Allison Transmission Holdings Inc
Form 10-Q
July 25, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

OR

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

Commission File No. 001-35456

ALLISON TRANSMISSION HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**26-0414014**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
One Allison Way Indianapolis, IN	**46222**
(Address of Principal Executive Offices)	**(Zip Code)**

(317) 242-5000

(Registrant s telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of July 14, 2014, there were 176,685,429 shares of Common Stock and 1,185 shares of Non-voting Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

Allison Transmission Holdings, Inc.

Condensed Consolidated Balance Sheets

(unaudited, dollars in millions, except share data)

	June 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 126.7**	$ 184.7
Accounts receivables net of allowance for doubtful accounts of $0.6 and $0.4	**227.0**	175.1
Inventories	**169.5**	160.4
Deferred income taxes, net	**94.9**	58.1
Other current assets	**29.4**	28.6
Total Current Assets	**647.5**	606.9
Property, plant and equipment, net	**538.2**	563.4
Intangible assets, net	**1,561.4**	1,610.8
Goodwill	**1,941.0**	1,941.0
Deferred income taxes, net	**1.1**	1.1
Other non-current assets	**82.7**	89.4
TOTAL ASSETS	**$ 4,771.9**	$ 4,812.6
LIABILITIES		
Current Liabilities		
Accounts payable	**$ 174.4**	$ 150.4
Product warranty liability	**23.2**	37.4
Current portion of long-term debt	**17.9**	17.9
Deferred revenue	**22.0**	29.2
Other current liabilities	**140.8**	152.3
Total Current Liabilities	**378.3**	387.2
Product warranty liability	**63.5**	53.1
Deferred revenue	**47.1**	43.2
Long-term debt	**2,651.5**	2,660.4
Deferred income taxes	**165.8**	76.2
Other non-current liabilities	**171.7**	153.7
TOTAL LIABILITIES	**3,477.9**	3,373.8

Commitments and contingencies (see NOTE O)				
STOCKHOLDERS EQUITY				
Common stock, $0.01 par value, 1,880,000,000 shares authorized, 176,577,025 and 183,375,436 shares issued and outstanding		**1.8**		1.8
Non-voting common stock, $0.01 par value, 20,000,000 shares authorized, 1,185 shares issued and outstanding		**0.0**		0.0
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding				
Paid in capital		**1,598.0**		1,631.8
Accumulated deficit		**(286.7)**		(173.8)
Accumulated other comprehensive loss, net of tax		**(19.1)**		(21.0)
TOTAL STOCKHOLDERS EQUITY		**1,294.0**		1,438.8
TOTAL LIABILITIES & STOCKHOLDERS EQUITY	**$**	**4,771.9**	$	4,812.6

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Allison Transmission Holdings, Inc.

Condensed Consolidated Statements of Comprehensive Income

(unaudited, dollars in millions, except share data)

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Net sales	**$ 536.1**	$ 512.1	**$ 1,029.7**	$ 969.5
Cost of sales	**297.6**	286.0	**568.7**	545.1
Gross profit	**238.5**	226.1	**461.0**	424.4
Selling, general and administrative expenses	**85.1**	85.6	**168.3**	173.5
Engineering research and development	**21.2**	22.8	**45.7**	51.8
Operating income	**132.2**	117.7	**247.0**	199.1
Interest income	**0.2**	0.2	**0.4**	0.4
Interest expense	**(36.8)**	(33.5)	**(72.1)**	(67.6)
Other expense, net	**(0.9)**	(2.6)	**(1.3)**	(5.7)
Income before income taxes	**94.7**	81.8	**174.0**	126.2
Income tax expense	**(37.5)**	(31.3)	**(64.7)**	(48.2)
Net income	**$ 57.2**	$ 50.5	**$ 109.3**	$ 78.0
Basic earnings per share attributable to common stockholders	**$ 0.32**	$ 0.27	**$ 0.61**	$ 0.42
Diluted earnings per share attributable to common stockholders	**$ 0.31**	$ 0.26	**$ 0.59**	$ 0.41
Dividends declared per common share	**$ 0.12**	$ 0.12	**$ 0.24**	$ 0.18
Comprehensive income	**$ 57.0**	$ 44.0	**$ 111.2**	$ 68.9

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Allison Transmission Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited, dollars in millions)

	Six months ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 109.3**	$ 78.0
Add (deduct) items included in net income not using (providing) cash:		
Amortization of intangible assets	**49.4**	55.0
Depreciation of property, plant and equipment	**47.4**	49.7
Deferred income taxes	**61.7**	49.0
Unrealized gain on derivatives	**(8.0)**	(15.7)
Stock-based compensation	**7.3**	7.7
Excess tax benefit from stock-based compensation	**(7.8)**	(7.0)
Amortization of deferred financing costs	**4.3**	4.7
Impairment loss on investment in technology-related initiatives		2.5
Other	**0.2**	(0.2)
Changes in assets and liabilities:		
Accounts receivable	**(52.0)**	(44.2)
Inventories	**(8.8)**	(7.8)
Accounts payable	**24.0**	35.6
Other assets and liabilities	**15.0**	(22.9)
Net cash provided by operating activities	**242.0**	184.4
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions of long-lived assets	**(22.7)**	(25.8)
Investments in technology-related initiatives	**(3.8)**	(6.3)
Collateral for interest rate derivatives	**1.7**	1.3
Proceeds from disposal of assets	**0.1**	0.2
Net cash used for investing activities	**(24.7)**	(30.6)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase of common stock	**(249.8)**	
Dividend payments	**(43.4)**	(33.4)
Proceeds from exercise of stock options	**22.4**	25.2
Payments on long-term debt	**(8.9)**	(11.8)
Excess tax benefit from stock-based compensation	**7.8**	7.0
Taxes paid related to net share settlement of equity awards	**(0.2)**	(3.1)
Debt financing fees	**(1.0)**	(1.6)
Net cash used for financing activities	**(273.1)**	(17.7)
Effect of exchange rate changes on cash	**(2.2)**	11.1
Net (decrease) increase in cash and cash equivalents	**(58.0)**	147.2
Cash and cash equivalents at beginning of period	**184.7**	80.2
Cash and cash equivalents at end of period	**$ 126.7**	$ 227.4
Supplemental disclosures:		
Interest paid	**$ 68.6**	$ 79.6
Income taxes paid	**$ 3.1**	$ 3.0

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Allison Transmission Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

NOTE A. OVERVIEW

Overview

Allison Transmission Holdings, Inc. and its subsidiaries (the Company or Allison), design and manufacture commercial and defense fully-automatic transmissions.

The business was founded in 1915 and has been headquartered in Indianapolis, Indiana since inception. The Company has 13 different transmission product lines. Although approximately 77% of revenues were generated in North America in 2013, the Company has a global presence by serving customers in Europe, Asia, South America and Africa. The Company serves customers through an independent network of approximately 1,400 independent distributor and dealer locations worldwide.

Since the introduction of the Company s first fully-automatic transmission over 60 years ago, the Company s products have gained acceptance in a wide variety of applications, including on-highway trucks (distribution, refuse, construction, fire and emergency), buses (primarily school, transit and hybrid-transit), motorhomes, off-highway vehicles and equipment (primarily energy, mining and construction) and defense vehicles (wheeled and tracked). The Company has developed over 100 different product models that are used in more than 2,500 different vehicle configurations, which are compatible with more than 500 combinations of engine brands, models and ratings. The Company also sells support equipment and Allison-branded replacement parts for the Company s transmissions and remanufactured transmissions for use in the vehicle aftermarket.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements as of and for the three and six months ended June 30, 2014 and 2013 have been prepared in accordance with accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the condensed consolidated financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. The information herein reflects all normal recurring material adjustments, which are, in the opinion of management, necessary for the fair statement of the results for the periods presented. The condensed consolidated financial statements herein consist of all wholly-owned domestic and foreign subsidiaries with all significant intercompany transactions eliminated.

These condensed consolidated financial statements present the financial position, results of operations and cash flows of the Company. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission (SEC) on February 24, 2014. The interim period financial results for the three and six month periods presented are not necessarily indicative of results to be expected for any other interim period or for the entire year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Significant estimates include, but are not limited to, allowance for doubtful accounts, sales allowances, government price adjustments, fair market values and future cash flows associated with goodwill, indefinite life intangibles, long-lived asset impairment tests, useful lives for depreciation and amortization, warranty liability, determination of discount and other assumptions for pension and other postretirement benefit expense, income taxes and deferred tax valuation allowances, derivative valuation, and contingencies. The Company s accounting policies involve the application of judgments and assumptions made by management that include inherent risks and uncertainties. Actual results could differ materially from these estimates. Changes in estimates are recorded in results of operations in the period that the events or circumstances giving rise to such changes occur.

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Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued authoritative accounting guidance on a company s accounting for revenue from contracts with customers. The guidance applies to all companies that enter into contracts with customers to transfer goods, service or nonfinancial assets. The guidance requires these companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires improved disclosures regarding the nature, timing, amount and uncertainty of revenue that is recognized. The guidance is effective prospectively for fiscal years beginning after December 15, 2016. Management is currently assessing the potential impact of the adoption of this guidance on the Company s consolidated financial statements.

In July 2013, the FASB issued authoritative accounting guidance on the presentation of an unrecognized tax benefit when net operating loss (NOL) carryforwards exist. The guidance requires presentation of an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for an NOL carryforward, a similar tax loss or a tax credit carryforward. The guidance became effective for fiscal years beginning after December 15, 2013. The adoption of this guidance did not have a material effect on the Company s condensed consolidated financial statements.

In March 2013, the FASB issued authoritative accounting guidance on a parent company s accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. The guidance clarifies that when a parent company ceases to have a controlling financial interest in a subsidiary or group of assets, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The guidance became effective for fiscal years beginning after December 15, 2013. The adoption of this guidance did not have an effect on the Company s condensed consolidated financial statements.

NOTE C. INVENTORIES

Inventories consisted of the following components (dollars in millions):

	June 30, 2014	**December 31, 2013**
Purchased parts and raw materials	**$ 86.4**	$ 79.7
Work in progress	**8.0**	5.7
Service parts	**45.4**	45.8
Finished goods	**29.7**	29.2
Total inventories	**$ 169.5**	$ 160.4

Inventory components shipped to third parties, primarily cores, parts to re-manufacturers, and parts to contract manufacturers, in which the Company has an obligation to buy back, are included in purchased parts and raw materials, with an offsetting liability in Other current liabilities.

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NOTE D. GOODWILL AND OTHER INTANGIBLE ASSETS

As of June 30, 2014 and December 31, 2013, the carrying amount of the Company s Goodwill was $1,941.0 million. The following presents a summary of other intangible assets (dollars in millions):

	Intangible assets, gross	June 30, 2014 Accumulated amortization	Intangible assets, net	Intangible assets, gross	December 31, 2013 Accumulated amortization	Intangible assets, net
Other intangible assets:						
Trade name	**$ 870.0**	**$**	**$ 870.0**	$ 870.0	$	$ 870.0
Customer relationships defense	**62.3**	**(26.1)**	**36.2**	62.3	(24.4)	37.9
Customer relationships commercial	**831.8**	**(400.9)**	**430.9**	831.8	(374.9)	456.9
Proprietary technology	**476.3**	**(262.9)**	**213.4**	476.3	(243.9)	232.4
Non-compete agreement	**17.3**	**(12.0)**	**5.3**	17.3	(11.1)	6.2
Patented technology defense	**28.2**	**(22.9)**	**5.3**	28.2	(21.2)	7.0
Tooling rights	**4.5**	**(4.2)**	**0.3**	4.5	(4.1)	0.4
Patented technology commercial	**260.6**	**(260.6)**		260.6	(260.6)	
Total	**$ 2,551.0**	**$ (989.6)**	**$ 1,561.4**	$ 2,551.0	$ (940.2)	$ 1,610.8

As of June 30, 2014 and December 31, 2013, the net carrying value of our Goodwill and other intangibles was $3,502.4 million and $3,551.8 million, respectively.

Amortization expense related to other intangible assets for the next five years and thereafter is expected to be (dollars in millions):

	2015	2016	2017	2018	2019	Thereafter
Amortization expense	$ 97.1	$ 92.4	$ 89.7	$ 87.2	$ 85.7	$ 189.9

NOTE E. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with the FASB s authoritative accounting guidance on fair value measurements, fair value is the price (exit price) that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements and utilizes the best available information that maximizes the use of observable inputs and minimizes the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs. The accounting guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by the relevant guidance are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, listed equities and publicly traded bonds.

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value. At each balance sheet date, the Company performs an analysis of all instruments subject to authoritative accounting guidance and includes, in Level 3, all of those whose fair value is based on significant unobservable inputs. As of June 30, 2014 and December 31, 2013, the Company did not have any Level 3 financial assets or liabilities.

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The Company s assets and liabilities that are measured at fair value include cash and cash equivalents, available-for-sale securities, derivative instruments, assets held in a rabbi trust and a deferred compensation obligation. The Company s cash equivalents consist of short-term U.S. government backed securities. The Company s available-for-sale securities consist of ordinary shares of Torotrak plc (Torotrak) associated with a license and exclusivity agreement with Torotrak. Torotrak s listed shares are traded on the London Stock Exchange under the ticker symbol TRK. The Company s derivative instruments consist of interest rate swaps, foreign currency forward contracts and commodity swaps. The Company s assets held in the rabbi trust consist principally of publicly available mutual funds and target date retirement funds. The Company s deferred compensation obligation is directly related to the fair value of assets held in the rabbi trust.

The Company s valuation techniques used to calculate the fair value of cash and cash equivalents, available-for-sale securities, assets held in the rabbi trust and the deferred compensation obligation represent a market approach in active markets for identical assets that qualifies as Level 1 in the fair value hierarchy. The Company s valuation techniques used to calculate the fair value of derivative instruments represent a market approach with observable inputs that qualify as Level 2 in the fair value hierarchy.

The foreign currency contracts consist of forward rate contracts which are intended to hedge exposure of transactions denominated in certain currencies and reduce the impact of currency price volatility on the Company s financial results. The commodity contracts consist of forward rate contracts which are intended to hedge exposure of transactions involving purchases of component parts and energy to power our facilities, reducing the impact of commodity price volatility on the Company s financial results.

For the fair value measurement of foreign currency derivatives, the Company uses forward foreign exchange rates received from the issuing financial institution. These rates are periodically corroborated by comparing to third-party broker quotes. The foreign currency hedges are accounted for within the authoritative accounting guidance set forth on accounting for derivative instruments and hedging activities and have been recorded at fair value based upon quoted market rates. The fair values are included in Other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company generally does not elect to apply hedge accounting for these foreign currency contracts, and as a result, unrealized fair value adjustments and realized gains and losses are recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

For the fair value measurement of commodity derivatives, the Company uses forward prices received from the issuing financial institution. These rates are periodically corroborated by comparing to third-party broker quotes. The commodity derivatives are accounted for within the authoritative accounting guidance set forth on accounting for derivative instruments and hedging activities and have been recorded at fair value based upon quoted market rates. The fair values are included in Other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company has either not qualified for or not elected hedge accounting treatment for these commodity contracts, and as a result, unrealized fair value adjustments and realized gains and losses are recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.

For the fair value measurement of interest rate derivatives, the Company uses valuations from the issuing financial institution. The Company corroborates the valuation through the use of third-party valuation services using a standard replacement valuation model. The floating-to-fixed interest rate swaps are based on the London Interbank Offered Rate (LIBOR) which is observable at commonly quoted intervals. The fair values are included in other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company has not qualified for hedge accounting treatment for the interest rate swaps and, as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income.

The following table summarizes the fair value of the Company s financial assets and (liabilities) as of June 30, 2014 and December 31, 2013 (dollars in millions):

	Fair Value Measurements Using					
	Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		TOTAL	
	June 30, 2014	**December 31, 2013**	**June 30, 2014**	**December 31, 2013**	**June 30, 2014**	**December 31, 2013**
Cash and cash equivalents	**$ 126.7**	$ 184.7	**$**	$	**$ 126.7**	$ 184.7
Available-for-sale securities	**11.2**	8.2			**11.2**	8.2
Rabbi trust assets	**2.7**	1.3			**2.7**	1.3
Deferred compensation obligation	**(2.7)**	(1.3)			**(2.7)**	(1.3)
Derivative assets			**0.4**	1.6	**0.4**	1.6

Derivative liabilities			**(12.2)**	(21.4)	**(12.2)**	(21.4)
Total	**$ 137.9**	$ 192.9	**$ (11.8)**	$ (19.8)	**$ 126.1**	$ 173.1

Of the available Cash and cash equivalents, approximately $125.7 million and $179.7 million was deposited in operating accounts while approximately $1.0 million and $5.0 million was invested in U.S. government backed securities as of June 30, 2014 and December 31, 2013, respectively.

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NOTE F. DEBT

Long-term debt and maturities are as follows (dollars in millions):

	June 30, 2014	December 31, 2013
Long-term debt:		
Senior Secured Credit Facility Term B-2 Loan, variable, due 2017	**$ 423.5**	$ 423.5
Senior Secured Credit Facility Term B-3 Loan, variable, due 2019	**1,774.6**	1,783.5
Senior Notes, fixed 7.125%, due 2019	**471.3**	471.3
Total long-term debt	**2,669.4**	2,678.3
Less: current maturities of long-term debt	**17.9**	17.9
Total long-term debt less current portion	**$ 2,651.5**	$ 2,660.4

As of June 30, 2014, the Company had $423.5 million of indebtedness associated with Allison Transmission, Inc. s (ATI), the Company s wholly-owned subsidiary, Senior Secured Credit Facility Term B-2 Loan due 2017 (Term B-2 Loan) and $1,774.6 million of indebtedness associated with ATI s Senior Secured Credit Facility Term B-3 Loan due 2019 (Term B-3 Loan) (together the Term B-2 Loan, Term B-3 Loan and revolving credit facility defined as the Senior Secured Credit Facility). The Company also had indebtedness of $471.3 million of ATI s 7.125% senior cash pay notes due May 2019 (7.125% Senior Notes).

The fair value of the Company s long-term debt obligations as of June 30, 2014 was $2,705.8 million. The fair value is based on quoted Level 1 market prices of the Company s debt as of June 30, 2014. It is not expected that the Company would be able to repurchase a significant amount of its debt at these levels. The difference between the fair value and carrying value of the long-term debt is driven primarily by trends in the financial markets.

Senior Secured Credit Facility

The Senior Secured Credit Facility is collateralized by a lien on substantially all assets of the Company including all of ATI s capital stock and all of the capital stock or other equity interest held by the Company, ATI and each of the Company s existing and future U.S. subsidiary guarantors (subject to certain limitations for equity interests of foreign subsidiaries and other exceptions set forth in the terms of the Senior Secured Credit Facility). In the second quarter of 2014, ATI entered into an amendment with the term loan lenders under its Senior Secured Credit Facility to refinance Term B-2 Loan. The interest rate margin applicable to such refinanced loan is at the Company s option, either (a) 2.75% over the LIBOR or (b) 1.75% over the greater of the prime lending rate provided by the British Banking Association or the federal funds effective rate published by the Federal Reserve Bank of New York plus 0.50%. The Company recorded $0.3 million of new deferred financing fees in the condensed consolidated financial statements. Interest on the Term B-3 Loan, as of June 30, 2014, is equal to the LIBOR (which may not be less than 1.00%) plus 2.75% based on the Company s total leverage ratio. As of June 30, 2014, these rates were approximately 2.91% and 3.75% on the Term B-2 Loan and Term B-3 Loan, respectively, and the weighted average rate on the Senior Secured Credit Facility was approximately 3.59%. The Senior Secured Credit Facility requires minimum quarterly principal payments on the Term B-2 Loan and Term B-3 Loan as well as prepayments from certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events and from a percentage of excess cash flow, if applicable. Due to voluntary prepayments, the Company has fulfilled all Term B-2 Loan required quarterly payments through its maturity date of 2017. The minimum required quarterly principal payment on the Term B-3 Loan is $4.5 million and remains through its maturity date of 2019. As of June 30, 2014, there had been no payments required for certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events. The remaining principal balance on each loan is due upon maturity.

The Senior Secured Credit Facility also provides for revolving credit borrowings. In the first quarter of 2014, ATI increased the revolving commitments available under the revolving portion of the Senior Secured Credit Facility to $465.0 million, net of an allowance for up to $75.0 million in outstanding letters of credit commitments. The increase was treated as a modification of debt under GAAP, and thus the Company recorded $0.6 million of new deferred financing fees in the condensed consolidated financial statements. Throughout the six months ended June 30, 2014, the Company made one withdrawal and payment on the revolving credit facility as part of its debt management plans. The maximum amount outstanding at any time on the revolving credit facility was $40.0 million, and the entire balance was repaid within the quarter it was borrowed. As of June 30, 2014, the Company had $453.0 million available under the revolving credit facility, net of $12.0 million in letters of credit. Revolving credit borrowings bear interest at a variable base rate plus an applicable margin based on the Company s total leverage ratio. As of June 30, 2014, this rate would have been between approximately 2.16% and 4.25%. In addition, there is an annual commitment fee, based on the Company s total leverage ratio, which as of June 30, 2014, was equal to 0.375% of the average unused revolving credit borrowings available under the Senior Secured Credit Facility. Revolving credit borrowings are payable at the option of the Company throughout the term of the Senior Secured Credit Facility with the balance due in January 2019.

The revolving portion of the Senior Secured Credit Facility requires the Company to maintain a specified maximum total senior secured leverage ratio of 5.50x when revolving loan commitments remain outstanding at the end of a fiscal quarter. On March 12, 2014, however, the revolving lenders holding a majority of the revolving loan commitments permanently waived and agreed that no event of default would result from any non-compliance so long as there were no revolving loans outstanding as of the last day of any fiscal quarter. As of June 30, 2014, the Company had no revolving loans outstanding, however the Company would have been in compliance with the maximum total senior secured leverage ratio, achieving a 3.11x ratio. Additionally within the terms of the Senior Secured Credit Facility, a senior secured leverage ratio at or below 3.50x results in the elimination of excess cash flow payments on the Senior Secured Credit Facility for the applicable year. The Senior Secured Credit Facility also provides certain financial incentives based on our total leverage ratio. A total leverage ratio at or below 4.00x results in a 25 basis point reduction to the applicable margin on the revolving credit facility, and a total leverage ratio at or below 3.50x results in a 12.5 basis point reduction to the revolving credit facility commitment fee and an additional 25 basis point reduction to the applicable margin on the revolving credit facility. A total leverage ratio at or below 3.25x results in a 25 basis point reduction to the applicable margin on our Term B-3 Loan. These reductions would remain in effect as long as the Company achieves a total leverage ratio at or below the related threshold. As of June 30, 2014, the total leverage ratio was 3.82x.

In addition, the Senior Secured Credit Facility, among other things, includes customary restrictions (subject to certain exceptions) on the Company s ability to incur certain indebtedness, grant certain liens, make certain investments or declare or pay certain dividends. As of June 30, 2014, the Company is in compliance with all covenants under the Senior Secured Credit Facility.

NOTE G. DERIVATIVES

The Company is exposed to certain financial risk from volatility in interest rates, foreign exchange rates and commodity prices. The risk is managed through the use of financial derivative instruments including interest rate swaps, foreign currency forward contracts and commodity swaps. The Company s current derivative instruments are used strictly as an economic hedge and not for speculative purposes. As necessary, the Company adjusts the values of the derivative instruments for counter-party or credit risk.

Interest Rate

The Company is subject to interest rate risk related to the Senior Secured Credit Facility and enters into interest rate swap contracts that are based on the LIBOR to manage a portion of this exposure. The Company has not elected hedge accounting treatment for these derivatives, and as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income. A summary of the Company s interest rate derivatives as of June 30, 2014 and December 31, 2013 follows (dollars in millions):

	June 30, 2014		**December 31, 2013**	
	Notional Amount	**Fair Value**	**Notional Amount**	**Fair Value**
3.75% Interest Rate Swap H, due August 2014	**$ 350.0**	**$ (1.1)**	$ 350.0	$ (7.2)
3.77% Interest Rate Swap I, due August 2014	**350.0**	**(1.1)**	350.0	(7.2)
2.96% Interest Rate Swap J, due August 2014	**125.0**	**(0.3)**	125.0	(2.0)
3.05% Interest Rate Swap K, due August 2014	**125.0**	**(0.3)**	125.0	(2.0)
3.44% Interest Rate Swap L, due August 2019*	**75.0**	**(1.7)**	75.0	(0.4)
3.43% Interest Rate Swap M, due August 2019*	**100.0**	**(2.3)**	100.0	(0.4)
3.37% Interest Rate Swap N, due August 2019*	**75.0**	**(1.6)**	75.0	(0.2)
3.19% Interest Rate Swap O, due August 2019*	**75.0**	**(1.2)**	75.0	0.2
3.08% Interest Rate Swap P, due August 2019*	**75.0**	**(0.9)**	75.0	0.4
2.99% Interest Rate Swap Q, due August 2019*	**50.0**	**(0.5)**	50.0	0.4
2.98% Interest Rate Swap R, due August 2019*	**50.0**	**(0.5)**	50.0	0.4
* include LIBOR floor of 1.00%	**$ 1,450.0**	**$ (11.5)**	$ 1,450.0	$ (18.0)

Certain of the Company s interest rate derivatives contain credit-risk and collateral contingent features under which downgrades in the Company s credit rating could require the Company to increase its collateral. Certain interest rate derivatives also contain provisions under which the Company may be required to post additional collateral if the LIBOR interest rate curve reaches certain levels.

As of June 30, 2014 and December 31, 2013, the Company had recorded cash collateral of $0.0 million and $1.7 million, respectively, in Other current assets in the Condensed Consolidated Balance Sheets, as the balances are subject to frequent change. The Company has also posted $2.0 million of collateral in the form of letters of credit.

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Currency Exchange

The Company s business is subject to foreign exchange rate risk. As a result, the Company enters into various forward rate contracts that qualify as derivatives under the authoritative accounting guidance to manage certain of these exposures. Forward contracts are used to hedge forecasted transactions and known exposure of payables denominated in a foreign currency. The Company generally has not elected to apply hedge accounting under the authoritative accounting guidance and recorded the unrealized fair value adjustments and realized gains and losses associated with these contracts in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

The following table summarizes the outstanding foreign currency forward contracts as of June 30, 2014 and December 31, 2013 (amounts in millions):

	June 30, 2014		December 31, 2013	
	Notional Amount	**Fair Value**	Notional Amount	Fair Value
Japanese Yen (JPY)	**¥ 600.0**	**$ 0.2**	¥ 600.0	$ (0.3)
		$ 0.2		$ (0.3)

Commodity

The Company s business is subject to commodity price risk, primarily with component suppliers. As a result, the Company enters into various commodity swap contracts that qualify as derivatives under the authoritative accounting guidance to manage certain of these exposures. Swap contracts are used to hedge forecasted transactions either of the commodity or of components containing the commodity. The Company has not qualified for hedge accounting treatment for these commodity contracts, and as a result, unrealized fair value adjustments and realized gains and losses associated with these contracts were charged directly to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

The following table summarizes the outstanding commodity swaps as of June 30, 2014 and December 31, 2013 (dollars in millions):

	June 30, 2014			December 31, 2013		
	Notional Amount	**Quantity**	**Fair Value**	**Notional Amount**	**Quantity**	**Fair Value**
Aluminum	**$ 18.5**	**9,350 metric tons**	**$ (0.5)**	$ 23.8	11,875 metric tons	$ (1.6)
Natural Gas	**N/A**	**N/A**		0.3	90,000 MMBtu	0.0
			$ (0.5)			$ (1.6)

The following tabular disclosures further describe the Company s derivative instruments and their impact on the financial condition of the Company (dollars in millions):

	June 30, 2014		December 31, 2013	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives not designated as hedging instruments				
Foreign currency contracts	**Other current assets**	**$ 0.2**	Other current liabilities	$ (0.3)
Commodity contracts	**Other current and non-current assets**	**0.2**	Other current and non-current assets	0.1

	Other current and non-current liabilities	**(0.7)**	Other current and non-current liabilities	(1.7)
Interest rate contracts	**Other non-current assets**	**0.0**	Other non-current assets	1.5
	Other current and non-current liabilities	**(11.5)**	Other current and non-current liabilities	(19.5)
Total derivatives not designated as hedging instruments		**$ (11.8)**		$ (19.9)

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The fair values of the derivatives are recorded between Other current and non-current assets and Other current and non-current liabilities as appropriate in the Condensed Consolidated Balance Sheets. As of June 30, 2014, the amount recorded to Other current assets for foreign currency contracts was $0.2 million. The amount recorded to Other non-current assets for commodity contracts was $0.2 million and the amount recorded to Other current liabilities for commodity contracts was ($0.7) million. The amounts recorded to Other current and non-current liabilities for interest rate contracts were ($2.8) million and ($8.7) million, respectively.

As of December 31, 2013, the amount recorded to Other current liabilities for foreign currency contracts was ($0.3) million. The amounts recorded to Other current and non-current assets for commodity contracts were $0.1 million and $0.0 million, respectively. The amounts recorded to Other current and non-current liabilities for commodity contracts were ($1.5) million and ($0.2) million, respectively. The amount recorded to Other non-current assets for interest rate contracts was $1.5 million. The amounts recorded to Other current and non-current liabilities for interest rate contracts were ($18.5) million and ($1.0) million, respectively.

The impact on the Company s Condensed Consolidated Statements of Comprehensive Income related to foreign currency and commodity contracts can be found in NOTE J, and the following tabular disclosure describes the location and impact on the Company s results of operations related to unrealized gain on interest rate derivatives (dollars in millions):

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Interest Expense	**$ 2.6**	$ 8.9	**$ 6.5**	$ 18.1

NOTE H. PRODUCT WARRANTY LIABILITIES

Product warranty liability activities consist of the following (dollars in millions):

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Beginning balance	**$ 90.4**	$ 107.5	**$ 90.5**	$ 109.7
Payments	**(10.7)**	(10.4)	**(19.1)**	(20.3)
Increase in liability (warranty issued during period)	**6.5**	7.8	**12.8**	13.3
Net adjustment to liability	**0.3**	0.5	**2.2**	2.5
Accretion (for Predecessor liabilities)	**0.2**	0.2	**0.3**	0.4
Ending balance	**$ 86.7**	$ 105.6	**$ 86.7**	$ 105.6

As of June 30, 2014, the current and non-current liabilities were $23.2 million and $63.5 million, respectively. As of June 30, 2013, the current and non-current liabilities were $35.8 million and $69.8 million, respectively.

NOTE I. DEFERRED REVENUE

As of June 30, 2014, the current and non-current liabilities related to deferred revenue for Extended Transmission Coverage (ETC) were $19.7 million and $47.1 million, respectively. As of June 30, 2013, the current and non-current liabilities related to deferred revenue for ETC were $20.9 million and $40.2 million, respectively.

Deferred revenue for ETC activity (dollars in millions):

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Beginning balance	**$ 63.8**	$ 61.6	**$ 63.6**	$ 63.5
Increases	**8.3**	4.8	**13.8**	8.1
Revenue earned	**(5.3)**	(5.3)	**(10.6)**	(10.5)

Ending balance	**$ 66.8**	$ 61.1	**$ 66.8**	$ 61.1

Deferred revenue recorded in current liabilities related to unearned net sales for defense contracts as of June 30, 2014 and 2013 was approximately $2.3 million and $0.4 million, respectively. During 2013 and 2014, the Company recorded deferred revenue for payments received from the U.S. government for certain tracked transmissions that were not shipped at the request of the U.S. government.

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NOTE J. OTHER EXPENSE, NET

Other expense, net consists of the following (dollars in millions):

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Loss on intercompany foreign exchange	**$ (1.8)**	$	**$ (1.8)**	$
Unrealized gain (loss) on derivative contracts (see NOTE G)	**1.3**	(0.5)	**1.5**	(2.4)
Grant program income	**0.8**	2.0	**1.4**	3.2
Public offering fees and expenses	**(0.8)**	(0.6)	**(1.1)**	(0.6)
Realized loss on derivative contracts (see NOTE G)	**(0.4)**	(1.0)	**(1.0)**	(1.6)
Loss on foreign exchange		(2.5)	**(0.5)**	(1.9)
Impairment loss on investments in technology-related initiatives				(2.5)
Other			**0.2**	0.1
Total	**$ (0.9)**	$ (2.6)	**$ (1.3)**	$ (5.7)

During the second quarter of 2014, the Company recorded a loss of $1.8 million resulting from intercompany financing transactions related to our India facility, of which $0.2 million was foreign exchange loss on intercompany payment and $1.6 million was from the revaluation of the remaining intercompany liability.

During the six months ended June 30, 2014, the Company completed three secondary public offerings of 35,000,000, 25,000,000 and 28,750,000 shares of its common stock held by investment funds affiliated with The Carlyle Group and Onex Corporation (collectively, the Sponsors) at public offering prices, less underwriting discounts and commissions, of $29.95, $29.78 and $29.17 per share, respectively. In connection with the offerings, the Company repurchased from the underwriters 5,000,000 shares in June 2014 and 3,428,179 shares in February 2014 at the prices paid by the underwriters and subsequently retired those shares. In addition, as part of the June offering, the underwriters exercised its option to purchase an additional 5,250,000 shares from the Sponsors at an offering price of $29.95 per share, the same price at which the 35,000,000 shares of common stock were sold to the underwriter. For the three and six months ended June 30, 2014, the Company incurred $0.8 million and $1.1 million, respectively, of expenses related to these public offerings.

In 2009, the Company was notified by the U.S. Department of Energy that it was selected to receive matching funds from a grant program funded by the American Recovery and Reinvestment Act for the development of Hybrid manufacturing capacity in the U.S. (the Grant Program). All applicable costs associated with the Grant Program have been charged to Engineering research and development while the Government s matching reimbursement is recorded to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income. Since inception of the Grant Program, the Company has recorded $47.4 million of Grant Program income to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.

For the three months ended June 30, 2014 and 2013, the Company recorded $0.0 million and $1.3 million, respectively, as a reduction of the basis of capital assets purchased under the Grant Program. For the six months ended June 30, 2014 and 2013, the Company recorded $0.0 million and $2.7 million, respectively, as a reduction of the basis of capital assets purchased under the Grant Program. Under the Grant Program, the Company has acquired approximately $7.1 million of assets that have been placed in service, resulting in related depreciation of $0.0 million and $0.0 million for the three months ended June 30, 2014 and 2013, respectively, and $0.1 million and $0.1 million for the six months ended June 30, 2014 and 2013, respectively.

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NOTE K. OTHER CURRENT LIABILITIES

Other current liabilities consist of the following (dollars in millions):

	As of June 30, 2014	As of December 31, 2013
Payroll and related costs	**$ 40.1**	$ 37.6
Defense price reduction reserve	**26.2**	26.8
Sales allowances	**23.4**	26.9
Accrued interest payable	**16.5**	11.2
Vendor buyback obligation	**12.5**	11.8
Taxes payable	**7.3**	8.6
Derivative liabilities	**3.5**	20.2
Research and development payable	**1.7**	
Other accruals	**9.6**	9.2
Total	**$ 140.8**	$ 152.3

NOTE L. EMPLOYEE BENEFIT PLANS

Components of net periodic benefit cost consist of the following (dollars in millions):

	Pension Plans Three months ended June 30,		Post-retirement Benefits Three months ended June 30,	
	2014	**2013**	**2014**	**2013**
Net periodic benefit cost:				
Service cost	**$ 3.3**	$ 4.1	**$ 0.6**	$ 0.8
Interest cost	**1.2**	1.0	**1.4**	1.4
Expected return on assets	**(1.9)**	(1.8)		
Prior service cost	**0.0**	0.0	**(0.9)**	(0.9)
Loss (gain)		0.1	**(0.2)**	
Net periodic benefit cost	**$ 2.6**	$ 3.4	**$ 0.9**	$ 1.3

	Pension Plans Six months ended June 30,		Post-retirement Benefits Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Net periodic benefit cost:				
Service cost	**$ 6.6**	$ 8.2	**$ 1.1**	$ 1.6
Interest cost	**2.5**	2.0	**2.9**	2.9
Expected return on assets	**(3.8)**	(3.4)		
Prior service cost	**0.0**	0.0	**(1.8)**	(1.8)
Loss (gain)		0.3	**(0.4)**	
Net periodic benefit cost	**$ 5.3**	$ 7.1	**$ 1.8**	$ 2.7

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NOTE M. INCOME TAXES

For the three and six months ended June 30, 2014, the Company recorded total tax expense of $37.5 million and $64.7 million, respectively. The effective tax rate for the three and six months ended June 30, 2014 was (39.6%) and (37.2%), respectively. For the three and six months ended June 30, 2013, the Company recorded a total tax expense of $31.3 million and $48.2 million, respectively. The effective rate for the three and six months ended June 30, 2013 was (38.3%) and (38.2%), respectively.

During the first quarter 2014, the Company incurred an ownership change resulting in a limitation on the utilization of the Company s net operating losses. The Company has reviewed the limitation and determined there is no concern about the Company s ability to utilize the tax attributes in the future.

The need to establish a valuation allowance against the deferred tax assets is assessed periodically based on a more-likely-than-not realization threshold, in accordance with authoritative accounting guidance. Appropriate consideration is given to all positive and negative evidence related to that realization. This assessment considers, among other matters, the nature, frequency and severity of recent losses, forecasts of future profitability, the duration of statutory carryforward periods, experience with tax attributes expiring unused, and tax planning alternatives. The weight given to these considerations depends upon the degree to which they can be objectively verified.

The Company has determined, based on the evaluation of both objective and subjective evidence available, that the domestic valuation allowance is not necessary and that it is more likely than not that the deferred tax assets are fully realizable. The Company has reached a sustained period of profitability and objectively measured positive evidence outweighed the negative evidence. The Company continues to provide for a valuation allowance on certain of its foreign deferred tax assets.

In accordance with the FASB s authoritative guidance on accounting for uncertainty in income taxes, the Company recorded a liability of $2.3 million for unrecognized tax benefits related to the 2010 Research & Development Credit as of June 30, 2014 and December 31, 2013. The accounting guidance prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. For the year ended December 31, 2013, the return will remain subject to examination by the various taxing authorities for the duration of the applicable statute of limitations (generally three years from the later of the date of filing or the due date of the return).

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NOTE N. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table reconciles changes in Accumulated other comprehensive loss (AOCL) by component (net of tax, dollars in millions):

	Three months ended			
	Available-for-sale securities	**Defined benefit pension items**	**Foreign currency items**	**Total**
AOCL as of March 31, 2013	$ 2.3	$ (37.3)	$ (11.5)	$ (46.5)
Other comprehensive loss before reclassifications	(0.3)		(5.8)	(6.1)
Amounts reclassified from AOCL		(0.4)		(0.4)
Net current period other comprehensive loss	$ (0.3)	$ (0.4)	$ (5.8)	$ (6.5)
AOCL as of June 30, 2013	$ 2.0	$ (37.7)	$ (17.3)	$ (53.0)
AOCL as of March 31, 2014	$ 1.2	$ (8.6)	$ (11.5)	$ (18.9)
Other comprehensive (loss) income before reclassifications	**(0.6)**		**0.9**	**0.3**
Amounts reclassified from AOCL		**(0.5)**		**(0.5)**
Net current period other comprehensive (loss) income	**$ (0.6)**	**$ (0.5)**	**$ 0.9**	**$ (0.2)**
AOCL as of June 30, 2014	**$ 0.6**	**$ (9.1)**	**$ (10.6)**	**$ (19.1)**

	Six months ended			
	Available-for-sale securities	**Defined benefit pension items**	**Foreign currency items**	**Total**
AOCL as of December 31, 2012	$ 2.2	$ (36.9)	$ (9.2)	$ (43.9)
Other comprehensive loss before reclassifications	(0.2)		(8.1)	(8.3)
Amounts reclassified from AOCL		(0.8)		(0.8)
Net current period other comprehensive loss	$ (0.2)	$ (0.8)	$ (8.1)	$ (9.1)
AOCL as of June 30, 2013	$ 2.0	$ (37.7)	$ (17.3)	$ (53.0)
AOCL as of December 31, 2013	$ 1.1	$ (7.9)	$ (14.2)	$ (21.0)
Other comprehensive (loss) income before reclassifications	**(0.5)**		**3.6**	**3.1**
Amounts reclassified from AOCL		**(1.2)**		**(1.2)**
Net current period other comprehensive (loss) income	**$ (0.5)**	**$ (1.2)**	**$ 3.6**	**$ 1.9**
AOCL as of June 30, 2014	**$ 0.6**	**$ (9.1)**	**$ (10.6)**	**$ (19.1)**

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The following table shows the location in the Condensed Consolidated Statements of Comprehensive Income affected by reclassifications from AOCL (dollars in millions):

AOCL Components	Amounts reclassified from AOCL Three months ended June 30, 2014	Three months ended June 30, 2013	Affected line item in the Condensed Consolidated Statements of Comprehensive Income
Amortization of defined benefit pension items:			
Prior service cost	**$ 0.8**	$ 0.7	Cost of sales
	0.0	0.2	Selling, general and administrative
	0.0		Engineering research and development
Actuarial loss	**0.1**		Cost of sales
	0.0	(0.1)	Selling, general and administrative
	0.0	(0.1)	Engineering research and development
Total reclassifications, before tax	**$ 0.9**	$ 0.7	Income before income taxes
Income tax expense	**(0.4)**	(0.3)	Tax expense
Total reclassifications	**$ 0.5**	$ 0.4	Net of tax

AOCL Components	Amounts reclassified from AOCL Six months ended June 30, 2014	Six months ended June 30, 2013	Affected line item in the Condensed Consolidated Statements of Comprehensive Income
Amortization of defined benefit pension items:			
Prior service cost	**$ 1.6**	$ 1.4	Cost of sales
	0.1	0.4	Selling, general and administrative
	0.0		Engineering research and development
Actuarial loss	**0.3**	(0.2)	Cost of sales
	0.0		Selling, general and administrative
	0.0	(0.2)	Engineering research and development
Total reclassifications, before tax	**$ 2.0**	$ 1.4	Income before income taxes
Income tax expense	**(0.8)**	(0.6)	Tax expense
Total reclassifications	**$ 1.2**	$ 0.8	Net of tax

Prior service cost and actuarial loss are included in the computation of the Company s net periodic benefit cost. Please see NOTE L for additional details.

NOTE O. COMMITMENTS AND CONTINGENCIES

Claims, Disputes, and Litigation

The Company is party to various legal actions and administrative proceedings and subject to various claims arising in the ordinary course of business. These proceedings primarily involve commercial claims, product liability claims, personal injury claims and workers compensation claims. The Company believes that the ultimate liability, if any, in excess of amounts already provided for in the condensed consolidated financial statements or covered by insurance on the disposition of these matters will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

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NOTE P. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

As of June 30, 2014, the Sponsors owned approximately 3% of the Company s outstanding common stock. Pursuant to an amended and restated stockholders agreement, a majority of the Board of Directors was designated by the Sponsors and is affiliated with the Sponsors. As a result, the Sponsors or their nominees to the Board of Directors have the ability to control the appointment of management, the entering into of mergers, sales of substantially all of the Company s assets and other extraordinary transactions and influence amendments to the Company s certificate of incorporation. The interests of the Sponsors could conflict with those of the Company s other stockholders. In addition, the Sponsors may in the future own businesses that directly compete with the Company.

Senior Notes Held by Executive Officers

As of June 30, 2014, Lawrence E. Dewey, our Chairman, President and Chief Executive Officer, and David S. Graziosi, our Executive Vice President, Chief Financial Officer and Treasurer held approximately $100,000 and $450,000, respectively, in aggregate principal amount of the 7.125% Senior Notes.

Repurchase of Common Stock held by Sponsors

During the six months ended June 30, 2014, the Company completed three secondary public offerings of 35,000,000, 25,000,000 and 28,750,000 shares of our common stock held by investment funds affiliated with the Sponsors at public offering prices, less underwriting discounts and commissions, of $29.95, $29.78 and $29.17 per share, respectively. In connection with the offerings, the Company repurchased from the underwriters 5,000,000 shares in June 2014 and 3,428,179 shares in February 2014 at the prices paid by the underwriters and subsequently retired those shares. In addition, as part of the June offering, the underwriters exercised its option to purchase an additional 5,250,000 shares from the Sponsors at an offering price of $29.95 per share, the same price at which the 35,000,000 shares of common stock were sold to the underwriter. The sales by the Sponsors resulted in their ownership decreasing to 3% of our outstanding common stock as of June 30, 2014.

NOTE Q. EARNINGS PER SHARE

The Company presents both basic and diluted earnings per share (EPS) amounts. Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted EPS is calculated by dividing net income by the weighted average number of common shares and common equivalent shares outstanding during the reporting period that are calculated using the treasury stock method for stock-based awards. The treasury stock method assumes that the Company uses the proceeds from the exercise of awards to repurchase common stock at the average market price during the period. The assumed proceeds under the treasury stock method include the purchase price that the grantee will pay in the future, compensation cost for future service that the Company has not yet recognized and any tax benefits that would be credited to additional paid-in-capital when the award generates a tax deduction. If there would be a shortfall resulting in a charge to additional paid-in-capital, such an amount would be a reduction of the proceeds to the extent of the gains.

The following table reconciles the numerators and denominators used to calculate basic EPS and diluted EPS (in millions, except per share data):

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Net income	**$ 57.2**	$ 50.5	**$ 109.3**	$ 78.0
Weighted average shares of common stock outstanding	**178.8**	185.9	**180.5**	185.3
Dilutive effect stock-based awards	**2.8**	4.0	**3.2**	3.6
Diluted weighted average shares of common stock outstanding	**181.6**	189.9	**183.7**	188.9
Basic earnings per share attributable to common stockholders	**$ 0.32**	$ 0.27	**$ 0.61**	$ 0.42
Diluted earnings per share attributable to common stockholders	**$ 0.31**	$ 0.26	**$ 0.59**	$ 0.41

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ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is intended to help the reader understand our business, financial condition, results of operations, liquidity and capital resources. You should read this discussion in conjunction with our condensed consolidated interim financial statements and the related notes contained elsewhere in this Quarterly Report on Form 10-Q.

The statements in this discussion regarding industry trends, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in Cautionary Note Regarding Forward-Looking Statements and Part II, Item 1A Risk Factors below. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

Overview

Allison Transmission Holdings, Inc. and its subsidiaries (our, us, we or the Company) design and manufacture fully-automatic transmissions fo medium- and heavy-duty commercial vehicles, medium- and heavy-tactical U.S. defense vehicles and hybrid-propulsion systems for transit buses. We generate our net sales primarily from the sale of transmissions, transmission parts, support equipment, defense kits, engineering services and extended transmission coverage to a wide array of original equipment manufacturers (OEMs), distributors and the U.S. government. Although approximately 77% of our net sales were generated in North America in 2013, we have a global presence, serving customers in Europe, Asia, South America and Africa. We have 13 different transmission product lines and serve customers through an established network of approximately 1,400 authorized independent distributors and dealers worldwide. Since the introduction of our first fully-automatic transmission over 60 years ago, our products have gained acceptance in a wide variety of applications, including on-highway trucks (distribution, refuse, construction, fire and emergency), buses (primarily school, transit and hybrid-transit), motorhomes, off-highway vehicles and equipment (primarily energy, mining and construction) and defense vehicles (wheeled and tracked).

Trends Impacting Our Business

Our net sales are driven by commercial vehicle production, which tends to be highly correlated to macroeconomic conditions. According to America s Commercial Transportation Research, commercial truck and bus production volumes in our North American on-highway markets are projected to grow, but to remain below the 1998-2008 average production levels through 2015. In the second half of 2014 we expect net sales to increase on a year-over-year basis principally driven by improved second half year-over-year demand conditions in the North America On-Highway and Off-Highway end markets, partially offset by weakness in the Outside North America On-Highway end market and previously considered reductions in Defense net sales.

Second Quarter Net Sales by End Market (in millions)

End Market	Q2 2014 Net Sales	Q2 2013 Net Sales	% Variance
North America On-Highway	**$ 243**	$ 216	13%
North America Hybrid Propulsion Systems for Transit Bus	**$ 28**	$ 27	4%
North America Off-Highway	**$ 23**	$ 8	188%
Defense	**$ 49**	$ 58	(16%)
Outside North America On-Highway	**$ 62**	$ 75	(17%)
Outside North America Off-Highway	**$ 24**	$ 36	(33%)
Service Parts, Support Equipment and Other	**$ 107**	$ 92	16%

Total Net Sales	**$ 536**	$ 512	5%

North America On-Highway end market net sales were up 13% for the second quarter 2014 compared to the second quarter 2013, principally driven by higher demand for Rugged Duty Series and Pupil Transport/Shuttle Series models.

North America Hybrid-Propulsion Systems for Transit Bus end market net sales were up 4% for the second quarter 2014 compared to the second quarter 2013, principally driven by intra-year movement in the timing of orders.

North America Off-Highway end market net sales were up 188% for the second quarter 2014 compared to the second quarter of 2013, principally driven by higher demand from hydraulic fracturing applications.

Defense end market net sales were down 16% for the second quarter 2014 compared to the second quarter 2013, principally driven by previously considered reductions in U.S. defense spending to longer term averages experienced during periods without active conflicts, partially offset by the recognition of previously deferred revenue totaling $15.8 million commensurate with the shipment of certain tracked transmissions at the request of the U.S. government.

Outside North America On-Highway end market net sales were down 17% for the second quarter 2014 compared to the second quarter 2013, reflecting weakness in China, Europe and South America.

Outside North America Off-Highway end market net sales were down 33% for the second quarter 2014 compared to the second quarter 2013, driven by weak demand conditions in the energy sector, partially offset by higher demand from the mining sector.

Service parts, support equipment and other end market net sales were up 16% for the second quarter 2014 compared to the second quarter 2013, principally driven by higher demand for North America service parts and North America On-Highway support equipment commensurate with increased transmission unit volumes.

Key Components of our Results of Operations

Net sales

We generate our net sales primarily from the sale of transmissions, transmission parts, support equipment, defense kits, engineering services and extended transmission coverage to a wide array of OEMs, distributors and the U.S. government. Sales are recorded net of provisions for customer allowances and other rebates. Engineering services are recorded as net sales in accordance with the terms of the contract. The associated costs are recorded in cost of sales. We also have royalty agreements with third parties that provide net sales as a result of joint efforts in developing marketable products.

During 2014 and 2013, the Company recorded deferred revenue for payments received from the U.S. government for certain tracked transmissions that were not shipped at the request of the U.S. government.

During the second quarter of 2014, the Company shipped all tracked transmissions previously recorded as deferred revenue and recognized approximately $15.8 million in net sales for the period.

Cost of sales

Our most significant components of cost of sales are purchased parts, the overhead expense related to our manufacturing operations and direct labor associated with the manufacture and assembly of transmissions and parts. For the six months ended June 30, 2014, direct material costs were approximately 67%, overhead costs were approximately 27%, and direct labor costs were approximately 6% of total cost of sales. We are subject to changes in our cost of sales caused by movements in underlying commodity prices. We seek to hedge against this risk by using commodity swap contracts and long-term supply agreements (LTSAs). See Part I, Item 3 Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk included below.

Selling, general and administrative expenses

The principal components of our selling, general and administrative expenses are salaries and benefits for our office personnel, advertising and promotional expenses, product warranty expense, expenses relating to certain information technology systems and amortization of our intangibles.

Engineering research and development

We incur costs in connection with research and development programs that are expected to contribute to future earnings. Such costs are expensed as incurred. In 2009, we were notified by the U.S. Department of Energy (DOE) that we were selected to receive matching funds up to $62.8 million from a cost-share grant program funded by the American Recovery and Reinvestment Act for the development of hybrid-propulsion system manufacturing capacity in the U.S. (the Grant Program). Applicable costs associated with the Grant Program have been charged to Engineering research and development. The DOE s matching reimbursement is recorded to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income, included in Part I, Item 1 of this Quarterly Report on Form 10-Q, or in the case of capital expenditure, as a reduction in the cost basis of the capital asset.

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Non-GAAP Financial Measures

We use Adjusted net income to measure our overall profitability because we believe it better reflects our cash flow generation by capturing the actual cash interest paid and cash taxes paid rather than our interest expense and tax expense as calculated under accounting principles generally accepted in the United States of America (GAAP) and excludes the impact of the non-cash annual amortization of certain intangible assets and other certain non-recurring items. We use Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin, Adjusted EBITDA margin excluding technology-related license expenses and Adjusted free cash flow to evaluate and control our cash operating costs and to measure our operating profitability. We believe the presentation of Adjusted net income, Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin, Adjusted EBITDA margin excluding technology-related license expenses and Adjusted free cash flow enhances our investors overall understanding of the financial performance and cash flow of our business.

You should not consider Adjusted net income, Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin and Adjusted EBITDA margin excluding technology-related license expenses as an alternative to net income, determined in accordance with GAAP, as an indicator of operating performance. You should not consider Adjusted free cash flow as an alternative to net cash provided by operating activities, determined in accordance with GAAP, as an indicator of our cash flow.

A directly comparable GAAP measure to Adjusted net income, Adjusted EBITDA and Adjusted EBITDA excluding technology-related license expenses is Net income. A directly comparable GAAP measure to Adjusted free cash flow is Net cash provided by operating activities. The following is a reconciliation of Net income to Adjusted net income, Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin and Adjusted EBITDA margin excluding technology-related license expenses, and a reconciliation of Net cash provided by operating activities to Adjusted free cash flow:

	For the three months ended June 30,		For the six months ended June 30,	
(unaudited, in millions)	**2014**	**2013**	**2014**	**2013**
Net income	**$ 57.2**	$ 50.5	**$ 109.3**	$ 78.0
plus:				
Interest expense, net	**36.6**	33.3	**71.7**	67.2
Cash interest expense	**(39.2)**	(49.6)	**(68.6)**	(79.6)
Income tax expense	**37.5**	31.3	**64.7**	48.2
Cash income taxes	**(1.0)**	(1.8)	**(3.1)**	(3.0)
Technology-related investments expense (a)				2.5
Public offering expenses (b)	**0.8**	0.6	**1.1**	0.6
Amortization of intangible assets	**24.7**	25.1	**49.4**	55.0
Adjusted net income	**$ 116.6**	$ 89.4	**$ 224.5**	$ 168.9
Cash interest expense	**39.2**	49.6	**68.6**	79.6
Cash income taxes	**1.0**	1.8	**3.1**	3.0
Depreciation of property, plant and equipment	**24.1**	25.0	**47.4**	49.7
Restructuring charge (c)	**0.7**	1.0	**0.7**	1.0
Loss (gain) on foreign exchange (d)	**1.7**	(0.1)	**1.4**	0.5
Unrealized (gain) loss on commodity hedge contracts (e)	**(1.2)**	0.6	**(1.1)**	1.9
Other (f)	**4.0**	4.3	**7.3**	7.7
Adjusted EBITDA	**$ 186.1**	$ 171.6	**$ 351.9**	$ 312.3
Adjusted EBITDA excluding technology-related license expenses (g)	**$ 186.1**	$ 171.6	**$ 355.2**	$ 318.3
Net sales	**$ 536.1**	$ 512.1	**$ 1,029.7**	$ 969.5
Adjusted EBITDA margin	**34.7%**	33.5%	**34.2%**	32.2%
Adjusted EBITDA margin excluding technology-related licenses expenses	**34.7%**	33.5%	**34.5%**	32.8%
Net cash provided by operating activities	**$ 143.4**	$ 129.7	**$ 242.0**	$ 184.4
(Deductions) or additions to reconcile to Adjusted free cash flow:				

Additions of long-lived assets	**(11.6)**	(13.2)	**(22.7)**	(25.8)
Fee to terminate services agreement with Sponsors				
Technology-related license expenses (g)			**3.3**	6.0
Adjusted free cash flow	**$ 131.8**	$ 116.5	**$ 222.6**	$ 164.6

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(a) Represents an impairment charge (recorded in Other expense, net) for investments in co-development agreements to expand our position in transmission technologies.
(b) Represents fees and expenses (recorded in Other expense, net) related to our secondary offerings in June 2014, April 2014 and February 2014, and proposed secondary offering in April 2013.
(c) Represents a charge (recorded in Selling, general and administrative, and Engineering research and development) related to employee headcount reductions in the second quarter of 2014 and second quarter of 2013.
(d) Represents losses (gains) (recorded in Other expense, net) on the mark-to-market of our foreign currency hedge contracts and on intercompany financing transactions related to our India facility.
(e) Represents (gains) losses (recorded in Other expense, net) on the mark-to-market of our commodity hedge contracts.
(f) Represents employee stock compensation expense (recorded in Cost of sales, Selling, general and administrative expenses, and Engineering research and development).
(g) Represents payments (recorded in Engineering research and development) for licenses to expand our position in transmission technologies.

Results of Operations

The following table sets forth certain financial information for the three months ended June 30, 2014 and 2013. The following table and discussion should be read in conjunction with the information contained in our condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Comparison of three months ended June 30, 2014 and 2013

	Three months ended June 30,			
(unaudited, dollars in millions)	**2014**	**% of net sales**	**2013**	**% of net sales**
Net sales	**$ 536.1**		$ 512.1	
Gross profit	**238.5**	**44.5%**	226.1	44.2%
Operating expenses:				
Selling, general and administrative expenses	**85.1**	**15.8**	85.6	16.7
Engineering research and development	**21.2**	**4.0**	22.8	4.5
Total operating expenses	**106.3**	**19.8**	108.4	21.2
Operating income	**132.2**	**24.7**	117.7	23.0
Other expense, net:				
Interest expense, net	**(36.6)**	**(6.8)**	(33.3)	(6.5)
Other expense, net	**(0.9)**	**(0.2)**	(2.6)	(0.5)
Total other expense, net	**(37.5)**	**(7.0)**	(35.9)	(7.0)
Income before income taxes	**94.7**	**17.7**	81.8	16.0
Income tax expense	**(37.5)**	**(7.0)**	(31.3)	(6.1)
Net income	**$ 57.2**	**10.7%**	$ 50.5	9.9%

Net sales.

Net sales for the quarter ended June 30, 2014 were $536.1 million compared to $512.1 million for the quarter ended June 30, 2013, an increase of 4.7%. The increase was principally driven by a $27.0 million, or 13%, increase in net sales of North American on-highway commercial products driven by higher demand from Rugged Duty Series and Pupil Transport/Shuttle Series models, a $15.0 million, or 188%, increase in net sales of North American off-highway products driven by higher demand from natural gas fracturing applications, a $15.0 million, or 16%, increase in net sales of parts and other products driven by higher demand for North America service parts and North America on-highway support equipment commensurate with increased transmission unit volumes, and a $1.0 million, or 4%, increase in net sales of North America hybrid-propulsion systems for transit buses driven by intra-year movement in the timing of orders, partially offset by a $13.0 million, or 17%, decrease in net sales of Outside North America on-highway products driven by weakness in China, Europe and South America, a $12.0 million, or 33%, decrease in net sales of Outside North America off-highway products driven by lower demand from the energy sector and a $9.0

million, or 16%, decrease in net sales of defense products due to lower U.S. defense spending. See Trends Impacting Our Business above for additional information on net sales by end markets.

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Gross profit.

Gross profit for the quarter ended June 30, 2014 was $238.5 million compared to $226.1 million for the quarter ended June 30, 2013, an increase of 5.5%. The increase was principally driven by $12.0 million related to increased net sales, $2.0 million of price increases on certain products and $1.0 million of favorable foreign exchange, partially offset by $3.0 million of unfavorable material costs.

Selling, general and administrative expenses.

Selling, general and administrative expenses for the quarter ended June 30, 2014 were $85.1 million compared to $85.6 million for the quarter ended June 30, 2013, a decrease of 0.6%. The decrease was principally driven by $0.4 million of lower intangible asset amortization and reduced global commercial spending activities.

Engineering research and development.

Engineering expenses for the quarter ended June 30, 2014 were $21.2 million compared to $22.8 million for the quarter ended June 30, 2013, a decrease of 7.0%. The decrease was principally driven by reduced product initiatives spending.

Interest expense, net.

Interest expense, net for the quarter ended June 30, 2014 was $36.6 million compared to $33.3 million for the quarter ended June 30, 2013, an increase of 9.9%. The increase was principally driven by $6.3 million of less favorable mark-to-market adjustments for our interest rate derivatives and $0.3 million of higher amortization of deferred financing charges, partially offset by $1.3 million of lower interest expense as a result of debt repayments and purchases, $1.3 million of lower interest expense related to our interest rate swaps and $0.7 million of lower expense as a result of lower interest rates on ATI s Senior Secured Credit Facility Term B-2 Loan due 2017 (Term B-2 Loan) and ATI s Senior Secured Credit Facility Term B-3 Loan due 2019 (Term B-3 Loan).

Other expense, net.

Other expense, net for the quarter ended June 30, 2014 was $0.9 million compared to $2.6 million for the quarter ended June 30, 2013, a decrease of 65.4%. The decrease in expense was principally driven by $2.5 million of favorable foreign exchange, $1.8 million of unrealized gains on derivative contracts, and $0.6 million realized gains on derivative contracts, partially offset by $1.8 million of foreign exchange loss on intercompany financing, $1.2 million of lower Grant Program income and $0.2 million of higher public offering fees and expenses.

Income tax expense.

Income tax expense for the second quarter of 2014 was $37.5 million resulting in an effective tax rate of 39.6% versus an effective tax rate of 38.3% in the second quarter of 2013. The change in effective tax rate was principally driven by the change in discrete activity.

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Comparison of six months ended June 30, 2014 and 2013

The following table sets forth certain financial information for the six months ended June 30, 2014 and 2013. The following table and discussion should be read in conjunction with the information contained in our condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

	Six months ended June 30,			
(unaudited, dollars in millions)	**2014**	**% of net sales**	**2013**	**% of net sales**
Net sales	**$ 1,029.7**		$ 969.5	
Gross profit	**461.0**	**44.8%**	424.4	43.8%
Operating expenses:				
Selling, general and administrative expenses	**168.3**	**16.4**	173.5	17.9
Engineering research and development	**45.7**	**4.4**	51.8	5.4
Total operating expenses	**214.0**	**20.8**	225.3	23.3
Operating income	**247.0**	**24.0**	199.1	20.5
Other expense, net:				
Interest expense, net	**(71.7)**	**(7.0)**	(67.2)	(6.9)
Other expense, net	**(1.3)**	**(0.1)**	(5.7)	(0.6)
Total other expense, net	**(73.0)**	**(7.1)**	(72.9)	(7.5)
Income before income taxes	**174.0**	**16.9**	126.2	13.0
Income tax expense	**(64.7)**	**(6.3)**	(48.2)	(5.0)
Net income	**$ 109.3**	**10.6%**	$ 78.0	8.0%

Net sales.

Net sales for the six months ended June 30, 2014 were $1,029.7 million compared to $969.5 million for the six months ended June 30, 2013, an increase of 6.2%. The increase was principally driven by a $72.0 million, or 18%, increase in net sales of North American on-highway commercial products driven by higher demand from Rugged Duty Series, Highway Series and Pupil Transport/Shuttle Series models, a $31.0 million, or 17%, increase in net sales of parts and other products driven by higher demand for global service parts and global on-highway support equipment commensurate with increased transmission unit volumes, and a $19.0 million, or 119%, increase in net sales of North American off-highway products driven by higher demand from natural gas fracturing applications, partially offset by a $32.0 million, or 28%, decrease in net sales of defense products due to lower U.S. defense spending, a $12.0 million, or 21%, decrease in net sales of Outside North America off-highway products driven by lower demand from the energy sector, a $11.0 million, or 8%, decrease in net sales of Outside North America on-highway products driven by weakness in Europe and South America, and a $6.0 million, or 10%, decrease in net sales of North America hybrid-propulsion systems for transit buses driven by lower demand due to engine emissions improvements and non-hybrid alternatives that generally require a fully-automatic transmission (e.g. xNG).

Gross profit.

Gross profit for the six months ended June 30, 2014 was $461.0 million compared to $424.4 million for the six months ended June 30, 2013, an increase of 8.6%. The increase was principally driven by $36.0 million related to increased net sales, $2.0 million of price increases on certain products and $3.0 million of favorable foreign exchange, partially offset by $4.0 million of higher manufacturing expense commensurate with increased net sales and $1.0 million of unfavorable material costs.

Selling, general and administrative expenses.

Selling, general and administrative expenses for the six months ended June 30, 2014 were $168.3 million compared to $173.5 million for the six months ended June 30, 2013, a decrease of 3.0%. The decrease was principally driven by $5.6 million of lower intangible asset amortization and reduced global commercial spending activities and lower stock compensation expense.

Engineering research and development.

Engineering expenses for the six months ended June 30, 2014 were $45.7 million compared to $51.8 million for the six months ended June 30, 2013, a decrease of 11.8%. The decrease was principally driven by $3.7 million of lower technology-related license expenses to expand our position in transmission technologies and reduced product initiatives spending.

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Interest expense, net.

Interest expense, net for the six months ended June 30, 2014 was $71.7 million compared to $67.2 million for the six months ended June 30, 2013, an increase of 6.7%. The increase was principally driven by $11.6 million of less favorable mark-to-market adjustments for our interest rate derivatives, partially offset by $2.6 million of lower interest expense as a result of debt repayments and purchases, $2.4 million of lower interest expense related to our interest rate swaps, $1.3 million of lower interest expense due to lower interest rates on ATI s Senior Secured Credit Facility Term B-2 Loan due 2017 (Term B-2 Loan) and AT s Senior Secured Credit Facility Term B-3 Loan due 2019 (Term B-3 Loan), and 0.8 million of lower amortization of deferred financing charges.

Other expense, net.

Other expense, net for the six months ended June 30, 2014 was $1.3 million compared to $5.7 million for the six months ended June 30, 2013, a decrease of 77.2%. The decrease in expense was principally driven by $3.9 million of unrealized gains on derivative contracts, a $2.5 million loss in 2013 on investments in technology-related initiatives, $1.4 million of favorable foreign exchange, $0.6 million realized gains on derivative contracts and $0.1 million of higher miscellaneous income, partially offset by $1.8 million of lower Grant Program income, $1.8 million of foreign exchange loss on intercompany financing and $0.5 million of higher public offering fees and expenses.

Income tax expense.

Income tax expense for the six months ended June 30, 2014 was $64.7 million resulting in an effective tax rate of 37.2% versus an effective tax rate of 38.2% for the six months ended June 30, 2013. The change in effective tax rate was principally driven by the change in discrete activity.

Liquidity and Capital Resources

We generate cash primarily from our operating activities. We had total available cash and cash equivalents of $126.7 million and $184.7 million as of June 30, 2014 and December 31, 2013, respectively. Of the available cash and cash equivalents, approximately $125.7 million and $179.7 million was deposited in operating accounts while approximately $1.0 million and $5.0 million was invested in U.S. government backed securities as of June 30, 2014 and December 31, 2013, respectively.

In the first quarter of 2014, we increased the revolving commitments available under the revolving portion of the Senior Secured Credit Facility (defined as the Term B-2 Loan, Term B-3 Loan and revolving credit facility) to $465.0 million, net of an allowance for up to $75.0 million in outstanding letters of credit commitments. We had $453.0 million and $395.0 million available under the revolving portion of our Senior Secured Credit Facility, net of approximately $12.0 million and $15.0 million in letters of credit issued and outstanding as of June 30, 2014 and December 31, 2013, respectively. As of June 30, 2014 and December 31, 2013, we had no outstanding borrowings on our revolving credit facility.

Our principal uses of cash are operating expenses, capital expenditures, debt service, dividends on common stock and working capital needs. The following table shows our sources and uses of funds for the six months ended June 30, 2014 and 2013 (in millions):

	Six months ended June 30,	
Statement of Cash Flows Data	**2014**	**2013**
Cash flows from operating activities	**$ 242.0**	$ 184.4
Cash flows used for investing activities	**(24.7)**	(30.6)
Cash flows used for financing activities	**(273.1)**	(17.7)

Generally, cash provided by operating activities has been adequate to fund our operations. Due to fluctuations in our cash flows and the growth in our operations, it may be necessary from time to time in the future to borrow under the Senior Secured Credit Facility to meet cash demands. We anticipate cash provided by operating activities, cash and cash equivalents and borrowing capacity under the Senior Secured Credit Facility will be sufficient to meet our cash requirements for the next twelve months.

Cash provided by operating activities

Operating activities for the six months ended June 30, 2014 generated $242.0 million of cash compared to $184.4 million for the six months ended June 30, 2013. The increase was principally driven by increased net sales, higher 2013 payments related to technology-related licenses and higher other liabilities, net, partially offset by lower accounts payable, and higher accounts receivable commensurate with increased net sales.

Cash used for investing activities

Investing activities for the six months ended June 30, 2014 used $24.7 million of cash compared to $30.6 million for the six months ended June 30, 2013. The decrease was principally driven by a decrease of $3.1 million in capital expenditures and $2.5 million of lower 2014 investments in technology-related initiatives. The decrease in capital expenditures was principally driven by lower product initiatives spending, partially offset by increased investments in productivity and replacement programs.

Cash used for financing activities

Financing activities for the six months ended June 30, 2014 used $273.1 million of cash compared to $17.7 million of cash for the six months ended June 30, 2013. The increase was principally driven by $249.8 million related to the repurchase of our common stock in connection with the February 2014 and June 2014 secondary offerings by funds affiliated with The Carlyle Group and Onex Corporation (collectively, the Sponsors) and $10.0 million of increased dividend payments, partially offset by $2.9 million of decreased payments on our long-term debt and $2.8 million of decreased proceeds from the exercise of stock options.

Our liquidity requirements are significant, primarily due to our debt service requirements. A one-eighth percent change in assumed interest rates for the Senior Secured Credit Facility, if fully drawn, as of June 30, 2014 would have no impact on interest expense due to the 1.00% LIBOR floor on our Term B-3 Loan and partial offset of our interest rate swaps. Our ability to make payments on and to refinance our indebtedness, and to fund planned capital expenditures will depend on our ability to generate cash in the future. This is subject to general economic, financial, competitive, legislative, regulatory and other factors that may be beyond our control.

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The revolving portion of the Senior Secured Credit Facility requires us to maintain a specified maximum total senior secured leverage ratio of 5.50x when revolving loan commitments remain outstanding at the end of a fiscal quarter. On March 12, 2014, however, the revolving lenders holding a majority of the revolving loan commitments permanently waived and agreed that no event of default would result from any non-compliance so long as there were no revolving loans outstanding as of the last day of any fiscal quarter. Throughout the six months ended June 30, 2014, we made one withdrawal and payment on the revolving credit facility as part of our debt management plans. The maximum amount outstanding at any time on the revolving credit facility was $40.0 million, and the entire balance was repaid within the quarter it was borrowed. As of June 30, 2014, we had no revolving loans outstanding, however, we would have been in compliance with the maximum total senior secured leverage ratio, achieving a 3.11x ratio. Additionally within the terms of the Senior Secured Credit Facility, a senior secured leverage ratio at or below 3.50x results in the elimination of excess cash flow payments on the Senior Secured Credit Facility for the applicable year. The Senior Secured Credit Facility also provides certain financial incentives based on our total leverage ratio. A total leverage ratio at or below 4.00x results in a 25 basis point reduction to the applicable margin on our revolving credit facility, and a total leverage ratio at or below 3.50x results in a 12.5 basis point reduction to the revolving credit facility commitment fee and an additional 25 basis point reduction to the applicable margin on our revolving credit facility. A total leverage ratio at or below 3.25x results in a 25 basis point reduction to the applicable margin on our Term B-3 Loan. These reductions would remain in effect as long as we achieve a total leverage ratio at or below the related threshold. As of June 30, 2014, the total leverage ratio was 3.82x.

In addition to the maximum total senior secured leverage ratio for the revolving portion of the Senior Secured Credit Facility, the Senior Secured Credit Facility and the indenture governing the 7.125% Senior Notes include, among other things, customary restrictions (subject to certain exceptions) on our ability to incur certain indebtedness or liens, make certain investments or declare or pay certain dividends. As of June 30, 2014, we are in compliance with all covenants under the Senior Secured Credit Facility.

Prior to May 15, 2015, we may redeem some or all of our 7.125% Senior Notes by paying the applicable make-whole premium. At any time on or after May 15, 2015, we may redeem some or all of the 7.125% Senior Notes at specified redemption prices in the governing indenture.

To manage interest rate risk associated with our variable rate debt, we currently have eleven interest rate swap contracts as of June 30, 2014 that qualify as derivatives under authoritative accounting guidance for derivative instruments and hedging activities. Our interest rate swaps do not qualify for hedge accounting treatment and, as a result, fair value adjustments are charged directly to interest expense in the Condensed Consolidated Statements of Comprehensive Income. Despite the fact that we have elected a mark-to-market approach as opposed to hedge accounting treatment, the contracts are used strictly as an economic hedge and not for speculative purposes.

As of June 30, 2014, certain of our interest rate derivatives contain credit-risk and collateral contingent features. Certain interest rate derivatives contain provisions under which downgrades in our credit rating could require us to increase our collateral. Certain interest rate derivatives also contain provisions under which we may be required to post additional collateral if LIBOR reaches certain levels. As of June 30, 2014, we have been required to post collateral of $0.0 million in cash and $2.0 million in letters of credit as a result of changes in interest rates. As of June 30, 2014, as these interest rate derivatives are close to maturity which results in the LIBOR cure reaching zero, there will be no change to the collateral requirement.

Contingencies

We are a party to various legal actions and administrative proceedings and subject to various claims arising in the ordinary course of business, including those relating to commercial transactions, product liability, safety, health, taxes, environmental and other matters. For more information, see NOTE O of our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Critical Accounting Policies and Significant Accounting Estimates

Our principal accounting policies are described in the Basis of Presentation and Principles of Consolidation section in the notes to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on February 24, 2014. The preparation of the condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of some assets and liabilities and, in some instances, the reported amounts of revenues and expenses during the applicable reporting period. Differences between actual and estimate are recorded in the period identified. Management believes the accounting estimates discussed above represent those accounting estimates requiring the exercise of judgment where a different set of judgments could result in the greatest changes to our reported results.

Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements.

Recently Issued Accounting Pronouncements

Refer to NOTE B, Summary of Significant Accounting Policies in Part I, Item 1, of this Quarterly Report on Form 10-Q.

Certain Relationships and Related Party Transactions

As of June 30, 2014, our Sponsors each owned approximately 3% of our outstanding common stock. Pursuant to an amended and restated stockholders agreement, a majority of the Board of Directors was designated by our Sponsors and is affiliated with our Sponsors. As a result, our Sponsors or their nominees to the Board of Directors have the ability to control the appointment of our management, the entering into of mergers, sales of substantially all of our assets and other extraordinary transactions and influence amendments to our certificate of incorporation. The interests of our Sponsors could conflict with those of our other stockholders. In addition, our Sponsors may in the future own businesses that directly compete with ours.

Repurchase of Common Stock held by Sponsors

During the six months ended June 30, 2014, we completed three secondary public offerings of 35,000,000, 25,000,000 and 28,750,000 shares of our common stock held by investment funds affiliated with the Sponsors at public offering prices, less underwriting discounts and commissions, of $29.95, $29.78 and $29.17 per share, respectively. In connection with the offerings, we repurchased from the underwriters 5,000,000 shares in June 2014 and 3,428,179 shares in February 2014 at the prices paid by the underwriters and subsequently retired those shares. In addition, as part of the June offering, the underwriters exercised its option to purchase an additional 5,250,000 shares from the Sponsors at an offering price of $29.95 per share, the same price at which the 35,000,000 shares of common stock were sold to the underwriter. The sales by the Sponsors resulted in their ownership decreasing to 3% of our outstanding common stock as of June 30, 2014.

Senior Notes Held by Executive Officers

As of June 30, 2014, Lawrence E. Dewey, our Chairman, President and Chief Executive Officer, and David S. Graziosi, our Executive Vice President, Chief Financial Officer and Treasurer, held approximately $100,000 and $450,000, respectively, in aggregate principal amount of the 7.125% Senior Notes.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. The words believe, expect, anticipate, intend, estimate and other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters identify forward-looking statements. You should not place undue reliance on these forward-looking statements. Although forward-looking statements reflect management s good faith beliefs, reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements speak only as of the date the statements are made. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changed circumstances or otherwise. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to: risks related to our substantial indebtedness; our participation in markets that are competitive; the highly cyclical industries in which certain of our end users operate; the failure of markets outside North America to increase adoption of fully-automatic transmissions; the concentration of our net sales in our top five customers and the loss of any one of these; future reductions or changes in government subsidies for hybrid vehicles, U.S. defense spending; general economic and industry conditions; the discovery of defects in our products, resulting in delays in new model launches, recall campaigns and/or increased warranty costs and reduction in future sales or damage to our brand and reputation; our ability to prepare for, respond to and successfully achieve our objectives relating to technological and market developments and changing customer needs; risks associated with our international operations; and labor strikes, work stoppages or similar labor disputes, which could significantly disrupt our operations or those of our principal customers.

Important factors that could cause actual results to differ materially from our expectations are disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on February 24, 2014. All written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements as well as other cautionary statements that are made from time to time in our public communications. You should evaluate all forward-looking statements made in this Quarterly Report on Form 10-Q in the context of these risks and uncertainties.

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ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk consists of changes in interest rates, foreign currency rate fluctuations and movements in commodity prices.

Interest Rate Risk

We are subject to interest rate market risk in connection with a portion of our long-term debt. Our principal interest rate exposure relates to outstanding amounts under our Senior Secured Credit Facility. Our Senior Secured Credit Facility provides for variable rate borrowings of up to $2,651.1 million including $453.0 million under our revolving credit facility, net of $12.0 million of letters of credit. A one-eighth percent change in assumed interest rates for the Senior Secured Credit Facility, if fully drawn, as of June 30, 2014 would have no impact on interest expense due to the 1.00% LIBOR floor on our Term B-3 Loan and partial offset of our interest rate swaps. As of June 30, 2014, we had no outstanding borrowings against the revolving credit facility.

From time to time, we enter into interest rate swap agreements to hedge our variable interest rate debt. Below is a list of our interest rate swaps as of June 30, 2014:

	Counterparty	Effective Date	Notional Amount (in millions)	LIBOR Fixed Rate
Interest Rate Swap H	Barclays Capital	Aug 2011-Aug 2014	$ 350.0	3.75%
Interest Rate Swap I	Deutsche Bank	Aug 2011-Aug 2014	$ 350.0	3.77%
Interest Rate Swap J	UBS	Aug 2013-Aug 2014	$ 125.0	2.96%
Interest Rate Swap K	UBS	Aug 2013-Aug 2014	$ 125.0	3.05%
Interest Rate Swap L	Barclays	Aug 2016-Aug 2019	$ 75.0	3.44%*
Interest Rate Swap M	JP Morgan	Aug 2016-Aug 2019	$ 100.0	3.43%*
Interest Rate Swap N	Bank of America	Aug 2016-Aug 2019	$ 75.0	3.37%*
Interest Rate Swap O	Deutsche Bank	Aug 2016-Aug 2019	$ 75.0	3.19%*
Interest Rate Swap P	Barclays	Aug 2016-Aug 2019	$ 75.0	3.08%*
Interest Rate Swap Q	Barclays	Aug 2016-Aug 2019	$ 50.0	2.99%*
Interest Rate Swap R	Deutsche Bank	Aug 2016-Aug 2019	$ 50.0	2.98%*

* include LIBOR floor of 1.00%

In certain circumstances, we and the counterparty are required to provide additional collateral under these swaps. We are exposed to increased interest expense if a counterparty defaults. Refer to NOTE F and NOTE G of the notes to our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Exchange Rate Risk

While our net sales and costs are denominated primarily in U.S. Dollars, net sales, costs, assets and liabilities are generated in other currencies including Japanese Yen, Euro, Indian Rupee, Brazilian Real, Chinese Yuan Renminbi, Canadian Dollar and Hungarian Forint. The expansion of our business outside North America may further increase the risk that cash flows resulting from these activities may be adversely affected by changes in currency exchange rates. As of June 30, 2014, we hold hedging contracts in the Japanese Yen, which are intended to hedge either known or forecasted cash flow payments denominated in the currency. We do not hold financial instruments for trading or speculative purposes.

Assuming current levels of foreign currency transactions, a 10% aggregate increase or decrease in the Japanese Yen, Euro, Indian Rupee, Chinese Yuan Renminbi and Canadian Dollar would correspondingly change our earnings by an estimated $2 million per year. This includes the partial offset of our hedging contracts described above. All other exposure to foreign currencies is considered immaterial.

Commodity Price Risk

We are subject to changes in our cost of sales caused by movements in underlying commodity prices. Approximately two-thirds of our cost of sales consists of purchased components with significant raw material content. A substantial portion of the purchased parts are made of aluminum and steel. The cost of aluminum parts include an adjustment factor on future purchases for fluctuations in aluminum prices based on accepted industry indices. In addition, a substantial amount of steel-based contracts also include an index-based component. As our costs change, we are able to pass through a portion of the changes in commodity prices to certain of our customers according to our LTSAs. We historically have not entered into long-term purchase contracts related to the purchase of aluminum and steel. We currently hold financial forward contracts that are intended to hedge forecasted aluminum purchases. Based on our forecasted demand for 2014, 2015 and 2016, as of June 30, 2014, the hedge contracts cover approximately 44%, 29% and 6% of our aluminum requirements, respectively. We do not hold financial instruments for trading or speculative purposes.

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Assuming current levels of commodity purchases, a 10% increase or decrease in the price of aluminum and steel would correspondingly change our earnings by approximately $1 million and $4 million per year, respectively. This includes the partial offset of our hedging contracts described above.

Many of our LTSAs have incorporated a cost-sharing arrangement related to potential future commodity price fluctuations. Our hedging policy is that we only hedge for our exposure and do not hedge any portion of the customers exposure. For purposes of the sensitivity analysis above, the impact of these cost sharing arrangements have not been included.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of the end of the period covered by this report. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act) during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are a party to various legal actions in the normal course of our business, including those related to commercial transactions, product liability, safety, health, taxes, environmental and other matters. See NOTE O in the notes to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

There have been no material changes from our risk factors as previously reported in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on February 24, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes repurchases of common stock settled during the three month period ended June 30, 2014:

	Total Number of Shares Purchased*	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans
April 2014				
May 2014				
June 2014	5,000,000	$ 29.95		
Total	5,000,000	$ 29.95		

* On June 9, 2014, upon the completion of an offering by the Sponsors of 35,000,000 shares, we repurchased from the underwriter in the offering approximately $150.0 million, or 5,000,000 shares, of our common stock sold by the Sponsors in the offering at a price per share equal to the price at which the underwriter purchased such shares from the Sponsors.

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Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description
10.36	Amendment No. 10 to the Credit Agreement, dated as of April 14, 2014, among Allison Transmission Holdings, Inc., Allison Transmission, Inc., as Borrower, the several banks and other financial institutions or entities from time to time parties thereto as Lenders, Citicorp North America, Inc., as Administrative Agent and the other agents and arrangers party thereto (incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed April 15, 2014)
10.37	Employment Agreement between Allison Transmission, Inc. and Lawrence E. Dewey, dated as of April 15, 2014 (incorporated by reference to Exhibit 10.2 to the Registrant s Current Report on Form 8-K filed April 15, 2014)*
10.38	Employment Agreement between Allison Transmission, Inc. and David S. Graziosi, dated as of April 15, 2014 (incorporated by reference to Exhibit 10.3 to the Registrant s Current Report on Form 8-K filed April 15, 2014)*
10.39	Amended and Restated Non-Employee Director Compensation Policy*
10.40	Form of 2011 Equity Incentive Award Plan Restricted Stock Unit Agreement for Non-Employee Directors for 2014 Compensation*
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.1	Certification of Periodic Report by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Indicates a management contract or compensatory plan or arrangement.

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SIGNATURES

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

	ALLISON TRANSMISSION HOLDINGS, INC.
Date: July 25, 2014	By: /s/ Lawrence E. Dewey Name: Lawrence E. Dewey Title: Chairman, President and Chief Executive Officer
Date: July 25, 2014	By: /s/ David S. Graziosi Name: David S. Graziosi Title: Executive Vice President, Chief Financial Officer and Treasurer (Principal Accounting Officer)