

CARPENTER TECHNOLOGY CORP

Form 10-Q

February 07, 2014

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2013

or

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 1-5828

CARPENTER TECHNOLOGY CORPORATION

(Exact name of Registrant as specified in its Charter)

Delaware

(State or other jurisdiction of incorporation or organization)

23-0458500

(I.R.S. Employer Identification No.)

P.O. Box 14662

Reading, Pennsylvania

(Address of principal executive offices)

19610

(Zip Code)

610-208-2000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Indicate by check mark 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: Accelerated filer:

Non-accelerated filer: (Do not check if a smaller reporting company) Smaller reporting company:

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

Yes No

The number of shares outstanding of the issuer's common stock as of January 30, 2014 was 53,062,414.

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CARPENTER TECHNOLOGY CORPORATION

FORM 10-Q

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Table of Contents**PART I****Item 1. Financial Statements****CARPENTER TECHNOLOGY CORPORATION****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

(in millions, except share data)

	December 31, 2013	June 30, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 106.2	\$ 257.5
Accounts receivable, net	266.2	342.0
Inventories	721.2	659.2
Deferred income taxes	-	2.7
Other current assets	29.6	20.1
Total current assets	1,123.2	1,281.5
Property, plant and equipment, net	1,331.0	1,168.4
Goodwill	257.7	257.7
Other intangibles, net	88.1	95.0
Other assets	95.4	80.3
Total assets	\$ 2,895.4	\$ 2,882.9
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 211.6	\$ 252.7
Accrued liabilities	146.6	168.5
Deferred income taxes	3.4	-
Total current liabilities	361.6	421.2
Long-term debt, net of current portion	604.3	604.2
Accrued pension liabilities	255.6	246.9
Accrued postretirement benefits	149.1	151.2
Deferred income taxes	74.6	73.3
Other liabilities	73.5	83.0
Total liabilities	1,518.7	1,579.8
Contingencies and commitments (see Note 8)		
STOCKHOLDERS EQUITY		
Common stock authorized 100,000,000 shares; issued 55,113,804 shares at December 31, 2013 and 54,925,335 shares at June 30, 2013; outstanding 53,046,624 shares at December 31, 2013 and 52,773,060 shares at June 30, 2013	275.6	274.6
Capital in excess of par value	259.4	254.4

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Reinvested earnings	1,262.2	1,217.3
Common stock in treasury (2,067,180 shares and 2,152,275 shares at December 31, 2013 and June 30, 2013, respectively), at cost	(103.3)	(107.5)
Accumulated other comprehensive loss	(317.2)	(335.7)
Total equity	1,376.7	1,303.1
Total liabilities and equity	\$ 2,895.4	\$ 2,882.9

See accompanying notes to consolidated financial statements

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

(in millions, except per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
NET SALES	\$ 503.5	\$ 533.5	\$ 1,002.1	\$ 1,078.5
Cost of sales	408.1	430.9	803.3	866.5
Gross profit	95.4	102.6	198.8	212.0
Selling, general and administrative expenses	47.9	49.9	95.5	97.7
Operating income	47.5	52.7	103.3	114.3
Interest expense	(3.7)	(4.4)	(8.2)	(9.6)
Other income, net	0.6	1.3	0.8	3.9
Income before income taxes	44.4	49.6	95.9	108.6
Income tax expense	14.9	16.4	31.8	35.9
Net income	29.5	33.2	64.1	72.7
Less: Net income attributable to noncontrolling interest	-	(0.2)	-	(0.5)
NET INCOME ATTRIBUTABLE TO CARPENTER	\$ 29.5	\$ 33.0	\$ 64.1	\$ 72.2
EARNINGS PER COMMON SHARE:				
Basic	\$ 0.55	\$ 0.62	\$ 1.20	\$ 1.36
Diluted	\$ 0.55	\$ 0.62	\$ 1.19	\$ 1.35
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	53.2	52.9	53.2	52.8
Diluted	53.6	53.3	53.6	53.2
Cash dividends per common share	\$ 0.18	\$ 0.18	\$ 0.36	\$ 0.36

See accompanying notes to consolidated financial statements

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

(\$ in millions)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Net income	\$ 29.5	\$ 33.2	\$ 64.1	\$ 72.7
Other comprehensive income (loss), net of tax				
Pension and post-retirement benefits, net of tax of \$(2.0) \$(2.6), \$(4.3) and \$(5.2), respectively	3.9	4.4	7.5	8.8
Net gain (loss) on derivative instruments, net of tax of \$(1.4), \$8.1, \$(3.6) and \$(3.5), respectively	2.4	(13.8)	6.0	5.9
Unrealized gain on marketable securities, net of tax of \$0.0, \$0.0, \$0.0 and \$0.0, respectively	0.2	0.1	0.1	0.1
Foreign currency translation	1.4	1.3	4.9	5.8
Other comprehensive income (loss)	7.9	(8.0)	18.5	20.6
Comprehensive income	37.4	25.2	82.6	93.3
Less: Comprehensive income attributable to the noncontrolling interest	-	(0.2)	-	(0.7)
Comprehensive income attributable to Carpenter	\$ 37.4	\$ 25.0	\$ 82.6	\$ 92.6

See accompanying notes to consolidated financial statements

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(\$ in millions)

	Six Months Ended December 31,	
	2013	2012
OPERATING ACTIVITIES		
Net income	\$ 64.1	\$ 72.7
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	53.5	51.1
Deferred income taxes	(0.7)	(0.3)
Net pension expense	28.0	34.3
Net loss on disposal of property and equipment	0.1	0.5
Changes in working capital and other:		
Accounts receivable	78.8	69.8
Inventories	(59.3)	(88.8)
Other current assets	(9.6)	(8.3)
Accounts payable	(41.2)	(48.0)
Accrued liabilities	(35.2)	(20.4)
Pension plan contributions	(3.1)	(57.9)
Other, net	(4.4)	(2.5)
Net cash provided from operating activities	71.0	2.2
INVESTING ACTIVITIES		
Purchases of property, equipment and software	(212.4)	(136.9)
Proceeds from disposals of property and equipment	0.3	0.1
Proceeds from sale of equity method investment	-	7.9
Net cash used for investing activities	(212.1)	(128.9)
FINANCING ACTIVITIES		
Dividends paid	(19.2)	(19.1)
Purchase of subsidiary shares from noncontrolling interest	-	(8.4)
Tax benefits on share-based compensation	1.9	3.3
Proceeds from stock options exercised	5.6	1.9
Net cash used for financing activities	(11.7)	(22.3)
Effect of exchange rate changes on cash and cash equivalents	1.5	1.1
DECREASE IN CASH AND CASH EQUIVALENTS	(151.3)	(147.9)
Cash and cash equivalents at beginning of period	257.5	211.0
Cash and cash equivalents at end of period	\$ 106.2	\$ 63.1
SUPPLEMENTAL CASH FLOW INFORMATION:		
Non-cash item:		
Technology licensing agreement, see Note 13	\$ 9.7	\$ -

See accompanying notes to consolidated financial statements

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CARPENTER TECHNOLOGY CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012

(Unaudited)

(\$ in millions, except per share data)

	Carpenter Stockholders Equity						
	Common Stock Par Value Of \$5	Capital in Excess of Par Value	Reinvested Earnings	Common Stock in Treasury	Accumulated Other Comprehensive Loss	Noncontrolling interest	Total Equity
Balances at June 30, 2012	\$ 274.0	\$ 252.7	\$ 1,109.6	\$ (120.0)	\$ (412.5)	\$ 9.3	\$ 1,113.1
Net income			72.2			0.5	72.7
Pension and post-retirement benefits, net of tax					8.8		8.8
Net gain on derivative instruments, net of tax					5.9		5.9
Purchase of subsidiary shares from noncontrolling interest		1.6				(10.0)	(8.4)
Unrealized gain on marketable securities, net of taxes					0.1		0.1
Foreign currency translation					5.6	0.2	5.8
Cash Dividends:							
Common @ \$0.36 per share			(19.1)				(19.1)
Share-based compensation plans		(5.2)		8.4			3.2
Stock options exercised	0.5	1.4					1.9
Tax windfall on share-based compensation		3.3					3.3
Balances at December 31, 2012	\$ 274.5	\$ 253.8	\$ 1,162.7	\$ (111.6)	\$ (392.1)	\$ 0.0	\$ 1,187.3

	Carpenter Stockholders Equity						
	Common Stock Par Value Of \$5	Capital in Excess of Par Value	Reinvested Earnings	Common Stock in Treasury	Accumulated Other Comprehensive Loss	Noncontrolling interest	Total Equity
Balances at June 30, 2013	\$ 274.6	\$ 254.4	\$ 1,217.3	\$ (107.5)	\$ (335.7)	\$ -	\$ 1,303.1
Net income			64.1				64.1
Pension and post-retirement benefits, net of tax					7.5		7.5
Net gain on derivative instruments, net of tax					6.0		6.0
Unrealized gain on marketable securities, net of taxes					0.1		0.1
Foreign currency translation					4.9		4.9
Cash Dividends:							
Common @ \$0.36 per share			(19.2)				(19.2)
Share-based compensation plans		(1.5)		4.2			2.7

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Stock options exercised	1.0	4.6						5.6
Tax windfall on share-based compensation		1.9						1.9
Balances at December 31, 2013	\$ 275.6	\$ 259.4	\$ 1,262.2	\$ (103.3)	\$ (317.2)	\$ -	\$ 1,376.7	

See accompanying notes to consolidated financial statements

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, considered necessary for a fair statement of the results are reflected in the interim periods presented. The June 30, 2013 consolidated balance sheet data was derived from audited financial statements, but does not include all the disclosures required by U.S. generally accepted accounting principles. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in Carpenter's annual report on Form 10-K for the year ended June 30, 2013 (the 2013 Form 10-K). Operating results for the three months and six months ended December 31, 2013 are not necessarily indicative of the operating results for any future period.

As used throughout this report, unless the context requires otherwise, the terms Carpenter, the Company, Registrant, Issuer, we and our refer to Carpenter Technology Corporation.

2. Earnings Per Common Share

The Company calculates basic and diluted earnings per share using the two class method. Under the two class method, earnings are allocated to common stock and participating securities (nonvested restricted shares and units that receive non-forfeitable dividends) according to their participation rights in dividends and undistributed earnings. The earnings available to each class of stock are divided by the weighted average number of shares for the period in each class.

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The calculations of basic and diluted earnings per common share for the three months and six months ended December 31, 2013 and 2012 were as follows:

(in millions, except per share data)	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Net income attributable to Carpenter	\$ 29.5	\$ 33.0	\$ 64.1	\$ 72.2
Less: earnings and dividends allocated to participating securities	(0.1)	(0.2)	(0.2)	(0.4)
Earnings available to Carpenter common stockholders used in calculation of basic earnings per share	\$ 29.4	\$ 32.8	\$ 63.9	\$ 71.8
Weighted average number of common shares outstanding, basic	53.2	52.9	53.2	52.8
Basic earnings per common share	\$ 0.55	\$ 0.62	\$ 1.20	\$ 1.36
Net income attributable to Carpenter	\$ 29.5	\$ 33.0	\$ 64.1	\$ 72.2
Less: earnings and dividends allocated to participating securities	(0.1)	(0.2)	(0.2)	(0.4)
Earnings available to Carpenter common stockholders used in calculation of diluted earnings per share	\$ 29.4	\$ 32.8	\$ 63.9	\$ 71.8
Weighted average number of common shares outstanding, basic	53.2	52.9	53.2	52.8
Effect of shares issuable under share based compensation plans	0.4	0.4	0.4	0.4
Weighted average number of common shares outstanding, diluted	53.6	53.3	53.6	53.2
Diluted earnings per common share	\$ 0.55	\$ 0.62	\$ 1.19	\$ 1.35

The following awards issued under share-based compensation plans were excluded from the above calculations of diluted earnings per share because their effects were anti-dilutive:

(in millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012

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Stock options

0.0

0.3

0.1

0.3

9

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The fair value of the Company's marketable securities was based on estimates of fair value as of December 31, 2013 and June 30, 2013. The following is a summary of marketable securities, all of which were classified as available-for-sale as of December 31, 2013 and June 30, 2013:

December 31, 2013 (\$ in millions)	Cost	Unrealized Losses	Estimated Fair Value
Non-current Municipal auction rate securities	\$ 5.9	\$ (0.4)	\$ 5.5
June 30, 2013 (\$ in millions)	Cost	Unrealized Losses	Estimated Fair Value
Non-current Municipal auction rate securities	\$ 5.9	\$ (0.5)	\$ 5.4

For the six months ended December 31, 2013 and 2012, proceeds from sales and maturities of marketable securities were \$0.0 million.

4. Inventories

Inventories consisted of the following components as of December 31, 2013 and June 30, 2013:

(\$ in millions)	December 31, 2013	June 30, 2013
Raw materials and supplies	\$ 147.9	\$ 111.6
Work in process	352.7	325.9
Finished and purchased products	220.6	221.7
Total inventory	\$ 721.2	\$ 659.2

Inventories are valued at the lower of cost or market. Cost for inventories is principally determined using the last-in, first-out (LIFO) method.

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****5. Accrued Liabilities**

Accrued liabilities consisted of the following as of December 31, 2013 and June 30, 2013:

(\$ in millions)	December 31, 2013		June 30, 2013	
Accrued compensation	\$	32.4	\$	49.4
Derivative financial instruments		29.6		29.1
Accrued postretirement benefits		15.5		15.4
Accrued interest expense		11.2		11.2
Accrued pension liabilities		9.3		9.7
Other		48.6		53.7
Total accrued liabilities	\$	146.6	\$	168.5

6. Pension and Other Postretirement Benefits

The components of the net periodic benefit cost related to the Company's pension and other postretirement benefits for the three months and six months ended December 31, 2013 and 2012 were as follows:

Three months ended December 31, (\$ in millions)	Pension Plans				Other Postretirement Plans			
	2013		2012		2013		2012	
Service cost	\$	8.2	\$	8.0	\$	1.0	\$	1.1
Interest cost		14.3		13.3		3.1		3.0
Expected return on plan assets		(15.7)		(13.7)		(1.6)		(1.6)
Amortization of net loss		5.5		7.0		0.3		0.8
Amortization of prior service cost (benefit)		0.1		0.2		-		(1.0)
	\$	12.4	\$	14.8	\$	2.8	\$	2.3

Six months ended December 31, (\$ in millions)	Pension Plans				Other Postretirement Plans			
	2013		2012		2013		2012	
Service cost	\$	16.2	\$	16.1	\$	2.0	\$	2.2
Interest cost		28.6		26.5		6.2		6.1
Expected return on plan assets		(31.4)		(27.4)		(3.2)		(3.2)
Amortization of net loss		11.0		14.0		0.6		1.6
Amortization of prior service cost (benefit)		0.2		0.4		-		(2.0)

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\$ 24.6 \$ 29.6 \$ 5.6 \$ 4.7

Historically, the Company capitalized in inventory only the service cost portion of periodic benefit costs associated with manufacturing employees. During the quarter ended December 31, 2013, the Company began to capitalize the portion of periodic benefit costs related to the interest cost, expected return on assets and amortization of net actuarial loss and prior service cost (benefit), which the Company refers to as pension earnings, interest and deferrals (pension EID) expense, related to current manufacturing employees in inventory. The impact of this change

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

resulted in an increase in the amount of capitalized periodic benefit costs of \$2.2 million during the three months and six months ended December 31, 2013. This change did not have a material impact on any previously reported amounts.

During the six months ended December 31, 2013 and 2012, the Company made \$3.1 million and \$57.9 million, respectively, of contributions to its defined benefit pension plans. The Company currently expects to make approximately \$3.2 million of contributions to its defined benefit pension plans during the remainder of fiscal year 2014.

7. Debt

The Company has a \$500 million syndicated credit agreement (Credit Agreement) that extends to June 2018. Interest on the borrowings under the Credit Agreement accrue at variable rates, based upon LIBOR or a defined Base Rate, both determined based upon the rating of the Company's senior unsecured long-term debt (the Debt Rating). The applicable margin to be added to LIBOR ranges from 0.75% to 1.90% (1.25% as of December 31, 2013), and for Base Rate-determined loans, from 0.00% to 0.90% (0.25% as of December 31, 2013). The Company also pays a quarterly commitment fee ranging from 0.075% to 0.375% (0.15% as of December 31, 2013), determined based upon the Debt Rating, of the unused portion of the \$500 million commitment under the Credit Agreement. In addition, the Company must pay certain letter of credit fees, ranging from 0.75% to 1.90% (1.25% as of December 31, 2013), with respect to letters-of-credit issued under the Credit Agreement. The Company has the right to voluntarily prepay and reborrow loans and to terminate or reduce the commitments under the facility. As of December 31, 2013, the Company had \$8.2 million of issued letters of credit under the Credit Agreement, with the balance of \$491.8 million available for future borrowings.

The Company is subject to certain financial and restrictive covenants under the Credit Agreement, which, among other things, require the maintenance of a minimum interest coverage ratio of 3.50 to 1.00. The interest coverage ratio is defined in the Credit Agreement as, for any period, the ratio of consolidated earnings before interest, taxes, depreciation and amortization and non-cash net pension expense (EBITDA) to consolidated interest expense for such period. The Credit Agreement also requires the Company to maintain a debt to capital ratio of less than 55%. The debt to capital ratio is defined in the Credit Agreement as the ratio of consolidated indebtedness, as defined therein, to consolidated capitalization, as defined therein. As of December 31, 2013 and June 30, 2013, the Company was in compliance with all of the covenants of the Credit Agreement.

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Long-term debt outstanding as of December 31, 2013 and June 30, 2013 consisted of the following:

(\$ in millions)	December 31, 2013	June 30, 2013
Medium-term notes, Series B at 6.74% to 7.10% due from April 2018 to May 2018 (face value of \$55.0 million at December 31, 2013 and June 30, 2013)	\$ 55.0	\$ 55.0
Senior unsecured notes, 5.200% due July 2021 (face value (of \$250.0 million at December 31, 2013 and June 30, 2013)	249.7	249.7
Senior unsecured notes, 4.45% due March 2023 (face value of \$300.0 million at December 31, 2013 and June 30, 2013)	299.6	299.5
Total	604.3	604.2
Less amounts due within one year	-	-
Long-term debt, net of current portion	\$ 604.3	\$ 604.2

For the three months ended December 31, 2013 and 2012, interest costs totaled \$3.7 million and \$4.4 million, respectively, of which \$4.5 million and \$1.5 million, respectively, were capitalized as part of the cost of property, plant, equipment and software. For the six months ended December 31, 2013 and 2012, interest costs totaled \$8.2 million and \$9.6 million, respectively, of which \$7.9 million and \$2.3 million, respectively, were capitalized as part of the cost of property, plant, equipment and software.

8. Contingencies and Commitments***Environmental***

The Company is subject to various federal, state, local and international environmental laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. Although compliance with these laws and regulations may affect the costs of the Company's operations, compliance costs to date have not been material. The Company has environmental remediation liabilities at some of its owned operating facilities and has been designated as a potentially responsible party (PRP) with respect to certain third-party Superfund waste-disposal sites and other third party-owned sites. Additionally, the Company has been notified that it may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against the Company. Neither the exact amount of remediation costs nor the final method of their allocation among all designated PRP s at these Superfund sites has been determined. The liability for future environmental remediation costs is evaluated by management on a quarterly basis. The Company accrues amounts for environmental remediation costs that represent management's best estimate of the probable and reasonably estimable undiscounted future costs related to environmental remediation. During the six months ended December 31, 2013, we increased the liability for a company-owned former operating site by \$0.1 million. The liabilities recorded for environmental remediation costs at Superfund sites, other third party-owned sites and Carpenter-owned current or former operating facilities remaining at December 31, 2013 and June 30, 2013 were \$14.9 million and \$14.8

million, respectively.

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Estimates of the amount and timing of future costs of environmental remediation requirements are inherently imprecise because of the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown remediation sites and the allocation of costs among the PRP s. Based upon information currently available, such future costs are not expected to have a material effect on Carpenter s financial position, results of operations or cash flows over the long-term. However, such costs could be material to Carpenter s financial position, results of operations or cash flows in a particular future quarter or year.

Other

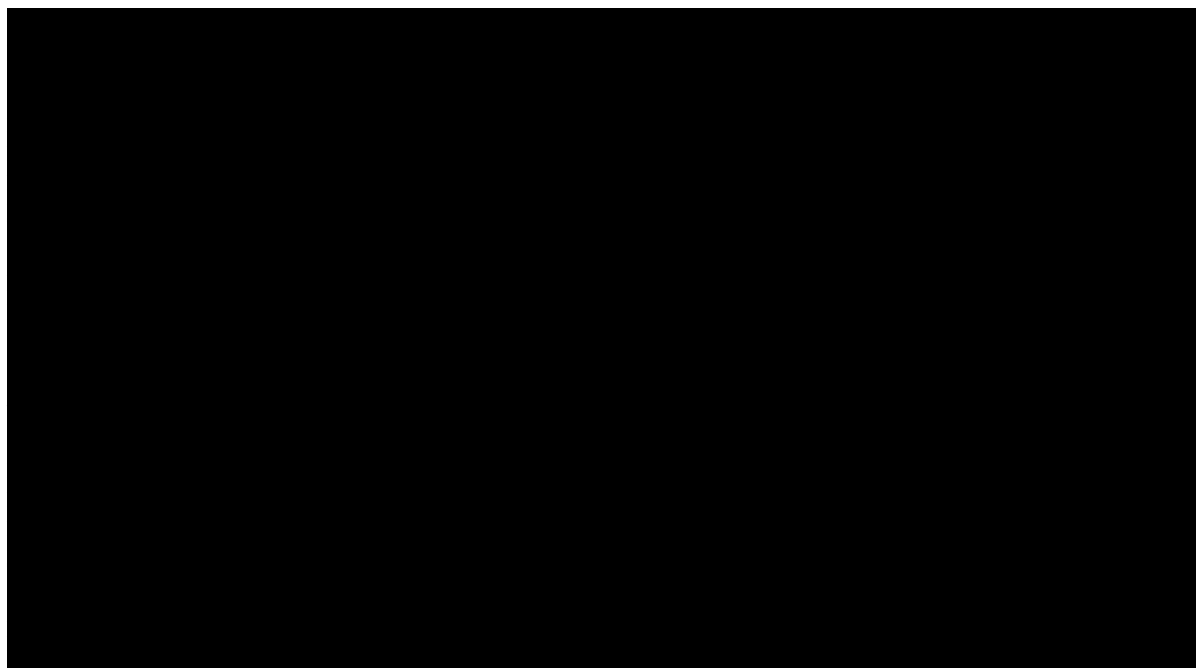
The Company is defending various routine claims and legal actions that are incidental to its business, and that are common to its operations, including those pertaining to product claims, commercial disputes, patent infringement, employment actions, employee benefits, compliance with domestic and foreign laws, personal injury claims and tax issues. Like many other manufacturing companies in recent years the Company, from time to time, has been named as a defendant in lawsuits alleging personal injury as a result of exposure to chemicals and substances in the workplace. The Company provides for costs relating to these matters when a loss is probable and the amount of the loss is reasonably estimable. The effect of the outcome of these matters on the Company s future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount and timing (both as to recording future charges to operations and cash expenditures) of the resolution of such matters. While it is not feasible to determine the outcome of these matters, management believes that the total liability from these matters will not have a material effect on the Company s financial position, results of operations or cash flows over the long-term. However, there can be no assurance that an increase in the scope of pending matters or that any future lawsuits, claims, proceedings or investigations will not be material to the Company s financial position, results of operations or cash flows in a particular future quarter or year.

9. Fair Value Measurements

The fair value hierarchy has three levels based on the inputs used to determine fair value. Level 1 refers to quoted prices in active markets for identical assets or liabilities. Level 2 refers to observable inputs other than quoted prices included in Level 1 such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. Level 3 refers to unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs. Currently, the Company does not use Level 3 inputs. The following tables present the Company s assets and liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy.

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The Company's derivative financial instruments consist of commodity forward contracts, foreign exchange forward contracts and interest rate swaps. These instruments are measured at fair value using the market method valuation technique. The inputs to this technique utilize information related to foreign exchange rates, commodity prices and interest rates published by third-party leading financial news and data providers. Though based on observable data, the valuation of these instruments is not based on actual transactions for the same instruments and, as such, these instruments are classified as Level 2. The Company's use of derivatives and hedging policies are more fully discussed in Note 11.

The Company has currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with accounting principles generally accepted in the United States.

The carrying amounts of other financial instruments not listed in the table below approximate fair value due to the short-term nature of these items.

The carrying amounts and estimated fair values of the Company's financial instruments not recorded at fair value in the financial statements were as follows:

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(\$ in millions)	December 31, 2013		June 30, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current portion	\$ 604.3	\$ 602.1	\$ 604.2	\$ 602.8
Company-owned life insurance	\$ 14.6	\$ 14.6	\$ 13.6	\$ 13.6

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The carrying amount for Company-owned life insurance reflects cash surrender values based upon the market values of underlying securities, net of any outstanding policy loans. The carrying value associated with the cash surrender value of these policies is recorded in other assets in the accompanying Consolidated Balance Sheets.

The fair values of long-term debt as of December 31, 2013 and June 30, 2013 were determined by using current interest rates for debt with terms and maturities similar to the Company's existing debt arrangements and accordingly would be classified as Level 2 inputs in the fair value hierarchy.

10. Other Income, Net

Other income, net consisted of the following:

(\$ in millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Unrealized gains (losses) on company owned life insurance contracts and investments held in rabbi trusts	\$ 1.1	\$ (0.1)	\$ 1.5	\$ 2.4
Equity in earnings of unconsolidated subsidiaries	0.1	1.9	0.3	1.3
Foreign exchange	(0.8)	(0.7)	(1.2)	(0.1)
Other income	0.2	0.2	0.2	0.3
Total other income, net	\$ 0.6	\$ 1.3	\$ 0.8	\$ 3.9

11. Derivatives and Hedging Activities

The Company uses commodity swaps and forwards, interest rate swaps, forward interest rate swaps and foreign currency forwards to manage risks generally associated with commodity price, interest rate and foreign currency rate fluctuations. The following explains the various types of derivatives and includes a recap about the impact the derivative instruments had on the Company's financial position, results of operations and cash flows.

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Cash Flow Hedging Commodity forward contracts: The Company enters into commodity forward contracts to fix the price of a portion of anticipated future purchases of certain critical raw materials and energy to manage the risk of cash flow variability associated with volatile commodity prices. The commodity forward contracts have been designated as cash flow hedges. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income to the extent effective, and reclassified to cost of sales in the period during which the hedged transaction affects earnings or it becomes probable that the forecasted transaction will not occur. As of December 31, 2013, the Company had forward contracts to purchase 35.1 million pounds of certain raw materials with settlement dates through December 2018.

Cash Flow Hedging Forward interest rate swaps: From time to time, the Company has entered into forward interest rate swap contracts to manage the risk of cash flow variability associated with fixed interest debt expected to be issued. The forward interest rate swaps have been designated as cash flow hedges. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income to the extent effective, and reclassified to interest expense in the period during which the hedged transaction affects earnings or it becomes probable that the forecasted transaction will not occur. In connection with the issuance of the \$300.0 million of fixed rate notes during the third quarter of fiscal year 2013, all

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outstanding forward interest rate swaps were settled resulting in a gain of \$2.7 million that has been recognized in AOCI. This gain will be amortized as a reduction to interest expense over the 10 year term of the notes.

Cash Flow Hedging - Foreign currency forward contracts: The Company uses foreign currency forward contracts to hedge a portion of anticipated future sales denominated in foreign currencies, principally the Euro and Pound Sterling, in order to offset the effect of changes in exchange rates. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income to the extent effective, and reclassified to net sales in the period during which the transaction affects earnings or it becomes probable that the forecasted transaction will not occur.

The Company also uses foreign currency forward contracts to protect certain short-term asset positions denominated in foreign currency against the effect of changes in exchange rates. These positions do not qualify for hedge accounting and accordingly, are marked-to-market at each reporting date through charges to other income and expense. As of December 31, 2013 and June 30, 2013, the fair value of the outstanding foreign currency forwards not designated as hedging instruments and the charges to income for changes in fair value for these contracts were not material.

Fair Value Hedging - Interest rate swaps: The Company has used interest rate swaps to achieve a level of floating rate debt relative to fixed rate debt where appropriate. The Company designated fixed to floating interest rate swaps as fair value hedges. Accordingly, the changes in the fair value of these instruments are immediately recorded in earnings. The mark-to-market values of both the fair value hedging instruments and the underlying debt obligations are recorded as equal and offsetting gains and losses in interest expense in the Consolidated Statements of Income. As of December 31, 2013, the Company has no outstanding interest rate swaps, as all previous interest rate swaps have settled or been terminated.

For the three months ended December 31, 2013 and 2012, net gains of \$0.0 million and \$0.4 million, respectively, were recorded as a reduction to interest expense. For the six months ended December 31, 2013 and 2012, net gains of \$0.0 million and \$0.9 million, respectively, were recorded as a reduction to interest expense. These amounts represent the impact of previously terminated swaps which were being amortized over the remaining term of the underlying debt.

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The fair value and location of outstanding derivative contracts recorded in the accompanying consolidated balance sheets were as follows as of December 31, 2013 and June 30, 2013:

December 31, 2013 (\$ in millions)	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:			
<i>Derivatives designated as hedging instruments:</i>			
Other current assets	\$ 0.3	\$ -	\$ 0.3
Total asset derivatives	\$ 0.3	\$ -	\$ 0.3
Liability Derivatives:			
<i>Derivatives designated as hedging instruments:</i>			
Accrued liabilities	\$ 0.8	\$ 28.8	\$ 29.6
Other liabilities	-	34.3	34.3
Total liability derivatives	\$ 0.8	\$ 63.1	\$ 63.9
June 30, 2013 (\$ in millions)	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:			
<i>Derivatives designated as hedging instruments:</i>			
Other current assets	\$ 0.9	\$ -	\$ 0.9
Total asset derivatives	\$ 0.9	\$ -	\$ 0.9
Liability Derivatives:			
<i>Derivatives designated as hedging instruments:</i>			
Accrued liabilities	\$ 0.4	\$ 28.7	\$ 29.1
Other liabilities	-	44.0	44.0
Total liability derivatives	\$ 0.4	\$ 72.7	\$ 73.1

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For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (AOCI) and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. The following is a summary of the (losses) gains related to cash flow hedges recognized during the three months and six months ended December 31, 2013 and 2012:

(\$ in millions)	Amount of (Loss) Gain Recognized in AOCI on Derivatives (Effective Portion)			
	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
Derivatives in Cash Flow Hedging Relationship:	2013	2012	2013	2012
Commodity contracts	\$ (3.0)	\$ (30.6)	\$ (4.4)	\$ (6.6)
Foreign exchange contracts	(0.3)	0.7	(0.8)	0.6
Forward interest rate swaps	-	0.8	-	(0.9)
Total	\$ (3.3)	\$ (29.1)	\$ (5.2)	\$ (6.9)

(\$ in millions)	Location of (Loss) Gain Reclassified from AOCI into Income (Effective Portion)	Amount of (Loss) Gain Reclassified from AOCI into Income (Effective Portion)			
		Three Months Ended		Six Months Ended	
		December 31,		December 31,	
Derivatives in Cash Flow Hedging Relationship		2013	2012	2013	2012
Commodity contracts	Cost of sales	\$ (6.8)	\$ (6.9)	\$ (14.4)	\$ (16.1)
Foreign exchange contracts	Net sales	(0.3)	(0.3)	(0.5)	(0.2)
Forward interest rate swaps	Interest expense	0.1	-	0.2	-
Total		\$ (7.0)	\$ (7.2)	\$ (14.7)	\$ (16.3)

The Company estimates that \$16.5 million of net derivative losses included in AOCI as of December 31, 2013 will be reclassified into earnings within the next 12 months. No significant cash flow hedges were discontinued during the quarter ended December 31, 2013. The Company recorded \$0.3 million of ineffectiveness during the three months and six months ended December 31, 2013 and no ineffectiveness during the three months and six months ended December 31, 2012.

The changes in AOCI associated with derivative hedging activities during the three months and six months ended December 31, 2013 and 2012 were as follows:

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(\$ in millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Balance, beginning	\$ (37.9)	\$ (13.1)	\$ (41.5)	\$ (32.8)
Current period changes in fair value, net of tax	(2.0)	(18.3)	(3.2)	(4.3)
Reclassification to earnings, net of tax	4.4	4.5	9.2	10.2
Balance, ending	\$ (35.5)	\$ (26.9)	\$ (35.5)	\$ (26.9)

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According to the provisions of the Company's derivative arrangements, in the event that the fair value of outstanding derivative positions with certain counterparties exceeds certain thresholds, the Company may be required to issue cash collateral to the counterparties. The Company's contracts with these counterparties allow for netting of derivative instrument positions executed under each contract. As of December 31, 2013 and June 30, 2013, the Company had no cash collateral held by counterparties.

The Company is exposed to credit loss in the event of nonperformance by counterparties on its derivative instruments as well as credit or performance risk with respect to its customer commitments to perform. Although nonperformance is possible, the Company does not anticipate nonperformance by any of the parties. In addition, various master netting arrangements are in place with counterparties to facilitate settlements of gains and losses on these contracts.

12. Income Taxes

The effective tax rate used for interim periods is the estimated annual effective consolidated tax rate, based on the current estimate of full year results, except that taxes related to specific events, if any, are recorded in the interim period in which they occur.

Income tax expense for the three months ended December 31, 2013 was \$14.9 million, or 33.6 percent of pre-tax income as compared with \$16.4 million, or 33.1 percent of pre-tax income for the three months ended December 31, 2012. Income tax expense for the six months ended December 31, 2013 was \$31.8 million, or 33.2 percent of pre-tax income as compared with \$35.9 million, or 33.1 percent of pre-tax income for the six months ended December 31, 2012.

13. Superalloy Powders Technical Assistance and Powder Supply Agreements

On September 30, 2013, the Company entered into a multi-level agreement with United Technologies Corporation (UTC) through its Pratt & Whitney Division, which includes a technical assistance agreement and a long-term powder supply agreement. The technical assistance agreement provides for the licensing of technology associated with the production of superalloy powders. As a result of the agreements, the Company plans to build a superalloy powder facility which is expected to take approximately 18 months to construct at an estimated cost of \$20 million. Once the facility is qualified by UTC, the Company will supply UTC with superalloy powder for up to 20 years. The powder supply agreement provides for minimum guaranteed purchase quantities of specified materials for a period of 12 years.

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According to the terms of the technology licensing agreement, the Company agreed to pay a \$13.0 million up-front license fee, which is payable in equal quarterly installments beginning on December 15, 2013. In December 2013, the Company made the first payment of \$3.3 million. As of December 31, 2013, \$13.0 million and \$9.7 million of the upfront license fee are included in other assets and accrued liabilities, respectively.

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14. Dissolution of Strategic Partnership

In November 2012, the Company dissolved its strategic partnership with Sandvik Materials Technology (Sandvik). Prior to the dissolution of the strategic partnership, the Company owned a 40 percent interest in Sandvik Powdermet AB, which the Company accounted for as an equity method investment. In addition, Sandvik owned a 40 percent interest in Carpenter Powder Products AB which has historically been reported as a noncontrolling interest. Under the terms of the dissolution agreement, the Company received \$7.9 million of proceeds from the sale of its investment in Sandvik Powdermet AB and paid \$8.4 million to repurchase the shares of Carpenter Products AB from Sandvik. During the quarter ended, December 31, 2012, the dissolution resulted in a \$1.9 million gain related to the sale of the investment in Sandvik Powdermet. No gain or loss was recognized related to the repurchase of the Carpenter Powder Products AB shares.

15. Business Segments

The Company changed its reportable segments beginning with fiscal year 2014 first quarter results. The change reflects the completion of the integration of the Latrobe Specialty Metals, Inc. (Latrobe) businesses acquired by the Company in February 2012. Prior to this change, the Latrobe businesses were reported as a separate segment to provide management with the focus and visibility into the business of the acquired operations. The previously reported Latrobe segment also included the results of the Company's distribution business in Mexico. Since the Latrobe businesses are now fully integrated, the previously reported Latrobe segment has been merged into the Company's operating model, in which the Company's integrated steel mill operations are managed distinctly from the collection of other differentiated operations. Beginning the first quarter of fiscal year 2014, the Company has two reportable segments, Specialty Alloys Operations (SAO) and Performance Engineered Products (PEP).

The SAO segment is comprised of the Company's major premium alloy and stainless steel manufacturing operations. This includes operations performed at mills primarily in Reading and Latrobe and surrounding areas in Pennsylvania, South Carolina and the new premium products manufacturing facility being built in Limestone County, Alabama. The combined assets of the SAO operations are being managed in an integrated manner to optimize efficiency and profitability across the total system.

The PEP segment is comprised of the Company's differentiated operations. This segment includes the Dynamet titanium business, the Carpenter Powder Products business, the Amega West business, the Specialty Steel Supply business and the Latrobe and Mexico distribution businesses. The businesses in the PEP segment are managed with an entrepreneurial structure to promote speed and flexibility, and drive overall revenue and profit growth.

The Company's executive management evaluates the performance of these operating segments based on sales, operating income and cash flow generation. Segment operating profit excludes general corporate costs, which include executive and director compensation, and other corporate

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facilities and administrative expenses not allocated to the segments. Also excluded are items that management considers not representative of ongoing operations, such as restructuring related charges, transaction costs associated with acquisitions and other specifically-identified income or expense items.

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The service cost component of the Company's net pension expense, which represents the estimated cost of future pension liabilities earned associated with active employees, is included in the operating income of the business segments. The residual net pension expense, which is comprised of the expected return on plan assets, interest costs on the projected benefit obligations of the plans and amortization of actuarial gains and losses and prior service costs, is included under the heading Pension earnings, interest & deferrals.

On a consolidated basis, there were no significant individual customers that accounted for more than 10 percent of the total net sales during the three months or six months ended December 31, 2013 and 2012, respectively.

The historical segment information for the three months and six months ended December 31, 2012, which is set forth below, was recast to conform to the fiscal year 2014 presentation.

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Segment Data (\$ in millions)	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Net Sales:				
Specialty Alloys Operations	\$ 407.5	\$ 428.4	\$ 802.5	\$ 859.4
Performance Engineered Products	113.7	126.6	232.2	261.6
Intersegment	(17.7)	(21.5)	(32.6)	(42.5)
Consolidated net sales	\$ 503.5	\$ 533.5	\$ 1,002.1	\$ 1,078.5