CARPENTER TECHNOLOGY CORP
Form 10-Q
January 31, 2019
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 December 31, 2018

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 (State or other jurisdiction of incorporation or organization)	23-0458500 (I.R.S. Employer Identification No.)
1735 Market Street, 15th Floor Philadelphia, Pennsylvania (Address of principal executive offices)	19103 (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 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, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth 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
		Emerging growth company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 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 January 25, 2019 was 47,380,199.

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

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

	December 31, 2018	June 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28.5	$56.2
Accounts receivable, net	339.6	378.5
Inventories	844.2	689.2
Other current assets	49.1	54.9
Total current assets	1,261.4	1,178.8
Property, plant and equipment, net	1,335.6	1,313.4
Goodwill	337.2	268.7
Other intangibles, net	60.0	63.3
Deferred income taxes	4.6	4.3
Other assets	163.0	178.5
Total assets	$ 3,161.8	$3,007.0
LIABILITIES		
Current liabilities:		
Short-term credit agreement borrowings	$ 100.6	$—
Accounts payable	266.4	214.7
Accrued liabilities	131.3	148.6
Total current liabilities	498.3	363.3
Long-term debt	547.7	545.7
Accrued pension liabilities	282.6	288.8
Accrued postretirement benefits	109.4	108.2
Deferred income taxes	155.2	161.6
Other liabilities	63.1	53.5
Total liabilities	1,656.3	1,521.1
Contingencies and commitments (see Note 10)		
STOCKHOLDERS' EQUITY		
Common stock — authorized 100,000,000 shares; issued 55,797,720 shares at December 31, 2018 and 55,712,229 shares at June 30, 2018; outstanding 47,380,199 shares at December 31, 2018 and 47,191,744 shares at June 30, 2018	279.0	278.6
Capital in excess of par value	315.0	310.0
Reinvested earnings	1,524.6	1,475.9
Common stock in treasury (8,417,521 shares and 8,520,485 shares at December 31, 2018 and June 30, 2018, respectively), at cost	(335.6)	(338.8)
Accumulated other comprehensive loss	(277.5)	(239.8)
Total stockholders' equity	1,505.5	1,485.9
Total liabilities and stockholders' equity	$ 3,161.8	$3,007.0

See accompanying notes to consolidated financial statements.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Net sales	$556.5	$487.8	$1,128.9	$967.5
Cost of sales	449.5	402.1	930.2	796.2
Gross profit	107.0	85.7	198.7	171.3
Selling, general and administrative expenses	51.6	44.3	98.3	87.7
Operating income	55.4	41.4	100.4	83.6
Interest expense	(7.0)	(7.3)	(13.2)	(14.5)
Other expense, net	(3.2)	(0.4)	(1.7)	(0.2)
Income before income taxes	45.2	33.7	85.5	68.9
Income tax expense (benefit)	9.7	(58.4)	18.5	(46.6)
Net income	$35.5	$92.1	$67.0	$115.5
EARNINGS PER COMMON SHARE:				
Basic	$0.73	$1.93	$1.39	$2.43
Diluted	$0.73	$1.92	$1.38	$2.41
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	47.7	47.2	47.7	47.1
Diluted	48.0	47.6	48.1	47.5
Cash dividends per common share	$0.20	$0.18	$0.40	$0.36

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 December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Net income	$35.5	$92.1	$67.0	$115.5
Other comprehensive (loss) income, net of tax				
Cumulative adjustment upon adoption of ASU 2017-12 reclassified to reinvested earnings	—	—	(1.0)	—
Pension and postretirement benefits, net of tax of $(0.5), $(0.8), $(1.1), and $(2.1), respectively	1.7	2.5	3.4	4.6
Net (loss) gain on derivative instruments, net of tax of $4.9, $(5.6), $13.6, and $(10.4), respectively	(15.4)	15.0	(38.4)	23.1
Marketable securities gain, net of tax of $0.0, $0.0, $0.0, $0.0, respectively	—	—	0.3	—
Foreign currency translation	(2.7)	(1.5)	(2.0)	0.3
Other comprehensive (loss) income	(16.4)	16.0	(37.7)	28.0
Comprehensive income	$19.1	$108.1	$29.3	$143.5

See accompanying notes to consolidated financial statements.

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

	Six Months Ended December 31, 2018	Six Months Ended December 31, 2017
OPERATING ACTIVITIES		
Net income	$67.0	$115.5
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	60.1	58.0
Deferred income taxes	4.9	(66.2)
Net pension expense	5.8	7.1
Share-based compensation expense	8.1	8.1
Net loss on disposals of property and equipment	0.1	0.4
Changes in working capital and other:		
Accounts receivable	39.4	(3.8)
Inventories	(150.9)	(81.5)
Other current assets	(8.0)	(17.6)
Accounts payable	52.8	11.8
Accrued liabilities	(28.0)	(6.2)
Pension plan contributions	(3.3)	(4.9)
Other postretirement plan contributions	(1.5)	(1.8)
Other, net	0.7	(1.6)
Net cash provided from operating activities	47.2	17.3
INVESTING ACTIVITIES		
Purchases of property, plant, equipment and software	(81.7)	(55.7)
Proceeds from disposals of property and equipment	0.1	—
Acquisition of business, net of cash acquired	(79.0)	—
Proceeds from sales of marketable securities	2.9	—
Net cash used for investing activities	(157.7)	(55.7)
FINANCING ACTIVITIES		
Credit agreement borrowings	122.2	—
Credit agreement repayments	(42.2)	—
Net change in short-term credit agreement borrowings	20.6	9.3
Dividends paid	(19.3)	(17.2)
Proceeds from stock options exercised	3.6	3.5
Withholding tax payments on share-based compensation awards	(4.3)	(0.6)
Net cash provided from (used for) financing activities	80.6	(5.0)
Effect of exchange rate changes on cash and cash equivalents	2.2	(2.2)
DECREASE IN CASH AND CASH EQUIVALENTS	(27.7)	(45.6)
Cash and cash equivalents at beginning of period	56.2	66.3
Cash and cash equivalents at end of period	$28.5	$20.7
SUPPLEMENTAL CASH FLOW INFORMATION:		
Non-cash investing activities:		
Acquisition of property, plant, equipment and software	$11.1	$5.8

See accompanying notes to consolidated financial statements.

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED DECEMBER 31, 2018 AND 2017
(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, 2018	$278.6	$ 310.0	$ 1,475.9	$ (338.8)	$ (239.8)	$ 1,485.9
Cumulative adjustment upon adoption of ASU 2017-12			1.0		(1.0)	—
Net income			67.0			67.0
Pension and postretirement benefits gain, net of tax					3.4	3.4
Marketable securities gain, net of tax					0.3	0.3
Net loss on derivative instruments, net of tax					(38.4)	(38.4)
Foreign currency translation					(2.0)	(2.0)
Cash Dividends:						
Common @ $0.40 per share			(19.3)			(19.3)
Share-based compensation plans		1.8		3.2		5.0
Stock options exercised	0.4	3.2				3.6
Balances at December 31, 2018	$279.0	$ 315.0	$ 1,524.6	$ (335.6)	$ (277.5)	$ 1,505.5

	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, 2017	$276.7	$ 284.8	$ 1,321.8	$ (341.6)	$ (343.1)	$ 1,198.6
Net income			115.5			115.5
Pension and postretirement benefits gain, net of tax					4.6	4.6
Net gain on derivative instruments, net of tax					23.1	23.1
Foreign currency translation					0.3	0.3
Cash Dividends:						0
Common @ $0.36 per share			(17.2)			(17.2)
Share-based compensation plans		6.7		1.7		8.4
Stock options exercised	0.6	2.9				3.5
Balances at December 31, 2017	$277.3	$ 294.4	$ 1,420.1	$ (339.9)	$ (315.1)	$ 1,336.8

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 accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America 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, 2018 consolidated balance sheet data was derived from audited financial statements, but does not include all of the disclosures required by accounting principles generally accepted in the United States of America. 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 fiscal year ended June 30, 2018 (the "2018 Form 10-K"). Operating results for the three and six months ended December 31, 2018 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.

During the six months ended December 31, 2018 the Company changed the presentation of net periodic pension cost and net periodic postretirement benefit cost in connection with the adoption of ASU 2017-07, Compensation - Retirement Benefits (Topic 715) - Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. Prior year amounts have been reclassified to conform to the three and six months ended December 31, 2018 presentation.

2. Recent Accounting Pronouncements

Recently Issued Accounting Pronouncements - Adopted in current period

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) which outlines a single comprehensive framework for all entities in all industries to apply in the determination of when to recognize revenue, and, therefore, supersedes virtually all existing revenue recognition requirements and guidance. This framework is expected to result in less complex guidance in application while providing a consistent and comparable methodology for revenue recognition. The standard provides a five-step model to be applied to all contracts with customers, with an underlying principle that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services.

The Company adopted ASU 2014-09 for all open contracts as of July 1, 2018 using the modified retrospective transition method. The adoption of the new standard did not have a material impact on the financial position of the Company, the results of its operations or its cash flows as of and for the three and six months ended December 31, 2018. There was no cumulative effect of adopting the standard at the date of initial application in reinvested earnings. The Company's revenue recognition accounting policy has been updated for the new guidance and the Company has expanded disclosure of revenues from contracts with customers.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory, which outlines updates to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. ASU 2016-16 is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted. The Company adopted the provisions of ASU 2016-16 in the first quarter of fiscal year 2019. The adoption of ASU 2016-16 did not materially impact the Company’s consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715) - Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The guidance changes how employers that sponsor defined benefit pension and other post-retirement benefit plans disaggregate the service cost components from other components of net periodic benefit costs in the income statement. This amendment requires that the service cost component be reported in net income as “cost of sales” or “selling, general and administrative expenses” in a manner consistent with the classification of direct labor and personnel costs of the eligible employees. Other components of net periodic benefit costs including interest costs, expected return on plan assets, amortization of net loss, amortization of prior service cost (benefits) (“pension earnings, interest and deferrals”) are classified as non-operating expense in “other expense, net” on the consolidated statements of income. The update specifies that only the service cost component is eligible for capitalization, which is consistent with the Company’s current practice. The Company adopted the provisions of ASU 2017-07 effective July 1, 2018 on a retrospective basis. For the three months ended December 31, 2017, $0.6 million has been reclassified from selling, general and administrative expenses to other expense, net on the consolidated statement of income. For the six months ended December 31, 2017, $1.1 million has been reclassified from selling, general and administrative expenses to other expense, net on the consolidated statement of income.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedge Activities, which amended and simplified the requirements of hedge accounting. ASU 2017-12 enables companies to more accurately present the economic effects of risk management activities in the financial statements. The guidance requires the presentation of all items that affect earnings to be recorded in the same income statement line as the hedged item and is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years with early adoption permitted. The Company adopted the provisions of ASU 2017-12 on July 1, 2018. Upon adoption, the Company reclassified $1.0 million of previously recorded hedge ineffectiveness from Reinvested Earnings to Accumulated Other Comprehensive Loss within the equity section of the balance sheet and provided expanded disclosures of derivative activity.

Recently Issued Accounting Pronouncements - Pending Adoption

In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842) with further clarifications and improvements included in ASU No. 2018-10, Codification Improvements to Topic 842, Leases and ASU 2018-11 Leases (Topic 842) Targeted Improvements, each issued in July 2018, all of which 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 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 adoption permitted. The Company is currently in the process of evaluating its existing lease portfolio, including accumulating all of the necessary information required to properly account for the leases under the new standard. Additionally, the Company selected a lease accounting software solution to support the new reporting requirements. The Company is evaluating the impact of the adoption of Topic 842 on the consolidated financial statements.