

ESTERLINE TECHNOLOGIES CORP

Form 10-Q

September 05, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended August 1, 2014.

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	(I.R.S. Employer
of incorporation or organization)	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

Edgar Filing: ESTERLINE TECHNOLOGIES CORP - Form 10-Q

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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 ☒ 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 ☐

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 ☒

As of September 2, 2014, 31,939,799 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 August 1, 2014 and October 25, 2013

(In thousands, except share amounts)

	August 1, 2014 (Unaudited)	October 25, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 210,456	\$ 179,178
Cash in escrow	-	4,018
Accounts receivable, net of allowances of \$9,946 and \$9,215	361,827	383,666
Inventories		
Raw materials and purchased parts	181,885	165,231
Work in progress	206,935	182,882
Finished goods	104,992	99,550
	493,812	447,663
Income tax refundable	7,681	6,526
Deferred income tax benefits	50,716	47,277
Prepaid expenses	24,816	18,183
Other current assets	4,286	5,204
Total Current Assets	1,153,594	1,091,715
Property, Plant and Equipment	790,516	767,861
Accumulated depreciation	427,311	396,664
	363,205	371,197
Other Non-Current Assets		

Edgar Filing: ESTERLINE TECHNOLOGIES CORP - Form 10-Q

Goodwill	1,132,987	1,128,977
Intangibles, net	560,893	580,949
Debt issuance costs, net of accumulated amortization of \$5,400 and \$4,359	4,637	6,211
Deferred income tax benefits	68,416	71,840
Other assets	24,726	11,223
	\$ 3,308,458	\$ 3,262,112

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED BALANCE SHEET

As of August 1, 2014 and October 25, 2013

(In thousands, except share amounts)

	August 1, 2014 (Unaudited)	October 25, 2013
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 123,376	\$ 123,597
Accrued liabilities	238,968	253,561
Current maturities of long-term debt	12,822	21,279
Deferred income tax liabilities	3,205	2,307
Federal and foreign income taxes	2,309	7,348
Total Current Liabilities	380,680	408,092
Long-Term Liabilities		
Credit facilities	115,000	130,000
Long-term debt, net of current maturities	513,119	537,859
Deferred income tax liabilities	178,796	193,119
Pension and post-retirement obligations	62,759	68,102
Other liabilities	47,313	40,188
Shareholders' Equity		
Common stock, par value \$.20 per share, authorized 60,000,000 shares, issued and outstanding 31,996,510 and 31,441,949 shares	6,399	6,288
Additional paid-in capital	648,974	604,511
Treasury stock at cost, repurchased 45,979 and 0 shares	(5,176)	-
Retained earnings	1,390,980	1,285,090
Accumulated other comprehensive loss	(42,012)	(22,284)
Total Esterline shareholders' equity	1,999,165	1,873,605
Noncontrolling interests	11,626	11,147
Total Shareholders' Equity	2,010,791	1,884,752
	\$3,308,458	\$3,262,112

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS)

For the Three and Nine Month Periods Ended August 1, 2014 and July 26, 2013

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	August 1, 2014	July 26, 2013	August 1, 2014	July 26, 2013
Net Sales	\$531,124	\$478,068	\$1,565,678	\$1,435,592
Cost of Sales	348,651	299,166	1,027,565	914,969
	182,473	178,902	538,113	520,623
Expenses				
Selling, general & administrative	95,293	101,822	289,969	298,711
Research, development and engineering	25,134	24,103	78,441	72,837
Restructuring charges	3,405	-	10,279	-
Goodwill impairment	-	3,454	-	3,454
Total Expenses	123,832	129,379	378,689	375,002
Operating Earnings from Continuing Operations	58,641	49,523	159,424	145,621
Interest Income	(146)	(132)	(403)	(381)
Interest Expense	7,870	9,050	24,939	30,976
Loss on Extinguishment of Debt	533	-	533	946
Earnings from Continuing Operations Before				
Income Taxes	50,384	40,605	134,355	114,080
Income Tax Expense	11,430	1,151	27,693	13,027
Earnings from Continuing Operations Including				
Noncontrolling Interests	38,954	39,454	106,662	101,053
Earnings Attributable to Noncontrolling Interests	(46)	(241)	(429)	(1,207)
Earnings from Continuing Operations				
Attributable to Esterline, Net of Tax	38,908	39,213	106,233	99,846
Loss from Discontinued Operations Attributable				
to Esterline, Net of Tax	-	(975)	(343)	(975)
Net Earnings Attributable to Esterline	\$38,908	\$38,238	\$105,890	\$98,871

Edgar Filing: ESTERLINE TECHNOLOGIES CORP - Form 10-Q

Earnings (Loss) Per Share Attributable to

Esterline - Basic:				
Continuing operations	\$1.22	\$1.25	\$3.34	\$3.21
Discontinued operations	-	(0.03)	(0.01)	(0.03)
Earnings (Loss) Per Share Attributable				
to Esterline - Basic	\$1.22	\$1.22	\$3.33	\$3.18

Earnings (Loss) Per Share Attributable to

Esterline - Diluted:				
Continuing operations	\$1.19	\$1.23	\$3.28	\$3.15
Discontinued operations	-	(0.03)	(0.01)	(0.03)
Earnings (Loss) Per Share Attributable				
to Esterline - Diluted	\$1.19	\$1.20	\$3.27	\$3.12
Comprehensive Income (Loss)	\$16,479	\$45,201	\$86,162	\$83,459

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Nine Month Periods Ended August 1, 2014 and July 26, 2013

(Unaudited)

(In thousands)

	Nine Months Ended	
	August 1, 2014	July 26, 2013
Cash Flows Provided (Used) by Operating Activities		
Net earnings including noncontrolling interests	\$ 106,319	\$ 100,078
Adjustments to reconcile net earnings including noncontrolling interests to		
net cash provided (used) by operating activities:		
Depreciation and amortization	87,443	87,941
Deferred income taxes	(13,104)	(12,238)
Share-based compensation	9,833	7,667
Gain on sale of capital assets	-	(915)
Goodwill impairment	-	3,454
Working capital changes, net of effect of acquisitions:		
Accounts receivable	23,480	51,063
Inventories	(42,411)	(32,774)
Prepaid expenses	(6,202)	(135)
Other current assets	(99)	(836)
Accounts payable	(4,508)	5,424
Accrued liabilities	(16,458)	4,277
Federal and foreign income taxes	(7,983)	(5,321)
Other liabilities	(1,440)	(10,394)
Other, net	(155)	(1,012)
	134,715	196,279
Cash Flows Provided (Used) by Investing Activities		
Purchase of capital assets	(35,009)	(37,765)
Proceeds from sale of capital assets	-	915
Acquisition of business, net of cash acquired	(44,745)	(40,689)
	(79,754)	(77,539)
Cash Flows Provided (Used) by Financing Activities		
Proceeds provided by stock issuance under employee stock plans	23,173	20,450
Excess tax benefits from stock option exercises	6,392	2,237
Share repurchases	(5,176)	-
Repayment of long-term credit facilities	(40,000)	(70,000)
Repayment of long-term debt	(34,076)	(209,541)
Proceeds from issuance of long-term credit facilities	25,000	175,000
Proceeds from government assistance	3,362	5,114

Edgar Filing: ESTERLINE TECHNOLOGIES CORP - Form 10-Q

Dividends paid to noncontrolling interests	(780)	(1,044)
Debt and other issuance costs	-	(453)
	(22,105)	(78,237)
Effect of Foreign Exchange Rates on Cash and Cash Equivalents	(1,578)	(1,930)
Net Increase (Decrease) in Cash and Cash Equivalents	31,278	38,573
Cash and Cash Equivalents - Beginning of Period	179,178	160,675
Cash and Cash Equivalents - End of Period	\$210,456	\$199,248
Supplemental Cash Flow Information:		
Cash paid for interest	\$26,066	\$25,873
Cash paid for taxes	49,036	30,608

ESTERLINE TECHNOLOGIES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Three and Nine Month Periods Ended August 1, 2014 and July 26, 2013

Note 1 – Basis of Presentation

The consolidated balance sheet as of August 1, 2014, the consolidated statement of operations and comprehensive income (loss) for the three and nine month periods ended August 1, 2014, and July 26, 2013, and the consolidated statement of cash flows for the nine month periods ended August 1, 2014, and July 26, 2013, 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 25, 2013, 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 nine months of fiscal 2014 contained 40 weeks, while the first nine months of fiscal 2013 contained 39 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 twelve-month period ending the last Friday of September of each year, beginning with the twelve-month period ending September 30, 2016. The Company's fiscal year 2014 remains unchanged and will end on October 31, 2014.

Note 2 – Recent Accounting Pronouncements

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.

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 170,300 and 219,800 in the third fiscal quarter of 2014 and 2013, respectively. Shares used for calculating earnings per share are disclosed in the following table.

(In thousands)	Three Months Ended August		Nine Months Ended August	
	1, 2014	July 26, 2013	1, 2014	July 26, 2013
Shares used for basic earnings per share	31,995	31,297	31,818	31,100
Shares used for diluted earnings per share	32,591	31,870	32,427	31,663

Share repurchase program

On June 19, 2014, the Company's board of directors approved a \$200 million share repurchase program. Under the program, the Company is authorized to repurchase up to \$200 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 three months ended August 1, 2014, the Company repurchased 45,979 shares under this program at an average price paid per share of \$112.57, for an aggregate purchase price of \$5.2 million.

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). Components of periodic pension cost consisted of the following:

(In thousands)	Three Months		Nine Months Ended	
	Ended August 1, 2014	July 26, 2013	August 1, 2014	July 26, 2013
Service cost	\$2,621	\$2,832	\$8,244	\$9,103
Interest cost	4,737	4,414	14,314	13,208
Expected return on plan assets	(6,504)	(5,836)	(19,398)	(17,142)
Amortization of prior service costs	19	20	58	62
Amortization of actuarial loss	1,213	3,465	3,913	10,320
Net Periodic Cost	\$2,086	\$4,895	\$7,131	\$15,551

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		Nine Months	
	Ended August 1, 2014	July 26, 2013	Ended August 1, 2014	July 26, 2013
Service cost	\$233	\$956	\$696	\$1,470
Interest cost	187	214	560	590
Amortization of prior service costs	(17)	(17)	(51)	(52)
Amortization of actuarial loss (gain)	(67)	8	(201)	24
Net Periodic Cost	\$336	\$1,161	\$1,004	\$2,032

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 August 1, 2014, and October 25, 2013.

(In thousands)	Level 2	
	August 1, 2014	October 25, 2013
Assets:		
Derivative contracts designated as hedging instruments	\$1,381	\$2,270
Derivative contracts not designated as hedging instruments	2,763	3,670
Embedded derivatives	1,222	706
Liabilities:		
Derivative contracts designated as hedging instruments	\$8,129	\$4,541
Derivative contracts not designated as hedging instruments	941	122
Embedded derivatives	518	344

(In thousands)	Level 3	
	August 1, 2014	October 25, 2013
Liabilities:		
Contingent purchase obligation	\$5,000	\$4,000

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.

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 August 1, 2014. 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. The Company paid \$4.0 million of contingent consideration in the second fiscal quarter of 2014 for satisfaction of its obligation related to Eclipse Electronic Systems, Inc. (Eclipse).

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 values 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 August 1, 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 August 1, 2014, and October 25, 2013, the Company had outstanding foreign currency forward exchange contracts principally to sell U.S. dollars with notional amounts of \$375.7 million and \$369.0 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. In fiscal 2010, the Company entered into interest rate swap agreements for \$175.0 million on the 2017 Notes. The swap agreements exchanged the fixed interest rate on the 2017 Notes of 6.625% for a variable interest rate. In the second fiscal quarter of 2013, the swap agreements were terminated and the Company redeemed the 2017 Notes with the proceeds from the \$175.0 million U.S. Term Loan. The Company recorded a gain on the swap termination of \$2.9 million in the second fiscal quarter of 2013.

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 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 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 values of derivative instruments in the Consolidated Balance Sheet at August 1, 2014, and October 25, 2013, consisted of:

Edgar Filing: ESTERLINE TECHNOLOGIES CORP - Form 10-Q

(In thousands)		Fair Value	
		August 1, 2014	October 25, 2013
Classification			
Foreign Currency Forward Exchange Contracts:			
	Other current assets	\$2,969	\$4,547
	Other assets	1,175	1,393
	Accrued liabilities	7,612	3,002
	Other liabilities	1,458	1,661
Embedded Derivative Instruments:			
	Other current assets	\$141	\$59
	Other assets	1,081	647
	Accrued liabilities	312	344
	Other liabilities	206	-

The effect of derivative instruments on the Consolidated Statement of Operations and Comprehensive Income (Loss) for the three and nine month periods ended August 1, 2014, and July 26, 2013, consisted of:

Fair Value Hedges

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

(In thousands)	Three	Nine
	Months	Months
	Ended	Ended
	August	August
Gain (Loss)	1, 26,	1, July 26,
	2014 2013	2014 2013
Interest rate swap contracts:		
Recognized in interest expense	\$ - \$ -	\$- \$(1,058)
Recognized in loss on extinguishment of debt	- -	- 2,918