

ESTERLINE TECHNOLOGIES CORP
Form 10-Q
March 01, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended January 25, 2013.

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
(State or other Jurisdiction
of incorporation or organization)

13-2595091
(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 No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of February 26, 2013, 30,989,131 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 25, 2013 and October 26, 2012

(In thousands, except share amounts)

| <u>ASSETS</u> | January 25, 2013 (Unaudited) | October 26, 2012 |
|--|------------------------------------|---------------------|
| Current Assets | | |
| Cash and cash equivalents | \$ 202,776 | \$ 160,675 |
| Cash in escrow | 5,017 | 5,016 |
| Accounts receivable, net of allowances of \$9,263 and \$9,029 | 331,335 | 383,362 |
| Inventories | | |
| Raw materials and purchased parts | 155,481 | 146,390 |
| Work in process | 178,729 | 174,824 |
| Finished goods | 87,416 | 88,623 |
| | 421,626 | 409,837 |
| Income tax refundable | 6,516 | 4,832 |
| Deferred income tax benefits | 47,430 | 46,000 |
| Prepaid expenses | 27,207 | 21,340 |
| Other current assets | 6,083 | 4,631 |
| Total Current Assets | 1,047,990 | 1,035,693 |
| Property, Plant and Equipment | 715,584 | 701,541 |
| Accumulated depreciation | 358,611 | 345,140 |
| | 356,973 | 356,401 |
| Other Non-Current Assets | | |
| Goodwill | 1,105,656 | 1,098,962 |
| Intangibles, net | 599,396 | 609,045 |
| Debt issuance costs, net of accumulated amortization of \$5,046 and \$4,577 | 8,349 | 8,818 |
| Deferred income tax benefits | 97,758 | 97,952 |
| Other assets | 19,282 | 20,246 |

\$ 3,235,404 \$ 3,227,117

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

For the Three Month Periods Ended January 25, 2013 and January 27, 2012

(Unaudited)

(In thousands, except per share amounts)

| | Three Months Ended | |
|---|---------------------|---------------------|
| | January 25, 2013 | January 27, 2012 |
| Net Sales | \$ 457,962 | \$ 470,882 |
| Cost of Sales | 297,617 | 312,801 |
| | 160,345 | 158,081 |
| Expenses | | |
| Selling, general & administrative | 98,611 | 94,697 |
| Research, development & engineering | 23,076 | 26,395 |
| Total Expenses | 121,687 | 121,092 |
| Operating Earnings | 38,658 | 36,989 |
| Interest Income | (101) | (95) |
| Interest Expense | 10,444 | 11,528 |
| Income Before Income Taxes | 28,315 | 25,556 |
| Income Tax Expense | 2,394 | 2,576 |
| Income Including Noncontrolling Interests | 25,921 | 22,980 |
| Income Attributable to Noncontrolling Interests | (810) | (192) |
| Net Earnings Attributable to Esterline | \$ 25,111 | \$ 22,788 |
| Earnings Per Share Attributable to Esterline: | | |
| Basic Earnings Per Share | \$.81 | \$.74 |
| Diluted Earnings Per Share | .80 | .73 |
| Comprehensive Income (Loss) | \$ 36,891 | \$ (41,078) |

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Three Month Periods Ended January 25, 2013 and January 27, 2012

(Unaudited)

(In thousands)

| | Three Months Ended | |
|---|---------------------|---------------------|
| | January 25, 2013 | January 27, 2012 |
| Cash Flows Provided (Used) by Operating Activities | | |
| Net earnings including noncontrolling interests | \$ 25,921 | \$ 22,980 |
| Adjustments to reconcile net earnings including noncontrolling interests to net cash provided (used) by operating activities: | | |
| Depreciation and amortization | 27,971 | 26,123 |
| Deferred income taxes | (3,516) | (7,619) |
| Share-based compensation | 3,743 | 2,648 |
| Gain on sale of capital assets | (51) | (447) |
| Working capital changes, net of effect of acquisitions: | | |
| Accounts receivable | 54,172 | 11,202 |
| Inventories | (8,743) | (2,439) |
| Prepaid expenses | (5,771) | (2,275) |
| Other current assets | (1,658) | 670 |
| Accounts payable | (6,683) | (3,777) |
| Accrued liabilities | (9,783) | (1,550) |
| Federal and foreign income taxes | 161 | 2,781 |
| Other liabilities | 9,486 | 75 |
| Other, net | 1,297 | (1,725) |
| | 86,546 | 46,647 |
| Cash Flows Provided (Used) by Investing Activities | | |
| Purchases of capital assets | (12,253) | (12,926) |
| Proceeds from sale of capital assets | 51 | 447 |
| Escrow deposit | (1) | (6) |
| | (12,203) | (12,485) |
| Cash Flows Provided (Used) by Financing Activities | | |
| Proceeds provided by stock issuance under employee stock plans | 3,671 | 1,379 |
| Excess tax benefits from stock options exercised | 335 | 6 |
| Dividends paid to noncontrolling interest | (514) | 0 |
| Proceeds from credit facilities | 82 | 0 |
| Repayment of long-term debt | (36,609) | (31,385) |
| Proceeds from government assistance | 650 | 7,942 |
| | (32,385) | (22,058) |
| Effect of Foreign Exchange Rates on Cash and Cash Equivalents | 143 | (3,850) |

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| | | | | |
|---|---------------------|--------|---------|------------|
| Net Increase in Cash and Cash Equivalents | | 42,101 | | 8,254 |
| Cash and Cash Equivalents | Beginning of Period | | 160,675 | 185,035 |
| Cash and Cash Equivalents | End of Period | \$ | 202,776 | \$ 193,289 |
| Supplemental Cash Flow Information | | | | |
| Cash paid for interest | | \$ | 2,830 | \$ 4,069 |
| Cash paid for taxes | | | 5,083 | 5,878 |

ESTERLINE TECHNOLOGIES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Three Month Periods Ended January 25, 2013 and January 27, 2012

1. The consolidated balance sheet as of January 25, 2013, the consolidated statement of operations for the three month periods ended January 25, 2013, and January 27, 2012, and the consolidated statement of cash flows for the three month periods ended January 25, 2013, and January 27, 2012, 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 26, 2012, 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.
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 672,825 and 632,275 in the first fiscal quarter of 2013 and 2012, respectively. Shares used for calculating earnings per share are disclosed in the following table.

(In thousands)

| | Three Months Ended | |
|--|---------------------|---------------------|
| | January 25, 2013 | January 27, 2012 |
| Shares Used for Basic Earnings Per Share | 30,904 | 30,631 |
| Shares Used for Diluted Earnings Per Share | 31,423 | 31,157 |

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

(In thousands)

| | Three Months Ended | |
|--|---------------------|---------------------|
| | January 25, 2013 | January 27, 2012 |
| Net Earnings | \$ 25,111 | \$ 22,788 |
| Change in Fair Value of Derivative Financial Instruments, Net of Tax (Expense) Benefit of \$(224) and \$1,479 | (46) | (3,350) |
| Change in Pension and Post-Retirement Obligations, Net of Tax Benefit (Expense) of \$55 and \$(831) | (151) | 1,494 |

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| | | | | |
|---|----|--------|----|----------|
| Foreign Currency Translation Adjustment | | 11,977 | | (62,010) |
| Comprehensive Income (Loss) | \$ | 36,891 | \$ | (41,078) |

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

| (In thousands) | January 25, 2013 | October 26, 2012 |
|---|---------------------|---------------------|
| Net unrealized gain on derivative contracts | \$ 1,577 | \$ 1,623 |
| Pension and post-retirement obligations | (99,330) | (99,179) |
| Currency translation adjustment | 24,249 | 12,272 |
| Total accumulated other comprehensive loss | \$ (73,504) | \$ (85,284) |

6. The income tax rate was 8.5% compared with 10.1% for the first fiscal quarter of 2013 and 2012, respectively. In the first fiscal quarter of 2013, the Company recognized \$3.7 million of discrete tax benefits principally 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. In the first fiscal quarter of 2012, the Company recognized \$2.3 million of discrete tax benefits due to a change in French tax laws associated with the holding company structure and the financing of the Souriau acquisition. The income tax rate differed from the statutory rate in the first fiscal quarter of 2013 and 2012, 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 \$5.1 million of tax benefits associated with research and development tax credits, capital and operating losses that are currently unrecognized could be recognized as a result of settlement of examinations and/or the expiration of a statute of limitations.

7. Subsequent to period end, on February 4, 2013, the Company acquired the Gamesman Group (Gamesman) for approximately \$39.9 million. Gamesman is a global supplier of input devices principally serving the gaming industry. Gamesman will be included in the Avionics & Controls segment.

8. As of January 25, 2013, 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 2013 and 2012 was \$3.7 million and \$2.6 million, respectively. During the first fiscal quarter of 2013 and 2012, the Company issued 91,422 and 30,493 shares, respectively, under its employee stock 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 2013 or 2012.

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 237,700 options and 311,400 options in the three month periods ended January 25, 2013, and January 27, 2012, respectively. The weighted-average grant date fair value of options granted during the three-month periods ended January 25, 2013, and January 27, 2012, was \$29.12 per share and \$23.74 per share, respectively.

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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 25, 2013 | | January 27, 2012 | |
| Risk-free interest rate | 0.79 | 1.88% | 0.91 | 2.11% |
| Volatility | 41.89 | 44.25% | 41.62 | 44.29% |
| Expected life (years) | 4.5 | 9.5 | 4.5 | 9.5 |
| Dividends | 0 | | 0 | |

In December 2012, the Board of Directors and Compensation Committee approved restricted stock unit awards under the equity incentive plan. The Company granted 32,200 restricted stock units during the three-month period ended January 25, 2013. The weighted-average grant date fair value of restricted stock units granted during the three-month period ended January 25, 2013, was \$62.52 per share. The fair value for 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. There were no restricted stock units granted in the three-month period ended January 27, 2012.

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 25, 2013 | | January 27, 2012 | |
| Service cost | \$ | 2,749 | \$ | 2,402 |
| Interest cost | | 4,317 | | 4,646 |
| Expected return on plan assets | | (5,573) | | (5,327) |
| Amortization of prior service cost | | 21 | | 10 |
| Amortization of actuarial loss | | 3,412 | | 2,575 |
| Net Periodic Cost | \$ | 4,926 | \$ | 4,306 |

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 25, 2013 | | January 27, 2012 | |
| Service cost | \$ | 259 | \$ | 102 |
| Interest cost | | 190 | | 163 |
| Amortization of prior service cost | | (17) | | 0 |
| Amortization of actuarial loss (gain) | | 8 | | (7) |
| Net Periodic Cost | \$ | 440 | \$ | 258 |

10.

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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 will range from LIBOR plus 1.5% to LIBOR plus 2.25% depending on the leverage ratios at the time the funds are drawn. At January 25, 2013, the Company had \$225.0 million outstanding under the secured credit facility at an interest rate of LIBOR plus 1.75% or 1.96%.

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 will range 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 25, 2013, the Company had 45.4 million outstanding or \$61.2 million under the Euro Term Loan at an interest rate of Euro LIBOR plus 1.75% or 1.81%. The loan amortizes at 1.25% of the original principal balance quarterly through March 2016, with the remaining balance due in July 2016.

The fair value of the Company's \$250.0 million 7.0% Senior Notes due August 2020 was \$277.5 million as of January 25, 2013, and October 26, 2012. The fair value of the Company's \$175.0 million 6.625% Senior Notes due March 2017 was \$176.8 million and \$181.3 million as of January 25, 2013, and October 26, 2012, respectively. The carrying amounts of the secured credit facility and Euro Term Loan due 2016 approximate fair value. Estimates of fair value for the Senior 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 5.01% at January 25, 2013.

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.

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 25, 2013, and October 26, 2012:

| (In thousands) | Level 2 | |
|--|---------------------|---------------------|
| | January 25, 2013 | October 26, 2012 |
| Assets: | | |
| Derivative contracts designated as hedging instruments | \$ 7,108 | \$ 7,753 |
| Derivative contracts not designated as hedging instruments | 1,908 | 1,387 |
| Embedded derivatives | 377 | 51 |
| Liabilities: | | |
| Derivative contracts designated as hedging instruments | \$ 1,794 | \$ 2,143 |
| Derivative contracts not designated as hedging instruments | 736 | 361 |
| Embedded derivatives | 264 | 470 |

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.

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 25, 2013. 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 25, 2013, and October 26, 2012, the Company had outstanding foreign currency forward exchange contracts principally to sell U.S. dollars with notional amounts of \$334.2 million and \$358.4 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 November 2010, the Company entered into an interest rate swap agreement for \$100.0 million on the \$175.0 million Senior Notes due in 2017. The swap agreement exchanged the fixed interest rate of 6.625% for a variable interest rate on the \$100.0 million of the principal amount outstanding. The variable interest rate is based upon LIBOR plus 4.865% and was 5.166% at January 25, 2013. The fair value of the Company's interest rate swap was a \$1.9 million asset at January 25, 2013, and was estimated by discounting expected cash flows using market interest rates. The Company records interest receivable and interest payable on interest rate swaps on a net basis. In December 2010, the Company entered into an interest rate swap agreement for \$75.0 million on the \$175.0 million Senior Notes due in 2017. The swap agreement exchanged the fixed interest rate of 6.625% for a variable interest rate on the \$75.0 million of the principal amount outstanding. The variable interest rate is based upon LIBOR plus 4.47% and was 4.771% at January 25, 2013. The fair value of the Company's interest rate swap was a \$1.7 million asset at January 25, 2013, and was estimated by discounting expected cash flows using market interest rates. The Company recognized a net interest receivable of \$1.2 million at January 25, 2013. On February 5, 2013, the \$75.0 million interest rate swap agreement to exchange the fixed interest rate on the \$175.0 million Senior Notes due in 2017 for a variable interest rate was called and is payable in 30 days.

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.

Fair Value of Derivative Instruments

Fair values of derivative instruments in the Consolidated Balance Sheet at January 25, 2013, and October 26, 2012, consisted of:

| (In thousands) | | Fair Value | |
|--------------------------|--|---------------------|---------------------|
| | Classification | January 25, 2013 | October 26, 2012 |
| Foreign Currency Forward | | | |
| Exchange Contracts: | Other current assets | \$ 4,797 | \$ 3,694 |
| | Other assets | 547 | 1,294 |
| | Accrued liabilities | 1,558 | 2,228 |
| | Other liabilities | 972 | 276 |
| Embedded Derivative | | | |
| Instruments: | Other current assets | \$ 377 | \$ 51 |
| | Accrued liabilities | 189 | 148 |
| | Other liabilities | 75 | 322 |
| Interest Rate Swaps: | Long-term debt, net of current maturities | \$ 3,672 | \$ 4,152 |

The effect of derivative instruments on the Consolidated Statement of Operations for the first fiscal quarter in 2013 and 2012 consisted of:

| (In thousands) | Location of Gain (Loss) | January 25, 2013 | January 27, 2012 |
|--|-------------------------|---------------------|---------------------|
| <i>Fair Value Hedges:</i> | | | |
| Interest rate swap contracts | Interest Expense | \$ 716 | \$ 567 |
| Embedded derivatives | Sales | 523 | 335 |
| <i>Cash Flow Hedges:</i> | | | |
| Foreign currency forward exchange contracts: | | | |
| Amount of gain (loss) recognized | | | |
| in AOCI (effective portion) | AOCI | \$ 257 | \$ (4,727) |
| Amount of gain (loss) reclassified | | | |
| from AOCI into income | Sales | (80) | (101) |
| <i>Net Investment Hedges:</i> | | | |
| Euro term loan | AOCI | \$ (2,416) | \$ 10,747 |

In each of the first fiscal quarters of 2013 and 2012, the Company recorded a loss of \$0.9 million and a loss of \$5.8 million on foreign currency forward exchange contracts that have not been designated as an accounting hedge, respectively. 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 2013 and 2012. 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 2013.

Amounts included in AOCI are reclassified into earnings when the hedged transaction settles. The Company expects to reclassify approximately \$2.0 million of net gain into earnings over the next 12 months. The maximum duration of the Company's foreign currency cash flow hedge contracts at January 25, 2013, is 23 months.

13. 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 25, 2013 | January 27, 2012 |
| Sales | | |
| Avionics & Controls | \$ 174,570 | \$ 179,572 |
| Sensors & Systems | 171,810 | 171,672 |
| Advanced Materials | 111,582 | 119,638 |
| Total Sales | \$ 457,962 | \$ 470,882 |
| Income from Operations | | |
| Avionics & Controls | \$ 18,589 | \$ 20,063 |
| Sensors & Systems | 19,001 | 6,815 |
| Advanced Materials | 17,644 | 23,073 |
| Segment Earnings | 55,234 | 49,951 |
| Corporate expense | (16,576) | (12,962) |
| Interest income | 101 | 95 |
| Interest expense | (10,444) | (11,528) |
| | \$ 28,315 | \$ 25,556 |

14. 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 25, 2013, and October 26, 2012, and for the applicable periods ended January 25, 2013, and January 27, 2012, for (a) Esterline Technologies Corporation (the Parent); (b) on a combined basis, the current subsidiary guarantors (Guarantor Subsidiaries) of the secured credit facility, Senior Notes due 2017, and Senior Notes due 2020; and (c) on a combined basis, the subsidiaries that are not guarantors of the secured credit facility, Senior Notes due 2017, and Senior Notes due 2020 (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 Senior Notes due 2017, and the Senior Notes due 2020.

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Condensed Consolidating Balance Sheet as of January 25, 2013.

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|---------------------------------------|---------------------|---------------------------|-----------------------------------|-----------------------|---------------------|
| Assets | | | | | |
| Current Assets | | | | | |
| Cash and cash equivalents | \$ 36,613 | \$ 1,219 | \$ 164,944 | \$ 0 | \$ 202,776 |
| Cash in escrow | 5,017 | 0 | 0 | 0 | 5,017 |
| Accounts receivable, net | 214 | 123,411 | 207,710 | 0 | 331,335 |
| Inventories | 0 | 166,348 | 255,278 | 0 | 421,626 |
| Income tax refundable | 0 | 6,516 | 0 | 0 | 6,516 |
| Deferred income tax benefits | 22,761 | 111 | 24,558 | 0 | 47,430 |
| Prepaid expenses | 132 | 7,189 | 19,886 | 0 | 27,207 |
| Other current assets | 167 | 626 | 5,290 | 0 | 6,083 |
| Total Current Assets | 64,904 | 305,420 | 677,666 | 0 | 1,047,990 |
| Property, Plant & | | | | | |
| Equipment, Net | 2,646 | 160,649 | 193,678 | 0 | 356,973 |
| Goodwill | 0 | 314,652 | 791,004 | 0 | 1,105,656 |
| Intangibles, Net | 0 | 122,609 | 476,787 | 0 | 599,396 |
| Debt Issuance Costs, Net | 7,126 | 0 | 1,223 | 0 | 8,349 |
| Deferred Income | | | | | |
| Tax Benefits | 36,014 | (294) | 62,038 | 0 | 97,758 |
| Other Assets | 7,572 | 1,498 | 10,212 | 0 | 19,282 |
| Amounts Due From (To) Subsidiaries | 0 | 527,892 | 0 | (527,892) | 0 |
| Investment in Subsidiaries | 2,484,669 | 1,180,596 | 164,099 | (3,829,364) | 0 |
| Total Assets | \$ 2,602,931 | \$ 2,613,022 | \$ 2,376,707 | \$ (4,357,256) | \$ 3,235,404 |

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|---|--------------|---------------------------|-----------------------------------|----------------|--------------|
| Liabilities and Shareholders' Equity | | | | | |
| Current Liabilities | | | | | |
| Accounts payable | \$ 2,159 | \$ 26,491 | \$ 74,665 | \$ 0 | \$ 103,315 |
| Accrued liabilities | 22,884 | 79,321 | 156,809 | 0 | 259,014 |
| Credit facilities | 0 | 0 | 82 | 0 | 82 |
| Current maturities of | | | | | |
| long-term debt | 0 | 174 | 10,779 | 0 | 10,953 |
| Deferred income tax | | | | | |
| liabilities | 232 | (1) | 5,389 | 0 | 5,620 |
| Federal and foreign | | | | | |
| income taxes | (251) | (23,002) | 27,579 | 0 | 4,326 |
| Total Current Liabilities | 25,024 | 82,983 | 275,303 | 0 | 383,310 |
| Credit Facilities | 225,000 | 0 | 0 | 0 | 225,000 |
| Long-Term Debt, Net | 428,672 | 44,060 | 105,597 | 0 | 578,329 |
| Deferred Income Tax | | | | | |
| Liabilities | 46,668 | (6) | 157,847 | 0 | 204,509 |
| Pension and Post- | | | | | |
| Retirement Obligations | 20,395 | 52,176 | 70,904 | 0 | 143,475 |
| Other Liabilities | 4,661 | 5,048 | 25,810 | 0 | 35,519 |
| Amounts Due To (From) | | | | | |
| Subsidiaries | 187,249 | 0 | 380,690 | (567,939) | 0 |
| Shareholders' Equity | 1,665,262 | 2,428,761 | 1,360,556 | (3,789,317) | 1,665,262 |
| Total Liabilities and | | | | | |
| Shareholders' Equity | \$ 2,602,931 | \$ 2,613,022 | \$ 2,376,707 | \$ (4,357,256) | \$ 3,235,404 |

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Condensed Consolidating Statement of Operations for the three month period ended January 25, 2013.

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|--|-----------|---------------------------|-----------------------------------|--------------|------------|
| Net Sales | \$ 0 | \$ 206,699 | \$ 252,170 | \$ (907) | \$ 457,962 |
| Cost of Sales | 0 | 131,866 | 166,658 | (907) | 297,617 |
| Expenses | 0 | 74,833 | 85,512 | 0 | 160,345 |
| Selling, general and administrative | 0 | 35,731 | 62,880 | 0 | 98,611 |
| Research, development and engineering | 0 | 11,058 | 12,018 | 0 | 23,076 |
| Total Expenses | 0 | 46,789 | 74,898 | 0 | 121,687 |
| Operating Earnings | 0 | 28,044 | 10,614 | 0 | 38,658 |
| Interest Income | (3,660) | (1,717) | (14,688) | 19,964 | (101) |
| Interest Expense | 8,081 | 6,321 | 16,006 | (19,964) | 10,444 |
| Income (Loss) Before Taxes | (4,421) | 23,440 | 9,296 | 0 | 28,315 |
| Income Tax Expense | | | | | |
| (Benefit) | (950) | 2,446 | 898 | 0 | 2,394 |
| Income (Loss) Including | | | | | |
| Noncontrolling Interests | (3,471) | 20,994 | 8,398 | 0 | 25,921 |
| Income Attributable to | | | | | |
| Noncontrolling Interests | 0 | 0 | (810) | 0 | (810) |
| Income (Loss) Attributable | | | | | |
| to Esterline | (3,471) | 20,994 | 7,588 | 0 | 25,111 |
| Equity in Net Income of | | | | | |
| Consolidated Subsidiaries | 28,582 | 658 | 0 | (29,240) | 0 |
| Net Income (Loss) | | | | | |
| Attributable to Esterline | \$ 25,111 | \$ 21,652 | \$ 7,588 | \$ (29,240) | \$ 25,111 |

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Condensed Consolidating Statement of Cash Flows for the three month period ended January 25, 2013.

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|---|-----------|---------------------------|-----------------------------------|--------------|-----------|
| Cash Flows Provided (Used) by Operating Activities | | | | | |
| Net earnings (loss) including noncontrolling interests | \$ 25,921 | \$ 21,652 | \$ 7,588 | \$ (29,240) | \$ 25,921 |
| Depreciation & amortization | 0 | 10,076 | 17,895 | 0 | 27,971 |
| Deferred income taxes | (284) | 6 | (3,238) | 0 | (3,516) |
| Share-based compensation | 0 | 1,467 | 2,276 | 0 | 3,743 |
| Gain on sale of capital assets | 0 | (32) | (19) | 0 | (51) |
| Working capital changes, net of effect of acquisitions: | | | | | |
| Accounts receivable | (33) | 17,220 | 36,985 | 0 | 54,172 |
| Inventories | 0 | (6,775) | (1,968) | 0 | (8,743) |
| Prepaid expenses | (56) | (1,798) | (3,917) | 0 | (5,771) |
| Other current assets | (33) | (74) | (1,551) | 0 | (1,658) |
| Accounts payable | 215 | 140 | (7,038) | 0 | (6,683) |
| Accrued liabilities | 5,547 | 218 | (15,548) | 0 | (9,783) |
| Federal & foreign income taxes | 3,167 | (1,212) | (1,794) | 0 | 161 |
| Other liabilities | 1,840 | (1,856) | 9,502 | 0 | 9,486 |
| Other, net | (2,240) | 4,777 | (1,240) | 0 | 1,297 |
| | 34,044 | 43,809 | 37,933 | (29,240) | 86,546 |
| Cash Flows Provided (Used) by Investing Activities | | | | | |
| Purchases of capital assets | (21) | (4,572) | (7,660) | 0 | (12,253) |
| Proceeds from sale of capital assets | 0 | 32 | 19 | 0 | 51 |
| Escrow deposit | (1) | 0 | 0 | 0 | (1) |
| | (22) | (4,540) | (7,641) | 0 | (12,203) |

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|--|-----------|---------------------------|-----------------------------------|--------------|------------|
| Cash Flows Provided (Used) by Financing Activities | | | | | |
| Proceeds provided by stock issuance under employee stock plans | 3,671 | 0 | 0 | 0 | 3,671 |
| Excess tax benefits from stock options exercised | 335 | 0 | 0 | 0 | 335 |
| Dividends paid to noncontrolling interest | 0 | 0 | (514) | 0 | (514) |
| Proceeds from credit facilities | 0 | 0 | 82 | 0 | 82 |
| Repayment of long-term debt | (15,000) | (92) | (21,517) | 0 | (36,609) |
| Proceeds from government assistance | 0 | 0 | 650 | 0 | 650 |
| Net change in intercompany financing | (3,193) | (39,324) | 13,277 | 29,240 | 0 |
| | (14,187) | (39,416) | (8,022) | 29,240 | (32,385) |
| Effect of foreign exchange rates on cash and cash equivalents | 8 | 42 | 93 | 0 | 143 |
| Net increase (decrease) in cash and cash equivalents | 19,843 | (105) | 22,363 | 0 | 42,101 |
| Cash and cash equivalents beginning of year | 16,770 | 1,324 | 142,581 | 0 | 160,675 |
| Cash and cash equivalents end of year | \$ 36,613 | \$ 1,219 | \$ 164,944 | \$ 0 | \$ 202,776 |

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Condensed Consolidating Balance Sheet as of October 26, 2012.

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|---------------------------------------|---------------------|---------------------------|-----------------------------------|-----------------------|---------------------|
| Assets | | | | | |
| Current Assets | | | | | |
| Cash and cash equivalents | \$ 16,770 | \$ 1,324 | \$ 142,581 | \$ 0 | \$ 160,675 |
| Cash in escrow | 5,016 | 0 | 0 | 0 | 5,016 |
| Accounts receivable, net | 181 | 140,631 | 242,550 | 0 | 383,362 |
| Inventories | 0 | 159,573 | 250,264 | 0 | 409,837 |
| Income tax refundable | 0 | 4,832 | 0 | 0 | 4,832 |
| Deferred income tax benefits | 22,874 | 105 | 23,021 | 0 | 46,000 |
| Prepaid expenses | 76 | 5,391 | 15,873 | 0 | 21,340 |
| Other current assets | 134 | 552 | 3,945 | 0 | 4,631 |
| Total Current Assets | 45,051 | 312,408 | 678,234 | 0 | 1,035,693 |
| Property, Plant & Equipment, Net | 2,811 | 161,998 | 191,592 | 0 | 356,401 |
| Goodwill | 0 | 314,641 | 784,321 | 0 | 1,098,962 |
| Intangibles, Net | 0 | 126,142 | 482,903 | 0 | 609,045 |
| Debt Issuance Costs, Net | 7,508 | 0 | 1,310 | 0 | 8,818 |
| Deferred Income Tax Benefits | 36,610 | (283) | 61,625 | 0 | 97,952 |
| Other Assets | 8,082 | 1,561 | 10,603 | 0 | 20,246 |
| Amounts Due From (To) Subsidiaries | 0 | 491,143 | 0 | (491,143) | 0 |
| Investment in Subsidiaries | 2,457,859 | 1,179,938 | 170,223 | (3,808,020) | 0 |
| Total Assets | \$ 2,557,921 | \$ 2,587,548 | \$ 2,380,811 | \$ (4,299,163) | \$ 3,227,117 |

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|--|---------------------|---------------------------|-----------------------------------|-----------------------|---------------------|
| Liabilities and Shareholders Equity | | | | | |
| Current Liabilities | | | | | |
| Accounts payable | \$ 1,944 | \$ 26,351 | \$ 80,394 | \$ 0 | \$ 108,689 |
| Accrued liabilities | 17,495 | 79,103 | 172,955 | 0 | 269,553 |
| Credit facilities | 0 | 0 | 0 | 0 | 0 |
| Current maturities of long-term debt | 0 | 174 | 10,436 | 0 | 10,610 |
| Deferred income tax liabilities | 213 | (1) | 4,913 | 0 | 5,125 |
| Federal and foreign income taxes | (3,418) | (23,822) | 29,609 | 0 | 2,369 |
| Total Current Liabilities | 16,234 | 81,805 | 298,307 | 0 | 396,346 |
| Credit Facilities | 240,000 | 0 | 0 | 0 | 240,000 |
| Long-Term Debt, Net | 429,152 | 44,107 | 124,801 | 0 | 598,060 |
| Deferred Income Tax Liabilities | 46,730 | (7) | 158,475 | 0 | 205,198 |
| Pension and Post-Retirement Obligations | 20,507 | 54,886 | 56,681 | 0 | 132,074 |
| Other Liabilities | 5,189 | 4,194 | 25,521 | 0 | 34,904 |
| Amounts Due To (From) Subsidiaries | 179,574 | 0 | 369,962 | (549,536) | 0 |
| Shareholders Equity | 1,620,535 | 2,402,563 | 1,347,064 | (3,749,627) | 1,620,535 |
| Total Liabilities and Shareholders Equity | \$ 2,557,921 | \$ 2,587,548 | \$ 2,380,811 | \$ (4,299,163) | \$ 3,227,117 |

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Condensed Consolidating Statement of Operations for the three month period ended January 27, 2012.

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|--|-----------|---------------------------|-----------------------------------|--------------|------------|
| Net Sales | \$ 0 | \$ 214,243 | \$ 257,243 | \$ (604) | \$ 470,882 |
| Cost of Sales | 0 | 135,359 | 178,046 | (604) | 312,801 |
| Expenses | 0 | 78,884 | 79,197 | 0 | 158,081 |
| Selling, general and administrative | 0 | 34,893 | 59,804 | 0 | 94,697 |
| Research, development and engineering | 0 | 11,076 | 15,319 | 0 | 26,395 |
| Total Expenses | 0 | 45,969 | 75,123 | 0 | 121,092 |
| Operating Earnings | 0 | 32,915 | 4,074 | 0 | 36,989 |
| Interest Income | (3,477) | (3,694) | (17,491) | 24,567 | (95) |
| Interest Expense | 8,834 | 6,580 | 20,681 | (24,567) | 11,528 |
| Income (Loss) Before Taxes | (5,357) | 30,029 | 884 | 0 | 25,556 |
| Income Tax Expense (Benefit) | (997) | 3,373 | 200 | 0 | 2,576 |
| Income (Loss) Including Noncontrolling Interests | (4,360) | 26,656 | 684 | 0 | 22,980 |
| Income Attributable to Noncontrolling Interests | 0 | 0 | (192) | 0 | (192) |
| Income (Loss) Attributable to Esterline | (4,360) | 26,656 | 492 | 0 | 22,788 |
| Equity in Net Income of Consolidated Subsidiaries | 27,148 | 10,094 | (2,890) | (34,352) | 0 |
| Net Income (Loss) Attributable to Esterline | \$ 22,788 | \$ 36,750 | \$ (2,398) | \$ (34,352) | \$ 22,788 |

Condensed Consolidating Statement of Cash Flows for the three month period ended January 27, 2012.

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|---|-----------|---------------------------|-----------------------------------|--------------|-----------|
| Cash Flows Provided (Used) by Operating Activities | | | | | |
| Net earnings (loss) including noncontrolling interests | \$ 22,980 | \$ 36,750 | \$ (2,398) | \$ (34,352) | \$ 22,980 |
| Depreciation & amortization | 0 | 9,561 | 16,562 | 0 | 26,123 |
| Deferred income taxes | 226 | (34) | (7,811) | 0 | (7,619) |
| Share-based compensation | 0 | 1,137 | 1,511 | 0 | 2,648 |
| Gain on sale of capital assets | 0 | (54) | (393) | 0 | (447) |
| Working capital changes, net of effect of acquisitions: | | | | | |
| Accounts receivable | (97) | 13,070 | (1,771) | 0 | 11,202 |
| Inventories | 0 | (5,763) | 3,324 | 0 | (2,439) |
| Prepaid expenses | (84) | (1,369) | (822) | 0 | (2,275) |
| Other current assets | 4 | (4) | 670 | 0 | 670 |
| Accounts payable | 325 | 172 | (4,274) | 0 | (3,777) |
| Accrued liabilities | 5,425 | 1,840 | (8,815) | 0 | (1,550) |
| Federal & foreign income taxes | 10,247 | (732) | (6,734) | 0 | 2,781 |
| Other liabilities | 1,965 | (1,153) | (737) | 0 | 75 |
| Other, net | 0 | 1,006 | (2,731) | 0 | (1,725) |
| | 40,991 | 54,427 | (14,419) | (34,352) | 46,647 |
| Cash Flows Provided (Used) by Investing Activities | | | | | |
| Purchases of capital assets | (408) | (7,285) | (5,233) | 0 | (12,926) |
| Proceeds from sale of capital assets | 0 | 54 | 393 | 0 | 447 |
| Escrow deposit | (6) | 0 | 0 | 0 | (6) |
| | (414) | (7,231) | (4,840) | 0 | (12,485) |

(In thousands)

| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Eliminations | Total |
|--|-----------|---------------------------|-----------------------------------|--------------|------------|
| Cash Flows Provided (Used) by Financing Activities | | | | | |
| Proceeds provided by stock issuance under employee stock plans | 1,379 | 0 | 0 | 0 | 1,379 |
| Excess tax benefits from stock options exercised | 6 | 0 | 0 | 0 | 6 |
| Dividends paid to noncontrolling interest | 0 | 0 | 0 | 0 | 0 |
| Proceeds from credit facilities | 0 | 0 | 0 | 0 | 0 |
| Repayment of long-term debt | (25,000) | (114) | (6,271) | 0 | (31,385) |
| Proceeds from government assistance | 0 | 0 | 7,942 | 0 | 7,942 |
| Net change in intercompany financing | (18,214) | (45,244) | 29,106 | 34,352 | 0 |
| | (41,829) | (45,358) | 30,777 | 34,352 | (22,058) |
| Effect of foreign exchange rates on cash and cash equivalents | 0 | (114) | (3,736) | 0 | (3,850) |
| Net increase (decrease) in cash and cash equivalents | (1,252) | 1,724 | 7,782 | 0 | 8,254 |
| Cash and cash equivalents beginning of year | 49,837 | 13,450 | 121,748 | 0 | 185,035 |
| Cash and cash equivalents end of year | \$ 48,585 | \$ 15,174 | \$ 129,530 | \$ 0 | \$ 193,289 |

Item 2. **Management's Discussion and Analysis of Financial Condition and Results of Operations**

Overview

We operate our businesses in three segments: Avionics & Controls, Sensors & Systems and Advanced Materials. Our segments are structured around our technical capabilities.

The Avionics & Controls segment includes avionics systems, control systems, interface technologies and communication systems capabilities. Avionics systems designs and develops cockpit systems integration and avionics solutions for commercial and military applications. Control systems designs and manufactures technology interface systems for military and commercial aircraft and land- and sea-based military vehicles. Interface technologies manufactures and develops custom control panels, input systems for medical, industrial, military and gaming industries. Communication systems designs and manufactures military audio and data products for severe battlefield environments, embedded communication intercept receivers for signal intelligence applications, as well as communication control systems to enhance security and aural clarity in military applications.

The Sensors & Systems segment includes power systems, connection technologies and advanced sensors capabilities. Power systems develops and manufactures electrical power switching and other related systems, principally for aerospace and defense customers. Connection technologies develops and manufactures highly engineered connectors for harsh environments and serves the aerospace, defense & space, power generation, rail and industrial equipment markets. Advanced sensors develops and manufactures high precision temperature and pressure sensors for aerospace and defense customers.

The Advanced Materials segment includes engineered materials and defense technologies capabilities. Engineered materials develops and manufactures thermally engineered components and high-performance elastomer products used in a wide range of commercial aerospace and military applications. Defense technologies develops and manufactures combustible ordnance components and warfare countermeasure devices for military customers. Sales in all segments include domestic, international, defense and commercial customers.

Our current business and strategic plan focuses on the continued development of our products principally for aerospace and defense markets. We are concentrating our efforts to expand our capabilities in these markets and to anticipate the global needs of our customers and respond to such needs with comprehensive solutions. These efforts focus on continuous research and new product development, acquisitions and strategic realignments of operations to expand our capabilities as a more comprehensive supplier to our customers across our entire product offering.

Net income was \$25.1 million, or \$0.80 per diluted share, in the first fiscal quarter of 2013 compared with \$22.8 million, or \$0.73 per diluted share, in the prior-year period.

Total sales decreased 2.7% over the prior-year period to \$458.0 million, principally reflecting lower sales in Avionics & Controls and the Advanced Materials segment. These two segments were impacted by reductions in defense spending mainly due to the continued uncertainty of U.S. congressional budget cuts, or sequestration, on defense spending. Without additional congressional action, further budget cuts as set forth in the Budget Control Act of 2011 will be implemented on March 1, 2013. While we believe we have adequately anticipated the impact on our financial results for fiscal 2013, the impact of sequestration is yet to be fully determined and additional reductions in defense spending over the next decade could occur.

Gross margin increased to 35.0% in the first fiscal quarter of 2013 compared with 33.6% in the prior-year period. The prior-year period included effects of purchase accounting to recognize the fair value of the Souriau Group (Souriau) acquired inventory as expense over the first inventory turn. Research, development and engineering spending decreased \$3.3 million over the prior-year period to 5.0% of sales due to decreased spending for Avionics & Controls developments. Selling, general and administrative expenses increased \$3.9 million over the prior-year period, reflecting a \$3.6 million increase in corporate expense. Selling, general and administrative expense as a percent of sales increased 1.4 percentage points over the prior-year period to 21.5% of sales. The increase in selling, general and administrative expense as a percent of sales mainly reflected lower sales volumes. Net income benefited from a decrease in the income tax rate to 8.5% from 10.1% in the prior-year period, reflecting certain discrete tax benefits.

Operating results for Avionics & Controls and Advanced Materials segments declined while Sensors & Systems improved compared to the prior-year period. The decrease in Avionics & Controls reflected lower sales of avionics systems. The decrease in Advanced Materials mainly reflected lower earnings from sales of engineered materials for defense applications. The increase in Sensors & Systems reflected a prior-year period charge of \$12.0 million due to recording Souriau's acquired inventory at its fair value.

Results of Operations

Three Month Period Ended January 25, 2013, Compared with Three Month Period Ended January 27, 2012

Sales for the first fiscal quarter decreased 2.7% when compared with the prior-year period. Sales by segment were as follows:

(In thousands)

| | Incr./(Decr.) from prior year period | Three Months Ended | |
|---------------------|--|---------------------|---------------------|
| | | January 25, 2013 | January 27, 2012 |
| Avionics & Controls | (2.8)% | \$ 174,570 | \$ 179,572 |
| Sensors & Systems | 0.1% | 171,810 | 171,672 |
| Advanced Materials | (6.7)% | 111,582 | 119,638 |
| Total Net Sales | | \$ 457,962 | \$ 470,882 |

The 2.8% decrease in sales of Avionics & Controls reflected decreased sales volumes of avionics systems of \$6 million and communication systems of \$3 million, partially offset by increased sales volumes of control systems. The decrease in avionics systems was principally due to a relative equal decline in cockpit integration and aviation product sales volumes. The decrease in cockpit integration sales reflected a reduction in retrofits for military transport aircraft and the T-6B. The decrease in avionics products mainly reflected the timing of orders and shipments from our defense customers. The decrease in communication systems principally reflected reduced sales of embedded communication intercept receivers. The increase in control systems mainly reflected strong commercial aviation demand.

The 6.7% decrease in sales of Advanced Materials principally reflected decreased sales volumes of defense technologies of \$6 million and decreased sales volumes of engineered materials. The decrease in defense technologies sales volumes mainly reflected lower sales of countermeasure devices due to production inefficiencies resulting in delayed shipments. The decrease in engineered materials mainly reflected lower demand for defense applications.

Overall, gross margin was 35.0% and 33.6% for the first fiscal quarter of 2013 and 2012, respectively. Gross profit was \$160.3 million and \$158.1 million for the first fiscal quarter of 2013 and 2012, respectively.

Avionics & Controls segment gross margin was 36.6% and 38.8% for the first fiscal quarter of 2013 and 2012, respectively. Segment gross profit was \$63.8 million compared to \$69.7 million in the prior-year period. The decrease in segment gross profit was principally due to lower gross profit on avionics systems of \$6 million mainly due to lower sales volumes for the T-6B military trainer cockpit and avionics products for defense applications. A \$3 million increase in gross profit on control systems was offset by a decrease in communication systems due to lower demand for embedded communication intercept receivers.

Sensors & Systems segment gross margin was 36.5% and 28.5% for the first fiscal quarter of 2013 and 2012, respectively. Segment gross profit was \$62.7 million compared to \$48.8 million in the prior-year period. The increase in gross profit was mainly due to increased gross profit for connection technologies of \$14 million. The prior-year period gross profit of connection technologies was impacted by a \$12 million charge due to recording Souriau's acquired inventory at its fair value.

Advanced Materials segment gross margin was 30.3% compared to 33.0% for the prior-year period. Segment gross profit was \$33.8 million compared to \$39.5 million in the prior-year period. The decrease in segment gross profit was principally due to a \$4 million reduction in gross profit on decreased sales of elastomer materials for defense applications. The decrease in gross profit on sales of defense technologies was due to lower sales and production inefficiencies of flare countermeasures.

Selling, general and administrative expenses (which include corporate expenses) totaled \$98.6 million, or 21.5% of sales, and \$94.7 million, or 20.1% of sales, for the first fiscal quarter of 2013 and 2012, respectively. The 1.4 percentage point increase in selling, general and administrative expense as a percentage of sales was principally due to lower sales volumes. The \$3.9 million increase in selling, general and administrative expenses mainly reflected higher corporate compensation expense and professional fees for regulatory compliance and acquisitions.

Research, development and engineering spending was \$23.1 million, or 5.0% of sales, for the first fiscal quarter of 2013 compared with \$26.4 million, or 5.6% of sales, for the first fiscal quarter of 2012. The decrease in research, development and engineering spending principally reflects lower spending on avionics systems. Fiscal 2013 research, development and engineering spending is expected to be in the range of approximately 5% to 5.25% of sales.

Segment earnings (operating earnings excluding corporate expenses and other income or expense) for the first fiscal quarter of 2013 totaled \$55.2 million, or 12.1% of sales, compared with \$50.0 million, or 10.6% of sales, for the first fiscal quarter in 2012.

Avionics & Controls segment earnings were \$18.6 million, or 10.6% of sales, in the first fiscal quarter of 2013 and \$20.1 million, or 11.2% of sales, in the first fiscal quarter of 2012, mainly reflecting a \$3 million decrease in avionics systems and a \$2 million decrease in communication systems, partially offset by an increase in control systems. Avionics systems earnings were impacted by decreased gross profit, partially offset by lower spending on research, development and engineering. Communication systems earnings were mainly impacted by decreased gross profit on lower sales of embedded communication intercept receivers.

Sensors & Systems segment earnings were \$19.0 million, or 11.1% of sales, for the first fiscal quarter of 2013 compared with \$6.8 million, or 4.0% of sales, for the first fiscal quarter of 2012, principally reflecting the \$12.0 million inventory fair value charge discussed above. Sensors & Systems also benefited by strong earnings from increased sales of power systems, partially offset by weaker earnings from decreased sales of advanced sensors for the aftermarket.

Advanced Materials segment earnings were \$17.6 million, or 15.8% of sales, for the first fiscal quarter of 2013 compared with \$23.1 million, or 19.3% of sales, for the first fiscal quarter of 2012, primarily reflecting decreased gross profit on lower sales of elastomer materials for defense applications.

Interest expense for the first fiscal quarter of 2013 was \$10.4 million compared with \$11.5 million for the first fiscal quarter of 2012, reflecting lower borrowings.

The income tax rate was 8.5% compared with 10.1% for the first fiscal quarter of 2013 and 2012, respectively. In the first fiscal quarter of 2013, the Company recognized \$3.7 million of discrete tax benefits principally 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. In the first fiscal quarter of 2012, the Company recognized \$2.3 million of discrete tax benefits due to a change in French tax laws associated with the holding company structure and the financing of the Souriau acquisition. The income tax rate differed from the statutory rate in the first fiscal quarter of 2013 and 2012, 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 \$5.1 million of tax benefits associated with research and development tax credits, capital and operating losses that are currently unrecognized could be recognized as a result of settlement of examinations and/or the expiration of a statute of limitations.

To the extent that sales are transacted in a currency other than the functional currency of the operating unit, we are subject to foreign currency fluctuation risk.

We use forward contracts to hedge our foreign currency exchange risk. To the extent that these hedges qualify under U.S. GAAP, the amount of gain or loss is deferred in Accumulated Other Comprehensive Income (AOCI) until the related sale occurs. Also, we are subject to foreign currency gains or losses from embedded derivatives on backlog denominated in a currency other than the functional currency of our operating companies or its customers. Gains and losses on forward contracts, embedded derivatives, and revaluation of assets and liabilities denominated in a currency other than the functional currency of the Company for the first fiscal quarter of 2013 and 2012 are as follows:

(In thousands)

| | Three Months Ended | |
|---|---------------------|---------------------|
| | January 25, 2013 | January 27, 2012 |
| Forward foreign currency contracts loss | \$ (905) | \$ (5,803) |
| Forward foreign currency contracts reclassified from AOCI | (80) | (101) |
| Embedded derivatives gain | 496 | 337 |
| Revaluation of monetary assets/liabilities gain (loss) | (3,113) | 3,351 |
| Total | \$ (3,602) | \$ (2,216) |

New orders for the first fiscal quarter of 2013 were \$473.6 million compared with \$467.8 million for the same period in 2012. Backlog was \$1.3 billion at January 25, 2013, compared to \$1.2 billion at January 27, 2012, and \$1.3 billion at the end of fiscal 2012.

Liquidity and Capital Resources

Cash and cash equivalents at January 25, 2013, totaled \$202.8 million, an increase of \$42.1 million from October 26, 2012. Net working capital increased to \$664.7 million at January 25, 2013, from \$639.3 million at October 26, 2012. Sources and uses of cash flows from operating activities principally consisted of cash received from the sale of products and cash payments for material, labor and operating expenses. Cash flows provided by operating activities were \$86.5 million and \$46.6 million in the first fiscal quarter of 2013 and 2012, respectively. The increase principally reflected high cash receipts from the sale of products.

Cash flows used by investing activities were \$12.2 million and \$12.5 million in the first fiscal quarter of 2013 and 2012, respectively. Cash flows used by investing activities in the first fiscal quarter of 2013 and 2012 mainly reflected cash paid for capital expenditures.

Cash flows used by financing activities were \$32.4 million in the first fiscal quarter of 2013 and mainly reflected \$36.6 million repayment of long-term debt. Cash flows used by financing activities were \$22.1 million in the first fiscal quarter of 2012 and mainly reflected \$28.3 million repayment of long-term debt and government assistance payments received of \$7.9 million.

Capital expenditures, consisting of machinery, equipment and computers, are anticipated to be approximately \$80.0 million during fiscal 2013, compared with \$49.4 million expended in fiscal 2012.

Total debt at January 25, 2013, was \$814.4 million and consisted of \$250.0 million of Senior Notes due in 2020, \$175.0 million of Senior Notes due in 2017, \$61.2 million (45.4 million) of the Euro Term Loan, \$225.0 million in borrowings under our secured credit facility, \$52.0 million government refundable advances, \$44.8 million under capital lease obligations, and \$6.4 million under our various foreign currency debt agreements and other debt agreements. On February 5, 2013, the \$75.0 million interest rate swap agreement to exchange the fixed interest rate on the \$175.0 million Senior Notes due in 2017 for a variable interest rate was called and is payable in 30 days.

Subsequent to period end, on February 4, 2013, we acquired the Gamesman Group (Gamesman) for approximately \$39.9 million. Gamesman is a global supplier of input devices principally serving the gaming industry. Gamesman will be included in the Avionics & Controls segment.

We believe cash on hand and funds generated from operations are adequate to service operating cash requirements and capital expenditures through the next twelve months.

Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases you can identify forward-looking statements by terminology such as anticipate, believe, continue, could, estimate, expect, intend, may, might, plan, potential, predict, should or will or the negative of such terms or other comparable terminology. Forward-Looking Statements and Risk Factors in our Annual Report on Form 10-K for the fiscal year ended October 26, 2012, that may cause our or the industry's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. You should not place undue reliance on these forward-looking statements. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, performance or achievements. Given these risks and uncertainties, you are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included or incorporated by reference into this report are made only as of the date hereof. We do not undertake and specifically decline any obligation to update any such statements or to publicly announce the results of any revisions to any such statements to reflect future events or developments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in our exposure to market risk during the first three months of fiscal 2013. A discussion of our exposure to market risk is provided in the Company's Annual Report on Form 10-K for the fiscal year ended October 26, 2012.

Item 4. Controls and Procedures

Our principal executive and financial officers evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of January 25, 2013. Based upon that evaluation, they concluded as of January 25, 2013, that our disclosure controls and procedures were effective to ensure that information we are required to disclose in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within time periods specified in Securities and Exchange Commission rules and forms. In addition, our principal executive and financial officers concluded as of January 25, 2013, that our disclosure controls and procedures are also effective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including to our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

During the time period covered by this report, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. **Legal Proceedings**

From time to time we are involved in legal proceedings arising in the ordinary course of business. We believe that adequate reserves for these liabilities have been made and that there is no litigation pending that could have a material adverse effect on our results of operations and financial condition.

Item 6. **Exhibits**

- 3.1 Amended and Restated Bylaws of the Company, effective December 13, 2012. (Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on December 18, 2012 [Commission File Number 1-6357].)
- 10.1* Esterline Technologies Corporation Fiscal Year 2013 Annual Incentive Compensation Plan.
- 10.2* Esterline Technologies Corporation Long-Term Incentive Plan.
- 10.3* Form of Global Stock Option Agreement under the Esterline Technologies Corporation Amended and Restated 2004 Equity Incentive Plan.
- 10.4* Form of Restricted Stock Unit Agreement under the Esterline Technologies Corporation Amended and Restated 2004 Equity Incentive Plan.
- 10.5* Promotion Letter from Esterline Technologies Corporation to Marcia Mason dated August 1, 2012.
- 10.6* Promotion Letter from Esterline Technologies Corporation to Albert Yost dated November 16, 2009.
- 10.7 Letter Agreement, dated December 13, 2012, among Esterline Technologies Corporation, Relational Investors, LLC and the other parties named in the Letter Agreement. (Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated December 18, 2012 [Commission File Number 1- 6357].)
- 11 Schedule setting forth computation of basic and diluted earnings per common share for the three month periods ended January 25, 2013, and January 27, 2012.
- 31.1 Certification of Chief Executive Officer.
- 31.2 Certification of Chief Financial Officer.
- 32.1 Certification (of R. Bradley Lawrence) pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification (of Robert D. George) pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Item 6.

Exhibits

| | |
|---------|---|
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

* Indicates management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

ESTERLINE TECHNOLOGIES CORPORATION
(Registrant)

Dated: March 1, 2013

By: /s/ Robert D. George
Robert D. George
*Chief Financial Officer, Vice President, and
Corporate Development
(Principal Financial Officer)*