exposure. The Company has not elected hedge accounting treatment for these derivatives, and as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income. A summary of the Company s interest rate derivatives as of September 30, 2014 and December 31, 2013 follows (dollars in millions):

	September 30, 2014		December 31, 2013	
	Notional Amount	Fair Value	Notional Amount	Fair Value
3.75% Interest Rate Swap H, due August 2014	**$**	**$**	$ 350.0	$ (7.2)
3.77% Interest Rate Swap I, due August 2014			350.0	(7.2)
2.96% Interest Rate Swap J, due August 2014			125.0	(2.0)
3.05% Interest Rate Swap K, due August 2014			125.0	(2.0)
3.44% Interest Rate Swap L, due August 2019*	**75.0**	**(1.5)**	75.0	(0.4)
3.43% Interest Rate Swap M, due August 2019*	**100.0**	**(2.0)**	100.0	(0.4)
3.37% Interest Rate Swap N, due August 2019*	**75.0**	**(1.4)**	75.0	(0.2)
3.19% Interest Rate Swap O, due August 2019*	**75.0**	**(1.0)**	75.0	0.2
3.08% Interest Rate Swap P, due August 2019*	**75.0**	**(0.7)**	75.0	0.4
2.99% Interest Rate Swap Q, due August 2019*	**50.0**	**(0.4)**	50.0	0.4
2.98% Interest Rate Swap R, due August 2019*	**50.0**	**(0.3)**	50.0	0.4
2.73% Interest Rate Swap S, due August 2019*	**50.0**		0.0	0.0
2.74% Interest Rate Swap T, due August 2019*	**75.0**		0.0	0.0
2.66% Interest Rate Swap U, due August 2019*	**50.0**	**0.1**	0.0	0.0
2.60% Interest Rate Swap V, due August 2019*	**50.0**	**0.2**	0.0	0.0
* includes LIBOR floor of 1.00%	**$ 725.0**	**$ (7.0)**	$ 1,450.0	$ (18.0)

In July 2014, the Company entered into two new interest rate swaps to hedge its variable interest rate exposure on the Senior Secured Credit Facility. Interest Rate Swap S has a notional amount of $50.0 million and is effective from August 2016 to August 2019 at an all-in fixed rate of 2.73% and a LIBOR floor of 1.00% with no independent collateral requirement. Interest Rate Swap T has a notional amount of $75.0 million and is effective from August 2016 to August 2019 at an all-in fixed rate of 2.74% and a LIBOR floor of 1.00% with no independent collateral requirement.

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In August 2014, the Company entered into two new interest rate swaps to hedge its variable interest rate exposure on the Senior Secured Credit Facility. Interest Rate Swap U has a notional amount of $50.0 million and is effective from August 2016 to August 2019 at an all-in fixed rate of 2.66% and a LIBOR floor of 1.00% with no independent collateral requirement. Interest Rate Swap V has a notional amount of $50.0 million and is effective from August 2016 to August 2019 at an all-in fixed rate of 2.60% and a LIBOR floor of 1.00% with no independent collateral requirement.

As of September 30, 2014, the Company did not have any interest rate derivatives subject to credit-risk or collateral requirement. As of December 31, 2013, certain of the Company s interest rate derivatives contained credit-risk and collateral contingent features under which downgrades in the Company s credit rating would have required the Company to increase its collateral. As of December 31, 2013, certain interest rate derivatives also contained provisions under which the Company was required to post additional collateral if the LIBOR interest rate curve reached certain levels.

As of September 30, 2014 and December 31, 2013, the Company had recorded cash collateral of $0.0 million and $1.7 million, respectively, in Other current assets in the Condensed Consolidated Balance Sheets, as the balances are subject to frequent change.

Currency Exchange

The Company s business is subject to foreign exchange rate risk. As a result, the Company enters into various forward rate contracts that qualify as derivatives under the authoritative accounting guidance to manage certain of these exposures. Forward contracts are used to hedge forecasted transactions and known exposure of payables denominated in a foreign currency. The Company generally has not elected to apply hedge accounting under the authoritative accounting guidance and recorded the unrealized fair value adjustments and realized gains and losses associated with these contracts in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

The following table summarizes the outstanding foreign currency forward contracts as of September 30, 2014 and December 31, 2013 (amounts in millions):

	September 30, 2014		December 31, 2013	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Japanese Yen (JPY)	**¥ 600.0**	**$ (0.2)**	¥ 600.0	$ (0.3)
		$ (0.2)		$ (0.3)

Commodity

The Company s business is subject to commodity price risk, primarily with component suppliers. As a result, the Company enters into various commodity swap contracts that qualify as derivatives under the authoritative accounting guidance to manage certain of these exposures. Swap contracts are used to hedge forecasted transactions either of the commodity or of components containing the commodity. The Company has not qualified for hedge accounting treatment for these commodity contracts, and as a result, unrealized fair value adjustments and realized gains and losses associated with these contracts were charged directly to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

The following table summarizes the outstanding commodity swaps as of September 30, 2014 and December 31, 2013 (dollars in millions):

	September 30, 2014			December 31, 2013		
	Notional Amount	Quantity	Fair Value	Notional Amount	Quantity	Fair Value
Aluminum	**$ 14.8**	**7,500 metric tons**	**$ 0.1**	$ 23.8	11,875 metric tons	$ (1.6)
Natural Gas	**0.2**	**40,000 MMBtu**		0.3	90,000 MMBtu	0.0

	$	**0.1**	$	(1.6)

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The following tabular disclosures further describe the Company s derivative instruments and their impact on the financial condition of the Company (dollars in millions):

	September 30, 2014		December 31, 2013	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives not designated as hedging instruments				
Foreign currency contracts	**Other current liabilities**	**$ (0.2)**	Other current liabilities	$ (0.3)
Commodity contracts	**Other current and non-current assets**	**0.4**	Other current and non-current assets	0.1
	Other current liabilities	**(0.3)**	Other current and non-current liabilities	(1.7)
Interest rate contracts	**Other non-current assets**	**0.4**	Other non-current assets	1.5
	Other non-current liabilities	**(7.3)**	Other current and non-current liabilities	(19.5)
Total derivatives not designated as hedging instruments		**$ (7.0)**		$ (19.9)

The fair values of the derivatives are recorded between Other current and non-current assets and Other current and non-current liabilities as appropriate in the Condensed Consolidated Balance Sheets. As of September 30, 2014, the amount recorded to Other current liabilities for foreign currency contracts was ($0.2) million. The amount recorded to Other current and non-current assets for commodity contracts was $0.4 million and the amount recorded to Other current liabilities for commodity contracts was ($0.3) million. The amount recorded to Other non-current assets for interest rate contracts was $0.4 million and the amount recorded to Other non-current liabilities for interest rate contracts was ($7.3) million.

As of December 31, 2013, the amount recorded to Other current liabilities for foreign currency contracts was ($0.3) million. The amounts recorded to Other current and non-current assets for commodity contracts were $0.1 million and $0.0 million, respectively. The amounts recorded to Other current and non-current liabilities for commodity contracts were ($1.5) million and ($0.2) million, respectively. The amount recorded to Other non-current assets for interest rate contracts was $1.5 million. The amounts recorded to Other current and non-current liabilities for interest rate contracts were ($18.5) million and ($1.0) million, respectively.

The impact on the Company s Condensed Consolidated Statements of Comprehensive Income related to foreign currency and commodity contracts can be found in NOTE J, and the following tabular disclosure describes the location and impact on the Company s results of operations related to unrealized gain on interest rate derivatives (dollars in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Interest expense	**$ 4.6**	$ 5.1	**$ 11.1**	$ 23.3

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NOTE H. PRODUCT WARRANTY LIABILITIES

Product warranty liability activities consist of the following (dollars in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Beginning balance	**$ 86.7**	$ 105.6	**$ 90.5**	$ 109.7
Payments	**(7.9)**	(10.1)	**(27.0)**	(30.4)
Increase in liability (warranty issued during period)	**7.2**	7.5	**20.0**	20.8
Net adjustments to liability	**(0.7)**	(11.4)	**1.5**	(8.9)
Accretion (for Predecessor liabilities)	**0.1**	0.1	**0.4**	0.5
Ending balance	**$ 85.4**	$ 91.7	**$ 85.4**	$ 91.7

As of September 30, 2014, the current and non-current liabilities were $23.2 million and $62.2 million, respectively. As of September 30, 2013, the current and non-current liabilities were $38.6 million and $53.1 million, respectively.

During the third quarter of 2013, the Company completed an analysis of its Dual Power Inverter Module (DPIM) extended coverage program and determined, that based on additional claims data and field information, the product warranty liability should be reduced by $8.2 million.

NOTE I. DEFERRED REVENUE

As of September 30, 2014, the current and non-current liabilities related to deferred revenue for Extended Transmission Coverage (ETC) were $20.1 million and $47.9 million, respectively. As of September 30, 2013, the current and non-current liabilities related to deferred revenue for ETC were $21.3 million and $41.7 million, respectively.

Deferred revenue for ETC activity (dollars in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Beginning balance	**$ 66.8**	$ 61.1	**$ 63.6**	$ 63.5
Increases	**6.3**	7.6	**20.1**	15.7
Revenue earned	**(5.1)**	(5.7)	**(15.7)**	(16.2)
Ending balance	**$ 68.0**	$ 63.0	**$ 68.0**	$ 63.0

During 2014 and 2013, the Company recorded deferred revenue for payments received from the U.S. government for certain tracked transmissions that were not shipped at the request of the U.S. government. Deferred revenue recorded in current liabilities related to unearned net sales for defense contracts as of September 30, 2014 and 2013 was approximately $1.1 million and $0.3 million, respectively.

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NOTE J. OTHER EXPENSE, NET

Other expense, net consists of the following (dollars in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Loss on intercompany foreign exchange	**$ (1.6)**	$ (2.3)	**$ (3.4)**	$ (2.3)
Grant program income	**0.7**	0.9	**2.1**	4.1
Gain on negotiation of commercial agreement	**2.0**		**2.0**	
Impairment loss on investments in technology-related initiatives	**(2.0)**		**(2.0)**	(2.5)
Unrealized gain (loss) on derivative contracts (see NOTE G)	**0.2**	1.3	**1.7**	(1.1)
Public offering fees and expenses	**(0.3)**	(0.3)	**(1.4)**	(0.9)
Realized loss on derivative contracts (see NOTE G)	**(0.0)**	(0.7)	**(1.0)**	(2.3)
Gain (loss) on foreign exchange		0.1	**(0.5)**	(1.8)
Loss on repayments and redemptions of long-term debt	**(0.3)**	(0.5)	**(0.3)**	(0.5)
Other	**(0.4)**		**(0.2)**	0.1
Total	**$ (1.7)**	$ (1.5)	**$ (3.0)**	$ (7.2)

For the three months ended September 30, 2014, the Company recorded a loss of $1.6 million resulting from intercompany financing transactions related to our India facility, all of which was from the revaluation of the remaining intercompany liability. For the nine months ended September 30, 2014, the Company recorded a loss of $3.4 million resulting from intercompany financing transactions related to our India facility, of which $0.2 million was foreign exchange loss on an intercompany payment and $3.2 million was from the revaluation of the remaining intercompany liability.

During the nine months ended September 30, 2014, the Company completed four secondary public offerings in September, June, April and February of 5,392,499, 40,250,000, 25,000,000, and 28,750,000 shares of its common stock held by investment funds affiliated with The Carlyle Group and Onex Corporation (collectively, the Sponsors) at public offering prices, less underwriting discounts and commissions, of $30.46, $29.95, $29.78 and $29.17 per share, respectively. In connection with certain of the offerings, the Company repurchased from the underwriters 5,000,000 shares in June 2014 and 3,428,179 shares in February 2014 at the prices paid by the underwriters and subsequently retired those shares. For the three and nine months ended September 30, 2014, the Company incurred $0.3 million and $1.4 million, respectively, of expenses related to these public offerings.

During the nine months ended September 30, 2013, the Company completed one secondary public offering in September of 23,805,000 shares of its common stock held by investment funds affiliated with the Sponsors at a public offering price, less underwriting discounts and commissions, of $21.175 per share. In connection with the offering, the Company repurchased from the underwriters 4,700,000 shares at the price paid by the underwriters and subsequently retired those shares. For the three and nine months ended September 30, 2013, the Company incurred $0.3 million and $0.9 million, respectively, of expenses related to this public offering and a proposed secondary offering in April 2013.

In 2009, the Company was notified by the U.S. Department of Energy that it was selected to receive matching funds from a grant program funded by the American Recovery and Reinvestment Act for the development of Hybrid manufacturing capacity in the U.S. (the Grant Program). All applicable costs associated with the Grant Program have been charged to Engineering research and development while the Government s matching reimbursement is recorded to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income. Since inception of the Grant Program, the Company has recorded $48.1 million of Grant Program income to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.

For the three months ended September 30, 2014 and 2013, the Company recorded $0.0 million and $0.2 million, respectively, as a reduction of the basis of capital assets purchased under the Grant Program. For the nine months ended September 30, 2014 and 2013, the Company recorded $0.0 million and $2.9 million, respectively, as a reduction of the basis of capital assets purchased under the Grant Program. Under the Grant Program, the Company has acquired approximately $7.1 million of assets that have been placed in service, resulting in related depreciation of $0.0 million and $0.1 million for the three months ended September 30, 2014 and 2013, respectively, and $0.2 million and $0.2 million for the nine months ended September 30, 2014 and 2013, respectively.

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NOTE K. OTHER CURRENT LIABILITIES

Other current liabilities consist of the following (dollars in millions):

	As of September 30, 2014	As of December 31, 2013
Payroll and related costs	**$ 48.2**	$ 37.6
Sales allowances	**25.3**	26.9
Accrued interest payable	**13.9**	11.2
Vendor buyback obligation	**12.6**	11.8
Defense price reduction reserve	**12.0**	26.8
Taxes payable	**12.3**	8.6
Research and development payable	**1.7**	
Derivative liabilities	**0.4**	20.2
Other accruals	**15.2**	9.2
Total	**$ 141.6**	$ 152.3

NOTE L. EMPLOYEE BENEFIT PLANS

Components of net periodic benefit cost consist of the following (dollars in millions):

	Pension Plans Three months ended September 30,		Post-retirement Benefits Three months ended September 30,	
	2014	2013	2014	2013
Net periodic benefit cost:				
Service cost	**$ 3.3**	$ 4.1	**$ 0.5**	$ 0.8
Interest cost	**1.3**	1.0	**1.5**	1.5
Expected return on assets	**(1.9)**	(1.6)		
Prior service cost	**0.0**	0.1	**(0.9)**	(0.9)
Loss (gain)		0.2	**(0.2)**	
Net periodic benefit cost	**$ 2.7**	$ 3.8	**$ 0.9**	$ 1.4

	Pension Plans Nine months ended September 30,	Post-retirement Benefits Nine months ended September 30,