ESTERLINE TECHNOLOGIES CORP
Form 10-Q
June 08, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended May 1, 2015.

OR

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

For the transition period from to

Commission file number 1-6357

ESTERLINE TECHNOLOGIES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	13-2595091
(State or other Jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

500 108th Avenue N.E., Bellevue, Washington 98004

(Address of principal executive offices)(Zip Code)

Registrant’s telephone number, including area code (425) 453-9400

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

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 þ No ¨

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

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

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

As of June 2, 2015, 30,809,348 shares of the issuer's common stock were outstanding.

PART I – FINANCIAL INFORMATION

Item 1.Financial Statements

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED BALANCE SHEET

As of May 1, 2015 and October 31, 2014

(In thousands, except share amounts)

	May 1, 2015 (Unaudited)		October 31, 2014	
ASSETS				
Current Assets				
Cash and cash equivalents	$	172,645	$	238,144
Accounts receivable, net of allowances of $9,808 and $10,023		384,662		379,889
Inventories				
Raw materials and purchased parts		179,908		165,839
Work in progress		196,920		178,354
Finished goods		102,760		89,402
		479,588		433,595
Income tax refundable		9,394		5,266
Deferred income tax benefits		52,524		48,679
Prepaid expenses		23,892		20,336
Other current assets		3,600		2,149
Current assets of businesses held for sale		40,399		41,446
		1,166,704		1,169,504

Total Current Assets				
Property, Plant and Equipment		716,721		721,460
Accumulated depreciation		410,123		402,118
		306,598		319,342
Other Non-Current Assets				
Goodwill		1,074,437		1,071,786
Intangibles, net		475,931		471,377
Debt issuance costs, net of accumulated amortization of $2,336 and $5,743		11,162		4,295
Deferred income tax benefits		62,759		71,307
Other assets		21,825		14,179
Non-current assets of businesses held for sale		56,952		71,677
	$	3,176,368	$	3,193,467

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED BALANCE SHEET

As of May 1, 2015 and October 31, 2014

(In thousands, except share amounts)

	May 1, 2015 (Unaudited)	October 31, 2014
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 123,448	$ 115,284
Accrued liabilities	264,493	262,536
Current maturities of long-term debt	1,002	12,774
Deferred income tax liabilities	2,851	1,773
Federal and foreign income taxes	1,617	1,571
Current liabilities of businesses held for sale	14,181	14,191
Total Current Liabilities	407,592	408,129
Long-Term Liabilities		
Credit facilities	120,000	100,000
Long-term debt, net of current maturities	722,954	509,720
Deferred income tax liabilities	137,983	149,165
Pension and post-retirement obligations	57,968	62,693
Other liabilities	29,958	46,884
Non-current liabilities of businesses held for sale	19,427	18,876
Shareholders' Equity		
Common stock, par value $.20 per share, authorized 60,000,000 shares, issued 32,302,123 and 32,123,717 shares	6,460	6,425
Additional paid-in capital	672,319	655,723
Treasury stock at cost, repurchased 1,431,664 and 269,228 shares	(157,604)	(30,262)
Retained earnings	1,415,637	1,387,508
Accumulated other comprehensive loss	(266,348)	(131,577)
Total Esterline shareholders' equity	1,670,464	1,887,817
Noncontrolling interests	10,022	10,183
Total Shareholders' Equity	1,680,486	1,898,000
	$ 3,176,368	$ 3,193,467

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS AND

COMPREHENSIVE INCOME (LOSS)

For the Three and Six Month Periods Ended May 1, 2015 and May 2, 2014

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	May 1, 2015	May 2, 2014	May 1, 2015	May 2, 2014
Net Sales	$500,080	$510,861	$946,424	$996,801
Cost of Sales	336,429	331,636	637,423	646,841
	163,651	179,225	309,001	349,960
Expenses				
Selling, general & administrative	100,742	92,035	194,398	181,167
Research, development and engineering	27,000	25,536	49,455	51,182
Restructuring charges	922	2,078	3,972	6,874
Other (income) expense	-	-	(12,744)	-
Total Expenses	128,664	119,649	235,081	239,223
Operating Earnings from Continuing Operations	34,987	59,576	73,920	110,737
Interest Income	(124)	(136)	(303)	(255)
Interest Expense	8,564	8,434	14,405	17,059
Loss on Extinguishment of Debt	329	-	329	-
Earnings from Continuing Operations Before Income Taxes	26,218	51,278	59,489	93,933
Income Tax Expense	4,542	10,386	12,692	19,012
Earnings from Continuing Operations Including Noncontrolling Interests	21,676	40,892	46,797	74,921
Earnings Attributable to Noncontrolling Interests	(44)	(297)	(107)	(383)
Earnings from Continuing Operations Attributable to Esterline, Net of Tax	21,632	40,595	46,690	74,538
Loss from Discontinued Operations Attributable to Esterline, Net of Tax	(1,822)	(3,691)	(18,561)	(7,556)

Net Earnings Attributable to Esterline	$19,810	$36,904	$28,129	$66,982
Earnings (Loss) Per Share Attributable to Esterline - Basic:				
Continuing operations	$0.70	$1.28	$1.49	$2.35
Discontinued operations	(0.06)	(0.12)	(0.59)	(0.24)
Earnings (Loss) Per Share Attributable to Esterline - Basic	$0.64	$1.16	$0.90	$2.11
Earnings (Loss) Per Share Attributable to Esterline - Diluted:				
Continuing operations	$0.69	$1.25	$1.46	$2.30
Discontinued operations	(0.06)	(0.11)	(0.58)	(0.23)
Earnings (Loss) Per Share Attributable to Esterline - Diluted	$0.63	$1.14	$0.88	$2.07
Comprehensive Income (Loss)	$33,544	$80,121	$(106,642)	$69,683

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ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Six Month Periods Ended May 1, 2015 and May 2, 2014

(Unaudited)

(In thousands)

	May 1, 2015	May 2, 2014
Cash Flows Provided (Used) by Operating Activities		
Net earnings including noncontrolling interests	$28,236	$67,365
Adjustments to reconcile net earnings including noncontrolling interests to net cash provided (used) by operating activities:		
Depreciation and amortization	49,853	59,282
Deferred income taxes	(7,472)	(8,410)
Share-based compensation	5,552	6,648
Gain on release of non-income tax liability	(15,656)	-
Loss on assets held for sale	15,846	-
Working capital changes, net of effect of acquisitions:		
Accounts receivable	12,183	33,331
Inventories	(24,280)	(33,485)
Prepaid expenses	(5,208)	(8,072)
Other current assets	(327)	(276)
Accounts payable	(2,920)	(10,650)
Accrued liabilities	(10,440)	(13,224)
Federal and foreign income taxes	56	(3,754)
Other liabilities	2,297	(1,587)
Other, net	7,958	(2,716)
	55,678	84,452
Cash Flows Provided (Used) by Investing Activities		
Purchase of capital assets	(23,435)	(21,297)
Acquisition of business, net of cash acquired	(171,070)	(44,043)
	(194,505)	(65,340)
Cash Flows Provided (Used) by Financing Activities		
Proceeds provided by stock issuance under employee stock plans	9,335	22,957
Excess tax benefits from stock option exercises	1,744	5,297
Shares repurchased	(127,342)	-
Repayment of long-term credit facilities	(190,000)	(25,000)
Repayment of long-term debt	(167,478)	(19,302)
Proceeds from issuance of long-term credit facilities	210,000	25,000

Proceeds from issuance of long-term debt	356,532	-
Proceeds from government assistance	3,142	-
Dividends paid to noncontrolling interests	-	(780)
Debt and other issuance costs	(7,890)	-
	88,043	8,172
Effect of Foreign Exchange Rates on Cash and Cash Equivalents	(14,715)	981
Net Increase (Decrease) in Cash and Cash Equivalents	(65,499)	28,265
Cash and Cash Equivalents - Beginning of Year	238,144	179,178
Cash and Cash Equivalents - End of Period	$172,645	$207,443
Supplemental Cash Flow Information:		
Cash paid for interest	$13,795	$14,688
Cash paid for taxes	14,472	29,724

ESTERLINE TECHNOLOGIES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Three and Six Month Periods Ended May 1, 2015 and May 2, 2014

Note 1 – Basis of Presentation

The consolidated balance sheet as of May 1, 2015, the consolidated statement of operations and comprehensive income (loss) for the three and six month periods ended May 1, 2015, and May 2, 2014, and the consolidated statement of cash flows for the six month periods ended May 1, 2015, and May 2, 2014, are unaudited but, in the opinion of management, all of the necessary adjustments, consisting of normal recurring accruals, have been made to present fairly the financial statements referred to above in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the above statements do not include all of the footnotes required for complete financial statements. The results of operations and cash flows for the interim periods presented are not necessarily indicative of results that can be expected for the full year.

The notes to the consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2014, provide a summary of significant accounting policies and additional financial information that should be read in conjunction with this Form 10-Q.

The timing of the Company's revenues is impacted by the purchasing patterns of customers and, as a result, revenues are not generated evenly throughout the year. Moreover, the Company's first fiscal quarter, November through January, includes significant holiday periods in both Europe and North America. The first six months of fiscal 2015 was 26 weeks, while the first six months of fiscal 2014 was 27 weeks.

On June 5, 2014, the Company's board of directors authorized a change in the Company's fiscal year end to the last Friday of September from the last Friday in October, effective for fiscal year 2016. The Company plans to report its financial results for the 11-month transition period of November 1, 2014, through October 2, 2015, on an Annual Report on Form 10-K and to thereafter file its annual report for each 12-month period ending the last Friday of September of each year, beginning with the 12-month period ending September 30, 2016.

Note 2 – Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (FASB) issued guidance that modifies the criteria used to qualify divestitures for classification as discontinued operations and expands disclosure related to disposals of significant components. The amendment will become effective for the Company in fiscal 2016, with early adoption permitted; however, the Company does not expect to early adopt the amended guidance. The amended guidance is expected to decrease the likelihood that future disposals will qualify for discontinued operations treatment, meaning that the results of operation of some future disposals may be reported as continuing operations.

In May 2014, the Financial Accounting Standards Board (FASB) amended requirements for an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective

and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for the Company in the first fiscal quarter of 2018. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on consolidated financial statements and related disclosures.

In April 2015, the Financial Accounting Standards Board (FASB) amended requirements related to the presentation of debt issuance cost. The updated standard requires debt issuance costs related to recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. The recognition and measurement of debt issuance costs are not affected by this amendment. The updated standard is effective for the Company in the first fiscal quarter of 2016. The Company does not expect that the standard will have a material impact on its consolidated financial statements and related disclosures.

Note 3 – Earnings Per Share and Shareholders' Equity

Basic earnings per share is computed on the basis of the weighted average number of shares outstanding during the year. Diluted earnings per share includes the dilutive effect of stock options and restricted stock units. Common shares issuable from stock options excluded from the calculation of diluted earnings per share because they were anti-dilutive were 243,450 and 177,100 in the second fiscal quarter of 2015 and 2014, respectively. Shares used for calculating earnings per share are disclosed in the following table.

In Thousands	Three Months Ended		Six Months Ended	
	May 1, 2015	May 2, 2014	May 1, 2015	May 2, 2014
Shares used for basic earnings per share	31,005	31,867	31,306	31,733
Shares used for diluted earnings per share	31,525	32,475	31,839	32,348

The authorized capital stock of the Company consists of 25,000 shares of preferred stock ($100 par value), 475,000 shares of serial preferred stock ($1.00 par value), each issuable in series, and 60,000,000 shares of common stock ($.20 par value). As of May 1, 2015, and October 31, 2014, there were no shares of preferred stock or serial preferred stock outstanding.

On June 19, 2014, the Company's board of directors approved a $200 million share repurchase program. In March 2015, the Company's board of directors approved an additional $200 million for the share repurchase program. Under the program, the Company is authorized to repurchase up to $400 million of outstanding shares of common stock from time to time, depending on market conditions, share price and other factors. Repurchases may be made in the open market or through private transactions, in accordance with SEC requirements. The Company may enter into a Rule 10(b)5-1 plan designed to facilitate the repurchase of all or a portion of the repurchase amount. The program does not require the Company to acquire a specific number of shares. Common stock repurchased can be reissued, and accordingly, the Company accounts for repurchased stock under the cost method of accounting.

During the six months ended May 1, 2015, the Company repurchased 1,162,436 shares under this program at an average price paid per share of $109.55, for an aggregate purchase price of $127.3 million.

Changes in issued and outstanding common shares are summarized as follows:

	May 1, 2015	October 31, 2014
Shares Issued:		
Balance, beginning of year	32,123,717	31,441,949
Shares issued under share-based compensation plans	178,406	681,768
Balance, end of current period	32,302,123	32,123,717

Treasury Stock:		
Balance, beginning of year	269,228	-
Shares purchased	1,162,436	269,228
Balance, end of current period	1,431,664	269,228
Shares outstanding, end of period	30,870,459	31,854,489

The components of Accumulated Other Comprehensive Gain (Loss):

In Thousands	May 1, 2015	October 31, 2014
Unrealized loss on derivative contracts	$(19,807)	$(14,179)
Tax effect	5,350	3,890
	(14,457)	(10,289)
Pension and post-retirement obligations	(80,438)	(90,225)
Tax effect	26,784	30,072
	(53,654)	(60,153)
Currency translation adjustment	(198,237)	(61,135)
Accumulated other comprehensive gain (loss)	$(266,348)	$(131,577)

Note 4 – Retirement Benefits

The Company's pension plans principally include a U.S. pension plan maintained by Esterline and a non-U.S. plan maintained by CMC Electronics, Inc. (CMC). The Company also sponsors a number of other non-U.S. defined benefit pension plans, primarily in France and Germany. In fiscal 2014, the Company offered vested terminated participants of its U.S. pension plan a one-time opportunity to elect a lump-sum payment from the plan in lieu of a lifetime annuity. In the first fiscal quarter of 2015, the Company made a $16.6 million lump-sum payment to vested terminated pension plan participants from the plan, which resulted in an actuarial estimated settlement charge of $3.0 million. The charge was recorded in selling, general and administrative expenses. Components of periodic pension cost consisted of the following:

In Thousands	Three Months Ended		Six Months Ended	
	May 1, 2015	May 2, 2014	May 1, 2015	May 2, 2014
Components of Net Periodic Cost				
Service cost	$2,830	$2,894	$5,700	$5,623
Interest cost	4,175	4,765	8,529	9,577
Expected return on plan assets	(6,385)	(6,939)	(12,859)	(13,451)
Settlement	-	-	2,991	-
Amortization of prior service cost	17	19	35	38
Amortization of actuarial (gain) loss	1,131	1,343	2,399	2,700
Net periodic cost (benefit)	$1,768	$2,082	$6,795	$4,487

The Company's principal post-retirement plans include non-U.S. plans, which are non-contributory healthcare and life insurance plans. The components of expense of these other retirement benefits consisted of the following:

In Thousands	Three Months Ended		Six Months Ended	
	May 1, 2015	May 2, 2014	May 1, 2015	May 2, 2014
Components of Net Periodic Cost				
Service cost	$205	$228	$425	$463
Interest cost	134	184	277	373
Amortization of prior service cost	(17)	(17)	(34)	(34)
Amortization of actuarial (gain) loss	(23)	(66)	(49)	(134)
Net periodic cost (benefit)	$299	$329	$619	$668

The Company amortizes prior service cost and actuarial gains and losses from accumulated other comprehensive income to expense over the remaining service period.

Note 5 – Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established that prioritizes the inputs to valuation

techniques used to measure fair value. An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The hierarchy of fair value measurements is described below:

Level 1 – Valuations are based on quoted prices that the Company has the ability to obtain in actively traded markets for identical assets and liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market or exchange traded market, a valuation of these instruments does not require a significant degree of judgment.

Level 2 – Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuations are based on model-based techniques for which some or all of the assumptions are obtained from indirect market information that is significant to the overall fair value measurement and which require a significant degree of management judgment.

The following table sets forth the Company's financial assets and liabilities that were measured at fair value on a recurring basis by level within the fair value hierarchy at May 1, 2015, and October 31, 2014.

In Thousands	Level 2	
	May 1, 2015	October 31, 2014
Assets:		
Derivative contracts designated as hedging instruments	$1,912	$24
Derivative contracts not designated as hedging instruments	1,006	1,081
Embedded derivatives	3,647	2,351
Liabilities:		
Derivative contracts designated as hedging instruments	$22,079	$14,592
Derivative contracts not designated as hedging instruments	4,333	4,188
Embedded derivatives	1,128	15

In Thousands	Level 3	
	May 1, 2015	October 31, 2014
Liabilities:		
Contingent purchase obligation	$5,000	$5,000

The Company's embedded derivatives are the result of entering into sales or purchase contracts that are denominated in a currency other than the Company's functional currency or the supplier's or customer's functional currency. The fair

value is determined by calculating the difference between quoted exchange rates at the time the contract was entered into and the period-end exchange rate. These contracts are categorized as Level 2 in the fair value hierarchy.

From time to time, the Company's derivative contracts consist of foreign currency exchange contracts and interest rate swap agreements. These derivative contracts are over the counter, and their fair value is determined using modeling techniques that include market inputs such as interest rates, yield curves, and currency exchange rates. These contracts are categorized as Level 2 in the fair value hierarchy.

The Company's contingent purchase obligations consist of additional contingent consideration in connection with the acquisition of Sunbank Family of Companies, LLC (Sunbank) of $5.0 million as of May 1, 2015. The contingent considerations will be payable to the sellers if certain performance objectives are met following the acquisition in accordance with the terms of the purchase agreement. The values recorded on the balance sheet were derived from the estimated probability that the performance objectives will be met. The contingent purchase obligation is categorized as Level 3 in the fair value hierarchy.

Note 6 – Derivative Financial Instruments

The Company uses derivative financial instruments in the form of foreign currency forward exchange contracts and interest rate swap contracts for the purpose of minimizing exposure to changes in foreign currency exchange rates on business transactions and interest rates, respectively. The Company's policy is to execute such instruments with banks the Company believes to be creditworthy and not to enter into derivative financial instruments for speculative purposes. These derivative financial instruments do not subject the Company to undue risk, as gains and losses on these instruments generally offset gains and losses on the underlying assets, liabilities, or anticipated transactions that are being hedged.

All derivative financial instruments are recorded at fair value in the Consolidated Balance Sheet. For a derivative that has not been designated as an accounting hedge, the change in the fair value is recognized immediately through earnings. For a derivative that has been designated as an accounting hedge of an existing asset or liability (a fair value hedge), the change in the fair value of both the derivative and underlying asset or liability is recognized immediately through earnings. For a derivative designated as an accounting hedge of an anticipated transaction (a cash flow hedge), the change in the fair value is recorded on the Consolidated Balance Sheet in Accumulated Other Comprehensive Income (AOCI) to the extent the derivative is effective in mitigating the exposure related to the anticipated transaction. The change in the fair value related to the ineffective portion of the hedge, if any, is immediately recognized in earnings. The amount recorded within AOCI is reclassified into earnings in the same period during which the underlying hedged transaction affects earnings.

The fair value of derivative instruments are presented on a gross basis, as the Company does not have any derivative contracts which are subject to master netting arrangements. At May 1, 2015, and October 31, 2014, the Company did not have any hedges with credit-risk-related contingent features or that required the posting of collateral. The cash flows from derivative contracts are recorded in operating activities in the Consolidated Statement of Cash Flows.

Foreign Currency Forward Exchange Contracts

The Company transacts business in various foreign currencies, which subjects the Company's cash flows and earnings to exposure related to changes in foreign currency exchange rates. These exposures arise primarily from purchases or sales of products and services from third parties. Foreign currency forward exchange contracts provide for the purchase or sale of foreign currencies at specified future dates at specified exchange rates, and are used to offset changes in the fair value of certain assets or liabilities or forecasted cash flows resulting from transactions denominated in foreign currencies. At May 1, 2015, and October 31, 2014, the Company had outstanding foreign currency forward exchange contracts principally to sell U.S. dollars with notional amounts of $374.2 million and $396.2 million, respectively. These notional values consist primarily of contracts for the European euro, British pound sterling and Canadian dollar, and are stated in U.S. dollar equivalents at spot exchange rates at the respective dates.

Interest Rate Swaps

The Company manages its exposure to interest rate risk by maintaining an appropriate mix of fixed and variable rate debt, which over time should moderate the costs of debt financing. When considered necessary, the Company may use financial instruments in the form of interest rate swaps to help meet this objective.

Embedded Derivative Instruments

The Company's embedded derivatives are the result of entering into sales or purchase contracts that are denominated in a currency other than the Company's functional currency or the supplier's or customer's functional currency.

Net Investment Hedge

In April 2015, the Company issued €330.0 million in 3.625% Senior Notes due April 2023 (2023 Notes) and requiring semi-annual interest payment in April and October each year until maturity. The Company designated the 2023 Notes a hedge of the investment of certain foreign business units. The foreign currency gain or loss that is effective as a hedge is reported as a component of other comprehensive income (loss) in shareholders' equity. To the extent that this hedge is ineffective, the foreign currency gain or loss is recorded in earnings. There was no ineffectiveness since inception of the hedge. The Company also designated the accrued interest on the 2023 Notes as a net investment hedge.

In July 2011, the Company entered into a Euro Term Loan for €125.0 million under the secured credit facility. The Company designated the Euro Term Loan a hedge of the investment in a certain French business unit. The foreign currency gain or loss that is effective as a hedge is reported as a component of other comprehensive income (loss) in shareholders' equity. To the extent that this hedge is ineffective, the foreign currency gain or loss is recorded in earnings. There was no ineffectiveness since inception of the hedge. On June 30, 2014, the Company paid off the remaining balance of the Euro Term Loan. As a result, the Company recorded a net loss of $0.5 million on extinguishment of debt.

Fair Value of Derivative Instruments

Fair value of derivative instruments in the Consolidated Balance Sheet at May 1, 2015, and October 31, 2014, consisted of:

In Thousands		Fair Value	
	Classification	May 1, 2015	October 31, 2014
Foreign Currency Forward Exchange Contracts:			
	Other current assets	$2,267	$1,052
	Other assets	651	53
	Accrued liabilities	20,983	15,490
	Other liabilities	5,429	3,290
Embedded Derivative Instruments:			
	Other current assets	$541	$296
	Other assets	3,106	2,055
	Accrued liabilities	105	15
	Other liabilities	1,023	-

The effect of derivative instruments on the Consolidated Statement of Operations and Comprehensive Income (Loss) for the three and six month periods ended May 1, 2015, and May 2, 2014, consisted of:

Fair Value Hedges

We recognized the following gains (losses) on contracts designated as fair value hedges:

In Thousands	Three Months Ended		Six Months Ended	
Gain (Loss)	May 1, 2015	May 2, 2014	May 1, 2015	May 2, 2014
Embedded derivatives:				
Recognized in sales	$(5,230)	$(1,881)	$654	$866

Cash Flow Hedges

We recognized the following gains (losses) on contracts designated as cash flow hedges:

In Thousands	Three Months Ended		Six Months Ended	
Gain (Loss)	May 1, 2015	May 2, 2014	May 1, 2015	May 2, 2014
Foreign currency forward exchange contracts:				
Recognized in AOCI (effective portion)	$24,588	$9,034	$7,780	$(2,735)
Reclassified from AOCI into sales	(8,627)	(2,242)	(13,408)	(2,741)

Net Investment Hedges

We recognized the following gains (losses) on contracts designated as net investment hedges:

In Thousands	Three Months Ended		Six Months Ended	
Gain (Loss)	May 1, 2015	May 2, 2014	May 1, 2015	May 2, 2014
Euro Term Loan:				
Recognized in AOCI	$-	$(556)	$-	$(28)
2023 Notes:				
Recognized in AOCI	$(13,035)	$-	$(13,035)	$-

During the first six months of fiscal 2015 and 2014, the Company recorded a loss of $1.8 million and a gain of $0.8 million, respectively, on foreign currency forward exchange contracts that have not been designated as accounting hedges. These foreign currency exchange gains (losses) are included in selling, general and administrative expense.

There was no significant impact to the Company's earnings related to the ineffective portion of any hedging instruments during the first six months of fiscal 2015 and 2014. In addition, there was no significant impact to the Company's earnings when a hedged firm commitment no longer qualified as a fair value hedge or when a hedged forecasted transaction no longer qualified as a cash flow hedge during the first six months of fiscal 2015 and 2014.

Amounts included in AOCI are reclassified into earnings when the hedged transaction settles. The Company expects to reclassify approximately $15.9 million of net loss into earnings over the next 12 months. The $15.9 million loss will reduce the Company's U.S.-dollar-denominated sales covered by qualified forward contracts to the forward rate when the Company entered into the forward contracts. The maximum duration of the Company's foreign currency cash flow hedge contracts at May 1, 2015, is 24 months.

Note 7 – Income Taxes

The income tax rate was 17.3% in the second fiscal quarter of 2015 compared with 20.3% in the prior-year period. In the second fiscal quarter of 2015 we recognized $0.3 million of discrete tax expense principally related to reconciling the prior year's income tax return to the income tax provision. In the second fiscal quarter of 2014, we recognized $0.6 million of discrete tax benefits principally related to the reduction of net deferred income tax liabilities as a result of the enactment of tax laws reducing the U.K. statutory income tax rate. The income tax rate differed from the statutory rate in the second fiscal quarter of 2015 and 2014, as both years benefited from various tax credits and certain foreign interest expense deductions.

The income tax rates were 21.3% and 20.2% for the first six months of fiscal 2015 and 2014, respectively. In the first six months of fiscal 2015, the Company recognized $0.8 million of discrete tax expense principally related to the following items. The first item was approximately $2.3 million of discrete tax expense principally related to reconciling the prior year's income tax return to the income tax provision. The second item was approximately $1.5 million of tax benefits due to the retroactive extension of the U.S. federal research and experimentation credits. In the first six months of fiscal 2014, the Company recognized approximately $1.1 million of discrete tax benefits principally related to the following items. The first item was approximately $0.6 million of tax benefits due to the release of reserves due to the expiration of a statute of limitations. The second item was a $0.5 million reduction of net deferred income tax liabilities as a result of the enactment of tax laws reducing the U.K. statutory income tax rate. The income tax rate differed from the statutory rate in the first six months of fiscal 2015 and 2014, as both years benefited from various tax credits and certain foreign interest expense deductions.

It is reasonably possible that within the next twelve months approximately $2.5 million of tax benefits that are currently unrecognized could be recognized as a result of settlement of examinations and/or the expiration of applicable statutes of limitations.

Note 8 – Debt

In March 2011, the Company entered into a secured credit facility for $460 million made available through a group of banks. The credit facility is secured by substantially all of the Company's assets and interest is based on standard

inter-bank offering rates. On April 9, 2015, the Company amended the secured credit facility to extend the expiration to April 9, 2020, increase the revolving credit facility to $500 million, and provide for a delayed-draw term loan facility of $250 million. Borrowing under the delayed-draw term loan facility, if utilized, may be used only for working capital and repayment or refinancing of our existing indebtedness and to pay the fees and expenses in connection therewith. The interest rate on the credit facility ranges from LIBOR plus 1.25% to LIBOR plus 2.00% depending on the leverage ratios at the time the funds are drawn. At May 1, 2015, the Company had $120.0 million outstanding under the secured credit facility at an interest rate of LIBOR plus 1.50%, which was 1.68% at May 1, 2015.

In April 2013, the Company amended the secured credit facility to provide for a $175.0 million term loan (U.S. Term Loan). The interest rate on the U.S. Term Loan ranges from LIBOR plus 1.5% to LIBOR plus 2.25% depending on the leverage ratios at the time the funds are drawn. On April 8, 2015, the Company paid off the $175 million U.S. Term Loan. In connection with the redemption, the Company wrote off $0.3 million in unamortized debt issuance costs as a loss on extinguishment of debt in the second fiscal quarter of 2015.

In August 2010, the Company issued $250.0 million in 7% Senior Notes due August 1, 2020 (2020 Notes), and requiring semi-annual interest payments in March and September of each year until maturity. The net proceeds from the sale of the notes, after deducting $4.4 million of debt issuance cost, were $245.6 million. The 2020 Notes are general unsecured senior obligations of the Company. The 2020 Notes are guaranteed, jointly and severally on a senior basis, by all the existing and future domestic subsidiaries of the Company unless designated as an “unrestricted subsidiary,” and those foreign subsidiaries that executed related subsidiary guarantees under the indenture covering the 2020 Notes. The 2020 Notes are subject to redemption at the option of the Company at any time prior to August 1, 2015, at a price equal to 100% of the principal amount, plus any accrued interest to the date of redemption and a make-whole provision. The 2020 Notes are also subject to redemption at the option of the Company, in whole or in part, on or after August 1, 2015, at redemption prices starting at 103.500% of the principal amount plus accrued interest during the period beginning August 1, 2015, and declining annually to 100% of principal and accrued interest on or after August 1, 2018.

In April 2015, the Company issued €330.0 million in 3.625% 2023 Notes requiring semi-annual interest payments in April and October of each year until maturity. The net proceeds from the sale of the notes, after deducting $5.7 million of debt issuance cost, were $350.8 million. The 2023 Notes are general unsecured senior obligations of the Company. The 2023 Notes are unconditionally guaranteed on a senior basis by the Company and certain subsidiaries of the Company that are guarantors under the Company's existing secured credit facility. The 2023 Notes are subject to redemption at the option of the Company at any time prior to April 15, 2018, at a price equal to 100% of the principal amount, plus any accrued interest to the date of redemption and a make-whole provision. The Company may also redeem up to 35% of the 2023 Notes before April 15, 2018, with the net cash proceeds from equity offerings. The 2023 Notes are also subject to redemption at the option of the Company, in whole or in part, on or after April 15, 2018, at redemption prices starting at 102.719% of the principal amount plus accrued interest during the period beginning April 15, 2018, and declining annually to 100% of principal and accrued interest on or after April 15, 2021.

Based on quoted market prices, the approximate fair value of the Company's 2020 Notes was approximately $261.7 million and $266.9 million as of May 1, 2015, and October 31, 2014, respectively. Based on quoted market prices, the approximate fair value of the Company's 2023 Notes was approximately $371.0 million as of May 1, 2015. The carrying amount of the secured credit facility approximates fair value. Estimates of fair value for the 2020 Notes and 2023 Notes are based on quoted market prices, and are considered Level 2 inputs as defined in the fair value hierarchy described in Note 5.

Government refundable advances consist of payments received from the Canadian government to assist in research and development related to commercial aviation. The repayment of this advance is based on year-over-year commercial aviation revenue growth at CMC beginning in 2014. Imputed interest on the advance was 4.30% at May 1, 2015. The debt recognized was $46.0 million and $51.9 million as of May 1, 2015, and October 31, 2014, respectively.

Note 9 – Commitments and Contingencies

As of May 1, 2015, and October 31, 2014, the Company had a $1.1 million and $1.5 million liability, respectively, related to environmental remediation at a previously sold business for which the Company provided indemnification.

In the first fiscal quarter of 2015, the Company recognized a $15.7 million gain and a $2.4 million reduction in interest expense upon the lapse of a statutory period related to a liability for a non-income tax position of an acquired company.

On March 5, 2014, the Company entered into a Consent Agreement with the U.S. Department of State's Directorate of Defense Trade Controls Office of Defense Trade Controls Compliance (DTCC) to resolve alleged International Traffic in Arms Regulations (ITAR) civil violations. The Consent Agreement settled the pending ITAR compliance matter with the DTCC previously reported by the Company that resulted from voluntary reports the Company filed with DTCC that disclosed possible technical and administrative violations of the ITAR. The Consent Agreement has a three-year term and provides for: (i) a payment of $20 million, $10 million of which is suspended and eligible for offset credit based on verified expenditures for past and future remedial compliance measures; (ii) the appointment of an external Special Compliance Official to oversee compliance with the Consent Agreement and the ITAR; (iii) two external audits of the Company's ITAR compliance program; and (iv) continued implementation of ongoing remedial compliance measures and additional remedial compliance measures related to automated systems and ITAR

compliance policies, procedures, and training.

The settlement amount in the Consent Agreement was consistent with the amount proposed by DTCC in August 2013, for which the Company estimated and recorded a $10 million charge in the third fiscal quarter ended July 26, 2013. The $10 million portion of the settlement that is not subject to suspension will be paid in installments, with $4 million paid in March 2014, $2 million paid in February 2015, and $2 million to be paid in each of March 2016 and 2017. The Company expects some part of recent investments made in its ITAR compliance program will be eligible for credit against the suspended portion of the settlement amount, which include: additional staffing, ongoing implementation of a new software system, employee training, and establishment of a regular compliance audit program and corrective action process. The Company expects recent and future investments in remedial compliance measures will be sufficient to cover the $10 million suspended payment.

Note 10 – Employee Stock Plans

As of May 1, 2015, the Company had three share-based compensation plans, which are described below. The compensation cost that has been charged against income for those plans was $5.6 million and $6.6 million for the first six months of fiscal 2015 and 2014, respectively. During the first six months of fiscal 2015 and 2014, the Company issued 178,406 and 491,320 shares, respectively, under its share-based compensation plans.

Employee Stock Purchase Plan (ESPP)

The ESPP is a “safe-harbor” designed plan whereby shares are purchased by participants at a discount of 5% of the market value on the purchase date and, therefore, compensation cost is not recorded.

Employee Sharesave Scheme

The Company offers shares under its employee sharesave scheme for U.K. employees. This plan allows participants the option to purchase shares at a 5% discount of the market price of the stock as of the beginning of the offering period. The term of these options is three years. The sharesave scheme is not a "safe-harbor" design, and therefore, compensation cost is recognized on this plan. Under the sharesave scheme, option exercise prices are equal to the fair market value of the Company's common stock on the date of grant. The Company granted 25,984 and 29,242 options in the six month periods ended May 1, 2015, and May 2, 2014, respectively. The weighted-average grant date fair value of options granted during the six month periods ended May 1, 2015, and May 2, 2014, was $24.31 and $27.03 per share, respectively.

	Six Months Ended	
	May 1, 2015	May 2, 2014
Volatility	25.80%	33.69%
Risk-free interest rate	0.93 %	0.73 %
Expected life (years)	3	3
Dividends	0	0

Equity Incentive Plan

Under the equity incentive plan, option exercise prices are equal to the fair market value of the Company's common stock on the date of grant. The Company granted 188,500 and 191,900 options to purchase shares in the six month periods ended May 1, 2015, and May 2, 2014, respectively. The weighted-average grant date fair value of options granted during the six month periods ended May 1, 2015, and May 2, 2014, was $48.63 and $45.20 per share, respectively.

The fair value of each option granted by the Company was estimated using a Black-Scholes pricing model, which uses the assumptions noted in the following table. The Company uses historical data to estimate volatility of the Company's common stock and option exercise and employee termination assumptions. The risk-free rate for the contractual life of the option is based on the U.S. Treasury zero coupon issues in effect at the time of the grant.

	Six Months Ended	
	May 1, 2015	May 2, 2014
Volatility	40.73 - 41.89%	41.87 - 43.17%
Risk-free interest rate	1.43 - 2.00%	1.73 - 2.99%
Expected life (years)	5 - 9	5 - 9
Dividends	0	0

The Company granted 20,300 and 77,075 restricted stock units in the six month periods ended May 1, 2015, and May 2, 2014, respectively. The weighted-average grant date fair value of restricted stock units granted during the six month periods ended May 1, 2015, and May 2, 2014, was $113.98 and $84.34 per share, respectively. The fair value of each restricted stock unit granted by the Company is equal to the fair market value of the Company's common stock on the date of grant.

Note 11 – Acquisitions

On January 31, 2015, the Company acquired the defense, aerospace and training display (DAT) business of Belgium-based Barco N.V. (Barco) for €150 million, or approximately $171 million, in cash. The Company incurred a $2.9 million foreign currency exchange loss in the funding of the acquisition in the first fiscal quarter of 2015. The Company financed the acquisition primarily using international cash reserves, with the balance funded by borrowings under its existing credit facility. The display business develops and manufactures visualization solutions for a variety of demanding defense and commercial aerospace applications. The display business is included in our Avionics & Controls segment.

The following summarizes the allocation of the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition. The fair value adjustment for inventory was $7.1 million, which will be recognized as cost of goods sold over 13 months, the estimated inventory turnover. Acquisition related costs of $3.3 million have been recognized as selling, general and administrative expense. The purchase price includes the value of existing technologies, the introduction of new technologies, and the addition of new customers. These factors resulted in recording goodwill of $63.5 million. The amount allocated to goodwill is not deductible for income tax purposes.