KAMAN Corp
Form 10-Q
October 28, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 27, 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: 001-35419

KAMAN CORPORATION

(Exact name of registrant as specified in its charter)

Connecticut	06-0613548
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1332 Blue Hills Avenue
Bloomfield, Connecticut 06002
(Address of principal executive offices) (Zip Code)
(860) 243-7100
(Registrant’s telephone number, including area code)

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ 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 x

At October 18, 2013, there were 27,118,789 shares of Common Stock outstanding.

PART I

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

KAMAN CORPORATION AND SUBSIDIARIES

(In thousands, except share and per share amounts) (Unaudited)

	September 27, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$11,052	$16,593
Accounts receivable, net	216,223	180,798
Inventories	384,940	367,385
Deferred income taxes	29,874	25,835
Other current assets	31,442	27,434
Total current assets	673,531	618,045
Property, plant and equipment, net of accumulated depreciation of $163,646 and $149,696, respectively	141,633	128,669
Goodwill	203,960	192,046
Other intangible assets, net	90,959	92,913
Deferred income taxes	31,555	42,905
Other assets	22,526	22,415
Total assets	$1,164,164	$1,096,993
Liabilities and Shareholders’ Equity		
Current liabilities:		
Notes payable	$—	$21
Current portion of long-term debt	10,000	10,000
Accounts payable – trade	113,938	113,143
Accrued salaries and wages	36,409	35,869
Current portion of amount due to Commonwealth of Australia	—	6,659
Advances on contracts	17,963	1,900
Other accruals and payables	56,755	53,468
Income taxes payable	658	2,892
Total current liabilities	235,723	223,952
Long-term debt, excluding current portion	276,682	249,585
Deferred income taxes	4,292	5,150
Underfunded pension	137,650	148,703
Other long-term liabilities	46,479	49,410
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Preferred stock, $1 par value, 200,000 shares authorized; none outstanding	—	—
Common stock, $1 par value, 50,000,000 shares authorized; voting; 27,099,238 and 26,881,257 shares issued, respectively	27,099	26,881
Additional paid-in capital	130,348	122,522
Retained earnings	430,864	399,473
Accumulated other comprehensive income (loss)	(117,250)	(121,590)
Less 318,825 and 277,473 shares of common stock, respectively, held in treasury, at cost	(7,723)	(7,093)
Total shareholders’ equity	463,338	420,193
Total liabilities and shareholders’ equity	$1,164,164	$1,096,993

See accompanying notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
KAMAN CORPORATION AND SUBSIDIARIES
(In thousands, except per share amounts) (Unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 27, 2013	September 28, 2012	September 27, 2013	September 28, 2012
Net sales	$423,663	$409,567	$1,243,463	$1,193,512
Cost of sales	304,806	295,498	893,083	861,011
Gross profit	118,857	114,069	350,380	332,501
Selling, general and administrative expenses	87,436	89,153	274,075	262,883
Net loss on sale of assets	—	53	100	21
Operating income	31,421	24,863	76,205	69,597
Interest expense, net	3,113	2,922	9,344	8,622
Other expense (income), net	(21)	(64)	368	(288)
Earnings from continuing operations before income taxes	28,329	22,005	66,493	61,263
Income tax expense	9,634	7,221	22,752	21,269
Earnings from continuing operations	$18,695	$14,784	$43,741	$39,994
Earnings from discontinued operations, net of taxes	64	198	64	870
Gain on disposal of discontinued operations, net of taxes	420	—	420	—
Total earnings from discontinued operations, net of taxes	484	198	484	870
Net earnings	$19,179	$14,982	$44,225	$40,864
Earnings per share:				
Basic earnings per share from continuing operations	$0.70	$0.56	$1.64	$1.52
Basic earnings per share from discontinued operations	—	0.01	—	0.03
Basic earnings per share from disposal of discontinued operations	0.02	—	0.02	—
Basic earnings per share	$0.72	$0.57	$1.66	$1.55
Diluted earnings per share from continuing operations	$0.68	$0.55	$1.61	$1.51
Diluted earnings per share from discontinued operations	—	0.01	—	0.03
Diluted earnings per share from disposal of discontinued operations	0.02	—	0.02	—
Diluted earnings per share	$0.70	$0.56	$1.63	$1.54
Average shares outstanding:				
Basic	26,770	26,455	26,721	26,380
Diluted	27,233	26,623	27,062	26,540
Dividends declared per share	$0.16	$0.16	$0.48	$0.48

See accompanying notes to condensed consolidated financial statements.

3

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
KAMAN CORPORATION AND SUBSIDIARIES
(In thousands) (Unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 27, 2013	September 28, 2012	September 27, 2013	September 28, 2012
Net earnings	$19,179	$14,982	$44,225	$40,864
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	4,669	2,961	(89)	3,487
Unrealized (loss) on derivative instruments, net of tax benefit of $74 and $0, and $36 and $0, respectively	(119)	—	(58)	—
Change in pension and post-retirement benefit plan liabilities, net of tax expense of $941 and $834, and $2,751 and $2,503, respectively	1,536	1,361	4,487	4,084
Other comprehensive income	6,086	4,322	4,340	7,571
Comprehensive income	$25,265	$19,304	$48,565	$48,435

See accompanying notes to condensed consolidated financial statements.

4

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
KAMAN CORPORATION AND SUBSIDIARIES
(In thousands) (Unaudited)

	For the Nine Months Ended	
	September 27, 2013	September 28, 2012
Cash flows from operating activities:		
Earnings from continuing operations	$43,741	$39,994
Adjustments to reconcile earnings from continuing operations to net cash provided by (used in) operating activities of continuing operations:		
Depreciation and amortization	23,720	20,427
Accretion of convertible notes discount	1,366	1,296
Provision for doubtful accounts	1,100	174
Net loss on sale of assets	100	21
Net loss (gain) on derivative instruments	130	(287)
Stock compensation expense	4,056	4,809
Excess tax (benefit) from share-based compensation arrangements	(350)	(720)
Deferred income taxes	2,619	(10)
Changes in assets and liabilities, excluding effects of acquisitions/divestitures:		
Accounts receivable	(33,354)	(6,094)
Inventories	(14,269)	(15,704)
Income tax refunds receivable	(3,099)	527
Other current assets	(1,371)	5,779
Accounts payable - trade	(4,814)	(556)
Accrued contract losses	(565)	(1,349)
Advances on contracts	16,063	(138)
Other accruals and payables	(1,762)	(10,369)
Income taxes payable	(2,263)	(328)
Pension liabilities	(5,208)	(1,843)
Other long-term liabilities	(1,016)	1,471
Net cash provided by operating activities of continuing operations	24,824	37,100
Net cash provided by operating activities of discontinued operations	484	977
Net cash provided by operating activities	25,308	38,077
Cash flows from investing activities:		
Proceeds from sale of assets	111	337
Expenditures for property, plant & equipment	(30,118)	(19,560)
Acquisition of businesses	(19,934)	(83,390)
Other, net	(642)	(407)
Cash used in investing activities of continuing operations	(50,583)	(103,020)
Cash used in investing activities of discontinued operations	—	(5)
Cash used in investing activities	(50,583)	(103,025)
Cash flows from financing activities:		
Net borrowings under revolving credit agreements	30,116	72,190
Debt repayment	(5,000)	(3,750)
Net change in book overdraft	3,617	1,707
Proceeds from exercise of employee stock awards	4,002	5,730
Purchase of treasury shares	(644)	(733)
Dividends paid	(12,806)	(12,637)
Other	(51)	(50)

Windfall tax benefit	350	720
Cash provided by financing activities of continuing operations	19,584	63,177
Cash used in financing activities of discontinued operations	—	(807)
Cash provided by financing activities	19,584	62,370
Net decrease in cash and cash equivalents	(5,691)	(2,578)
Effect of exchange rate changes on cash and cash equivalents	150	(166)
Cash and cash equivalents at beginning of period	16,593	14,985
Cash and cash equivalents at end of period	$11,052	$12,241

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

1. BASIS OF PRESENTATION

The December 31, 2012, Condensed Consolidated Balance Sheet amounts have been derived from the previously audited Consolidated Balance Sheet of Kaman Corporation and subsidiaries (collectively, the "Company"), but do not include all disclosures required by accounting principles generally accepted in the United States of America ("US GAAP"). In the opinion of management, the remainder of the condensed financial information reflects all adjustments necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature, unless otherwise disclosed in this report. Certain amounts in the prior period condensed consolidated financial statements have been reclassified to conform to current presentation. The statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The results of operations for the interim periods presented are not necessarily indicative of trends or of results to be expected for the entire year.

The Company has a calendar year-end; however, its first three fiscal quarters follow a 13-week convention, with each quarter ending on a Friday. The third quarter for 2013 and 2012 ended on September 27, 2013 and September 28, 2012, respectively.

2. RECENT ACCOUNTING STANDARDS

In January 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-01, Balance Sheet (ASC Topic 210) - Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. ASU No. 2013-01 applies to derivatives accounted for in accordance with Accounting Standards Codification ("ASC") Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with ASC Section 210-20-45 or ASC Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The standard became effective on January 1, 2013. These changes had no impact on the Company's condensed consolidated financial statements.

In January 2013, the FASB also issued ASU No. 2013-02, Comprehensive Income (ASC Topic 220) - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU No. 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The Company adopted this standard beginning January 1, 2013. (See Note 16, Shareholders' Equity and Accumulated Other Comprehensive Income.)

In March 2013, the FASB issued ASU No. 2013-05, Foreign Currency Matters (ASC Topic 830) - Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. The objective is to resolve the diversity in practice about whether ASC Subtopic 810-10, Consolidation - Overall or ASC Subtopic 830-30 Foreign Currency Matters - Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity. The update is effective for financial statement periods beginning after December 15, 2013 with early adoption permitted. The Company will adopt this standard beginning January 1, 2014. The Company does not expect these changes to have an impact on its consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-10, Derivatives and Hedging (ASC Topic 815) - Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. The amendments in this update permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under ASC Topic 815, in addition to U.S. Treasury ("UST") and London Interbank Offered Rate ("LIBOR"). The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The Company has not entered into any new hedging relationships since July 17, 2013.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

2. RECENT ACCOUNTING STANDARDS (CONTINUED)

In July 2013, the FASB also issued ASU No. 2013-11, Income Taxes (ASC Topic 740) - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The objective is to end some inconsistent practices with regard to the presentation on the balance sheet of unrecognized tax benefits.The update is effective for financial statement periods beginning after December 15, 2013, with early adoption permitted. The Company will adopt this standard beginning January 1, 2014. The Company does not expect these changes to have a material impact on its consolidated financial statements.

3. DISCONTINUED OPERATIONS

On December 31, 2012, the Company sold substantially all of the assets and liabilities of the Distribution segment's Canadian operations. As a result, the Company has reported the results of operations and financial position of this component as discontinued operations within the condensed consolidated financial statements for all periods presented.

The following tables provide information regarding the results of discontinued operations:

	For the Three Months Ended		For the Nine Months Ended	
	September 27, 2013	September 28, 2012	September 27, 2013	September 28, 2012
In thousands				
Net sales of discontinued operations	$—	$5,046	$—	$15,303
Income from discontinued operations	86	246	86	1,191
Other income (expense), net, from discontinued operations	—	5	—	(66)
Earnings from discontinued operations before income taxes	86	251	86	1,125
Income tax expense	22	53	22	255
Earnings from discontinued operations before gain on disposal	$64	$198	$64	$870
Gain on disposal of discontinued operations	—	—	—	—
Reduction of provision for income taxes on gain	420	—	420	—
Net gain on disposal	420	—	420	—
Net earnings from discontinued operations	$484	$198	$484	$870

During the third quarter, the Company recorded a gain on discontinued operations due to a $0.4 million favorable tax result versus previous estimates and other activity related to the settlement of the closing balance sheet.

4. ACQUISITIONS

As previously disclosed in the Company's Form 10-Q for the quarter ended June 28, 2013, on June 14, 2013, the Company acquired substantially all of the assets of Northwest Hose & Fittings, Inc. ("Northwest Hose"). Northwest Hose, formed in 1995, is an authorized Parker Hannifin distributor of hydraulic hose, fittings and adapters as well as couplers and industrial hose to a diverse group of industries such as the metals, agricultural, industrial machinery and equipment industries. Northwest Hose is headquartered in Spokane, Washington.

On July 31, 2013, the Company acquired substantially all of the assets of Ohio Gear & Transmission of Eastlake, Ohio. Founded in 1973, Ohio Gear & Transmission is a distributor of mechanical power transmission equipment, bearings & electric automation systems as well as a designer and fabricator of specialized gearing products to a variety of industries including food, packaging, material handling, and general machinery.

On August 15, 2013, the Company acquired Western Fluid Components, Inc. ("Western"). Western is headquartered in Everett, Washington, and has other Washington facilities in Tacoma, Kirkland and Bellingham. Founded in 1975, Western is one of the largest fluid connector distributors in Washington and a full-line distributor for Parker Hannifin’s Fluid Connector Group.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

4. ACQUISITIONS (CONTINUED)

The above reported acquisitions were accounted for as business combinations. Assets acquired and liabilities assumed were recorded based on their fair value at the date of acquisition. The fair value of assets acquired and liabilities assumed were as follows:

In thousands	
Cash	$143
Accounts receivable	3,122
Inventories	3,423
Property, plant and equipment	446
Other tangible assets	797
Goodwill	9,493
Other intangible assets	4,788
Liabilities	(4,248)
Total of net assets acquired	17,964
Less cash received	(143)
Total consideration	$17,821

The Company has paid $16.9 million of the total consideration of $17.8 million for these acquisitions through September 27, 2013. The goodwill associated with Northwest Hose and Ohio Gear & Transmission is tax deductible. The goodwill for the three acquisitions is the result of expected synergies from combining the operations of the acquired businesses with the Company's operations and intangible assets that do not qualify for separate recognition, such as an assembled workforce. Included in the Condensed Consolidated Statements of Operations is $4.2 million and $4.7 million of revenue from these acquisitions for the three months and nine months ended September 27, 2013, respectively.

The fair value of the identifiable intangible assets of $4.8 million, consisting primarily of customer lists/relationships, non-compete agreements and trade names, was determined using the income approach. Specifically, the discounted cash flows method was utilized for the customer relationships and non-compete agreements and the relief-from-royalty method was utilized for the trade names. The fair value of the customer relationships ($4.6 million) is being amortized on a straight-line basis over periods ranging from 7 to 10 years; and the fair value of the other intangible assets ($0.2 million) is being amortized over periods ranging from 3 to 5 years, the estimated lives of the assets.

5. RESTRUCTURING COSTS

During 2013, the Company initiated restructuring activities primarily at its Distribution segment to align the cost structure of the organization with its revenue levels. This included workforce reductions and the consolidation of field operations where the Distribution segment had multiple facilities in the same geographic area. The Distribution segment restructuring resulted in net workforce reductions of 110 employees and the exiting of five facilities. The Company intends to settle all liabilities associated with these restructuring activities during 2013.

The following table summarizes the accrual balances by cost type for the 2013 restructuring actions:

	Severance	Other [(a)]	Total
In thousands			

Restructuring accrual balance at December 31, 2012	$—	$—	$—
Provision	3,283	250	3,533
Cash payments	(2,329)	(230)	(2,559)
Restructuring accrual balance at September 27, 2013	$954	$20	$974

(a) Includes costs associated with the consolidation of facilities.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

6. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net consists of the following:

In thousands	September 27, 2013	December 31, 2012
Trade receivables	$142,805	$117,426
U.S. Government contracts:		
Billed	23,488	18,261
Costs and accrued profit – not billed	2,562	2,568
Commercial and other government contracts:		
Billed	50,275	45,547
Costs and accrued profit – not billed	578	144
Less allowance for doubtful accounts	(3,485)	(3,148)
Accounts receivable, net	$216,223	$180,798

Accounts receivable, net includes amounts for matters such as contract changes, negotiated settlements and claims for unanticipated contract costs. These amounts are as follows:

In thousands	September 27, 2013	December 31, 2012
Contract changes, negotiated settlements and claims for unanticipated contract costs	$—	$397
Total	$—	$397

7. FAIR VALUE MEASUREMENTS

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date.

The Company uses a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Observable inputs other than quoted prices included in Level 1, such as quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The following table presents the carrying value and fair value of financial instruments that are not carried at fair value:

	September 27, 2013		December 31, 2012	
In thousands	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt:				
Level 1	$106,626	$142,966	$105,260	$144,460

Level 2	180,056	167,091	154,325	143,135
Total	$286,682	$310,057	$259,585	$287,595

9

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

7. FAIR VALUE MEASUREMENTS (CONTINUED)

The above fair values were computed based on quoted market prices (Level 1) and discounted future cash flows (Level 2 observable inputs), as applicable. Differences from carrying values are attributable to interest rate changes subsequent to when the transaction occurred. The increase in fair value of the long-term debt is driven by increased borrowings under the Company's Revolving Credit Facility, partially offset by a lower quoted market price for the Company's convertible notes.

The fair values of Cash and cash equivalents, Accounts receivable, net, Notes payable, and Accounts payable - trade approximate their carrying amounts due to the short-term maturities of these instruments.

Recurring Fair Value Measurements

The table below segregates all financial assets and liabilities that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine their fair value at the measurement date:

In thousands	Total Carrying Value at September 27, 2013	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Derivative instruments	$114	$—	$114	$—
Total assets	$114	$—	$114	$—
Derivative instruments	$185	$—	$185	$—
Total liabilities	$185	$—	$185	$—

In thousands	Total Carrying Value at December 31, 2012	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Derivative instruments	$1,506	$—	$1,506	$—
Total assets	$1,506	$—	$1,506	$—

The Company’s derivative instruments are foreign exchange contracts and interest rate swaps that are measured at fair value using observable market inputs such as forward rates and our counterparties’ credit risks. Based on these inputs, the derivative instruments are classified within Level 2 of the valuation hierarchy and have been included in other current assets, other assets and other long-term liabilities on the Condensed Consolidated Balance Sheets at September 27, 2013, and December 31, 2012. Based on the continued ability to trade and enter into forward contracts, we consider the markets for our fair value instruments to be active.

The Company evaluated the credit risk associated with the counterparties to these derivative instruments and determined that as of September 27, 2013, such credit risks have not had an adverse impact on the fair value of these instruments.

8. DERIVATIVE FINANCIAL INSTRUMENTS

Derivatives Overview

The Company is exposed to certain risks relating to its ongoing business operations, including market risks relating to fluctuations in foreign currency exchange rates and interest rates. Derivative financial instruments are recognized on the Condensed Consolidated Balance Sheets as either assets or liabilities and are measured at fair value. Changes in the fair values of derivatives are recorded each period in earnings or accumulated other comprehensive income, depending on whether a derivative is effective as part of a hedged transaction. Gains and losses on derivative instruments reported in accumulated other comprehensive income are subsequently included in earnings in the periods in which earnings are affected by the hedged item. The Company does not use derivative instruments for speculative purposes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

8. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Derivatives Overview (continued)

The Company holds forward exchange contracts designed to hedge forecasted transactions denominated in foreign currencies and to minimize the impact of foreign currency fluctuations on the Company's earnings and cash flows. Some of these contracts were designated as cash flow hedges. The Company will include in earnings amounts currently included in accumulated other comprehensive income upon recognition of cost of sales related to the underlying transaction. No material amounts were reclassified to income from other comprehensive income for derivative instruments formerly designated as cash flow hedges during the three or nine months ended September 27, 2013, or September 28, 2012. Over the next twelve months, the income related to cash flow hedges expected to be reclassified from other comprehensive income is $0.2 million.

Derivatives Designated as Cash Flow Hedges

The Company's Term Loan Facility ("Term Loan") contains floating rate obligations and is subject to interest rate fluctuations. During 2013, the Company entered into interest rate swap agreements for the purposes of hedging the eight quarterly variable-rate interest payments under its Term Loan due in 2014 and 2015. These interest rate swap agreements were designated as cash flow hedges and are intended to manage interest rate risk associated with the Company's variable rate borrowings and minimize the impact on the Company's earnings and cash flows of interest rate fluctuations attributable to changes in LIBOR rates.

The following table shows the fair value of derivative instruments designated as cash flow hedging instruments:

		Fair Value		
	Balance Sheet Location	September 27, 2013	December 31, 2012	Notional Amount
In thousands				
Derivative Liabilities				
Interest rate swap contracts	Other long-term liabilities	$185	$—	$90,000- $70,000
Total		$185	$—	

The following table shows the gain or (loss) recognized in other comprehensive income for derivatives designated as cash flow hedges:

	For the Three Months Ended		For the Nine Months Ended	
	September 27, 2013	September 28, 2012	September 27, 2013	September 28, 2012
In thousands				
Derivative Liabilities				
Interest rate swap contracts	$(256)	$—	$(185)	$—
Total	$(256)	$—	$(185)	$—

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

8. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Derivatives Not Designated as Hedging Instruments

The following table shows the fair value of derivative instruments not designated as hedging instruments:

In thousands	Balance Sheet Location	Fair Value September 27, 2013	December 31, 2012	Notional Amount
Derivative Assets				
Foreign exchange contracts	Other current assets	$—	$1,345	$0 / $3,408 Australian Dollars
Foreign exchange contracts	Other current assets	114	161	$2,829/ $4,110
Total		$114	$1,506	

On February 12, 2009, the Company dedesignated the forward contract it had entered into to hedge $36.5 million (AUD) of its $39.5 million (AUD) minimum required payments to the Commonwealth of Australia. The Company settled its final minimum required payment with the Commonwealth of Australia on April 2, 2013.

The following table shows the location and amount of the gain or (loss) recognized on the Condensed Consolidated Statements of Operations for derivatives not designated as hedge instruments:

		For the Three Months Ended		For the Nine Months Ended	
	Income Statement Location	September 27, 2013	September 28, 2012	September 27, 2013	September 28, 2012
In thousands					
Derivative Assets					
Foreign exchange contracts	Other (income) expense, net	$—	$79	$—	$362
Foreign exchange contracts	Other (income) expense, net	(136)	104	47	176
Total		$(136)	$183	$47	$538

9. INVENTORIES

Inventories consist of the following:

In thousands	September 27, 2013	December 31, 2012
Merchandise for resale	$137,577	$137,426
Contracts and other work in process	236,001	216,233
Finished goods (including certain general stock materials)	11,362	13,726
Total	$384,940	$367,385

Inventories include amounts associated with matters such as contract changes, negotiated settlements and claims for unanticipated contract costs. These amounts are as follows:

In thousands	September 27, 2013	December 31, 2012
Contract changes, negotiated settlements and claims for unanticipated contract costs	$11,599	$6,861

Total	$11,599	$6,861

12

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

INVENTORIES (CONTINUED)

K-MAX® inventory of $17.4 million and $18.0 million as of September 27, 2013, and December 31, 2012, respectively, is included in contracts and other work in process inventory and finished goods. Management believes that a significant portion of this K-MAX® inventory will be sold after September 27, 2014, based upon the anticipation of supporting the fleet for the foreseeable future.

At September 27, 2013 and December 31, 2012, $48.3 million and $52.6 million, respectively, of SH-2G(I), formerly SH-2G(A), inventory was included on the Company's balance sheet in contracts and other work in process inventory. On May 8, 2013, the Company announced that it had entered into a $120.6 million contract with the New Zealand Ministry of Defence for the sale of ten SH-2G(I) Super Seasprite aircraft, spare parts, a full mission flight simulator, and related logistics support. Although a substantial portion of the SH-2G(I) inventory will be used in the performance of this new contract, management believes that $22.5 million of the SH-2G(I) inventory will be sold after September 27, 2014, based upon the time needed to prepare the aircraft for sale and the requirements of our customer. For more information on the SH-2G(I) inventory, see Note 12, Commitments and Contingencies.

Long-term Contracts

For long-term aerospace contracts, the Company generally recognizes revenue and cost based on the percentage-of-completion method of accounting, which allows for recognition of revenue as work on a contract progresses. The Company recognizes revenues and cost based on either (1) the cost-to-cost method, in which sales and profit are recorded based upon the ratio of costs incurred to estimated total costs to complete the contract, or (2) the units-of-delivery method, in which sales are recognized as deliveries are made and cost of sales is computed on the basis of the estimated ratio of total cost to total sales.

Revenue and cost estimates for all significant long-term contracts for which revenue is recognized using the percentage-of-completion method of accounting are reviewed and reassessed quarterly. Based upon these reviews, the Company records the effects of adjustments in profit estimates each period. If at any time the Company determines that in the case of a particular contract total costs will exceed total contract revenue, the Company will record a provision for the entire anticipated contract loss at that time. There was a net decrease to the Company's operating income from changes in contract estimates of $0.1 million and $0.3 million for the three-month periods ended September 27, 2013, and September 28, 2012, respectively. There was a net decrease in operating income of $2.8 million and $1.8 million for the nine-month periods ended September 27, 2013, and September 28, 2012, respectively, attributable to changes in contract estimates. The decrease for the nine months ended September 27, 2013, was a result of cost growth due to revised estimates in various programs, including the Sikorsky BLACK HAWK helicopter program, Bell helicopter offload program and a fuze program. The decrease for the nine months ended September 28, 2012, was due to additional cost for one of the Company's fuze programs and production issues encountered during the first half of 2012.

10. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Goodwill

The following table sets forth the change in the carrying amount of goodwill for each reportable segment and for the Company:

	Distribution	Aerospace	Total
In thousands			

Gross balance at December 31, 2012	$96,155	$110,072	$206,227
Accumulated impairment	—	(14,181)	(14,181)
Net balance at December 31, 2012	96,155	95,891	192,046
Additions	9,493	2,485	11,978
Impairments	—	—	—
Foreign currency translation	(16)	(48)	(64)
Ending balance at September 27, 2013	$105,632	$98,328	$203,960

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

10. GOODWILL AND OTHER INTANGIBLE ASSETS, NET (CONTINUED)

Goodwill (continued)

Additions to Goodwill at the Company's Distribution segment relate to the acquisitions completed during the first nine months of 2013, as set forth in Note 4 - Acquisitions. Additions to the Goodwill for our Aerospace segment relate to an earnout payment from a previous acquisition.

In accordance with ASC 350, Intangibles – Goodwill and Other (“ASC 350”), the Company evaluates goodwill for possible impairment on at least an annual basis. The Company is currently in the process of preparing its forecast, which it will use to complete its annual evaluation. Based upon information obtained to this point in the forecast process, management notes that there are external factors that could impact the expected future cash flows for three reporting units, as described below. Further investigation of these factors could result in the write-off of some or all of the goodwill associated with these three reporting units.

In 2012, the Company's VT Composites reporting unit experienced delays on certain programs that were driven by changes in customers' requirements. The Company anticipated these changes in requirements would shift revenues and related cash flows into 2013 and future periods. The anticipated deferred revenues did not materialize to the levels the Company had projected in 2013, and therefore the propriety of the forecasted recoveries in future years is being evaluated. The goodwill associated with this reporting unit is $18.8 million.

The Company's U.K. reporting unit has been successful in winning new orders during 2012 and 2013; however, this reporting unit continues to experience higher than expected working capital requirements related to start-up expenditures associated with these new contracts. The goodwill associated with this reporting unit is $31.8 million.

The Company's Engineering Services reporting unit has experienced a decline in revenues during 2013 due to a reduction in requirements by a major OEM customer. This reporting unit generates revenue primarily through the billing of employees' time spent on customer projects. The Company believes that this is a temporary reduction in the OEM customer requirements; the relationship between this reporting unit and the customer continues to be strong and has not suffered as a result of the decline in project requirements. The goodwill associated with this reporting unit is $8.5 million

Other intangible assets consisted of:

		At September 27, 2013		At December 31, 2012	
	Amortization Period	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
In thousands					
Customer lists / relationships	6-21 years	$108,688	$(21,369)	$103,894	$(15,541)
Trademarks / trade names	3-7 years	2,695	(1,483)	2,655	(1,128)
Non-compete agreements and other	1-9 years	6,112	(3,819)	5,979	(3,091)
Patents	17 years	636	(501)	636	(491)
Total		$118,131	$(27,172)	$113,164	$(20,251)

The changes in other intangible assets are attributable to changes in foreign currency exchange rates and the acquisitions completed during the first nine months of 2013.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued
For the three months and nine months ended September 27, 2013 and September 28, 2012
(Unaudited)

11. PENSION PLANS

Components of net pension cost for the Qualified Pension Plan and Supplemental Employees' Retirement Plan ("SERP") are as follows:

	For the Three Months Ended			
	Qualified Pension Plan		SERP	
	September 27, 2013	September 28, 2012	September 27, 2013	September 28, 2012
In thousands				
Service cost for benefits earned during the year	$3,587	$3,519	$85	$96
Interest cost on projected benefit obligation	6,399	6,578	78	105
Expected return on plan assets	(10,337)	(9,470)	—	—
Amortization of prior service cost	25	24	—	—
Amortization of net loss	2,387	1,962	65	39
Net pension benefit cost	$2,061			