CARPENTER TECHNOLOGY CORP
Form 10-Q
October 27, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 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)

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 x No o

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

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

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

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

The number of shares outstanding of the issuer’s common stock as of October 24, 2016 was 46,616,837.

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PART I
Item 1. Financial Statements

CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in millions, except share data)

	September 30, 2016	June 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 50.9	$ 82.0
Accounts receivable, net	240.7	253.6
Inventories	661.6	628.7
Other current assets	89.9	46.4
Total current assets	1,043.1	1,010.7
Property, plant and equipment, net	1,338.1	1,351.4
Goodwill	244.8	244.8
Other intangibles, net	61.6	63.2
Deferred income taxes	7.6	8.2
Other assets	118.9	116.0
Total assets	$ 2,814.1	$ 2,794.3
LIABILITIES		
Current liabilities:		
Accounts payable	$ 153.5	$ 159.6
Accrued liabilities	110.8	139.2
Total current liabilities	264.3	298.8
Long-term debt	609.6	611.3
Accrued pension liabilities	501.7	509.3
Accrued postretirement benefits	116.7	116.6
Deferred income taxes	156.8	102.4
Other liabilities	44.1	51.0
Total liabilities	1,693.2	1,689.4
Contingencies and commitments (see Note 8)		
STOCKHOLDERS’ EQUITY		
Common stock — authorized 100,000,000 shares; issued 55,266,523 shares at September 30, 2016 and 55,254,569 shares at June 30, 2016; outstanding 46,619,990 shares at September 30, 2016 and 46,600,125 shares at June 30, 2016	276.3	276.3
Capital in excess of par value	276.4	273.5
Reinvested earnings	1,294.2	1,308.9
Common stock in treasury (8,646,533 shares and 8,654,444 shares at September 30, 2016 and June 30, 2016, respectively), at cost	(343.6)	(343.9)
Accumulated other comprehensive loss	(382.4)	(409.9)
Total stockholders' equity	1,120.9	1,104.9
Total liabilities and stockholders' equity	$ 2,814.1	$ 2,794.3

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in millions, except per share data)

	Three Months Ended September 30,	
	2016	2015
Net sales	$389.0	$455.6
Cost of sales	343.0	387.0
Gross profit	46.0	68.6
Selling, general and administrative expenses	44.6	43.4
Restructuring charges	—	0.4
Operating income	1.4	24.8
Interest expense	(7.3)	(6.6)
Other income (expense), net	0.6	(2.1)
(Loss) income before income taxes	(5.3)	16.1
Income tax expense	0.9	7.2
Net (loss) income	$(6.2)	$8.9
(LOSS) EARNINGS PER COMMON SHARE:		
Basic	$(0.13)	$0.18
Diluted	$(0.13)	$0.18
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	46.9	49.7
Diluted	46.9	49.9
Cash dividends per common share	$0.18	$0.18

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
($ in millions)

	Three Months Ended September 30,	
	2016	2015
Net (loss) income	$(6.2)	$8.9
Other comprehensive income (loss), net of tax		
Pension and postretirement benefits, net of tax of $(10.5) and $(2.3), respectively	17.4	3.7
Net gain (loss) on derivative instruments, net of tax of $(6.5) and $3.4, respectively	10.8	(5.5)
Foreign currency translation	(0.7)	(3.3)
Other comprehensive income (loss)	27.5	(5.1)
Comprehensive income	$21.3	$3.8

See accompanying notes to consolidated financial statements.

CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
($ in million)

	Three Months Ended September 30,	
	2016	2015
OPERATING ACTIVITIES		
Net (loss) income	$(6.2)	$8.9
Adjustments to reconcile net (loss) income to net cash provided from operating activities:		
Depreciation and amortization	28.9	29.9
Deferred income taxes	37.5	(1.0)
Net pension expense	16.8	13.4
Share-based compensation expense	3.0	2.7
Net loss on disposals of property and equipment	0.1	0.1
Changes in working capital and other:		
Accounts receivable	13.2	24.4
Inventories	(33.5)	(33.0)
Other current assets	(44.6)	(4.8)
Accounts payable	(0.7)	2.5
Accrued liabilities	(10.7)	(1.6)
Other postretirement plan contributions	(1.4)	(3.4)
Other, net	1.5	3.4
Net cash provided from operating activities	3.9	41.5
INVESTING ACTIVITIES		
Purchases of property, equipment and software	(26.6)	(29.9)
Other	—	4.0
Net cash used for investing activities	(26.6)	(25.9)
FINANCING ACTIVITIES		
Dividends paid	(8.5)	(9.0)
Purchases of treasury stock	—	(45.9)
Payments on seller financed debt related to purchase of software	—	(1.2)
Proceeds from stock options exercised	0.3	0.1
Net cash used for financing activities	(8.2)	(56.0)
Effect of exchange rate changes on cash and cash equivalents	(0.2)	1.0
DECREASE IN CASH AND CASH EQUIVALENTS	(31.1)	(39.4)
Cash and cash equivalents at beginning of period	82.0	70.0
Cash and cash equivalents at end of period	$50.9	$30.6
SUPPLEMENTAL CASH FLOW INFORMATION:		
Non-cash investing activities:		
Acquisition of property, equipment and software	$9.6	$10.7

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015
(Unaudited)
($ in millions, except per share data)

	Common Stock Par Value Of $5	Common Stock Capital in Excess of Par Value	Reinvested Earnings	Common Stock in Treasury	Accumulated Other Comprehensive (Loss) Income	Total Equity
Balances at June 30, 2016	$276.3	$ 273.5	$ 1,308.9	$ (343.9)	$ (409.9)	$ 1,104.9
Net loss			(6.2)			(6.2)
Pension and postretirement benefits gain, net of tax					17.4	17.4
Net gain on derivative instruments, net of tax					10.8	10.8
Foreign currency translation					(0.7)	(0.7)
Cash Dividends:						0
Common @ $0.18 per share			(8.5)			(8.5)
Share-based compensation plans		2.6		0.3		2.9
Stock options exercised		0.3				0.3
Balances at September 30, 2016	$276.3	$ 276.4	$ 1,294.2	$ (343.6)	$ (382.4)	$ 1,120.9

	Common Stock Par Value Of $5	Common Stock Capital in Excess of Par Value	Reinvested Earnings	Common Stock in Treasury	Accumulated Other Comprehensive (Loss) Income	Total Equity
Balances at June 30, 2015	$276.2	$ 266.6	$ 1,332.4	$ (221.1)	$ (328.2)	$ 1,325.9
Net income			8.9			8.9
Pension and postretirement benefits gain, net of tax					3.7	3.7
Net loss on derivative instruments, net of tax					(5.5)	(5.5)
Foreign currency translation					(3.3)	(3.3)
Cash Dividends:						0
Common @ $0.18 per share			(9.0)			(9.0)
Purchase of treasury stock				(45.9)		(45.9)
Share-based compensation plans		2.0		0.4		2.4
Stock options exercised		0.1				0.1
Tax shortfall on share-based compensation		(0.1)				(0.1)
Balances at September 30, 2015	$276.2	$ 268.6	$ 1,332.3	$ (266.6)	$ (333.3)	$ 1,277.2

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, considered necessary for a fair statement of the results are reflected in the interim periods presented. The June 30, 2016 consolidated balance sheet data was derived from audited financial statements, but does not include all of the disclosures required by U.S. generally accepted accounting principles. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in Carpenter's annual report on Form 10-K for the year ended June 30, 2016 (the "2016 Form 10-K"). Operating results for the three months ended September 30, 2016 are not necessarily indicative of the operating results for any future period.

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

2. Restructuring and Asset Impairment Charges

During fiscal year 2016, the Company approved restructuring actions consisting of an early retirement incentive to be funded by the Company's qualified pension plan and other severance related costs paid by the Company. In addition, as a result of the prolonged weakness in oil and gas drilling and exploration activities, the Company recorded non-cash asset impairment charges. At this time, the Company does not expect any additional charges related to these restructuring actions in the future.

Activity and reserve balances for restructuring charges were as follows:

($ in millions)	
Reserve balance at June 30, 2015	$2.3
Restructuring and asset impairment charges	18.0
Payments from qualified pension plan associated with restructuring charges	(9.4)
Cash payments	(3.0)
Non-cash asset impairment charges and other	(7.6)
Reserve balance at June 30, 2016	0.3
Cash payments	(0.3)
Reserve balance at September 30, 2016	$—

3. (Loss) Earnings per Common Share

The Company calculates basic and diluted (loss) earnings per share using the two class method. Under the two class method, (loss) earnings are allocated to common stock and participating securities (non-vested restricted shares and units that receive non-forfeitable dividends) according to their participation rights in dividends and undistributed earnings. The (loss) earnings available to each class of stock are divided by the weighted average number of outstanding shares for the period in each class. Diluted earnings per share assumes the issuance of common stock for all potentially dilutive share equivalents outstanding. For the three months ended September 30, 2016, the Company incurred a net loss and accordingly excluded all potentially dilutive securities from the determination of diluted loss per share as their impact was anti-dilutive.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The calculations of basic and diluted (loss) earnings per common share for the three months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended September 30,	
(in millions, except per share data)	2016	2015
Net (loss) income	$(6.2)	$8.9
Less: earnings and dividends allocated to participating securities	—	—
(Loss) earnings available for common stockholders used in calculation of basic (loss) earnings per common share	$(6.2)	$8.9
Weighted average number of common shares outstanding, basic	46.9	49.7
Basic (loss) earnings per common share	$(0.13)	$0.18
Net (loss) income	$(6.2)	$8.9
Less: earnings and dividends allocated to participating securities	—	—
(Loss) earnings available for common stockholders used in calculation of diluted (loss) earnings per common share	$(6.2)	$8.9
Weighted average number of common shares outstanding, basic	46.9	49.7
Effect of shares issuable under share-based compensation plans	—	0.2
Weighted average number of common shares outstanding, diluted	46.9	49.9
Diluted (loss) earnings per common share	$(0.13)	$0.18

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

	Three Months Ended September 30,	
(in millions)	2016	2015
Stock options	1.8	1.3
Restricted stock awards	0.1	—

4. Inventories

Inventories consisted of the following components as of September 30, 2016 and June 30, 2016:

($ in millions)	September 30, 2016	June 30, 2016
Raw materials and supplies	$ 147.8	$ 137.6

Work in process	329.3	298.9
Finished and purchased products	184.5	192.2
Total inventory	$ 661.6	$ 628.7

Inventories are valued at the lower of cost or market. Cost for inventories is principally determined using the last-in, first-out ("LIFO") method. The Company also uses the first-in, first-out ("FIFO") and average costs methods. As of September 30, 2016 and June 30, 2016, $120.5 million and $118.4 million of inventory, respectively, was accounted for using a method other than the LIFO method.

5. Accrued Liabilities

Accrued liabilities consisted of the following as of September 30, 2016 and June 30, 2016:

($ in millions)	September 30, 2016	June 30, 2016
Accrued compensation and benefits	$ 36.2	$ 41.8
Derivative financial instruments	20.0	31.6
Accrued postretirement benefits	13.7	13.8
Deferred revenue	8.9	8.9
Accrued interest expense	5.6	11.2
Accrued pension liabilities	4.1	10.1
Accrued income taxes	0.8	1.5
Other	21.5	20.3
Total accrued liabilities	$ 110.8	$ 139.2

6. Pension and Other Postretirement Benefits

The components of the net periodic benefit cost related to the Company's pension and other postretirement benefits for the three months ended September 30, 2016 and 2015 were as follows:

Three months ended September 30,	Pension Plans		Other Postretirement Plans	
($ in millions)	2016	2015	2016	2015
Service cost	$ 8.2	$ 7.7	$ 0.9	$ 0.8
Interest cost	13.1	14.5	2.3	2.5
Expected return on plan assets	(15.3)	(16.4)	(1.7)	(1.7)
Amortization of net loss	9.4	6.8	0.8	0.7
Amortization of prior service cost (benefit)	0.2	0.1	(1.6)	(1.6)
Curtailment charge	0.5	$—	$ —	$ —
Net periodic benefit costs	$ 16.1	$ 12.7	$ 0.7	$ 0.7

During the three months ended September 30, 2016 and 2015, the Company made no contributions to its qualified defined benefit pension plans.

On September 14, 2016, the Company announced changes to retirement plans it offers to certain employees. The Company will freeze benefits accrued to eligible participants of its largest qualified defined benefit pension plan and certain non-qualified benefit plans effective December 31, 2016. The Company recognized the plan freeze in the three months ended September 30, 2016 as a curtailment, since it eliminates the accrual of defined benefits for future services for a significant number of participants. The impact of the curtailment includes a one-time accelerated recognition of outstanding unamortized prior service costs of $0.5 million. The curtailment event triggered a re-measurement for the affected benefit plans as of August 31, 2016 using a weighted average discount rate of 3.57 percent. The re-measurement resulted in a reduction of accrued pension liabilities during the quarter of $18.7 million.

In October 2016, the Company made a voluntary pension contribution of $100 million to the affected qualified pension benefit plan that was announced in connection with the plan freeze.

7. Debt

The Company's $500.0 million syndicated credit facility (“Credit Agreement”) extends to June 2018. Interest on the borrowings under the Credit Agreement accrue at variable rates, based upon LIBOR or a defined “Base Rate,” both determined based upon the rating of the Company’s senior unsecured long-term debt (the “Debt Rating”). The applicable margin to be added to LIBOR ranges from 0.75% to 1.90% (1.45% as of September 30, 2016), and for Base Rate-determined loans, from 0.00% to 0.90% (0.45% as of September 30, 2016). The Company also pays a quarterly commitment fee ranging from 0.075% to 0.375% (0.225% as of September 30, 2016), determined based upon the Debt Rating, of the unused portion of the $500.0 million commitment under the Credit Agreement. In addition, the Company must pay certain letter of credit fees, ranging from 0.75% to 1.90% (1.45% as of September 30, 2016), with respect to letters of credit issued under the Credit Agreement. The Company has the right to voluntarily prepay and re-borrow loans and to terminate or reduce the commitments under the facility. As of September 30, 2016, the Company had $5.8 million of issued letters of credit with the balance of $494.2 million available to the Company.

The Company is subject to certain financial and restrictive covenants under the Credit Agreement, which, among other things, require the maintenance of a minimum interest coverage ratio of 3.50 to 1.00. The interest coverage ratio is defined in the Credit Agreement as, for any period, the ratio of consolidated earnings before interest, taxes, depreciation and amortization and non-cash net pension expense (“EBITDA”) to consolidated interest expense for such period. The Credit Agreement also requires the Company to maintain a debt to capital ratio of less than 55 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 September 30, 2016 and June 30, 2016, the Company was in compliance with all of the covenants of the Credit Agreement.

Long-term debt outstanding as of September 30, 2016 and June 30, 2016 consisted of the following:

($ in millions)	September 30, 2016	June 30, 2016
Medium-term notes, Series B at 6.97% to 7.10% due from April 2018 to May 2018 (face value of $55.0 million at September 30, 2016 and June 30, 2016)	$ 55.0	$ 55.0
Senior unsecured notes, 5.20% due July 2021 (face value of $250.0 million at September 30, 2016 and June 30, 2016)	256.0	257.8
Senior unsecured notes, 4.45% due March 2023 (face value of $300.0 million at September 30, 2016 and June 30, 2016)	298.6	298.5
Total	609.6	611.3
Less: amounts due within one year	—	—
Long-term debt, net of current portion	$ 609.6	$ 611.3

For the three months ended September 30, 2016 and 2015, interest costs totaled $7.5 million and $7.2 million, respectively, of which $0.2 million and $0.6 million, respectively, were capitalized as part of the cost of property, plant, equipment and software.

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8. Contingencies and Commitments

Environmental

The Company is subject to various federal, state, local and international environmental laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. Although compliance with these laws and regulations may affect the costs of the Company's operations, compliance costs to date have not been material. The Company has environmental remediation liabilities at some of its owned operating facilities and has been designated as a potentially responsible party ("PRP") with respect to certain third party Superfund waste-disposal sites and other third party-owned sites. The Company accrues amounts for environmental remediation costs that represent management's best estimate of the probable and reasonably estimable future costs related to environmental remediation. During the three months ended September 30, 2016, the Company decreased the liability for a company-owned former operating site by $0.2 million. The liabilities recorded for environmental remediation costs at Superfund sites, other third party-owned sites and Carpenter-owned current or former operating facilities remaining at September 30, 2016 and June 30, 2016 were $16.0 million and $16.2 million, respectively. Additionally, the Company has been notified that it may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against the Company. Neither the exact amount of remediation costs nor the final method of their allocation among all designated PRP's at these Superfund sites have been determined. Accordingly, at this time, the Company cannot reasonably estimate expected costs for such matters. The liability for future environmental remediation costs that can be reasonably estimated is evaluated by management on a quarterly basis.

Other

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

9. Share Repurchase Program

In October 2014, the Company's Board of Directors authorized a share repurchase program. The program authorizes the purchase of up to $500.0 million of the Company's outstanding common stock and expires October 2016. The shares may be repurchased from time to time at the Company's discretion based on capital needs of the business, general market conditions and the market price of the stock. The share repurchase program may be discontinued at any time. During the three months ended September 30, 2016, the Company did not purchase shares of its common stock on the open market. As of September 30, 2016, $251.6 million remains available for future purchases.

10. Fair Value Measurements

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

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CARPENTER TECHNOLOGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy:

September 30, 2016	Fair Value Measurements Using Input Type
($ in millions)	Level 2
Assets:	
Marketable securities	
Municipal auction rate securities	$ 4.2
Derivative financial instruments	8.9
Total assets	$ 13.1
Liabilities:	
Derivative financial instruments	$ 24.6

June 30, 2016	Fair Value Measurements Using Input Type
($ in millions)	Level 2
Assets:	
Marketable securities	
Municipal auction rate securities	$ 4.1
Derivative financial instruments	11.8
Total assets	$ 15.9
Liabilities:	
Derivative financial instruments	$ 43.9

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

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

The carrying amounts of other financial instruments not listed in the table below approximate fair value due to the short-term nature of these items. The carrying amounts and estimated fair values of the Company's financial instruments not recorded at fair value in the financial statements were as follows:

	September 30, 2016	June 30, 2016

($ in millions)	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt	$609.6	$614.9	$611.3	$597.7
Company-owned life insurance	$14.1	$14.1	$14.0	$14.0

The carrying amount of company-owned life insurance reflects cash surrender values based upon the market values of underlying securities, using Level 2 inputs, net of any outstanding policy loans. The carrying value associated with the cash surrender value of these policies is recorded in other assets in the accompanying consolidated balance sheets.

The fair values of long-term debt as of September 30, 2016 and June 30, 2016 were determined by using current interest rates for debt with terms and maturities similar to the Company's existing debt arrangements and accordingly would be classified as Level 2 inputs in the fair value hierarchy.

11. Derivatives and Hedging Activities

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

Cash Flow Hedging — Commodity forward contracts: The Company enters into commodity forward contracts to fix the price of a portion of anticipated future purchases of certain critical raw materials and energy to manage the risk of cash flow variability associated with volatile commodity prices. The commodity forward contracts have been designated as cash flow hedges. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income (loss) ("AOCI") to the extent effective, and reclassified to cost of sales in the period during which the hedged transaction affects earnings or it becomes probable that the forecasted transaction will not occur. As of September 30, 2016, the Company had forward contracts to purchase 18.7 million pounds of certain raw materials with settlement dates through December 2020.

Cash Flow Hedging — Forward interest rate swaps: Historically, the Company has entered into forward interest rate swap contracts to manage the risk of cash flow variability associated with fixed interest debt expected to be issued. The forward interest rate swaps were designated as cash flow hedges. The qualifying hedge contracts were marked-to-market at each reporting date and any unrealized gains or losses were included in AOCI to the extent effective, and reclassified to interest expense in the period during which the hedged transaction affected earnings or it became probable that the forecasted transaction would not occur. Upon the issuance of the fixed rate debt, the forward interest rate swap contracts were terminated. The realized gains at the time the interest rate swap contracts were terminated are being amortized over the term of the underlying debt. For the three months ended September 30, 2016 and 2015, net gains of $0.1 million and $0.1 million, respectively, related to the previously terminated contracts were recorded as a reduction to interest expense.

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

The Company also uses foreign currency forward contracts to protect certain short-term asset positions denominated in foreign currencies against the effect of changes in exchange rates. These positions do not qualify for hedge accounting and accordingly are marked-to-market at each reporting date through charges to other income and expense.

As of September 30, 2016 and June 30, 2016, the fair value of the outstanding foreign currency forwards not designated as hedging instruments and the charges to income for changes in fair value for these contracts were not material.

Fair Value Hedging - Interest rate swaps: The Company uses interest rate swaps to achieve a level of floating rate debt relative to fixed rate debt where appropriate. The Company has designated fixed to floating interest rate swaps as fair value hedges. Accordingly, the changes in the fair value of these instruments are immediately recorded in earnings. The mark-to-market values of both the fair value hedging instruments and the underlying debt obligations are recorded as equal and offsetting gains and losses in interest expense in the consolidated statements of operations. As of September 30, 2016 and June 30, 2016, the total notional amount of floating interest rate contracts was $150.0 million. For the three months ended September 30, 2016 and 2015, net gains of $0.4 million and $0.7 million, respectively, were recorded as a reduction to interest expense.

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The fair value and location of outstanding derivative contracts recorded in the accompanying consolidated balance sheets were as follows as of September 30, 2016 and June 30, 2016:

September 30, 2016 ($ in millions)	Interest Rate Swaps	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:				
Derivatives designated as hedging instruments:				
Other current assets	$ 0.4	$ 0.3	$ 0.4	$ 1.1
Other assets	7.8	—	—	7.8
Total asset derivatives	$ 8.2	$ 0.3	$ 0.4	$ 8.9
Liability Derivatives:				
Derivatives designated as hedging instruments:				
Accrued liabilities	$ —	$ 0.1	$ 20.0	$ 20.1
Other liabilities	—	—	4.5	4.5
Total liability derivatives	$ —	$ 0.1	$ 24.5	$ 24.6

June 30, 2016 ($ in millions)	Interest Rate Swaps	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:				
Derivatives designated as hedging instruments:				
Other current assets	$ 1.2	$ 0.3	$ 0.6	$ 2.1
Other assets	9.7	—	—	9.7
Total asset derivatives	$ 10.9	$ 0.3	$ 0.6	$ 11.8
Liability Derivatives:				
Derivatives designated as hedging instruments:				
Accrued liabilities	$ —	$ 0.3	$ 31.3	$ 31.6
Other liabilities	—	—	12.3	12.3
Total liability derivatives	$ —	$ 0.3	$ 43.6	$ 43.9

Substantially all of the derivative contracts are subject to master netting arrangements, or similar agreements with each counterparty, which provide for the option to settle contracts on a net basis when they settle on the same day and in the same currency. In addition, these arrangements provide for a net settlement of all contracts with a given counterparty in the event that the arrangement is terminated due to the occurrence of default or a termination event. The Company presents the outstanding derivative contracts on a net basis by counterparty in the consolidated balance sheets. If the Company had chosen to present the derivative contracts on a gross basis, the total asset derivatives would have been $12.0 million and total liability derivatives would have been $27.7 million as of September 30, 2016.

According to the provisions of the Company’s derivative arrangements, in the event that the fair value of outstanding derivative positions with certain counterparties exceeds certain thresholds, the Company may be required to issue cash collateral to the counterparties. As of September 30, 2016 and June 30, 2016, the Company had no cash collateral held by counterparties.

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

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Cash Flow Hedges

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of AOCI and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings or it becomes probable the forecasted transactions will not occur. The following is a summary of the gains (losses) related to cash flow hedges recognized during the three months ended September 30, 2016 and 2015:

($ in millions)	Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion) Three Months Ended September 30, 2016	2015
Derivatives in Cash Flow Hedging Relationship:		
Commodity contracts	$ 7.0	$ (18.5)
Foreign exchange contracts	—	0.2
Total	$ 7.0	$ (18.3)

($ in millions)	Location of (Loss) Gain Reclassified from AOCI into Income	Amount of (Loss) Gain Reclassified from AOCI into Income (Effective Portion) Three Months Ended September 30, 2016	2015	Amount of Gain Reclassified from AOCI into Income (Ineffective Portion) Three Months Ended September 30, 2016	2015
Derivatives in Cash Flow Hedging Relationship:					
Commodity contracts	Cost of sales	$ (10.1)	$ (9.3)	$ 0.5	$ —
Foreign exchange contracts	Net sales	0.1	(0.1)	—	—
Forward interest rate swaps	Interest expense	0.1	0.1	—	—
Total		$ (9.9)	$ (9.3)	$ 0.5	$ —

The Company estimates that $15.7 million of net derivative losses included in AOCI as of September 30, 2016 will be reclassified into income within the next 12 months. No significant cash flow hedges were discontinued during the three months ended September 30, 2016.

12. Other Income (Expense), Net

Other income (expense), net consisted of the following:

	Three Months Ended September 30,	
($ in millions)	2016	2015
Foreign exchange	$—	$(1.2)
Unrealized gains (losses) on company-owned life insurance contracts and investments held in rabbi trusts	0.5	(1.2)
Equity in earnings of unconsolidated subsidiaries	—	0.3
Interest Income	0.1	—
Total other income (expense), net	$0.6	$(2.1)

13. Income Taxes

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

Income tax expense for the three months ended September 30, 2016 was $0.9 million, or 17.0 percent of pre-tax loss as compared with $7.2 million, or 44.7 percent of pre-tax income for the three months ended September 30, 2015. In September 2016, the Company announced plans to freeze the largest qualified defined benefit pension plan and certain non-qualified benefit plans. In October 2016, the Company made a voluntary pension contribution of $100 million to the affected qualified pension benefit plan that was announced in connection with the plan freeze. The current period tax expense includes a discrete tax charge of $2.1 million due to reduced tax benefits for domestic manufacturing claimed in prior periods that were impacted by the voluntary pension contribution paid in October 2016. Income tax expense for the three months ended September 30, 2015 included a discrete tax charge of $2.0 million for the deferred tax liability on unremitted earnings of one of our foreign subsidiaries.

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

14. Business Segments

The Company has two reportable segments, Specialty Alloys Operations ("SAO") and Performance Engineered Products ("PEP").

The SAO segment is comprised of the Company's major premium alloy and stainless steel manufacturing operations. This includes operations performed at mills primarily in Reading and Latrobe and surrounding areas in Pennsylvania, South Carolina and 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 flexibility and agility to quickly respond to market dynamics.

The Company's executive management evaluates the performance of these operating segments based on sales, operating income and cash flow generation. Segment operating profit excludes general corporate costs, which include executive and director compensation, and other corporate facilities and administrative expenses not allocated to the segments. Also excluded are items that management considers not representative of ongoing operations, such as excess inventory write-downs, restructuring and asset impairment charges, goodwill impairment and other specifically-identified income or expense items.

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

On a consolidated basis, one customer, Alcoa Inc., accounted for approximately 12 percent and 13 percent of the net sales for the three months ended September 30, 2016 and 2015, respectively. Approximately 24 percent and 22 percent of the accounts receivable outstanding at September 30, 2016 and June 30, 2016, respectively, is due from two customers, Alcoa Inc. and Precision Castparts Corporation.

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Segment Data	Three Months Ended September 30,	
($ in millions)	2016	2015
Net Sales:		
Specialty Alloys Operations	$315.1	$372.6
Performance Engineered Products	78.5	91.5
Intersegment	(4.6)	(8.5)
Consolidated net sales	$389.0	$455.6

Segment Data	Three Months Ended September 30,	
($ in millions)	2016	2015
Operating Income (Loss):		
Specialty Alloys Operations	$25.0	$41.1
Performance Engineered Products	(2.8)	(0.4)
Corporate costs	(13.8)	(12.0)
Pension earnings, interest and deferrals	(7.1)	(4.8)
Intersegment	0.1	0.9
Consolidated operating income	$1.4	$24.8

Segment Data	Three Months Ended September 30,	
($ in millions)	2016	2015
Depreciation and Amortization:		
Specialty Alloys Operations	$23.4	$23.5
Performance Engineered Products	5.1	5.7
Corporate	0.8	0.9
Intersegment	(0.4)	(0.2)
Consolidated depreciation and amortization	$28.9	$29.9

Segment Data	Three Months Ended September 30,	
($ in millions)	2016	2015
Capital Expenditures:		
Specialty Alloys Operations	$14.7	$19.7
Performance Engineered Products	4.5	9.1
Corporate	7.5	1.1
Intersegment	(0.1)	—
Consolidated capital expenditures	$26.6	$29.9

Segment Data	September 30,	June 30,
($ in millions)	2016	2016
Total Assets:		

Specialty Alloys Operations	$ 2,254.0	$2,256.5
Performance Engineered Products	415.4	415.8
Corporate	166.0	151.3
Intersegment	(21.3)	(29.3)
Consolidated total assets	$ 2,814.1	$2,794.3

15. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance in ASU 2014-09 requires that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance in ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of this guidance by one year. As such, the Company is required to adopt this standard for its interim and annual periods beginning after December 15, 2017. Early adoption is permitted for interim and annual periods beginning after December 15, 2016. The Company is evaluating the impact of the adoption of ASU 2014-09 on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). ASU No. 2016-02 improves transparency and comparability among companies by recognizing lease assets and lease liabilities on the balance sheet and by disclosing key information about leasing arrangements. ASU No. 2016-02 is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2018, with early application permitted. The Company is evaluating the impact of the adoption of ASU 2016-02 on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08 Revenue from Contracts with Customers (Topic 606) - Principal versus Agent Considerations (Reporting Revenue Gross versus Net). ASU No. 2016-08 requires an entity to determine whether the nature of its promise to provide goods or services to a customer is performed in a principal or agent capacity and to recognize revenue in a gross or net manner based on its principal/agent designation. ASU No. 2016-08 is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early application permitted. The Company is evaluating the impact of the adoption of ASU 2016-08 on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation — Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment Accounting, which outlines new provisions intended to simplify various aspects related to accounting for share-based payments and their presentation in the financial statements. ASU No. 2016-09 is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2016, with early application permitted. The Company is evaluating the impact of the adoption of ASU 2016-09 on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments, which outlines new provisions intended to reduce the existing diversity in practice related to accounting for the cash flow and its presentation in the financial statements. ASU No. 2016-15 is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early application permitted. The Company is evaluating the impact of the adoption of ASU 2016-15 on the consolidated financial statements.

16. Reclassifications from Accumulated Other Comprehensive (Loss) Income

The changes in AOCI by component, net of tax, for the three months ended September 30, 2016 and 2015 were as follows:

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Three Months Ended September 30, 2016 ($ in millions) (a)	Cash flow hedging items	Pension and other postretirement benefit plan items	Unrealized losses on available-for-sale securities	Foreign currency items	Total
Balance at June 30, 2016	$ (21.8)	$ (344.3)	$ (0.3)	$ (43.5)	$ (409.9)
Other comprehensive income (loss) before reclassifications	4.4	11.4	—	(0.7)	15.1
Amounts reclassified from AOCI (b)	6.4	6.0	—	—	12.4
Net other comprehensive income (loss)	10.8	17.4	—	(0.7)	27.5
Balance at September 30, 2016	$ (11.0)	$ (326.9)	$ (0.3)	$ (44.2)	$ (382.4)

Three Months Ended September 30, 2015 ($ in millions) (a)	Cash flow hedging items	Pension and other postretirement benefit plan items	Unrealized losses on available-for-sale securities	Foreign currency items	Total
Balance at June 30, 2015	$ (28.5)	$ (256.8)	$ (0.3)	$ (42.6)	$ (328.2)
Other comprehensive loss before reclassifications	(11.4)	—	—	(3.3)	(14.7)
Amounts reclassified from AOCI (b)	5.9	3.7	—	—	9.6
Net other comprehensive (loss) income	(5.5)	3.7	—	(3.3	