TD AMERITRADE HOLDING CORP
Form 10-Q
May 06, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2011**

OR

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from __________ to __________**

Commission file number: 0-49992

TD Ameritrade Holding Corporation
(Exact name of registrant as specified in its charter)

Delaware	**82-0543156**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4211 South 102nd Street, Omaha, Nebraska, 68127
(Address of principal executive offices) (Zip Code)
(402) 331-7856
(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, and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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 during the preceding 12 months. Yes þ No o

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

As of April 28, 2011, there were 571,360,738 outstanding shares of the registrant s common stock.

TD AMERITRADE HOLDING CORPORATION

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Part I FINANCIAL INFORMATION
Item 1. Financial Statements
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
TD Ameritrade Holding Corporation

We have reviewed the condensed consolidated balance sheet of TD Ameritrade Holding Corporation (the Company) as of March 31, 2011, and the related condensed consolidated statements of income for the three-month and six-month periods ended March 31, 2011 and 2010, and the condensed consolidated statements of cash flows for the six-month periods ended March 31, 2011 and 2010. These financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of TD Ameritrade Holding Corporation as of September 30, 2010, and the related consolidated statements of income, stockholders equity, and cash flows for the year then ended (not presented herein) and in our report dated November 19, 2010, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of September 30, 2010, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ ERNST & YOUNG LLP

Minneapolis, Minnesota
May 6, 2011

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TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	March 31, 2011 (Unaudited)	September 30, 2010
ASSETS		
Cash and cash equivalents	$ 1,081,138	$ 741,492
Short-term investments	3,598	3,592
Cash and investments segregated in compliance with federal regulations		994,026
Receivable from brokers, dealers and clearing organizations	1,049,713	1,207,723
Receivable from clients net of allowance for doubtful accounts	9,343,998	7,391,432
Receivable from affiliates	95,507	92,946
Other receivables net of allowance for doubtful accounts	85,554	68,928
Securities owned, at fair value	112,880	217,234
Property and equipment net of accumulated depreciation and amortization	306,428	272,211
Goodwill	2,466,989	2,467,013
Acquired intangible assets net of accumulated amortization	1,072,814	1,124,259
Deferred income taxes	9,119	9,915
Other assets	129,458	136,147
Total assets	$ 15,757,196	$ 14,726,918
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Payable to brokers, dealers and clearing organizations	$ 2,116,335	$ 1,934,315
Payable to clients	7,210,407	6,810,391
Accounts payable and accrued liabilities	599,536	476,306
Payable to affiliates	3,894	3,244
Deferred revenue	50,263	63,512
Long-term debt	1,279,110	1,302,269
Capitalized lease obligations	17,436	20,799
Deferred income taxes	348,902	344,203
Total liabilities	11,625,883	10,955,039
Stockholders equity:		
Preferred stock, $0.01 par value; 100 million shares authorized, none issued		
Common stock, $0.01 par value; one billion shares authorized; 631,381,860 shares issued; March 31, 2011 - 572,186,084 outstanding; September 30, 2010 - 576,134,924 outstanding	6,314	6,314
Additional paid-in capital	1,563,070	1,390,283
Retained earnings	3,381,644	3,122,305

Treasury stock, common, at cost March 31, 2011 - 59,195,776 shares; September 30, 2010 - 55,246,936 shares	(820,180)	(747,271)
Deferred compensation	272	196
Accumulated other comprehensive income	193	52
Total stockholders equity	4,131,313	3,771,879
Total liabilities and stockholders equity	$ 15,757,196	$ 14,726,918

See notes to condensed consolidated financial statements.

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TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	**2010**	**2011**	**2010**
Revenues:				
Transaction-based revenues:				
Commissions and transaction fees	$ 338,320	$ 301,272	$ 631,016	$ 610,660
Asset-based revenues:				
Interest revenue	122,804	101,412	239,624	202,652
Brokerage interest expense	(1,237)	(1,444)	(2,528)	(3,271)
Net interest revenue	121,567	99,968	237,096	199,381
Insured deposit account fees	187,471	169,963	365,942	325,295
Investment product fees	40,440	30,349	81,137	59,769
Total asset-based revenues	349,478	300,280	684,175	584,445
Other revenues	30,430	33,882	59,228	64,947
Net revenues	718,228	635,434	1,374,419	1,260,052
Operating expenses:				
Employee compensation and benefits	169,662	164,876	332,069	311,515
Clearing and execution costs	25,119	24,131	48,918	46,035
Communications	27,811	24,641	54,725	49,300
Occupancy and equipment costs	33,153	33,843	68,344	68,733
Depreciation and amortization	16,579	13,463	32,715	27,073
Amortization of acquired intangible assets	24,073	25,024	48,664	50,603
Professional services	40,059	31,465	80,376	65,172
Advertising	81,400	71,570	155,983	136,763
Gains on money market funds and client guarantees		(1,936)		(1,936)
Other	17,456	20,892	35,623	38,926
Total operating expenses	435,312	407,969	857,417	792,184
Operating income	282,916	227,465	517,002	467,868
Other expense:				
Interest on borrowings	7,486	10,937	18,310	22,567

Loss on debt refinancing				8,392
Total other expense	7,486	10,937	18,310	30,959
Pre-tax income	275,430	216,528	498,692	436,909
Provision for income taxes	103,762	53,976	181,985	138,119
Net income	$ 171,668	$ 162,552	$ 316,707	$ 298,790
Earnings per share basic	$ 0.30	$ 0.28	$ 0.55	$ 0.51
Earnings per share diluted	$ 0.30	$ 0.27	$ 0.55	$ 0.50
Weighted average shares outstanding basic	573,305	589,618	574,407	588,721
Weighted average shares outstanding diluted	579,459	596,390	580,360	596,008
Dividends declared per share	$ 0.05	$	$ 0.10	$

See notes to condensed consolidated financial statements.

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TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands, except share amounts)

	Six Months Ended March 31, 2011	2010
Cash flows from operating activities:		
Net income	$ 316,707	$ 298,790
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	32,715	27,073
Amortization of acquired intangible assets	48,664	50,603
Deferred income taxes	4,963	174,039
Loss on disposal of property	1,929	1,850
Gains on money market funds and client guarantees		(1,936)
Loss on debt refinancing		8,392
Stock-based compensation	15,730	17,504
Excess tax benefits on stock-based compensation	(8,866)	(8,414)
Other, net	121	(821)
Changes in operating assets and liabilities:		
Cash and investments segregated in compliance with federal regulations	994,026	4,264,432
Receivable from brokers, dealers and clearing organizations	158,010	312,533
Receivable from clients, net	(1,952,566)	(1,148,013)
Receivable from/payable to affiliates, net	(1,718)	(5,662)
Other receivables, net	(17,375)	4,077
Securities owned	104,354	(270,271)
Other assets	(10,614)	(13,037)
Payable to brokers, dealers and clearing organizations	182,020	(255,210)
Payable to clients	400,016	(3,065,837)
Accounts payable and accrued liabilities	129,251	(198,358)
Deferred revenue	(13,249)	5,129
Net cash provided by operating activities	384,118	196,863
Cash flows from investing activities:		
Purchase of property and equipment	(69,415)	(38,391)
Cash received in sale of business	5,228	
Purchase of short-term investments		(2,200)
Proceeds from sale and maturity of short-term investments		2,200
Proceeds from redemption of money market funds		51,478
Other, net	544	(2)
Net cash provided by (used in) investing activities	(63,643)	13,085

See notes to condensed consolidated financial statements.

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TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Unaudited)
(In thousands, except share amounts)

	Six Months Ended March 31, 2011	Six Months Ended March 31, 2010
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	$	$ 1,248,557
Payment of debt issuance costs		(10,664)
Principal payments on long-term debt	(4,262)	(1,410,638)
Principal payments on capital lease obligations	(3,363)	(7,095)
Proceeds from exercise of stock options; Six months ended March 31, 2011 - 574,958 shares; 2010 - 2,482,271 shares	2,833	8,260
Purchase of treasury stock; Six months ended March 31, 2011 - 2,241,887 shares; 2010 - 224,595 shares	(46,512)	(4,450)
Return of prepayment on structured stock repurchase	118,834	
Payment of cash dividends	(57,368)	
Excess tax benefits on stock-based compensation	8,866	8,414
Net cash provided by (used in) financing activities	19,028	(167,616)
Effect of exchange rate changes on cash and cash equivalents	143	37
Net increase in cash and cash equivalents	339,646	42,369
Cash and cash equivalents at beginning of period	741,492	791,211
Cash and cash equivalents at end of period	$ 1,081,138	$ 833,580
Supplemental cash flow information:		
Interest paid	$ 24,725	$ 11,601
Income taxes paid	$ 54,974	$ 103,331
Tax benefit on exercises and distributions of stock-based compensation	$ 8,890	$ 12,680
Noncash financing activities:		
Issuance of capital lease obligations	$	$ 4,395
Settlement of structured stock repurchase; 3,159,360 shares	$ 50,366	$

See notes to condensed consolidated financial statements.

TD AMERITRADE HOLDING CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the Three-Month and Six-Month Periods Ended March 31, 2011 and 2010
(Unaudited)

1. BASIS OF PRESENTATION

The condensed consolidated financial statements include the accounts of TD Ameritrade Holding Corporation and its wholly-owned subsidiaries (collectively, the Company). Intercompany balances and transactions have been eliminated.

These financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and, in the opinion of management, reflect all adjustments, which are all of a normal recurring nature, necessary to present fairly the financial position, results of operations and cash flows for the periods presented in conformity with U.S. generally accepted accounting principles. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s annual report filed on Form 10-K for the fiscal year ended September 30, 2010.

2. ACQUIRED INTANGIBLE ASSETS

The Company s acquired intangible assets consist of the following as of March 31, 2011 (dollars in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Client relationships	$ 1,229,431	$ (378,189)	$ 851,242
Technology and content	99,161	(26,361)	72,800
Trade names	10,100	(9,186)	914
Non-competition agreement	5,486	(3,302)	2,184
Trademark license	145,674		145,674
	$ 1,489,852	$ (417,038)	$ 1,072,814

Estimated future amortization expense for acquired intangible assets outstanding as of March 31, 2011 is as follows (dollars in thousands):

Fiscal Year	Estimated Amortization Expense
2011 Remaining	$ 47,507
2012	92,370
2013	91,102
2014	90,641
2015	89,839
2016	85,544
Thereafter (to 2025)	430,137
Total	$ 927,140

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3. CASH AND CASH EQUIVALENTS

The Company s cash and cash equivalents is summarized in the following table (dollars in thousands):

	March 31, 2011	September 30, 2010
Corporate	$ 346,748	$ 234,993
Broker-dealer subsidiaries	626,725	426,618
Trust company subsidiary	70,701	50,937
Investment advisory subsidiaries	36,964	28,944
Total	$ 1,081,138	$ 741,492

Capital requirements may limit the amount of cash available for dividend from the broker-dealer and trust company subsidiaries to the parent company. Cash and cash equivalents of the investment advisory subsidiaries is generally not available for corporate purposes.

4. INCOME TAXES

The Company s effective income tax rate for the six months ended March 31, 2011 was 36.5%, compared to 31.6% for the six months ended March 31, 2010. The provision for income taxes for the six months ended March 31, 2011 was somewhat lower than normal due to $5.4 million of favorable resolutions of state income tax matters and $1.4 million of favorable deferred income tax adjustments resulting from recent state income tax law changes. These items favorably impacted the Company s earnings for the six months ended March 31, 2011 by approximately $0.01 per share. The provision for income taxes for the six months ended March 31, 2010 was unusually low due to $28.8 million of favorable resolutions of certain federal and state income tax matters. These items favorably impacted the Company s earnings for the six months ended March 31, 2010 by approximately $0.05 per share.

5. LONG-TERM DEBT

Long-term debt consists of the following (dollars in thousands):

March 31, 2011	Face Value	Unamortized Discount	Fair Value Adjustment (1)	Net Carrying Value
Senior Notes:				
2.950% Senior Notes due 2012	$ 250,000	$ (143)	$ 7,152	$ 257,009
4.150% Senior Notes due 2014	500,000	(362)	24,782	524,420
5.600% Senior Notes due 2019	500,000	(597)	(1,722)	497,681
Total long-term debt	$ 1,250,000	$ (1,102)	$ 30,212	$ 1,279,110

September 30, 2010	Face Value	Unamortized Discount	Fair Value Adjustment (1)	Net Carrying Value
Senior Notes:				
2.950% Senior Notes due 2012	$ 250,000	$ (185)	$ 9,299	$ 259,114
4.150% Senior Notes due 2014	500,000	(411)	39,936	539,525
5.600% Senior Notes due 2019	500,000	(632)	N/A	499,368

Total Senior Notes	1,250,000	(1,228)	49,235	1,298,007
Other	4,262	N/A	N/A	4,262
Total long-term debt	$ 1,254,262	$ (1,228)	$ 49,235	$ 1,302,269

(1) Fair value adjustments relate to changes in the fair value of the debt while in a fair value hedging relationship. See Interest Rate Swaps below.

Interest Rate Swaps The Company is exposed to changes in the fair value of its fixed-rate Senior Notes resulting from interest rate fluctuations. To hedge this exposure, on December 30, 2009, the Company entered into fixed-for-variable interest

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rate swaps on the 2.950% Senior Notes due December 1, 2012 (the 2012 Notes) and the 4.150% Senior Notes due December 1, 2014 (the 2014 Notes) for notional amounts of $250 million and $500 million, respectively, with maturity dates matching the respective maturity dates of the 2012 Notes and 2014 Notes. In addition, on January 7, 2011, the Company entered into a fixed-for-variable interest rate swap on the 5.600% Senior Notes due December 1, 2019 (the 2019 Notes) for a notional amount of $500 million, with a maturity date matching the maturity date of the 2019 Notes. The interest rate swaps effectively change the fixed-rate interest on the Senior Notes to variable-rate interest. Under the terms of the interest rate swap agreements, the Company receives semi-annual fixed-rate interest payments based on the same rates applicable to the Senior Notes, and makes quarterly variable-rate interest payments based on three-month LIBOR plus (a) 0.9693% for the swap on the 2012 Notes, (b) 1.245% for the swap on the 2014 Notes and (c) 2.3745% for the swap on the 2019 Notes. As of March 31, 2011, the weighted-average effective interest rate on the Senior Notes was 1.95%.

The interest rate swaps are accounted for as fair value hedges and qualify for the shortcut method of accounting. Changes in the payment of interest resulting from the interest rate swaps are recorded as an offset to interest on borrowings on the Condensed Consolidated Statements of Income. Changes in fair value of the interest rate swaps are completely offset by changes in fair value of the related notes, resulting in no effect on net income. The following table summarizes gains and losses resulting from changes in the fair value of the interest rate swaps and the hedged fixed-rate debt:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Gain (loss) on fair value of interest rate swaps	$ 492	$ 14,856	$ (19,023)	$ 14,856
Gain (loss) on fair value of hedged fixed-rate debt	(492)	(14,856)	19,023	(14,856)
Net gain (loss) recorded in interest on borrowings	$	$	$	$

The following table summarizes the fair value of outstanding derivatives designated as hedging instruments on the Condensed Consolidated Balance Sheets (dollars in thousands):

	March 31, 2011	September 30, 2010
Derivatives recorded under the caption Other assets:		
Interest rate swap assets	$ 31,934	$ 49,235
Derivatives recorded under the caption Accounts payable and accrued liabilities:		
Interest rate swap liabilities	$ 1,722	$

The interest rate swaps are subject to counterparty credit risk. Credit risk is managed by limiting activity to approved counterparties that meet a minimum credit rating threshold and by entering into credit support agreements. The bilateral credit support agreements related to the interest rate swaps require daily collateral coverage, in the form of cash or U.S. Treasury securities, for the aggregate fair value of the interest rate swaps. As of March 31, 2011 and September 30, 2010, the interest rate swap counterparty for the 2012 Notes and 2014 Notes had pledged $34.8 million and $52.9 million of collateral, respectively, to the Company in the form of U.S. Treasury securities. As of March 31, 2011, the Company had pledged $1.8 million of collateral for the 2019 Notes to the interest rate swap counterparty in the form of cash.

6. CAPITAL REQUIREMENTS

The Company s broker-dealer subsidiaries are subject to the SEC Uniform Net Capital Rule (Rule 15c3-1 under the Securities Exchange Act of 1934), which requires the maintenance of minimum net capital, as defined. Net capital is calculated for each broker-dealer subsidiary individually. Excess net capital of one broker-dealer subsidiary may not be used to offset a net capital deficiency of another broker-dealer subsidiary. Net capital and the related net capital requirement may fluctuate on a daily basis.

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Net capital and net capital requirements for the Company s broker-dealer subsidiaries are summarized in the following table (dollars in thousands):

	March 31, 2011			September 30, 2010		
	Net Capital	Minimum Net Capital Required	Excess Net Capital	Net Capital	Minimum Net Capital Required	Excess Net Capital
TD Ameritrade Clearing, Inc.	$ 1,208,072	$ 211,121	$ 996,951	$ 1,092,692	$ 177,644	$ 915,048
TD Ameritrade, Inc.	301,337	1,000	300,337	142,859	1,000	141,859
Bellevue Chicago, LLC	N/A	N/A	N/A	39,039	250	38,789
Totals	$ 1,509,409	$ 212,121	$ 1,297,288	$ 1,274,590	$ 178,894	$ 1,095,696

TD Ameritrade Clearing, Inc. (TDAC) is a clearing broker-dealer and TD Ameritrade, Inc. is an introducing broker-dealer. Prior to October 12, 2010, Bellevue Chicago, LLC (formerly thinkorswim, Inc.) was registered as an introducing broker-dealer. On May 25, 2010, Bellevue Chicago, LLC transferred its introducing broker-dealer business to TD Ameritrade, Inc. On October 12, 2010, the Company withdrew Bellevue Chicago, LLC s registration as a broker-dealer.

The Company s non-depository trust company subsidiary, TD Ameritrade Trust Company (TDATC), is subject to capital requirements established by the State of Maine, which requires TDATC to maintain minimum Tier 1 capital, as defined. TDATC s Tier 1 capital was $19.4 million and $22.3 million as of March 31, 2011 and September 30, 2010, respectively, which exceeded the required Tier 1 capital by $9.4 million and $12.3 million, respectively.

7. COMMITMENTS AND CONTINGENCIES

Spam Litigation A purported class action, captioned *Elvey v. TD Ameritrade, Inc.*, was filed on May 31, 2007 in the United States District Court for the Northern District of California. The complaint alleges that there was a breach in TD Ameritrade, Inc. s systems, which allowed access to e-mail addresses and other personal information of account holders, and that as a result account holders received unsolicited e-mail from spammers promoting certain stocks and have been subjected to an increased risk of identity theft. The complaint requests unspecified damages and injunctive and other equitable relief. A second lawsuit, captioned *Zigler v. TD Ameritrade, Inc.*, was filed on September 26, 2007, in the same jurisdiction on behalf of a purported nationwide class of account holders. The factual allegations of the complaint and the relief sought are substantially the same as those in the first lawsuit. The cases were consolidated under the caption *In re TD Ameritrade Accountholders Litigation* and a consolidated complaint was filed. The Company hired an independent consultant to investigate whether identity theft occurred as a result of the breach. The consultant conducted four investigations from August 2007 to June 2008 and reported that it found no evidence of identity theft. On December 20, 2010, TD Ameritrade, Inc. received preliminary Court approval of a proposed class settlement agreement between TD Ameritrade, Inc. and plaintiffs Richard Holober and Brad Zigler. Under the proposed settlement, the Company will pay no less than $2.5 million in settlement benefits. Total compensation to be paid to all eligible members of the settlement class will not exceed $6.5 million, inclusive of any award of attorneys fees and costs. In addition, the settlement agreement provides that the Company will retain an independent information technology security consultant to assess whether the Company has met certain information technology security standards. The proposed settlement is subject to final approval by the Court. A hearing on final approval of the proposed settlement was held on April 19, 2011. The Court has not yet ruled on the matter.

Reserve Fund Matters During September 2008, The Reserve, an independent mutual fund company, announced that the net asset value of the Reserve Yield Plus Fund declined below $1.00 per share. The Yield Plus Fund was not a money market mutual fund, but its stated objective was to maintain a net asset value of $1.00 per share. TD Ameritrade, Inc. s clients continue to hold shares in the Yield Plus Fund (now known as Yield Plus Fund In Liquidation), which is being liquidated. On July 23, 2010, The Reserve announced that through that date it had distributed approximately 94.8% of the Yield Plus Fund assets as of September 15, 2008 and that the Yield Plus Fund had approximately $39.7 million in total remaining assets. The Reserve stated that the fund s Board of Trustees has set aside almost the entire amount of the remaining assets to cover potential claims, fees and expenses. The Company estimates that TD Ameritrade, Inc. clients current positions held in the Reserve Yield Plus Fund amount to approximately 79% of the fund.

TD Ameritrade, Inc. has received subpoenas and other requests for documents and information from the SEC and other regulatory authorities regarding TD Ameritrade, Inc. s offering of the Yield Plus Fund to clients. TD Ameritrade, Inc. is cooperating with the investigations and requests. On January 27, 2011, TD Ameritrade, Inc. entered into a settlement with the SEC, agreeing to the entry of an Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities

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Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions (Order). In the Order, the SEC finds that TD Ameritrade, Inc. failed reasonably to supervise its registered representatives with a view to preventing their violations of Section 17(a)(2) of the Securities Act of 1933 in connection with their offer and sale of the Yield Plus Fund. TD Ameritrade, Inc. did not admit or deny any of the findings in the Order, and no fine was imposed. Under the settlement agreement, TD Ameritrade, Inc. agreed to pay $0.012 per share to all eligible current or former clients that purchased shares of the Yield Plus Fund and continued to own those shares. Clients that purchased Yield Plus Fund shares through independent registered investment advisors were not eligible for the payment. In February 2011, the Company paid clients approximately $10 million under the settlement agreement.

The Pennsylvania Securities Commission has filed an administrative order against TD Ameritrade, Inc. involving the sale of Yield Plus Fund securities to 21 Pennsylvania clients. An administrative hearing will be held to determine whether there have been violations of certain provisions of the Pennsylvania Securities Act of 1972 and rules thereunder and to determine what, if any, administrative sanctions should be imposed. TD Ameritrade, Inc. is defending the action.

In November 2008, a purported class action lawsuit was filed with respect to the Yield Plus Fund. The lawsuit is captioned *Ross v. Reserve Management Company, Inc. et al.* and is pending in the U.S. District Court for the Southern District of New York. The Ross lawsuit is on behalf of persons who purchased shares of Reserve Yield Plus Fund. On November 20, 2009, the plaintiffs filed a first amended complaint naming as defendants the fund s advisor, certain of its affiliates and the Company and certain of its directors, officers and shareholders as alleged control persons. The complaint alleges claims of violations of the federal securities laws and other claims based on allegations that false and misleading statements and omissions were made in the Reserve Yield Plus Fund prospectuses and in other statements regarding the fund. The complaint seeks an unspecified amount of compensatory damages including interest, attorneys fees, rescission, exemplary damages and equitable relief. On January 19, 2010, the defendants submitted motions to dismiss the complaint. The motions are pending.

The Company estimates that its clients current aggregate shortfall, based on the original par value of their holdings in the Yield Plus Fund, less the value of fund distributions to date and the value of payments under the Company s SEC settlement, is approximately $37 million. This amount does not take into account any assets remaining in the fund that may become available for future distributions.

The Company is unable to predict the outcome or the timing of the ultimate resolution of the Pennsylvania action and the Ross lawsuit, or the potential loss, if any, that may result from these unresolved matters. However, management believes the outcome of these pending proceedings is not likely to have a material adverse effect on the financial condition, results of operations or cash flows of the Company.

Other Legal and Regulatory Matters The Company is subject to other lawsuits, arbitrations, claims and other legal proceedings in connection with its business. Some of these legal actions include claims for substantial or unspecified compensatory and/or punitive damages. A substantial adverse judgment or other unfavorable resolution of these matters could have a material adverse effect on the Company s financial condition, results of operations and cash flows or could cause the Company significant reputational harm. Management believes the Company has adequate legal defenses with respect to these legal proceedings to which it is a defendant or respondent and the outcome of these pending proceedings is not likely to have a material adverse effect on the financial condition, results of operations or cash flows of the Company. However, the Company is unable to predict the outcome or the timing of the ultimate resolution of these matters, or the potential losses, if any, that may result from these matters.

In the normal course of business, the Company discusses matters with its regulators raised during regulatory examinations or otherwise subject to their inquiry. These matters could result in censures, fines, penalties or other sanctions. Management believes the outcome of any resulting actions will not be material to the Company s financial condition, results of operations or cash flows. However, the Company is unable to predict the outcome or the timing of the ultimate resolution of these matters, or the potential fines, penalties or injunctive or other equitable relief, if any, that may result from these matters.

Income Taxes The Company s federal and state income tax returns are subject to examination by taxing authorities. Because the application of tax laws and regulations to many types of transactions is subject to varying interpretations, amounts reported in the condensed consolidated financial statements could be significantly changed at a later date upon final determinations by taxing authorities. The Toronto-Dominion Bank (TD) has agreed to indemnify the Company for tax obligations, if any, pertaining to activities of TD Waterhouse Group, Inc. (TD Waterhouse) prior to the Company s acquisition of TD Waterhouse in January 2006.

General Contingencies In the ordinary course of business, there are various contingencies that are not reflected in the condensed consolidated financial statements. These include the Company s broker-dealer subsidiaries client activities involving the execution, settlement and financing of various client securities transactions. These activities may expose the Company to credit risk in the event the clients are unable to fulfill their contractual obligations.

Client securities activities are transacted on either a cash or margin basis. In margin transactions, the Company extends credit to the client, subject to various regulatory and internal margin requirements, collateralized by cash and securities in the client s account. In connection with these activities, the Company also executes and clears client transactions involving the sale of securities not yet purchased (short sales). Such margin-related transactions may expose the Company to credit risk in the event a client s assets are not sufficient to fully cover losses that the client may incur. In the event the client fails to satisfy its obligations, the Company has the authority to purchase or sell financial instruments in the client s account at prevailing market prices in order to fulfill the client s obligations. The Company seeks to mitigate the risks associated with its client securities activities by requiring clients to maintain margin collateral in compliance with various regulatory and internal guidelines. The Company monitors required margin levels throughout each trading day and, pursuant to such guidelines, requires clients to deposit additional collateral, or to reduce positions, when necessary.

The Company loans securities temporarily to other broker-dealers in connection with its broker-dealer business. The Company receives cash as collateral for the securities loaned. Increases in securities prices may cause the market value of the securities loaned to exceed the amount of cash received as collateral. In the event the counterparty to these transactions does not return the loaned securities, the Company may be exposed to the risk of acquiring the securities at prevailing market prices in order to satisfy its client obligations. The Company mitigates this risk by requiring credit approvals for counterparties, by monitoring the market value of securities loaned on a daily basis and requiring additional cash as collateral when necessary, and by participating in a risk-sharing program offered through the Options Clearing Corporation (OCC).

The Company borrows securities temporarily from other broker-dealers in connection with its broker-dealer business. The Company deposits cash as collateral for the securities borrowed. Decreases in securities prices may cause the market value of the securities borrowed to fall below the amount of cash deposited as collateral. In the event the counterparty to these transactions does not return the cash deposited, the Company may be exposed to the risk of selling the securities at prevailing market prices. The Company mitigates this risk by requiring credit approvals for counterparties, by monitoring the collateral values on a daily basis and requiring collateral to be returned by the counterparties when necessary, and by participating in a risk-sharing program offered through the OCC.

The Company transacts in reverse repurchase agreements in connection with its broker-dealer business. The Company s policy is to take possession or control of securities with a market value in excess of the principal amount loaned, plus accrued interest, in order to collateralize resale agreements. The Company monitors the market value of the underlying securities that collateralize the related receivable on resale agreements on a daily basis and may require additional collateral when deemed appropriate.

As of March 31, 2011, client excess margin securities of approximately $12.9 billion and stock borrowings of approximately $0.8 billion were available to the Company to utilize as collateral on various borrowings or for other purposes. The Company had loaned approximately $2.1 billion and repledged approximately $1.2 billion of that collateral as of March 31, 2011.

Guarantees The Company is a member of and provides guarantees to securities clearinghouses and exchanges. Under related agreements, the Company is generally required to guarantee the performance of other members. Under these agreements, if a member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet shortfalls. The Company s liability under these arrangements is not quantifiable and could exceed the cash and securities it has posted to the clearinghouse as collateral. However, the potential for the Company to be required to make payments under these agreements is considered remote. Accordingly, no contingent liability is carried on the Condensed Consolidated Balance Sheets for these guarantees.

See Insured Deposit Account Agreement in Note 12 for a description of a guarantee included in that agreement.

Employment Agreements The Company has entered into employment agreements with several of its key executive officers. These employment agreements generally provide for annual base salary and incentive compensation, stock award acceleration and severance payments in the event of termination of employment under certain defined circumstances or changes in control of the Company. Incentive compensation amounts are based on the Company s financial performance and other factors.

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8. FAIR VALUE DISCLOSURES

Accounting Standards Codification (ASC) 820-10, *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches, including market, income and/or cost approaches. ASC 820-10 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability, developed based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company s own assumptions about the assumptions market participants would use in pricing the asset or liability, developed based on the best information available in the circumstances.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as follows:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. This category includes active exchange-traded funds, mutual funds and equity securities.

Level 2 Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Such inputs include quoted prices in markets that are not active, quoted prices for similar assets and liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means. This category includes most debt securities and other interest-sensitive financial instruments.

Level 3 Unobservable inputs for the asset or liability, where there is little, if any, observable market activity or data for the asset or liability. This category includes assets and liabilities related to money market and other mutual funds managed by The Reserve for which the net asset value has declined below $1.00 per share and the funds are being liquidated. This category also includes auction rate securities for which the periodic auctions have failed.

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The following tables present the Company s fair value hierarchy for assets and liabilities measured on a recurring basis as of March 31, 2011 and September 30, 2010 (dollars in thousands):

	As of March 31, 2011			
	Level 1	Level 2	Level 3	Fair Value
Assets:				
Short-term investments:				
U.S. government securities	$	$ 2,498	$	$ 2,498
U.S. government agency debt securities		1,100		1,100
Subtotal Short-term investments		3,598		3,598
Securities owned:				
Auction rate securities			109,385	109,385
Money market and other mutual funds			1,026	1,026
Equity securities	1,314	227		1,541
U.S. government debt securities		166		166
Municipal debt securities		117		117
Corporate debt securities		165		165
Other debt securities		480		480
Subtotal Securities owned	1,314	1,155	110,411	112,880
Other assets:				
Interest rate swaps(1)		31,934		31,934
Total assets at fair value	$ 1,314	$ 36,687	$ 110,411	$ 148,412
Liabilities:				
Accounts payable and accrued liabilities:				
Securities sold, not yet purchased:				
Equity securities	$ 1,882	$ 5	$	$ 1,887
Municipal debt securities		148		148
Corporate debt securities		10		10
Other debt securities		79		79
Subtotal Securities sold, not yet purchased	1,882	242		2,124
Interest rate swaps(1)		1,722		1,722
Total liabilities at fair value	$ 1,882	$ 1,964	$	$ 3,846

(1) See Interest Rate Swaps in Note 5 for details.

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	As of September 30, 2010			
	Level 1	Level 2	Level 3	Fair Value
Assets:				
Short-term investments:				
U.S. government securities	$	$ 2,494	$	$ 2,494
U.S. government agency debt securities		1,098		1,098
Subtotal Short-term investments		3,592		3,592
Securities owned:				
Auction rate securities			209,288	209,288
Money market and other mutual funds			5,404	5,404
Equity securities	453	10		463
Municipal debt securities		1,487		1,487
Corporate debt securities		487		487
Other debt securities		105		105
Subtotal Securities owned	453	2,089	214,692	217,234
Other assets:				
Interest rate swaps (1)		49,235		49,235
Total assets at fair value	$ 453	$ 54,916	$ 214,692	$ 270,061
Liabilities:				
Accounts payable and accrued liabilities:				
Securities sold, not yet purchased:				
Equity securities	$ 2,213	$ 14	$	$ 2,227
Municipal debt securities		375		375
Corporate debt securities		378		378
Other debt securities		161		161
Total liabilities at fair value	$ 2,213	$ 928	$	$ 3,141

(1) See Interest Rate Swaps in Note 5 for details.

There were no transfers between any levels of the fair value hierarchy during the periods presented in the tables below. The following tables present the changes in Level 3 assets and liabilities measured on a recurring basis for the three months and six months ended March 31, 2011 and 2010 (dollars in thousands):

	Three Months Ended March 31, 2011	
		Purchases,
	Net Gains	Sales,

	December 31, 2010	Included in Earnings (1)	Issuances and Settlements, Net	March 31, 2011
Assets:				
Securities owned:				
Auction rate securities	$ 194,523	$ 2,592	$ (87,730)	$ 109,385
Money market and other mutual funds	970		56	1,026
Total Securities owned	$ 195,493	$ 2,592	$ (87,674)	$ 110,411

(1) Net gains on auction rate securities are recorded in other revenues on the Condensed Consolidated Statements of Income and $0.8 million of the net gains relate to assets held as of March 31, 2011.

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	September 30, 2010	Six Months Ended March 31, 2011 Net Gains Included in Earnings (1)	Purchases, Sales, Issuances and Settlements, Net	March 31, 2011
Assets:				
Securities owned:				
Auction rate securities	$ 209,288	$ 2,971	$ (102,874)	$ 109,385
Money market and other mutual funds	5,404		(4,378)	1,026
Total Securities owned	$ 214,692	$ 2,971	$ (107,252)	$ 110,411

(1) Net gains on auction rate securities are recorded in other revenues on the Condensed Consolidated Statements of Income and $0.8 million of the net gains relate to assets held as of March 31, 2011.

	December 31, 2009	Three Months Ended March 31, 2010 Gains Included in Earnings	Purchases, Sales, Issuances and Settlements, Net	March 31, 2010
Assets:				
Short-term investments:				
Money market mutual funds	$ 39,377	$ 507(1)	$ (39,884)	$
Securities owned:				
Auction rate securities	266,657	538(2)	21,294	288,489
Money market and other mutual funds	4,607		(734)	3,873
Subtotal Securities owned	271,264	538	20,560	292,362
Total assets at fair value	$ 310,641	$ 1,045	$ (19,324)	$ 292,362

(1) Gains on money market mutual funds relate to shares of The Reserve Primary Fund that the Company continued to hold as of March 31, 2010, which were carried at a fair value of zero as of that date. These gains were included in gains on money market funds and client guarantees on the Condensed Consolidated Statements of Income.

(2) Gains on auction rate securities were recorded in other revenues on the Condensed Consolidated Statements of Income and did not relate to assets held as of March 31, 2010.

Six Months Ended March 31, 2010

Purchases,

	September 30, 2009	Gains Included in Earnings	Sales, Issuances and Settlements, Net	March 31, 2010
Assets:				
Short-term investments:				
Money market mutual funds	$ 50,971	$ 507(1)	$ (51,478)	$
Securities owned:				
Auction rate securities	14,579	909(2)	273,001	288,489
Money market and other mutual funds	5,049		(1,176)	3,873
Subtotal Securities owned	19,628	909	271,825	292,362
Total assets at fair value	$ 70,599	$ 1,416	$ 220,347	$ 292,362

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(1) Gains on money market mutual funds relate to shares of The Reserve Primary Fund that the Company continued to hold as of March 31, 2010, which were carried at a fair value of zero as of that date. These gains were included in gains on money market funds and client guarantees on the Condensed Consolidated Statements of Income.

(2) Gains on auction rate securities were recorded in other revenues on the Condensed Consolidated Statements of Income and did not relate to assets held as of March 31, 2010.

There were no nonfinancial assets or liabilities measured at fair value during the three months and six months ended March 31, 2011 and 2010.

Valuation Techniques

In general, and where applicable, the Company uses quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing methodology applies to the Company s Level 1 assets and liabilities. If quoted prices in active markets for identical assets and liabilities are not available to determine fair value, then the Company uses quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable, either directly or indirectly. This pricing methodology applies to the Company s Level 2 assets and liabilities.

Level 2 Measurements:

Debt Securities The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads.

Interest Rate Swaps These derivatives are valued using a model that incorporates interest rate yield curves, which are observable for substantially the full term of the contract. The valuation model is widely accepted in the financial services industry and does not involve significant judgment because most of the inputs are observable in the marketplace.

Level 3 Measurements:

Money Market and Other Mutual Funds The fair value of positions in money market and other mutual funds managed by The Reserve is estimated by management based on the underlying portfolio holdings data published by The Reserve.

Auction Rate Securities (ARS) ARS are long-term variable rate securities tied to short-term interest rates that are reset through a Dutch auction process, which generally occurs every seven to 35 days. Holders of ARS were previously able to liquidate their holdings to prospective buyers by participating in the auctions. During fiscal 2008, the Dutch auction process failed and holders were no longer able to liquidate their holdings through the auction process. The fair value of Company ARS holdings is estimated based on an internal pricing model. The pricing model takes into consideration the characteristics of the underlying securities as well as multiple inputs, including counterparty credit quality, expected timing of redemptions and an estimated yield premium that a market participant would require over otherwise comparable securities to compensate for the illiquidity of the ARS. These inputs require significant management judgment.

Fair Value of Senior Notes

As of March 31, 2011, the Company s Senior Notes had an aggregate estimated fair value, based on quoted market prices, of approximately $1.31 billion, compared to the aggregate carrying value of the Senior Notes on the Condensed Consolidated Balance Sheet of $1.28 billion. As of September 30, 2010, the Company s Senior Notes had an aggregate estimated fair value, based on quoted market prices, of approximately $1.34 billion, compared to the aggregate carrying value of the Senior Notes on the Condensed Consolidated Balance Sheet of $1.30 billion.

9. EARNINGS PER SHARE

The following is a reconciliation of the numerator and denominator used in the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	**2010**	**2011**	**2010**
Net income	$ 171,668	$ 162,552	$ 316,707	$ 298,790
Weighted average shares outstanding basic	573,305	589,618	574,407	588,721
Effect of dilutive securities:				
Common stock equivalent shares related to stock-based compensation	6,154	6,772	5,953	7,287
Weighted average shares outstanding diluted	579,459	596,390	580,360	596,008
Earnings per share basic	$ 0.30	$ 0.28	$ 0.55	$ 0.51
Earnings per share diluted	$ 0.30	$ 0.27	$ 0.55	$ 0.50

10. COMPREHENSIVE INCOME

Comprehensive income is as follows (dollars in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	**2010**	**2011**	**2010**
Net income	$ 171,668	$ 162,552	$ 316,707	$ 298,790
Other comprehensive income:				
Net unrealized gains (losses) on investment securities available-for-sale	1	(5)	1	(5)
Foreign currency translation adjustment	9	18	140	36
Total other comprehensive income	10	13	141	31
Comprehensive income	$ 171,678	$ 162,565	$ 316,848	$ 298,821

11. STRUCTURED STOCK REPURCHASE

On August 20, 2010, the Company entered into an agreement with an investment bank counterparty to effect a structured repurchase of up to 12 million shares of its common stock. The Company entered into this structured stock repurchase agreement in order to lower the average cost of acquiring shares of its common stock. Under the terms of the agreement, the Company prepaid $169.2 million to the counterparty, which was recorded as a reduction of additional paid-in capital on the Condensed Consolidated Balance Sheet. Settlement of the transaction occurred on December 1, 2010 and the Company purchased approximately 3.2 million shares for approximately $50.4 million ($15.94 per share). The number of shares the Company purchased from the counterparty and the purchase price were based on the average of the daily volume-weighted average share price of the Company s common stock over the measurement period for the transaction, less a pre-determined discount. Upon settlement of the transaction, the excess prepayment amount of $118.8 million was returned to the Company in cash and was recorded as additional paid-in capital.

12. RELATED PARTY TRANSACTIONS

Transactions with TD and Affiliates

As a result of the acquisition of TD Waterhouse during fiscal 2006, TD became an affiliate of the Company. TD owned approximately 43.2% of the Company s common stock as of March 31, 2011. Pursuant to the Stockholders Agreement among TD, the Company and certain other stockholders, TD has the right to designate five of twelve members of the Company s

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board of directors. The Company transacts business and has extensive relationships with TD and certain of its affiliates. A description of significant transactions with TD and its affiliates is set forth below.

Insured Deposit Account Agreement

The Company is party to an insured deposit account (IDA) agreement with TD Bank USA, N.A. (TD Bank USA), TD Bank, N.A. and TD. Under the IDA agreement, TD Bank USA and TD Bank, N.A. (together, the Depository Institutions) make available to clients of the Company FDIC-insured money market deposit accounts as either designated sweep vehicles or as non-sweep deposit accounts. The Company provides marketing, recordkeeping and support services for the Depository Institutions with respect to the money market deposit accounts. In exchange for providing these services, the Depository Institutions pay the Company a fee based on the yield earned on the client IDA assets, less the actual interest paid to clients, a flat fee to the Depository Institutions of 25 basis points and the cost of FDIC insurance premiums.

The IDA agreement has a term of five years beginning July 1, 2008, and is automatically renewable for successive five-year terms, provided that it may be terminated by any party upon two years prior written notice. The agreement provides that the fee earned on the IDA agreement is calculated based on three primary components: (a) the actual yield earned on investments in place as of July 1, 2008, which were primarily fixed-income securities backed by Canadian government guarantees, (b) the yield on other fixed-rate investments, based on prevailing fixed rates for identical balances and maturities in the interest rate swap market (generally LIBOR-based) at the time such investments were added to the IDA portfolio and (c) floating-rate investments, based on the monthly average rate for 30-day LIBOR. The agreement provides that, from time to time, the Company may request amounts and maturity dates for the other fixed-rate investments (component (b) above) in the IDA portfolio, subject to the approval of the Depository Institutions. For the month of March 2011, the IDA portfolio was comprised of approximately 4% component (a) investments, 89% component (b) investments and 7% component (c) investments.

In the event the fee computation results in a negative amount, the Company must pay the Depository Institutions the negative amount. This effectively results in the Company guaranteeing the Depository Institutions revenue of 25 basis points on the IDA agreement, plus the reimbursement of FDIC insurance premiums. The fee computation under the IDA agreement is affected by many variables, including the type, duration, credit quality, principal balance and yield of the investment portfolio at the Depository Institutions, the prevailing interest rate environment, the amount of client deposits and the yield paid on client deposits. Because a negative IDA fee computation would arise only if there were extraordinary movements in many of these variables, the maximum potential amount of future payments the Company could be required to make under this arrangement cannot be reasonably estimated. Management believes the potential for the fee calculation to result in a negative amount is remote and the fair value of the guarantee is not material. Accordingly, no contingent liability is carried on the Condensed Consolidated Balance Sheets for the IDA agreement.

Mutual Fund Agreements

The Company and an affiliate of TD are parties to a sweep fund agreement, transfer agency agreement, shareholder services agreement and a dealer agreement pursuant to which certain mutual funds are made available as money market sweep or direct purchase options to Company clients. The Company performs certain distribution and marketing support services with respect to those funds. In consideration for offering the funds and performing the distribution and marketing support services, an affiliate of TD compensates the Company in accordance with the provisions of the sweep fund agreement. The Company also performs certain services for the applicable fund and earns fees for those services. The agreement may be terminated by any party upon one year s prior written notice and may be terminated by the Company upon 30 days prior written notice under certain circumstances.

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In addition, the Company has various other services agreements and transactions with TD and its affiliates. The following tables summarize revenues and expenses resulting from transactions with TD and its affiliates (dollars in thousands):

		Revenues from TD and Affiliates			
		Three months ended		Six months ended	
	Statement of Income	March 31,		March 31,	
Description	**Classification**	**2011**	**2010**	**2011**	**2010**
Insured Deposit Account Agreement	Insured deposit account fees	$ 187,471	$ 169,963	$ 365,942	$ 325,295
Mutual Fund Agreements	Investment product fees	2,250	1,176	5,873	3,962
Referral and Strategic Alliance Agreement	Various	900	187	1,686	187
Securities borrowing and lending, net	Net interest revenue	1,378	338	2,271	739
TD Waterhouse Canada Order Routing Agreement	Other revenues	809		1,415	
TD Waterhouse UK Servicing Agreement	Commissions and transaction fees	140		250	
Payment for order flow	Commissions and transaction fees				527
Total revenues		$ 192,948	$ 171,664	$ 377,437	$ 330,710

		Expenses to TD and Affiliates			
		Three months ended		Six months ended	
	Statement of Income	March 31,		March 31,	
Description	**Classification**	**2011**	**2010**	**2011**	**2010**
Canadian Call Center Services Agreement	Professional services	$ 4,740	$ 4,451	$ 8,996	$ 8,719
Certificates of Deposit Brokerage Agreement	Advertising	806	1,246	1,845	2,276
Cash Management Services Agreement	Clearing and execution costs	225	220	428	406
Referral and Strategic Alliance Agreement	Various	453	221	1,059	221
Total expenses		$ 6,224	$ 6,138	$ 12,328	$ 11,622

The following table summarizes the classification and amount of receivables from and payables to TD and affiliates of TD on the Condensed Consolidated Balance Sheets resulting from related party transactions (dollars in thousands):

	March 31, 2011	September 30, 2010

Assets:		
Receivable from brokers, dealers and clearing organizations	$ 121	$ 1,201
Receivable from affiliates	95,507	90,523
Liabilities:		
Payable to brokers, dealers and clearing organizations	$ 117,513	$ 40,849
Payable to affiliates	3,894	3,244

Receivables from and payables to TD affiliates resulting from client cash sweep activity are generally settled in cash the next business day. Receivables from and payables to brokers, dealers and clearing organizations primarily relate to securities borrowing and lending activity and are settled in accordance with the contractual terms. Other receivables from and payables to affiliates of TD are generally settled in cash on a monthly basis.

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13. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The Senior Notes are jointly and severally and fully and unconditionally guaranteed by TD Ameritrade Online Holdings Corp. (TDAOH), a wholly-owned subsidiary of the Company. Presented below is condensed consolidating financial information for the Company, its guarantor subsidiary and its non-guarantor subsidiaries for the periods indicated.

TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATING BALANCE SHEET
AS OF MARCH 31, 2011
(Unaudited)
(In thousands)

	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Total
ASSETS					
Cash and cash equivalents	$ 133,309	$ 36,523	$ 911,306	$	$ 1,081,138
Receivable from brokers, dealers and clearing organizations			1,049,713		1,049,713
Receivable from clients, net of allowance for doubtful accounts			9,343,998		9,343,998
Investments in subsidiaries	5,445,954	5,031,427	557,306	(11,034,687)	
Receivable from affiliates	1,532	207,274	96,938	(210,237)	95,507
Goodwill			2,466,989		2,466,989
Acquired intangible assets		145,674	927,140		1,072,814
Other	77,783	5,675	590,436	(26,857)	647,037
Total assets	$ 5,658,578	$ 5,426,573	$ 15,943,826	$ (11,271,781)	$ 15,757,196
LIABILITIES AND STOCKHOLDERS EQUITY					
Liabilities:					
Payable to brokers, dealers and clearing organizations	$	$	$ 2,116,335	$	$ 2,116,335
Payable to clients			7,210,407		7,210,407
Accounts payable and accrued liabilities	107,726	18,262	478,949	(5,401)	599,536
Payable to affiliates	140,429	1,717	71,985	(210,237)	3,894
Long-term debt	1,279,110				1,279,110
Other		42,317	395,740	(21,456)	416,601
Total liabilities	1,527,265	62,296	10,273,416	(237,094)	11,625,883
Stockholders equity	4,131,313	5,364,277	5,670,410	(11,034,687)	4,131,313
Total liabilities and stockholders equity	$ 5,658,578	$ 5,426,573	$ 15,943,826	$ (11,271,781)	$ 15,757,196

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TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATING BALANCE SHEET
AS OF SEPTEMBER 30, 2010
(Unaudited)
(In thousands)

	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Total
ASSETS					
Cash and cash equivalents	$ 67,033	$ 25,058	$ 649,401	$	$ 741,492
Cash and investments segregated in compliance with federal regulations			994,026		994,026
Receivable from brokers, dealers and clearing organizations			1,207,723		1,207,723
Receivable from clients, net of allowance for doubtful accounts			7,391,432		7,391,432
Investments in subsidiaries	5,180,736	4,751,641	543,556	(10,475,933)	
Receivable from affiliates	1,782	218,437	128,147	(255,420)	92,946
Goodwill			2,467,013		2,467,013
Acquired intangible assets		145,674	978,585		1,124,259
Other	91,057	5,902	640,744	(29,676)	708,027
Total assets	$ 5,340,608	$ 5,146,712	$ 15,000,627	$ (10,761,029)	$ 14,726,918
LIABILITIES AND STOCKHOLDERS EQUITY					
Liabilities:					
Payable to brokers, dealers and clearing organizations	$	$	$ 1,934,315	$	$ 1,934,315
Payable to clients			6,810,391		6,810,391
Accounts payable and accrued liabilities	96,578	18,157	366,789	(5,218)	476,306
Payable to affiliates	174,144	1,845	82,675	(255,420)	3,244
Long-term debt	1,298,007		4,262		1,302,269
Other		42,563	410,409	(24,458)	428,514
Total liabilities	1,568,729	62,565	9,608,841	(285,096)	10,955,039
Stockholders equity	3,771,879	5,084,147	5,391,786	(10,475,933)	3,771,879
Total liabilities and stockholders equity	$ 5,340,608	$ 5,146,712	$ 15,000,627	$ (10,761,029)	$ 14,726,918

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TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATING STATEMENT OF INCOME
THREE MONTHS ENDED MARCH 31, 2011
(Unaudited)
(In thousands)

	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Total
Net revenues	$ 1,468	$ 59	$ 718,220	$ (1,519)	$ 718,228
Operating expenses	825	61	435,945	(1,519)	435,312
Operating income (loss)	643	(2)	282,275		282,916
Other expense	7,417		69		7,486
Income (loss) before income taxes and equity in income of subsidiaries	(6,774)	(2)	282,206		275,430
Provision for (benefit from) income taxes	(1,976)	(32)	105,770		103,762
Income (loss) before equity in income of subsidiaries	(4,798)	30	176,436		171,668
Equity in income of subsidiaries	176,466	181,444	10,272	(368,182)	
Net income	$ 171,668	$ 181,474	$ 186,708	$ (368,182)	$ 171,668

TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATING STATEMENT OF INCOME
THREE MONTHS ENDED MARCH 31, 2010
(Unaudited)
(In thousands)

	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Total
Net revenues	$ 2,583	$ 35	$ 635,427	$ (2,611)	$ 635,434
Operating expenses	2,194	(731)	409,117	(2,611)	407,969
Operating income	389	766	226,310		227,465
Other expense	10,634		303		10,937
Income (loss) before income taxes and equity in income of	(10,245)	766	226,007		216,528

subsidiaries					
Provision for (benefit from) income taxes	(26,347)	(4,235)	84,558		53,976
Income before equity in income of subsidiaries	16,102	5,001	141,449		162,552
Equity in income of subsidiaries	146,450	133,046		(279,496)	
Net income	$ 162,552	$ 138,047	$ 141,449	$ (279,496)	$ 162,552

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TD AMERITRADE HOLDING CORPORATION
CONDENSED CONSOLIDATING STATEMENT OF INCOME
SIX MONTHS ENDED MARCH 31, 2011
(Unaudited)
(In thousands)

	Parent	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Total
Net revenues	$ 5,293	$ 121	$ 1,374,395	$ (5,390)	$ 1,374,419
Operating expenses	4,439	125	858,243	(5,390)	857,417
Operating income (loss)	854	(4)	516,152	—	

—

5.1

Mortgage-backed securities
3.2

—

—

3.2

Total
$
10.8

$
—

$
—

$
10.8

Adjustments to the fair value of available-for-sale securities are recorded as increases or decreases, net of income taxes, within accumulated other comprehensive gain (loss) in stockholders' equity. The cost of securities sold is based on the specific identification method; realized gains and losses resulting from such sales are included in the Condensed Consolidated Statements of Comprehensive Income within "Other, net".

The company reviews its investment portfolio for any unrealized losses that would be deemed other-than-temporary and require the recognition of an impairment loss in earnings. If the cost of an investment exceeds its fair value, the company evaluates, among other factors, general market conditions, the duration and extent to which the fair value is less than its cost, the company's intent to hold the investment, and whether it is more likely than not that the company will be required to sell the investment before recovery of the amortized cost basis. The company also considers the type of security, related industry and sector performance, and published investment ratings. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established. If conditions within individual markets, industry segments, or macro-economic environments deteriorate, the company could incur future impairments.

Maturities of debt securities included in marketable securities as of August 31, 2013, are as follows.

(In millions)	Cost	Fair Value
Due within one year	$4.2	$4.2
Due after one year through five years	6.7	6.7
Due after five years through ten years	0.1	0.1
Total	$11.0	$11.0

12. COMMITMENTS AND CONTINGENCIES

Product Warranties

The company provides warranty coverage to the end-user for parts and labor on products sold. The standard length of warranty is 12 years; however, this varies depending on the product classification. The company does not sell or otherwise issue warranties or warranty extensions as stand-alone products. Reserves have been established for the various costs associated with the company's warranty program and are included in the Condensed Consolidated Balance Sheets under "Accrued warranty." General warranty reserves are based on historical claims experience and other currently available information. These reserves are adjusted once an issue is identified and the actual cost of correction becomes known or can be estimated.

(In millions)	Three Months Ended	
	August 31, 2013	September 1, 2012
Accrual Balance — beginning	$24.8	$22.2
Accrual for warranty matters	4.9	6.8
Settlements and adjustments	(5.1)	(5.4)
Accrual Balance — ending	$24.6	$23.6

Guarantees

The company is periodically required to provide performance bonds in order to do business with certain customers. These arrangements are common and generally have terms ranging between one and three years. The bonds are required to provide assurances to customers that the products and services they have purchased will be installed and/or provided properly and without damage to their facilities. The bonds are provided by various bonding agencies; however, the company is ultimately liable for claims that may occur against them. As of August 31, 2013, the company had a maximum financial exposure related to performance bonds totaling approximately $7.1 million. The company has no history of claims, nor is it aware of circumstances that would require it to pay under any of these arrangements. The company also believes that the resolution of any claims that might arise in the future, either individually or in the aggregate, would not materially affect the company's financial statements. Accordingly, no liability has been recorded as of August 31, 2013 and June 1, 2013.

The company has entered into standby letter of credit arrangements for the purpose of protecting various insurance companies against default on the payment of certain premiums and claims. A majority of these arrangements are related to the company's wholly-owned captive insurance company. As of August 31, 2013, the company had a maximum financial exposure from these standby letters of credit totaling approximately $9.7 million. Of this amount, approximately $7.3 million is considered usage against the company's revolving credit facility. The company has no history of claims, nor is it aware of circumstances that would require it to perform under any of these arrangements and believes that the resolution of any claims that might arise in the future, either individually or in the aggregate, would not materially affect the company's financial statements. Accordingly, no liability has been recorded as of August 31, 2013 and June 1, 2013.

Contingencies

The company leases a facility in the U.K. under an agreement that expired in June 2011, and the company is currently leasing the facility on a month to month basis. Under the terms of the lease, the company is required to perform the maintenance and repairs necessary to address the general dilapidation of the facility. The ultimate cost of this provision to the company is dependent on a number of factors including, but not limited to, the future use of the facility by the lessor and whether the company chooses and is permitted to renew the lease term. The company has estimated the cost of these maintenance and repairs to be between $0 million and $3.0 million, depending on the outcome of future plans and negotiations. As a result, an estimated liability of $1.3 million has been recorded under the caption “Other accrued liabilities” in the Condensed Consolidated Balance Sheets as of August 31, 2013, and June 1, 2013, respectively.

The company is also involved in legal proceedings and litigation arising in the ordinary course of business. In the opinion of management, the outcome of such proceedings and litigation currently pending will not materially affect the company's consolidated financial statements.

13. DEBT

During the second quarter of fiscal 2012, the company entered into an amendment and restatement of the syndicated revolving line of credit, which provides the company with up to $150 million in revolving variable interest borrowing capacity and includes an "accordion feature" allowing the company to increase, at its option and subject to the approval of the participating banks, the aggregate borrowing capacity of the facility by $75 million. The facility expires in November 2016 and outstanding borrowings bear interest at rates based on the prime rate, federal funds rate, LIBOR, or negotiated rates as outlined in the agreement. Interest is payable periodically throughout the period if borrowings are outstanding. As of August 31, 2013 and June 1, 2013, total usage against this facility was $7.3 million and $7.7 million, respectively, all of which related to outstanding letters of credit.

During the second quarter of fiscal 2013, the company entered into a revolving line of credit, which provides the company with approximately $5.0 million in revolving variable interest borrowing capacity. The company intends to utilize the revolver, which is denominated in Chinese Renminbi, to meet working capital cash flow needs at its Ningbo, China operations. The uncommitted facility is subject to changes in bank approval and outstanding borrowings bear interest at rates based on a benchmark lending rate. Each draw on the line of credit is subject to a maximum period of one year, and corresponding interest is payable on the maturity date of each draw. As of August 31, 2013, there were no borrowings against this facility.

Subsequent to the end of the first quarter of fiscal 2014, the company entered into a revolving line of credit, which provides the company with approximately $5.0 million in revolving variable interest borrowing capacity. The company intends to utilize the revolver, which is denominated in Chinese Renminbi, to meet working capital cash flow needs at its South China operations. The uncommitted facility is subject to changes in bank approval and outstanding borrowings bear interest at rates based on a benchmark lending rate.

14. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)
The following table provides an analysis of the changes in accumulated other comprehensive income (loss) for the three months ended August 31, 2013 and September 1, 2012:

	Three Months Ended	
(In millions)	August 31, 2013	September 1, 2012
Cumulative translation adjustments at beginning of year	$(14.0)	$(13.0)
Translation adjustments	(0.7)	2.8
Balance at end of period	(14.7)	(10.2)
Pension and other post-retirement benefit plans at beginning of year	(110.3)	(127.6)
Adjustments to pension and other post-retirement benefit plans	(0.3)	(0.6)
Reclassification to earnings - cost of sales (net of tax $(.3), $(.5))	0.5	1.0
Reclassification to earnings - operating expenses (net of tax $(.8), $(.7))	1.2	1.2
Balance at end of period	(108.9)	(126.0)
Total accumulated other comprehensive loss	$(123.6)	$(136.2)

15. RESTRUCTURING ACTIVITIES
In May 2012, the company announced a plan ("The 2012 Plan") to consolidate the Nemschoff manufacturing operations in Sheboygan, Wisconsin with the closure of the Sioux Center, Iowa seating plant. The 2012 Plan included the consolidation of the Sheboygan manufacturing sites into one location. This plan reduced fixed costs and operating expenses and improved operating performance and profitability, which further enhanced productivity. The 2012 Plan reduced the company's workforce in North America by approximately 70 employees. No additional restructuring expenses are anticipated in future periods for the 2012 Plan.

16. OPERATING SEGMENTS
The company's reportable segments consist of North American Furniture Solutions, Non-North American Furniture Solutions, and Specialty and Consumer. The North American Furniture Solutions reportable segment includes the operations associated with the design, manufacture, and sale of furniture products for work-related settings, including office, education, and healthcare environments, throughout the United States and Canada. The business associated with the company's owned contract furniture dealers is also included in the North American Furniture Solutions reportable segment. The Non-North American Furniture Solutions reportable segment includes the operations associated with the design, manufacture, and sale of furniture products, primarily for work-related settings for Mexico and outside of North America, as well as Non-North America consumer retail business. The Specialty and Consumer reportable segment includes the operations associated with the design, manufacture, and sale of high-end furniture products including Geiger wood products, Maharam textiles, Herman Miller Collection products and the company's North American consumer retail business.

The company also reports a “Corporate” category consisting primarily of startup business and unallocated corporate expenses including restructuring and impairment costs.

The accounting policies of the reportable operating segments are the same as those of the company. Additionally, the company employs a methodology for allocating corporate costs and assets with the underlying objective of this methodology being to allocate corporate costs according to the relative usage of the underlying resources and to allocate corporate assets according to the relative expected benefit. The company has determined that allocation based on relative net sales is appropriate. The majority of corporate costs are allocated to the operating segments; however, certain costs generally considered the result of isolated business decisions are not subject to allocation and are evaluated separately from the rest of the regular ongoing business operations. For example, restructuring charges that are reflected in operating earnings are allocated to the "Corporate" category.

The performance of the operating segments is evaluated by the company's management using various financial measures. The following is a summary of certain key financial measures for the respective fiscal periods indicated.

	Three Months Ended	
(In millions)	August 31, 2013	September 1, 2012
Net Sales:		
North American Furniture Solutions	$318.2	$320.3
Non-North American Furniture Solutions	81.6	94.6
Specialty and Consumer	68.3	34.8
Corporate	—	—
Total	$468.1	$449.7
Depreciation and Amortization:		
North American Furniture Solutions	$7.1	$7.1
Non-North American Furniture Solutions	2.0	1.8
Specialty and Consumer	2.0	0.6
Corporate	—	—
Total	$11.1	$9.5
Operating Earnings (Loss):		
North American Furniture Solutions	$34.0	$26.9
Non-North American Furniture Solutions	(0.1)	5.5
Specialty and Consumer	5.2	2.4
Corporate	—	(0.5)
Total	$39.1	$34.3
Capital Expenditures:		
North American Furniture Solutions	$4.5	$8.8
Non-North American Furniture Solutions	1.4	6.8
Specialty and Consumer	0.6	0.1
Corporate	—	—
Total	$6.5	$15.7

(In millions)	August 31, 2013	June 1, 2013
Total Assets		
North American Furniture Solutions	$439.5	$427.8
Non-North American Furniture Solutions	242.0	250.9
Specialty and Consumer	170.4	174.3
Corporate	121.1	93.5
Total	$973.0	$946.5
Total Goodwill		
North American Furniture Solutions	$136.0	$136.1
Non-North American Furniture Solutions	40.9	41.1
Specialty and Consumer	49.8	49.8
Corporate	—	—
Total	$226.7	$227.0

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of certain significant factors that affected the company's financial condition, earnings and cash flow during the periods included in the accompanying condensed consolidated financial statements and should be read in conjunction with the company's Annual Report on Form 10-K for the fiscal year ended June 1, 2013. References to “Notes” are to the footnotes included in the condensed consolidated financial statements.

Discussion of Current Business Conditions

Net sales in the quarter totaled $468.1 million, an increase of 4.1 percent from the same quarter last fiscal year. New orders in the first quarter were $471.2 million, 4.2 percent higher than the prior year period. Operating earnings in the first quarter were 8.4 percent of net sales, an improvement from 7.6 percent a year ago. The company's earnings in the quarter were reduced by costs associated with the previously announced strategy to terminate its domestic defined benefit pension plans. The results were also negatively impacted by non-recurring costs capitalized in inventory as part of the acquisition of Maharam. Excluding these expenses, adjusted operating earnings[1] in the first quarter were 9.3 percent of net sales - the highest level achieved by the company in almost 5 years.

Diluted earnings per share in the first quarter was $0.38 per share, compared to $0.34 per share in the same period of fiscal 2013. Excluding the impact of legacy pension and the Maharam inventory amortization, adjusted diluted earnings per share[1] in the first quarter totaled $0.43 per share. This compares to adjusted diluted earnings per share of $0.37 per share in the first quarter of last fiscal year.

Our Specialty and Consumer segment was once again a standout story this quarter with sales up more than 96 percent from the first quarter of fiscal 2013. Maharam was the single largest contributor to that performance. However, it's important to note that the Herman Miller Collection, Retail, and Geiger all experienced double digit year-on-year sales gains. This segment best illustrates our success in strategically diversifying our business into areas that offer new growth and higher margins. We are very pleased with the addition of Maharam to our Specialty and Consumer segment including the results from operations, the reaction from the market, and the contributions of the Maharam leaders and employees.

Net sales within our North American Furniture Solutions segment ended the quarter slightly ahead of our expectations, driven by improved demand from healthcare customers (including government healthcare entities) and modest growth in the core commercial office business. This growth was consistent with recent economic data which remains mixed but seems generally supportive of improving industry conditions. This includes sluggish but continued job growth, higher Architectural Billing Index ("ABI") and non-residential construction indices, and improving business sentiment—all of which is reflected in BIFMA's recent projections for this calendar year and next.

Although we did see an improvement in activity from government-related healthcare agencies, the remainder of our federal government business was again weak. This had a significant influence on overall order activity in our North American Furniture Solutions segment. The magnitude of this multi-year decline in government furniture purchases is dramatic and has been felt across our industry. While we have certainly participated in that pain, we do believe our government market share is stable relative to competitors and the sales team is earning our share of the business that is available. Despite this clear challenge, we believe Herman Miller is well positioned as more customers, both in the U.S. and abroad, search for a new office landscape that better serves the needs of their people and the performance of their business.

The pattern of demand in our Non-North American Furniture Solutions segment differed sharply from what we saw in North America this quarter. Net sales for this segment were down 13.7% compared to the same period in the prior year driven by the challenging economic environment in Europe, Australia and, to a lesser extent, some markets in Asia. The decline in sales was also exacerbated by the timing of orders, which were much stronger in the second half of the first quarter. As a result, we built backlog this quarter, which we expect to ship in future periods. In total, segment sales - adjusted for currency translation - were down 12.3% from last year. By comparison, orders (adjusted for the impact of currency translation effects) were up almost 3% - with the strongest order performance coming from Mexico and the Middle East. While we are disappointed with this segment's results for the quarter, our Non-North American team has had a strong track record of good operating results and we continue to believe the demographics of the emerging markets will result in long-term growth and opportunity for Herman Miller.

(1) Non-GAAP measurements; see accompanying reconciliations and explanations.

Our results for the quarters ended August 31, 2013 and September 1, 2012 include expenses associated with the transition from (and planned termination of) the domestic defined benefit pension plans. These expenses, referred to as, “legacy pension expenses” throughout this document, include settlements caused by the transition and net periodic benefit expenses, subsequent to September 1, 2012, related to the defined benefit plans in question. They also include incremental pension expenses in the first quarter of fiscal 2013 resulting from modifications we made to the investment strategy of our defined benefit plan assets in order to prepare for the termination process. We recognized legacy pension expenses totaling $3.1 million and $1.7 million for the first quarter of fiscal 2014 and 2013, respectively. Of these amounts, $2.1 million and $0.8 million are recorded within Operating expenses and the remaining portion is included in Cost of sales, thus reducing gross margin by approximately 20 basis points. For segment reporting purposes, $2.7 million of these legacy expenses are reflected in the company's North American Furniture Solutions business segment. The remaining portion is included in the Specialty and Consumer segment. We expect to complete the final phase of its legacy pension termination in the second quarter of fiscal 2014. The completion of this process will result in approximately $170.0 million of additional pre-tax legacy pension expenses and cash contributions to the pension plans which we currently estimate will total between $50 million and $55 million.

Capital expenditures totaled $6.5 million for the quarter ended August 31, 2013, a decrease of $9.2 million compared to the first quarter of fiscal 2013. The decrease in capital spending was primarily due to timing, and as we move through the balance of the year, we expect capital spending to ramp-up, particularly in support of several planned manufacturing facility and equipment initiatives, new products and showroom investments. We anticipate our full year capital spending to range between $55 million and $65 million.

The remaining sections within Item 2 include additional analysis of our three months ended August 31, 2013, including discussion of significant variances compared to the prior year period.

Reconciliation of Non-GAAP Financial Measures

This report contains Adjusted operating earnings measures and Adjusted earnings per share – diluted that are Non-GAAP financial measures. Adjusted operating earnings and Adjusted earnings per share – diluted are calculated by excluding from Operating earnings and Earnings per share – diluted items that we believe are not indicative of our ongoing operating performance. Such items consist of expenses associated with restructuring actions taken to adjust our cost structure to the current business climate and transition-related expenses, including amortization and settlement expenses relating to defined benefit pension plans that we intend to terminate, as well as expenses related to the step-up of inventory valuation stemming from the acquisition of Maharam. We present Adjusted operating earnings and Adjusted earnings per share – diluted because we consider them to be important supplemental measures of our performance and believe them to be useful in analyzing ongoing results from operations.

Adjusted operating earnings and Adjusted earnings per share – diluted are not measurements of our financial performance under GAAP and should not be considered an alternative to Operating earnings and Earnings per share – diluted under GAAP. Adjusted operating earnings and Adjusted earnings per share – diluted have limitations as analytical tools and should not be considered in isolation or as a substitute for analysis of our results as reported under GAAP. In addition, in evaluating Adjusted operating earnings and Adjusted earnings per share – diluted, you should be aware that in the future we may incur expenses similar to the adjustments in this presentation. Our presentation of Adjusted operating earnings and Adjusted earnings per share – diluted should not be construed as an indication that our future results will be unaffected by unusual or infrequent items. We compensate for these limitations by providing prominence of our GAAP results and using Adjusted operating earnings and Adjusted earnings per share – diluted only as a supplement.

The following table reconciles Operating earnings to Adjusted operating earnings for the periods indicated.

	Three Months Ended	
(Dollars In millions)	August 31, 2013	September 1, 2012
Operating earnings	$39.1	$34.3
Percentage of net sales	8.4 %	7.6 %
Add: Restructuring and impairment expenses	—	0.5
Add: Inventory step-up expenses	1.4	—
Add: Legacy pension expenses (1)	3.1	1.7
Adjusted operating earnings	$43.6	$36.5
Percentage of net sales	9.3 %	8.1 %

The following table reconciles Earnings per share – diluted to Adjusted earnings per share – diluted for the periods indicated.

	Three Months Ended	
	August 31, 2013	September 1, 2012
Earnings per share – diluted	$0.38	$0.34
Add: Restructuring and impairment expenses	—	0.01
Add: Inventory step-up expenses	0.02	—
Add: Legacy pension expenses (1)	0.03	0.02
Adjusted earnings per share – diluted	$0.43	$0.37

(1) At the end of fiscal 2012, the company modified the asset allocation strategy of its U.S. defined benefit pension plans. This change was made in response to the decision to close and ultimately terminate these plans. Legacy pension expenses are included as an adjustment to Operating earnings and Earnings per share – diluted only in periods subsequent to this change in allocation.

Analysis of First Quarter Results

The following table presents certain key highlights from the results of operations for the periods indicated.

(In millions, except per share data)	Three Months Ended			
	August 31, 2013	September 1, 2012	Percent Change	
Net sales	$468.1	$449.7	4.1	%
Cost of sales	298.1	300.0	(0.6	)%
Gross margin	170.0	149.7	13.6	%
Operating expenses	130.9	114.9	13.9	%
Restructuring and impairment expenses	—	0.5	(100.0	)%
Total operating expenses	130.9	115.4	13.4	%
Operating earnings	39.1	34.3	14.0	%
Net other expenses	4.6	4.3	7.0	%
Earnings before income taxes	34.5	30.0	15.0	%
Income tax expense	12.0	10.0	20.0	%
Net earnings	$22.5	$20.0	12.5	%
Earnings per share - diluted	$0.38	$0.34	11.8	%
Orders	471.2	452.0	4.2	%
Backlog	$275.7	$280.2	(1.6	)%

The following table presents, for the periods indicated, select components of the company's Condensed Consolidated Statements of Comprehensive Income as a percentage of net sales.

	Three Months Ended			
	August 31, 2013		September 1, 2012	
Net sales	100.0	%	100.0	%
Cost of sales	63.7		66.7	
Gross margin	36.3		33.3	
Operating expenses	28.0		25.6	
Restructuring and impairment expenses	—		0.1	
Total operating expenses	28.0		25.7	
Operating earnings	8.4		7.6	
Net other expenses	1.0		1.0	
Earnings before income taxes	7.4		6.7	
Income tax expense	2.6		2.2	
Net earnings	4.8		4.4	

Consolidated Sales

Net sales in the first quarter of fiscal 2014 were $468.1 million, an increase of $18.4 million from the same period last year. The fourth quarter fiscal 2013 acquisition of Maharam contributed $27.3 million in net sales in the current quarter, which was partially offset by the impact of dealer divestitures in the third quarter of fiscal 2013 and the first quarter of fiscal 2014. The dealer divestitures had the effect of reducing sales by approximately $9.9 million compared to the first quarter of fiscal 2013. The overall impact of foreign currency changes for the first quarter was to decrease net sales by approximately $1.9 million relative to the first quarter of the prior year. The impact of net changes in pricing is estimated to have had a $5.0 million increase on net sales during the first quarter of fiscal 2014. The remaining year over year change in sales was due to a decrease in sales volumes in the current period.

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The following table presents the quantification of the changes in net sales from the first quarter of fiscal 2013 to the first quarter of fiscal 2014.

(In millions)	
First Quarter Fiscal 2013 Net sales	$449.7
Acquisitions and divestitures	
Maharam acquisition	27.3
Dealer divestitures	(9.9)
Impact from foreign currency	(1.9)
Net changes in pricing	5.0
Change in sales volumes	(2.1)
First Quarter Fiscal 2014 Net sales	$468.1

Performance versus the Domestic Contract Furniture Industry

We monitor the trade statistics reported by the BIFMA, the trade association for the U.S. domestic office furniture industry, and consider them an indicator of industry-wide sales and order performance. BIFMA publishes statistical data for the contract segment and the office supply segment within the U.S. furniture market. The U.S. contract segment is primarily composed of large to mid-size corporations serviced by a network of dealers. The office supply segment is primarily made up of smaller customers serviced by wholesalers and retailers. We primarily participate, and believe we are a leader in, the contract segment. While comparisons to BIFMA are important, we continue to pursue a strategy of revenue diversification that makes us less reliant on the drivers that impact BIFMA and lessens our dependence on the U.S. office furniture market.

We also use BIFMA statistical information as a benchmark for the performance of our domestic U.S. business (as defined by BIFMA) and also to that of our competitors. The timing of large project-based business may affect comparisons to this data. We remain cautious about reaching conclusions regarding changes in market share based on analysis of data on a short term basis. Instead, we believe such conclusions should only be reached by analyzing comparative data over several quarters.

While the sales and order data for our U.S. operations provide a relative comparison to BIFMA, it is not intended to be an exact comparison. The data we report to BIFMA is consistent with the BIFMA definition of office furniture “consumption.” This definition differs slightly from the categorization we have presented in this report. Notwithstanding this difference, we believe our presentation provides the reader with a more relevant comparison.

For the three-month period ended August 31, 2013, the company's domestic U.S. shipments, as defined by BIFMA, increased 5.7 percent year-over-year, while the company's domestic orders decreased 0.1 percent. BIFMA reported an estimated year-over-year increase in shipments of 3.2 percent and an increase in orders of 1.6 percent for the comparable period.

Consolidated Gross Margin

Consolidated gross margin in the first quarter was 36.3 percent of net sales; an increase of 300 basis points compared to the first quarter last year. The benefit captured from price increases, net of incremental discounting, had the effect of increasing gross margin by approximately 100 basis points. This benefit drove an increase in net sales of approximately $5.0 million during the first quarter of fiscal 2014 relative to the first quarter of the prior year. An improvement in pricing net of incremental discounting increases net sales relative to prior periods. In addition, the acquisition of Maharam had the effect of increasing the gross margin percent by 90 basis points in the first quarter of fiscal 2014.

The following table presents, for the periods indicated, the components of the company's cost of sales as a percentage of net sales.

	Three Months Ended		
Period Ended	August 31, 2013	September 1, 2012	Change
Direct materials	40.8 %	44.3 %	(3.5)%
Direct labor	6.5	6.3	0.2
Manufacturing overhead	10.6	10.1	0.5
Freight and distribution	5.8	6.0	(0.2)
Cost of sales	63.7 %	66.7 %	(3.0)%

Direct material costs as a percent of net sales decreased 350 basis points as compared to the first quarter of fiscal 2013. The material costs as a percent of net sales decreased 40 basis points related to the impact of net pricing, 40 basis points due to lower commodity prices, 70 basis points as result of insourcing various components and products, and 20 basis points as a result of the dealer divestitures. The remaining decrease was related to favorable impact of changes in the product and channel mix compared to the prior year period.

Direct labor was 6.5 percent of net sales for the first quarter of fiscal 2014, an increase of 20 basis points from the same period last year. The acquisition of Maharam reduced the direct labor as a percent of net sales by 40 basis points. This was partially offset by the the dealer divestitures which had the effect of increasing the direct labor as a percent of net sales by 10 basis points. The remaining increase in the direct labor percent was due to the impact of changes in the product mix compared to the prior year period.

Manufacturing overhead was 10.6 percent of net sales for the first quarter of fiscal 2014, increasing 50 basis points from the first quarter of the prior year. Overhead costs as a percent of net sales were increased by 30 basis points due to higher employee incentive costs compared to the first quarter of fiscal 2013. These increases were partially offset by lower overhead costs as a percent of net sales due to the acquisition of Maharam of 10 basis points, dealer divestitures of 20 basis points, and lower medical costs of 40 basis points. The remaining increase was due to the impact of changes in the product mix compared to the prior year period.

Freight and distribution expenses, as a percentage of sales, was 5.8 percent for fiscal 2014; decreasing 20 basis points as compared to the prior year. This reduction was primarily due to the acquisition of Maharam.

Operating Expenses and Operating Earnings

First quarter operating expenses were $130.9 million, or 28.0 percent of net sales, which is an increase of $16.0 million over the first quarter of fiscal 2013. The increase in operating expenses primarily relates to legacy pension costs of $1.4 million, and the acquisition of Maharam, which contributed an additional $12.4 million of operating expenses in the quarter. In addition, research and development, marketing expenses, and employee incentive costs increased $2.3 million, $2.4 million, and $2.4 million, respectively. Warranty expenses for the period were lower by $1.9 million due to lower customer specific claims in the period compared to the prior year. The dealer divestitures in fiscal 2013 had the effect of decreasing operating expenses by $2.2 million in the first quarter of fiscal 2014 compared to the same period in the prior year. The remaining change was related to decreases in various other operating expenses compared to the prior year period.

Operating expenses are also impacted by changes in foreign currency exchange rates. During the first quarter of fiscal 2014, the estimated impact to operating expenses was a decrease of approximately $0.5 million relative to the prior year period.

The following table presents the quantification of the changes in total operating expenses from fiscal 2013 to fiscal 2014.

(In millions)		
First Quarter Fiscal 2013 Operating expenses	$115.4	
Selling, general & administrative change		
Acquisitions and divestitures		
Maharam acquisition	12.4	
Dealer divestitures	(2.2	)
Legacy pension expenses	1.4	
Warranty	(1.9	)
Marketing and selling	2.4	
Employee incentive costs	2.4	

Impact from foreign currency	(0.5)
Design and research	2.3
Other	(0.3)
Restructuring and impairment change	(0.5)
First Quarter Fiscal 2014 Operating expenses	$130.9

Operating earnings in the first quarter were $39.1 million, an increase of $4.8 million compared to the same period last year. This increase relates to improvements in gross margin of $20.3 million net of the increases in operating expenses of $16.0 million.

Other Income/Expense and Income Taxes
Net other expense of $4.6 million in the first quarter of fiscal 2014 was $0.3 million higher compared to the prior year period. The increase in the current period was primarily due to an increase in the currency loss and lower interest income due to the decrease in cash.

The effective tax rates for the three months ended August 31, 2013 and September 1, 2012 were 34.7 percent and 33.5 percent, respectively. The increase in the rate is primarily due to a mix shift of earnings between taxing jurisdictions.

Reportable Operating Segments
The business is comprised of various operating segments as defined by generally accepted accounting principles in the United States. These operating segments are determined on the basis of how the company internally reports and evaluates financial information used to make operating decisions. For external reporting purposes, the company has identified the following reportable segments:

North American Furniture Solutions — Includes the operations associated with the design, manufacture, and sale of furniture products for work-related settings, including office, education, and healthcare environments, throughout the United States and Canada. The North American Furniture Solutions reportable segment is the aggregation of two operating segments. In addition, the company has determined that both operating segments within the North American Furniture Solutions reportable segment each represent reporting units.
Non-North American Furniture Solutions — Includes the operations associated with the design, manufacture, and sale of furniture products, primarily for work-related settings, for Mexico and outside of North America as well as the company's Non-North America consumer retail business.
Specialty and Consumer — Includes the operations associated with the design, manufacture, and sale of high-end furniture products and textiles including Geiger wood products, Maharam textiles, Herman Miller Collection products and the company's North American consumer retail business.

The company also reports a corporate category consisting primarily of startup business and unallocated corporate expenses including restructuring and other related expenses (including impairment expenses). The current quarter and prior year period segment results are as follows:

(In millions)	Three Months Ended		
	August 31, 2013	September 1, 2012	Change
Net Sales:			
North American Furniture Solutions	$318.2	$320.3	$(2.1)
Non-North American Furniture Solutions	81.6	94.6	(13.0)
Specialty and Consumer	68.3	34.8	33.5
Corporate	—	—	—
Total	$468.1	$449.7	
Operating Earnings (Loss):			
North American Furniture Solutions	$34.0	$26.9	$7.1
Non-North American Furniture Solutions	(0.1)	5.5	(5.6)
Specialty and Consumer	5.2	2.4	2.8
Corporate	—	(0.5)	0.5
Total	$39.1	$34.3	

Further information regarding the reportable operating segments can be found in Note 16.

North America

Net sales within the North American Furniture Solutions reportable segment ("North America") decreased 2.1 million to $318.2 million in the first quarter, representing a 0.7 percent decrease from the first quarter last year. The impact of foreign currency changes was to decrease the first quarter fiscal 2014 net sales by approximately $0.5 million compared to the same period last year. The current quarter also experienced a $9.9 million decrease in sales due to divestitures of owned dealers. Pricing terms that were more favorable in the current quarter drove an increase in sales of $4.1 million. The remaining change in net sales was primarily driven by increased volumes.

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Operating earnings for North America in the first quarter were $34.0 million, or 10.7 percent of net sales. This compares to operating earnings of $26.9 million or 8.4 percent of net sales in the first quarter fiscal 2013. The increase in the operating earnings was primarily due to improved leverage from production caused by higher volumes and a favorable shift in product mix. Warranty expenses for the period were also lower by approximately $2.1 million due to lower customer specific claims in the period compared to the prior year. The improvement in operating earnings was partially offset by a decrease in operating earnings of $0.9 million related to the sale of owned dealers, as well as an increase in employee incentives of $3.0 million and legacy pension costs of $1.0 million as compared to the prior year.

Non-North America
Net sales within the Non-North American Furniture Solutions reportable segment ("Non-North America") were $81.6 million in the first quarter, a decrease of $13.0 million from the first quarter of fiscal 2013. Net sales decreased due to the impact of foreign currency changes by approximately $1.4 million compared to the same period in the prior fiscal year. The remaining decrease in sales was due primarily to lower volumes across the Non-North America business.

Operating earnings within Non-North America were a loss of $0.1 million and income of $5.5 million for the first quarter of fiscal 2014 and fiscal 2013, respectively. The impact of foreign currency changes decreased the operating earnings in the current period for Non-North America by approximately $0.7 million compared to the same period in the prior year. The remaining decrease in operating earnings was primarily driven by declining leverage due to the lower sales volumes.

Specialty and Consumer
Net sales for the first quarter within the Specialty and Consumer reportable segment were $68.3 million compared to $34.8 million in the prior year period. Net sales during the quarter increased by $27.3 million due to the acquisition of Maharam. Pricing net of discounting was favorable compared to the first quarter of 2013 resulting in increased sales of $0.9 million. The remaining change in net sales was primarily driven by increased volumes.

Operating earnings within Specialty and Consumer were $5.2 million for the first quarter of fiscal 2014 or 7.6 percent of net sales. This compares to operating earnings of $2.4 million or 6.9 percent of net sales in the same period in the prior fiscal year. Operating earnings for the period increased mainly due to the results of Maharam, which added operating earnings of $1.5 million as compared to the same period in the prior year. The remaining change in operating earnings as a percent of net sales was driven by improved net pricing and increased sales volumes in the current period.

Financial Condition, Liquidity, and Capital Resources
The table below presents certain key cash flow and capital highlights for the periods indicated.

(In millions)	Three Months Ended	
	August 31, 2013	September 1, 2012
Cash and cash equivalents, end of period	$110.1	$184.3
Marketable securities, end of period	11.0	9.2
Cash provided by operating activities	38.2	28.7
Cash used in investing activities	(6.2)	(15.1)
Cash used in financing activities	(4.3)	(1.3)
Capital expenditures	(6.5)	(15.7)
Stock repurchased and retired	(3.8)	(0.4)
Common stock issued	6.1	0.4
Dividends paid	(7.3)	(1.3)
Interest-bearing debt, end of period	250.0	250.0
Available unsecured credit facility, end of period [1]	142.7	142.3

(1) Amounts shown are net of outstanding letters of credit of $7.3 million and $7.7 million as of August 31, 2013 and September 1, 2012, respectively, which are applied against the company's unsecured credit facility.

Cash Flow — Operating Activities
Cash generated from operating activities was $38.2 million for the three months ended August 31, 2013, as compared to $28.7 million in the prior year.

Three Months Ended August 31, 2013
Through the first three months of fiscal 2014, changes in working capital balances drove an inflow of cash totaling $3.3 million. The main factors driving the increase in cash from working capital were a decrease in accounts receivable of $4.8 million and an increase in accrued income taxes of $15.1 million. These factors more than offset drivers within working capital that decreased cash, such as an increase in prepaid expenses of $6.0 million and a decrease in accrued compensation and benefits of $6.5 million.

The company froze future benefit accruals of its primary domestic defined benefit plan as of September 1, 2012. The termination process is expected to be completed during fiscal 2014. During the second quarter of fiscal 2014, the company expects to make the final plan contributions necessary to complete the termination process which are estimated to total between $50.0 million and $55.0 million.

Three Months Ended September 1, 2012
Through the first three months of fiscal 2013, changes in working capital balances drove a use of cash totaling $0.9 million. The main factors impacting working capital were an increase in accounts receivable and inventory of $6.6 million and $2.1 million, respectively. These amounts were partially offset by a decrease in prepaid expenses of $8.3 million. The company also contributed cash of $3.7 million to its defined benefit plans during the first three months of fiscal 2013.

Cash Flow — Investing Activities
The most significant cash outflow during the first three months of fiscal 2014 relates to investments in capital assets. The company purchased $6.5 million of capital assets in fiscal 2014 compared to $15.7 million in the first three months of fiscal 2013. In the same period of the prior year, $5.5 million of the capital expenditures related to the company's purchase of property in Ningbo, China. At the end of the first quarter of fiscal 2014, there were outstanding commitments for capital purchases of $8.8 million compared to $12.1 million for the same period in the prior year. The company expects full-year capital purchases to range between $55 million and $65 million primarily related to planned investments in the company's facilities. This compares to full-year capital spending of $50.2 million in fiscal 2013.

Cash Flow — Financing Activities
Cash outflows used in financing activities were $4.3 million for the first three months of fiscal 2014 compared to $1.3 million in the first three months of the prior year. Cash outflows for dividend payments were $7.3 million and $1.3 million for the first three months of fiscal 2014 and fiscal 2013, respectively. Dividend payments this quarter reflected the increased quarterly dividend of $0.125 per share that the company announced during the third quarter of fiscal 2013. Cash inflows for stock issuances related to employee benefit programs were $6.1 million and $0.4 million during the first three months of fiscal 2014 and fiscal 2013, respectively.

Outstanding standby letters of credit totaled $9.7 million of which $7.3 million is considered as usage against the company's unsecured revolving credit facility at the end of the first quarter of fiscal 2014. At the end of the first quarter the availability under this credit facility was $142.7 million. The provisions of the private placement notes and unsecured credit facility require that the company adhere to certain covenant restrictions and maintain certain performance ratios. The company was in compliance with all such restrictions and performance ratios this quarter and expects to remain in compliance in the future.

At the end of the first quarter of fiscal 2014, the company had cash and cash equivalents of $110.1 million including $45.0 million of cash and cash equivalents held outside the U.S. In addition, the company had marketable securities of $11.0 million held by one of its international subsidiaries. The subsidiary holding the company's marketable securities is taxed as a U.S. taxpayer at the company's election; consequently, for tax purposes all U.S. tax impacts for this subsidiary have been recorded. The company currently has no plans to repatriate cash from foreign subsidiaries during fiscal 2014. The company has $4.7 million of cash held outside of the U.S. for which all U.S. taxes have been recorded. The company's intent is to permanently reinvest the remainder of the cash outside of the U.S. The company's plans do not indicate a need to repatriate these balances to fund U.S. operations.

The company believes cash on hand, cash generated from operations, and the borrowing capacity will provide adequate liquidity to fund near term and future business operations and capital needs.

Contractual Obligations
Contractual obligations associated with the ongoing business and financing activities will require cash payments in future periods. A table summarizing the amounts and estimated timing of these future cash payments was provided in the company's Form 10-K filing for the year ended June 1, 2013.

Guarantees
The company provides certain guarantees to third parties under various arrangements in the form of product warranties, loan guarantees, standby letters of credit, lease guarantees, performance bonds and indemnification provisions. These arrangements are accounted for and/or disclosed in accordance with FASB ASC Topic 460, Guarantees, as described in Note 12 to the condensed consolidated financial statements.

Variable Interest Entities
On occasion, the company provides financial support to certain independent dealers in the form of term loans, lines of credit, and/or loan guarantees that may represent variable interests in such entities. As of August 31, 2013, the company was not considered to be the primary beneficiary of any such dealer relationships under FASB ASC Topic 810, Consolidation. Accordingly, the company is not required to consolidate the financial statements of any of these entities as of August 31, 2013.

The risk and rewards associated with the interests in these dealerships are primarily limited to the outstanding loans and guarantee amounts. As of August 31, 2013, the company's maximum exposure to potential losses, net of reserve amounts, related to outstanding loans to these other entities was zero.

Contingencies
See Note 12 to the condensed consolidated financial statements.

Critical Accounting Policies
The company strives to report financial results clearly and understandably. The company follows accounting principles generally accepted in the United States in preparing its consolidated financial statements, which require certain estimates and judgments that affect the financial position and results of operations for the company. The company continually reviews the accounting policies and financial information disclosures. A summary of the more significant accounting policies that require the use of estimates and judgments in preparing the financial statements is provided in the company's Form 10-K filing for the year ended June 1, 2013. During the first three months of fiscal 2014, there was no material change in the accounting policies and assumptions previously disclosed.

New Accounting Standards
See Note 2 to the condensed consolidated financial statements.

Safe Harbor Provisions
Certain statements in this filing are not historical facts but are “forward-looking statements” as defined under Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act, as amended. Such statements are based on management's beliefs, assumptions, current expectations, estimates and projections about the office furniture industry, the economy and the company itself. Words like “anticipates,” “believes,” “confident,” “estimates,” “expects,” “forecasts,” “likely,” “plans,” “projects,” “should,” variations of such words, and similar expressions id such forward-looking statements. These statements do not guarantee future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict with regard to timing, extent, likelihood, and degree of occurrence. These risks include, without limitation, employment and general economic conditions, the pace of economic activity in the U.S. and in our international markets, the estimate and timing of anticipated pension amortization, settlement expenses and defined benefit plan pension contributions, the pace and level of government procurement, the increase in white collar employment, the willingness of customers to undertake capital expenditures,

the types of products purchased by customers, competitive pricing pressures, the availability and pricing of raw materials, our reliance on a limited number of suppliers, currency fluctuations, the ability to increase prices to absorb the additional costs of raw materials, the financial strength of our dealers, the financial strength of our customers, the mix of our products purchased by customers, our ability to attract and retain key executives and other qualified employees, our ability to continue to make product innovations, the success of newly introduced products, our ability to obtain targeted margins from new products, our ability to serve all of our markets, possible acquisitions, divestitures or alliances, the outcome of pending litigation or governmental audits or investigations, political risk in the international markets we serve, and other risks identified in our filings with the Securities and Exchange Commission. Therefore, actual results and outcomes may materially differ from what we express or forecast. Furthermore, Herman Miller, Inc. undertakes no obligation to update, amend, or clarify forward-looking statements.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

The information concerning quantitative and qualitative disclosures about market risk contained in the company's Annual Report on Form 10-K for its fiscal year ended June 1, 2013 is incorporated herein by reference.

Direct Material Costs
The company is exposed to risks arising from market price changes for certain direct materials used in its manufacturing processes. The largest direct material costs incurred by the company are for steel, plastic/textiles, wood particleboard, and aluminum components. The market price of plastics and textiles are sensitive to the cost of oil and natural gas. The cost of wood particleboard has been impacted by continual downsizing of production capacity in the wood market. Aluminum component prices are sensitive to changes in energy costs associated with the conversion of raw materials to aluminum ingots.

Defined Benefit Pension Plans
The company is exposed to risks in its defined benefit pension plan balance sheet liability arising from sensitivity to changes in yields on high-quality corporate bonds, which are used to determine the Projected Benefit Obligation ("PBO"), and on actual market returns on plan assets. An increase or decrease to bond yields causes an inverse effect on the PBO and increased or decreased returns on assets have a corresponding one-to-one effect on the balance sheet liability. A decline in the value of pension plan assets or rise in pension plan PBO could result in increases to the balance sheet pension liability, increases in pension expense, and increases in required funding. At the end of fiscal year 2013, the discount rate used for establishing the primary U.S. defined benefit plan's balance sheet liability and projected fiscal 2014 net periodic benefit costs was 3.43 percent. As a rule of thumb, the company views a change of 100 basis points (in this discount rate) as having a 10 percent effect on the plan's Projected Benefit Obligation or an approximately $31 million effect on the pension balance sheet liability. Generally, both the PBO and plan assets are determined as of the fiscal year-end measurement date.

The company's strategy to close and terminate its domestic defined benefit pension plans will likely require benefit distributions in the form of purchased annuity contracts for certain plan participants. The cost of these contracts will depend on a variety of market specific factors, including but not limited to the general level of demand in the market for similar annuity contracts, the profile of plan participants who elect to have their benefits distributed in the form of an annuity, and the level of market interest rates at the time of purchase. The company expects the termination process to be completed during the second quarter of fiscal 2014. At the time of termination, the company will be required to make additional contributions to the plans. The company estimates that this additional funding will total between $50 million and $55 million.

Foreign Exchange Risk
The company manufactures its products in the United States, United Kingdom and China. It also sources completed products and product components from outside the United States. The company's completed products are sold in numerous countries around the world. Sales in foreign countries as well as certain expenses related to those sales are transacted in currencies other than the company's reporting currency, the U.S. dollar. Accordingly, production costs and profit margins related to these sales are affected by the currency exchange relationship between the countries where the sales take place and the countries where the products are sourced or manufactured. These currency exchange relationships can also affect the company's competitive positions within these markets.

In the normal course of business, the company enters into contracts denominated in foreign currencies. The principal foreign currencies in which the company conducts its business are the British pound sterling, European euro, Canadian dollar, Australian dollar, Japanese yen, Mexican peso, Brazilian real, Indian rupee, Hong Kong dollar and Chinese renminbi. As of August 31, 2013, thirteen contracts in total were placed to offset various currency exposures. To offset net asset exposure denominated in non-functional currency, six forward contracts were placed, including two forward contracts to sell 5.2 million euros, one forward contract to sell 0.4 million Australian dollars, two forward contracts to sell 2.8 million U.S. dollars, and one forward contract to sell 26.5 million Hong Kong dollars. Conversely, six contracts were placed to offset the company's net liability exposure denominated in non-functional currency. These six contracts included forward contracts to buy 8.7 million U.S. dollars and 0.3 million British pound sterling. As of June 1, 2013, the company had outstanding, thirteen forward currency instruments designed to offset either net asset or net liability exposure that was denominated in non-functional currencies. One forward contract was placed to offset a 9.5 million Hong Kong dollar-denominated net asset exposure, two forward contracts were placed to offset a 6.4 million euro-denominated net asset exposure, two forward contracts were placed to offset a 5.4 million U.S. dollar-denominated net asset exposure, and one forward contract was placed to offset a 0.6 million Australian dollar-denominated net asset exposure. One forward contract was placed to offset 1.3 million British pound sterling-denominated net liability exposure and six forward contracts were placed to offset a 6.7 million U.S.dollar-denominated net liability exposure.

Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision of, and with the participation of management, the company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of August 31, 2013, and have concluded that as of that date, the company's disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

There were no changes in the company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the quarterly period ended August 31, 2013, that have materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting.

HERMAN MILLER, INC.
PART II — OTHER INFORMATION

Item 1: Legal Proceedings

Referred to in Note 12 of the condensed consolidated financial statements.

Item 1A: Risk Factors

There have been no material changes in the assessment of the company's risk factors from those set forth in the Annual Report on Form 10-K for the year ended June 1, 2013.

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

(A) Issuer Purchases of Equity Securities

The following is a summary of share repurchase activity during the quarter ended August 31, 2013.

Period	(a) Total Number of Shares (or Units) Purchased[1]	(b) Average price Paid per Share or Unit	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be Purchased Under the Plans or Programs (in millions)
6/2/13 - 6/29/13	238	$27.71	238	$163.0
6/30/13 - 7/27/13	131,748	$28.79	131,748	$159.2
7/28/13 - 8/31/13	96	$26.80	96	$159.2
Total	132,082		132,082	

[1] No shares were purchased outside of a publicly announced plan or program.

No repurchase plans expired or were terminated during the first quarter of fiscal 2014, nor do any plans exist under which the company does not intend to make further purchases.

During the period covered by this report, the company did not sell any of its equity shares that were not registered under the Securities Act of 1933.

Item 3: Defaults upon Senior Securities — None

Item 4: Mine Safety Disclosures — Not applicable

Item 5: Other Information — None

Item 6: Exhibits

The following exhibits (listed by number corresponding to the Exhibit table as Item 601 in Regulation S-K) are filed with this Report:

Exhibit Number	Document
10	Material Contracts

(a) Letter agreement dated July 16, 2013 between Herman Miller Inc. and Ken Goodson, exhibit 10.1.

(b) Form of Herman Miller, Inc. Long-Term Incentive Plan TSR Performance Share Award Agreement, exhibit 10.2.

(c) Form of Herman Miller, Inc. Long-Term Incentive Plan EBITDA Performance Share Unit Award Agreement, exhibit 10.3.

(d) Officers' Supplemental Retirement Income Plan, exhibit 10.4.

(e) Officers' Salary Continuation Plan, exhibit 10.5.

(f) Herman Miller, Inc. Executive Equalization Retirement Plan, exhibit 10.6.

(g) Herman Miller, Inc. Executive Equalization Retirement Plan - First Amendment, exhibit 10.7.

31.1	Certificate of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certificate of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

SIGNATURES

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

HERMAN MILLER, INC.

October 9, 2013	/s/ Brian C. Walker Brian C. Walker Chief Executive Officer (Duly Authorized Signatory for Registrant)
October 9, 2013	/s/ Gregory J. Bylsma Gregory J. Bylsma Chief Financial Officer (Duly Authorized Signatory for Registrant)

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