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<br>(State or other jurisdiction of incorporation or organization) | 23-0458500<br>(I.R.S. Employer Identification No.) |
| 1735 Market Street, 15th Floor<br>Philadelphia, Pennsylvania<br>(Address of principal executive offices) | 19103<br>(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 | 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.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows a reclassification from accumulated other comprehensive income to reinvested earnings for standard tax effects resulting from the Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018. ASU 2018-02 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 evaluating the impact of the adoption of ASU 2018-02 on the consolidated financial statements.

3. Revenue

The Company recognizes revenue in accordance with Topic 606, Revenue from Contracts. The Company applies the five-step model in the FASB's guidance, which requires the Company to: (i) identify the contract with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when, or as, the Company satisfies a performance obligation.

The Company recognizes revenue when performance obligations under the terms of a customer purchase order or contract are satisfied. This occurs when control of the goods and services have been transferred to the customer, which is generally determined when title, ownership, and risk of loss pass to the customer, all of which occurs upon shipment or delivery of the product or the service is performed. Consignment transactions are arrangements where the Company transfers product to a customer location but retains ownership and control of such product until it is used by the customer. Revenue for consignment arrangements is recognized upon usage by the customer. Service revenue is recognized as the services are performed.

The customer purchase order or contract for goods transferred has a single performance obligation for which revenue is recognized at a point in time. The standard terms and conditions of a customer purchase order include general rights of return and product warranty provisions related to nonconforming product. Depending on the circumstances, the product is either replaced or a quality adjustment is issued. Such warranties do not represent a separate performance obligation.

Each customer purchase order or contract sets forth the transaction price for the products and services purchased under that arrangement. Some customer arrangements include variable consideration, such as volume rebates, which generally depend upon the Company's customers meeting specified performance criteria, such as a purchasing level over a period of time. The Company exercises judgment to estimate the most likely amount of variable consideration at each reporting date.

Revenue is measured as the amount of consideration the Company expects to receive in exchange for its product. The normal payment terms are 30 days. The Company has elected to use the practical expedient that permits a Company to not adjust for the effects of a significant financing component if it expects that at the contract inception, the period between when the Company transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

Amounts billed to customers for shipping and handling activities to fulfill the Company's promise to transfer the goods are included in revenues and costs incurred by the Company for the delivery of goods are classified as cost of sales in the consolidated statements of income. Shipping terms may vary for products shipped outside the United States depending on the mode of transportation, the country where the material is shipped and any agreements made with the customers.

Contract liabilities are recognized when the Company has received consideration from a customer to transfer goods or services at a future point in time when the Company performs under the purchase order or contract. Contract liabilities were \$14.2 million and \$10.4 million at December 31, 2018 and June 30, 2018, respectively, and are included in accrued liabilities on the consolidated balance sheets.

The Company has elected to use the practical expedient that permits the omission of disclosure for remaining performance obligations which are expected to be satisfied within one year or less.

Disaggregation of Revenue

The Company operates in two business segments, Specialty Alloys Operations ("SAO") and Performance Engineered Products ("PEP"). Revenue is disaggregated within these two business segments by diversified end-use markets and also by geographical location. Comparative information of the Company's overall revenues by end-use markets and geography for the three months and six months ended December 31, 2018 and 2017 were as follows:

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

| End-Use Market Data | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| ($ in millions) | 2018 | 2017 | 2018 | 2017 |
| Aerospace and defense | $299.0 | $264.9 | $609.7 | $523.5 |
| Energy | 42.8 | 31.8 | 87.1 | 63.8 |
| Transportation | 37.8 | 35.8 | 78.1 | 72.5 |
| Medical | 45.5 | 42.8 | 92.5 | 81.0 |
| Industrial and consumer | 97.5 | 83.1 | 193.6 | 167.5 |
| Distribution | 33.9 | 29.4 | 67.9 | 59.2 |
| Consolidated net sales | $556.5 | $487.8 | $1,128.9 | $967.5 |

| Geographic Data | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| ($ in millions) | 2018 | 2017 | 2018 | 2017 |
| United States | $385.3 | $327.1 | $769.3 | $646.9 |
| Europe | 83.2 | 84.5 | 173.2 | 169.4 |
| Asia Pacific | 43.7 | 40.8 | 92.3 | 78.6 |
| Mexico | 20.4 | 11.4 | 42.7 | 23.3 |
| Canada | 14.9 | 14.0 | 32.6 | 30.1 |
| Other | 9.0 | 10.0 | 18.8 | 19.2 |
| Consolidated net sales | $556.5 | $487.8 | $1,128.9 | $967.5 |

4. Acquisitions

On October 22, 2018, the Company acquired all the outstanding shares of LPW Technology Ltd. (“LPW”), for a cash purchase price of $79.0 million, net of cash acquired. The acquisition combines LPW’s metal powder lifecycle management technology and processes with the Company's technical expertise in producing highly engineered metal powders and additively manufactured components. The preliminary purchase price allocation was as follows: $2.1 million of accounts receivable, $4.7 million of inventory, $0.4 million of other current assets, $11.8 million of property and equipment, $69.8 million of goodwill, $4.4 million of accounts payable, $2.9 million of current liabilities and $2.5 million of other liabilities. The preliminary purchase price allocation was estimated due to the timing of the acquisition. The final purchase price allocation may change in future reporting periods upon finalization of the valuation analysis, which the Company expects to complete in the fourth quarter of fiscal year 2019.

On February 21, 2018, the Company acquired all of the outstanding membership interests of MB CalRAM LLC (“CalRAM”), for a cash purchase price of $13.3 million. The acquisition provided the Company with immediate entry into the rapidly expanding part production segment of the additive manufacturing value chain. The purchase price allocation was completed in the fourth quarter of fiscal year 2018 and resulted in the purchase price being allocated to $0.2 million of working capital, $2.6 million of property and equipment, $5.2 million of identifiable intangible assets and $5.3 million of goodwill.

5. Earnings per Common Share

The Company calculates basic and diluted earnings per share using the two class method. Under the two class method, 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 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.

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

The calculations of basic and diluted earnings per common share for the three and six months ended December 31, 2018 and 2017 were as follows:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| (in millions, except per share data) | 2018 | 2017 | 2018 | 2017 |
| Net income | $35.5 | $92.1 | $67.0 | $115.5 |
| Less: earnings and dividends allocated to participating securities | (0.4 ) | (0.9 ) | (0.8 ) | (1.0 ) |
| Earnings available for common stockholders used in calculation of basic earnings per common share | $35.1 | $91.2 | $66.2 | $114.5 |
| Weighted average number of common shares outstanding, basic | 47.7 | 47.2 | 47.7 | 47.1 |
| Basic earnings per common share | $0.73 | $1.93 | $1.39 | $2.43 |
| Net income | $35.5 | $92.1 | $67.0 | $115.5 |
| Less: earnings and dividends allocated to participating securities | (0.4 ) | (0.9 ) | (0.8 ) | (1.0 ) |
| Earnings available for common stockholders used in calculation of diluted earnings per common share | $35.1 | $91.2 | $66.2 | $114.5 |
| Weighted average number of common shares outstanding, basic | 47.7 | 47.2 | 47.7 | 47.1 |
| Effect of shares issuable under share-based compensation plans | 0.3 | 0.4 | 0.4 | 0.4 |
| Weighted average number of common shares outstanding, diluted | 48.0 | 47.6 | 48.1 | 47.5 |
| Diluted earnings per common share | $0.73 | $1.92 | $1.38 | $2.41 |

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 December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| (in millions) | 2018 | 2017 | 2018 | 2017 |
| Stock options | 0.8 | 0.6 | 0.4 | 0.8 |

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## 6. Inventories

Inventories consisted of the following components as of December 31, 2018 and June 30, 2018:

| ($ in millions) | December 31, 2018 | June 30, 2018 |
|---|---|---|
| Raw materials and supplies | $ 177.3 | $ 157.5 |
| Work in process | 465.0 | 372.5 |
| Finished and purchased products | 201.9 | 159.2 |
| Total inventory | $ 844.2 | $ 689.2 |

Inventories are valued at the lower of cost or market. Cost for inventories is principally determined using the last-in, first-out (“LIFO”) inventory costing method. The Company also uses the first-in, first-out (“FIFO”) and average cost methods. As of December 31, 2018 and June 30, 2018, $181.3 million and $138.6 million of inventory, respectively, was accounted for using a method other than the LIFO inventory costing method.

## 7. Accrued Liabilities

Accrued liabilities consisted of the following as of December 31, 2018 and June 30, 2018:

| ($ in millions) | December 31, 2018 | June 30, 2018 |
|---|---|---|
| Accrued compensation and benefits | $ 51.1 | $ 83.3 |
| Accrued postretirement benefits | 15.4 | 15.4 |
| Deferred revenue | 14.2 | 10.4 |
| Derivative financial instruments | 12.7 | — |
| Accrued interest expense | 10.4 | 10.4 |
| Accrued pension liabilities | 3.3 | 3.3 |
| Accrued income taxes | 1.9 | 1.4 |
| Other | 22.3 | 24.4 |
| Total accrued liabilities | $ 131.3 | $ 148.6 |

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8. 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 and six months ended December 31, 2018 and 2017 were as follows:

| Three months ended December 31, | Pension Plans | | Other Postretirement Plans | |
|---|---|---|---|---|
| ($ in millions) | 2018 | 2017 | 2018 | 2017 |
| Service cost | $ 2.3 | $ 2.4 | $ 0.6 | $ 0.7 |
| Interest cost | 13.2 | 13.0 | 2.5 | 2.4 |
| Expected return on plan assets | (16.2) | (16.5) | (1.7 ) | (1.7 ) |
| Amortization of net loss | 2.6 | 3.4 | 0.4 | 0.7 |
| Amortization of prior service cost (benefit) | 0.5 | 0.5 | (1.3 ) | (1.3 ) |
| Net periodic benefit costs | $ 2.4 | $ 2.8 | $ 0.5 | $ 0.8 |

| Six months ended December 31, | Pension Plans | | Other Postretirement Plans | |
|---|---|---|---|---|
| ($ in millions) | 2018 | 2017 | 2018 | 2017 |
| Service cost | $ 4.6 | $ 4.7 | $ 1.2 | $ 1.3 |
| Interest cost | 26.4 | 26.1 | 5.1 | 4.8 |
| Expected return on plan assets | (32.4) | (33.0) | (3.5 ) | (3.5 ) |
| Amortization of net loss | 5.2 | 6.8 | 0.8 | 1.5 |
| Amortization of prior service cost (benefit) | 1.0 | 1.0 | (2.6 ) | (2.6 ) |
| Net periodic benefit costs | $ 4.8 | $ 5.6 | $ 1.0 | $ 1.5 |

During the six months ended December 31, 2018 and 2017, the Company made $3.3 million and $4.9 million, respectively, of contributions to its qualified defined benefit pension plans. The Company currently expects to contribute $2.4 million to its qualified defined benefit pension plans during the remainder of fiscal year 2019.

9. Debt

The Company maintains a $400.0 million unsecured revolving credit facility ("Credit Agreement") that extends to March 2022. Interest on the borrowings under the Credit Agreement accrue at variable rates, based upon LIBOR or a defined "Base Rate," both are 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 1.00% to 1.75% (1.50% as of December 31, 2018), and for Base Rate-determined loans, from 0.00% to 0.75% (0.50% as of December 31, 2018). The Company also pays a quarterly commitment fee ranging from 0.125% to 0.400% (0.275% as of December 31, 2018), determined based upon the Debt Rating, of the unused portion of the $400.0 million commitment under the Credit Agreement. In addition, the Company must pay certain letter of credit fees, ranging from 1.00% to 1.75% (1.50% as of December 31, 2018), 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 December 31, 2018, the Company had $6.0 million of issued letters of credit and $100.6 million of short-term borrowings under the Credit Agreement with the balance of $293.4 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 December 31, 2018 and June 30, 2018, the Company was in compliance with all of the covenants of the Credit Agreement.

Long-term debt outstanding as of December 31, 2018 and June 30, 2018 consisted of the following:

| ($ in millions) | December 31, 2018 | June 30, 2018 |
|---|---|---|
| Senior unsecured notes, 5.20% due July 2021 (face value of $250.0 million at December 31, 2018 and June 30, 2018) | $ 248.5 | $ 246.6 |
| Senior unsecured notes, 4.45% due March 2023 (face value of $300.0 million at December 31, 2018 and June 30, 2018) | 299.2 | 299.1 |
| Total | 547.7 | 545.7 |
| Less: amounts due within one year | — | — |
| Long-term debt | $ 547.7 | $ 545.7 |

For the three months ended December 31, 2018 and 2017, interest costs totaled $7.9 million and $7.9 million, respectively, of which $0.9 million and $0.6 million, respectively, were capitalized as part of the cost of property, equipment and software. For the six months ended December 31, 2018 and 2017, interest costs totaled $15.1 million and $15.6 million, respectively, of which $1.9 million and $1.1 million, respectively, were capitalized as part of the cost of property, equipment and software.

## 10. 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 six months ended December 31, 2018, 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 December 31, 2018 and June 30, 2018 were $15.9 million and $16.1 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 PRPs 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.

Estimates of the amount and timing of future costs of environmental remediation requirements are inherently imprecise because of the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown remediation sites and the allocation of costs among the PRPs. Based upon information currently available, such future costs are not expected to have a material effect on the Company's financial position, results of operations or cash flows over the long-term. However, such costs could be material to the Company's financial position, results of operations or cash flows in a particular future quarter or year.

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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.

11. 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.

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:

| December 31, 2018 | Fair Value Measurements Using Input Type | |
|---|---|---|
| ($ in millions) | Level 2 | |
| Assets: | | |
| Derivative financial instruments | $ | 2.8 |
| | | |
| Liabilities: | | |
| Derivative financial instruments | $ | 22.4 |

| June 30, 2018 | Fair Value Measurements Using Input Type |
|---|---|
| ($ in millions) | Level 2 |

| | | |
|---|---|---|
| Assets: | | |
| Marketable securities: | | |
| Municipal auction rate securities | $ | 2.9 |
| Derivative financial instruments | 35.2 | |
| Total assets | $ | 38.1 |
| | | |
| Liabilities: | | |
| Derivative financial instruments | $ | 3.4 |

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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 commodity prices, foreign exchange rates 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 12.

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:

| | December 31, 2018 | | June 30, 2018 | |
|---|---|---|---|---|
| ($ in millions) | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Long-term debt | $547.7 | $547.4 | $545.7 | $558.3 |
| Company-owned life insurance | $15.6 | $15.6 | $16.4 | $16.4 |

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 December 31, 2018 and June 30, 2018 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.

12. 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 summary of 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 (loss) income ("AOCI") 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 December 31, 2018, the Company had forward contracts to purchase 22.2 million pounds of certain raw materials with settlement dates through December 2023.

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 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 December 31, 2018 and 2017, 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. For the six months ended December 31, 2018 and 2017, net gains of $0.2 million and $0.2 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 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 December 31, 2018 and June 30, 2018, 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 income. As of December 31, 2018 and June 30, 2018, the total notional amount of floating interest rate contracts was $150.0 million for both periods. For the three months ended December 31, 2018 and 2017, net losses of $0.1 million were recorded as an increase to interest expense and net gains of $0.2 million were recorded as a reduction to interest expense, respectively. For the six months ended December 31, 2018 and 2017, net losses of $0.3 million were recorded as an increase to interest expense and net gains of $0.4 million were recorded as a reduction to interest expense, respectively.

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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 December 31, 2018 and June 30, 2018:

| December 31, 2018<br>($ in millions) | Interest Rate Swaps | Foreign Currency Contracts | Commodity Contracts | Total Derivatives |
|---|---|---|---|---|
| Asset Derivatives: | | | | |
| Derivatives designated as hedging instruments: | | | | |
| Other current assets | $ — | $ 1.2 | $ 0.5 | $ 1.7 |
| Other assets | — | — | 1.1 | 1.1 |
| Total asset derivatives | $ — | $ 1.2 | $ 1.6 | $ 2.8 |
| Liability Derivatives: | | | | |
| Derivatives designated as hedging instruments: | | | | |
| Accrued liabilities | $ 0.2 | $ — | $ 12.5 | $ 12.7 |
| Other liabilities | 1.1 | 0.1 | 8.5 | 9.7 |
| Total liability derivatives | $ 1.3 | $ 0.1 | $ 21.0 | $ 22.4 |

| June 30, 2018<br>($ in millions) | Interest Rate Swaps | Foreign Currency Contracts | Commodity Contracts | Total Derivatives |
|---|---|---|---|---|
| Asset Derivatives: | | | | |
| Derivatives designated as hedging instruments: | | | | |
| Other current assets | $ 0.1 | $ 0.4 | $ 15.3 | $ 15.8 |
| Other assets | — | — | 19.4 | 19.4 |
| Total asset derivatives | $ 0.1 | $ 0.4 | $ 34.7 | $ 35.2 |
| Liability Derivatives: | | | | |
| Derivatives designated as hedging instruments: | | | | |
| Accrued liabilities | $ — | $ 0.1 | $ — | $ 0.1 |
| Other liabilities | 2.9 | — | 0.4 | 3.3 |
| Total liability derivatives | $ 2.9 | $ 0.1 | $ 0.4 | $ 3.4 |

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 $7.2 million and total liability derivatives would have been $26.8 million as of December 31, 2018.

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 December 31, 2018 and June 30, 2018, 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 and Fair Value Hedges

For derivative instruments that are designated and qualify as cash flow hedges, 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 (losses) gains related to cash flow hedges recognized during the three and six months ended December 31, 2018 and 2017:

| | Amount of (Loss) Gain Recognized in AOCI on Derivatives | | | |
|---|---|---|---|---|
| | Three Months Ended December 31, | | Six Months Ended December 31, | |
| ($ in millions) | 2018 | 2017 | 2018 | 2017 |
| Derivatives in Cash Flow Hedging Relationship: | | | | |
| Commodity contracts | $(20.0) | $20.7 | $(53.6) | $30.3 |
| Foreign exchange contracts | 0.4 | (0.3) | 0.6 | (0.7) |
| Total | $(19.6) | $20.4 | $(53.0) | $29.6 |

| ($ in millions) | Location of Gain (Loss) Reclassified from AOCI into Income | Amount of Gain (Loss) Reclassified from AOCI into Income Three Months Ended December 31, | |
|---|---|---|---|
| | | 2018 | 2017 |
| Derivatives in Cash Flow Hedging Relationship: | | | |
| Commodity contracts | Cost of sales | $ 0.2 | $ (0.2) |
| Foreign exchange contracts | Net sales | 0.3 | (0.1) |
| Forward interest rate swaps | Interest expense | 0.1 | 0.1 |
| Total | | $ 0.6 | $ (0.2) |

| ($ in millions) | Location of (Loss) Gain Reclassified from AOCI into Income | Amount of (Loss) Gain Reclassified from AOCI into Income Six Months Ended December 31, | |
|---|---|---|---|
| | | 2018 | 2017 |
| Derivatives in Cash Flow Hedging Relationship: | | | |
| Commodity contracts | Cost of sales | $ (1.8) | $ (2.8) |
| Foreign exchange contracts | Net sales | 0.6 | (0.5) |
| Forward interest rate swaps | Interest expense | 0.2 | 0.2 |
| Total | | $ (1.0) | $ (3.1) |

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The following is a summary of total amounts presented in the consolidated statements of income in which the effects of cash flow and fair value hedges are recorded during the three and six months ended December 31, 2018 and 2017:

| ($ in millions) | Three Months Ended December 31, 2018 | | | Three Months Ended December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Net Sales | Cost of Sales | Interest Expense | Net Sales | Cost of Sales | Interest Expense |
| Total amounts presented in the consolidated statements of income in which the effects of cash flow and fair value hedges are recorded | $556.5 | $449.5 | $ 7.0 | $487.8 | $402.1 | $ 7.3 |
| Gain (loss) on Derivatives in Cash Flow Hedging Relationship: | | | | | | |
| Commodity contracts | | | | | | |
| Amount of gain (loss) reclassified from AOCI to income | $— | $0.2 | $ — | $— | $(0.2 ) | $ — |
| Foreign currency forward contracts | | | | | | |
| Amount of gain (loss) reclassified from AOCI to income | 0.3 | — | — | (0.1 ) | — | — |
| Interest rate swap agreements | | | | | | |
| Amount of gain reclassified from AOCI to income | — | — | 0.1 | — | — | 0.1 |
| Gain (loss) on Derivatives in Fair Value Hedging Relationship: | | | | | | |
| Interest rate swap agreements | | | | | | |
| Hedged Item | — | — | 0.1 | — | — | (0.2 ) |
| Derivatives designated as hedging instruments | — | — | (0.1 ) | — | — | 0.2 |
| Total gain (loss) | $0.3 | $0.2 | $ 0.1 | $(0.1 ) | $(0.2 ) | $ 0.1 |

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| ($ in millions) | Six Months Ended December 31, 2018 Net Sales | Cost of Sales | Interest Expense | Six Months Ended December 31, 2017 Net Sales | Cost of Sales | Interest Expense |
|---|---|---|---|---|---|---|
| Total amounts presented in the consolidated statements of income in which the effects of cash flow and fair value hedges are recorded | $1,128.9 | $930.2 | $ 13.2 | $967.5 | $796.2 | $ 14.5 |
| Gain (loss) on Derivatives in Cash Flow Hedging Relationship: | | | | | | |
| Commodity contracts | | | | | | |
| Amount of loss reclassified from AOCI to income | $— | $(1.8) | $ — | $— | $(2.8) | $ — |
| Foreign currency forward contracts | | | | | | |
| Amount of gain (loss) reclassified from AOCI to income | 0.6 | — | — | (0.5) | — | — |
| Interest rate swap agreements | | | | | | |
| Amount of gain reclassified from AOCI to income | — | — | 0.2 | — | — | 0.2 |
| Gain (loss) on Derivatives in Fair Value Hedging Relationship: | | | | | | |
| Interest rate swap agreements | | | | | | |
| Hedged Item | — | — | 0.3 | — | — | (0.4) |
| Derivatives designated as hedging instruments | — | — | (0.3) | — | — | 0.4 |
| Total gain (loss) | $0.6 | $(1.8) | $ 0.2 | $(0.5) | $(2.8) | $ 0.2 |

The Company estimates that $10.3 million of net derivative gains included in AOCI as of December 31, 2018 will be reclassified into income within the next 12 months. No significant cash flow hedges were discontinued during the three and six months ended December 31, 2018.

As of December 31, 2018, and June 30, 2018, the following amounts were recorded on the consolidated balance sheets related to cumulative basis adjustments for fair value hedges of interest rate risk:

| ($ in millions) | Carrying amount of the hedged liabilities December 31, 2018 | June 30, 2018 | Cumulative amount of fair value gain in the carrying amount of the hedged liabilities December 31, 2018 | June 30, 2018 |
|---|---|---|---|---|
| Line item in the consolidated balance sheets in which the hedged item is included: | | | | |
| Long-Term Debt | $148.9 | $147.1 | $(1.1) | $(2.9) |

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13. Other Expense, Net

Other expense, net consisted of the following:

| ($ in millions) | Three Months Ended December 31, 2018 | Three Months Ended December 31, 2017 | Six Months Ended December 31, 2018 | Six Months Ended December 31, 2017 |
|---|---|---|---|---|
| Unrealized (losses) gains on company-owned life insurance contracts and investments held in rabbi trusts | $(2.9) | $0.9 | $(1.9) | $1.4 |
| Foreign exchange (loss) gain | (0.3) | (0.9) | 0.1 | (0.8) |
| Pension earnings, interest and deferrals | — | (0.6) | — | (1.1) |
| Other | — | 0.2 | 0.1 | 0.3 |
| Total other expense, net | $(3.2) | $(0.4) | $(1.7) | $(0.2) |

14. 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. The annual effective tax rate is based upon a number of significant estimates and judgments, including the estimated annual pre-tax income of the Company in each tax jurisdiction in which it operates, and the development of tax planning strategies during the year. In addition, the Company’s tax expense can be impacted by changes in tax rates or laws, the finalization of tax audits, and other factors that cannot be predicted with certainty. As such there can be significant volatility in interim tax provisions.

Income tax expense for the three months ended December 31, 2018 was $9.7 million, or 21.5 percent of pre-tax income as compared with a benefit of $58.4 million, or negative 173.3 percent of pre-tax income for the three months ended December 31, 2017. Income tax expense in the six months ended December 31, 2018 was $18.5 million, or 21.6 percent of pre-tax income as compared with a benefit of $46.6 million, or negative 67.6 percent of pre-tax income in the six months ended December 31, 2017.

Income tax expense in the three and six months ended December 31, 2018 includes tax benefits of $1.8 million as a result of changes in the Company’s prior year tax positions. Income tax expense in the three and six months ended December 31, 2017 included a net tax benefit of $66.0 million which reflects a $73.3 million tax benefit related to the re-measurement of deferred tax assets and liabilities at the reduced federal tax rate, and a charge of $5.1 million for the transition tax. Tax expense in the prior period also included a charge of $2.2 million associated with a state law change that will limit our ability to utilize certain state net operating loss carryforwards.

An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (the “Act”) was enacted on December 22, 2017. The Act included provisions that reduced the federal corporate income tax rate, created a territorial tax system with a one-time mandatory tax on previously deferred foreign earnings (i.e. transition tax), and changed certain business deductions including allowing for immediate expensing of certain qualified capital expenditures and limitations on deductions of interest expense. The permanent reduction to the U.S. federal corporate income tax rate from 35 percent to 21 percent was effective January 1, 2018. Based on the Company's interpretation of the Act, during fiscal year 2018, the Company recorded a provisional tax charge of $5.0 million for the transition tax and a provisional tax benefit of $74.6 million for the re-measurement of deferred tax assets and liabilities. The accounting for the income tax effects of the Act was completed during the three months ended December 31, 2018. A discrete tax benefit of $0.2 million was recorded for the transition tax offset by a discrete tax charge of $0.2 million for the re-measurement of deferred tax assets and liabilities in the three months ended December 31, 2018. Under the Act, the transition tax will be paid over an eight year period beginning in fiscal year 2019.

As of June 30, 2018 the Company had $100.6 million of indefinitely reinvested foreign earnings on which it recognized $4.7 million of U.S. income tax due to the one-time repatriation tax. If these earnings were to be repatriated, no significant non-U.S. Federal tax would be incurred.

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The Act also established new tax provisions that become effective in fiscal year 2019, including but not limited to eliminating the corporate alternative minimum tax, creating the base erosion anti-abuse tax (“BEAT”), establishing new limitations on deductible interest expense and certain executive compensation, creating a new provision designed to tax global intangible low-tax income (“GILTI”) and generally eliminating U.S. Federal income taxes on dividends from foreign subsidiaries. The Company does not anticipate being subject to the BEAT provision due to the revenue thresholds. An accounting policy election must be made to either treat taxes due on future GILTI inclusions in U.S. taxable income as a current period expense when incurred or reflect such portion of the future GILTI inclusions in U.S. taxable income that relate to existing basis differences in the Company’s current measurement of deferred taxes. The Company has treated the GILTI inclusion in U.S. taxable income as a current period expense in its annual effective tax rate for fiscal year 2019.

15. Business Segments

The Company has two reportable segments, SAO and 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, Pennsylvania and surrounding areas as well as 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 CalRAM business, the LPW 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 includes executive and director compensation and other corporate facilities and administrative expenses not allocated to the segments.

On a consolidated basis, one customer, Arconic, Inc., accounted for approximately 10 percent of net sales for each of the three months ended December 31, 2018 and 2017. On a consolidated basis, one customer, Arconic, Inc., accounted for approximately 10 percent of net sales for each of the six months ended December 31, 2018 and 2017. Approximately 13 percent of the accounts receivable outstanding at December 31, 2018 is due from one customer, Arconic Inc. No single customer accounted for 10 percent or more of the accounts receivable outstanding at June 30, 2018.

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| ($ in millions) | 2018 | 2017 | 2018 | 2017 |
| Net Sales: | | | | |
| Specialty Alloys Operations | $461.6 | $406.3 | $937.1 | $803.1 |
| Performance Engineered Products | 112.9 | 104.8 | 224.6 | 205.5 |
| Intersegment | (18.0) | (23.3) | (32.8) | (41.1) |
| Consolidated net sales | $556.5 | $487.8 | $1,128.9 | $967.5 |

| ($ in millions) | Three Months Ended December 31, 2018 | 2017 | Six Months Ended December 31, 2018 | 2017 |
|---|---|---|---|---|
| Operating Income: | | | | |
| Specialty Alloys Operations | $69.0 | $49.8 | $121.7 | $100.3 |
| Performance Engineered Products | 4.4 | 7.5 | 11.7 | 12.8 |
| Corporate | (18.4 ) | (13.9 ) | (34.2 ) | (26.9 ) |
| Intersegment | 0.4 | (2.0 ) | 1.2 | (2.6 ) |
| Consolidated operating income | $55.4 | $41.4 | $100.4 | $83.6 |

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| ($ in millions) | Three Months Ended December 31, 2018 | Three Months Ended December 31, 2017 | Six Months Ended December 31, 2018 | Six Months Ended December 31, 2017 |
|---|---|---|---|---|
| Depreciation and Amortization: | | | | |
| Specialty Alloys Operations | $23.8 | $23.4 | $47.5 | $46.5 |
| Performance Engineered Products | 5.5 | 5.1 | 10.5 | 10.1 |
| Corporate | 1.2 | 0.9 | 2.4 | 1.8 |
| Intersegment | (0.2) | (0.2) | (0.3) | (0.4) |
| Consolidated depreciation and amortization | $30.3 | $29.2 | $60.1 | $58.0 |

| ($ in millions) | Three Months Ended December 31, 2018 | Three Months Ended December 31, 2017 | Six Months Ended December 31, 2018 | Six Months Ended December 31, 2017 |
|---|---|---|---|---|
| Capital Expenditures: | | | | |
| Specialty Alloys Operations | $20.8 | $11.2 | $41.4 | $28.4 |
| Performance Engineered Products | 13.3 | 6.3 | 26.9 | 11.1 |
| Corporate | 6.5 | 9.6 | 14.2 | 16.7 |
| Intersegment | (0.5) | (0.3) | (0.8) | (0.5) |
| Consolidated capital expenditures | $40.1 | $26.8 | $81.7 | $55.7 |

| ($ in millions) | December 31, 2018 | June 30, 2018 |
|---|---|---|
| Total Assets: | | |
| Specialty Alloys Operations | $ 2,341.9 | $2,312.1 |
| Performance Engineered Products | 657.3 | 513.6 |
| Corporate | 173.6 | 193.2 |
| Intersegment | (11.0) | (11.9) |
| Consolidated total assets | $ 3,161.8 | $3,007.0 |

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16. Reclassifications from Accumulated Other Comprehensive (Loss) Income (AOCI)

The changes in AOCI by component, net of tax, for the three months ended December 31, 2018 and 2017 were as follows:

| Three Months Ended December 31, 2018 ($ in millions) (a) | Cash flow hedging items | Pension and other postretirement benefit plan items | Unrealized (losses) gains on available-for-sale securities | Foreign currency items | Total |
|---|---|---|---|---|---|
| Balance at September 30, 2018 | $ (0.2) | $ (218.7) | $ — | $ (42.2) | $ (261.1) |
| Other comprehensive loss before reclassifications | (14.9) | — | — | (2.7) | (17.6) |
| Amounts reclassified from AOCI (b) | (0.5) | 1.7 | — | — | 1.2 |
| Net other comprehensive (loss) income | (15.4) | 1.7 | — | (2.7) | (16.4) |
| Balance at December 31, 2018 | $ (15.6) | $ (217.0) | $ — | $ (44.9) | $ (277.5) |

| Three Months Ended December 31, 2017 ($ 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 September 30, 2017 | $ 5.8 | $ (296.9) | $ (0.3) | $ (39.7) | $ (331.1) |
| Other comprehensive income (loss) before reclassifications | 14.9 | — | — | (1.5) | 13.4 |
| Amounts reclassified from AOCI (b) | 0.1 | 2.5 | — | — | 2.6 |
| Net other comprehensive income (loss) | 15.0 | 2.5 | — | (1.5) | 16.0 |
| Balance at December 31, 2017 | $ 20.8 | $ (294.4) | $ (0.3) | $ (41.2) | $ (315.1) |

(a) All amounts are net of tax. Amounts in parentheses indicate debits.
(b) See separate table below for further details.

The changes in AOCI by component, net of tax, for the six months ended December 31, 2018 and 2017 were as follows:

| Six Months Ended December 31, 2018 ($ in millions) (a) | Cash flow hedging items | Pension and other postretirement benefit plan items | Unrealized (losses) gains on available-for-sale securities | Foreign currency items | Total |
|---|---|---|---|---|---|