CARPENTER TECHNOLOGY CORP
Form 10-K
August 18, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2016

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 1-5828

CARPENTER TECHNOLOGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	23-0458500
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
P.O. Box 14662 Reading, Pennsylvania	19610
(Address of principal executive offices)	(Zip Code)

610-208-2000
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $5 Par Value	New York Stock Exchange
Title of each class	Name of each exchange on which registered

Securities registered pursuant to 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No ý

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 the filing requirements for at least the past 90 days.
Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 (or for such shorter period that the registrant was required to submit and post such files)
Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o 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 ý

The aggregate market value of the registrants' voting common stock held by non-affiliates at December 31, 2015 was $1,415,149,138, based on the closing price per share of the registrant's common stock on that date of $30.27 as reported on the New York Stock Exchange.

As of August 12, 2016, 46,612,582 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Selected portions of the Company's fiscal year 2016 definitive Proxy Statement are incorporated by reference into Part III of this Report.

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PART I

Item 1. Business

(a) General Development of Business:

Carpenter Technology Corporation, incorporated in 1904, is engaged in the manufacturing, fabrication and distribution of specialty metals. As used throughout this report, unless the context requires otherwise, the terms "Carpenter", "Company", "Registrant", "Issuer", "we" and "our" refer to Carpenter Technology Corporation.

(b) Financial Information About Segments:

We are organized in two reportable business segments: Specialty Alloys Operations ("SAO") and Performance Engineered Products ("PEP"). See Note 18 to our consolidated financial statements included in Item 8. "Financial Statements and Supplementary Data" for additional segment reporting information.

(c) Narrative Description of Business:
(1) General:

We develop, manufacture and distribute cast/wrought and powder metal stainless steels and special alloys including high temperature (iron-nickel-cobalt base), stainless, superior corrosion resistant, controlled expansion alloys, ultra-high strength and implantable alloys, tool and die steels and other specialty metals, as well as cast/wrought titanium alloys. We also manufacture and rent down-hole drilling tools and components used in the oil and gas industry.

We provide material solutions to the changing needs of the aerospace and defense, energy, transportation, medical and industrial and consumer industries. We have continued to increase our global manufacturing capacity as well as expand our operations to provide customers with solutions to today's changing materials challenges.

Reportable Segments

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 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.
(2) Raw Materials:

Our business depends on continued delivery of critical raw materials for our day-to-day operations. These raw materials include nickel, cobalt, chromium, manganese, molybdenum, titanium, iron and scrap containing iron and nickel. Some of the sources of these raw materials, many of which are international, could be subject to potential interruptions of supply as a result of political events, labor unrest or other reasons. These potential interruptions could cause material shortages and affect availability and price. We have arrangements with certain vendors to provide consigned materials at our manufacturing facilities available for our consumption as necessary.

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We have long-term relationships with major suppliers who provide availability of material at competitive prices. Purchase prices of certain raw materials have historically been volatile. We use pricing surcharges, indexing mechanisms, base price adjustments and raw material forward contracts to reduce the impact of increased costs for the most significant of these materials. There can be delays between the time of the increase in the price of raw materials and the realization of the benefits of such mechanisms or actions that could have a short-term impact on our results and could affect the comparability of our results from period to period.

(3) Patents and Licenses:

We own a number of United States and international patents and have granted licenses under some of them. In addition, certain products that we produce are covered by patents held or owned by other companies from whom licenses have been obtained. The duration of a patent issued in the United States is between 14 and 20 years from the date of filing a patent application or issuance of the patents. The duration of patents issued outside of the United States vary from country to country. Generally, patent licenses are structured to match the duration of the underlying patent. Although these patents and licenses are believed to be of value, we do not consider our business to be materially dependent upon any single such item or related group of such items.

(4) Seasonality of Business:

Our sales are normally influenced by seasonal factors. Historically, our sales in the first two fiscal quarters (the respective three months ending September 30 and December 31) are typically the lowest — principally because of annual plant vacation and maintenance shutdowns by us, as well as by many of our customers. However, the timing of major changes in the general economy or the markets for certain products can alter this historical pattern.

The chart below summarizes the percent of net sales by quarter for the past three fiscal years:

Quarter Ended	2016	2015	2014
September 30,	25 %	25 %	23 %
December 31,	25	24	23
March 31,	25	26	26
June 30,	25	25	28
	100%	100%	100%

(5) Customers:

On a consolidated basis, we are not dependent upon a single customer, or a very few customers, such that the loss of any one or more particular customers would have a materially adverse effect on our consolidated statement of income. One customer, Alcoa Inc., accounted for approximately 13 percent of net sales for the year ended June 30, 2016. No single customer accounted for 10 percent or more of net sales during fiscal years 2015 and 2014. Approximately 22 percent of the accounts receivable outstanding at June 30, 2016 is due from two customers, Alcoa Inc. and Precision Castparts Corporation. Approximately 17 percent of the accounts receivable outstanding at June 30, 2015 is due from one customer, Alcoa Inc. See Note 18 to our consolidated financial statements included in Item 8. “Financial Statements and Supplementary Data” for additional information.

(6) Backlog:

As of June 30, 2016, we had a sales backlog of orders excluding surcharge, believed to be firm, of approximately $306 million, substantially all of which is expected to be shipped within fiscal year 2017. Our backlog of orders excluding surcharge as of June 30, 2015 was approximately $435 million.

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(7) Competition:

Our business is highly competitive. We supply materials to a wide variety of end-use market sectors and compete with various companies depending on end-use market, product or geography. We are leaders in specialty materials for critical applications with over 125 years of metallurgical and manufacturing expertise. A significant portion of the products we produce are highly engineered materials for demanding applications. There are less than ten companies producing one or more similar products that we consider our major competitors for our high value products used in demanding applications, particularly in our Aerospace and Defense and Energy end-use markets. These products are generally required to meet complex customer product specifications and often require the materials to be qualified prior to supplying the customer orders. Our experience, technical capabilities, product offerings and research and development efforts that we have in our niche markets represent barriers to existing and potential competitors.

For other products, there are several dozen smaller producing companies and converting companies that are also competitors, as well as several hundred independent distributors of products similar to those distributed by us. Additionally, numerous foreign companies produce various specialty metal products similar to those produced by us. Furthermore, a number of different products may, in certain instances, be substituted for our finished products.

(8) Research, Product and Process Development:

Our expenditures for company-sponsored research and development were $16.3 million, $18.7 million and $18.5 million in fiscal years 2016, 2015 and 2014, respectively. We believe that our ability to be an innovator in special material development and manufacturing processes has been and will continue to be an important factor in the success of the Company. Our worldwide staff of expert metallurgists, research and development scientists, engineers and service professionals work closely with our customers to identify and provide innovative solutions to specific product requirements.

(9) Environmental Regulations:

We are subject to various stringent 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. Management evaluates the liability for future environmental remediation costs on a quarterly basis. We accrue amounts for environmental remediation costs representing management's best estimate of the probable and reasonably estimable costs relating to environmental remediation. For further information on environmental remediation, see the Contingencies section included in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the notes to our consolidated financial statements included in Item 8. "Financial Statements and Supplementary Data".

Our costs of maintaining and operating environmental control equipment were $13.5 million, $14.8 million and $13.3 million for fiscal years 2016, 2015 and 2014, respectively. The capital expenditures for environmental control equipment were $0.7 million, $0.5 million and $2.2 million for fiscal years 2016, 2015 and 2014, respectively. We anticipate spending approximately $3 million on major domestic environmental capital projects over the next five fiscal years. This includes approximately $1 million in fiscal year 2017. Due to the possibility of future regulatory developments, the amount of future capital expenditures may vary from these estimates.

(10) Employees:

As of June 30, 2016, our total workforce consisted of approximately 4,500 employees, which included approximately 125 production employees in Washington, Pennsylvania who are covered under a collective bargaining agreement which expires on August 31, 2016, and approximately 440 employees in Latrobe, Pennsylvania who are covered under a collective bargaining agreement which expires August 1, 2017.

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(d) Financial information about foreign and domestic operations and export sales:

Sales outside of the United States, including export sales, were $569.9 million, $646.8 million and $635.1 million in fiscal years 2016, 2015 and 2014, respectively. Long-lived assets held outside of the United States were $28.0 million, $30.0 million and $27.5 million as of June 30, 2016, 2015 and 2014, respectively. For further information on domestic and international sales, see Note 18 to our consolidated financial statements included in Item 8. “Financial Statements and Supplementary Data”.

(e) Available Information:

Our Board of Directors has adopted a Code of Ethics for the Chief Executive Officer and Senior Financial Officers of Carpenter Technology Corporation, which is also applicable to our other executive officers. There were no waivers of the Code of Ethics in fiscal year 2016. The Code of Ethics and any information regarding any waivers of the Code of Ethics are disclosed on Carpenter’s website at www.cartech.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through our website as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission (“SEC”). Our website and the content contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

The public may read and copy any materials the Company files with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and other information regarding issuers that file electronically. Such information can be accessed through the Internet at www.sec.gov.

Item 1A. Risk Factors

There are inherent risks and uncertainties associated with all businesses that could adversely affect operating performances or financial conditions. The following discussion outlines the risks and uncertainties that management believes are the most material to our business. However, these are not the only risks or uncertainties that could affect our business. Certain risks are associated specifically with our business, industry or customer base, while others have a broader effect.

The demand for certain products we produce may be cyclical.

Demand in our end-use markets, including companies in the aerospace and defense, energy, transportation, medical and industrial and consumer markets, can be cyclical in nature and sensitive to general economic conditions, competitive influences and fluctuations in inventory levels throughout the supply chain. As such, our results of operations, financial condition, cash flows and availability of credit could fluctuate significantly from period to period.

A significant portion of our sales represents products sold to customers in the commercial aerospace and defense and energy markets. The cyclicality of those markets can adversely affect our current business and our expansion objectives.

The commercial aerospace and defense market is historically cyclical due to both external and internal market factors. These factors include general economic conditions, airline profitability, consumer demand for air travel, varying fuel and labor costs, price competition and international and domestic political conditions such as military conflict and the threat of terrorism. The length and degree of cyclical fluctuation can be influenced by any one or combination of these factors and therefore are difficult to predict with certainty. A downturn in the commercial aerospace and defense industry would adversely affect the demand for our products and/or the prices at which we are able to sell our products; our results of operations and financial condition could be materially adversely affected.

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The energy market has also been historically cyclical, principally as a result of volatile oil prices. Due to the prolonged weakness in oil and gas drilling and exploration activity oil prices have been depressed. The decline in oil prices has negatively impacted the demand for our products used in our Energy and Industrial and Consumer end-use markets. Our future success requires us to, among other things, expand in key international energy markets by successfully adding to our customer base, distribution channels and product portfolio. The outlook for oil prices remains uncertain. The duration of the current low price environment or further deterioration in prices could further adversely affect the demand for products, which could impact our results of operations and financial condition.
Any significant delay or inability to successfully expand our operations in a timely and cost effective manner could materially adversely affect our business, financial condition and results of operations.

Over the last few years, we have undertaken capital projects associated with expanding our production capacity and capability, including our state-of-the-art manufacturing facility in Athens, Alabama and our adjacent superalloy powder facility. These projects place a significant demand on management and operational resources. Our success in expanding our operations in a cost effective manner depends upon numerous factors including the ability of management to ensure the necessary resources are in place to properly execute these projects, our ability to obtain the necessary internal and customer qualifications to produce material from the facility and our ability to operate the facility to maximize the potential opportunities with minimal impacts to our existing operations. If we are not able to achieve the anticipated results from our capital expansion projects, or if we incur unanticipated excess costs, our results of operations and financial position may be materially adversely affected.

Periods of reduced demand and excess supply as well as the availability of substitute lower cost materials can adversely affect our ability to price and sell our products at the profitability levels we require to be successful.

Additional worldwide capacity and reduced demand for our products could significantly impact future worldwide pricing which would adversely impact our results of operations and financial condition. In addition, continued availability of lower cost, substitute materials may also cause significant fluctuations in future results as our customers opt for a lower cost alternative.

We change prices on our products as we deem necessary. In addition to the above general competitive impact, other market conditions and various economic factors beyond our control can adversely affect the timing of our pricing actions. The effects of any pricing actions may be delayed due to long manufacturing lead times or the terms of existing contracts. There is no guarantee that the pricing actions we implement will be effective in maintaining the Company’s profit margin levels.

We rely on third parties to supply certain raw materials that are critical to the manufacture of our products and we may not be able to access alternative sources of these raw materials if the suppliers are unwilling or unable to meet our demand.

Costs of certain critical raw materials, such as nickel, cobalt, chromium, manganese, molybdenum, titanium, iron and scrap containing iron and nickel have been volatile due to factors beyond our control. We are able to mitigate most of the adverse impact of rising raw material costs through raw material surcharges, indices to customers and raw material forward contracts, but changes in business conditions could adversely affect our ability to recover rapid increases in raw material costs and may adversely affect our results of operations.

In addition, the availability of these critical raw materials is subject to factors that are not in our control. In some cases, these critical raw materials are purchased from suppliers operating in countries that may be subject to unstable political and economic conditions. At any given time, we may be unable to obtain an adequate supply of these critical raw materials on a timely basis, at prices and other terms acceptable to us, or at all.

If suppliers increase the price of critical raw materials or are unwilling or unable to meet our demand, we may not have alternative sources of supply. In addition, to the extent that we have quoted prices to customers and accepted customer orders for products prior to purchasing necessary raw materials, or have existing contracts, we may be unable to raise the price of products to cover all or part of the increased cost of the raw materials to our customers. The manufacture of some of our products is a complex process and requires long lead times. As a result, we may experience delays or shortages in the supply of raw materials. If unable to obtain adequate and timely deliveries of required raw materials, we may be unable to timely manufacture sufficient quantities of products. This could cause us to lose sales, incur additional costs, delay new product introductions or suffer harm to our reputation.

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Regulations related to conflict minerals could adversely impact our business.

The SEC has promulgated final rules mandated by the Dodd-Frank Act regarding disclosure of the use of tin, tantalum, tungsten and gold, known as conflict minerals, in products manufactured by public companies. These rules require due diligence to determine whether such minerals originated from the Democratic Republic of Congo (the "DRC") or an adjoining country and whether such minerals helped finance the armed conflict in the DRC. The Company timely filed its annual conflict minerals report required by the rules on June 1, 2016. There will be costs associated with complying with these disclosure requirements going forward, including costs to determine the origin of conflict minerals used in our products. In addition, the implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in our products. Also, we may face disqualification as a supplier for customers and reputational challenges if the due diligence procedures we continue to implement do not enable us to verify the origins for all conflict minerals or to determine that such minerals are DRC conflict-free.

We provide benefits to active and retired employees throughout most of our Company, most of which are not covered by insurance; and thus, our financial condition can be adversely affected if our investment returns are insufficient to meet these obligations.

We have obligations to provide substantial benefits to active and retired employees, and most of the associated costs are paid by the Company and are not covered by insurance. In addition, certain employees are covered by defined benefit pension plans, with the majority of our plans covering employees in the United States. Many domestic and international competitors do not provide defined benefit plans and/or retiree health care plans, and other international competitors operate in jurisdictions with government sponsored health care plans that may offer them a cost advantage. A decline in the value of plan investments in the future, an increase in costs or liabilities or unfavorable changes in laws or regulations that govern pension plan funding could materially change the timing and amount of required pension funding. A requirement to accelerate or increase pension contributions in the future could have a material adverse effect on our results of operations and financial condition.

The extensive environmental, health and safety regulatory regimes applicable to our manufacturing operations create potential exposure to significant liabilities.

The nature of our manufacturing business subjects our operations to numerous and varied federal, state, local and international laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. We have used, and currently use and manufacture, substantial quantities of substances that are considered hazardous, extremely hazardous or toxic under worker safety and health laws and regulations. Although we implement controls and procedures designed to reduce continuing risk of adverse impacts and health and safety issues, we could incur substantial cleanup costs, fines and civil or criminal sanctions, third party property damage or personal injury claims as a result of violations, non-compliance or liabilities under these regulatory regimes required at our facilities.
We have environmental remediation liabilities at some of our owned operating facilities and have been designated as a potentially responsible party ("PRP") with respect to certain third party Superfund or similar waste disposal sites and other third party owned sites. Additionally, we have been notified that we may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against us. From time to time, we are a party to lawsuits and other proceedings involving alleged violations of, or liabilities arising from, environmental laws.

When our liability is probable and we can reasonably estimate our costs, we record environmental liabilities in our financial statements. However, in many cases, we are not able to determine whether we are liable, or if liability is probable, in order to reasonably estimate the loss or range of loss which could result from such environmental liabilities. Estimates of our liability remain subject to additional uncertainties, including the nature and extent of site contamination, available remediation alternatives, the extent of corrective actions that may be required, and the number and financial condition of other PRP's, as well as the extent of their responsibility for the remediation. We adjust our accruals to reflect new information as appropriate. Future adjustments could have a material adverse effect on our results of operations in a given period, but we cannot reliably predict the amounts of such future adjustments. Future developments, administrative actions or liabilities relating to environmental matters could have a material adverse effect on our financial condition, cash flows or results of operations.

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Our manufacturing processes, and the manufacturing processes of many of our suppliers and customers, are energy intensive and generate carbon dioxide and other “Greenhouse Gases”, and pending legislation or regulation of Greenhouse Gases, if enacted or adopted in an onerous form, could have a material adverse impact on our results of operations, financial condition and cash flows.

Political and scientific debates related to the impacts of greenhouse gas emissions on the global climate are prevalent. Regulation or some form of legislation aimed at reducing the greenhouse gas emissions is currently being considered both in the United States and globally. As a specialty alloy manufacturer, we will be affected, both directly and indirectly, if proposed climate change legislation, such as use of a “cap and trade”, is enacted. Such legislation could have a material adverse impact on our results of operations, financial condition and cash flows.

Product liability and product quality claims could adversely affect our operating results.

We produce ultra-high strength, high temperature and corrosion-resistant alloys designed for our customers’ demanding applications particularly in our Aerospace and Defense, Energy and Medical end-use markets. Failure of the materials that are included in our customers’ applications could give rise to substantial product liability claims. There can be no assurance that our insurance coverage will be adequate or continue to be available on terms acceptable to us. We have a complex manufacturing process necessary to meet our customers’ stringent product specifications. We are also required to adhere to various third party quality certifications and perform sufficient internal quality reviews to ensure compliance with established standards. If we fail to meet the customer specifications for their products, we may be subject to product quality costs and claims. These costs are generally not insured. The impacts of product liability and quality claims could have a material adverse impact on the results of our operations, financial condition and cash flows.

Our business subjects us to risks of litigation claims, as a routine matter, and this risk increases the potential for a loss that might not be covered by insurance.

Litigation claims relate to the conduct of our currently and formerly owned businesses, including claims pertaining to product liability, commercial disputes, employment actions, employee benefits, compliance with domestic and federal laws, personal injury, patent infringement and tax issues. Due to the uncertainties of litigation, we can give no assurance that we will prevail on claims made against us in the lawsuits that we currently face or that additional claims will not be made against us in the future. The outcome of litigation cannot be predicted with certainty, and some of these lawsuits, claims or proceedings may be determined adversely to us. The resolution in any reporting period of one or more of these matters could have a material adverse effect on our results of operations for that period. We can give no assurance that any other matters brought in the future will not have a material effect on our results of operations, financial condition and cash flows.

A portion of our workforce is covered by collective bargaining agreements and union attempts to organize our other employees may cause work interruptions or stoppages.

Approximately 125 production employees at our Dynamet business unit located in Washington, PA are covered by a collective bargaining agreement. This agreement expires in August 2016. Approximately 440 production employees at our Latrobe business unit located in Latrobe, Pennsylvania are covered by a collective bargaining agreement. This agreement expires in August 2017. There can be no assurance that we will succeed in concluding collective bargaining agreements with the unions to replace those that expire. From time to time, the employees at our manufacturing facility in Reading, Pennsylvania, participate in election campaigns or union organizing attempts. There is no guarantee that future organization attempts will not result in union representation.

Our manufacturing processes are complex and depend upon critical, high cost equipment for which there may be only limited or no production alternatives.

It is possible that we could experience prolonged periods of reduced production due to unplanned equipment failures, and we could incur significant repair or replacement costs in the event of those failures. It is also possible that operations could be disrupted due to other unforeseen circumstances such as power outages, explosions, fires, floods, accidents and severe weather conditions. We must make regular, substantial capital investments and changes to our manufacturing processes to lower production costs, improve productivity, manufacture new or improved products and remain competitive. We may not be in a position to take advantage of business opportunities or respond to competitive pressures if we fail to update, replace or make additions to our equipment or our manufacturing processes in a timely manner. The cost to repair or replace much of our equipment or facilities would be significant. We cannot be certain that we will have sufficient internally generated cash or acceptable external financing to make necessary capital expenditures in the future.

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A significant portion of our manufacturing and production facilities are located in Reading and Latrobe, Pennsylvania and Athens, Alabama, which increases our exposure to significant disruption to our business as a result of unforeseeable developments in these geographic areas.

It is possible that we could experience prolonged periods of reduced production due to unforeseen catastrophic events occurring in or around our manufacturing facilities in Reading and Latrobe, Pennsylvania and Athens, Alabama. As a result, we may be unable to shift manufacturing capabilities to alternate locations, accept materials from suppliers, meet customer shipment needs or address other severe consequences that may be encountered. Our financial condition, cash flows and results of operations could be materially adversely affected.

We rely on third parties to supply energy consumed at each of our energy-intensive production facilities.

The prices for and availability of electricity, natural gas, oil and other energy resources are subject to volatile market conditions. These market conditions often are affected by political and economic factors beyond our control. Disruptions or lack of availability in the supply of energy resources could temporarily impair the ability to operate our production facilities. Further, increases in energy costs, or changes in costs relative to energy costs paid by competitors, has affected and may continue to adversely affect our profitability. To the extent that these uncertainties cause suppliers and customers to be more cost sensitive, increased energy prices may have an adverse effect on our results of operations, financial condition and cash flows.

We consider acquisitions, joint ventures and other business combination opportunities, as well as possible business unit dispositions, as part of our overall business strategy, that involve uncertainties and potential risks that we cannot predict or anticipate fully.

From time to time, management holds discussions with management of other companies to explore such aforementioned opportunities. As a result, the relative makeup of the businesses comprising our Company is subject to change. Acquisitions, joint ventures and other business combinations involve various inherent risks. Such risks include difficulties in integrating the operations, technologies, products and personnel of the acquired companies, diversion of management’s attention from existing operations, difficulties in entering markets in which we have limited or no direct prior experience, dependence on unfamiliar supply chains, insufficient revenues to offset increased expenses associated with acquisitions, loss of key employees of the acquired companies, inaccurate assessment of undisclosed liabilities, difficulties in realizing projected efficiencies, synergies and cost savings, and increases in our debt or limitation on our ability to access additional capital when needed.

Our business may be impacted by external factors that we may not be able to control.

War, civil conflict, terrorism, natural disasters and public health issues including domestic or international pandemic have caused and could cause damage or disruption to domestic or international commerce by creating economic or political uncertainties. Additionally, the volatility in the financial markets could negatively impact our business. These events could result in a decrease in demand for our products, affect the availability of credit facilities to us, our customers or other members of the supply chain necessary to transact business, make it difficult or impossible to deliver orders to customers or receive materials from suppliers, affect the availability or pricing of energy sources or result in other severe consequences that may or may not be predictable. As a result, our business, financial condition and results of operations could be materially adversely affected.

We believe that international sales, which are associated with various risks, will continue to account for a significant percentage of our future revenues.

Risks associated with international sales include without limitation: political and economic instability, including weak conditions in the world’s economies; difficulty in collecting accounts receivable; unstable or unenforced export controls; changes in legal and regulatory requirements; policy changes affecting the markets for our products; changes in tax laws and tariffs; and exchange rate fluctuations (which may affect sales to international customers and the value of profits earned on international sales when converted into dollars). In addition, we will need to invest in building our capabilities and infrastructure to meet our international growth goals. Any of these factors could materially adversely affect our results for the period in which they occur.

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We value most of our inventory using the LIFO method, which could be repealed resulting in adverse effects on our cash flows and financial condition.

The cost of our inventories is primarily determined using the Last-In, First-Out (“LIFO”) method. Under the LIFO inventory valuation method, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period even though these materials and other costs may have been incurred at significantly different values due to the length of time of our production cycle. Generally in a period of rising prices, LIFO recognizes higher costs of goods sold, which both reduces current income and assigns a lower value to the year-end inventory. Recent proposals have been aimed at repealing the election to use the LIFO method for income tax purposes. According to these proposals, generally taxpayers that currently use the LIFO method would be required to revalue their LIFO inventory to its First-In, First-Out (“FIFO”) value. As of June 30, 2016, if the FIFO method of inventory had been used instead of the LIFO method, our inventories would have been approximately $98 million higher. This increase in inventory would result in a one-time increase in taxable income which may be taken into account over the following several taxable years. The repeal of the LIFO method could result in a substantial tax liability which could adversely impact our cash flows and financial condition.

We depend on the retention of key personnel.

Much of our future success depends on the continued service and availability of skilled personnel, including members of our executive management team, management, metallurgists and production positions. The loss of key personnel could adversely affect our ability to perform until suitable replacements are found.

We could be adversely impacted if our information technology (“IT”) and computer systems do not perform properly or if we fail to protect the integrity of confidential data.

Management relies on IT infrastructure, including hardware, network, software, people and processes, to provide useful information to conduct our business and support assessments and conclusions about operating performance. Our inability to produce relevant and/or reliable measures of operating performance in an efficient, cost-effective and well-controlled fashion may have significant negative impacts on our future operations. In addition, any material failure, interruption of service, or compromised data security could adversely affect our operations. Security breaches in our information technology could result in theft, destruction, loss, misappropriation or release of confidential data or intellectual property which could adversely impact our future results.

We are in the process of implementing a new enterprise resource planning system and problems with the design or implementation of this system could interfere with our business and operations.

We are engaged in a multi-year implementation of a new global enterprise resource planning (ERP) system. Our ERP system is being designed to accurately maintain books and records, record transactions, provide important information to our management and prepare our financial statements. The implementation of the new ERP system has required, and will continue to require, the investment of significant financial and human resources. Any disruptions, delays or deficiencies in the design and implementation of the new ERP system could adversely affect our financial condition and results of operations.

The carrying value of goodwill and other intangible assets may not be recoverable.

Goodwill and other long-lived assets including property, plant and equipment and other intangible assets are recorded at fair value on the date of acquisition. We review these assets at least annually for impairment. Impairment may result from, among other things, deterioration in performance, adverse market conditions, adverse changes in applicable laws or regulations and a variety of other factors. Any future impairment of goodwill or other long-lived assets could have a material adverse effect on our results of operations.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

The principal locations of our primary domestic integrated mills in our SAO segment are located in Reading and Latrobe, Pennsylvania and Athens, Alabama. In addition, SAO manufactures large diameter hollow bar in Orwigsburg, Pennsylvania and Elyria, Ohio and operates a mini mill manufacturing stainless steel bar and wire in Hartsville, South Carolina. The principal locations for PEP businesses include titanium alloy production facilities located in Washington, Pennsylvania and Clearwater, Florida, powder products manufacturing facilities in Bridgeville, Pennsylvania; Athens Alabama and Woonsocket, Rhode Island and a facility in Houston, Texas for manufacturing of machined components used in the drilling, exploration and production of oil and gas. The PEP segment also includes domestic leased warehouses and service centers located in Houston, Texas; San Antonio, Texas; Midland, Texas; Oklahoma City, Oklahoma; Casper, Wyoming; Lafayette, Louisiana; West Alexander, Pennsylvania; Vienna, Ohio; Chicago, Illinois; Pinehurst, Texas and Mobile, Alabama. The PEP segment includes one owned service center in White House, Tennessee.

The Reading, Hartsville, Washington, Bridgeville, Orwigsburg, Elyria, Woonsocket, Latrobe, Houston and Athens facilities are owned. The Clearwater facility is owned, but the land is leased.

We also own or lease manufacturing facilities, distribution centers, service centers and sales offices in a number of foreign countries, including Sweden, Canada, Singapore, China, Mexico, Taiwan, the United Arab Emirates, the United Kingdom and Belgium.

Our corporate offices, located in Wyomissing, Pennsylvania, are leased. In February 2016, we announced plans to move the corporate offices to Philadelphia, PA. We currently expect to move prior to the end of calendar 2016.

Our plants, customer service centers, and distribution centers were acquired or leased at various times over several years. There is an active maintenance program to ensure a safe operating environment and to keep facilities in good condition. In addition, we have an active capital spending program to replace equipment as needed to keep it technologically competitive on a worldwide basis. We believe our facilities are in good condition and suitable for our business needs.

Item 3. Legal Proceedings

From time to time, we are a party to lawsuits and other proceedings involving alleged violations of, or liabilities arising from, environmental laws. We have environmental remediation liabilities at some of our owned operating facilities and have been designated as a potentially responsible party (“PRP”) with respect to certain third party Superfund or similar waste disposal sites and other third party owned sites. Additionally, we have been notified that we may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against us. 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 our financial position, results of operations or cash flows over the long-term. However, such costs could be material to our financial position, results of operations or cash flows in a particular future quarter or year.

In addition, from time to time, we are a party to certain routine claims and legal actions and other contingent liabilities incident to the normal course of business which pertain to litigation, product claims, commercial disputes, employment actions, employee benefits, compliance with domestic and foreign laws, personal injury claims, patent infringement and tax issues. Based on information currently available, the ultimate resolution of our known contingencies, individually or in the aggregate and including the matters described in Note 10 to the consolidated financial statements in this Form 10-K, is not expected to have a material adverse effect on our financial position, cash

flows or results of operations. 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 our financial position, results of operations or cash flows in a particular future quarter or year.
See the “Contingencies” section included in Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operation”, and the “Contingencies and Commitments” section included in Note 10 to our consolidated financial statements included in Item 8. “Financial Statements and Supplementary Data”, included in this Form 10-K, the contents of which are incorporated by reference to this Item 3.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 4A. Executive Officers of the Registrant

Listed below are the names of our corporate executive officers, including those required to be listed as executive officers for SEC purposes, each of whom assumes office after the annual organization meeting of the Board of Directors which immediately follows the Annual Meeting of Stockholders.

Tony R. Thene was appointed President and Chief Executive Officer effective July 1, 2015. Since joining Carpenter in January 2013, Mr. Thene served as the Senior Vice President and Chief Financial Officer. Mr. Thene joined Carpenter after 23 years with Alcoa Inc., a leading producer of primary and fabricated aluminum, holding various management positions.

Damon J. Audia was appointed Senior Vice President and Chief Financial Officer effective October 19, 2015. Mr. Audia joined Carpenter from The Goodyear Tire & Rubber Company where he worked for ten years and most recently served as Senior Vice President of Finance for the company's North America division.

David L. Strobel was appointed Senior Vice President and Chief Technology Officer effective July 13, 2015. Since joining Carpenter in 1983, Mr. Strobel has held numerous positions of increasing responsibility, including Vice President - Manufacturing, Vice President - Technology and Senior Vice President - Global Operations. Mr. Strobel retired from the Company in August 2016.

Joseph E. Haniford was appointed Chief Operating Officer effective June 30, 2016. Since joining Carpenter in July 2015, Mr. Haniford served as Senior Vice President - Specialty Alloys Operations. Mr. Haniford joined Carpenter from EnTrans International where he was responsible for all operations as the company's Chief Operating Officer and was a member of the Board of Directors. Prior to EnTrans International, Mr. Haniford worked for Alcoa, Inc. for more than 30 years in various executive leadership positions.

Name	Age	Position	Assumed Present Position
Tony R. Thene	55	President and Chief Executive Officer	July 2015
Damon J. Audia	45	Senior Vice President and Chief Financial Officer	October 2015
David L. Strobel	55	Senior Vice President and Chief Technology Officer	July 2015
Joseph E. Haniford	57	Chief Operating Officer	June 2016

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PART II
Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is listed on the New York Stock Exchange ("NYSE") and traded under the symbol "CRS". The following table sets forth, for the periods indicated, the high and low prices for our common stock as reported by the NYSE:

	Fiscal Year 2016		Fiscal Year 2015	
Quarter Ended:	High	Low	High	Low
September 30	$41.25	$29.18	$64.69	$44.98
December 31	$37.18	$27.55	$53.12	$41.43
March 31	$36.18	$23.99	$49.73	$34.28
June 30	$38.16	$28.74	$45.42	$34.80
Annual	$41.25	$23.99	$64.69	$34.28

The range of our common stock price on the NYSE from July 1, 2016 to August 12, 2016 was $32.44 to $40.46. The closing price of the common stock was $36.62 on August 12, 2016.

We have paid quarterly cash dividends on our common stock for over 120 consecutive years. We paid a quarterly dividend of $0.18 per share of common stock during each quarter of fiscal years 2016 and 2015.

As of August 12, 2016, there were 2,332 common stockholders of record.

Information regarding Securities Authorized for Issuance under Equity Compensation Plans is set forth in Item 12 hereto "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters".

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Cumulative Total Stockholder Return

The graph below compares the cumulative total stockholder return on our common stock to the cumulative total return of the S&P MidCap 400 Index, the most widely used index for mid-sized companies, and our Peer Group, for each of the last five fiscal years ended June 30, 2016. The cumulative total return assumes an investment of $100 on June 30, 2011 and the reinvestment of any dividends during the period. Our Peer Group consists of the companies in the Russell Materials and Processing Growth Index. We believe the companies included in our Peer Group, taken as a whole, provide a more meaningful comparison in terms of product offerings, markets served, competition and other relevant factors. The total stockholder return for the peer group is weighted according to the respective issuer's stock market capitalization at the beginning of each period.

	6/11	6/12	6/13	6/14	6/15	6/16
Carpenter Technology Corporation	$100.00	$84.10	$80.37	$114.16	$70.91	$61.70
S&P Midcap 400	$100.00	$97.67	$122.27	$153.12	$162.92	$165.09
Russell Materials & Processing Growth	$100.00	$89.57	$111.20	$143.43	$145.31	$139.78

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Issuer Purchases of Equity Securities

In October 2014, the Company's Board of Directors authorized a share repurchase program up to $500.0 million of the Company's shares of Common Stock over two years. The shares of Common Stock may be repurchased from time to time at our discretion based on capital needs of the business, general market conditions and market price of the stock. The timing or amount of the shares to be repurchased cannot be assured. The share repurchase program may be discontinued at any time. As of June 30, 2016, $251.6 million of the $500.0 million remained available for future purchases.

Item 6. Selected Financial Data

Five-Year Financial Summary
in millions, except per share data
(Fiscal years ended June 30,)

	2016(a)(c)	2015(b)(c)	2014	2013(d)	2012(d)(e)
Summary of Operations:					
Net sales	$ 1,813.4	$ 2,226.7	$2,173.0	$2,271.7	$ 2,028.7
Operating income	$ 51.6	$ 111.5	$212.0	$232.7	$ 210.1
Net income	$ 11.3	$ 58.7	$132.8	$146.5	$ 121.6
Net income attributable to Carpenter	$ 11.3	$ 58.7	$132.8	$146.1	$ 121.2
Financial Position at Year-End:					
Cash and cash equivalents	$ 82.0	$ 70.0	$120.0	$257.5	$ 211.0
Total assets	$ 2,794.3	$ 2,902.6	$3,053.7	$2,878.6	$ 2,625.7
Long-term debt, net of current portion	$ 611.3	$ 603.8	$600.5	$599.9	$ 303.8
Per Common Share:					
Net earnings:					
Basic	$ 0.23	$ 1.11	$2.48	$2.75	$ 2.55
Diluted	$ 0.23	$ 1.11	$2.47	$2.73	$ 2.53
Cash dividend-common	$ 0.72	$ 0.72	$0.72	$0.72	$ 0.72
Weighted Average Common Shares Outstanding:					
Basic	48.1	52.6	53.3	52.9	47.1
Diluted	48.2	52.7	53.6	53.2	47.5

(a) Fiscal year 2016 included $22.5 million of excess inventory write-down charges, $12.5 million of goodwill impairment charges and $18.0 million of restructuring and impairment charges including of $7.6 million of impairment of intangible assets and property, plant and equipment and $10.4 million of restructuring costs related primarily to an early retirement incentive and other severance related costs. See Note 2 in the Notes to the Consolidated Financial Statements included in Item 8 "Financial Statements and Supplementary Data" of this report.

(b) Fiscal year 2015 included $29.1 million of restructuring costs related principally to workforce reduction, facility closures and write-down of certain assets. See Note 2 in the Notes to the Consolidated Financial Statements included in Item 8 "Financial Statements and Supplementary Data" of this report.

(c) The weighted average common shares outstanding for fiscal years 2016 and 2015 included 5.5 million and 0.9 million less shares, respectively, related to the share repurchase program authorized in October 2014. During the year ended June 30, 2016 and 2015, we repurchased 3,762,200 shares and 2,995,272 shares, respectively, of common stock for $123.9 million and $124.5 million, respectively.

(d) The weighted average common shares outstanding for fiscal years 2013 and 2012 included an additional 8.1 million and 2.7 million, respectively, shares issued in connection with the Latrobe acquisition.

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(e) Fiscal year 2012 included $11.7 million of acquisition-related costs incurred in connection with the Latrobe acquisition that was consummated on February 29, 2012.

See Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for discussion of factors that affect the comparability of the “Selected Financial Data”.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Background and General

Our discussions below in this Item 7 should be read in conjunction with our consolidated financial statements, including the notes thereto, included in this annual report on Form 10-K.

We are engaged in the manufacturing, fabrication and distribution of specialty metals. We primarily process basic raw materials such as nickel, cobalt, titanium, manganese, chromium, molybdenum, iron scrap and other metal alloying elements through various melting, hot forming and cold working facilities to produce finished products in the form of billet, bar, rod, wire and narrow strip in many sizes and finishes. We also produce certain metal powders. Our sales are distributed directly from our production plants and distribution network as well as through independent distributors. Unlike many other specialty steel producers, we operate our own worldwide network of service and distribution centers. These service centers, located in the United States, Canada, Mexico, Europe and Asia allow us to work more closely with customers and to offer various just-in-time stocking programs. We also manufacture and rent down-hole drilling tools and components used in the oil and gas industry.

As part of our overall business strategy, we have sought out and considered opportunities related to strategic acquisitions, divestitures and joint collaborations as well as possible business unit dispositions aimed at broadening our offering to the marketplace. We have participated with other companies to explore potential terms and structures of such opportunities and expect that we will continue to evaluate these opportunities.

While we prepare our financial statements in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”), we also utilize and present certain financial measures that are not based on or included in U.S. GAAP (we refer to these as “Non-GAAP financial measures”). Please see the section “Non-GAAP Financial Measures” below for further discussion of these financial measures, including the reasons why we use such financial measures and reconciliations of such financial measures to the nearest U.S. GAAP financial measures.

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Business Trends

Selected financial results for the past three fiscal years are summarized below:

	Fiscal Year		
($ in millions, except per share data)	2016	2015	2014
Net sales	$1,813.4	$2,226.7	$2,173.0
Net sales excluding surcharge revenue (1)	$1,572.6	$1,811.8	$1,782.8
Operating income	$51.6	$111.5	$212.0
Operating income excluding pension earnings, interest and deferrals ("pension EID") expense (1)	$70.9	$121.0	$233.8
Net income	$11.3	$58.7	$132.8
Diluted earnings per share	$0.23	$1.11	$2.47
Purchases of property, equipment and software	$95.2	$170.5	$349.2
Free cash flow (1)	$138.6	$74.4	$(147.8)
Pounds sold (in thousands) (2)	242,560	277,482	290,388

(1) See the section "Non-GAAP Financial Measures" below for further discussion of these financial measures.

(2) Includes specialty and titanium alloys, stainless steel and powder materials.

As a result of the realignment of the commercial team during fiscal year 2016, we changed the manner in which sales are classified by end-use market so that we could better evaluate our sales results from period to period. In order to make the discussion of sales by end-use market meaningful, we have reclassified the fiscal year 2015 and 2014 sales by end-use market to conform to the fiscal year 2016 presentation.

Our sales are across a diversified list of end-use markets. The table below summarizes our sales by market over the past three fiscal years:

	Fiscal Year					
	2016		2015		2014	
($ in millions)	Dollars	% of Total	Dollars	% of Total	Dollars	% of Total
Aerospace and defense	$981.5	54 %	$1,053.8	48 %	$1,006.8	47 %
Energy	130.6	7	285.6	13	309.9	14
Transportation	160.6	8	171.0	7	153.5	7
Medical	121.5	7	129.4	6	117.6	5
Industrial and consumer	300.9	17	450.0	20	447.6	21
Distribution	118.3	7	136.9	6	137.6	6
Total net sales	$1,813.4	100%	$2,226.7	100%	$2,173.0	100%

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Impact of Raw Material Prices and Product Mix

We value most of our inventory utilizing LIFO inventory costing methodology. Under the LIFO inventory costing method, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period even though these materials may have been acquired at potentially significantly different values due to the length of time from the acquisition of the raw materials to the sale of the processed finished goods to the customers. In a period of rising raw material costs, the LIFO inventory valuation normally results in higher cost of sales. Conversely, in a period of decreasing raw material costs, the LIFO inventory valuation normally results in lower cost of sales.

The volatility of the costs of raw materials has impacted our operations over the past several years. We, and others in our industry, generally have been able to pass cost increases on major raw materials through to our customers using surcharges that are structured to recover increases in raw material costs. Generally, the formula used to calculate a surcharge is based on published prices of the respective raw materials for the previous month which correlates to the prices we pay for our raw material purchases. However, a portion of our surcharges to customers may be calculated using a different surcharge formula or may be based on the raw material prices at the time of order, which creates a lag between surcharge revenue and corresponding raw material costs recognized in cost of sales. The surcharge mechanism protects our net income on such sales except for the lag effect discussed above. However, surcharges have had a dilutive effect on our gross margin and operating margin percentages as described later in this report.

Approximately 25 percent of our net sales are sales to customers under firm price sales arrangements. Firm price sales arrangements involve a risk of profit margin fluctuations, particularly when raw material prices are volatile. In order to reduce the risk of fluctuating profit margins on these sales, we enter into commodity forward contracts to purchase certain critical raw materials necessary to produce the related products sold. Firm price sales arrangements generally include certain annual purchasing commitments and consumption schedules agreed to by the customers at selling prices based on raw material prices at the time the arrangements are established. If a customer fails to meet the volume commitments (or the consumption schedule deviates from the agreed-upon terms of the firm price sales arrangements), the Company may need to absorb the gains or losses associated with the commodity forward contracts on a temporary basis. Gains or losses associated with commodity forward contracts are reclassified to earnings/loss when earnings are impacted by the hedged transaction. Because we value most of our inventory under the LIFO costing methodology, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period attempting to match the most recently incurred costs with revenues. Gains and/or losses on the commodity forward contracts are reclassified from other comprehensive income together with the actual purchase price of the underlying commodities when the underlying commodities are purchased and recorded in inventory. To the extent that the total purchase price of the commodities, inclusive of the gains or losses on the commodity forward contracts, are higher or lower relative to the beginning of year costs, our cost of goods sold reflects such amounts. Accordingly, the gains and/or losses associated with commodity forward contracts may not impact the same period that the firm price sales arrangements revenue is recognized, and comparisons of gross profit from period to period may be impacted. These firm price sales arrangements are expected to continue as we look to strengthen our long-term customer relationships by expanding, renewing and in certain cases extending to a longer term, our customer long-term arrangements.

We produce hundreds of grades of materials, with a wide range of pricing and profit levels depending on the grade. In addition, our product mix within a period is subject to the fluctuating order patterns of our customers as well as decisions we may make on participation in certain products based on available capacity including the impacts of capacity commitments we may have under existing customer agreements. While we expect to see positive contribution from a more favorable product mix in our margin performance over time, the impact by period may fluctuate, and period-to-period comparisons may vary.

Net Pension Expense

Net pension expense, as we define it below, includes the net periodic benefit costs related to both our pension and other postretirement plans. The net periodic benefit costs are determined annually based on beginning of year balances and are recorded ratably throughout the fiscal year, unless a significant re-measurement event occurs. The following is a summary of the net periodic benefit costs for the years ended June 30, 2016, 2015 and 2014:

	Years Ended June 30,		
($ in millions)	2016	2015	2014
Pension plans	$ 50.9	$ 34.5	$ 49.0
Other postretirement plans	2.9	10.0	11.1
Net periodic benefit costs	$ 53.8	$ 44.5	$ 60.1

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The service cost component of net pension expense represents the estimated cost of future pension liabilities earned associated with active employees. The pension earnings, interest and deferrals (“pension EID”) 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.

During the year ended June 30, 2016, we offered an early retirement incentive to certain employees. As a result of the incentive, $9.4 million was paid from the Company's qualified pension plan consisting of various personnel-related costs to cover severance payments.

During the year ended June 30, 2015, in connection with a restructuring plan, we reduced approximately 200 salaried positions. As a result, $8.3 million was paid from the Company's qualified pension plan consisting primarily of various personnel-related costs to cover severance payments and medical coverage.

Net pension expense is recorded in accounts that are included in both the cost of sales and selling, general and administrative expenses based on the function of the associated employees. The following is a summary of the classification of net pension expense for the years ended June 30, 2016, 2015 and 2014:

	Years Ended June 30,		
($ in millions)	2016	2015	2014
Cost of sales			
Service cost	$28.1	$29.3	$28.2
Pension earnings, interest and deferrals	13.2	5.0	14.2
	41.3	34.3	42.4
Selling, general and administrative expenses			
Service cost	6.4	7.3	7.9
Pension earnings, interest and deferrals	6.1	4.5	7.6
Curtailment gain	—	(1.6)	—
	12.5	10.2	15.5
Net pension expense	$53.8	$44.5	$57.9

As of June 30, 2016 and 2015, amounts capitalized in gross inventory were $10.6 million and $9.5 million, respectively.

Operating Performance Overview

Fiscal year 2016 was a successful year for Carpenter related to numerous changes made in how we operate as a company, including:

- We strengthened our Carpenter team by adding experienced external talent and promoted internal talent into critical roles.

- We defined our strategy as a solutions provider helping our customers solve their most challenging problems and giving them competitive advantage.

- We reorganized our commercial team to be market focused versus product focused. We are aggressively seeking avenues to deepen customer relationships and expand the participation of our high-end specialty alloys across the most critical applications.

- We launched the Carpenter Operating Model. The Carpenter Operating Model is unlocking manufacturing efficiencies and commercial opportunities, while also driving further improvements in working capital efficiency and capital spending discipline.

These strategic initiatives are aimed at enabling our organization to not only overcome the near term cyclical challenges but also better position Carpenter to generate growth and improve margins over the long-term.

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Results of Operations — Fiscal Year 2016 Compared to Fiscal Year 2015

For fiscal year 2016, we reported net income of $11.3 million, or $0.23 per diluted share, compared with net income of $58.7 million, or $1.11 per diluted share, a year earlier. Our fiscal year 2016 results reflect operating cost improvements driven by the implementation of the Carpenter Operating Model which were more than offset by the impact of lower volumes principally in our Energy, Industrial and Consumer and Aerospace and Defense end-use markets and non-cash impairment charges related to certain assets in the Company's oil and gas businesses within the Performance Engineered Products ("PEP") segment. The non-cash impairment charges consist of:

- Excess inventory write-down charges totaling $22.5 million
- Goodwill impairment charges totaling $12.5 million
- Impairment of intangible assets and property, plant and equipment charges totaling $7.6 million

In addition, the Company recorded $10.4 million of restructuring charges consisting primarily of an early retirement incentive offered to certain employees funded by the Company's pension plan.

Net Sales

Net sales for fiscal year 2016 were $1,813.4 million, which was a 19 percent decrease from fiscal year 2015. Excluding surcharge revenue, sales were 13 percent lower than fiscal year 2015 on 13 percent lower volume. The results reflect weakness in demand for materials used in the Energy end-use market which also affected order patterns for customers in the Industrial and Consumer end-use market.

Geographically, sales outside the United States decreased 12 percent from fiscal year 2015 to $569.9 million. The decrease is primarily due to sales to Asia and Canada in the Energy and Industrial and Consumer end-use markets. In addition, sales to Europe decreased in the Aerospace and Defense, Energy, Medical and Industrial and Consumer end-use markets. A portion of our sales outside the United States are denominated in foreign currencies. The impact of fluctuations in foreign currency exchange rates resulted in a $9.5 million decrease in sales during the fiscal year 2016 compared to fiscal year 2015. International sales as a percentage of our total net sales represented 31 percent and 29 percent for fiscal year 2016 and fiscal year 2015, respectively.

Sales by End-Use Markets

We sell to customers across diversified end-use markets. The following table includes comparative information for our net sales, which includes surcharge revenue, by principal end-use markets. We believe this is helpful supplemental information in analyzing the performance of the business from period to period.

	Fiscal Year		$	%
($ in millions)	2016	2015	Decrease	Decrease
Aerospace and defense	$981.5	$1,053.8	$(72.3)	(7)%
Energy	130.6	285.6	(155.0)	(54)%
Transportation	160.6	171.0	(10.4)	(6)%
Medical	121.5	129.4	(7.9)	(6)%
Industrial and consumer	300.9	450.0	(149.1)	(33)%
Distribution	118.3	136.9	(18.6)	(14)%
Total net sales	$1,813.4	$2,226.7	$(413.3)	(19)%

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The following table includes comparative information for our net sales by the same principal end-use markets, but excluding surcharge revenue:

($ in millions)	Fiscal Year 2016	Fiscal Year 2015	$ Increase (Decrease)	% (Increase) Decrease
Aerospace and defense	$823.1	$823.5	$ (0.4)	— %
Energy	115.3	245.0	(129.7)	(53)%
Transportation	136.8	130.9	5.9	5 %
Medical	114.5	118.5	(4.0)	(3)%
Industrial and consumer	265.2	358.3	(93.1)	(26)%
Distribution	117.7	135.6	(17.9)	(13)%
Total net sales excluding surcharge revenue	$1,572.6	$1,811.8	$ (239.2)	(13)%

Sales to the Aerospace and Defense market decreased 7 percent from fiscal year 2015 to $981.5 million. Excluding surcharge revenue, sales were flat on similar shipment volume. The results reflect stronger demand for materials used in structural applications and an increase in sales of engine materials as a result of additional activity across the new platforms offset by a decrease in sales of titanium fastener material. In addition, we are experiencing strength in our defense related sales with continued spending on supported programs.

Sales to the Energy market of $130.6 million reflected a 54 percent decrease from fiscal year 2015. Excluding surcharge revenue, sales decreased 53 percent on 50 percent lower shipment volume. The results reflect the impact of low oil and gas prices and slowing demand, which has significantly reduced drilling and exploration activity. The North American average directional rig count, a leading indicator of drilling activity, decreased 53 percent from the same period a year ago.

Transportation market sales decreased 6 percent from fiscal year 2015 to $160.6 million. Excluding surcharge revenue, sales increased 5 percent on 3 percent lower shipment volume. The results reflect a strengthening mix for our materials used in engine, valve and fuel system materials. Low fuel prices drove up sales for vehicle platforms with higher Carpenter material content. In addition, sales of light trucks increased from the year ago period.

Sales to the Medical market decreased 6 percent to $121.5 million from fiscal year 2015. Excluding surcharge revenue, sales decreased 3 percent on 2 percent lower shipment volume. The results reflect pricing pressures on transactional business for titanium and stainless steel materials.

Industrial and Consumer market sales were $300.9 million for fiscal year 2016. Excluding surcharge revenue, sales decreased 26 percent on 22 percent lower shipment volume. The results reflect decreased demand for materials used in capital equipment and industrial components due in part to the drilling and exploration activity.

Distribution sales decreased 14 percent from the same period a year ago to $118.3 million. Excluding surcharge revenue, sales decreased 13 percent from the same period a year ago.

Gross Profit

Gross profit in fiscal year 2016 decreased to $255.9 million, or 14.1 percent of net sales from $318.3 million, or 14.3 percent of net sales for fiscal year 2015. During the year ended June 30, 2016, we recorded a $22.5 million excess inventory adjustment in our oil and gas businesses within the PEP segment due to the prolonged weakness in oil and gas businesses. Excluding the impacts of the excess inventory write-down and surcharge revenue, our gross margin in fiscal year 2016 was 17.7 percent as compared 17.6 percent in the same period a year ago. The results reflect lower operating costs driven by the implementation of the Carpenter Operating Model which were offset by lower volume principally in our Energy and Industrial and Consumer end-use markets compared to the same period a year ago.

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Our surcharge mechanism is structured to recover increases in raw material costs, although in certain cases with a lag effect as discussed above. While the surcharge generally protects the absolute gross profit dollars, it does have a dilutive effect on gross margin as a percent of sales. The following represents a summary of the dilutive impact of the surcharge on gross margin excluding the impact of the excess inventory write-down. We present and discuss these financial measures because management believes removing the impact of these items provides a more consistent and meaningful basis for comparing results of operations from period to period. See the section "Non-GAAP Financial Measures" below for further discussion of these financial measures.

	Fiscal Year	
($ in millions)	2016	2015
Net sales	$1,813.4	$2,226.7
Less: surcharge revenue	240.8	414.9
Net sales excluding surcharge revenue	$1,572.6	$1,811.8
Gross profit	$255.9	$318.3
Excess inventory write-down	22.5	—
Gross profit excluding the excess inventory write-down	$278.4	$318.3
Gross margin	14.1 %	14.3 %
Gross margin excluding surcharge revenue and excess inventory write-down	17.7 %	17.6 %

Selling, General and Administrative Expenses

Selling, general and administrative expenses in fiscal year 2016 were $173.8 million, or 9.6 percent of net sales (11.1 percent of net sales excluding surcharge revenue), compared to $177.7 million, or 8.0 percent of net sales (9.8 percent of net sales excluding surcharge revenue), in fiscal year 2015. Selling, general and administrative expenses decreased due to lower salaries and benefits of $5.6 million primarily as a result of the restructuring actions taken in fiscal year 2015, lower variable compensation expense of $3.1 million partially offset by consulting costs of $4.2 million related to the Business Management Office (BMO) and strategic business review. The BMO is focused on profit optimization, operating cost improvement and inventory reductions.

Restructuring and Asset Impairment Charges

During fiscal year 2016, we incurred $18.0 million of restructuring and asset impairment charges. This included $7.6 million of non-cash impairment charges to write down property, plant and equipment and other intangible assets. The remaining $10.4 million consisted primarily of an early retirement incentive that resulted in a reduction of approximately 130 production and maintenance positions.

During fiscal year 2015, we incurred $29.1 million of restructuring charges. We implemented a reduction of approximately 200 salaried positions resulting in a charge of $12.7 million consisting primarily of various personnel-related costs to cover severance payments, medical coverage and related items. We also exited the ultra-fine grain materials development program resulting in a charge of $13.4 million during fiscal year 2015. In addition, we announced the closure of a facility resulting in a charge of $3.0 million to reflect the write-down of certain property and equipment. The actions taken in fiscal year 2015 aimed to yield approximately $30 million of fixed costs savings were realized in fiscal year 2016.

Activities undertaken in connection with the fiscal years 2016 and 2015 restructuring plans are complete.

Goodwill Impairment Charge

The Company's Amega West Services ("Amega") and Specialty Steel Supply ("SSS") reporting units within the PEP Segment have been significantly impacted by the prolonged weakness in oil and gas drilling and exploration activity driven by depressed oil prices. As a result, during the fiscal year 2016 we recorded an impairment charge of $12.5 million which represents the entire balance of the goodwill recorded for these reporting units.

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Operating Income

Our operating income in fiscal year 2016 decreased to $51.6 million, or 2.8 percent of net sales as compared with $111.5 million, or 5.0 percent in net sales in fiscal year 2015. Excluding surcharge revenue, pension EID and special items, operating margin was 8.5 percent for the fiscal year 2016 and 8.6 percent for the same period a year ago. The decrease in the operating margin reflects lower volume principally in our Energy and Industrial and Consumer end-use markets partially offset by operating cost improvements and overhead cost reductions compared to the same period a year ago.

Operating income has been significantly impacted by our pension EID, which may be volatile based on conditions in the financial markets, as well as other special items. The following presents our operating income and operating margin, in each case excluding the impact of surcharge on net sales, pension EID, the excess inventory write-down, restructuring and asset impairment charges, goodwill impairment and other special items. We present and discuss these financial measures because management believes removing the impact of these items provides a more consistent and meaningful basis for comparing results of operations from period to period. See the section "Non-GAAP Financial Measures" below for further discussion of these financial measures.

	Fiscal Year	
($ in millions)	2016	2015
Net sales	$1,813.4	$2,226.7
Less: surcharge revenue	240.8	414.9
Net sales excluding surcharge revenue	$1,572.6	$1,811.8
Operating income	$51.6	$111.5
Pension EID	19.3	9.5
Operating income excluding pension EID	70.9	121.0
Special items:		
Excess inventory write-down	22.5	—
Restructuring and asset impairment charges	18.0	29.1
Goodwill impairment	12.5	—
Consulting costs	9.3	5.1
Operating income excluding pension EID and special items	$133.2	$155.2
Operating margin	2.8 %	5.0 %
Operating margin excluding surcharge revenue, pension EID and special items	8.5 %	8.6 %

Interest Expense

Fiscal year 2016 interest expense was $28.0 million compared to $27.7 million in fiscal year 2015. We have used interest rate swaps to achieve a level of floating rate debt to fixed rate debt. Interest expense for fiscal 2016 includes net gains from interest rate swaps of $2.6 million compared with $2.9 million of net gains from interest rate swaps for the fiscal year 2015.

Other Expense (Income), Net

Other expense for fiscal year 2016 was $2.1 million as compared with other income of $5.3 million a year ago. The results reflect negative impacts in foreign exchange losses of $2.7 million for the current period compared to the same period a year ago. The fiscal year 2015 results include a $4.4 million favorable legal settlement.

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Income Taxes

Our effective tax rate (income tax expense as a percent of income before taxes) for fiscal year 2016 was 47.4 percent as compared to 34.1 percent in fiscal year 2015. The fiscal year 2016 tax rate includes the impact of non-cash goodwill impairment charges, a portion of which is non-deductible for tax purposes, as well as a tax charge of $2.8 million recorded due to a change in business strategy for one of our foreign subsidiaries that resulted in a change in our intent with regard to the indefinite reinvestment of the foreign earnings for this subsidiary. The fiscal year 2016 tax rate also includes net tax benefits of $0.8 million primarily for additional research and development credits as a result of the December 2015 enactment of the Protecting Americans from Tax Hikes Act of 2015. Income tax expense in the prior year includes a net tax charge of $1.6 million for the unfavorable impact of bonus depreciation on domestic manufacturing benefits, net of additional research and development credits as a result of the enactment of the Tax Increase Prevention Act of 2014.

As of June 30, 2016, we had $106.5 million of indefinitely reinvested foreign earnings for which we had not provided deferred income taxes.

See Note 16 to the consolidated financial statements in Item 8, “Financial Statements and Supplementary Data” for a full reconciliation of the statutory federal tax rate to the effective tax rates.

Business Segment Results

Summary information about our operating results on a segment basis is set forth below. For more detailed segment information, see Note 18 to the consolidated financial statements included in Item 8, “Financial Statements and Supplementary Data”.

The following table includes comparative information for volumes by business segment:

(Pounds sold, in thousands)	Fiscal Year 2016	Fiscal Year 2015	Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	234,296	269,550	(35,254)	(13)%
Performance Engineered Products	11,626	15,262	(3,636)	(24)%
Intersegment	(3,362)	(7,330)	3,968	54 %
Consolidated pounds sold	242,560	277,482	(34,922)	(13)%

* Pounds sold data for PEP segment includes Dynamet and Carpenter Powder Products businesses only.

The following table includes comparative information for net sales by business segment:

($ in millions)	Fiscal Year 2016	Fiscal Year 2015	$ Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	$1,481.0	$1,796.6	$ (315.6)	(18)%
Performance Engineered Products	358.7	497.7	(139.0)	(28)%
Intersegment	(26.3)	(67.6)	41.3	61 %
Total net sales	$1,813.4	$2,226.7	$ (413.3)	(19)%

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The following table includes comparative information for our net sales by business segment, but excluding surcharge revenue:

($ in millions)	Fiscal Year 2016	Fiscal Year 2015	$ Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	$1,239.6	$1,373.5	$(133.9)	(10)%
Performance Engineered Products	357.9	496.5	(138.6)	(28)%
Intersegment	(24.9)	(58.2)	33.3	57%
Total net sales excluding surcharge revenue	$1,572.6	$1,811.8	$(239.2)	(13)%

Specialty Alloys Operations Segment

Net sales in fiscal year 2016 for the SAO segment decreased 18 percent to $1,481.0 million, as compared with $1,796.6 million in fiscal year 2015. Excluding surcharge revenue, sales decreased 10 percent from a year ago. The fiscal year 2016 net sales reflected 13 percent lower shipment volume as compared to fiscal year 2015. The results reflect weakness in the Energy and Industrial and Consumer end-use markets compared to the prior year same period.

Operating income for the SAO segment in fiscal year 2016 was $176.9 million, or 11.9 percent of net sales (14.3 percent of net sales excluding surcharge revenue), compared to $155.2 million, or 8.6 percent of net sales (11.3 percent of net sales excluding surcharge revenue), for fiscal year 2015. The increase in operating income reflects operating cost improvements driven by the implementation of the Carpenter Operating Model, an insurance recovery benefit of $4 million and a favorable shift in product mix.

Performance Engineered Products Segment

Net sales for fiscal year 2016 for the PEP segment were $358.7 million as compared with $497.7 million for fiscal year 2015. Excluding surcharge revenue, net sales were decreased 28 percent. The results reflect decreased net sales primarily due to the current weakness in the Energy end-use market.

Operating loss for the PEP segment for fiscal year 2016 was $5.5 million, or 1.5 percent of net sales, as compared with operating income of $39.1 million, or 7.9 percent of net sales for fiscal year 2015. The results reflect the impact of the weak Energy end-use market due to limited drilling activity.

Results of Operations — Fiscal Year 2015 Compared to Fiscal Year 2014

For fiscal year 2015, we reported net income of $58.7 million, or $1.11 per diluted share, compared with net income of $132.8 million, or $2.47 per diluted share, a year earlier. Our fiscal year 2015 results reflect the impact of increasing sales by 2 percent in a challenging market environment which was more than offset by the weakness in the oil and gas businesses, increased operating costs and the restructuring plan implemented in the third quarter of fiscal year 2015.

Net Sales

Net sales for fiscal year 2015 were $2,226.7 million, which was a 2 percent increase from fiscal year 2014. Excluding surcharge revenue, sales were 2 percent higher than fiscal year 2014 on 4 percent lower volume. The results reflect sales increasing in the Aerospace and Defense, Medical and Transportation end-use markets, partially offset by the weakness in the Energy end-use market due to weak market conditions. The increase in sales combined with lower shipment volume reflects a favorable shift in product mix.

Geographically, sales outside the United States increased 2 percent from fiscal year 2014 to $646.8 million. International sales as a percentage of our total net sales represented 29 percent for both fiscal years 2015 and 2014.

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Sales by End-Use Markets

We sell to customers across diversified end-use markets. The following table includes comparative information for our net sales, which includes surcharge revenue, by principal end-use markets which we believe is helpful supplemental information in analyzing the performance of the business from period to period:

($ in millions)	Fiscal Year 2015	Fiscal Year 2014	$ Increase (Decrease)	% Increase (Decrease)
Aerospace and defense	$1,053.8	$1,006.8	$ 47.0	5 %
Energy	285.6	309.9	(24.3)	(8)%
Transportation	171.0	153.5	17.5	11 %
Medical	129.4	117.6	11.8	10 %
Industrial and consumer	450.0	447.6	2.4	1 %
Distribution	136.9	137.6	(0.7)	(1)%
Total net sales	$2,226.7	$2,173.0	$ 53.7	2 %

The following table includes comparative information for our net sales by the same principal end-use markets, but excluding surcharge revenue:

($ in millions)	Fiscal Year 2015	Fiscal Year 2014	$ Increase (Decrease)	% Increase (Decrease)
Aerospace and defense	$823.5	$795.0	$ 28.5	4 %
Energy	245.0	269.7	(24.7)	(9)%
Transportation	130.9	120.5	10.4	9 %
Medical	118.5	107.8	10.7	10 %
Industrial and consumer	358.3	353.5	4.8	1 %
Distribution	135.6	136.3	(0.7)	(1)%
Total net sales excluding surcharge revenue	$1,811.8	$1,782.8	$ 29.0	2 %

Sales to the Aerospace and Defense end-use market increased 5 percent from fiscal year 2014 to $1,053.8 million. Excluding surcharge revenue, sales increased 4 percent on 2 percent higher shipment volume. The results reflect an increase in sales of fastener materials and a stronger demand for engine materials, partially offset by lower demand for structural and defense materials.

Sales to the Energy end-use market of $285.6 million reflected an 8 percent decrease from fiscal year 2014. Excluding surcharge revenue, sales decreased 9 percent on 9 percent lower shipment volume. The results reflect demand softness in materials used in oil and gas drilling and completions in the second half of fiscal year 2015. Also, North American average directional and horizontal rig count decreased 46 percent from the prior year. These declines were partially offset by a moderate increase in power generation sales.

Transportation end-use market sales increased 11 percent from fiscal year 2014 to $171.0 million. Excluding surcharge revenue, sales increased 9 percent on 5 percent higher shipment volume. The results reflect a strengthening mix for our materials used in engine fasteners, valve and fuel system materials. Low fuel prices drove up sales for vehicle platforms with higher Carpenter material content. In addition, sales of light trucks increased from the year ago period. Also, fiscal year 2015 backlog is experiencing growth due to an improved mix compared to fiscal year 2014.

Sales to the Medical end-use market increased 10 percent to $129.4 million from fiscal year 2014. Excluding surcharge revenue, sales increased 10 percent on 13 percent higher shipment volume. The results reflect strength in demand for materials used for surgical instruments, as well as increased sales of titanium materials used in orthopedic implant procedures. However, the medical market pricing environment remains extremely competitive.

Industrial and Consumer end-use market sales were $450.0 million for fiscal year 2015. Excluding surcharge revenue, sales increased 1 percent on 14 percent lower shipment volume. The results reflect a favorable shift in product mix related to high-end consumer electronics and industrial capital goods.

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Distribution end-use market sales decreased 1 percent from the same period a year ago to $136.9 million. Excluding surcharge revenue, sales decreased 1 percent from the same period a year ago.

Gross Profit

Gross profit in fiscal year 2015 decreased to $318.3 million, or 14.3 percent of net sales (17.6 percent of net sales excluding surcharge revenue), from $398.9 million, or 18.4 percent of net sales (22.4 percent of net sales excluding surcharge revenue), for fiscal year 2014. The results reflect a stronger product mix which was more than offset by higher operating costs, unfavorable cost absorption as a result of reducing inventory and incremental depreciation expense due to the Athens facility which was placed into service late in fiscal year 2014.

Our surcharge mechanism is structured to recover increases in raw material costs, although in certain cases with a lag effect as discussed above. While the surcharge generally protects the absolute gross profit dollars, it does have a dilutive effect on gross margin as a percent of sales. The following represents a summary of the dilutive impact of the surcharge on gross margin for fiscal years 2015 and 2014. We present and discuss these financial measures because management believes removing the impact of these items provides a more consistent and meaningful basis for comparing results of operations from period to period. See the section “Non-GAAP Financial Measures” below for further discussion of these financial measures.

	Fiscal Year			
($ in millions)	2015		2014	
Net sales	$2,226.7		$2,173.0	
Less: surcharge revenue	414.9		390.2	
Net sales excluding surcharge revenue	$1,811.8		$1,782.8	
Gross profit	$318.3		$398.9	
Gross margin	14.3	%	18.4	%
Gross margin excluding surcharge revenue	17.6	%	22.4	%

Selling, General and Administrative Expenses

Selling, general and administrative expenses in fiscal year 2015 were $177.7 million, or 8.0 percent of net sales (9.8 percent of net sales excluding surcharge revenue), compared to $186.9 million, or 8.6 percent of net sales (10.5 percent of net sales excluding surcharge revenue), in fiscal year 2014. Selling, general and administrative expenses decreased from the same period last year primarily due to lower depreciation and amortization expense of $4.3 million, lower variable compensation expense of $3.5 million, a reduction in pension EID expense of $3.1 million and lower severance of $1.6 million compared to prior year. These favorable items were partially offset by consulting costs of $5.1 million in fiscal year 2015 related to the BMO and strategic business review.

Restructuring and Asset Impairment Charges

During fiscal year 2015 we incurred $29.1 million of restructuring charges. We implemented a reduction of 200 salaried positions resulting in a charge of $12.7 million consisting primarily of various personnel-related costs to cover severance payments, medical coverage and related items. We also exited the ultra-fine grain materials development program resulting in a charge of $13.4 million during the fiscal year. In addition, we announced the closure of facilities resulting in a charge of $3.0 million to reflect the write-down of certain inventory, property and equipment and related items.

Activities undertaken in connection with the restructuring plan were complete by the first quarter of fiscal year 2016.

Operating Income

Our operating income in fiscal year 2015 decreased to $111.5 million as compared with $212.0 million in fiscal year 2014. The results reflect a strengthening product mix and lower selling, general and administrative expenses more than offset by higher operating costs, incremental depreciation expense due to the Athens facility which was placed into service in fiscal year 2014 and restructuring charges.

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Operating income has been significantly impacted by our pension EID, which may be volatile based on conditions in the financial markets as well as other special items. The following presents our operating income and operating margin, in each case excluding the impact of surcharge on net sales, pension EID, restructuring and asset impairment charges and special items. We present and discuss these financial measures because management believes removing the impacts of these items provides a more consistent and meaningful basis for comparing results of operations from period to period. See the section "Non-GAAP Financial Measures" below for further discussion of these financial measures.

	Fiscal Year	
($ in millions)	2015	2014
Net sales	$2,226.7	$2,173.0
Less: surcharge revenue	414.9	390.2
Net sales excluding surcharge revenue	$1,811.8	$1,782.8
Operating income	$111.5	$212.0
Pension EID	9.5	21.8
Operating income excluding pension EID	121.0	233.8
Special items:		
Restructuring and asset impairment charges	29.1	—
Consulting costs	5.1	—
Weather-related costs	—	8.0
Operating income excluding pension EID and special items	$155.2	$241.8
Operating margin	5.0 %	9.8 %
Operating margin excluding surcharge revenue, pension EID and special items	8.6 %	13.6 %

Interest Expense

Fiscal year 2015 interest expense of $27.7 million increased 63 percent compared to $17.0 million in fiscal year 2014. The increase in interest expense is due to capitalized interest of $2.7 million during the year ended June 30, 2015 compared to $15.1 million the same period a year ago which primarily reflects the impact of placing a significant amount of the assets, attributable to the construction project at our Athens manufacturing plant, in service late in fiscal year 2014. This is offset by net gains from interest rate swaps of $2.9 million as compared to $0.0 million in fiscal year 2014. We have used interest rate swaps to achieve a level of floating rate debt to fixed rate debt.

Other Income, Net

Other income for fiscal year 2015 was $5.3 million as compared with $1.4 million a year ago. The year ended June 30, 2015 includes a $4.4 million favorable legal settlement.

Income Taxes

Our effective tax rate (income tax expense as a percent of income before taxes) for fiscal year 2015 was 34.1 percent as compared to 32.4 percent in fiscal year 2014. The tax rates for both periods were lower than the statutory rate of 35 percent, primarily due to benefits associated with the domestic manufacturing deduction. The fiscal year 2015 tax rate includes net tax charges of $1.6 million for the unfavorable impact of bonus depreciation on domestic manufacturing benefits recorded in the prior year, net of additional research and development credits as a result of the December 2014 enactment of the Tax Increase Prevention Act.

As of June 30, 2014 we had $128.4 million of indefinitely reinvested foreign earnings for which we had not provided deferred income taxes. Due to the authorization of the $500.0 million share repurchase program in October 2014, we changed our intent with regard to the indefinite reinvestment of a portion of the foreign earnings of one of our foreign subsidiaries for fiscal year 2014 and prior years. As a result of this change, we repatriated approximately $38 million during the third quarter of fiscal year 2015 with minimal tax cost. The remaining balance of unremitted foreign earnings continues to be indefinitely reinvested.

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See Note 16 to the consolidated financial statements in Item 8, "Financial Statements and Supplementary Data" for a full reconciliation of the statutory federal tax rate to the effective tax rates.

Business Segment Results

Summary information about our operating results on a segment basis is set forth below. For more detailed segment information, see Note 18 to the consolidated financial statements included in Item 8, "Financial Statements and Supplementary Data".

The following table includes comparative information for volumes by business segment:

(Pounds sold, in thousands)	Fiscal Year 2015	Fiscal Year 2014	Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	269,550	282,914	(13,364)	(5)%
Performance Engineered Products	15,262	12,248	3,014	25 %
Intersegment	(7,330)	(4,774)	(2,556)	(54)%
Consolidated pounds sold	277,482	290,388	(12,906)	(4)%

* Pounds sold data for PEP segment includes Dynamet and Carpenter Powder Products businesses only.

The following table includes comparative information for net sales by business segment:

($ in millions)	Fiscal Year 2015	Fiscal Year 2014	$ Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	$1,796.6	$1,741.6	$ 55.0	3 %
Performance Engineered Products	497.7	498.6	(0.9)	—
Intersegment	(67.6)	(67.2)	(0.4)	(1)%
Total net sales	$2,226.7	$2,173.0	$ 53.7	2 %

The following table includes comparative information for our net sales by business segment, but excluding surcharge revenue:

($ in millions)	Fiscal Year 2015	Fiscal Year 2014	$ Increase (Decrease)	% Increase
Specialty Alloys Operations	$1,373.5	$1,344.6	$ 28.9	2 %
Performance Engineered Products	496.5	496.6	(0.1)	—
Intersegment	(58.2)	(58.4)	0.2	—
Total net sales excluding surcharge revenue	$1,811.8	$1,782.8	$ 29.0	2 %

Specialty Alloys Operations Segment

Net sales in fiscal year 2015 for the SAO segment increased 3 percent to $1,796.6 million, as compared with $1,741.6 million in fiscal year 2014. Excluding surcharge revenue, sales increased 2 percent from a year ago. The fiscal year 2015 net sales reflected 5 percent lower shipment volume as compared to fiscal year 2014. The increase in sales combined with lower shipment volumes reflects a favorable shift in product mix despite challenging market conditions.

Operating income for the SAO segment in fiscal year 2015 was $155.2 million, or 8.6 percent of net sales (11.3 percent of net sales excluding surcharge revenue), compared to $232.7 million, or 13.4 percent of net sales (17.3 percent of net sales excluding surcharge revenue), for fiscal year 2014. The decrease in operating income reflects the impacts of a strengthening mix which was more than offset by the operational issues, higher operating costs and incremental depreciation expense related to our Athens facility.

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Performance Engineered Products Segment

Net sales for fiscal year 2015 for the PEP segment were $497.7 million as compared with $498.6 million for fiscal year 2014. Excluding surcharge revenue, net sales were flat. The results reflect increased net sales of powder products and sales of titanium bar and wire products which was offset by lower rentals and sales of down-hole drilling tools due to the weakness in the Energy end-use market.

Operating income for the PEP segment for fiscal year 2015 was $39.1 million, or 7.9 percent of net sales, as compared with $45.5 million, or 9.1 percent of net sales for fiscal year 2014. The results reflect the impacts of the weak market conditions in the oil and gas businesses experienced during the second half of fiscal year 2015, partially offset by improved performance in the titanium and powder products businesses.

Liquidity and Financial Resources

We ended fiscal year 2016 with $82.0 million of cash, an increase of $12.0 million from fiscal year 2015. During fiscal year 2016 our cash from operations was $256.9 million as compared with $282.6 million in fiscal year 2015. Our free cash flow, which we define under “Non-GAAP Financial Measures” below, was positive $138.6 million as compared to positive $74.4 million for the same period a year ago. The increase in free cash flow reflects significantly lower capital spending levels largely related to the winding down in capital expenditures associated with the construction of our Athens, Alabama facility. Capital expenditures for property, equipment and software were $95.2 million for fiscal year 2016 as compared to $170.5 million for the fiscal year 2015. In fiscal year 2017, we expect capital expenditures to be approximately $120 million.

During fiscal year 2016, we used $123.9 million to purchase 3,762,200 shares of common stock pursuant to the terms of the share repurchase program authorized by our Board of Directors in October 2014. To date we used $248.4 million to purchase 6,757,472 shares.

Dividends for the fiscal year 2016 were $34.8 million, as compared with $37.9 million in the prior year and were paid at the same quarterly rate of $0.18 per share of common stock in both periods.

For the years ended June 30, 2016, 2015 and 2014, interest costs totaled $29.9 million, $30.4 million and $32.1 million, respectively, of which $1.9 million, $2.7 million and $15.1 million, respectively, were capitalized as part of the cost of property, plant, equipment and software.

During fiscal year 2016, we made no cash contributions to our qualified pension plans, and are required to make cash contributions of $0.7 million to our pension plans during fiscal year 2017. Over the next five years, current estimates indicate that we will be required to make about $216.6 million of cash contributions to our pension plans, based on the laws in effect for pension funding as of June 30, 2016, and subject to market returns and interest rate assumptions.

We have demonstrated the ability to generate cash to meet our needs through cash flows from operations, management of working capital and the availability of outside sources of financing to supplement internally generated funds. We generally target minimum liquidity, consisting of cash and cash equivalents added to available borrowing capacity under our credit agreement, of $150.0 million. Our syndicated revolving credit agreement (“Credit Agreement”) contains a revolving credit commitment of $500.0 million and expires in June 2018. As of June 30, 2016, we had $7.1 million of issued letters of credit. The balance of the Credit Agreement ($492.9 million as of June 30, 2016) remains available to us. As of June 30, 2016, we had total liquidity of approximately $575 million, including $82.0 million of cash and cash equivalents. From time to time during the year ended June 30, 2016 we have borrowed under our Credit Agreement and subsequently repaid any outstanding borrowings prior to June 30, 2016. The weighted average daily borrowing under the Credit Agreement during the year ended June 30, 2016 was $15.3 million with daily outstanding borrowings ranging from $0.0 million to $50.8 million.

We evaluate liquidity needs for alternative uses including funding external growth opportunities, share repurchases as well as funding consistent dividend payments to stockholders. Over the last several years, we declared and paid quarterly cash dividends of $0.18 per share.

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As of June 30, 2016, we had cash and cash equivalents of approximately $35 million held at various foreign subsidiaries. Our global cash deployment considers, among other things, the geographic location of our subsidiaries' cash balances, the locations of our anticipated liquidity needs and the cost to access international cash balances, as necessary. The repatriation of cash from certain foreign subsidiaries could have adverse tax consequences as we may be required to pay and record U.S. income taxes and foreign withholding taxes in various tax jurisdictions on these funds to the extent they were previously considered permanently reinvested. From time to time, we evaluate opportunities to repatriate cash from foreign jurisdictions. Our current plans consider repatriating cash only at levels that would result in minimal or no net adverse tax consequences in the near term. From time to time, we may make short-term intercompany borrowings against our cash held outside the United States in order to reduce or eliminate any required borrowing under our Credit Agreement.

We are subject to certain financial and restrictive covenants under the Credit Agreement, which, among other things, require the maintenance of a minimum interest coverage ratio (3.50 to 1.00 as of June 30, 2016). 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 percent. 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 June 30, 2016, the Company was in compliance with all of the covenants of the Credit Agreement.

The following table shows our actual ratio performance with respect to the financial covenants, as of June 30, 2016:

	Covenant Requirement	Actual Ratio
Consolidated interest coverage	3.50 to 1.00 (minimum)	10.23 to 1.00
Consolidated debt to capital	55% (maximum)	36%

We continue to believe that we will maintain compliance with the financial and restrictive covenants in future periods. To the extent that we do not comply with the covenants under the Credit Agreement, this could reduce our liquidity and flexibility due to potential restrictions on borrowings available to us unless we are able to obtain waivers or modifications of the covenants.

Non-GAAP Financial Measures

The following provides additional information regarding certain non-GAAP financial measures that we use in this report. Our definitions and calculations of these items may not necessarily be the same as those used by other companies.

Net Sales and Gross Margin Excluding Surcharge Revenue and Special Items

This report includes discussions of net sales as adjusted to exclude the impact of raw material surcharge and the resulting impact on gross margins, as well as the excess inventory write-down, which represent financial measures that have not been determined in accordance with U.S. GAAP. We present and discuss these financial measures because management believes removing the impact of raw material surcharge from net sales and cost of sales provides a more consistent basis for comparing results of operations from period to period for the reasons discussed earlier in this report. In addition, management believes that excluding the excess inventory write-down from gross profit and gross margin is helpful in analyzing our operating performance as the excess inventory write-down is not indicative of ongoing operating performance. Management uses its results excluding these amounts to evaluate its operating performance and to discuss its business with investment institutions, the Company's board of directors and others. See our earlier discussions of "Gross Profit" for reconciliations of net sales and gross margin, excluding surcharge revenue and the excess inventory write-down, to net sales as determined in accordance with U.S. GAAP. Net sales and gross margin excluding surcharge revenue and the excess inventory write-down is not a U.S. GAAP financial measure and should not be considered in isolation of, or as a substitute for, net sales and gross margin calculated in accordance with U.S. GAAP.

Operating Income and Operating Margin Excluding Surcharge Revenue, Pension EID and Special Items

This report includes discussions of operating income and operating margin as adjusted to exclude the impact of raw material surcharge revenue, pension EID, the excess inventory write-down, restructuring and asset impairment charges, goodwill impairment and other special items which represent financial measures that have not been determined in accordance with U.S. GAAP. We present and discuss these financial measures because management believes removing the impact of raw material surcharge from net sales and cost of sales provides a more consistent and meaningful basis for comparing results of operations from period to period for the reasons discussed earlier in this report. In addition, management believes that excluding pension

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EID, the excess inventory write-down, restructuring and asset impairment charges, goodwill impairment and other special items from operating income and operating margin is helpful in analyzing our operating performance particularly as pension EID may be volatile due to changes in the financial markets and the excess inventory write-down, restructuring and asset impairment charges, goodwill impairment and other special items are not indicative of ongoing operating performance. Management uses its results excluding these amounts to evaluate its operating performance and to discuss its business with investment institutions, the Company's board of directors and others. See our earlier discussion of operating income for a reconciliation of operating income and operating margin excluding pension EID, the excess inventory write-down, restructuring and asset impairment charges, goodwill impairment and other special items to operating income and operating margin determined in accordance with U.S. GAAP. Operating income and operating margin excluding surcharge revenue, pension EID, the excess inventory write-down, restructuring and asset impairment charges, goodwill impairment and special items is not a U.S. GAAP financial measure and should not be considered in isolation of, or as a substitute for, operating income and operating margin calculated in accordance with U.S. GAAP.

Adjusted Earnings Per Share

The following provides a reconciliation of adjusted earnings per share, to its most directly comparable U.S. GAAP financial measures:

($ in millions, except per share amounts)	Income Before Income Taxes	Income Tax Benefit (Expense) (a)	Net Income	Earnings Per Diluted Share
Year ended June 30, 2016, as reported	$ 21.5	$ (10.2)	$ 11.3	$ 0.23
Special Items				
Excess inventory write-down	22.5	(7.8)	14.7	0.31
Restructuring and asset impairment charges	18.0	(5.7)	12.3	0.26
Goodwill impairment	12.5	(3.2)	9.3	0.19
Consulting costs	9.3	(3.3)	6.0	0.13
Income tax item	—	2.8	2.8	0.06
Impact of tax law change	—	(0.8)	(0.8)	(0.02)
Total impact of special items	62.3	(18.0)	44.3	0.93
Year ended June 30, 2016, as adjusted	$ 83.8	$ (28.2)	$ 55.6	$ 1.16

($ in millions, except per share amounts)	Income Before Income Taxes	Income Tax Benefit (Expense) (a)	Net Income	Earnings Per Diluted Share
Year ended June 30, 2015, as reported	$89.1	$ (30.4)	$ 58.7	$ 1.11
Special Items				
Restructuring and asset impairment charges	29.1	(10.2)	18.9	0.36
Consulting costs	5.1	(1.8)	3.3	0.07
Legal settlement	(4.4)	1.5	(2.9)	(0.06)

Impact of tax law change	—	1.6	1.6	0.03
Total impact of special items	29.8	(8.9)	20.9	0.40
Year ended June 30, 2015, as adjusted	$118.9	$ (39.3)	$ 79.6	$ 1.51

(a) The income tax effect of the special items was determined using a normalized effective income tax rate of 35 percent unless the item had specific discrete income tax impacts such as certain nontaxable goodwill and asset impairment charges and impacts of tax law changes.

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Management believes that the presentation of earnings per share adjusted to exclude the impacts of the excess inventory write-down, restructuring and asset impairment charges, goodwill impairment and other special items is helpful in analyzing the operating performance of the Company, as these costs are not indicative of ongoing operating performance. Management uses its results excluding these amounts to evaluate its operating performance and to discuss its business with investment institutions, the Company's board of directors and others. Our definitions and calculations of these items may not necessarily be the same as those used by other companies. Adjusted earnings per share is not a U.S. GAAP financial measure and should not be considered in isolation of, or as a substitute for, earnings per share calculated in accordance with U.S. GAAP.

Free Cash Flow

The following provides a reconciliation of free cash flow, as used in this annual report, to its most directly comparable U.S. GAAP financial measures:

	Fiscal Year		
($ in millions)	2016	2015	2014
Net cash provided from operating activities	$256.9	$282.6	$239.6
Purchases of property, equipment and software	(95.2)	(170.5)	(349.2)
Dividends paid	(34.8)	(37.9)	(38.5)
Proceeds from disposals of plant and equipment and assets held for sale	1.4	0.2	0.3
Proceeds from sale of equity method investment	6.3	—	—
Other	4.0	—	—
Free cash flow	$138.6	$74.4	$(147.8)

Management believes that the presentation of free cash flow provides useful information to investors regarding our financial condition because it is a measure of cash generated which management evaluates for alternative uses. It is management’s current intention to use excess cash to fund investments in capital equipment, acquisition opportunities, treasury stock repurchases and consistent dividend payments. Free cash flow is not a U.S. GAAP financial measure and should not be considered in isolation of, or as a substitute for, cash flows calculated in accordance with U.S. GAAP.

Critical Accounting Policies and Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an on-going basis, we evaluate our estimates, including those related to bad debts, customer claims, inventories, goodwill, intangible assets, income taxes, pensions and other postretirement benefits, contingencies and litigation, environmental liabilities and derivative instruments and hedging activities.

We believe the following are the critical accounting policies and areas affected by significant judgments and estimates impacting the preparation of our consolidated financial statements.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the failure of our customers to make required payments. We perform ongoing credit evaluations of our customers and monitor their payment patterns. Should the financial condition of our customers deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories

Inventories are stated at the lower of cost or market. The cost of inventories is primarily determined using the LIFO method. We also use the FIFO and average cost methods. As of June 30, 2016 and 2015, $118.4 million and $154.9 million of inventory, respectively, was accounted for using a method other than the LIFO method.

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Costs include direct materials, direct labor and applicable manufacturing overhead and other direct costs. Under the LIFO inventory valuation method, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period even though these materials and other costs may have been incurred at significantly different values due to the length of time of our production cycle. The prices for many of the raw materials we use have been volatile. Since we value most of our inventory utilizing the LIFO inventory costing methodology, rapid changes in raw material costs have an impact on our operating results. In a period of rising prices, cost of sales expense recognized under LIFO is generally higher than the cash costs incurred to acquire the inventory sold. Conversely, in a period of declining raw material prices, cost of sales recognized under LIFO is generally lower than cash costs incurred to acquire the inventory sold.

Since the LIFO inventory valuation methodology is designed for annual determination, interim estimates of the annual LIFO valuation are required. We recognize the effects of the LIFO inventory valuation method on an interim basis by estimating the expected annual LIFO cost based on cost changes to date. These projections of annual LIFO inventory valuation reserve changes are updated quarterly and are evaluated based upon material, labor and overhead costs.

Pension and Other Postretirement Benefits

The amount of the pension expense, which is determined annually, is based upon the value of the assets in the pension trusts at the beginning of the fiscal year as well as actuarial assumptions, such as the discount rate and the expected long-term rate of return on plan assets. The assumed long-term rate of return on pension plan assets is reviewed at each year-end based on the plan’s investment policies, an analysis of the historical returns of the capital markets and current interest rates. Based on the current funding level, the allocation policy for pension plan assets is to have approximately 60 percent in return seeking assets and 40 percent in liability matching assets. Return seeking assets include domestic and international equities and diversified loan funds. Liability matching assets include long duration bond funds. As the funding level of the plans improves in increments of 5 percent, assets will be shifted from return seeking to liability matching in increments of 4 percent as a de-risking strategy. The plan discount rate is determined by reference to the Bond:Link interest rate model based upon a portfolio of highly rated U.S. corporate bonds with individual bonds that are theoretically purchased to settle the plan’s anticipated cash outflows. The fluctuations in stock and bond markets could cause actual investment results to be significantly different from those assumed, and therefore, significantly impact the valuation of the assets in our pension trusts. Changes in actuarial assumptions could significantly impact the accounting for the pension assets and liabilities. If the assumed long-term rate of return on plan assets was changed by 0.25 percent, the net pension expense would change by $2.5 million. If the discount rate was changed by 0.25 percent, the net pension expense would change by $4.0 million.

Long-Lived Assets

Long-lived assets are reviewed for impairment and written down to fair value whenever events or changes in circumstances indicate that the carrying value may not be recoverable through estimated future undiscounted cash flows. The amount of the impairment loss is the excess of the carrying amount of the impaired assets over the fair value of the assets based upon estimated future discounted cash flows. We evaluate long-lived assets for impairment by individual business unit. Changes in estimated cash flows could have a significant impact on whether or not an asset is impaired and the amount of the impairment.

Goodwill

Goodwill is not amortized, but instead is tested for impairment, at least annually at the reporting unit level. Potential impairment is identified by comparing the fair value of a reporting unit to its carrying value. The fair value is estimated based principally upon discounted cash flow analysis. If the carrying value of the reporting unit exceeds its fair value, any impairment loss is measured by comparing the carrying value of the reporting unit’s goodwill to its implied fair value. The discounted cash flow analysis for each reporting unit tested requires significant estimates and assumptions related to cash flow forecasts, discount rates, terminal values and income tax rates. The cash flow forecasts are developed based on assumptions about each reporting unit’s markets, product offerings, pricing, capital expenditure and working capital requirements as well as cost performance. The discount rates used in the discounted cash flow are estimated based on a market participant’s perspective of each reporting unit's weighted average cost of capital. The terminal value, which represents the value attributed to the reporting unit beyond the forecast period, is estimated using a perpetuity growth rate assumption. The income tax rates used in the discounted cash flow analysis represent estimates of the long-term statutory income tax rates for each reporting unit based on the jurisdictions in which the reporting units operate.

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Two of the Company's reporting units, Amega West Services ("Amega") and Specialty Steel Supply ("SSS"), have been significantly impacted by the prolonged weakness in oil and gas drilling and exploration activity driven by depressed oil prices. Given weak market conditions, depressed customer orders, reporting units results lower than expectation, we performed an interim impairment test during the third quarter of fiscal year 2016. In connection with the interim impairment test for Amega and SSS, we also performed an interim goodwill impairment test for the Latrobe Distribution reporting unit, for which results have been below expectations for the last several quarters. As a result of the goodwill impairment testing completed in the third quarter of fiscal year 2016, we determined that the goodwill associated with Amega and SSS was impaired and recorded an impairment charge of $12.5 million which represents the entire balance of the goodwill recorded for these reporting units. No other impairment was identified at the interim impairment testing date.

As of June 30, 2016, we had four remaining reporting units with goodwill recorded. Goodwill associated with our SAO reporting unit is tested at the SAO segment level and represents 80 percent of our total goodwill. All other goodwill is associated with our PEP segment, which includes 3 reporting units with goodwill recorded.

As of June 30, 2016, the fair value of the SAO and Latrobe Distribution reporting units exceeded the carrying value by approximately 10 percent and 20 percent, respectively. The goodwill recorded related to the SAO and Latrobe Distribution reporting units as of June 30, 2016 was $195.5 million and $14.0 million, respectively. The discounted cash flows analysis for the SAO and Latrobe Distribution reporting units includes assumptions related to our ability to increase volume, improve mix, expand product offerings and continue to implement opportunities to reduce costs over the next several years. For purposes of the discounted cash flow analysis for the SAO and Latrobe Distribution reporting unit's fair value, we used a weighted average cost capital of 10.5 and 11.5 percent, respectively, and a terminal growth rate assumption of 3 percent.

The estimate of fair value requires significant judgment. We based our fair value estimates on assumptions that we believe to be reasonable but that are unpredictable and inherently uncertain, including estimates of future growth rates and operating margins and assumptions about the overall economic climate and the competitive environment for our business units. There can be no assurance that our estimates and assumptions made for purposes of our goodwill and identifiable intangible asset testing as of the time of testing will prove to be accurate predictions of the future. If our assumptions regarding business projections, competitive environments or anticipated growth rates are not correct, we may be required to record goodwill and/or intangible asset impairment charges in future periods, whether in connection with our next annual impairment testing or earlier, if an indicator of an impairment is present before our next annual evaluation.

Environmental Expenditures

Environmental expenditures that pertain to current operations or to future revenues are expensed or capitalized consistent with Carpenter's capitalization policy for property, plant and equipment. Expenditures that result from the remediation of an existing condition caused by past operations and that do not contribute to current or future revenues are expensed. Liabilities are recognized for remedial activities when the remediation is probable and the cost can be reasonably estimated. Most estimated liabilities are not discounted to present value due to the uncertainty as to the timing and duration of expected costs. For one former operating facility site, due to the routine nature of the expected costs, the liability for future costs is discounted to present value over 20 years assuming a discount rate of approximately 3 percent and 4 percent as of June 30, 2016 and 2015, respectively.

Income Taxes

Deferred income taxes result from temporary differences in the recognition of income and expense for financial and income tax reporting purposes, or differences between the fair value of assets acquired in business combinations accounted for as purchases for financial reporting purposes and their corresponding tax bases. Deferred income taxes represent future tax benefits (assets) or costs (liabilities) to be recognized when those temporary differences reverse. We evaluate on a quarterly basis whether, based on all available evidence, we believe that our deferred income tax assets will be realizable. Valuation allowances are established when it is estimated that it is more likely than not that the tax benefit of the deferred tax assets will not be realized. The evaluation includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused. Future realization of deferred income tax assets ultimately depends upon the existence of sufficient taxable income within the carryback or carryforward period available under tax law.

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Management determines whether a tax position should be recognized in the financial statements by evaluating whether it is more likely than not that the tax position will be sustained upon examination by the tax authorities based upon the technical merits of the position. For those tax positions which should be recognized, the measurement of a tax position is determined as being the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Interest and penalties on estimated liabilities for uncertain tax positions are recorded as components of the provision for income taxes.

Derivative Financial Instruments

Our current risk management strategies include the use of derivative instruments to reduce certain risks. The critical strategies include: (1) the use of commodity forward contracts to fix the price of a portion of anticipated future purchases of certain raw materials and energy to offset the effects of changes in the costs of those commodities; and (2) the use of 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 commodity forwards and foreign currency forwards have been designated as cash flow hedges and unrealized net gains and losses are recorded in the accumulated other comprehensive loss component of stockholders' equity. The unrealized gains or losses are reclassified to the income statement when the hedged transaction affects earnings or if the anticipated transactions are no longer expected to occur. We use interest rate swaps to maintain a certain level of floating rate debt relative to fixed rate debt. Interest rate swaps have been designated as fair value hedges. Accordingly, the mark-to-market values of both the interest rate swap and the underlying debt obligations are recorded as equal and offsetting gains and losses in the interest expense component of the consolidated statement of income. We have also used forward interest rate swaps to manage the risk of cash flow variability associated with fixed interest debt expected to be issued. We evaluate all derivative instruments each quarter to determine that they are highly effective. Any ineffectiveness is recorded in our consolidated statement of income. We also use foreign currency forward contracts to protect certain short-term asset or liability 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.

New Accounting Pronouncements

For information with respect to new accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 19, Recent Accounting Pronouncements, to Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data".

Off Balance Sheet Arrangements

We had no off balance sheet arrangements during the periods presented.

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Contractual Obligations

At June 30, 2016, we had the following contractual obligations and other commercial commitments and contingencies:

		Fiscal Year					
($ in millions)	Total	2017	2018	2019	2020	2021	Thereafter
Long-term debt (1)	$605.0	$—	$55.0	$—	$—	$—	$ 550.0
Estimated interest payments (2)	161.6	30.2	29.5	26.4	26.4	26.4	22.7
Operating leases	40.3	10.2	8.6	6.1	4.9	3.8	6.7
Pension plan contributions (3)	599.7	0.7	50.5	46.0	64.2	55.2	383.1
Accrued post-retirement benefits (4)	145.3	13.7	14.1	14.3	14.5	14.7	74.0
Purchase obligations (5)	140.2	140.2	—	—	—	—	—
Pension benefits (6)	34.2	3.3	3.2	3.2	3.4	3.5	17.6
Total	$1,726.3	$198.3	$160.9	$96.0	$113.4	$103.6	$ 1,054.1

(1) Refer to Note 8 to Notes to Consolidated Financial Statements included in Item 8. “Financial Statements and Supplementary Data”.

(2) Estimated interest payments for long-term debt were calculated based on the applicable rates and payment dates. No interest payments are included for any potential borrowings under our revolving credit facility.

(3) Pension plan contributions represent required minimum contributions for plan years beginning January 1, 2016. These amounts were calculated based on actuarial valuations as prescribed by pension funding regulations in the United States effective June 30, 2016. Estimated fiscal year contributions have been included through fiscal year 2027. The actual required pension contributions in future periods may be different.

(4) Postretirement benefits for certain plans may be paid from corporate assets or certain designated plan assets. Estimated fiscal year postretirement benefit payments have been included through fiscal year 2026.

(5) We have entered into purchase commitments primarily for various key raw materials at market related prices, all made in the normal course of business. The commitments include both fixed and variable price provisions. We used June 30, 2016 raw material prices for commitments with variable pricing.

(6) Pension benefits for certain plans are paid from corporate assets. There is no guarantee that future payments will be paid from corporate assets rather than plan assets.

Market Sensitive Instruments and Risk Management

See “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” for discussion of market sensitive instruments and associated market risk for Carpenter.

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Contingencies

Environmental

We are 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 our operations, compliance costs to date have not been material. We have environmental remediation liabilities at some of our owned operating facilities and have 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, we have been notified that we may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against us. Neither the exact amount of remediation costs nor the final method of their allocation among all designated PRP's at these Superfund sites have been determined. Accordingly, at this time, we cannot reasonably estimate expected costs for such matters. The liability for future environmental remediation costs that can be reasonably estimated is evaluated on a quarterly basis. We accrue amounts for environmental remediation costs that represent our best estimate of the probable and reasonably estimable future costs related to environmental remediation. During the fiscal years 2016, 2015 and 2014 the Company increased the liability for a company-owned former operating site by $0.3 million, $0.4 million and $0.7 million, respectively. 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 June 30, 2016 and 2015 were $16.2 million and $15.9 million, respectively.

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 our financial position, results of operations or cash flows over the long-term. However, such costs could be material to our financial position, results of operations or cash flows in a particular future quarter or year.

Other

We are defending various routine claims and legal actions that are incidental to our business, and that are common to our 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 we, from time to time, have been named as a defendant in lawsuits alleging personal injury as a result of exposure to chemicals and substances in the workplace. We provide 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 our 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, we believe that the total liability from these matters will not have a material effect on our 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 our financial position, results of operations or cash flows in a particular future quarter or year.

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Act of 1995. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ from those projected, anticipated or implied. The most significant of these uncertainties are described in this Form 10-K. They include but are not limited to: (1) the cyclical nature of the specialty materials business and certain end-use markets, including aerospace, defense, industrial, transportation, consumer, medical and energy, or other influences on Carpenter's business such as new competitors, the consolidation of competitors, customers and suppliers, or the transfer of manufacturing capacity from the United States to foreign countries; (2) the ability of Carpenter to achieve cash generation, growth, earnings, profitability, cost savings and reductions, productivity improvements or process changes; (3) the ability to recoup increases in the cost of energy, raw materials, freight or other factors; (4) domestic and foreign excess manufacturing capacity for certain metals; (5) fluctuations in currency exchange rates; (6) the degree of success of government trade actions; (7) the valuation of the assets and liabilities in Carpenter's pension trusts and the accounting for pension plans; (8) possible labor disputes or work stoppages; (9) the potential that our customers may substitute alternate materials or adopt different manufacturing practices that replace or limit the suitability of our products; (10) the ability to successfully acquire other assets or businesses and integrate such acquisitions; (11) the availability of credit facilities to Carpenter, its customers or other members of the supply chain; (12) the ability to obtain energy or raw materials, especially from suppliers located in countries that may be subject to unstable

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political or economic conditions; (13) Carpenter's manufacturing processes are dependent upon highly specialized equipment located primarily in facilities in Reading, Latrobe and Athens for which there may be limited alternatives if there are significant equipment failures or a catastrophic event; (14) the ability to hire and retain key personnel, including members of the executive management team, management, metallurgists and other skilled personnel; (15) fluctuations in oil and gas prices and production; (16) the success of restructuring actions; and (17) share repurchases are at Carpenter's discretion and could be affected by changes in Carpenter's share price, operating results, capital spending, cash flows, inventory, acquisitions, investments, tax laws and general market conditions. Any of these factors could have an adverse and/or fluctuating effect on Carpenter’s results of operations. The forward-looking statements in this document are intended to be subject to the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Carpenter undertakes no obligation to update or revise any forward-looking statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We use derivative financial instruments to reduce certain types of financial risk. Firm price sales arrangements involve a risk of profit margin fluctuations particularly as raw material prices have been volatile. Firm price sales arrangements generally include certain annual purchasing commitments and consumption schedules agreed to by the customers at selling prices based on raw material prices at the time the arrangements are established. As discussed in Note 15 to the consolidated financial statements included in Part II, Item 8. “Financial Statements and Supplementary Data”, in order to reduce the risk of fluctuating profit margins on these sales, we enter into commodity forward contracts to purchase certain critical raw materials necessary to produce the products sold under the firm price sales arrangements. If a customer fails to perform its obligations under the firm price sales arrangements, we may realize losses as a result of the related commodity forward contracts. Our customers have historically performed under these arrangements and we believe that they will honor such obligations in the future.

We are actively involved in managing risks associated with energy resources. Risk containment strategies include interaction with primary and secondary energy suppliers as well as obtaining adequate insurance coverage to compensate us for potential business interruption related to lack of availability of energy resources. In addition, we have used forwards to fix the price of a portion of our anticipated future purchases of certain energy requirements to protect against the impact of significant increases in energy costs. We also use surcharge mechanisms to offset a portion of these charges where appropriate.

Fluctuations in foreign currency exchange rates could subject us to risk of losses on anticipated future cash flows from our international operations or customers. Foreign currency forward contracts are used to hedge certain foreign exchange risk.

We use interest rate swaps to achieve a level of floating rate debt relative to fixed rate debt where appropriate. Historically, we have entered into forward swap contracts to manage the risk of cash flow variability associated with fixed interest debt expected to be issued.

All hedging strategies are reviewed and approved by senior financial management before being implemented. Senior financial management has established policies regarding the use of derivative instruments that prohibit the use of speculative or leveraged derivatives. Market valuations are performed at least quarterly to monitor the effectiveness of our risk management programs.

Based on the current funding level, the allocation policy for pension plan assets is to have approximately 60 percent in return seeking assets and 40 percent in liability matching assets. Return seeking assets include domestic and international equities and diversified loan funds. Liability matching assets include long duration bond funds. As the funding level of the plans improves in increments of 5 percent, assets will be shifted from return seeking to liability matching in increments of 4 percent as a de-risking strategy.

The status of our financial instruments as of June 30, 2016 is provided in Note 15 to the consolidated financial statements included in Item 8, “Financial Statements and Supplementary Data”. Assuming on June 30, 2016, (a) an instantaneous 10 percent decrease in the price of raw materials and energy for which we have commodity forward contracts, and (b) a 10 percent strengthening of the U.S. dollar versus foreign currencies for which foreign exchange forward contracts existed, our results of operations would not have been materially affected in either scenario.

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Item 8. Financial Statements and Supplementary Data

Index to Consolidated Financial Statements and Supplementary Data

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Management’s Responsibilities for Financial Reporting

Management prepared the financial statements included in this Annual Report on Form 10-K and is responsible for their integrity and objectivity. The statements were prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts based on management’s best judgments and estimates. Financial information elsewhere in this Annual Report is consistent with that in the financial statements.

Carpenter maintains a system of internal controls, supported by a code of conduct, designed to provide reasonable assurance that assets are safeguarded and transactions are properly executed and recorded for the preparation of financial information. We believe Carpenter’s system of internal controls provides this appropriate balance. The system of internal controls and compliance is continually monitored by Carpenter’s internal audit staff.

The Audit/Finance Committee of the Board of Directors, composed of independent directors, meets regularly with management, Carpenter’s internal auditors and our independent registered public accounting firm to consider audit results and to discuss significant internal control, auditing and financial reporting matters. Both the independent registered public accounting firm and internal auditors have unrestricted access to the Audit/Finance Committee.
Management’s Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluations of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Carpenter’s internal control over financial reporting as of June 30, 2016. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (COSO) in Internal Control — Integrated Framework. Based on its assessment, management concluded that, as of June 30, 2016, Carpenter’s internal control over financial reporting is effective based on those criteria.

The effectiveness of Carpenter’s internal control over financial reporting as of June 30, 2016 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing herein.

/s/ Tony R. Thene
Tony R. Thene
President and Chief Executive Officer

/s/ Damon J. Audia
Damon J. Audia
Senior Vice President and Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of Carpenter Technology Corporation

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Carpenter Technology Corporation and its subsidiaries at June 30, 2016 and June 30, 2015, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2016 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(1) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania

August 18, 2016

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended June 30, 2016, 2015 and 2014

($ in millions, except per share data)	2016	2015	2014
NET SALES	$1,813.4	$2,226.7	$2,173.0
Cost of sales	1,535.0	1,908.4	1,774.1
Cost of sales - excess inventory write-down	22.5	—	—
Gross profit	255.9	318.3	398.9
Selling, general and administrative expenses	173.8	177.7	186.9
Restructuring and asset impairment charges	18.0	29.1	—
Goodwill impairment	12.5	—	—
Operating income	51.6	111.5	212.0
Interest expense	(28.0)	(27.7)	(17.0)
Other (expense) income, net	(2.1)	5.3	1.4
Income before income taxes	21.5	89.1	196.4
Income tax expense	10.2	30.4	63.6
Net income	$11.3	$58.7	$132.8
EARNINGS PER COMMON SHARE:			
Basic	$0.23	$1.11	$2.48
Diluted	$0.23	$1.11	$2.47
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:			
Basic	48.1	52.6	53.3
Diluted	48.2	52.7	53.6

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
For the Years ended June 30, 2016, 2015 and 2014

($ in millions)	2016	2015	2014
Net income	$11.3	$58.7	$132.8
Other comprehensive (loss) income, net of tax			
Pension and postretirement benefits (loss) gain, net of tax of $52.8, $12.0 and $(22.1), respectively	(87.5)	(20.1)	36.9
Net gain (loss) on derivative instruments, net of tax of $(4.0), $21.7 and $(29.5), respectively	6.7	(36.1)	49.1
Unrealized gain on marketable securities, net of tax of $0.0, $0.0 and $0.0, respectively	—	0.1	—
Foreign currency translation	(0.9)	(26.9)	4.5
Other comprehensive (loss) income, net of tax	(81.7)	(83.0)	90.5
Comprehensive (loss) income, net of tax	$(70.4)	$(24.3)	$223.3

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2016, 2015 and 2014

($ in millions)	2016	2015	2014
OPERATING ACTIVITIES			
Net income	$11.3	$58.7	$132.8
Adjustments to reconcile net income to net cash provided from operating activities:			
Depreciation and amortization	119.3	122.3	111.9
Goodwill impairment charge	12.5	—	—
Non-cash excess inventory write-down	22.5	—	—
Non-cash restructuring and asset impairment charges	7.6	7.6	—
Deferred income taxes	0.8	60.4	(9.7)
Net pension expense	53.8	44.5	57.9
Payments from qualified pension plan associated with restructuring charges	9.4	8.3	—
Stock-based compensation expense	8.7	10.0	11.4
Net loss on disposal of property and equipment	0.6	1.2	1.5
Changes in working capital and other:			
Accounts receivable	48.2	25.4	5.6
Inventories	1.6	36.0	(37.0)
Other current assets	(2.1)	(0.3)	(5.0)
Accounts payable	(7.6)	(59.9)	16.8
Accrued liabilities	(14.0)	(12.1)	(21.1)
Pension plan contributions	—	(7.2)	(6.3)
Other postretirement plan contributions	(13.0)	(13.2)	(13.1)
Other, net	(2.7)	0.9	(6.1)
Net cash provided from operating activities	256.9	282.6	239.6
INVESTING ACTIVITIES			
Purchases of property, equipment and software	(95.2)	(170.5)	(349.2)
Proceeds from disposals of property and equipment and assets held for sale	1.4	0.2	0.3
Proceeds received from sale of equity method investment	6.3	—	—
Proceeds from maturities of marketable securities	0.9	0.3	0.3
Other	4.0	—	—
Net cash used for investing activities	(82.6)	(170.0)	(348.6)
FINANCING ACTIVITIES			
Dividends paid	(34.8)	(37.9)	(38.5)
Purchases of treasury stock	(123.9)	(124.5)	—
Payments on seller financed debt related to purchase of software	(4.9)	—	—
Tax benefits on share-based compensation	—	0.7	2.3
Proceeds from stock options exercised	0.5	2.3	7.1
Net cash used for financing activities	(163.1)	(159.4)	(29.1)
Effect of exchange rate changes on cash and cash equivalents	0.8	(3.2)	0.6
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	12.0	(50.0)	(137.5)
Cash and cash equivalents at beginning of year	70.0	120.0	257.5
Cash and cash equivalents at end of year	$82.0	$70.0	$120.0

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED BALANCE SHEETS
June 30, 2016 and 2015

($ in millions, except share data)	2016			2015			
ASSETS							
Current assets:							
Cash and cash equivalents	$	82.0		$70.0			
Accounts receivable, net of allowance for doubtful accounts of $4.1 million and $3.8 million at June 30, 2016 and 2015, respectively	253.6			304.1			
Inventories	628.7			655.8			
Deferred income taxes	—			3.3			
Other current assets	46.4			37.2			
Total current assets	1,010.7			1,070.4			
Property, plant and equipment, net		4,500		9,000		8,748	
Less: undistributed earnings attributed to participating securities (basic calculation)	10,367		—		39,932		—
Basic net income (loss) attributable to common stockholders	$7,542	$	(77,983)	$	29,027	$	(76,730)
Denominator for basic net income (loss) per share:							
Weighted-average shares outstanding	206,235,839		204,368,982		206,201,937		203,361,710
Weighted-average unvested restricted shares outstanding	(3,894,630)		(2,481,891)		(4,002,144)		(1,842,836)
Denominator for basic net income (loss) per share:	202,341,209		201,887,091		202,199,793		201,518,874
Basic net income (loss) per share attributable to common stockholders	$0.04	$	(0.39)	$	0.14	$	(0.38)

The following table presents the calculation of diluted net income per share for periods presented:

(in thousands, except per share data):

	Three months ended	Three months ended	Six months ended	Six months ended

	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Numerator for diluted net income (loss) per share:				
Net income (loss)	$22,409	$(73,483)	$77,959	$(67,982)
Less: Series B preferred stock dividends	4,500	4,500	9,000	8,748
Less: undistributed earnings attributed to participating securities (diluted calculation)	9,865	—	37,949	—
Diluted net income (loss) attributable to common stockholders	$8,044	$(77,983)	$31,010	$(76,730)
Denominator for diluted net income (loss) per share:				
Weighted-average shares outstanding	206,235,839	204,368,982	206,201,937	203,361,710
Weighted-average unvested restricted shares outstanding	(3,894,630)	(2,481,891)	(4,002,144)	(1,842,836)
Effect of dilutive potential shares	34,540,870	—	35,172,388	—
Denominator for diluted net income (loss) per share:	236,882,079	201,887,091	237,372,181	201,518,874
Diluted net income (loss) per share attributable to common stockholders	$0.03	$(0.39)	$0.13	$(0.38)

The following table summarizes shares subject to exercise or vesting conditions as more fully described in Note 9: Capital Stock. These shares could potentially be dilutive in future periods if we realize net income attributable to common and participating stockholders and the contingent or unvested stock is converted to WMIH common stock. The cash payment of $84.4 million, which would be received upon exercise of the warrants, has not been considered as an offset to the dilutive shares under warrants outstanding below.

	Potential dilution to common	
	Minimum shares	Maximum shares
Restricted shares subject to vesting	4,039,591	4,087,639
Series A Preferred Stock	10,065,629	10,065,629
Warrants outstanding	61,400,000	61,400,000
Series B Preferred Stock	266,666,667	342,857,143
Potential dilutive shares if converted to common	342,171,887	418,410,411

Note 13: Fair Value Measurement

Determining which category an asset or liability falls within the hierarchy requires significant judgment. We evaluate our hierarchy disclosures each quarter. Assets and liabilities measured at fair value on a recurring basis are summarized as follows:

The financial instrument that is measured at fair value on a recurring basis is summarized as follows as of June 30, 2016:

Liabilities	Level 1	Level 2	Level 3	June 30, 2016
Derivative liability - embedded conversion feature	$ —	$ —	$42,018	$42,018

The financial instrument that is measured at fair value on a recurring basis is summarized as follows as of December 31, 2015:

Liabilities	Level 1	Level 2	Level 3	December 31, 2015
Derivative liability - embedded conversion feature	$ —	$ —	$120,848	$120,848

The following table shows the change in Level 3 liability measured at fair value on a recurring basis for the year ended December 31, 2015 and the six months ended June 30, 2016:

	Derivative liability embedded conversion feature
Balance, January 1, 2015	$ —
Issuance during 2015	66,227
Unrealized loss on change in fair value	54,621
Balance, December 31, 2015	120,848
Issuance during 2016	—
Unrealized (gain) on change in fair value	(78,830)
Balance, June 30, 2016	$ 42,018

On January 5, 2015, WMIH raised $600.0 million of capital (less transaction costs) through the issuance of 600,000 shares of Series B Preferred Stock. The shares carry a liquidation preference of $1,000 per share, equal to their initial purchase price. In addition, they have a mandatory redemption right three years from issuance date at a price equal to the initial investment amount, plus accrued dividends at 3% per annum.

The purpose of the capital raise was principally to pursue strategic acquisitions of operating companies that fit the Company’s desired business model. Management intends to pursue such an acquisition or acquisitions with the proceeds of the capital raise, and should it occur during the three-year term of the Series B Preferred Stock, there is a mandatory conversion of these shares into common stock of WMIH. Mandatory conversion occurs at a price that is the lesser of:

i) $2.25 per share of WMIH common stock; and

ii) the arithmetic average of daily volume weighted average prices of WMIH’s common stock during the 20 trading day period ending on the trading day immediately preceding the public announcement by WMIH of its entry into a definitive agreement for such acquisition, subject to a floor of $1.75 per share of WMIH common stock.

We use a binomial lattice option pricing model to value the embedded conversion feature that is subject to fair value liability accounting. The key inputs which we utilize in the determination of the fair value as of the reporting date include our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, expected stock price volatility over the term of the convertible preferred securities, which we estimated at 40% for both June 30, 2016 and December 31, 2015, and risk-free interest rate, which was estimated at 0.4% as of June 30, 2016 and 0.6% as of December 31, 2015. In addition, the model requires the input of an expected probability of occurrence, which we estimated at 90% for both June 30, 2016 and December 31, 2015, and the timing of a Qualified Acquisition which initiates the mandatory conversion, which we estimated at 9 months from June 30, 2016 and 12 months from December 31, 2015. The fair value of the embedded conversion feature liability is revalued each balance sheet date utilizing our model computations with the decrease or increase in fair value being reported in the statement of operations as unrealized gain or (loss) on change in fair value of derivative liability - embedded conversion feature, respectively. The primary factors affecting the fair value of the embedded conversion feature liability are the probability of occurrence and timing of a Qualified Acquisition, our stock price and our stock price volatility. In addition, the use of a model requires the input of subjective assumptions, and changes to these assumptions could provide differing results.

Our reported net income was approximately $78.0 million for the six months ended June 30, 2016. If the closing stock price of our common stock had been 10% lower, our net income would have been approximately $40.5 million higher. If the closing stock price of our common stock had been 10% higher, our net income would have been approximately $43.5 million lower. If our volatility assumption on June 30, 2016 had been 10% lower, our net income would have been approximately $5.6 million higher and if our volatility assumption had been 10% higher, our net income would have been approximately $4.3 million lower. If our probability of a transaction occurring assumption on June 30, 2016 had been 10% lower, our net income would have been approximately $4.7 million higher and if our probability of a transaction occurring assumption had been 10% higher, our net income would have been approximately $4.7 million lower.

Note 14: Subsequent Events

On July 1, 2016, WMIH through the trustee and collateral agent of the Second Lien Notes made a partial redemption of Second Lien Notes in the amount of approximately $0.9 million. In addition, WMIH authorized approximately $10 thousand of interest due on the Second Lien Notes which was paid in cash. The principal balance of the Second Lien Notes, after this partial redemption, is projected to total $19.6 million as of July 1, 2016.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
The following discussion should be read in conjunction with our financial statements and the related notes, included in Item 1 of Part I of this Quarterly Report on Form 10-Q. The following is a discussion and analysis of our results of operations for the three and six months ended June 30, 2016 and 2015 and financial condition as of June 30, 2016 and December 31, 2015 (dollars in thousands, except per share data and as otherwise indicated).

References as used herein, unless the context requires otherwise, to (i) the "Company," "we," "us," or "our" refer to WMIH Corp. (formerly WMI Holdings Corp.) and its subsidiaries on a consolidated basis; (ii) "WMIH" refers only to WMIH Corp., without regard to its subsidiaries; (iii) "WMIHC" refers only to WMI Holdings Corp., without regard to its subsidiaries; (iv) "WMMRC" refers to WM Mortgage Reinsurance Company, Inc. (a wholly-owned subsidiary of WMIH); and (v) "WMIIC" refers to WMI Investment Corp. (a wholly-owned subsidiary of WMIH).

FORWARD-LOOKING STATEMENTS AND INFORMATION

This quarterly report includes forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical fact included in this report that address activities, events, conditions or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business and these statements are not guarantees of future performance. These statements can be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements may include the words "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," "strategy," "future," "opportunity," "will," "would," "will be," "will continue," "will likely result" and similar expressions. Such forward-looking statements invol risks and uncertainties that may cause actual events, results or performance to differ materially from those indicated by such statements. These risks are identified and discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 under Risk Factors in Part I, Item 1A. These risk factors will be important to consider in determining future results and should be reviewed in their entirety. These forward-looking statements are expressed in good faith and we believe there is a reasonable basis for them. However, there can be no assurance that the events, results or trends identified in these forward-looking statements will occur or be achieved. Forward-looking statements speak only as of the date they are made, and we do not undertake to update any forward-looking statement, except as required by law. Therefore, you should not rely on these statements being current as of any time other than the time at which this document was filed with the SEC.

OVERVIEW

Our Business Strategy and Operating Environment

WMIH Corp. ("WMIH") is a corporation duly organized and existing under the laws of the State of Delaware. On May 11, 2015, WMIH merged with its parent corporation, WMI Holdings Corp., a Washington corporation ("WMIHC"), with WMIH as the surviving corporation in the merger (the "Merger"). The Merger occurred as part of the reincorporation of WMIHC from the State of Washington to the State of Delaware effective May 11, 2015 (the "Reincorporation Date").

WMIH is the direct parent of WM Mortgage Reinsurance Company, Inc. ("WMMRC") and WMI Investment Corp. ("WMIIC"). Since emergence from bankruptcy on March 19, 2012 (the "Effective Date"), we had limited operations other than WMMRC's legacy reinsurance business, which is being operated in runoff mode. We continue to operate WMMRC's business in runoff mode and our primary strategic objective is to consummate one or more acquisitions of an operating business, either through a merger, purchase, business combination or other form of acquisition, and grow our business.

Until such time as an acquisition is consummated, we intend to continue to seek, identify and evaluate acquisition opportunities of varying sizes across a broad array of industries for the purpose of facilitating an acquisition by WMIH of one or more operating businesses. Our management team meets regularly with the Corporate Strategy and Development Committee of our Board of Directors (the "CS&D Committee") to discuss and evaluate potential acquisition targets. During the six months ended June 30, 2016 and the year ended December 31, 2015, the CS&D Committee met formally and informally numerous times to assess various opportunities. In 2015 and 2016, we have focused primarily on acquisition targets in the financial services industry, including targets with consumer finance, commercial finance, specialty finance, leasing and insurance operations.

On January 5, 2015, WMIH announced that it had completed an offering (the "Series B Preferred Stock Financing") of 600,000 shares of its 3% Series B Convertible Preferred Stock, par value $0.00001, liquidation preference $1,000 per share (the "Series B Preferred Stock") in the amount of aggregate gross proceeds equal to $600 million, pursuant to a Purchase Agreement (the "Purchase Agreement") with Citigroup Global Markets Inc. ("Citi") and KKR Capital Markets LLC ("KCM"), an affiliate of KKR Fund Holdings L.P. ("KKR Fund") and KKR Management Holdings L.P. ("KKR Management"). The net proceeds from the Series B Preferred Stock Financing in the amount of $598.5 million were deposited into an escrow account and initially invested in United States government securities having a maturity of 180 days or less, in certain money market funds, or cash items. The net proceeds of the Series B Preferred Stock Financing will be released from escrow to us from time to time in amounts needed to finance our efforts to explore and fund, in whole or in part, acquisitions whether completed or not, including reasonable attorney fees and expenses, accounting expenses, due diligence and financial advisor fees and expenses. For further information on the Series B Preferred Stock Financing, see Note 9: Capital Stock, to the condensed consolidated financial information in Item 1 of Part I of this Quarterly Report on Form 10-Q.

During the year ended December 31, 2015, WMIH identified a potential acquisition opportunity and participated in a competitive sale process with respect to an operating division of a public company. However, we were not able to reach a definitive agreement for the transaction and discussions ceased on October 13, 2015. In connection with the foregoing, the Company expended time and resources to explore this potential acquisition, including the incurrence of approximately $11.1 million in fees and expenses for financial advisory, legal and consulting services. As permitted under the terms of the Series B Preferred Stock Financing, the fees and costs associated with the exploration of this acquisition opportunity were paid using a portion of the proceeds of the Series B Preferred Stock Financing. WMIH will continue to evaluate acquisition opportunities and work with our strategic partner, an affiliate of KKR & CO. L.P. (together with its affiliates, "KKR"), to identify, consider and evaluate potential mergers, acquisitions, business combinations and other strategic opportunities. As of June 30, 2016, we had not consummated an acquisition and we can provide no assurances that we will successfully consummate a transaction and, if so, on what terms.

In connection with our stated objective to consummate one or more acquisitions of an operating business, we may explore various financing alternatives to fund our external growth strategy, including further improving our capital structure, which may include increasing, reducing and/or refinancing debt, amending the terms of outstanding preferred stock, pursuing capital raising activities, such as the issuance of new preferred or common equity and/or a rights offering to our existing stockholders, launching an exchange offer, and pursuing other transactions involving our outstanding securities.

With respect to our current operations, the Company currently operates a single business through its subsidiary, WMMRC, whose sole activity is the reinsurance of mortgage insurance policies. WMMRC has been operated in runoff mode since September 26, 2008. Since that date, WMMRC has not underwritten any new policies (and by extension any new risk). WMMRC, through predecessor companies, began reinsuring risks in 1997 and continued reinsuring risks through September 25, 2008.

All of WMMRC's reinsurance agreements are on an excess of loss basis, except for certain reinsurance treaties with GMIC and Radian during 2007 and 2008, which are reinsured on a 50% quota share basis. Pursuant to the excess of loss reinsurance treaties, WMMRC reinsures a second loss layer which ranges from 5% to 10% of the risk in force in excess of the primary mortgage insurer's first loss percentages which range from 4% to 5%. Each calendar year, or book year, is treated separately from other years when calculating losses. In return for accepting a portion of the risk, WMMRC receives, net of ceding commission, a percentage of the premium that ranges from 25% to 40%.

Beginning in 2006, the U.S. housing market and related credit markets experienced a multi-year downturn. During that period, housing prices declined materially, credit guidelines tightened, delays in mortgage servicing and foreclosure activities occurred, and deterioration in the credit performance of mortgage loans occurred. In addition, the macro-economic environment during that period demonstrated limited economic growth, stubbornly high unemployment, and limited median wage gains. Beginning in 2012, home prices began to rise again. The current outlook for the housing market is cautiously optimistic with historically low interest rates, steady employment growth, increased household formation rates and less restrictive credit conditions. Nevertheless, WMMRC's operating environment remains somewhat uncertain as much of its results over the next few years will be directly affected by the inventory of pending defaulted mortgages at its ceding companies arising primarily from mortgages originated in calendar years 2005 through 2008. However, its financial exposure to that environment has been reduced as the remaining net aggregate risk exposure has decreased due to the runoff nature of its operations.

Our wholly owned subsidiary WMIIC has no assets or liabilities and we are beginning the process of dissolving this entity.

Our Financial Information

The financial information in this Quarterly Report on Form 10-Q has been derived from our condensed consolidated financial statements.

Critical Accounting Policies

Our condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States ("GAAP"), which requires management to make estimates and assumptions that affect reported and disclosed amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. We believe that the critical accounting policies set forth in the accompanying condensed consolidated financial statements describe the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements. These accounting policies pertain to premium revenues and risk transfer, valuation of investments, loss and loss adjustment expense reserves, our values under fresh start accounting, the resulting loss contract reserve and the valuation of the derivative liability relating to the embedded conversion feature on the Series B Preferred Stock. If actual events differ significantly from the underlying judgments or estimates used by management in the application of these accounting policies, there could be a material effect on our results of operations and financial condition.

The Company adopted fresh start accounting in accordance with ASC 852 on the Effective Date.

Recently issued accounting standards and their impact on the Company have been presented under "New Accounting Pronouncements" in Note 2: Significant Accounting Policies to the condensed consolidated financial statements in Item 1 of this Quarterly Report on Form 10-Q.

Segments

The Company manages its business on the basis of one operating segment, mortgage reinsurance, in accordance with GAAP. Within the mortgage reinsurance segment, our current risks arise solely from the reinsurance of mortgage insurance policies that were placed on certain residential mortgage loans prior to the bankruptcy of Washington Mutual, Inc. ("WMI"). The majority of these policies were required by mortgage lenders as a stipulation to approve the mortgage loans. The mortgage insurance policies protect the beneficiaries of the policy from all or a portion of default-related losses.

Overview of Revenues and Expenses

Because WMIH has no current significant operations of its own, its cash flow is derived almost entirely from earnings on its investment portfolio, and payments it receives from, and dividends paid by, WMMRC. At this time, all dividends received by WMIH from WMMRC that constitute Runoff Proceeds must be distributed to holders of WMIH's Second Lien Notes in accordance with the terms of the Second Lien Indenture as described below in this Item 2 under "Notes Payable."

WMMRC's revenues consist primarily of the following:

- net premiums earned on reinsurance contracts;
- positive changes to (and corresponding releases from) loss reserves; and
- net investment income and net gains (losses) on WMMRC's investment portfolio.

WMMRC's expenses consist primarily of the following:

- underwriting expenses; and
- general and administrative expenses.

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Results of Operations for the three and six months ended June 30, 2016 and June 30, 2015

For the three and six months ended June 30, 2016, we reported net operating losses of $0.5 million and $0.9 million, respectively. This compares to net operating income of $0.7 million and a net operating loss of $1.1 million for the three and six months ended June 30, 2015, respectively. The components that gave rise to net operating losses for the three and six months ended June 30, 2016 and for the three and six months ended June 30, 2015 are summarized in the table below under the Net (Loss) Income section. The most significant variances between the comparative three month periods ended June 30, 2016 and June 30, 2015 include (i) a reduction in revenue of approximately $0.1 million, (ii) a reduction in interest expense of $0.3 million, (iii) a net decrease in underwriting expense of $0.1 million, (iv) a decrease in our general and administrative expenses of $0.8 million and (v) a reduction of the loss contract reserve of $0.5 million during the three months ended June 30, 2016 versus a decrease of $2.7 million during the same period in 2015. The most significant variances between the comparative six month periods ended June 30, 2016 and June 30, 2015 include (i) a reduction in revenue of approximately $0.3 million, (ii) a reduction in interest expense of $0.5 million, (iii) a net increase in underwriting expense of $0.8 million, (iv) a decrease in our general and administrative expenses of $1.8 million, and (v) a reduction of the value of the loss contract reserve during the six months ended June 30, 2016 of $1.8 million versus a decrease of $2.7 million during the same period in 2015.

For the three and six months ended June 30, 2016, we reported net income attributable to common and participating shareholders of $17.9 million and $69.0 million as compared to net losses attributable to common and participating shareholders of $78.0 million and $76.7 million for the three and six months ended June 30, 2015, respectively. This $95.9 million positive change in results when comparing the three months ended June 30, 2016 to the three months ended June 30, 2015 and the $145.7 million positive change in results when comparing the six months ended June 30, 2016 to the six months ended June 30, 2015, is primarily the result of the change in fair market value of an embedded derivative. This embedded derivative was recorded as a result of the variable conversion feature in our Series B Preferred Stock and the change in fair market value is reflected on our condensed consolidated statements of operations as the other income item "change in fair value of derivative liability - embedded conversion feature" which resulted in $22.9 million and $78.8 million of other income for the three and six months ended June 30, 2016, respectively, compared to other expense of $82.5 million and $75.2 million for the three and six months ended June 30, 2015, respectively. This item is solely attributable to a change in fair market value of the derivative liability – embedded conversion feature and is a non-cash item. The fair value of this derivative liability is analyzed each period and should not be relied upon to produce changes of this magnitude on an on-going basis as it could also result in a non-cash expense or benefit in future periods. The fair value of the embedded conversion feature will become additional paid in capital upon conversion of the Series B Preferred Stock, or be reduced to zero upon redemption of the Series B Preferred Stock, as the case may be. For additional details on the derivative liability – embedded conversion feature, see Note 9: Capital Stock and Note 13: Fair Value Measurement to the condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q. In addition to this charge, several other items had an impact on earnings for the three and six months ended June 30, 2016, including decreased general and administrative expenses and decreased interest expense. The interest expense decreased as a result of the significant reductions in our Runoff Note balances discussed further below. Our revenues decreased, as expected, due to the status of our primary operating subsidiary, WMMRC, operating in runoff mode and the decreasing amount of assets under trust that resulted from prior commutations of reinsurance agreements. Underwriting expenses were higher on a comparative basis, primarily due to increases in Premium Deficiency Reserves in the six months ended June 30, 2016 and decreases in Premium Deficiency Reserves during the six months ended June 30, 2015 as further described below in this Item 2 under "Losses or Benefits Incurred and Losses and Loss Adjustment Expenses."

The total revenue for the three and six months ended June 30, 2016 was $1.4 million and $2.9 million, respectively, compared to revenue of $1.5 million and $3.2 million, respectively, for the three and six months ended June 30, 2015. The decrease in revenue is attributable to WMMRC continuing to operate in runoff mode and previously consummated commutations of reinsurance agreements. In addition, because WMMRC is operating in runoff mode, we expect premiums-earned revenue to continue to decrease, as no new business is being undertaken.

Underwriting expenses or recoveries (defined as losses and loss adjustment expenses and ceding commission expenses) decreased by $0.1 million to a $0.2 million expense for the three months ended June 30, 2016 compared to an expense of $0.3 million for the three months ended June 30, 2015. Underwriting expenses or recoveries decreased by $0.8 million to a $0.7 million expense for the six months ended June 30, 2016 compared to a benefit of $0.1 million for the six months ended June 30, 2015. These changes in expense are related to the operation of WMMRC in runoff mode and the corresponding decrease in revenues and the change in Premium Deficiency Reserves as further described below in this Item 2 under "Losses or Benefits Incurred and Losses and Loss Adjustment Expenses." As more fully described in Note 2: Significant Accounting Policies to the condensed consolidated financial statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, due to the current condition of the mortgage insurance market, WMMRC has recorded reserves based on ceded case reserves and incurred but not recorded ("IBNR") loss levels established and reported by the primary mortgage guaranty carriers as of each reporting period. Management believes that its estimate of aggregate liability for unpaid losses and loss adjustment expenses as of June 30, 2016, represents its best estimate, based upon the available data, of the amount necessary to cover the current cost of losses.

As of June 30, 2016, the loss contract reserve was analyzed and determined to have a value of $7.8 million. The value of this reserve was $9.6 million at December 31, 2015. The value of the loss contract reserve decreased by $0.5 million and $1.8 million, respectively, during the three and six months ended June 30, 2016 and decreased by $2.7 million during the three and six months ended June 30, 2015. Consequently, there was a related reduction of expenses relating to the change in value of the loss contract reserve for the three and six months ended June 30, 2016 and June 30, 2015. The loss contract reserve was established at a value of $63.1 million on March 19, 2012 as a result of our reorganization.

For the three and six months ended June 30, 2016, our investment portfolio reported net investment income of $0.6 million and $1.2 million, respectively, as compared to net investment income of $0.1 million and $0.5 million, respectively, for the three and six months ended June 30, 2015. The components of the investment income are more fully described below in the Net Investment Income section.

General and Administrative Expenses

For the three and six months ended June 30, 2016, our general and administrative expenses totaled $1.5 million and $3.5 million, respectively, compared to general and administrative expenses totaling $2.3 million and $5.3 million, respectively, for the same periods in 2015. The reduction primarily relates to the additional expenses incurred in connection with our satisfaction of post-closing covenants in the Series B Preferred Stock Financing, including the reincorporation in the State of Delaware that occurred in 2015 and which were not incurred in 2016.

Interest Expense

For the three and six months ended June 30, 2016, we incurred $0.7 million and $1.4 million, respectively, of interest expense on the Runoff Notes, which is further described below in this Item 2 under “Notes Payable.” This compares to $1.0 million and $1.9 million, respectively, of interest expense, all of which related to the Runoff Notes, which was incurred during the same period in 2015. The interest related to Runoff Notes decreased primarily due to the reduction of Runoff Note principal balances by $1.3 million during the six months ended June 30, 2016 and by $9.5 million during the year ended December 31, 2015. As of April 27, 2015, the First Lien Notes were fully redeemed by the Company and the First Lien Indenture was satisfied and discharged. Because sufficient Runoff Proceeds have not always been available to pay accrued interest on the Runoff Notes, a portion of our obligation to pay interest on the Runoff Notes has been satisfied using the “pay-in-kind” or “PIK” feature available under the Indentures. The accrued interest is converted to PIK Notes at the next payment date if there is not sufficient cash available to satisfy the required interest payment. For the six months ended June 30, 2016, no PIK Notes were issued in satisfaction of our obligation to pay interest on the Runoff Notes and $1.4 million of interest was paid in cash. For the six months ended June 30, 2015, $0.9 million of PIK Notes were issued in satisfaction of our obligation to pay interest on the Runoff Notes and $1.0 million of interest was paid in cash.

Net (Loss) Income

Net operating losses for the three and six months ended June 30, 2016 totaled $0.5 million and $0.9 million, respectively, compared to net operating income of $0.7 million and a net operating loss of $1.1 million, respectively, for the three and six months ended June 30, 2015. The primary factors impacting the change in net operating income (loss) for the periods are summarized in the tables below.

For the three and six months ended June 30, 2016, we reported net income attributable to common and participating stockholders of $17.9 million and $69.0 million, respectively. This result compares to net loss attributable to common and participating stockholders of $78.0 million and $76.7 million, respectively, for the three and six months ended June 30, 2015.

Three months ended June 30, 2016 versus three months ended June 30, 2015 summary of change in net operating (loss) income and net income attributable to common and participating stockholders (in thousands):

	Three months ended			
	June 30, 2016	June 30, 2015	Percentage change	Dollar value change
Net revenues	$1,389	$1,470	-6 %	$(81)
Underwriting expenses (benefit) (net)	213	343	38 %	130
General and administrative expenses	1,492	2,306	35 %	814
Loss contract reserve change	(435)	(2,783)	-84 %	(2,348)
Interest expense	665	951	30 %	286
Net operating (loss) income	(546)	653	-184 %	(1,199)
Other income	—	8,322	-100 %	8,322
Unrealized gain (loss) on change in fair value of derivative liability - embedded conversion feature	22,955	(82,458)	128 %	105,413
Redeemable convertible series B preferred stock dividends	(4,500)	(4,500)	0 %	—
Net income (loss) attributable to common and participating stockholders	$17,909	$(77,983)	123 %	$95,892

Six months ended June 30, 2016 versus six months ended June 30, 2015 summary of change in net operating (loss) income and net income attributable to common and participating stockholders (in thousands):

	Six months ended			
	June 30, 2016	June 30, 2015	Percentage change	Dollar value change
Net revenues	$2,889	$3,220	-10 %	$(331)
Underwriting expenses (benefit) (net)	678	(75)	-1004 %	(753)
General and administrative expenses	3,521	5,279	33 %	1,758
Loss contract reserve change	(1,797)	(2,783)	35 %	(986)
Interest expense	1,358	1,905	29 %	547
Net operating (loss)	(871)	(1,106)	21 %	235
Other income	—	8,322	100 %	8,322
Unrealized gain (loss) on change in fair value of derivative liability - embedded conversion feature	78,830	(75,198)	205 %	154,028
Redeemable convertible series B preferred stock dividends	(9,000)	(8,748)	-3 %	(252)
Net income (loss) attributable to common and participating stockholders	$68,959	$(76,730)	190 %	$145,689

Comprehensive (Loss) Income

The Company has no comprehensive (loss) income other than the net (loss) income disclosed in the condensed consolidated statement of operations.

Premiums Earned

The majority of WMMRC's reinsurance contracts require premiums to be written and earned monthly. In a few cases, the premiums earned reflect the pro rata inclusion into income of premiums written over the life of the reinsurance contracts. Details of premiums earned are provided in the following table:

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Premiums assumed	$ 626	$ 1,325	$ 1,224	$ 2,514
Change in unearned premiums	165	17	416	177
Premiums earned	$ 791	$ 1,342	$ 1,640	$ 2,691

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For the three and six months ended June 30, 2016, premiums earned totaled $0.8 million and $1.6 million, respectively, a decrease of $0.5 million and $1.1 million, respectively, when compared to premiums earned of $1.3 million and $2.7 million, respectively, for the three and six months ended June 30, 2015. The Company’s premiums earned are expected to continue to decrease due to WMMRC operating in runoff mode.

Losses or Benefits Incurred and Losses and Loss Adjustment Expenses

Losses incurred include losses paid and changes in loss reserves, including reserves for IBNR, premium deficiency reserves net of actual and estimated loss recoverable amounts. Details of net losses or benefits incurred for the three and six months ended June 30, 2016 and June 30, 2015, respectively, are provided in the following table:

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Losses and loss adjustment expense (benefit)	$ 132	$ 223	$ 519	$ (318)

We establish reserves for each contract based on estimates of the ultimate cost of all losses including losses incurred but not reported. These estimated ultimate reserves are based on reports received from ceding companies, industry data and historical experience as well as our own actuarial estimates. Quarterly, we review these estimates on a contract by contract basis and adjust the estimates as we deem necessary based on updated information and our internal actuarial estimates.

For the three and six months ended June 30, 2016, the loss ratios were 17% and 32% respectively, compared to a loss ratio of 17% and a benefit ratio of 12%, respectively, for the three and six months ended June 30, 2015. The loss or benefit ratio is calculated by dividing incurred benefit or losses for the period by earned premiums. The ratio provides a measure of underwriting profit or loss. Loss reinsurance contracts (which represent the significant majority of our loss exposure) are generally structured with limits set on the aggregate amount of losses that can be incurred over the life of such contract. Upon reaching such limits, no additional losses may be realized under the terms of the contract. Nevertheless, even when applicable contract limits are reached, revenues from premiums collected continue to be ceded for the remaining life of the contract. Beginning in 2013, a majority of WMMRC’s reinsurance arrangements for the 2005 through 2008 book years reached their respective loss limits. As a result, WMMRC does not expect to incur any additional losses for those book years; however, WMMRC may continue to realize revenues from those book years, to the extent premiums are ceded therefrom.

The components of the liability for losses and loss adjustment reserves are as follows at June 30, 2016 and December 31, 2015, respectively:

	June 30, 2016	December 31, 2015
Case-basis reserves	$ 926	$ 4,193
IBNR reserves	1	75
Premium deficiency reserves	1,266	795
Total losses and loss adjustment reserves	$ 2,193	$ 5,063

Losses and loss adjustment reserve activity are as follows for the periods ended June 30, 2016 and December 31, 2015, respectively:

	Six months ended June 30, 2016	Year ended December 31, 2015
Balance at beginning of period	$5,063	$ 18,947
Incurred or (released) - prior periods	519	(1,115)
Paid or terminated - prior periods	(3,389)	(12,769)
Total losses and loss adjustment reserves	$2,193	$ 5,063

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Net Investment Income

A summary of our net investment income for the periods ended June 30, 2016 and 2015, respectively, is as follows:

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Investment income:				
Amortization of premium or discount on fixed-maturity securities	$ (51)	$ (144)	$ (173)	$ (323)
Investment income on fixed-maturity securities	241	326	559	739
Interest income on cash and cash equivalents	367	62	695	119
Realized net gain from sale of investments	5	81	1	267
Unrealized gain (loss) on trading securities held at period end	36	(197)	167	(273)
Net investment income	$ 598	$ 128	$ 1,249	$ 529

Federal Income Taxes

The Company has no current tax liability due as a result of its tax loss position for periods ended June 30, 2016, June 30, 2015 and December 31, 2015. More detailed information regarding the Company's tax position including net operating loss ("NOL") carry forwards is provided in Note 6: Income Taxes to the consolidated financial statements in Item 8 of the Annual Report on Form 10-K for the year ended December 31, 2015 and in Note 5: Income Taxes to the condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

The Company files a consolidated federal income tax return. Pursuant to a tax sharing agreement, WMMRC's federal income tax liability is calculated on a separate return basis determined by applying 35% to taxable income, in accordance with the provisions of the Internal Revenue Code (the "Code") that apply to mortgage insurance companies. WMIH, as WMMRC's parent, pays federal income taxes on behalf of WMMRC and settles the federal income tax obligation on a current basis in accordance with the tax sharing agreement. WMMRC made no tax payments to WMIH during the periods ended June 30, 2016 and December 31, 2015 associated with the Company's tax liability from the current or preceding periods.

Deferred federal income taxes arise from temporary differences between the valuation of assets and liabilities as determined for financial reporting purposes and income tax purposes. Temporary differences principally relate to discounting of loss reserves, recognition of unearned premiums, changes in value of loss contract reserves and embedded derivatives, net operating losses and unrealized gains and losses on investments.

We believe WMIH experienced an ownership change under Section 382 of the Code in connection with its bankruptcy plan becoming effective. Prior to emergence from bankruptcy, WMI abandoned the stock of Washington Mutual Bank, thereby generating a worthless stock deduction of approximately $8.37 billion, which gave rise to a NOL carry forward for the year ended December 31, 2012. We believe that the total available and utilizable NOL carry forward at December 31, 2015 was approximately $6.00 billion and at June 30, 2016 we believe that there was no limit under Section 382 of the Code on the use of these NOLs. As of June 30, 2016 and December 31, 2015, the Company recorded a valuation allowance equal to 100% of the net deferred federal income tax asset due to uncertainty regarding the Company's ability to realize these benefits in the future.

Investments

General

We hold investments at both WMIH and WMMRC and the two portfolios consist entirely of fixed income instruments, excluding funds in overnight money market funds totaling $88.0 million and $99.1 million as of June 30, 2016 and December 31, 2015, respectively. In addition, at June 30, 2016 and December 31, 2015, respectively, the Company held $0.9 million and less than $1.0 thousand of restricted cash in the “Collateral Account” (described below in this Item 2 under “Notes Payable”) established by the Company as required under the Indentures for the benefit of the runoff noteholders. The Company held $572.1 million and $571.4 million of restricted cash from the Series B Preferred Stock Financing in its escrow account at June 30, 2016 and December 31, 2015, respectively.

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The value of the consolidated Company's total cash and investments decreased during the six months ended June 30, 2016. Cash and investments, which excludes restricted cash of $573.0 million and $571.4 million at June 30, 2016 and December 31, 2015, respectively, totaled $94.4 million and $112.7 million at June 30, 2016 and December 31, 2015, respectively. The primary factors that contributed to this decrease in investments were (i) the payment of a total of $9.0 million in Series B Preferred Stock cash dividends during the six months ended June 30, 2016; (ii) the transfer by management of excess capital from WMMRC to reduce indebtedness; and (iii) the payment of cash for reserved losses by WMMRC.

We work with investment broker dealers and, in the case of WMMRC, collateral trustees, in determining whether a market for a financial instrument is active or inactive. We regularly obtain indicative pricing from market makers and from multiple dealers and compare the level of pricing variances as a way to observe market liquidity for certain investment securities. We also obtain trade history and live market quotations from publicly quoted sources, such as Bloomberg, for trade volume and frequency observation. While we obtain market pricing information from broker dealers, the ultimate fair value of our investments is based on portfolio statements provided by financial institutions that hold our accounts.

During the six months ended June 30, 2016 and the year ended December 31, 2015, we transferred $3.1 million and $9.9 million, respectively, of corporate securities that mature within 12 months from Level 2 to Level 1, due to improved liquidity in capital markets for those securities. Please refer to Note 4: Investment Securities to the condensed consolidated financial statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, for additional information regarding our investment securities.

WMIH

WMIH's investments are valued at fair value and any unrealized gains or losses are reflected in net investment income in the condensed consolidated statements of income. WMIH primarily invests in fixed maturity securities and at June 30, 2016 and at December 31, 2015, WMIH has $55.0 million and $62.9 million, respectively, of investments in obligations of U.S. government sponsored enterprises, all of which will mature within the next 12 months. WMIH also had $3.1 million and $7.0 million of cash and cash equivalents at June 30, 2016 and December 31, 2015, respectively.

WMMRC

WMMRC's investments are valued at fair value and any unrealized gains or losses are reflected in net investment income in the condensed consolidated statements of income. At June 30, 2016, approximately 90% of WMMRC's cash and investments were held in four trusts for the benefit of primary mortgage insurers with whom WMMRC established agreements to reinsure private mortgage insurance risk. The total portfolio, excluding funds in overnight money market instruments, was valued at approximately $33.0 million and $36.2 million at June 30, 2016 and December 31, 2015, respectively. At June 30, 2016, approximately 33% of the portfolio consisted of securities that will mature within the next 12 months and the remainder of the securities will mature between one and four years from June 30, 2016. WMMRC also had $3.3 million cash and cash equivalents at June 30, 2016.

Liquidity and Capital Resources

General

WMIH is organized as a holding company with limited operations of its own. With respect to its own operations, WMIH's continuing cash needs are limited to the payment of general and administrative expenses, costs related to possible acquisitions, dividends on the Series B Preferred Stock and principal and interest payments on the Runoff Notes described below in this Item 2 under "Notes Payable." Interest and principal payments on the Runoff Notes are payable solely from Runoff Proceeds (as defined in the Indentures) received by WMIH from WMMRC from time to time. Except in limited circumstances described in Note 7: Notes Payable to the condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q, the Runoff Notes are nonrecourse to WMIH. In addition, our significant business operations are conducted through our wholly-owned reinsurance subsidiary, WMMRC, which formerly underwrote risks associated with our mortgage reinsurance programs, but is being operated in runoff and has not written any new business since September 26, 2008. There are restrictions on WMMRC’s ability to pay dividends which are described in more detail below. WMIH does not currently expect to pay dividends on its common shares.

In regard to the Series B Preferred Stock, we are required (if and when declared by our Board and until the Series B Preferred Stock is converted, redeemed or repurchased) to pay cumulative regular dividends out of funds legally available therefor at an annual rate of 3% per share of the liquidation preference of $1,000 per share of Series B Preferred Stock. WMIH has declared and paid $9.0 million, $8.0 million and $17.0 million of dividends on its Series B Preferred Stock during the six months ended June 30, 2016, June 30, 2015 and the year ended December 31, 2015, respectively, and has accrued an additional $0.7 million of dividends based on the 3% interest rate during each of the six months ended June 30, 2016, June 30, 2015 and the year ended December 31, 2015, respectively.

The payment of $9.0 million in dividends on our Series B Preferred Stock was our single largest use of cash during the six months ended June 30, 2016. This dividend obligation is likely to continue to be a significant financial obligation of the Company until we either consummate a Qualified Acquisition or redeem or repurchase the Series B Preferred Stock.

Unless previously converted into common stock, we are required to redeem the Series B Preferred Stock on January 5, 2018 (the "Redemption Date") in the event we have not consummated a Qualified Acquisition. In addition, we are required to offer to repurchase (if not previously converted) the Series B Preferred Stock upon a Change of Control (as such term is defined in the Certificate of Designation creating the Series B Preferred Stock). The aggregate redemption costs, assuming all 600,000 shares remain outstanding, of all of the Series B Preferred Stock is $600 million, plus accrued and unpaid dividends, if any, whether or not declared. We continue to work diligently to pursue and consummate a Qualified Acquisition prior to the Redemption Date, which would result in the conversion of all of the Series B Preferred Stock into common stock. However, in the event we are unable to consummate a Qualified Acquisition, the redemption or repurchase of the Series B Preferred Stock would substantially deplete our available cash for acquisitions and business operations and could have a material adverse effect on our financial condition and business operations. There can be no assurance that we will complete a Qualified Acquisition prior to the Redemption Date.

We may explore various financing alternatives to fund our external growth strategy, including improving our capital structure, which may include increasing, reducing and/or refinancing debt, amending the terms of outstanding preferred stock, pursuing capital raising activities, such as the issuance of new preferred or common equity and/or a rights offering to our existing stockholders, launching an exchange offer, and pursuing other transactions involving our outstanding securities. There can be no assurance that any such future transaction will occur or, if so, on what terms.

Liquidity Management

The objective of liquidity management is to ensure the Company has the continuing ability to maintain cash flows that are adequate to fund operations and meet obligations and other commitments on a timely and cost-effective basis. The Company establishes and maintains liquidity guidelines for WMIH as well as for WMMRC, its principal operating subsidiary. Funds held by WMMRC are not available to WMIH to satisfy its liquidity needs. Any dividend or payment by WMMRC to WMIH must be approved by the Insurance Commissioner of the State of Hawaii. In addition, all dividends paid by WMMRC to WMIH that constitute Runoff Proceeds must first be used to make payments on the Second Lien Notes as provided under the Second Lien Indenture. In light of the restrictions on dividends applicable to WMMRC, WMIH's principal sources of liquidity are its unrestricted investments, investment income derived from these investments, fees paid to WMIH by WMMRC with respect to services provided pursuant to the two services agreements approved by the Insurance Commissioner of the State of Hawaii, cash and cash equivalents on hand, and additionally, cash, cash equivalents and investments held in escrow.

Our current sources of liquidity include premium receipts, investment income, cash on hand, and approximately $572.1 million restricted cash held in escrow received by WMIH in connection with the Series B Preferred Stock Financing and investment securities. Because of the runoff nature of WMMRC's business, as discussed above, all cash available to WMMRC is primarily used to pay reinsurance losses and loss adjustment expenses, ceding commissions, interest and principal obligations on the Runoff Notes (only if WMIH is in receipt of Runoff Proceeds; otherwise WMIH pays interest using the "payment-in-kind" ("PIK") option available under the Indentures) and general and administrative expenses.

The Company monitors operating activities, forecasts liquidity needs and adjusts composition of investment securities in order to address liquidity needs. The Company currently has negative quarterly cash flows primarily due to loss expenses at WMMRC, general and administrative costs, interest payable on Second Lien Notes and dividend payments on the Series B Preferred Stock. As a result, the Company maintains a very high quality and short duration investment portfolio in order to match its liability profile at both levels of the consolidated organization.

WMMRC has net assets totaling $35.1 million and $37.8 million as of June 30, 2016 and December 31, 2015, respectively. These net assets are not immediately available for distribution to WMIH due to restrictions imposed by the trust arrangements referenced above, and the requirement that the Insurance Commissioner of the State of Hawaii must approve dividends from WMMRC. Distributions from WMMRC to WMIH are further restricted by the terms of the Runoff Notes described in Note 7: Notes Payable to the condensed consolidated financial statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Capital Structure and Management

WMIH’s capital structure consists of stockholders’ equity, Series B Preferred Stock proceeds held in escrow and classified as mezzanine and $20.4 million of term debt as of June 30, 2016 represented by the Second Lien Notes and governed by the terms of the Second Lien Indenture. We issued term debt of $130.0 million represented by the Runoff Notes on the Effective Date. As of June 30, 2016, this term debt has subsequently decreased by a net amount of $109.6 million as a result of principal payments totaling $129.0 million net of PIK Notes which have been issued totaling $19.4 million, resulting in a remaining principal balance equal to $20.4 million. First Lien Notes were redeemed in their entirety on April 27, 2015 and the First Lien Indenture was satisfied and discharged.

On the Effective Date, all shares of common and preferred equity securities previously issued by WMI were cancelled and extinguished. Prior to reincorporation, WMIH was authorized to issue up to 500,000,000 shares of common stock and up to 5,000,000 shares of preferred stock, each with a par value of $0.00001 per share. Upon reincorporation in Delaware, which is more fully described in Note 1: The Company and its Subsidiaries to the condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q, and pursuant to WMIH's Amended and Restated Certificate of Incorporation, WMIH is authorized to issue up to 3,500,000,000 shares of common stock and up to 10,000,000 shares of preferred stock, each with a par value of $0.00001 per share. As of June 30, 2016, 206,380,800 shares of WMIH's common stock were issued and outstanding, and 1,600,000 shares of its preferred stock were issued and outstanding.

On January 30, 2014, pursuant to an Investment Agreement, WMIH issued 1,000,000 shares of Series A Convertible Preferred Stock (the "Series A Preferred Stock") for a purchase price of $11.1 million and warrants to purchase 61,400,000 shares of WMIH's common stock, 30,700,000 of which have an exercise price of $1.32 per share and 30,700,000 of which have an exercise price of $1.43 per share. The Series A Preferred Stock has rights substantially similar to those associated with WMIH's common stock, with the exception of a liquidation preference, conversion rights and customary anti-dilution protections. The Series A Preferred Stock has a liquidation preference equal to the greater of (i) $10.00 per one million shares of Series A Preferred Stock plus declared but unpaid dividends on such shares and (ii) the amount that the holder would be entitled to in a relevant transaction had the Series A Preferred Stock been converted to common stock of WMIH. The Series A Preferred Stock is convertible at a conversion price of $1.10 per share into shares of common stock of WMIH, either at the option of the holder or automatically upon transfer by KKR Fund to a non-affiliated party. As a result of the calculation of a beneficial conversion feature as required by ASC 470, a preferred deemed dividend of $9.5 million was recorded in conjunction with the issuance of the Series A Preferred Stock. This preferred deemed dividend resulted in an increase to our accumulated deficit, and as an increase in additional paid in capital. Further, KKR Fund, as the holder of the Series A Preferred Stock and the warrants, has received other rights pursuant to the Investor Rights Agreement as more fully described in Note 9: Capital Stock, to our condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

On January 5, 2015, WMIH announced that it had completed the Series B Preferred Stock Financing and issued 600,000 shares of Series B Preferred Stock for aggregate gross proceeds of $600.0 million, pursuant to the Purchase Agreement with Citi and KCM (together the "Initial Purchasers"). In connection with the Series B Preferred Stock Financing, WMIH entered into an Escrow Agreement (the "Escrow Agreement") with Citibank, N.A., as Escrow Agent, pursuant to which WMIH caused to be deposited with the Escrow Agent the amount of $598.5 million representing the net proceeds of the Series B Preferred Stock Financing less offering fees payable on January 5, 2015 but before payment of other offering fees and expenses (including fees contingent upon future events). These net proceeds will be released from escrow from time to time to WMIH as instructed by WMIH in amounts necessary to, among other things, explore and/or fund, in whole or in part, acquisitions, whether completed or not. The entire net proceeds will be released from escrow as instructed by WMIH upon a Qualified Acquisition (as defined in the Escrow Agreement).

In connection with the Series B Preferred Stock Financing, WMIH filed with the Secretary of State of Washington Articles of Amendment of Articles of Incorporation (the "Articles of Amendment") containing the Certificate of Designation creating the Series B Preferred Stock and designating the rights and preferences of the Series B Preferred Stock. Holders of shares of the Series B Preferred Stock are entitled to receive, when, as and if declared, cumulative regular dividends at an annual rate of 3% per share of the liquidation preference of $1,000 per share of Series B Preferred Stock, payable in cash. On each date that WMIH closes any Acquisition (as defined below), outstanding shares of Series B Preferred Stock having an aggregate liquidation preference equal to the net proceeds of the offering utilized in such Acquisition (as defined below), on a pro rata basis, will automatically convert into shares of WMIH's common stock. In addition, on the date WMIH closes a Qualified Acquisition (as defined below), all outstanding shares of Series B Preferred Stock will automatically convert into shares of WMIH's common stock. Each date that WMIH closes an Acquisition (including a Qualified Acquisition) will be a "Mandatory Conversion Date." "Acquisition" means any acquisition by WMIH (or any of its direct or indirect wholly-owned subsidiaries), in a single transaction or a series of transactions, whether by purchase, merger or otherwise, of all or substantially all of the assets of, all the equity interests in, or a business line, unit or division of, any person. “Qualified Acquisition” means an Acquisition that, taken together with prior Acquisitions (if any), collectively utilizes aggregate net proceeds of the offering of $450.0 million. Unless the Series B Preferred Stock has been previously repurchased at the option of a holder upon the occurrence of certain put events or mandatorily converted, WMIH will redeem all outstanding shares of Series B Preferred Stock, if any, on the Mandatory Redemption Date which is the third anniversary of January 5, 2015 (or January 5, 2018). The reincorporation of WMIH from the State of Washington to the State of Delaware resulted in the increase of the size of its Board of Directors from 7 to up to 11 members and the authorization of a number of shares of its common stock sufficient to permit the conversion of all shares of Series B Preferred Stock (collectively, the “Reincorporation”).

The foregoing transactions pertaining to the Series A Preferred Stock and Series B Preferred Stock are more fully described in Note 9: Capital Stock, to the condensed consolidated financial statements in Item 1 of this Quarterly Report on Form 10-Q.

WMIH may, subject to market conditions, and the limitations set forth in the Second Lien Indenture (described below), determine to incur additional indebtedness or raise additional equity capital in connection with undertaking one or more acquisitions.

While WMIH is not subject to regulatory capital requirements, WMMRC is required to comply with various solvency and liquidity requirements pursuant to the insurance laws of the State of Hawaii. WMMRC is required to maintain minimum capital and surplus requirements of an amount established under applicable Hawaii law and deemed appropriate by the Insurance Commissioner of the State of Hawaii. As of June 30, 2016, management believes that WMMRC is compliant with applicable statutory solvency, liquidity and minimum capital and surplus requirements. The payment of dividends by WMMRC is subject to statutory restrictions imposed by Hawaii insurance laws and regulations and requires approval from the Insurance Commissioner of the State of Hawaii. In addition, the Second Lien Indenture imposes restrictions on WMMRC business activities. During the six months ended June 30, 2016 and the year ended December 31, 2015, WMMRC paid $3.6 million and $19.9 million in dividends to WMIH which were deposited into the Collateral Account (as defined below) and were distributed in accordance with the Indentures.

Notes Payable

On the Effective Date, WMIH issued $110.0 million aggregate principal amount of its 13% Senior First Lien Notes due 2030 (the “First Lien Notes”) under an Indenture, dated as of March 19, 2012 (the “First Lien Indenture”), between WMIH and Wilmington Trust, National Association, as Trustee. In addition, WMIH issued $20.0 million aggregate principal amount of its 13% Senior Second Lien Notes due 2030 (the “Second Lien Notes” and, together with the First Lien Notes, the “Runoff Notes”) under an Indenture, dated as of March 19, 2012 (the “Second Lien Indenture” and, together with the First Lien Indenture, the “Indentures”), between WMIH and Law Debenture Trust Company of New York, as Trustee. The Runoff Notes are scheduled to mature on March 19, 2030 and pay interest quarterly.

The Runoff Notes are secured by, and have a specified priority in right of payment in, (a) a securities or deposit account into which WMIH will deposit distributions it receives from WMMRC of Runoff Proceeds (as defined in the Indentures) (the “Collateral Account”) and (b) the equity interests in, and assets of, either WMMRC, or such other entity as holds (or may hold in the future) WMMRC’s existing portfolio of assets, to the extent a lien has been granted therein (with any such lien subject to regulatory approval). No such regulatory approval has been obtained as of the date of this Quarterly Report on Form 10-Q.

WMIH will, and has agreed to cause WMMRC to, deposit all distributions, dividends or other receipts in respect of Runoff Proceeds Distributions (as defined in the Indentures) on the date paid to WMIH in the Collateral Account established in accordance with the terms of the Indentures. On any interest payment date, payments are made from the Collateral Account and from any other Runoff Proceeds Distributions in the priority set forth in the Indentures. Generally, under the Indentures payments are required to be made first to the Trustees for any fees and expenses, then to WMIH for an amount equal to the Issuer Priority Amount (as defined in the Indentures), then to the holders of the First Lien Notes for interest and principal, then to WMIH for an amount equal to the Issuer Secondary Amount (as defined in the Second Lien Indenture), and lastly to the holders of the Second Lien Notes for interest and principal. After payment in full of all interest and principal to the holders of the First Lien Notes and Second Lien Notes, all amounts on deposit in the Collateral Account and any other Runoff Proceeds will be paid to WMIH. As of June 30, 2016, the Issuer Priority Amount, the First Lien Runoff Notes, and the Issuer Secondary Amount have been paid in full and the First Lien Indenture has been discharged and satisfied. The obligations created by the Runoff Notes are nonrecourse to WMIH except for certain actions for specific performance and in certain limited circumstances as more fully described in Section 7.16 of the Indentures with respect to Runoff Proceeds Distributions in the Collateral Account or for failure to comply with certain specified covenants relating to (i) the deposit of Runoff Proceeds in the Collateral Account, (ii) payment of Runoff Proceeds in the Collateral Account in accordance with the order of priority established in the Indentures, (iii) failure to seek to obtain the appropriate regulatory approval to permit the dividend of Runoff Proceeds to WMIH and (iv) the failure to cause WMMRC to deposit Runoff Proceeds into a segregated account.

In connection with certain interest payments due and payable in respect of the First and Second Lien Notes, WMIH elected, consistent with the terms of the Indentures, to issue PIK Notes (as defined in the Indentures) in lieu of making such interest payment in cash when no cash was available. The aggregate face amount of PIK Notes issued as of June

30, 2016 and December 31, 2015 totaled approximately $19.4 million at the end of both periods. Total outstanding principal amounts under these notes totaled approximately $20.4 million and $21.7 million as of June 30, 2016 and December 31, 2015, respectively. Approximately $1.3 million and $9.5 million of Runoff Note principal was paid during the six months ended June 30, 2016 and during the year ended December 31, 2015, respectively. As of June 30, 2016 and December 31, 2015, respectively, the Collateral Account contained $0.9 million and less than $1.0 thousand of cash received from WMMRC which was or will be ultimately used for administrative expenses and interest and principal payments on the Runoff Notes in accordance with the Indentures.

Contractual Obligations, Commitments and Contingencies

WMMRC has engaged a Hawaii-based service provider, Marsh Management Services Inc., to provide accounting and related management services for its operations. In exchange for performing these services, WMMRC pays such service provider a management fee.

On March 19, 2012, WMIH entered into an Investment Management Agreement with WMMRC. Under the terms of this agreement, WMIH receives a fee from WMMRC equal to the product of (x) the ending dollar amount of assets under management during the calendar month in question and (y) .002 divided by 12. WMIH is responsible for investing the funds of WMMRC based on applicable investment criteria and subject to rules and regulations to which WMMRC is subject. The Investment Management Agreement has been approved by the Insurance Commissioner of the State of Hawaii.

On March 19, 2012, WMIH entered into an Administrative Services Agreement with WMMRC. Under the terms of this agreement, WMIH receives from WMMRC a fee of $110 thousand per month. WMIH is responsible for providing administrative services to support, among other things, supervision, governance, financial administration and reporting, risk management and claims management as may be necessary, together with such other general or specific administrative services that may be reasonably required or requested by WMMRC in the ordinary course of its business. The Administrative Services Agreement has been approved by the Insurance Commissioner of the State of Hawaii.

Total amounts incurred under the Investment Management Agreement and Administration Services Agreement totaled $0.7 million and $0.7 million for the six months ended June 30, 2016 and 2015, respectively. The expense and related income eliminate on consolidation.

On March 22, 2012, WMIH and the WMI Liquidating Trust (the “Trust”) entered into a Transition Services Agreement (the “TSA”). Pursuant to the TSA, the Trust makes available certain services and employees to the Company. The TSA provided the Company with office space (prior to the Company entering into its own lease) for its current employees and continues to provide basic infrastructure and support services to facilitate the Company’s operations. The TSA as amended, extends the term of the agreement through October 31, 2016, with automatic renewals thereafter for successive additional three-month terms, subject to non-renewal at the end of any additional term upon written notice by either party at least 30 days prior to the expiration of the additional term.

In connection with implementing the Plan, certain holders of specified “Allowed Claims” had the right to elect to receive such holder’s “Pro Rata Share of the Common Stock Allotment.” Essentially, the Plan defines the “Pro Rata Share of the Common Stock Allotment” as a pro rata share of ten million (10,000,000) shares of WMIH’s common stock (i.e. five percent (5%)) issued and outstanding on the Effective Date. Holders exercising the foregoing election did so in lieu of receiving (i) 50% of such holder’s interest in and to certain litigation proceeds that could be realized by the Trust on account of certain claims and causes of action asserted by the Trust as contemplated by the Plan (“Litigation Proceeds”), and (ii) some or all of the Runoff Notes to which such holder may be entitled (if such holder elected to receive Runoff Notes in accordance with the terms of the Plan).

If a holder exercised the election described above and, as a result of such election, received shares of WMIH’s common stock, then such holder’s share of Runoff Notes to which the election was effective (i.e., One Dollar ($1.00) of original principal amount of Runoff Notes for each share of WMIH’s common stock) were not issued. In addition, as a result of making the aforementioned election, such holders conveyed to WMIH, and WMIH retained an economic interest in Litigation Proceeds, if any, recovered by the Trust in connection with certain litigation brought by the Trust as contemplated by the Plan. Distributions, if any, to WMIH on account of the foregoing will be effected in accordance with the Plan and the court order confirming the Plan.

On or about October 14, 2014, the Trust filed a lawsuit in King County Superior Court in the State of Washington against 16 former directors and officers of WMI (the “D&O Litigation”). The Trust’s complaint alleged, among other things, that the defendants named therein breached their fiduciary duties to WMI and committed corporate waste and fraud by squandering WMI’s financial resources. In connection with the settlement of the D&O Litigation, during the year ended December 31, 2015, among the Trust, certain former directors and officers of WMI and certain insurance carriers that underwrote director and officer liability insurance policies for the benefit of WMI and its affiliates (including such former directors and officers), such insurance carriers agreed to pay the Trust $37.0 million, of which

$3.0 million would be placed into a segregated reserve account (the “RSA Reserve”) to be administered by a third party pursuant to the terms of a Reserve Settlement Agreement (the “RSA”).

During the year ended December 31, 2015, WMIH had other income of $7.8 million as a result of its receipt of net Litigation Proceeds related to the D&O Litigation. As of June 30, 2016, $2.5 million remains in the RSA Reserve. Under the RSA, funds are released from the RSA Reserve to the Trust if and when certain designated conditions are satisfied. If and when these funds are released to the Trust, and to the extent WMIH is entitled to receive such funds in accordance with the Plan, it is anticipated the Trust will make payments to WMIH in an amount equal to WMIH’s share of Litigation Proceeds as provided under the Plan. Due to the contingent nature of future distributions from the RSA Reserve, there can be no assurance that WMIH will receive any distributions from the remaining balance in the RSA Reserve in the future.

As of June 30, 2016, WMIH has not received any Litigation Proceeds, other than as described above, and there can be no assurance that WMIH will receive any distributions on account of Litigation Proceeds in the future.

As a member of the Litigation Subcommittee of the Trust, Mr. Willingham, who serves as a WMIH Board member and Chairman of the WMIH Audit Committee, participates in overseeing the prosecution of recovery claims by the Trust.

As a result of the Company’s reorganization in bankruptcy, an intangible asset was identified related to reinsurance contracts which were held by WMMRC. The contracts were evaluated to determine whether the value attributable to such contracts was either above market or in a loss contract position. After taking such evaluation into consideration, a loss contract reserve totaling $63.1 million was recorded on the Effective Date. The Company adopted the fair value option relative to this reserve. The reserve will be evaluated at each reporting date for changes to its value. As of June 30, 2016 and December 31, 2015, the loss contract reserve was analyzed and determined to have a value of $7.8 million and $9.6 million, respectively. The value of this reserve decreased by $1.8 million during the six months ended June 30, 2016 and decreased by $2.7 million during the six months ended June 30, 2015. The value of this reserve will ultimately be reduced to zero, therefore it will improve operating results in future periods as it will reduce future expenses. For additional information see Note 2: Significant Accounting Policies in Item 1 of Part I of this Quarterly Report on Form 10-Q.

In conjunction with the Series B Preferred Stock Financing, the Company is contractually committed to make certain fee payments if future events occur. These fees are recorded and presented on our condensed consolidated balance sheets as other liabilities. The total balance of $13.9 million of other liabilities is comprised of $12.3 million of accrued fees relating to the Series B Preferred Stock Financing, an accrual for professional fees currently payable of approximately $0.9 million, $0.7 million of accrued dividends relating to the Series B Preferred Stock and several small accruals for recurring business expenses.

Off-Balance Sheet Financing Arrangements

We have no obligations, assets or liabilities which would be considered off-balance sheet arrangements. We do not participate in transactions that create relationships with unconsolidated entities or financial partnerships, often referred to as variable interest entities, which would have been established for the purpose of facilitating off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.
We are principally exposed to three types of market risk:

- interest rate risk;
- credit risk; and
- liquidity risk.

There have been no material changes to our market risks as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

Item 4. Controls and Procedures.
Evaluation of disclosure controls and procedures.

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer, and Interim Chief Financial Officer, the effectiveness of the disclosure controls and procedures of the Company as of June 30, 2016. Based on that evaluation, our Chief Executive Officer and Interim Chief Financial Officer have concluded that, as of June 30, 2016, the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective in ensuring that information required to be disclosed by the Company in reports the Company files or submits under the Exchange Act:

(1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and

(2) is accumulated and communicated to the Company's management, including the Company's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There was no change in the Company's internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during its most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.
As of June 30, 2016, the Company was not a party to, or aware of, any pending legal proceedings or investigations requiring disclosure at this time.

Item 1A. Risk Factors.
In addition to the information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in “Part I-Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015. There have been no material changes in our risk factors from those disclosed in such Annual Report.

Item 6. Exhibits.
The following exhibits are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

		Incorporated by reference			
Exhibit Number	Exhibit Description	Form	Exhibit	Filing Date	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation of WMIH Corp.	8-K12G3	3.1	5/13/15	
3.2	Amended and Restated Bylaws of WMIH Corp.	8-K12G3	3.2	5/13/15	
12.1	Statement RE: Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Dividends				X
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
32.1	Certifications of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
101.INS	XBRL Instance Document.				X
101.SCH	XBRL Taxonomy Extension Schema Document.				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.				X

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 thereunto duly authorized.

WMIH CORP.
(Registrant)

Dated: August 5, 2016	By:	/s/ William C. Gallagher
	Name:	William C. Gallagher
	Title:	Chief Executive Officer

Dated: August 5, 2016	By:	/s/ Timothy F. Jaeger
	Name:	Timothy F. Jaeger
	Title:	Interim Chief Financial Officer