ESTERLINE TECHNOLOGIES CORP
Form 10-Q
March 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended January 31, 2014.

Or

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

For the transition period from _________ to _________

Commission file number 1-6357

ESTERLINE TECHNOLOGIES CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(Address of principal executive offices)(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

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

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

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

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

As of March 3, 2014, 31,812,639 shares of the issuer s common stock were outstanding.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED BALANCE SHEET

As of January 31, 2014 and October 25, 2013

(In thousands, except share amounts)

ASSETS	January 31, 2014 (Unaudited)	October 25, 2013
Current Assets		
Cash and cash equivalents	$ 208,438	$ 179,178
Cash in escrow	4,018	4,018
Accounts receivable, net of allowances of $9,931 and $9,215	328,016	383,666
Inventories		
Raw materials and purchased parts	172,653	165,231
Work in process	196,857	182,882
Finished goods	105,146	99,550
	474,656	447,663
Income tax refundable	5,878	6,526
Deferred income tax benefits	46,482	47,277
Prepaid expenses	24,850	18,183
Other current assets	4,013	5,204
Total Current Assets	1,096,351	1,091,715
Property, Plant and Equipment	767,127	767,861
Accumulated depreciation	400,673	396,664
	366,454	371,197
Other Non-Current Assets		
Goodwill	1,130,754	1,128,977
Intangibles, net	581,179	580,949
Debt issuance costs, net of accumulated amortization of $4,785 and $4,359	5,785	6,211
Deferred income tax benefits	71,173	71,840

Other assets		18,639		11,223
	$	3,270,335	$	3,262,112

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED BALANCE SHEET

As of January 31, 2014 and October 25, 2013

(In thousands, except share amounts)

LIABILITIES AND SHAREHOLDERS EQUITY	January 31, 2014 (Unaudited)	October 25, 2013
Current Liabilities		
Accounts payable	$ 116,052	$ 123,597
Accrued liabilities	238,918	253,561
Current maturities of long-term debt	21,044	21,279
Deferred income tax liabilities	2,609	2,307
Federal and foreign income taxes	4,926	7,348
Total Current Liabilities	383,549	408,092
Long-Term Liabilities		
Credit facilities	155,000	130,000
Long-term debt, net of current maturities	530,245	537,859
Deferred income tax liabilities	187,063	193,119
Pension and post-retirement obligations	64,229	68,102
Other liabilities	55,005	40,188
Shareholders Equity		
Common stock, par value $.20 per share, authorized 60,000,000 shares, issued and outstanding 31,777,632 and 31,441,949	6,356	6,288
Additional paid-in capital	626,143	604,511
Retained earnings	1,315,168	1,285,090
Accumulated other comprehensive loss	(62,800)	(22,284)
Total Esterline shareholders equity	1,884,867	1,873,605
Noncontrolling interests	10,377	11,147
Total Shareholders Equity	1,895,244	1,884,752
	$ 3,270,335	$ 3,262,112

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS AND

COMPREHENSIVE INCOME (LOSS)

For the Three Month Periods Ended January 31, 2014 and January 25, 2013

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended January 31, 2014	Three Months Ended January 25, 2013
Net Sales	$ 504,980	$ 457,962
Cost of Sales	331,685	297,617
	173,295	160,345
Expenses		
Selling, general & administrative	96,206	98,611
Research, development & engineering	26,506	23,076
Restructuring charges	4,796	0
Total Expenses	127,508	121,687
Operating Earnings	45,787	38,658
Interest Income	(120)	(101)
Interest Expense	8,630	10,444
Earnings Before Income Taxes	37,277	28,315
Income Tax Expense	7,113	2,394
Earnings Including Noncontrolling Interests	30,164	25,921
Earnings Attributable to Noncontrolling Interests	(86)	(810)
Net Earnings Attributable to Esterline	$ 30,078	$ 25,111
Earnings Per Share Attributable to Esterline:		
Basic Earnings Per Share	$ .95	$ .81
Diluted Earnings Per Share	.93	.80

Comprehensive Income (Loss)	$	(10,438)	$	36,891

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Three Month Periods Ended January 31, 2014 and January 25, 2013

(Unaudited)

(In thousands)

	Three Months Ended	
	January 31, 2014	January 25, 2013
Cash Flows Provided (Used) by Operating Activities		
Net earnings including noncontrolling interests	$ 30,164	$ 25,921
Adjustments to reconcile net earnings including noncontrolling interests to net cash provided (used) by operating activities:		
Depreciation and amortization	29,639	27,971
Deferred income taxes	(1,445)	(3,516)
Share-based compensation	3,583	3,743
Working capital changes, net of effect of acquisitions:		
Accounts receivable	56,012	54,172
Inventories	(25,033)	(8,743)
Prepaid expenses	(6,334)	(5,771)
Other current assets	515	(1,658)
Accounts payable	(11,443)	(6,683)
Accrued liabilities	(15,640)	(9,783)
Federal and foreign income taxes	(3,531)	161
Other liabilities	(143)	9,486
Other, net	(6,421)	1,296
	49,923	86,596
Cash Flows Provided (Used) by Investing Activities		
Purchases of capital assets	(11,533)	(12,253)
Acquisition of business, net of cash acquired	(44,599)	0
	(56,132)	(12,253)
Cash Flows Provided (Used) by Financing Activities		
Proceeds provided by stock issuance under employee stock plans	14,677	3,671
Excess tax benefits from stock option exercises	3,440	335
Repayment of long-term credit facilities	0	(15,000)
Repayment of long-term debt	(3,847)	(21,609)
Proceeds from issuance of long-term credit facilities	25,000	82

Proceeds from government assistance		0		650
Dividends paid to noncontrolling interests		(702)		(514)
		38,568		(32,385)
Effect of Foreign Exchange Rates on Cash and Cash Equivalents		(3,099)		143
Net Increase in Cash and Cash Equivalents		29,260		42,101
Cash and Cash Equivalents Beginning of Period		179,178		160,675
Cash and Cash Equivalents End of Period	$	208,438	$	202,776
Supplemental Cash Flow Information				
Cash paid for interest	$	11,893	$	2,830
Cash paid for taxes		14,082		5,083

ESTERLINE TECHNOLOGIES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Three Month Periods Ended January 31, 2014 and January 25, 2013

1. The consolidated balance sheet as of January 31, 2014, the consolidated statement of operations and comprehensive income (loss) for the three month periods ended January 31, 2014, and January 25, 2013, and the consolidated statement of cash flows for the three month periods ended January 31, 2014, and January 25, 2013, are unaudited but, in the opinion of management, all of the necessary adjustments, consisting of normal recurring accruals, have been made to present fairly the financial statements referred to above in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the above statements do not include all of the footnotes required for complete financial statements. The results of operations and cash flows for the interim periods presented are not necessarily indicative of results that can be expected for the full year.

2. The notes to the consolidated financial statements in the Company s Annual Report on Form 10-K for the fiscal year ended October 25, 2013, provide a summary of significant accounting policies and additional financial information that should be read in conjunction with this Form 10-Q.

3. The timing of the Company s revenues is impacted by the purchasing patterns of customers and, as a result, revenues are not generated evenly throughout the year. Moreover, the Company s first fiscal quarter, November through January, includes significant holiday periods in both Europe and North America. The first fiscal quarter of 2014 was 14 weeks, while the first fiscal quarter of 2013 was 13 weeks.

4. Basic earnings per share is computed on the basis of the weighted average number of shares outstanding during the year. Diluted earnings per share includes the dilutive effect of stock options and restricted stock units. Common shares issuable from employee stock plans that are excluded from the calculation of diluted earnings per share because they were anti-dilutive were 194,900 and 672,825 in the first fiscal quarter of 2014 and 2013, respectively. Shares used for calculating earnings per share are disclosed in the following table.

(In thousands)	Three Months Ended	
	January 31, 2014	January 25, 2013
Shares Used for Basic Earnings Per Share	31,608	30,904
Shares Used for Diluted Earnings Per Share	32,230	31,423

5. The Company s comprehensive income (loss) is as follows:

(In thousands)	Three Months Ended

	January 31, 2014	January 25, 2013
Net Earnings	$ 30,078	$ 25,111
Change in Fair Value of Derivative Financial Instruments, Net of Tax [1]	(8,923)	(46)
Change in Pension and Post-Retirement Obligations, Net of Tax [2]	1,892	(151)
Foreign Currency Translation Adjustment	(33,485)	11,977
Comprehensive Income (Loss)	$ (10,438)	$ 36,891

[1] Net of tax benefit (expense) of $3,345 and $(224) for the first fiscal quarter of 2014 and 2013, respectively.

[2] Net of tax benefit (expense) of $(801) and $55 for the first fiscal quarter of 2014 and 2013, respectively.

The Company s accumulated other comprehensive loss is comprised of the following:

(In thousands)	January 31, 2014	October 25, 2013
Net unrealized loss on derivative contracts	$ (10,419)	$ (1,496)
Pension and post-retirement obligations	(54,293)	(56,185)
Currency translation adjustment	1,912	35,397
Total accumulated other comprehensive loss	$ (62,800)	$ (22,284)

6. On December 20, 2013, the Company acquired Sunbank Family of Companies, LLC (Sunbank) for approximately $45 million, $25 million of which was from the Company s credit facility, and excluding up to $5 million in additional contingent consideration based upon achievement of certain sales levels over a two-year period. Sunbank is a manufacturer of electrical cable accessories, connectors and flexible conduit systems. Sunbank is included in the Sensors & Systems segment.

On February 4, 2013, the Company acquired the Gamesman Group (Gamesman) for $40.8 million. Gamesman is a global supplier of input devices principally serving the gaming industry. Gamesman is included in the Avionics & Controls segment.

7. The income tax rate was 19.1% in the first fiscal quarter of 2014 compared with 8.5% in the prior-year period. In the first fiscal quarter of 2014, the Company recognized approximately $0.5 million of discrete tax benefits principally related to the release of reserves due to the expiration of a statute of limitations. In the first fiscal quarter of 2013, the Company recognized $3.7 million of discrete tax benefits related to the following items. The first item was approximately $1.5 million of tax benefits due to the retroactive extension of the U.S. federal research and experimentation credits. The second item was approximately $2.2 million of tax benefits related to the settlement of U.S. and foreign tax examinations. The income tax rate differed from the statutory rate in the first fiscal quarter of 2014 and 2013, as both years benefited from various tax credits and certain foreign interest expense deductions.

It is reasonably possible that within the next twelve months approximately $1.6 million of tax benefits that are currently unrecognized could be recognized as a result of settlement of examinations and/or the expiration of a statute of limitations.

8. As of January 31, 2014, the Company had three share-based compensation plans, which are described below. The compensation cost that has been charged against income for those plans for the first fiscal quarter of 2014 and 2013 was $3.6 million and $3.7 million, respectively. During the first fiscal quarter of 2014 and 2013, the Company issued 335,683 and 91,422 shares, respectively, under its share-based compensation plans.

Employee Stock Purchase Plan (ESPP)

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

Employee Sharesave Scheme

The Company offers shares under its employee sharesave scheme for U.K. employees. This plan allows participants the option to purchase shares at a 5% discount of the market price of the stock as of the beginning of the offering period. The term of these options is three years. The sharesave scheme is not a safe-harbor design, and therefore, compensation cost is recognized on this plan. Under the sharesave scheme, option exercise prices are equal to the fair market value of the Company s common stock on the date of grant. No options were granted during the first fiscal quarter of 2014 or 2013.

Equity Incentive Plan

Under the equity incentive plan, option exercise prices are equal to the fair market value of the Company s common stock on the date of grant. The Company granted 187,200 options and 237,700 options in the three month periods ended January 31, 2014, and January 25, 2013, respectively. The weighted-average grant date fair value of options granted during the three month periods ended January 31, 2014, and January 25, 2013, was $45.14 per share and $29.12 per share, respectively.

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

	Three Months Ended	
	January 31, 2014	January 25, 2013
Risk-free interest rate	1.73 2.99%	0.79 1.88%
Volatility	41.87 43.17%	41.89 44.25%
Expected life (years)	5 9	4.5 9.5
Dividends	0	0

The Company granted 76,575 and 32,200 restricted stock units in the three month periods ended January 31, 2014, and January 25, 2013, respectively. The weighted-average grant date fair value of restricted stock units granted during the three month periods ended January 31, 2014, and January 25, 2013, was $84.31 and $62.52 per share, respectively. The fair value of each restricted stock unit granted by the Company is equal to the fair market value of the Company s common stock on the date of grant.

9. The Company s pension plans principally include a U.S. pension plan maintained by Esterline and a non-U.S. plan maintained by CMC Electronics, Inc. (CMC). Components of periodic pension cost consisted of the following:

(In thousands)	Three Months Ended	
	January 31, 2014	January 25, 2013
Service cost	$ 2,730	$ 2,749
Interest cost	4,813	4,317
Expected return on plan assets	(6,515)	(5,573)
Amortization of prior service cost	19	21
Amortization of actuarial loss	1,357	3,412
Net Periodic Cost	$ 2,404	$ 4,926

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

(In thousands)	Three Months Ended	
	January 31, 2014	January 25, 2013
Service cost	$ 235	$ 259

Interest cost		189		190
Amortization of prior service cost		(17)		(17)
Amortization of actuarial loss (gain)		(68)		8
Net Periodic Cost	$	339	$	440

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

10. In March 2011, the Company entered into a $460.0 million secured credit facility made available through a group of banks. The credit facility is secured by substantially all of the Company s assets and interest is based on standard inter-bank offering rates. The credit facility expires in July 2016. The interest rate ranges from

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LIBOR plus 1.5% to LIBOR plus 2.25% depending on the leverage ratios at the time the funds are drawn. At January 31, 2014, the Company had $155.0 million outstanding under the secured credit facility at an interest rate of LIBOR plus 1.75%, which was 1.91% at January 31, 2014.

In July 2011, the Company amended the secured credit facility to provide for a 125.0 million term loan (Euro Term Loan). The interest rate on the Euro Term Loan ranges from Euro LIBOR plus 1.5% to Euro LIBOR plus 2.25% depending on the leverage ratios at the time the funds are drawn. At January 31, 2014, the Company had 16.4 million outstanding, or $22.2 million, under the Euro Term Loan at an interest rate of Euro LIBOR plus 1.75%, which was 1.97% at January 31, 2014. The loan amortizes at 1.25% of the original principal balance quarterly through March 2016, with the remaining balance due in July 2016.

In April 2013, the Company amended the secured credit facility to provide for a $175.0 million term loan (U.S. Term Loan). The interest rate on the U.S. Term Loan ranges from LIBOR plus 1.5% to LIBOR plus 2.25% depending on the leverage ratios at the time the funds are drawn. At January 31, 2014, the Company had $168.4 million outstanding under the U.S. Term Loan at an interest rate of LIBOR plus 1.75%, which was 1.91% at January 31, 2014. The loan amortizes at 1.25% of the original principal balance quarterly through March 2016, with the remaining balance due in July 2016.

In April 2013, the Company redeemed the $175.0 million 6.625% Senior Notes due March 2017 (2017 Notes). In connection with the redemption, the Company wrote off $1.3 million in unamortized debt issuance costs as a charge against interest expense. In addition, the Company incurred a $3.9 million redemption premium and received proceeds of $2.9 million from the termination of its $175.0 million interest rate swap agreements. As a result, the redemption of the 2017 Notes resulted in a net loss of $0.9 million on extinguishment of debt in the second quarter of fiscal 2013.

Based on quoted market prices, the fair value of the Company s $250.0 million 7.0% Senior Notes due August 2020 (2020 Notes) was $272.5 million as of January 31, 2014, and October 25, 2013. The carrying amounts of the secured credit facility, Euro Term Loan and the U.S. Term Loan due 2016 approximate fair value. Estimates of fair value for the 2020 Notes are based on quoted market prices, and considered Level 2 inputs as defined in the fair value hierarchy, described in Note 11.

Government refundable advances consist of payments received from the Canadian government to assist in research and development related to commercial aviation. The repayment of this advance is based on year-over-year commercial aviation revenue growth at CMC beginning in 2014. Imputed interest on the advance was 4.27% at January 31, 2014. The discounted value of debt recognized was $54.1 million and $56.9 million as of January 31, 2014, and October 25, 2013, respectively.

11. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. An asset or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The hierarchy of fair value measurements is described below:

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

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

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

The following table sets forth the Company s financial assets and liabilities that were measured at fair value on a recurring basis by level within the fair value hierarchy at January 31, 2014, and October 25, 2013:

(In thousands)	Level 2	
	January 31, 2014	October 25, 2013
Assets:		
Derivative contracts designated as hedging instruments	$ 1,312	$ 2,270
Derivative contracts not designated as hedging instruments	2,883	3,670
Embedded derivatives	3,266	706
Liabilities:		
Derivative contracts designated as hedging instruments	$ 15,824	$ 4,541
Derivative contracts not designated as hedging instruments	378	122
Embedded derivatives	357	344

(In thousands)	Level 3	
	January 31, 2014	October 25, 2013
Liabilities:		
Contingent purchase obligation	$ 9,000	$ 4,000

The Company s embedded derivatives are the result of entering into sales or purchase contracts that are denominated in a currency other than the Company s functional currency or the supplier s or customer s functional currency. The fair value is determined by calculating the difference between quoted exchange rates at the time the contract was entered into and the period-end exchange rate. These contracts are categorized as Level 2 in the fair value hierarchy.

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

The Company s contingent purchase obligations consist of additional contingent consideration in connection with the acquisitions of Eclipse Electronic Systems, Inc. (Eclipse) and Sunbank. The contingent considerations will be payable to the sellers if certain performance objectives are met following the acquisition in accordance with the terms of each agreement. The values recorded on the balance sheet were derived from the estimated probability that the performance objectives will be met. The contingent purchase obligations are categorized as Level 3 in the fair value hierarchy.

12. The Company uses derivative financial instruments in the form of foreign currency forward exchange contracts and interest rate swap contracts for the purpose of minimizing exposure to changes in foreign currency exchange

rates on business transactions and interest rates, respectively. The Company s policy is to execute such instruments with banks the Company believes to be credit worthy and not to enter into derivative financial instruments for speculative purposes. These derivative financial instruments do not subject the Company to undue risk, as gains and losses on these instruments generally offset gains and losses on the underlying assets, liabilities, or anticipated transactions that are being hedged.

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

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

Foreign Currency Forward Exchange Contracts

The Company transacts business in various foreign currencies which subjects the Company s cash flows and earnings to exposure related to changes in foreign currency exchange rates. These exposures arise primarily from purchases or sales of products and services from third parties. Foreign currency forward exchange contracts provide for the purchase or sale of foreign currencies at specified future dates at specified exchange rates and are used to offset changes in the fair value of certain assets or liabilities or forecasted cash flows resulting from transactions denominated in foreign currencies. As of January 31, 2014, and October 25, 2013, the Company had outstanding foreign currency forward exchange contracts principally to sell U.S. dollars with notional amounts of $364.4 million and $369.0 million, respectively. These notional values consist primarily of contracts for the European euro, British pound sterling and Canadian dollar, and are stated in U.S. dollar equivalents at spot exchange rates at the respective dates.

Interest Rate Swaps

The Company manages its exposure to interest rate risk by maintaining an appropriate mix of fixed and variable rate debt, which over time should moderate the costs of debt financing. When considered necessary, the Company may use financial instruments in the form of interest rate swaps to help meet this objective. In fiscal 2010, the Company entered into interest rate swap agreements for $175.0 million on the 2017 Notes. The swap agreements exchanged the fixed interest rate on the 2017 Notes of 6.625% for a variable interest rate. In the second quarter of fiscal 2013, the swap agreements were terminated and the Company redeemed the 2017 Notes with the proceeds from the $175.0 million U.S. Term Loan. The Company recorded a gain on the swap termination of $2.9 million in the second quarter of fiscal 2013.

Embedded Derivative Instruments

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

Net Investment Hedge

In July 2011, the Company entered into a Euro Term Loan for 125.0 million under the secured credit facility. The Company designated the Euro Term Loan a hedge of the investment in a certain French business unit. The foreign currency gain or loss that is effective as a hedge is reported as a component of other comprehensive income in shareholders equity. To the extent that this hedge is ineffective, the foreign currency gain or loss is recorded in earnings. There was no ineffectiveness since inception of the hedge.

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Fair Value of Derivative Instruments

Fair value of derivative instruments in the Consolidated Balance Sheet at January 31, 2014, and October 25, 2013, consisted of:

(In thousands)		Fair Value	
	Classification	January 31, 2014	October 25, 2013
Foreign Currency Forward Exchange Contracts:			
	Other current assets	$ 2,992	$ 4,547
	Other assets	1,203	1,393
	Accrued liabilities	10,627	3,002
	Other liabilities	5,575	1,661
Embedded Derivative Instruments:			
	Other current assets	$ 53	$ 59
	Other assets	3,213	647
	Accrued liabilities	357	344

The effect of derivative instruments on the Consolidated Statement of Operations and Comprehensive Income (Loss) for the first fiscal quarter in 2014 and 2013 consisted of:

(In thousands)	Location of Gain (Loss)	January 31, 2014	January 25, 2013
Fair Value Hedges:			
Interest rate swap contracts	Interest Expense	$ 0	$ 716
Embedded derivatives	Sales	2,819	523
Cash Flow Hedges:			
Foreign currency forward exchange contracts:			
Amount of gain (loss) recognized in AOCI (effective portion)	AOCI	$ (11,803)	$ 257
Amount of gain (loss) reclassified from AOCI into income	Sales	(464)	(80)
Net Investment Hedges:			
Euro term loan	AOCI	$ 529	$ (2,416)

In each of the first fiscal quarters of 2014 and 2013, the Company recorded a loss of $0.5 million and a gain of $0.4 million, respectively, on foreign currency forward exchange contracts that have not been designated as an accounting hedge. These foreign currency exchange losses are included in selling, general and administrative expense.

There was no significant impact to the Company s earnings related to the ineffective portion of any hedging instruments during the first fiscal quarter of 2014 and 2013. In addition, there was no significant impact to the Company s earnings when a hedged firm commitment no longer qualified as a fair value hedge or when a hedged forecasted transaction no longer qualified as a cash flow hedge during the first fiscal quarter of 2014.

Amounts included in AOCI are reclassified into earnings when the hedged transaction settles. The Company expects to reclassify approximately $9.2 million of net loss into earnings over the next 12 months. The maximum duration of the Company s foreign currency cash flow hedge contracts at January 31, 2014, is 24 months.

13. On December 5, 2013, the Company announced the acceleration of its plans to consolidate certain facilities and create cost efficiencies through shared services in sales, general and administrative and support functions. These integration activities are expected to result in charges and expenses of approximately $40 million. The Company expects to incur costs of $25 million to $30 million in fiscal 2014 to support these efforts, with the balance to be incurred in fiscal 2015. The costs are mainly for severance, relocation of facilities and losses on the write off of certain property, plant and equipment. In the first fiscal quarter of 2014, restructuring expense totaled $5.4 million, reflecting a $2.5 million loss on the write off of certain property, plant and equipment and $2.3 million in severance. The Company has recorded an accrued liability for $2.8 million for these activities as of January 31, 2014.

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

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

15. Segment information:

Business segment information for continuing operations includes the segments of Avionics & Controls, Sensors & Systems and Advanced Materials.

(In thousands)	Three Months Ended	
	January 31, 2014	January 25, 2013
Sales		
Avionics & Controls	$ 200,439	$ 174,570
Sensors & Systems	187,089	171,810
Advanced Materials	117,452	111,582
Total Sales	$ 504,980	$ 457,962

Earnings From Operations Before Income Taxes		
Avionics & Controls	$ 24,764	$ 18,589
Sensors & Systems	20,238	19,001
Advanced Materials	16,004	17,644
Segment Earnings	61,006	55,234
Corporate expense	(15,219)	(16,576)
Interest income	120	101
Interest expense	(8,630)	(10,444)
	$ 37,277	$ 28,315

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16. The following schedules set forth condensed consolidating financial information as required by Rule 3-10 of Securities and Exchange Commission Regulation S-X as of January 31, 2014, and October 25, 2013, and for the applicable periods ended January 31, 2014, and January 25, 2013, for (a) Esterline Technologies Corporation (the Parent); (b) on a combined basis, the current subsidiary guarantors (Guarantor Subsidiaries) of the secured credit facility, 2017 Notes (for periods prior to the ending of the fiscal quarter ended April 26, 2013), and 2020 Notes; and (c) on a combined basis, the subsidiaries that are not guarantors of the secured credit facility, 2017 Notes (for periods prior to the ending of the fiscal quarter ended April 26, 2013), and 2020 Notes (Non-Guarantor Subsidiaries). The Guarantor Subsidiaries are direct and indirect wholly-owned subsidiaries of Esterline Technologies Corporation and have fully and unconditionally, jointly and severally, guaranteed the secured credit facility, the 2017 Notes (for periods prior to the ending of the fiscal quarter ended April 26, 2013) and the 2020 Notes.

Condensed Consolidating Balance Sheet as of January 31, 2014.

(In thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Assets					
Current Assets					
Cash and cash equivalents	$ 14,798	$ 5,426	$ 188,214	$ 0	$ 208,438
Cash in escrow	4,018	0	0	0	4,018
Accounts receivable, net	228	128,972	198,816	0	328,016
Inventories	0	209,636	265,020	0	474,656
Income tax refundable	3,125	2,753	0	0	5,878
Deferred income tax benefits	23,835	177	22,470	0	46,482
Prepaid expenses	57	9,017	15,776	0	24,850
Other current assets	84	115	3,814	0	4,013
Total Current Assets	46,145	356,096	694,110	0	1,096,351
Property, Plant & Equipment, Net	1,625	174,832	189,997	0	366,454
Goodwill	0	366,634	764,120	0	1,130,754
Intangibles, Net	0	159,127	422,052	0	581,179
Debt Issuance Costs, Net	4,913	0	872	0	5,785
Deferred Income Tax Benefits	17,371	1	53,801	0	71,173
Other Assets	140	6,501	11,998	0	18,639
Amounts Due From (To) Subsidiaries	0	587,462	0	(587,462)	0
	2,718,924	979,555	342,374	(4,040,853)	0

Investment in Subsidiaries										
Total Assets	$	2,789,118	$	2,630,208	$	2,479,324	$	(4,628,315)	$	3,270,335

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(In thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Liabilities and Shareholders Equity					
Current Liabilities					
Accounts payable	$ 1,507	$ 33,149	$ 81,396	$ 0	$ 116,052
Accrued liabilities	10,936	84,557	143,425	0	238,918
Current maturities of long-term debt	8,750	399	11,895	0	21,044
Deferred income tax liabilities	568	23	2,018	0	2,609
Federal and foreign income taxes	248	(31,098)	35,776	0	4,926
Total Current Liabilities	22,009	87,030	274,510	0	383,549
Credit Facilities	155,000	0	0	0	155,000
Long-Term Debt, Net	409,688	55,365	65,192	0	530,245
Deferred Income Tax Liabilities	57,322	(5)	129,746	0	187,063
Pension and Post-Retirement Obligations	17,449	650	46,130	0	64,229
Other Liabilities	18,453	3,944	32,608	0	55,005
Amounts Due To (From) Subsidiaries	213,953	0	406,256	(620,209)	0
Shareholders Equity	1,895,244	2,483,224	1,524,882	(4,008,106)	1,895,244
Total Liabilities and Shareholders Equity	$ 2,789,118	$ 2,630,208	$ 2,479,324	$ (4,628,315)	$ 3,270,335

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss) for the three month period ended January 31, 2014.

(In thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net Sales	$ 0	$ 229,129	$ 277,293	$ (1,442)	$ 504,980
Cost of Sales	0	147,680	185,447	(1,442)	331,685
	0	81,449	91,846	0	173,295
Expenses					
Selling, general and administrative	0	40,424	55,782	0	