

CARPENTER TECHNOLOGY CORP  
Form 10-K  
August 29, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**FORM 10-K**

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**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES**

**EXCHANGE ACT OF 1934 (No Fee Required)**

For the fiscal year ended June 30, 2007

Commission file number 1-5828

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**CARPENTER TECHNOLOGY CORPORATION**

(Exact name of Registrant as specified in its Charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**23-0458500**  
(I.R.S. Employer  
Identification No.)

**P. O. Box 14662, Reading, PA**  
(Address of principal executive offices)

**19610**  
(Zip Code)

**610-208-2000**

(Registrant's telephone number, including area code)

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Securities registered pursuant to Section 12(b) of the Act:

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(Title of each class)  
Common stock, par value \$5 per share

(Name of each exchange on which registered)  
New York Stock Exchange

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Securities registered pursuant to 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 the filing requirements for at least the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined by Rule 12b-2 of the Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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As of August 21, 2007, 25,827,130 shares of Common Stock of Carpenter Technology Corporation were outstanding.

The aggregate market value of Common Stock held only by non-affiliates at December 31, 2006 was \$2,579,549,291, based on the closing price per share of Common Stock on that date of \$102.52 as reported on the New York Stock Exchange.

**DOCUMENTS INCORPORATED BY REFERENCE**

Part III incorporates by reference certain information from the 2007 definitive Proxy Statement.

The Exhibit Index appears on pages E-1 to E-5.

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**PART I**

**Item 1. Business**

**(a) General Development of Business:**

Carpenter Technology Corporation (Carpenter), incorporated in 1904, is engaged in the manufacturing, fabrication and distribution of specialty metals and engineered products. We made no significant changes in the form of our organization or mode of conducting business during the year ended June 30, 2007.

**(b) Financial Information About Segments:**

We are organized in the following business units: Specialty Alloys Operations, Dynamet, Carpenter Powder Products, and Engineered Products. For segment reporting, the Specialty Alloys Operations, Dynamet and Carpenter Powder Products operating units have been aggregated into one reportable segment, Specialty Metals, because of the similarities in products, processes, customers, distribution methods and economic characteristics. See Note 20 to our consolidated financial statements included in Item 8. Financial Statements and Supplementary Data for additional segment reporting information.

**(c) Narrative Description of Business:**

**(1) Products:**

We primarily process basic raw materials such as nickel, titanium, chromium, iron scrap and other metal alloying elements through various melting, hot forming and cold working facilities to produce finished products in the form of billet, bar, rod, wire, narrow strip, special shapes, and hollow forms in many sizes and finishes. We also produce certain metal powders and fabricated metal products. In addition, ceramic products are produced from various raw materials using molding, heating and other processes.

Our Specialty Metals segment includes the manufacturing and distribution of stainless steels, titanium, high temperature alloys, electronic alloys, tool steels and other alloys in billet, bar, wire, rod, strip and powder forms. Specialty Metals sales are distributed directly from our production plants and distribution network as well as through independent distributors.

Our Engineered Products segment includes the manufacture and sale of structural ceramic products, ceramic cores for the investment casting industry and custom shaped bar.

Our major classes of products are:

Special alloys

Special purpose alloys used in critical components such as bearings and fasteners. Heat resistant alloys that range from slight modifications of stainless steels to complex nickel and cobalt base alloys. Alloys for electronic, magnetic and electrical applications with controlled thermal expansion characteristics, or high electrical resistivity or special magnetic characteristics.

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## Stainless steels

A broad range of corrosion resistant alloys including conventional stainless steels and many proprietary grades for special applications.

## Titanium products

A corrosion resistant, highly specialized metal with a combination of high strength and low density. Most common uses are in aircraft fasteners, medical devices, sporting equipment and chemical and petroleum processing.

## Ceramics and other materials

Certain engineered products, including ceramic cores for investment castings ranging from small simple configurations to large complex shapes and structural ceramic components, as well as drawn solid shapes.

## Tool and other steels

Tool and die steels, which are extremely hard metal alloys, used for tooling and other wear-resisting components in metalworking operations such as stamping, extrusion and machining. Other steels include carbon and alloy steels purchased for distribution and other miscellaneous products.

**(2) Classes of Products:**

The amounts and percentages of our net sales contributed by our major classes of products for the last three fiscal years are summarized in the following table:

(\$ in millions)	2007		2006		2005	
Special alloys	\$ 895.6	46%	\$ 703.8	45%	\$ 515.6	39%
Stainless steels	696.8	36	528.1	34	531.9	40
Titanium products	187.7	10	176.3	11	112.5	9
Ceramics and other materials	104.1	5	102.2	6	98.7	8
Tool and other steels	60.6	3	57.8	4	55.5	4
Total net sales	\$ 1,944.8	100%	\$ 1,568.2	100%	\$ 1,314.2	100%

**(3) Raw Materials:**

Our Specialty Metals segment depends on continued delivery of critical raw materials for its day-to-day operations. These raw materials include nickel, ferrochrome, cobalt, molybdenum, titanium, manganese and scrap. Some of these raw materials sources, many of which are international, could be subject to potential interruptions of supply as a result of political events, labor unrest or other reasons. These potential interruptions could cause material shortages and affect availability and price.

We have long-term relationships with major suppliers who provide availability of material at competitive prices. Purchase prices of certain raw materials have historically been volatile, and have been especially volatile over the past few years. We use pricing surcharges, indexing mechanisms and base price adjustments to reduce the impact of increased costs for the most significant of these materials. There can be delays between the time of the increase in the price of raw materials and the realization of the benefits of such mechanisms or actions that could have a short-term impact on our results.

**Table of Contents****(4) Patents and Licenses:**

We own a number of United States and international patents and have granted licenses under some of them. Certain of our products are covered by patents held or owned by other companies from whom licenses have been obtained. Although these patents and licenses are believed to be of value, we do not consider our business to be materially dependent upon any single patent or patent rights.

**(5) Seasonality of Business:**

Our sales are normally influenced by seasonal factors. Historically, our sales in the first two fiscal quarters (three months ending September 30 and December 31) are typically the lowest principally because of annual plant vacation and maintenance shutdowns by us as well as by many of our customers. However, the timing of major changes in the general economy or the markets for certain products can alter this pattern, particularly when certain raw materials are in short supply.

The chart below summarizes the percent of net sales by quarter for the past three fiscal years:

<b><u>Quarter Ended</u></b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
September 30	21%	22%	23%
December 31	22	22	24
March 31	28	27	26
June 30	29	29	27
	100%	100%	100%

**(6) Customers:**

On a consolidated basis, we are not dependent upon a single customer, or a very few customers, to the extent that the loss of any one or more would have a materially adverse effect on our consolidated statement of operations. In our Engineered Products segment (see Note 20 to the consolidated financial statements included in Item 8. Financial Statements and Supplementary Data for further segment discussion), which accounted for \$105.7 million, \$102.9 million and \$129.1 million of our sales in fiscal years 2007, 2006 and 2005, respectively, approximately 27 percent (\$28.0 million), 24 percent (\$24.6 million) and 18 percent (\$23.6 million) of segment sales were attributable to one customer in fiscal 2007, 2006 and 2005, respectively. There were no other significant individual customer sales volumes during fiscal years 2007, 2006 or 2005.

**(7) Backlog:**

As of June 30, 2007 we had a backlog of orders, believed to be firm, of approximately \$438 million, substantially all of which is expected to be shipped within fiscal year 2008. Our backlog as of June 30, 2006 was approximately \$481 million. Our backlogs have become less indicative of future sales levels due to shifting product mixes and customer ordering patterns.

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**(8) Competition:**

Our business is highly competitive. We supply materials to a wide variety of end-use market sectors and compete with various companies depending on end-use market, product or geography.

There are approximately ten domestic companies producing one or more similar specialty metal products that are considered to be major competitors to the specialty metals operations in one or more end-use markets. There are several dozen smaller producing companies and converting companies in the United States that are competitors. We also compete directly with several hundred independent distributors of products similar to those distributed by us. Additionally, numerous foreign producers export into the United States various specialty metal products similar to those produced by us. Furthermore, a number of different products may, in certain instances, be substituted for our finished product.

Imports of foreign specialty steels, particularly stainless steels, have long been a concern to the domestic steel industry because of the potential for unfair pricing by foreign producers. Foreign governments through direct and indirect subsidies have often supported such pricing practices. These unfair trade practices have resulted in high import penetration into the U.S. stainless steel markets, with calendar year 2006 levels at approximately 52 percent for stainless bar, 44 percent for stainless rod and 58 percent for stainless wire.

Because of the unfair trade practices and the resulting injury, we have joined with other domestic producers of specialty metals in the filing of trade actions against foreign producers as well as lobbying various government agencies for the creation of laws and regulations to eliminate the competitive benefits realized by the unfair trade practices. These proposals are aimed at tax and regulatory reform needed to provide incentives to domestic producers and disincentives for foreign producers to import products into the United States. We will continue to monitor developments related to what we consider unfairly traded imports from foreign competitors and develop appropriate actions in response.

Under the provisions of the Continued Dumping and Subsidy Offset Act of 2000 (the Act), which was signed into law on October 28, 2000, we have received distributions from the United States Customs Service ( Customs ). Under the Act, Customs establishes special accounts for funds to be distributed annually to eligible domestic producers. The special accounts are sourced with duties collected by Customs on pre-existing anti-dumping or countervailing duty orders. We have received distributions under the Act totaling \$6.4 million, \$4.7 million and \$4.1 million in fiscal years 2007, 2006 and 2005, respectively.

**(9) Research, Product and Process Development:**

Our expenditures for company-sponsored research and development were \$11.5 million, \$10.2 million and \$10.0 million in fiscal 2007, 2006 and 2005, respectively. We believe that our ability to be a product innovator in special material development and manufacturing is an important factor in the success of the Company. Our strong commitment to setting new industry standards is evidenced by our Specialty Alloys Research and Development Center, where teams work in such areas as physical metallurgy, analytical chemistry, materials characterization and process and systems development. We have highly skilled engineering teams specializing in specific products at each of our operations. We anticipate continued increases in our devotion of resources for these efforts in fiscal 2008.



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**(10) Environmental Regulations:**

We are subject to various stringent federal, state, local and international environmental laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. Management evaluates the liability for future environmental remediation costs on a quarterly basis. We accrue amounts for environmental remediation costs representing management's best estimate of the probable and reasonably estimable costs relating to environmental remediation. For further information on environmental remediation, see the Contingencies section included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 13 to our consolidated financial statements included in Item 8. Financial Statements and Supplementary Data .

Our costs of maintaining and operating environmental control equipment were \$12.0 million, \$11.3 million and \$11.2 million for fiscal 2007, 2006 and 2005, respectively. The capital expenditures for environmental control equipment were \$0.2 million for each of the fiscal years ending June 30, 2007, 2006 and 2005, respectively. We anticipate spending approximately \$1.0 million on major domestic environmental capital projects over the next five fiscal years. This includes approximately \$0.2 million in fiscal 2008 and \$0.2 million in fiscal 2009. Due to the possibility of future regulatory developments, the amount of future capital expenditures may vary from these estimates.

**(11) Employees:**

As of June 30, 2007, our total workforce was 4,152 employees, of which approximately 400 employees were covered under collective bargaining agreements. The largest agreement, which covers 280 employees of Certech, Inc., in Wood-Ridge and Carlstadt, New Jersey, is effective through January 2010. The collective bargaining agreement for our Dynamet production employees in Washington, Pennsylvania covers 113 employees and will expire on August 31, 2007.

**(d) Financial information about foreign and domestic operations and export sales:**

Sales outside of the United States, including export sales, were \$574.7 million, \$496.4 million and \$365.0 million in fiscal 2007, 2006 and 2005, respectively.

For further information on domestic and international sales, see Note 20 to our consolidated financial statements included in Item 8. Financial Statements and Supplementary Data .

**(e) Available Information:**

The Board of Directors adopted a Code of Ethics for the Chief Financial Officer and Senior Financial Officers of Carpenter Technology Corporation. There were no waivers of the Code in fiscal 2007. The Code and any information regarding any waivers of the Code are disclosed on Carpenter's website at [www.carttech.com](http://www.carttech.com). Our Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through our Internet website as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission (SEC). Our Internet website and the content contained therein or

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connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and other information regarding issuers that file electronically. Such information can be accessed through the Internet at [www.sec.gov](http://www.sec.gov).

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### **Item 1A. Risk Factors.**

There are inherent risks and uncertainties associated with all businesses that could adversely affect operating performances or financial conditions. The following discussion outlines the risks and uncertainties that management believes are the most material to our business. However, these are not the only risks or uncertainties that could affect our business. Certain risks are associated specifically with our business, industry or customer base, while others are broader.

***Cyclical Demand for Certain Products.*** Demand in our end-use markets, including companies in the aerospace, industrial supply, consumer, automotive, medical, energy and power generation markets, can be cyclical in nature and sensitive to general economic conditions, competitive influences and fluctuations in inventory levels throughout the supply chain. As a result, our results of operations, financial condition, cash flows and availability of credit could fluctuate significantly from period to period.

***Commercial Aerospace.*** A growing portion of our sales represents products sold to customers in the commercial aerospace market. The commercial aerospace market is historically cyclical due to both external and internal market factors. These factors include general economic conditions, airline profitability, consumer demand for air travel, varying fuel and labor costs, price competition, and international and domestic political conditions such as military conflict and the threat of terrorism. The length and degree of cyclical fluctuation can be influenced by any one or combination of these factors and therefore are difficult to predict with certainty. A downturn in the commercial aerospace industry would adversely affect the demand for our products and/or the prices at which we are able to sell our products, and our results of operations, business and financial condition could be materially adversely affected.

***Excess Worldwide Capacity.*** The steel industry continues to operate in an environment of excess supply. Continued domestic and international over-capacity could lead to an overall reduction in prices of certain non-specialty products. Continued availability of lower cost, substitute materials may also cause significant fluctuation in future results as our customers opt for a lower cost alternative. In addition, developing economies such as China and India have led to a rapid increase in demand for certain products resulting in price and supply variations and causing companies to implement plans to meet that increased demand. If the demand from these economically developing countries subsides, additional excess worldwide capacity could significantly impact future worldwide pricing or export practices of certain products.

***Product Pricing.*** Periodically, factors such as competition and excess manufacturing capacity have resulted in reduced selling prices for certain products. These selling price reductions have had and may have a significant negative impact on our revenues, profit margins and overall financial condition.

Although inflationary trends in recent years have been moderate, certain critical raw material costs, such as nickel, chromium, titanium, and scrap containing iron and nickel have been volatile. While we are able to mitigate most of the adverse impact of rising raw material costs through raw material surcharges or indices to customers, changes in business conditions could adversely affect our ability to recover rapid increases in raw material costs and may adversely affect our results of operations.

We change prices on certain of our products from time-to-time. The timing of pricing actions can be dependent on market conditions, various economic factors, raw material costs and

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availability, competitive factors, operating costs and other factors, which may be beyond our control. The effects of any pricing actions may be delayed due to long manufacturing lead times or the terms of existing contracts. There is no guarantee that pricing actions implemented will be able to offset rising material costs or maintain the Company's profit margin levels.

***Dependence on Critical Raw Materials Subject to Price and Availability Fluctuations.*** We rely on third parties to supply certain raw materials that are critical to the manufacture of our products. These raw materials include nickel, chromium, titanium and scrap containing iron and nickel. Purchase prices and availability of these critical raw materials are subject to volatility due to factors that are not in our control. In some cases, these materials are purchased from suppliers operating in countries that may be subject to unstable political and economic conditions. At any given time we may be unable to obtain an adequate supply of these critical raw materials on a timely basis, at prices and other terms acceptable to us, or at all.

If suppliers increase the price of critical raw materials or are unwilling or unable to meet our demand, we may not have alternative sources of supply. In addition, to the extent that we have quoted prices to customers and accepted customer orders for products prior to purchasing necessary raw materials, or have existing contracts, we may be unable to raise the price of products to cover all or part of the increased cost of the raw materials to our customers.

The manufacture of some of our products is a complex process and requires long lead times. As a result, we may experience delays or shortages in the supply of raw materials. If unable to obtain adequate and timely deliveries of required raw materials, we may be unable to timely manufacture sufficient quantities of products. This could cause us to lose sales, incur additional costs, delay new product introductions or suffer harm to our reputation.

***Implementation of Operations Expansion Projects.*** We are undertaking a capital project, which will continue through 2009, in connection with our recently announced premium melt expansion. Any delay or inability to successfully expand our operations in a timely and cost effective manner could materially adversely affect our business, financial condition and results of operations. This growth places a significant demand on management and operational resources. Our success will depend upon numerous factors including the ability of management to ensure the necessary resources are in place to properly execute this project and the ability of key suppliers to deliver the necessary equipment according to schedule.

***Medical Costs and Retirement Benefits.*** We provide medical benefits to active and retired employees throughout most of our company. Most of the cost is paid by the company and is not covered by insurance. In addition, certain of our employees are covered by defined benefit pension plans with the majority of our plans covering employees in the United States. As of June 30, 2007, the defined benefit pension plan was funded in accordance with the requirements of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code. We do not expect to be required to make contributions to the defined benefit pension plans for at least the next several years, based upon current actuarial projections. A decline in the value of plan investments in the future, an increase in costs or liabilities or unfavorable changes in laws or regulations that govern pension plan funding could materially change the timing and amount of required pension funding. A requirement to fund any deficit created in the future could have a material adverse effect on our results of operations and financial condition. Many domestic and international competitors do not provide defined benefit retiree health care and other international

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competitors operate in jurisdictions with government sponsored health care plans that may offer them a cost advantage.

**Environmental Matters.** We are subject to various federal, state, local and international environmental laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. We could incur substantial cleanup costs, fines and civil or criminal sanctions, third party property damage or personal injury claims as a result of violations or liabilities under these laws or non-compliance with environmental permits required at our facilities.

We have environmental remediation liabilities at some of our owned operating facilities and have been designated as a potentially responsible party ( PRP ) with respect to certain third-party Superfund or similar waste disposal sites and other third party owned sites. Additionally, we have been notified that we may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against us. From time-to-time, we are a party to lawsuits and other proceedings involving alleged violations of, or liabilities arising from, environmental laws.

When our liability is probable and we can reasonably estimate our costs, we record environmental liabilities in our financial statements. In many cases, we are not able to determine whether we are liable, or if liability is probable, to reasonably estimate the loss or range of loss. Estimates of our liability remain subject to additional uncertainties, including the nature and extent of site contamination, available remediation alternatives, the extent of corrective actions that may be required, and the number and financial condition of other PRPs, as well as the extent of their responsibility for the remediation. We adjust our accruals to reflect new information as appropriate. Future adjustments could have a material adverse effect on our results of operations in a given period, but we cannot reliably predict the amounts of such future adjustments. At June 30, 2007, our reserves for environmental matters totaled approximately \$5.5 million. Future developments, administrative actions or liabilities relating to environmental matters could have a material adverse effect on our financial condition or results of operations.

**Current or Future Litigation and Claims.** We are defending various claims and legal actions that have been or may be asserted against us relating to the conduct of our currently and formerly owned businesses, including those pertaining to product liability, commercial disputes, employment actions, employee benefits, compliance with domestic and federal laws, personal injury and tax issues. Due to the uncertainties of litigation, we can give no assurance that we will prevail on claims made against us in the lawsuits that we currently face or that additional claims will not be made against us in the future. The outcome of litigation cannot be predicted with certainty, and some of these lawsuits, claims or proceedings may be determined adversely to us. The resolution in any reporting period of one or more of these matters could have a material adverse effect on our results of operations for that period. We can give no assurance that any other matters brought in the future will not have a material effect on our financial condition, liquidity or results of operations.

**Labor Matters.** We have approximately 4,152 full-time employees, the majority of which are not covered by a collective bargaining agreement. Approximately 400 total employees at two of our business units are covered by various collective bargaining agreements. The agreements expire at various times in the future, with the largest agreement covering 280 employees of Certech, Inc., in Wood-Ridge and Carlstadt, New Jersey, and is effective through January 2010. The collective bargaining agreement for our Dynamet production employees located in Washington, Pennsylvania, which covers 113 employees, will expire in August, 2007. There can be no assurance that we will succeed in concluding collective

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bargaining agreements with the unions to replace those that expire. From time to time, the employees at our primary manufacturing facility in Reading, Pennsylvania, participate in election campaigns or union organizing attempts as to whether they should be represented by a union for collective bargaining. There is no guarantee that future organization attempts will not result in union representation.

***Complex Manufacturing Processes Requiring High Cost Capital Equipment.*** Our manufacturing processes are complex and depend upon critical, high cost equipment for which there may be only limited or no production alternatives. It is possible that we could experience prolonged periods of reduced production due to unplanned equipment failures, and we could incur significant repair or replacement costs in the event of those failures. It is also possible that operations could be disrupted due to other unforeseen circumstances such as power outages, explosions, fires, floods, accidents and severe weather conditions. We must make regular, substantial capital investments and changes to our manufacturing processes to lower production costs, improve productivity, manufacture new or improved products and remain competitive. We may not be in a position to take advantage of business opportunities or respond to competitive pressures if we fail to update, replace or make additions to our equipment or our manufacturing processes in a timely manner. The cost to repair or replace much of our equipment or facilities would be significant. We cannot be certain that we will have sufficient internally generated cash or acceptable external financing to make necessary capital expenditures in the future.

***Concentration of Manufacturing Locations.*** A significant portion of our manufacturing and production facilities are located in Reading, Pennsylvania. It is possible that we could experience prolonged periods of reduced production due to unforeseen catastrophic events occurring in or around our manufacturing facilities in Reading, Pennsylvania. The Company may be unable to shift manufacturing capabilities to alternate locations, accept materials from suppliers, meet customer shipment needs or result in other severe consequences. As a result our financial condition and results of our operations could be materially adversely affected.

***Availability of Energy Resources.*** We rely on third parties to supply energy consumed at each of our energy-intensive production facilities. The prices for and availability of electricity, natural gas, oil and other energy resources are subject to volatile market conditions. These market conditions often are affected by political and economic factors beyond our control. Disruptions or lack of availability in the supply of energy resources could temporarily impair the ability to operate our production facilities. Further, increases in energy costs, or changes in costs relative to energy costs paid by competitors, has and may continue to adversely affect our profitability. To the extent that these uncertainties cause suppliers and customers to be more cost sensitive, increased energy prices may have an adverse effect on our results of operations and financial condition.

***Acquisition and Disposition Strategies.*** We consider acquisition, joint ventures and other business combination opportunities as well as possible business unit dispositions as part of our overall business strategy. From time-to-time, management holds discussions with management of other companies to explore such opportunities. As a result, the relative makeup of the businesses comprising our Company is subject to change. Acquisitions, joint ventures and other business combinations involve various inherent risks, such as difficulties in integrating the operations, technologies, products and personnel of the acquired companies, diversion of management's attention from existing operations, difficulties in entering markets in which we have limited or no direct prior experience, dependence on unfamiliar supply chains, insufficient revenues to offset increased expenses associated with acquisitions, loss of key employees of the acquired companies, inaccurate assessment of undisclosed liabilities, difficulties in realizing projected efficiencies, synergies and cost

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savings and increases in our debt or limitation in our ability to access additional capital when needed.

***Internal Controls Over Financial Reporting.*** Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements or inaccuracies. Effectiveness of reporting results in future periods is subject to the risk that controls may become inadequate, or that the degree of compliance with the policies or procedures may deteriorate.

***Political and Social Turmoil and Other World Issues.*** War, civil conflict, terrorism, natural disasters and public health issues including domestic or international pandemic have caused and could cause damage or disruption to domestic or international commerce by creating economic or political uncertainties. These events could result in a decrease in demand for our products, make it difficult or impossible to deliver orders to customers or receive materials from suppliers, effect the availability or pricing of energy sources or result in other severe consequences that may or may not be predictable. As a result, our business, financial condition and results of operations could be materially adversely affected.

***International Sales.*** We believe that international sales will continue to account for a significant percentage of our future revenues. Risks associated with international sales include without limitation: political and economic instability, including weak conditions in the world's economies; accounts receivable collection; export controls; changes in legal and regulatory requirements; policy changes affecting the markets for our products; changes in tax laws and tariffs; and exchange rate fluctuations (which may affect sales to international customers and the value of profits earned on international sales when converted into dollars). Any of these factors could materially adversely affect our results for the period in which they occur.

***Safety Issues.*** Various federal, state, local and international worker safety laws and regulations are applicable to our operations. We have used, and currently use and manufacture substantial quantities of substances that are considered hazardous, extremely hazardous or toxic under worker safety and health laws and regulations. Although we implement controls and procedures designed to reduce continuing risk of health and safety issues, we could incur substantial costs, fines and civil or criminal sanctions or personal injury claims as a result of violations or liabilities under these laws.

***Retention of Key Personnel.*** Much of our future success depends on the continued service and availability of skilled personnel, including members of our executive management team, management, metallurgists and production positions. The loss of key personnel could adversely affect our ability to perform until suitable replacements are found.

### **Item 1B. Unresolved Staff Comments.**

None.

### **Item 2. Properties**

The primary locations of our specialty metals manufacturing plants are: Reading, Pennsylvania; Hartsville, South Carolina; Washington, Pennsylvania; Orangeburg, South Carolina; Bridgeville, Pennsylvania; Orwigsburg, Pennsylvania; Clearwater, Florida; Elyria, Ohio; Torshalla, Sweden; and

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Crawley, England. The Reading, Hartsville, Washington, Orangeburg, Bridgeville, Orwigsburg, Elyria, Torshalla and Crawley plants are owned. The Clearwater plant is owned, but the land is leased. The Torshalla facilities are leased.

The primary locations of our engineered products manufacturing operations are: Wood-Ridge and Carlstadt, New Jersey; Wilkes-Barre, Pennsylvania; Twinsburg, Ohio; Auburn, California; Palmer, Massachusetts; Derby and Corby, England; Queretaro, Mexico; and Clayton, Australia. The Corby and Queretaro plants are owned, while the other locations are leased.

Our corporate offices, located in Wyomissing, Pennsylvania, are leased.

We also operate regional customer service and distribution centers, most of which are leased, at various locations in several states and foreign countries.

Our plants, customer service centers, and distribution centers were acquired or leased at various times over several years. There is an active maintenance program to ensure a safe operating environment and to keep facilities in good condition. In addition, we have had an active capital spending program to replace equipment as needed to keep it technologically competitive on a world-wide basis. We believe our facilities are in good condition and suitable for our business needs. As a specialty materials and alloys producer with considerable diversity in the types of product we manufacture, any measurement of the practical capacities at our facilities is affected by product mix and is therefore not meaningful in total.

### **Item 3. Legal Proceedings**

Pending legal proceedings involve ordinary routine litigation incidental to our business. We are not aware of any material proceedings to which any of our Directors, Officers, or affiliates, or any owners of more than five percent of any class of our voting securities, or any associate of any of our Directors, Officers, affiliates, or security holders, is a party adverse to us or has a material interest adverse to our interests or those of our subsidiaries. There is no administrative or judicial proceeding arising under any Federal, State or local provisions regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment that (1) is material to our business or financial condition, (2) involves a claim for damages, potential monetary sanctions or capital expenditures exceeding ten percent of our current assets, or (3) includes a governmental authority as a party and involves potential monetary sanctions in excess of \$100,000.

### **Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of our stockholders during the fourth quarter of fiscal 2007.



**Table of Contents****PART II****Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is listed on the New York Stock Exchange ( NYSE ) and traded under the symbol CRS . The following table sets forth, for the periods indicated, the high and low closing prices for our common stock as reported by the NYSE.

Quarter Ended:	Fiscal 2007		Fiscal 2006	
	High	Low	High	Low
September 30	\$ 120.15	\$ 90.67	\$ 64.94	\$ 51.28
December 31	\$ 119.09	\$ 97.91	\$ 71.30	\$ 51.64
March 31	\$ 125.16	\$ 97.29	\$ 97.82	\$ 72.01
June 30	\$ 136.53	\$ 120.23	\$ 139.75	\$ 95.18
Annual	\$ 136.53	\$ 90.67	\$ 139.75	\$ 51.28

The range of our common stock price on the NYSE from July 1, 2007 to August 21, 2007 was \$103.75 to \$148.06. The closing price of the common stock was \$110.75 on August 21, 2007.

We have paid quarterly cash dividends on our common stock for over 100 consecutive years. We paid a quarterly dividend of \$0.225 per common share during the first, second and third quarters and \$0.30 per common share during the fourth quarter of fiscal 2007.

We paid a quarterly dividend of \$0.15 per common share during each quarter of fiscal 2006.

As of August 21, 2007, there were 3,411 common stockholders of record.

**Cumulative Total Stockholder Return**

The graph below compares the cumulative total stockholder return on Carpenter's common stock to the cumulative total return of the Russell 2000 Index, S&P MidCap Index, our New Peer Group and our Old Peer Group for each of the last five fiscal years ended June 30, 2007. The cumulative total return assumes an investment of \$100 on June 30, 2002 and the reinvestment of any dividends during the period. The Russell 2000 is a broad-based index that includes smaller market capitalization stocks. The S&P MidCap 400 Index is the most widely used index for mid-sized companies. In June 2007, Carpenter's common stock was added to the S&P MidCap 400 Index. We believe that the S&P MidCap 400 is more representative of companies with similar market and economic characteristics to Carpenter. We do not believe the Russell 2000 index is representative of our current market capitalization status and we will cease using this index in future reports. The companies in the Old Peer Group Index were: Allegheny Technologies, Inc., A.M. Castle & Co., Quanex Corporation, RTI International Metals, Inc., Ryerson Tull, Inc. and the Timken Company. The companies included in the New Peer Group Index are: Allegheny Technologies, Inc., Titanium Metals Corporation, RTI International Metals, Inc., Haynes International, Inc., AK Steel Holding Corp., Steel Dynamics, Inc. and Universal Stainless & Alloy Products, Inc. We believe that the companies included in our New Peer Group, taken as a whole, provide a more meaningful comparison in terms of competition, product offerings and other relevant factors. The total stockholder return for the peer groups is weighted according to the respective issuer's stock market capitalization at the beginning of each period.

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	6/02	6/03	6/04	6/05	6/06	6/07
Carpenter Technology Corporation	100.00	56.20	124.25	190.46	428.03	487.20
Russell 2000	100.00	98.36	131.18	143.57	164.50	191.53
S&P Midcap 400	100.00	99.29	127.07	144.90	163.71	194.01
New Peer Group	100.00	51.05	108.04	142.14	421.55	596.87
Old Peer Group	100.00	66.31	119.90	140.95	285.87	385.92

**Table of Contents****Issuer Purchases of Equity Securities**

The following table contains information about purchases by us of our common stock during the fourth quarter of fiscal 2007:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Approximate Value of Shares that May Yet Be Purchased  Under the Plans or Programs  (in millions)</b>
April 1-30, 2007				\$ 236.1
May 1-31, 2007				\$ 236.1
June 1-30, 2007	126,325	\$ 130.43	115,002	\$ 221.1
Quarter ended June 30, 2007	126,325	\$ 130.43	115,002	\$ 221.1

The shares purchased in June included 11,323 shares which were purchased pursuant to the exercise by 1993 Plan and Directors Plan participants of their right to elect stock-for-tax withholding in connection with the vesting of restricted shares under the plans.

The remaining 115,002 shares were purchased under a share repurchase program authorized by the Company's Board of Directors. The program authorizes the repurchase of up to \$250 million of Carpenter's outstanding common stock. As of June 30, 2007, approximately \$221 million of the \$250 million remained available for future repurchases. The above purchases were all made on the open market. The repurchases will occur at such times and at such prices as the management of the Company determines. The share repurchase program will be funded with the Company's cash after giving consideration to capital investments, acquisitions and future cash flows. The timing or amount of the shares to be repurchased cannot be assured. The share repurchase program expires in September 2008.

**Table of Contents****Item 6. Selected Financial Data**

## Five-Year Financial Summary

Dollar amounts in millions, except per share data

(years ended June 30)

	2007	2006	2005 <sup>(a)</sup>	2004 <sup>(b)</sup>	2003 <sup>(c)</sup>
<b>Summary of Operations</b>					
Net sales	\$ 1,944.8	\$ 1,568.2	\$ 1,314.2	\$ 1,016.7	\$ 871.1
Operating income	\$ 323.8	\$ 310.7	\$ 204.2	\$ 68.1	\$ 8.1
Net income (loss)	\$ 227.2	\$ 211.8	\$ 135.5	\$ 36.0	\$ (10.9)
<b>Financial Position at Year-End</b>					
Cash	\$ 300.8	\$ 352.8	\$ 159.5	\$ 80.0	\$ 53.5
Marketable securities	\$ 372.7	\$ 141.8	\$ 110.9	\$ 25.4	\$
Total assets	\$ 2,025.7	\$ 1,887.9	\$ 1,653.4	\$ 1,456.2	\$ 1,399.9
Long-term obligations, net of current portion (including convertible preferred stock)	\$ 299.5	\$ 333.1	\$ 333.7	\$ 332.7	\$ 396.7
<b>Per Share Data</b>					
Net earnings (loss):					
Basic	\$ 8.79	\$ 8.33	\$ 5.54	\$ 1.51	\$ (0.56)
Diluted	\$ 8.63	\$ 8.08	\$ 5.37	\$ 1.49	\$ (0.56)
Cash dividend-common	\$ 0.975	\$ 0.60	\$ 0.4075	\$ 0.330	\$ 0.5775

<sup>(a)</sup> Fiscal 2005 included an \$8.7 million pre-tax gain on the sale of Carpenter Special Products Corporation in June 2005, which was sold for a total sales price of \$19.5 million. See Note 21 to the consolidated financial statements included in Item 8. Financial Statements and Supplemental Data .

<sup>(b)</sup> Fiscal 2004 included a \$2.3 million pre-tax loss on early retirement of debt related to a \$20 million open market purchase of certain medium term notes previously issued by the company and the termination of interest rate swaps associated with the partial repayment of foreign currency loans. See Note 10 to the consolidated financial statements included in Item 8. Financial Statements and Supplementary Data .

<sup>(c)</sup> Fiscal 2003 included restructuring costs of \$26.1 million related principally to workforce reduction, pension plan curtailment loss, and writedown of certain assets. Fiscal 2003 also included \$0.9 million gain on sale of business related to the sale of two business units. In addition, fiscal 2003 included a \$4.5 million loss on the early retirement of debt related to the redemption of approximately \$90 million of the Company's 9 percent debentures due 2022.

See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for discussion of factors that affect the comparability of the Selected Financial Data .

**Table of Contents****Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Overview**

*This Overview is intended to provide a context for the following Management's Discussion and Analysis of Financial Condition and Results of Operation. Management's Discussion and Analysis of Financial Condition and Results of Operation should be read in conjunction with our consolidated financial statements, including the notes thereto, included in this annual report on Form 10-K. We have attempted to identify the most important matters on which our management focuses in evaluating our financial condition and operating performance and the short-term and long-term opportunities, challenges and risks (including material trends and uncertainties) which we face. We also discuss the actions we are taking to address these opportunities, challenges and risks. The Overview is not intended as a summary of, or a substitute for review of, Management's Discussion and Analysis of Financial Condition and Results of Operation*

**Business**

Carpenter is engaged in the manufacturing, fabrication, and distribution of specialty metals and engineered products. We primarily process basic raw materials such as nickel, titanium, chromium, iron scrap and other metal alloying elements through various melting, hot forming and cold working facilities to produce finished products in the form of billet, bar, rod, wire, narrow strip, special shapes and hollow forms in many sizes and finishes. We also produce certain metal powders and fabricated metal products. In addition, ceramic products are produced from various raw materials using molding, heating and other processes.

Our Specialty Metals segment includes the manufacturing and distribution of stainless steels, titanium, high temperature alloys, electronic alloys, tool steels and other alloys in billet, bar, wire, rod, strip and powder forms. Specialty Metals sales are distributed directly from our production plants and distribution network as well as through independent distributors.

Our Engineered Products segment includes the manufacture and sale of structural ceramic products, ceramic cores for the investment casting industry and custom shaped bar.

In July 2007, we announced certain changes to our organization which management believes will allow us to better focus on the customer, end-use markets and to reach our operational excellence goals. The announcement included the key appointments of a Senior Vice President Advanced Metals Operations and a Senior Vice President Premium Alloys Operations. These changes will impact the Company's financial reporting related to segment information. The Company is currently evaluating the impact of the changes and expects that the segment information reported during fiscal 2008 will reflect the organizational changes discussed above.

The table below shows our net sales by major product class for the past three fiscal years:

(\$ in millions)	2007		2006		2005	
Special alloys	\$ 895.6	46%	\$ 703.8	45%	\$ 515.6	39%
Stainless steels	696.8	36	528.1	34	531.9	40
Titanium products	187.7	10	176.3	11	112.5	9
Ceramics and other materials	104.1	5	102.2	6	98.7	8
Tool and other steels	60.6	3	57.8	4	55.5	4
Total net sales	\$ 1,944.8	100%	\$ 1,568.2	100%	\$ 1,314.2	100%

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Unlike many other specialty steel producers, we operate our own worldwide network of service/distribution centers. These service centers, located in the United States, Canada, Mexico and Europe, allow us to work more closely with customers and to offer various just-in-time stocking programs. As a result, we often serve as a technical partner in customizing specialty metals or in developing new ones.

Our sales are across a diversified list of end-use markets. The table below summarizes our estimated sales by market over the past three fiscal years.

(\$ in millions)	2007		2006		2005	
Aerospace	\$ 725.8	37%	\$ 636.6	41%	\$ 383.5	29%
Industrial	440.2	23	302.0	19	327.1	25
Consumer	206.5	11	176.5	11	210.3	16
Automotive	236.8	12	181.8	12	182.9	14
Medical	131.2	7	139.7	9	96.0	7
Energy	204.3	10	131.6	8	114.4	9
<b>Total net sales</b>	<b>\$ 1,944.8</b>	<b>100%</b>	<b>\$ 1,568.2</b>	<b>100%</b>	<b>\$ 1,314.2</b>	<b>100%</b>

In an effort to increase revenue and profits, we have increased our presence in fast-growing international markets. In recent years, we have expanded our sales and marketing efforts in Europe, Asia, and North America. Our European headquarters are based in Brussels, with our Asian sales directed from Singapore. Outside the United States, company-owned distribution facilities are located in Mexico, Canada, the United Kingdom and Belgium. In addition to the United States, where the majority of our manufacturing exists, we have manufacturing facilities in the United Kingdom, Mexico, Sweden and Australia. In fiscal 2007, 2006 and 2005, 29.6 percent (\$574.7 million), 31.7 percent (\$496.4 million) and 27.8 percent (\$365.0 million) of our sales were to customers outside of the United States, respectively.

We believe that our ability to be a product innovator in special material development and manufacturing is an important factor in the success of the Company. Our strong commitment to setting new industry standards is evidenced by our Specialty Alloys Research and Development Center, where teams work in such areas as physical metallurgy, analytical chemistry, materials characterization and process and systems development. We have highly skilled engineering teams specializing in specific products at each of our operations.

As part of our overall business strategy, we have sought out and considered opportunities related to strategic divestitures, acquisitions, and joint venture propositions. Management has participated in discussions with other companies to explore potential terms and structure of such opportunities. The Company expects that it will continue to evaluate these opportunities.

**Table of Contents****Business Trends**

Net sales, earnings, free cash flow and pounds sold for the past three fiscal years are summarized below:

(in millions, except per share data)	2007	2006	2005
Net sales	\$ 1,944.8	\$ 1,568.2	\$ 1,314.2
Net income	\$ 227.2	\$ 211.8	\$ 135.5
Diluted earnings per share	\$ 8.63	\$ 8.08	\$ 5.37
Free Cash Flow	\$ 202.3	\$ 202.8	\$ 133.8
Pounds Sold (in thousands)*	223,246	221,329	238,640

\* includes specialty and titanium alloys, stainless steel and powder materials

Our results of operations have improved significantly over the past three fiscal years largely as a result of favorable market conditions and our focus on lean and waste reduction, especially in the aerospace, energy and medical markets. The key components of our business strategy are as follows:

A shift in product mix to higher value materials;

Improved margins from an intentional reduction in the sale of marginally profitable products;

Pricing products for the value delivered;

Expansion of sales in markets outside of the U.S.;

Efforts to achieve operational excellence through our focus on lean and waste reduction.

Specifically, we use the phrase "lean and waste reduction" to refer to eliminating or reducing non-value added activities, process variation reduction, process control, work concentration, product flow based on specific customer quantity demand and constraint removal. Our lean and waste reduction philosophy applies to all aspects of our business, including product development, order taking and scheduling, manufacturing, logistics and administrative processes.

We value most of our inventory utilizing the last-in, first-out ( LIFO ) inventory costing methodology. Under the LIFO inventory costing method, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period even though these materials may have been acquired at potentially significantly different values due to the length of time from the time the raw materials are acquired to the time the processed finished goods are sold to the customer. In a period of rising raw material costs, the LIFO inventory valuation normally results in higher costs of sales. Increases in the cost of raw materials have impacted our operations over the past few years. We, and others in our industry, generally have been able to pass these cost increases through to our customers using surcharges which are structured to recover high raw material costs. In the last several years, as raw material prices have escalated, surcharges have become an increasingly significant component of our net sales. This has impacted our sales numbers and had a dilutive effect on our gross margin and operating margin percentages as described later in this discussion. The formula used to calculate the surcharge is based on prices quoted on the London Metal Exchange ( LME ) for the previous month for the respective raw materials. Surcharge revenues, which are included in net sales, were \$497.1 million, \$199.6 million and \$148.9 million for the years ended June 30, 2007, 2006 and 2005, respectively.

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### **Special Items Recorded in Fiscal Years 2005**

During the fourth quarter of 2005, we recorded a gain of \$8.7 million before taxes on the sale of our subsidiary, Carpenter Special Products Corporation ( CSPC ). The divestiture was part of the Company's strategy to focus on its specialty material businesses. CSPC had sales of less than \$30 million in fiscal 2005 and accounted for less than 2 percent of consolidated operating income.

### **Results of Operations Fiscal 2007 compared to Fiscal 2006**

Our net income for fiscal 2007 was \$227.2 million, or \$8.63 per diluted share, versus net income of \$211.8 million, or \$8.08 per diluted share, for fiscal 2006.

For fiscal 2007, Carpenter generated record sales and net income. Sales growth, excluding surcharge, was driven primarily by the Company's increased focus on the energy market and strong demand from the industrial market.

Record fiscal year net income was achieved primarily as a result of the Company's growth in sales and continued focus on operational excellence.

Free cash flow (see page 30 for Carpenter's definition and a reconciliation to GAAP) was \$202.3 million in fiscal 2007. At June 30, 2007, our cash and marketable securities exceeded our total debt by \$340.8 million.

### **Net Sales**

Net sales for fiscal 2007 were \$1.9 billion, which was an increase of 24 percent from \$1.6 billion in fiscal 2006. The \$376.6 million increase in net sales was due to increases in surcharge revenues and volume as well as improved product mix. Excluding surcharges, fiscal 2007 sales increased by 6 percent compared to fiscal 2006.

International sales in fiscal 2007 increased 16 percent from fiscal 2006 to \$574.7 million primarily as a result of higher surcharges and increased shipments to the energy market. Sales outside of the U.S. accounted for 29.6 percent of total sales in fiscal 2007 compared to 31.7 percent in fiscal 2006. Details of sales by geographical region for the past three fiscal years are presented in Note 20 to the consolidated financial statements included in Item 8. Financial Statements and Supplementary Data .

In terms of end-use markets, sales to the aerospace market of \$725.8 million in fiscal 2007 increased 14 percent from fiscal 2006. Excluding surcharge revenues, sales to the aerospace market increased by 1 percent. The static sales level reflects supply chain inventory adjustments stemming from the robust demand for nickel based alloys and titanium coil that took place in the second half of fiscal 2006, which resulted in reduced purchasing levels by customers throughout fiscal 2007. In addition, sales reflected a decline in business with a key customer during fiscal 2007, who is now procuring a portion of its material needs internally from a recently acquired subsidiary.

Sales to the industrial sector of \$440.2 million, which includes materials used in equipment and other capital goods applications, increased by 46 percent in fiscal 2007 from fiscal 2006. Excluding surcharge revenues, sales to the industrial market increased by 25 percent. The growth was driven by increased shipments of higher value materials used in capital equipment and the manufacture of valves and fittings used in applications such as the construction and maintenance of chemical and food processing facilities. Additionally, the sales growth reflected increased shipments to the semiconductor sector.



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Consumer market sales increased by 17 percent from the prior year, to \$206.5 million. Adjusted for surcharge revenues, sales decreased by 9 percent. The reduction was primarily a result of reduced sales of materials used in consumer electronics and fasteners used in consumer products.

Sales to the automotive market in fiscal 2007 increased 30 percent to \$236.8 million during fiscal 2007. Sales, excluding surcharge revenue, increased 4% from the prior year. The marginal increase reflected the lower automotive production rates in North America and Europe. In addition, the Company elected not to participate in certain marginally profitable business.

Sales to the medical market of \$131.2 million were 6 percent below a year ago. Adjusted for surcharge revenue, sales declined 13 percent. The decline mostly reflected continuing inventory adjustments taking place within the supply chain for titanium and specialty alloy materials.

## **Gross Profit**

Gross profit in fiscal 2007 grew to \$457.7 million, or 23.5 percent of sales, from \$436.1 million, or 27.8 percent of sales, a year ago. The increased gross profit was achieved despite the negative impact from record high nickel prices throughout most of the year. As a result of the rise in nickel prices, the Company's surcharge revenue increased to approximately \$497 million or 150 percent more than fiscal 2006. The Company's surcharge mechanism is structured to recover high raw material costs. While the surcharge protects the absolute gross profit dollars, it does have a dilutive effect on gross margin. In fiscal 2007, the dilutive effect on the gross margin from the increased surcharge versus fiscal 2006 was approximately 450 basis points.

Additionally, the Company's gross profit was negatively impacted by the lag effect in the surcharge mechanism. This lag effect can result in additional margin decline during periods of rapidly escalating raw material prices. The Company has estimated that the lag effect negatively impacted gross margin by approximately 140 basis points when comparing fiscal 2007 to fiscal 2006.

Adjusted for the dilutive effect of the surcharge and the negative impact from the lag in the surcharge mechanism, the gross margin would have improved in fiscal 2007 by 170 basis points from fiscal 2006. The underlying improvement was driven by a richer product mix as well as ongoing cost controls.

## **Selling and Administrative Expenses**

Selling and administrative expenses in fiscal 2007 were \$133.9 million, or 6.9 percent of net sales, compared to \$125.4 million, or 8.0 percent of net sales, in fiscal 2006. The increase primarily reflected \$4.4 million related to executive transition costs and \$1.6 million associated with the review of a possible acquisition.

## **Interest Expense**

Fiscal 2007 interest expense of \$22.8 million decreased 2 percent from \$23.3 million in fiscal 2006. Interest on substantially all of our debt was at a fixed rate and the level of debt was consistent throughout the two-year period.

## **Other Income, Net**

The higher amount reflected \$8.1 million of increased interest income due to higher investment balances in cash and marketable securities and \$1.7 million of increased receipts from the Continued Dumping and Subsidy Offset Act of 2000.

**Table of Contents****Income Taxes**

Our effective tax rate (income tax expense as a percent of income before taxes) for fiscal 2007 was 31.4 percent as compared to 31.5 percent last year. The fiscal year 2007 tax rate was more favorable than the statutory rate of 35 percent primarily due to the following items. We recorded a reduction in income tax expense of \$3.5 million, or 1.1 percent of pretax income, reflecting the reversal of valuation allowances that had been recorded against state net operating loss carryforwards in prior years. Under Statement of Financial Accounting Standards No. 109 (SFAS109), valuation allowances should be reviewed each year and an assessment must be made as to the likelihood of recovery of those deferred taxes. Based on current year and forecasted taxable income in certain jurisdictions, we determined that it was appropriate to reverse a portion of this valuation allowance in fiscal 2007. We recognized a benefit of \$4.2 million, or 1.3 percent due to a favorable state tax settlement. We recognized a benefit of \$2.8 million, or 0.8 percent of pretax income, in connection with the domestic manufacturing deduction, which was part of the American Jobs Creation Act of 2004 allowing a special deduction for qualified manufacturing activities.

The fiscal year 2006 tax rate was more favorable than the statutory rate of 35 percent due to several reasons. We recorded a reduction in income tax expense of \$5.8 million, or 1.9 percent of pretax income, reflecting the reversal of valuation allowances that had been recorded against state and foreign net operating loss carryforwards in prior years. Based on fiscal 2006 and forecasted taxable income in certain jurisdictions, we determined that it was appropriate to reverse a portion of this valuation allowance in fiscal 2006. We recognized a benefit of \$4.6 million, or 1.5 percent of pretax income, related to US export incentives. We recognized a benefit of \$3.2 million, or 1.0 percent of pretax income, in connection with the domestic manufacturing deduction, which was part of the American Jobs Creation Act of 2004 allowing a special deduction for qualified manufacturing activities.

See Note 18 to the consolidated financial statements in Item 8. Financial Statements and Supplementary Data for a full reconciliation of the statutory federal tax rate to the effective tax rates.

**Business Segment Results** (See Note 20 to the consolidated financial statements included in Item 8. Financial Statements and Supplementary Data ):

**Specialty Metals Segment**

Net sales in fiscal 2007 for this segment, which aggregates the Specialty Alloys Operations (SAO), Dynamet, and Carpenter Powder Products (CPP), of \$1.84 billion were \$371 million, or 25 percent, higher than the \$1.47 billion for fiscal 2006. Adjusted for surcharge revenue, sales increased 6 percent from the prior year.

Sales of stainless steel products grew 32 percent to \$696.8 million from \$528.1 million a year ago. Excluding surcharge revenue, sales increased 11 percent. Stainless sales benefited primarily from increased shipments to the industrial market and from the sale of higher value products.

Sales of specialty alloys increased 27 percent to \$895.6 million from \$703.8 million a year ago. Adjusted for surcharge revenue, specialty alloys sales increased 2 percent. Growth in the energy market and increased sales of higher value products were the primary drivers of the sales growth which was partially offset by reduced shipments to the aerospace and medical markets.

Titanium sales rose 6 percent to \$187.7 million from \$176.3 million a year ago. Sales benefited from increased shipments of fastener wire to the aerospace market.

Operating income for the Specialty Metals segment was a record \$323.0 million or 17.6 percent of sales compared to \$311.8 million or 21.3 percent a year ago. The change in operating income primarily reflected the Company's growth in sales, a richer product mix and the Company's continued focus on operational improvements.

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Operating income as a percent of sales decreased due to the dilutive effect on margins from the increase in surcharge revenue and the negative impact from the lag effect of the Company's surcharge mechanism.

### **Engineered Products Segment**

Fiscal 2007 net sales for the Engineered Products segment increased 3 percent to \$105.7 million from \$102.9 million for the same period a year ago.

Operating income was \$19.1 million or 18.1 percent of sales for fiscal 2007 compared to \$17.1 million or 16.6 percent of sales a year ago. Increased volume and better operating efficiencies at certain operating locations were the primary drivers of the increase.

### **Results of Operations Fiscal 2006 compared to Fiscal 2005**

Our net income for fiscal 2006 was \$211.8 million, or \$8.08 per diluted share, versus net income of \$135.5 million, or \$5.37 per diluted share, for fiscal 2005.

Sales and operating profits were driven by strong demand for our higher value materials, especially from the aerospace and medical markets, higher selling prices, and cost savings and containment due to our continued focus on lean and variation reduction. Sales grew in most of our major product classes.

Free cash flow (see page 30 for Carpenter's definition and a reconciliation to GAAP) was \$202.8 million in fiscal 2006. At June 30, 2006, our cash and marketable securities exceeded our total debt by \$161.3 million.

### **Net Sales**

Net sales for fiscal 2006 were \$1.6 billion, which was an increase of 19 percent from \$1.3 billion in fiscal 2005. The \$254.0 million increase in net sales was due to improved demand in our aerospace and medical markets, higher prices including surcharges and base price increases and product mix. Excluding surcharges, fiscal 2006 sales increased by 19 percent compared to fiscal 2005.

International sales in fiscal 2006 increased 36 percent to \$496.4 million from the prior year primarily as a result of strong demand for higher value materials, particularly in the European aerospace and medical markets. Sales outside of the U.S. accounted for 31.7 percent of total sales in fiscal 2006 compared to 27.8 percent in fiscal 2005. Details of sales by geographical region for the past three fiscal years are presented in Note 20 to the consolidated financial statements included in Item 8. Financial Statements and Supplementary Data .

Sales of our special alloys in fiscal 2006 increased 37 percent from the prior year, to \$703.8 million. The increase was driven by strong demand from the aerospace markets for alloys used in the manufacture of aircraft engines and structural components. The increase also reflected higher sales to the medical, automotive and energy markets, as well as higher base selling prices and surcharges.

Stainless steel sales of \$528.1 million in fiscal 2006 were relatively flat compared to the prior year. Higher selling prices and improved product mix offset reduced shipments of marginally profitable products and lower sales to the industrial and automotive markets.

Titanium alloy sales of \$176.3 million in fiscal 2006 were 57 percent more than fiscal 2005. Increased sales to the aerospace and medical markets and higher selling prices due to the effect of passing through significantly higher titanium costs drove the increase.

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Sales of our ceramic and other materials in fiscal 2006 increased by 4 percent from fiscal 2005, to \$102.2 million. Higher sales of ceramic cores and related products used in casting turbine blades for the aerospace market and fuel injectors for diesel engines were offset by lower sales of structural ceramic components sold to the industrial market and ceramic cores sold to the consumer market.

In terms of end-use markets, sales to the aerospace market of \$636.6 million in fiscal 2006 increased 66 percent from fiscal 2005. The increase was driven primarily by demand for high temperature alloys used in jet engine components and for titanium and special alloys used in airframe structural components. We have seen continued strength in the underlying demand for our materials due to the number and type of aircraft being built.

Sales to the industrial sector of \$302.0 million, which includes materials used in equipment and other capital goods applications, decreased by 8 percent in fiscal 2006 from fiscal 2005. The decrease primarily reflects reduced sales of marginally profitable products.

Consumer market sales in fiscal 2006 decreased by 16 percent from the prior year, to \$176.5 million. This decrease resulted from reduced sales to the sporting goods, housing, and electronic markets.

Sales to the automotive market in fiscal 2006 remained relatively flat at \$181.8 million. The increased popularity of high performance engines and more stringent emissions standards resulted in higher demand for special alloys and ceramic components, which offset reduced demand of other products driven by lower automobile production levels and corresponding adjustments in inventory within the supply chain.

Sales to the medical market of \$139.7 million were 45 percent above fiscal 2005, with strong growth in both domestic and international markets for our titanium materials and special alloys. Sales also benefited from pricing actions driven by the higher cost of materials and a favorable product mix.

### **Gross Profit**

Gross profit in fiscal 2006 grew to \$436.1 million, or 27.8 percent of sales, from \$316.1 million, or 24.1 percent of sales, a year ago. The improvement in our gross profit percentage was due to higher base prices, product mix improvement due to increased demand for higher value materials and the elimination of marginally profitable product lines, increased productivity, and cost reduction attributed to continued success from our focus on lean and variation reduction.

### **Selling and Administrative Expenses**

Selling and administrative expenses in fiscal 2006 were \$125.4 million, or 8.0 percent of net sales, compared to \$120.6 million, or 9.2 percent of net sales, in fiscal 2005. The increase in dollars primarily reflected increases in stock based compensation and other variable compensation expenses of \$4.0 million, increases in outside professional fees of \$3.0 million, and higher non-cash pension costs of \$2.3 million. Fiscal 2005 included \$4.2 million of expense representing the increase in a reserve related to ongoing cleanup costs at a location that was closed in 1987. Fiscal 2006 expense related to this location was \$0.7 million.

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### **Interest Expense**

Fiscal 2006 interest expense of \$23.3 million was approximately equal to fiscal 2005. Interest on substantially all of our debt is at a fixed rate and the level of debt was consistent throughout the two-year period.

### **Other Income, Net**

Other income, net was \$21.7 million in fiscal 2006 versus \$8.8 million in fiscal 2005. Interest income was \$13.9 million in fiscal 2006 compared to \$5.6 million in the prior year. This increase reflected higher average balances of cash during the year, and higher interest rates. Foreign exchange gains resulted in other income of \$1.5 million in fiscal 2006 while we recorded a loss of \$1.4 million in fiscal 2005. Fiscal 2006 included the receipt of \$4.7 million of tariffs from the U.S. Customs Department under the Dumping and Subsidy Offset Act of 2001. Fiscal 2005 included \$4.1 million of these funds.

### **Income Taxes**

Our effective tax rate for fiscal 2006 was 31.5 percent as compared to 28.7 percent for fiscal 2005. The fiscal year 2006 tax rate was more favorable than the statutory rate of 35 percent primarily due to the following items. We recorded a reduction in income tax expense of \$5.8 million, or 1.9 percent of pretax income, reflecting the reversal of valuation allowances that had been recorded against state and foreign net operating loss carryforwards in prior years. Under Statement of Financial Accounting Standards No. 109 (SFAS109), valuation allowances should be reviewed each year and an assessment must be made as to the likelihood of recovery of those deferred taxes. Based on fiscal 2006 and forecasted taxable income in certain jurisdictions, we determined that it was appropriate to reverse a portion of this valuation allowance in fiscal 2006. We recognized a benefit of \$4.6 million, or 1.5 percent of pretax income, related to US export incentives. We recognized a benefit of \$3.2 million, or 1.0 percent of pretax income, in connection with the domestic manufacturing deduction, which was part of the American Jobs Creation Act of 2004 allowing a special deduction for qualified manufacturing activities.

The fiscal year 2005 tax rate was more favorable than the statutory rate of 35 percent due to several reasons. We recognized a benefit of \$4.5 million representing the conclusion of an IRS review of prior year's tax returns. Also, we recorded a reduction in income tax expense of \$3.0 million reflecting the reversal of a portion of state tax net operating loss carryforward valuation allowances that had been recorded in prior years. During fiscal 2005, we adjusted the rates used to value state deferred taxes based on our review of effective tax rates in those states, which resulted in a decrease in tax expense of \$2.8 million.

See Note 18 to the consolidated financial statements in Item 8. Financial Statements and Supplementary Data for a full reconciliation of the statutory federal tax rate to the effective tax rates.

**Business Segment Results** (See Note 20 to the consolidated financial statements included in Item 8. Financial Statements and Supplementary Data):

### **Specialty Metals Segment**

Net sales in fiscal 2006 for this segment, which aggregates the Specialty Alloys Operations (SAO), Dynamet, and Carpenter Powder Products (CPP), of \$1,467.1 million were \$278.8 million, or 23 percent higher than the \$1,188.3 million for fiscal 2005. SAO sales increased 21 percent from fiscal 2005 due to solid demand from the aerospace market, the sale of higher value materials to the medical and automotive markets, and pricing actions. Dynamet's sales increased 57 percent in fiscal 2006 compared to fiscal 2005 due to robust demand from the aerospace market, continued growth in the

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domestic and international medical markets, higher base selling prices, and higher prices reflecting the pass through of significantly higher titanium costs. CPP's sales in fiscal 2006 were 10 percent higher than the prior year due to higher selling prices, stronger demand from the industrial market, and a better product mix.

Operating income for the Specialty Metals segment was \$311.8 million in fiscal 2006 compared to \$183.9 million in fiscal 2005. The increase in operating income reflected increased sales of higher value materials, base pricing actions and continued operational improvements.

### **Engineered Products Segment**

Fiscal 2006 sales for this segment were \$102.9 million, a 20 percent decrease from \$129.1 million for the prior year. The exclusion of the sales of \$29.2 million from a company divested at the end of fiscal 2005 represents the majority of this decrease.

Operating income for the Engineered Products segment for fiscal 2006 was \$17.1 million compared to \$22.2 million for fiscal 2005. The decrease in income was primarily due to the exclusion of the profits from the divested company and reduced sales in our structural ceramics component business.

### **Management's Discussion of Liquidity and Capital Resources**

We have maintained the ability to generate cash to meet our needs through cash flow from operations, management of working capital and the flexibility to use outside sources of financing to supplement internally generated funds.

Free cash flow as defined on page 30 was \$202.3 million in fiscal 2007 versus \$202.8 million a year ago.

Our cash flow from operations was \$275.1 million for fiscal 2007 and \$237.6 million a year ago. Accounts receivable were \$63.9 million higher than a year ago due to the increased level of sales, however, days sales outstanding remained relatively consistent at 46 days in fiscal 2007 compared to 44 days in fiscal 2006. Capital expenditures for plant, equipment and software were \$47.1 million during fiscal 2007 versus \$19.3 million for fiscal 2006. During fiscal 2007, the Company paid \$25.7 million in quarterly cash dividends as well as repurchasing \$28.9 million of common shares under the announced share repurchase program in an effort to build stockholder value.

The Company maintains a \$150 million revolving credit facility which expires in August 2010. The revolving credit facility includes a minimum EBITDA-to-interest expense coverage covenant and a maximum debt-to-capital ratio covenant.

At June 30, 2007, we had \$11.0 million of issued letters of credit under the revolving credit facility. The balance of the revolving credit facility (\$139.0 million) was available to us. In addition to this facility, we had \$50.0 million available under an accounts receivable purchase facility maintained with an independent financial institution with an expiration date of March 2010. As of June 30, 2007, there was no utilization of the facility.

In fiscal 2008, the Company will be required to make payments related to maturities of long-term debt totaling \$33.2 million.

For the years ended June 30, 2007, 2006 and 2005, interest cost totaled \$23.3 million, \$23.6 million, and \$23.1 million, of which \$0.5 million, \$0.3 million, and \$0.1 million, respectively, were capitalized as part of the cost of plant, equipment and software.

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As part of our financing strategy, we consider the levels of fixed rate debt versus floating rate debt in order to optimize our cost of debt. Historically, we have used interest rate swaps to achieve this targeted level. These instruments obligate us to pay a swap counterparty either a floating rate of interest in return for us receiving a fixed rate of interest or obligate us to pay a fixed rate of interest in return for us receiving a floating rate of interest. We had no significant swaps in effect as of June 30, 2007 or 2006. Favorable market conditions during fiscal 2005 allowed the company to unwind its remaining swaps at a gain. These gains are amortized over the remaining life of the underlying debt issue as a reduction to interest expense.

We believe that our current financial resources, both from internal and external sources, will be adequate to meet our foreseeable needs. At June 30, 2007, we had approximately \$189.0 million available under our credit facility and our accounts receivable purchase facility.

**Non-GAAP Financial Measures**

The following tables provide additional information regarding certain non-GAAP financial measures. Our definitions and calculations of these items may not necessarily be the same as those used by other companies.

<b>FREE CASH FLOW</b> <b>(in millions)</b>	<b>Year Ended June 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Net cash provided from operations	\$ 275.1	\$ 237.6	\$ 142.5
Purchases of plant, equipment and software	(47.1)	(19.3)	(13.8)
Proceeds from the sale of business			15.4
Proceeds from disposals of plant and equipment		1.0	1.1
Dividends paid	(25.7)	(16.5)	(11.4)
Free cash flow	\$ 202.3	\$ 202.8	\$ 133.8

Management believes that the presentation of free cash flow provides useful information to investors regarding our financial condition because it is a measure of cash generated which management evaluates for alternative uses. It is management's current intention to apply excess cash to the repayment of debt when economically feasible, or for other general corporate purposes.

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### **Critical Accounting Policies and Estimates:**

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an on-going basis, we evaluate our estimates, including those related to bad debts, customer claims, inventories, goodwill, intangible assets, income taxes, pensions and other postretirement benefits, contingencies and litigation, environmental liabilities, and derivative instruments and hedging activities.

We believe the following are the critical accounting policies and areas affected by significant judgments and estimates impacting the preparation of our consolidated financial statements.

#### *Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts for estimated losses resulting from the failure of our customers to make required payments. We perform ongoing credit evaluations of our customers and monitor their payment patterns. Should the financial condition of our customers deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

#### *Inventories*

Inventories are stated at the lower of cost or market. The cost of inventories is determined primarily using the last-in, first-out (LIFO) method. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between our cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory writedowns may be required.

#### *Pension and Other Postretirement Benefits*

The amount of the pension expense, which is determined annually, is based upon the value of the assets in the pension trust at the beginning of the fiscal year as well as actuarial assumptions, such as the discount rate and the expected long-term rate of return on plan assets. The assumed long-term rate of return on pension plan assets is reviewed at each year end based on the plan's investment policies, an analysis of the historical returns of the capital markets, and current interest rates. The plan's current allocation policy is to have approximately 60 percent U.S. and international equities and 40 percent fixed income. The discount rate for the U.S. plan is determined by reference to Moody's AA corporate bond index with maturities that approximate the anticipated cash outflows from the plan. The fluctuations in stock and bond markets could cause actual investment results to be significantly different from those assumed, and therefore, significantly impact the valuation of the assets in our pension trust. Changes in actuarial assumptions could significantly impact the accounting for the pension assets and liabilities. If the assumed long-term rate of return on plan assets was changed by 1 percent, the net pension expense would change by approximately \$8.8 million. If the discount rate was changed by 0.25 percent, the net pension expense would change by approximately \$2.1 million.

#### *Long-Lived Assets*

Long-lived assets are reviewed for impairment and written down to fair value whenever events or changes in circumstances indicate that the carrying value may not be recoverable through estimated future undiscounted cash flows. The amount of the impairment loss is the excess of the carrying amount of the impaired assets over the fair value of the assets based upon estimated future discounted cash flows. We evaluate long-lived assets for impairment by individual business unit. Changes in



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estimated cash flows could have a significant impact on whether or not an asset is impaired and the amount of the impairment.

### *Goodwill*

Goodwill is not amortized, but instead is tested for impairment, at least annually. Potential impairment is identified by comparing the fair value of a reporting unit to its carrying value, including goodwill. The fair value is estimated based upon discounted cash flow analysis and the use of market multiples. If the carrying value of the reporting unit exceeds its fair value, any impairment loss is measured by comparing the carrying value of the reporting unit's goodwill to its implied fair value. Changes in anticipated discounted cash flows and comparable market multiples could have a significant impact on whether or not goodwill is impaired and the amount of impairment.

### *Environmental Expenditures*

Environmental expenditures that pertain to current operations or to future revenues are expensed or capitalized consistent with Carpenter's capitalization policy for property, plant and equipment. Expenditures that result from the remediation of an existing condition caused by past operations and that do not contribute to current or future revenues are expensed. Liabilities are recognized for remedial activities when the remediation is probable and the cost can be reasonably estimated. Recoveries of expenditures for environmental remediation are recognized as assets only when recovery is deemed probable. Estimated liabilities are not discounted to present value, but estimated assets are measured on a discounted basis.

### *Income Taxes*

Deferred income taxes result from temporary differences in the recognition of income and expense for financial and income tax reporting purposes, or differences between the fair value of assets acquired in business combinations accounted for as purchases for financial reporting purposes and their corresponding tax bases. Deferred income taxes represent future tax benefits (assets) or costs (liabilities) to be recognized when those temporary differences reverse. We evaluate on a quarterly basis whether, based on all available evidence, we believe that our deferred income tax assets will be realizable. Valuation allowances are established when it is estimated that it is probable (more likely than not) that the tax benefit of the deferred tax assets will not be realized. The evaluation, as prescribed by Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused. Future realization of deferred income tax assets ultimately depends upon the existence of sufficient taxable income within the carryback, carryforward period available under tax law.

### *Derivative Financial Instruments*

Our current risk management strategies include the use of derivative instruments to reduce certain risks. The critical strategies include: (1) the use of commodity options to fix the price of a portion of anticipated future purchases of certain raw materials and energy to offset the effects of changes in the costs of those commodities; and (2) the use of foreign currency forwards and options to hedge a portion of anticipated future sales denominated in foreign currencies, principally the Euro, Pound Sterling and Australian dollar, in order to offset the effect of changes in exchange rates. Historically, we have also used interest rate swaps to maintain a certain level of floating rate debt relative to fixed rate debt. The commodity options and foreign currency forwards and options have been designated as cash flow hedges and unrealized net gains and losses are recorded in the

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accumulated other comprehensive income (loss) component of stockholders' equity. When used, interest rate swaps were designated as fair value hedges and the changes in fair value of these instruments were immediately recorded in earnings. The mark-to-market values of both the fair value hedging instruments and the underlying debt obligations were recorded as equal and offsetting gains and losses in the interest expense component of the consolidated statement of income. As of June 30, 2007 and 2006, substantially all interest rate swap agreements were terminated. We evaluate all derivative instruments each quarter to determine that they are highly effective. Any ineffectiveness is recorded in our consolidated statement of operations. If the anticipated future transactions were no longer expected to occur, unrealized gains and losses on the related hedges would be reclassified to the consolidated statement of operations.

*New Accounting Pronouncements*

For information with respect to new accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 1, Summary of Significant Accounting Policies, to Notes to Consolidated Financial Statements included in Part II, Item 8, Financial Statements and Supplementary Data.

**Off Balance Sheet Arrangements**

We had no off balance sheet arrangements during the periods presented.

**Contractual Obligations**

At June 30, 2007, we had the following contractual cash obligations and other commercial commitments and contingencies:

(in millions)	Total	Fiscal 2008	Fiscal 2009	Fiscal 2010	Fiscal 2011	Fiscal 2012	There- after
Long-term debt	\$ 332.7	\$ 33.2	\$ 23.3	\$ 20.0	\$	\$ 100.0	\$ 156.2
Accrued post-retirement benefits	140.4	12.1	12.1	12.7	13.4	14.0	76.1
Interest on long-term debt	122.7	23.0	21.3	19.7	18.5	11.8	28.4
Operating leases	21.6	8.3	6.7	2.6	1.6	1.0	1.4
Purchase commitments	451.1	430.4	20.7				
Total contractual obligations	\$ 1,068.5	\$ 507.0	\$ 84.1	\$ 55.0	\$ 33.5	\$ 126.8	\$ 262.1

We have entered into purchase commitments primarily for various key raw materials and equipment purchases at market related prices, all made in the normal course of business.

In addition, we had \$11.0 million of outstanding letters of credit as of June 30, 2007.

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### **Market Sensitive Instruments and Risk Management**

See Item 7A. Quantitative and Qualitative Disclosures About Market Risk for discussion of market sensitive instruments and associated market risk for Carpenter.

### **Contingencies**

#### **Environmental**

We are subject to various federal, state, local and international environmental laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. Although compliance with these laws and regulations may affect our costs of operations, compliance costs to date have not been material. We have environmental remediation liabilities at some of our owned operating facilities and have been designated as a potentially responsible party ( PRP ) with respect to certain third-party Superfund waste disposal sites and other third party owned sites. Additionally, we have been notified that we may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against us. Neither the exact amount of remediation costs nor the final method of their allocation among all designated PRPs at these Superfund sites has been determined. The liability for future environmental remediation costs is evaluated by management on a quarterly basis. We accrue amounts for environmental remediation costs that represent management's best estimate of the probable and reasonably estimable costs related to environmental remediation. During fiscal years 2007, 2006 and 2005, an additional \$0.1 million, \$0.3 million and \$0.5 million, respectively, was accrued related to three of our environmental remediation sites. The liabilities recorded for environmental remediation costs at Superfund sites, at other third party-owned sites and at Carpenter-owned current or former operating facilities remaining at June 30, 2007, 2006 and 2005, were \$5.5 million, \$5.9 million and \$6.1 million, respectively. The estimated range at June 30, 2007 of the reasonably possible future costs of remediation at Superfund sites, at other third party-owned sites and at Carpenter-owned current or former operating facilities is between \$5.5 million and \$9.9 million.

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

#### **Other**

We are also defending various claims and legal actions, and are subject to contingencies that are common to our operations, including those pertaining to product claims, commercial disputes, employment actions, employee benefits, compliance with domestic and federal laws, personal injury claims and tax issues. We provide for costs relating to these matters when a loss is probable and the amount is reasonably estimable. The effect of the outcome of these matters on our future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount and timing (both as to recording future charges to operations and cash expenditures) of the resolution of such matters. While it is not feasible to determine the outcome of these matters, management believes that the total ultimate liability will not have a material effect on our financial position, results of operations or cash flows. However, such costs could be material to our financial position, results of operations or cash flows in a particular future quarter or year.

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**Future Outlook**

As we enter fiscal 2008, we anticipate another year of record results, despite some initial headwinds from continued supply chain adjustments in the medical market and reduced sales to the industrial market. We expect sales to the aerospace market will strengthen in the second half of fiscal 2008 as a result of increasing demand for nickel-based alloys used in engine and structural applications.

We will continue to focus on high performance materials in order to be well positioned to capitalize on growth opportunities in our key end-use markets.

The Company plans to invest \$150 million in capital expenditures in fiscal 2008 to support our customers as well as invest in markets where we have significant opportunity based on our portfolio of products. The planned capital expenditures includes approximately \$75 million associated with the Company's previously announced \$115 million expansion of its premium let operations. Additionally, the planned capital expenditures include approximately \$14 million related to the Company's previously announced upgrade of its hot rolling facility.

The Company expects that cash flows from operations will approach \$300 million in fiscal 2008 and anticipates that free cash flow will be approximately \$100 million.

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### Forward-looking Statements

This Form 10-K contains various Forward-looking Statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements, which represent our expectations or beliefs concerning various future events, include statements concerning future revenues and continued growth in various market segments. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ from those projected, anticipated or implied. The most significant of these uncertainties are described in this Form 10-K. They include but are not limited to: 1) the cyclical nature of the specialty materials business and certain end-use markets, including aerospace, industrial, automotive, consumer, medical and energy, or other influences on our business such as new competitors, the consolidation of customers and suppliers or the transfer of manufacturing capacity from the United States to foreign countries; 2) our ability to achieve cost savings, productivity improvements or process changes; 3) our ability to recoup increases in the costs of energy and raw materials or other factors; 4) domestic and foreign excess manufacturing capacity for certain metals; 5) fluctuations in currency exchange rates; 6) the degree of success of government trade actions; 7) the valuation of the assets and liabilities in our pension trusts and the accounting for pension plans; 8) possible labor disputes or work stoppages; and 9) the potential that our customers may substitute alternate materials or adopt different manufacturing practices that replace or limit the suitability of our products. Any of these factors could have an adverse and/or fluctuating effect on our results of operations. The forward-looking statements in this document are intended to be subject to the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We undertake no obligation to update or revise any forward-looking statements.

### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

We use derivative financial instruments to reduce certain types of financial risk. Raw material cost fluctuations for our Specialty Metals segment are normally offset by selling price adjustments, primarily through the use of surcharge mechanisms and base price adjustments. Firm price sales contracts involve a risk of profit margin decline in the event of raw material increases. We reduce this risk on certain raw materials by entering into commodity forward contracts, which are effective hedges of the risk, on these firm sales contracts.

We are actively involved in managing risks associated with energy resources. Risk containment strategies include interaction with primary and secondary energy suppliers as well as obtaining adequate insurance coverage to compensate us for potential business interruption related to lack of availability of energy resources. In addition, we have used forwards and options to fix the price of a portion of our anticipated future purchases of certain energy to protect against the impact of significant increases in energy costs. We also use surcharge mechanisms to offset a portion of these charges where appropriate.

Fluctuations in foreign currency exchange rates could subject us to risk of losses on anticipated future cash flows from our international operations or customers. Foreign currency forward contracts are used to hedge certain foreign exchange risk.

Historically, we have used interest rate swaps to achieve a level of floating rate debt relative to fixed rate debt where appropriate.

All hedging strategies are reviewed and approved by senior financial management before being implemented. Senior financial management has established policies regarding the use of derivative instruments that prohibit the use of speculative or leveraged derivatives. Market valuations are performed at least quarterly to monitor the effectiveness of our risk management programs.

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The status of our financial instruments as of June 30, 2007 is provided in Note 10 to the consolidated financial statements included in Item 8.

Financial Statements and Supplementary Data . Assuming on June 30, 2007 (a) an instantaneous 10 percent decrease in the price of raw materials and energy for which we have commodity forward contracts, our results of operations would not have been materially affected and (b) a 10 percent strengthening of the U.S. dollar versus foreign currencies for which foreign exchange forward contracts existed, our results of operations would not have been materially affected.

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### **Management's Responsibilities for Financial Reporting**

Carpenter's management prepared the financial statements included in this Annual Report on Form 10-K and is responsible for their integrity and objectivity. The statements were prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts based on management's best judgments and estimates. Financial information elsewhere in this Annual Report is consistent with that in the financial statements.

Carpenter maintains a system of internal controls, supported by a code of conduct, designed to provide reasonable assurance that assets are safeguarded and transactions are properly executed and recorded for the preparation of financial information. We believe Carpenter's system of internal controls provides this appropriate balance. The system of internal controls and compliance is continually monitored by Carpenter's internal audit staff.

The Audit/Finance Committee of the Board of Directors, composed of independent directors who are neither current nor former employees of Carpenter, meets regularly with management, Carpenter's internal auditors and our independent registered public accounting firm to consider audit results and to discuss significant internal control, auditing and financial reporting matters. Both the independent registered public accounting firm and internal auditors have unrestricted access to the Audit/Finance Committee.

### **Management's Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluations of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Carpenter's internal control over financial reporting as of June 30, 2007. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*. Based on our assessment, we concluded that as of June 30, 2007, Carpenter's internal control over financial reporting is effective based on those criteria.

Management's assessment of Carpenter's internal control over financial reporting as of June 30, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing herein, which expresses unqualified opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting as of June 30, 2007.

/s/ Anne L. Stevens  
Anne L. Stevens  
Chairman, President and Chief Executive Officer

/s/ K. Douglas Ralph  
K. Douglas Ralph  
Senior Vice President - Finance and Chief Financial  
Officer



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### **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and

Stockholders of Carpenter Technology Corporation:

We have completed integrated audits of Carpenter Technology Corporation's consolidated financial statements and of its internal control over financial reporting as of June 30, 2007 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

#### Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Carpenter Technology Corporation and its subsidiaries (the Company) at June 30, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(1) presents fairly in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements and schedule in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for defined benefit pension and other postretirement plans effective June 30, 2007.

#### Internal control over financial reporting

Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that the Company maintained effective internal control over financial reporting as of June 30, 2007 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commissions (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal

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control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP  
**PricewaterhouseCoopers LLP**  
Philadelphia, Pennsylvania  
August 24, 2007

**Table of Contents****Consolidated Statements of Income**

Carpenter Technology Corporation

For the years ended June 30, 2007, 2006 and 2005

(in millions, except per share data)	2007	2006	2005
<b>NET SALES</b>	\$ 1,944.8	\$ 1,568.2	\$ 1,314.2
Cost of sales	1,487.1	1,132.1	998.1
<b>Gross profit</b>	457.7	436.1	316.1
Selling and administrative expenses	133.9	125.4	120.6
Gain on sale of business			(8.7)
<b>Operating income</b>	323.8	310.7	204.2
Interest expense	22.8	23.3	23.0
Other income, net	(30.0)	(21.7)	(8.8)
<b>Income before income taxes</b>	331.0	309.1	190.0
Income tax expense	103.8	97.3	54.5
<b>NET INCOME</b>	\$ 227.2	\$ 211.8	\$ 135.5
<b>EARNINGS PER COMMON SHARE:</b>			
Basic	\$ 8.79	\$ 8.33	\$ 5.54
Diluted	\$ 8.63	\$ 8.08	\$ 5.37
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:</b>			
Basic	25.7	25.2	24.2
Diluted	26.3	26.1	25.1

See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Statements of Cash Flows**

Carpenter Technology Corporation

For the years ended June 30, 2007, 2006 and 2005

(in millions)	2007	2006	2005
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 227.2	\$ 211.8	\$ 135.5
Adjustments to reconcile net income to net cash provided from operations:			
Depreciation and amortization	48.7	47.6	50.2
Deferred income taxes	5.7	(11.0)	7.7
Net pension expense	4.9	10.8	2.4
Net loss on asset disposals	1.3	1.0	1.2
Gain on sale of business			(8.7)
Changes in working capital and other:			
Accounts receivable	(63.9)	(39.5)	(31.8)
Inventories	(8.1)	3.6	(49.8)
Other current assets	(4.5)	7.2	(9.2)
Accounts payable	77.8	4.0	26.2
Accrued current liabilities	(14.6)	16.6	46.1
Contribution to VEBA			(25.0)
Other, net	0.6	(14.5)	(2.3)
<b>Net cash provided from operations</b>	<b>275.1</b>	<b>237.6</b>	<b>142.5</b>
<b>INVESTING ACTIVITIES</b>			
Purchases of plant, equipment and software	(47.1)	(19.3)	(13.8)
Proceeds from disposals of plant and equipment		1.0	1.1
Proceeds from sale of business			15.4
Purchases of marketable securities	(680.3)	(411.8)	(135.7)
Proceeds from sales of marketable securities	449.4	381.1	50.2
<b>Net cash used for investing activities</b>	<b>(278.0)</b>	<b>(49.0)</b>	<b>(82.8)</b>
<b>FINANCING ACTIVITIES</b>			
Net change in short-term debt			(2.3)
Payments on long-term debt	(0.2)	(0.2)	(20.2)
Dividends paid	(25.7)	(16.5)	(11.4)
Purchase of treasury stock	(28.9)		
Tax benefits on share-based compensation	7.7	8.0	
Proceeds from common stock options exercised	4.2	15.0	54.2
<b>Net cash (used for) provided from financing activities</b>	<b>(42.9)</b>	<b>6.3</b>	<b>20.3</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>(6.2)</b>	<b>(1.6)</b>	<b>(0.5)</b>
<b>(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(52.0)</b>	<b>193.3</b>	<b>79.5</b>
Cash and cash equivalents at beginning of year	352.8	159.5	80.0
<b>Cash and cash equivalents at end of year</b>	<b>\$ 300.8</b>	<b>\$ 352.8</b>	<b>\$ 159.5</b>

See accompanying notes to consolidated financial statements.



**Table of Contents****Consolidated Balance Sheets**

Carpenter Technology Corporation

June 30, 2007 and 2006

(in millions, except share data)	2007	2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 300.8	\$ 352.8
Marketable securities	372.7	141.8
Accounts receivable, net of allowance for doubtful accounts of \$4.0 and \$3.8 at June 30, 2007 and 2006, respectively	303.2	234.7
Inventories	235.0	224.3
Deferred income taxes	13.3	13.7
Other current assets	30.7	32.0
<b>Total current assets</b>	<b>1,255.7</b>	<b>999.3</b>
Property, plant and equipment, net	537.4	541.1
Prepaid pension cost	132.4	247.1
Goodwill	46.4	46.4
Trademarks and trade names, net	19.2	20.1
Other assets	34.6	33.9
<b>Total assets</b>	<b>\$ 2,025.7</b>	<b>\$ 1,887.9</b>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	\$ 215.9	\$ 137.4
Accrued liabilities	117.1	133.8
Current portion of long-term debt	33.2	0.2
<b>Total current liabilities</b>	<b>366.2</b>	<b>271.4</b>
Long-term debt, net of current portion	299.5	333.1
Accrued postretirement benefits	90.9	102.2
Deferred income taxes	143.5	189.0
Other liabilities	57.9	45.9
<b>Total liabilities</b>	<b>958.0</b>	<b>941.6</b>
Contingencies and commitments (see Note 13)		
<b>STOCKHOLDERS EQUITY</b>		
Convertible preferred stock authorized 2,000,000 shares; issued 290.4 shares at June 30, 2006		18.0
Common stock authorized 100,000,000 shares; issued 27,276,122 shares and 26,505,018 shares at June 30, 2007 and 2006, respectively	136.4	132.5
Capital in excess of par value common stock	328.0	294.2
Reinvested earnings	751.3	549.8
Common stock in treasury (1,154,351 shares and 990,610 shares at June 30, 2007 and 2006, respectively), at cost	(65.7)	(37.3)
Deferred compensation		(1.5)
Accumulated other comprehensive loss	(82.3)	(9.4)
<b>Total stockholders equity</b>	<b>1,067.7</b>	<b>946.3</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 2,025.7</b>	<b>\$ 1,887.9</b>

See accompanying notes to consolidated financial statements.

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## Consolidated Statement of Changes in Stockholders Equity

Carpenter Technology Corporation

For the years ended June 30, 2007, 2006 and 2005

	Convertible Preferred Stock		Common Stock		Common		Accumulated		Total Stockholders Equity
	Par Value	Capital in Excess of Par Value	Reinvested Earnings	Treasury Stock	Deferred Compensation	Other Comp. Loss			
(in millions, except per share data)	\$	\$	\$	\$	\$	\$	\$	\$	
<b>Balances at June 30, 2004</b>	<b>20.8</b>	<b>120.7</b>	<b>215.1</b>	<b>230.4</b>	<b>(38.0)</b>	<b>(9.5)</b>	<b>(1.5)</b>	<b>538.0</b>	
Net income				135.5				135.5	
Cash Dividends:									
Common @ \$0.4075 per share				(9.8)				(9.8)	
Preferred @ \$5,362.50 per share				(1.6)				(1.6)	
Stock options exercised		8.9	45.3					54.2	
Minimum pension liability, net of tax							(4.0)	(4.0)	
Other	(1.1)	0.1	17.7		2.2	0.3	(7.3)	11.9	
<b>Balances at June 30, 2005</b>	<b>19.7</b>	<b>129.7</b>	<b>278.1</b>	<b>354.5</b>	<b>(35.8)</b>	<b>(9.2)</b>	<b>(12.8)</b>	<b>724.2</b>	
Net income				211.8				211.8	
Cash Dividends:									
Common @ \$0.60 per share				(15.0)				(15.0)	
Preferred @ \$5,362.50 per share				(1.5)				(1.5)	
Stock options exercised		2.5	12.5					15.0	
Minimum pension liability, net of tax							0.3	0.3	
Reclassification of unamortized share-based compensation			(5.8)			5.8			
Tax benefit on share-based compensation			8.0					8.0	
Other	(1.7)	0.3	1.4		(1.5)	1.9	3.1	3.5	
<b>Balances at June 30, 2006</b>	<b>18.0</b>	<b>132.5</b>	<b>294.2</b>	<b>549.8</b>	<b>(37.3)</b>	<b>(1.5)</b>	<b>(9.4)</b>	<b>946.3</b>	
Net income				227.2				227.2	
Cash Dividends:									
Common @ \$0.60 per share				(24.9)				(24.9)	
Preferred @ \$5,362.50 per share				(0.8)				(0.8)	
Stock options exercised		1.0	3.2					4.2	
Minimum pension liability, net of tax							(6.2)	(6.2)	
Tax benefit on share-based compensation			7.7					7.7	
Purchase of treasury stock					(28.9)			(28.9)	
Conversion of preferred shares to common shares	(18.0)	2.9	15.1						
Adjustment to initially apply SFAS 158, net of tax							(70.6)	(70.6)	
Share-based compensation			6.2		4.5			10.7	
Other			1.6		(4.0)	1.5	3.9	3.0	



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<b>Balances at June 30, 2007</b>	\$	\$ 136.4	\$ 328.0	\$ 751.3	\$ (65.7)	\$	\$ (82.3)	\$ 1,067.7
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See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Statement of Changes in Stockholders Equity (continued)**

Carpenter Technology Corporation

For the years ended June 30, 2007, 2006 and 2005

	Preferred		Common Shares		Net
	Shares Issued	Issued	Treasury	Outstanding	
<b>Balances at June 30, 2004</b>	<b>333.7</b>	<b>24,141,150</b>	<b>(1,106,772)</b>	<b>23,034,378</b>	
Stock options exercised		1,774,261			1,774,261
Restricted stock awards			100,600		100,600
Other	(16.9)	33,826	(20,676)		13,150
<b>Balances at June 30, 2005</b>	<b>316.8</b>	<b>25,949,237</b>	<b>(1,026,848)</b>	<b>24,922,389</b>	
Stock options exercised		500,992			500,992
Restricted stock awards		5,400	73,908		79,308
Other	(26.4)	49,389	(37,670)		11,719
<b>Balances at June 30, 2006</b>	<b>290.4</b>	<b>26,505,018</b>	<b>(990,610)</b>	<b>25,514,408</b>	
Stock options exercised		192,958			192,958
Restricted stock awards			99,587		99,587
Conversion of preferred shares to common shares	(290.4)	580,857			580,857
Purchase of treasury stock			(235,072)		(235,072)
Other		(2,711)	(28,256)		(30,967)
<b>Balances at June 30, 2007</b>		<b>27,276,122</b>	<b>(1,154,351)</b>	<b>26,121,771</b>	

**Consolidated Statements of Comprehensive Income**

Carpenter Technology Corporation

For the years ended June 30, 2007, 2006 and 2005

(in millions)	2007	2006	2005
Net income	\$ 227.2	\$ 211.8	\$ 135.5
Unrealized gain on securities classified as available-for-sale, net of tax of \$0.0, \$(0.1) and \$0.0 million, respectively		0.1	
Net (losses) gains on derivative instruments, net of tax of \$1.9 million, \$(1.1) million, and \$6.3 million, respectively	(3.1)	1.9	(9.0)
Minimum pension liability, net of taxes of \$4.0 million, \$(0.1) million, and \$2.3 million, respectively	(6.2)	0.3	(4.0)
Foreign currency translation	7.0	1.1	1.7
Comprehensive income	\$ 224.9	\$ 215.2	\$ 124.2

See accompanying notes to consolidated financial statements.



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**Notes to Consolidated Financial Statements**

**1. Summary of Significant Accounting Policies**

**Basis of Consolidation** The consolidated financial statements include the accounts of Carpenter and all majority-owned subsidiaries. All significant intercompany accounts and transactions are eliminated. Investments in companies in which Carpenter exercises significant influence, but which it does not control (generally a 20 to 50 percent ownership interest), are accounted for on the equity method of accounting and Carpenter's share of their income or loss is included in other income, net in the Consolidated Statement of Income.

**Revenue Recognition** Revenue, net of related discounts and allowances, is recognized when product is shipped and title and risk of loss has transferred to the customer.

**Freight and Handling Fees and Costs** Freight and handling costs billed separately to customers are included as part of sales, and freight and handling costs expensed are included as part of cost of sales on the Consolidated Statement of Income.

**Research and Development** Research and development expenditures, which amounted to \$11.5, \$10.2 and \$10.0 million in fiscal 2007, 2006 and 2005, respectively, are expensed as incurred and are generally reported in cost of sales in the Consolidated Statement of Income. Substantially all development costs are related to developing new products or designing significant improvements to existing products.

**Cash Equivalents** Cash equivalents consist of highly liquid instruments with maturities at the time of acquisition of three months or less. Cash equivalents are stated at cost, which approximates market.

**Marketable Securities** Carpenter considers all highly liquid investments with an original maturity of more than three months when purchased and all auction-rate securities and variable rate demand notes to be marketable securities. Carpenter has determined that all of its marketable securities are to be classified as available-for-sale. These securities are carried at market value, with the unrealized gains and losses reported as a component of accumulated other comprehensive loss. Interest and dividends on securities classified as available-for-sale are included in other income, net.

**Accounts Receivable** Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of outstanding amounts. Trade credit is extended based upon periodic evaluation of each customer's ability to perform its obligations. The Company determines accounts receivable allowances based on an aging of accounts and a review of specific accounts identified as collection risks. We do not require collateral to secure accounts receivable.

**Inventories** Inventories are valued at the lower of cost or market. Cost for inventories is principally determined by the Last-In, First-Out (LIFO) method. Carpenter also uses the First-In, First-Out (FIFO) and average cost methods. For fiscal 2007 and 2006, \$76.6 million and \$62.1 million of inventory, respectively, was accounted for using a method other than the LIFO method.

**Fixed Assets and Depreciation** Fixed assets are stated at historical cost less accumulated depreciation. Depreciation for financial reporting purposes is computed by the straight-line

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**Notes to Consolidated Financial Statements (continued)**

method over the estimated useful lives of the assets. Depreciation for income tax purposes is computed using accelerated methods. Upon disposal, assets and related depreciation are removed from the accounts and the differences between the net amounts and proceeds from disposal are included in cost of goods sold in the consolidated statement of operations.

**Computer Software and Amortization** Computer software is included in other assets on the consolidated balance sheet, and is amortized for financial reporting purposes on a straight-line basis over the respective estimated useful lives, ranging principally from 3 to 7 years.

**Goodwill** Goodwill, representing the excess of the cost over the net tangible and identifiable intangible assets of acquired businesses, is stated at cost.

Goodwill is not amortized but instead is annually tested for impairment, or more frequently if events or circumstances indicate that the carrying amount of goodwill may be impaired. Potential impairment is identified by comparing the fair value of a reporting unit to its carrying value, including goodwill. The fair value is estimated using discounted cash flow and the use of market multiples valuation techniques. These valuation techniques require the use of estimates and assumptions related to projected operating results, capital expenditures and working capital levels as well as the cost of capital. If the carrying value of the reporting unit exceeds its fair value, any impairment loss is measured by comparing the carrying value of the reporting unit's goodwill to its implied fair value.

**Trademarks and Trade Names** The costs of trademarks and trade names are amortized on a straight-line basis over the estimated useful lives of 30 years.

**Impairment of Long-Lived Assets** Long-lived assets, including property, plant and equipment and intangible assets subject to amortization, are reviewed for impairment and written down to fair value whenever events or changes in circumstances indicate that the carrying value may not be recoverable through future undiscounted cash flows. The amount of the impairment loss is the excess of the carrying amount of the impaired assets over the fair value of the assets based upon discounted future cash flows.

**Environmental Expenditures** Environmental expenditures that pertain to current operations or to future revenues are expensed or capitalized consistent with Carpenter's capitalization policy for property, plant and equipment. Expenditures that result from the remediation of an existing condition caused by past operations and that do not contribute to current or future revenues are expensed. Liabilities are recognized for remedial activities when the remediation is probable and the cost can be reasonably estimated. Recoveries of expenditures for environmental remediation are recognized as assets only when recovery is deemed probable. Estimated liabilities are not discounted to present value, but estimated assets are measured on a discounted basis.

**Derivative Financial Instruments** All derivative financial instruments are recorded on the balance sheet at their fair value and changes in fair value are recorded each period in current earnings or comprehensive income. Carpenter enters into derivative financial instruments to hedge certain anticipated transactions, firm commitments, or assets and liabilities denominated in foreign currencies. Historically, Carpenter has utilized interest rate swaps to convert floating rate debt to fixed rate, or to convert fixed rate debt to floating rate.

**Foreign Currency Translation** Assets and liabilities of most international operations are translated into U.S. dollars at exchange rates in effect at year-end, and their income statements

**Table of Contents****Notes to Consolidated Financial Statements (continued)**

are translated at the average monthly exchange rates prevailing during the year. The resulting translation gains and losses are recorded each period as a component of accumulated other comprehensive income until the international entity is sold or liquidated. Gains and losses from transactions denominated in foreign currencies are reported in other income, net in the consolidated statement of operations.

**Deferred Income Taxes** Deferred income taxes are recognized by applying enacted statutory tax rates, applicable to future years, to temporary differences between the tax bases and financial statement carrying values of Carpenter's assets and liabilities. Valuation allowances are recorded to reduce deferred tax assets to amounts that are more likely than not to be realized.

**Earnings per Share** Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding for the period. Diluted earnings per share is calculated by dividing net income adjusted for the assumed shortfall between common and preferred dividends by the weighted average number of shares outstanding for the period, adjusted for the effect of an assumed conversion of preferred shares and the effect of all potentially dilutive stock options and stock units at the end of the period.

**Litigation** Periodically, Carpenter and its subsidiaries are parties to lawsuits arising out of the normal course of business. Carpenter records liabilities when a loss is probable and can be reasonably estimated. These estimates are based on an analysis made by internal and external legal counsel considering information known at the time.

**Share-Based Compensation** As of June 30, 2007, Carpenter has two share-based employee compensation plans, which are described in detail in Note 14. Beginning July 1, 2005, Carpenter adopted Statement of Financial Accounting Standards No. 123 (R) Share Based Payment (SFAS 123R) using the modified prospective method. The adoption of SFAS 123R did not have a material effect on operating income, income before taxes, net income, basic earnings per share or diluted earnings per share. In connection with the adoption of SFAS 123R during fiscal 2006, \$8.0 million related to the tax benefits associated with share-based compensation was reclassified from net cash provided from operations to net cash provided from financing activities.

For the year ended June 30, 2005, Carpenter accounted for its stock option plans and other stock-based compensation in accordance with the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No share-based employee compensation cost related to stock options was reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the proforma effect on net income and earnings per share had Carpenter accounted for share-based compensation in accordance with SFAS 123R for the year ended June 30, 2005:

(in millions, except per share data)	2005
Net income as reported	\$ 135.5
Deduct: Total share-based employee compensation expense determined under fair value based method for all stock option awards, net of related tax effect	(0.4)
Pro forma net income	\$ 135.1

**Table of Contents****Notes to Consolidated Financial Statements (continued)**

Earnings per share:	
Basic as reported	\$ 5.54
Basic pro forma	\$ 5.53
Diluted as reported	\$ 5.37
Diluted pro forma	\$ 5.36

For the year ended June 30, 2005, Carpenter accounted for stock-based compensation with retirement eligible provisions using the nominal vesting period approach. Beginning in fiscal 2006, with the adoption of FASB 123R, the Company began using the non-substantive vesting period approach for new awards granted with retirement eligible provisions. Applying the nominal vesting period approach rather than the non-substantive vesting period approach did not have a material effect on net income for any of the periods presented.

**Concentration of Credit Risk** Financial instruments that are potentially subject to concentrations of credit risk consist primarily of cash and cash equivalents, investments in marketable securities and trade receivables. Investment and cash management policies have been implemented that limit deposit concentrations and limit investments to investment grade securities. The risk with respect to trade receivables is mitigated by monitoring payment terms and periodic credit evaluations we perform on our customers, the short duration of our payment terms and by the diversification of our customer base. No single customer accounted for more than 10% or more of total sales in fiscal 2007, 2006 and 2005.

**Use of Estimates** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**New Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 ( FIN 48 ). FIN 48 provides clarification related to accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are required to be adopted for fiscal years beginning after December 15, 2006. During the first quarter of our fiscal year ended June 30, 2008, we will adopt and apply the provisions of FIN 48 to all tax positions upon initial adoption with any cumulative effect adjustment to be recognized as an adjustment to retained earnings. Based on our evaluation as of June 30, 2007, we expect that the adoption of FIN 48 will result in an increase of noncurrent liabilities of approximately \$1.0 million to \$2.0 million with an offsetting decrease to reinvested earnings in the same amount.

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**Notes to Consolidated Financial Statements (continued)**

In September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements ( SAB 108 ). SAB 108 addresses the diversity in practice in quantifying financial statement misstatements and establishes an approach that requires quantification of financial statement misstatements based on the effects of the misstatements in a company s financial statements and related disclosures. SAB 108 is effective for fiscal years ending after November 15, 2006. The application of SAB 108 did not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS 157 ), which establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards that permit, or in some cases require, estimates of fair market value. SFAS 157 also expands financial statement disclosure requirements about a company s use of fair value measurements, including the effect of such measures on earnings. The Company is required to adopt this new accounting guidance effective the first quarter of fiscal 2009. The Company is currently evaluating the provisions of SFAS 157; however, the adoption is not expected to have a material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Post-Retirement Plans ( SFAS 158 ). SFAS 158 requires employers to recognize the obligations associated with the funded status of a benefit plan in their statement of financial position. The provisions of SFAS 158 were adopted as of the year ended June 30, 2007. Adoption resulted in a decrease in assets of \$114.3 million and a decrease in liabilities of \$43.7 million and a reduction in shareholders equity through an adjustment to accumulated other comprehensive loss of \$70.6 million. The adoption had no impact on our results of operations or cash flows.

In February 2007, FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 ( SFAS 159 ). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value and report unrealized gains and losses on these instruments in earnings. SFAS 159 is effective for fiscal years that begin after November 15, 2007 (July 1, 2008 for the Company). The Company is currently evaluating the provisions of SFAS 159.

**2. Financial Statement Revision**

Certain prior year amounts have been revised to present variable rate demand notes or other financial instruments properly as marketable securities or cash equivalents, based on the underlying characteristics of the investments. As a result, the Consolidated Statements of Cash Flows for the years ended June 30, 2006 and 2005 and the Consolidated Balance Sheet as of June 30, 2006 have been revised to reflect the proper classification of these securities. This revision had no impact on Carpenter s net income, changes in stockholders equity, net cash provided from operating activities or free cash flow. The effects of this revision are as follows:



**Table of Contents****Notes to Consolidated Financial Statements (continued)**

	Years Ended June 30,			
	2006		2005	
	As Originally Reported	As Revised	As Originally Reported	As Revised
<b>Statement of Cash Flows:</b>				
Purchases of marketable securities	\$ (450.4)	\$ (411.8)	\$ (172.4)	\$ (135.7)
Sales of marketable securities	\$ 476.0	\$ 381.1	\$ 94.6	\$ 50.2
Net cash provided from (used for) investing activities	\$ 7.3	\$ (49.0)	\$ (75.1)	\$ (82.8)
Increase in cash and cash equivalents	\$ 249.6	\$ 193.3	\$ 87.2	\$ 79.5
Cash and cash equivalents at beginning of period	\$ 163.8	\$ 159.5	\$ 76.6	\$ 80.0
Cash and cash equivalents at end of period	\$ 413.4	\$ 352.8	\$ 163.8	\$ 159.5

(in millions)	June 30, 2006	
	As Originally Reported	As Revised
	<b>Balance Sheet:</b>	
Cash and cash equivalents	\$ 413.4	\$ 352.8
Marketable securities	\$ 81.2	\$ 141.8
Total current assets	\$ 999.3	\$ 999.3

**3. Earnings Per Common Share**

The calculations of earnings per share for the years ended June 30, 2007, 2006 and 2005 are shown below.

(in millions, except per share data)	2007	2006	2005
<b>Basic EPS:</b>			
Net income	\$ 227.2	\$ 211.8	\$ 135.5
Dividends accrued on convertible preferred stock, net of tax benefits	(0.8)	(1.5)	(1.6)
Earnings available to common stockholders	\$ 226.4	\$ 210.3	\$ 133.9
Weighted average common shares outstanding	25.7	25.2	24.2
Basic earnings per share	\$ 8.79	\$ 8.33	\$ 5.54

**Table of Contents****Notes to Consolidated Financial Statements (continued)**

<b>Diluted EPS:</b>				
Net income		\$ 227.2	\$ 211.8	\$ 135.5
Assumed shortfall between common and preferred dividends		(0.4)	(0.8)	(1.0)
Earnings available for common stockholders		\$ 226.8	\$ 211.0	\$ 134.5
Weighted average number of common shares outstanding		25.7	25.2	24.2
Assumed conversion of preferred shares		0.4	0.6	0.7
Effect of shares issuable under stock option plans		0.2	0.3	0.2
Adjusted weighted average common shares		26.3	26.1	25.1
Diluted net earnings per share		\$ 8.63	\$ 8.08	\$ 5.37

**4. Investments in Marketable Securities**

The fair value of Carpenter's investments in marketable securities is based on quoted market prices as of June 30, 2007 and 2006. The following is a summary of marketable securities as of June 30, 2007 and 2006, all of which were classified as available-for-sale:

<b>June 30, 2007</b>				
(in millions)	Corporate Bonds	Government Bonds	Other Fixed Income Securities	Total
Cost	\$	\$ 371.5	\$ 1.2	\$ 372.7
Unrealized losses				
Estimated fair value	\$	\$ 371.5	\$ 1.2	\$ 372.7
Due in one year or less	\$	\$ 371.5	\$ 1.2	\$ 372.7
Due in one through three years				
	\$	\$ 371.5	\$ 1.2	\$ 372.7
<b>June 30, 2006</b>				
(in millions)	Corporate Bonds	Government Bonds	Other Fixed Income Securities	Total
Cost	\$ 23.4	\$ 101.3	\$ 17.1	\$ 141.8
Unrealized losses				
Estimated fair value	\$ 23.4	\$ 101.3	\$ 17.1	\$ 141.8
Due in one year or less	\$ 23.4	\$ 101.3	\$ 17.1	\$ 141.8
Due in one through three years				
	\$ 23.4	\$ 101.3	\$ 17.1	\$ 141.8

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Substantially all of the Company's marketable securities are variable rate demand notes (VRDN). VRDN are variable rate bonds tied to short-term interest rates, but with stated

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maturities greater than 90 days. VRDN trade at par value, therefore no realized or unrealized gains/losses occur.

For the fiscal years ended June 30, 2007, 2006 and 2005, proceeds from sales of marketable securities were \$449.4, \$381.1 million and \$50.2 million, respectively. Realized losses on these sales during each of the fiscal years were approximately \$0.1 million.

**5. Inventories**

(in millions)	June 30	
	2007	2006
Raw materials and supplies	\$ 29.1	\$ 28.8
Work in process	138.3	132.0
Finished and purchased products	67.6	63.5
	\$ 235.0	\$ 224.3

If the first-in, first-out method of inventory had been used instead of the LIFO method, inventories would have been \$501.0 and \$267.7 million higher as of June 30, 2007 and 2006, respectively. Current cost of LIFO-valued inventories was \$659.5 million at June 30, 2007 and \$444.1 million at June 30, 2006. The reductions in LIFO-valued inventories decreased cost of sales by \$4.4 million during fiscal 2007 and \$2.0 million during fiscal 2006. There was no reduction during fiscal 2005.

**6. Property, Plant and Equipment**

(in millions)	June 30	
	2007	2006
Land	\$ 7.4	\$ 7.2
Buildings and building equipment	234.7	231.8
Machinery and equipment	1,106.3	1,092.8
Construction in progress	31.4	9.9
Total at cost	1,379.8	1,341.7
Less: accumulated depreciation and amortization	842.4	800.6
	\$ 537.4	\$ 541.1

The estimated useful lives of depreciable assets are as follows:

Asset Category	Useful Life	
	(in Years)	
Buildings and building equipment	20	45
Machinery and equipment	3	30

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Depreciation and amortization for the years ended June 30, 2007, 2006 and 2005 was \$47.1 million, \$45.8 million and \$46.8 million, respectively.

**Table of Contents****Notes to Consolidated Financial Statements (continued)****7. Goodwill and Trademarks and Trade Names, Net  
Goodwill**

Carpenter conducted its annual impairment review as of June 30, 2007 and 2006 and determined that there was no goodwill impairment. At June 30, 2007 and 2006 the Specialty Metals segment accounted for \$34.6 million of the goodwill and the Engineered Products segment accounted for \$11.8 million.

There were no changes to the carrying amount of goodwill during the fiscal years ended June 30, 2007, 2006 or 2005.

**Trademarks and Trade Names, Net**

(in millions)	June 30,	
	2007	2006
Trademarks and trade names, at cost	\$ 29.9	\$ 29.9
Less accumulated amortization	(10.7)	(9.8)
<b>Trademarks and trade names, net</b>	<b>\$ 19.2</b>	<b>\$ 20.1</b>

Carpenter recorded \$0.9 million of amortization expense during fiscal year 2007, \$1.0 million during fiscal year 2006, and \$1.1 million during fiscal year 2005. The estimated annual amortization expense for each of the succeeding five fiscal years is \$1.0 million.

**8. Debt**

The Company maintains a \$150 million revolving credit facility which expires in August 2010. The revolving credit facility includes two financial covenants, a minimum EBITDA-to-interest expense coverage and a maximum debt-to-capital ratio.

At fiscal year end, the Company had \$11.0 million of issued letters of credit under the revolving credit facility. The balance of the revolving credit facility (\$139.0 million) was available to the Company. In addition to this facility, the Company had \$50 million available to it under an Accounts Receivable Purchase Facility (see Note 9).

Long-term debt outstanding at June 30, 2007 and 2006 consists of the following:

(in millions)	June 30,	
	2007	2006
Senior unsecured notes, 6.625% due May 2013	\$ 99.5	\$ 99.4
Medium-term notes, Series B at 6.28% to 7.10% due from April 2008 to 2018 (face value of \$132.0 million at June 30, 2007 and 2006)	132.3	132.7