

Allison Transmission Holdings Inc
Form 10-Q
July 28, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2015

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
(State or other jurisdiction of
incorporation or organization)

26-0414014
(I.R.S. Employer
Identification Number)

One Allison Way

Indianapolis, IN
(Address of Principal Executive Offices)

46222
(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

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (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

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, 2015, there were 176,422,605 shares of Common Stock outstanding.

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Table of Contents**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, 2015	December 31, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 216.8	\$ 263.0
Accounts receivable net of allowance for doubtful accounts of \$0.6 and \$0.3, respectively	228.1	207.4
Inventories	155.3	143.5
Deferred income taxes, net	97.8	119.7
Other current assets	27.5	24.4
Total Current Assets	725.5	758.0
Property, plant and equipment, net	485.4	514.6
Intangible assets, net	1,463.4	1,512.0
Goodwill	1,941.0	1,941.0
Deferred income taxes, net	1.3	1.3
Other non-current assets	66.4	77.3
TOTAL ASSETS	\$ 4,683.0	\$ 4,804.2
LIABILITIES		
Current Liabilities		
Accounts payable	\$ 142.4	\$ 151.7
Product warranty liability	21.0	24.0
Current portion of long-term debt	22.6	17.9
Deferred revenue	21.9	20.6
Other current liabilities	113.9	131.7
Total Current Liabilities	321.8	345.9
Product warranty liability	52.7	59.6

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Deferred revenue	52.8	48.7
Long-term debt	2,392.0	2,502.6
Deferred income taxes	273.0	238.2
Other non-current liabilities	225.1	211.4
TOTAL LIABILITIES	3,317.4	3,406.4
Commitments and contingencies (see NOTE O)		
STOCKHOLDERS EQUITY		
Common stock, \$0.01 par value, 1,880,000,000 shares authorized, 177,091,171 shares issued and outstanding and 179,488,247 shares issued and outstanding, respectively	1.8	1.8
Non-voting common stock, \$0.01 par value, 20,000,000 shares authorized, none issued and outstanding		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized, none issued and outstanding		
Paid in capital	1,685.0	1,651.0
Accumulated deficit	(270.7)	(215.5)
Accumulated other comprehensive loss, net of tax	(50.5)	(39.5)
TOTAL STOCKHOLDERS EQUITY	1,365.6	1,397.8
TOTAL LIABILITIES & STOCKHOLDERS EQUITY	\$ 4,683.0	\$ 4,804.2

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

Table of Contents**Allison Transmission Holdings, Inc.****Condensed Consolidated Statements of Comprehensive Income****(unaudited, dollars in millions, except per share data)**

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Net sales	\$ 511.0	\$ 536.1	\$ 1,014.6	\$ 1,029.7
Cost of sales	274.7	297.6	539.1	568.7
Gross profit	236.3	238.5	475.5	461.0
Selling, general and administrative expenses	75.6	85.1	149.0	168.3
Engineering research and development	23.2	21.2	45.4	45.7
Loss associated with impairment of long-lived assets			1.3	
Operating income	137.5	132.2	279.8	247.0
Interest income	0.2	0.2	0.4	0.4
Interest expense	(23.3)	(36.8)	(60.4)	(72.1)
Premiums and expenses on tender offer and redemption of long-term debt	(25.1)		(25.1)	
Other (expense) income, net	(2.2)	(0.9)	0.6	(1.3)
Income before income taxes	87.1	94.7	195.3	174.0
Income tax expense	(32.7)	(37.5)	(72.5)	(64.7)
Net income	\$ 54.4	\$ 57.2	\$ 122.8	\$ 109.3
Basic earnings per share attributable to common stockholders	\$ 0.30	\$ 0.32	\$ 0.68	\$ 0.61
Diluted earnings per share attributable to common stockholders	\$ 0.30	\$ 0.31	\$ 0.68	\$ 0.59
Dividends declared per common share	\$ 0.15	\$ 0.12	\$ 0.30	\$ 0.24
Comprehensive income, net of tax	\$ 55.3	\$ 57.0	\$ 111.8	\$ 111.2

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

Table of Contents**Allison Transmission Holdings, Inc.****Condensed Consolidated Statements of Cash Flows****(unaudited, dollars in millions)**

	Six months ended June 30,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 122.8	\$ 109.3
Add (deduct) items included in net income not using (providing) cash:		
Deferred income taxes	67.3	61.7
Amortization of intangible assets	48.6	49.4
Depreciation of property, plant and equipment	43.4	47.4
Premiums and expenses on tender offer and redemption of long-term debt	25.1	
Excess tax benefit from stock-based compensation	(8.0)	(7.8)
Unrealized loss (gain) on derivatives	6.8	(8.0)
Stock-based compensation	4.7	7.3
Amortization of deferred financing costs	3.8	4.3
Loss associated with impairment of long-lived assets	1.3	
Other	(0.3)	0.2
Changes in assets and liabilities:		
Accounts receivable	(23.2)	(52.0)
Inventories	(14.2)	(8.8)
Accounts payable	(9.1)	24.0
Other assets and liabilities	(35.3)	15.0
Net cash provided by operating activities	233.7	242.0
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions of long-lived assets	(14.9)	(22.7)
Investments in technology-related initiatives		(3.8)
Collateral for interest rate derivatives		1.7
Proceeds from disposal of assets	0.2	0.1
Net cash used for investing activities	(14.7)	(24.7)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchases and redemption of long-term debt	(491.0)	
Issuance of long-term debt	470.0	
Repurchases of common stock	(114.7)	(249.8)
Payments on long-term debt	(104.6)	(8.9)
Dividend payments	(53.9)	(43.4)
Proceeds from exercise of stock options	21.8	22.4
Excess tax benefit from stock-based compensation	8.0	7.8
Debt financing fees	(7.5)	(1.0)
Taxes paid related to net share settlement of equity awards	(0.5)	(0.2)

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Net cash used for financing activities	(272.4)	(273.1)
Effect of exchange rate changes on cash	7.2	(2.2)
Net decrease in cash and cash equivalents	(46.2)	(58.0)
Cash and cash equivalents at beginning of period	263.0	184.7
Cash and cash equivalents at end of period	\$ 216.8	\$ 126.7
Supplemental disclosures:		
Interest paid	\$ 53.6	\$ 68.6
Income taxes paid	\$ 3.9	\$ 3.1

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 (Allision, the Company or we) design and manufacture commercial and defense fully-automatic transmissions. The business was founded in 1915 and has been headquartered in Indianapolis, Indiana since inception. Allison was an operating unit of General Motors Corporation from 1929 until 2007, when Allison once again became a stand-alone company. In March 2012, Allison began trading on the New York Stock Exchange under the symbol, ALSN .

We have approximately 2,700 employees and 13 different transmission product lines. Although approximately 80% of revenues were generated in North America in 2014, we have a global presence by serving customers in Europe, Asia, South America and Africa. We serve customers through an independent network of approximately 1,400 independent distributor and dealer locations worldwide.

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, 2015 and 2014 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 statements 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 comprehensive income 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, 2014 as filed with the Securities and Exchange Commission (SEC) on February 20, 2015. Certain immaterial reclassifications have been made in the condensed consolidated financial statements of prior periods to conform to the current period presentation. These reclassifications have no impact on previously reported net income, total stockholders equity or cash flows. 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.

Table of Contents***Recently Issued Accounting Pronouncements***

In April 2015, the Financial Accounting Standards Board (FASB) issued authoritative accounting guidance to simplify the presentation of the debt issuance costs. The guidance requires that the debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs are not affected. The guidance is effective for public entities for interim and annual reporting periods beginning after December 15, 2015, but can be early-adopted. Management is assessing the potential impact of the adoption of this guidance on the Company's consolidated financial statements.

In August 2014, the FASB issued authoritative accounting guidance on the disclosure of uncertainties about an entity's ability to continue as a going concern. The guidance requires management to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that financial statements are available to be issued when applicable) and to provide related footnote disclosures. The guidance is effective prospectively for interim and annual reporting periods beginning after December 15, 2016, but can be early-adopted. While the adoption of this guidance is not expected to have an effect on the Company's consolidated financial statements, it could affect the disclosure applied under these circumstances in the future.

In May 2014, the 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, services 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. As originally proposed, the guidance was effective prospectively for interim and annual reporting periods beginning after December 15, 2016. On April 1, 2015, the FASB proposed a one-year deferral of the effective date. Under the proposal, the guidance would be effective on a retrospective or modified retrospective basis for public entities for interim and annual reporting periods beginning after December 15, 2017. The proposal also would permit both public and nonpublic entities to adopt the guidance as early as December 15, 2016. Early adoption prior to that date would not be permitted. In July 2015, the FASB proposed deferral was approved. Management is assessing the potential impact of the adoption of this guidance on the Company's consolidated financial statements.

NOTE C. INVENTORIES

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

	June 30, 2015	December 31, 2014
Purchased parts and raw materials	\$ 74.0	\$ 72.3
Work in progress	6.0	6.1
Service parts	48.0	46.5
Finished goods	27.3	18.6
Total inventories	\$ 155.3	\$ 143.5

Inventory components shipped to third parties, primarily cores, parts to re-manufacturers, and parts to contract manufacturers, 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. See NOTE K, Other Current Liabilities for more information.

Table of Contents**NOTE D. GOODWILL AND OTHER INTANGIBLE ASSETS**

As of June 30, 2015 and December 31, 2014, 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):

	June 30, 2015		December 31, 2014		Intangible assets, net	
	Intangible assets, gross	Accumulated amortization	Intangible assets, gross	Intangible assets, gross		
Other intangible assets:						
Trade name	\$ 870.0	\$	\$ 870.0	\$ 870.0	\$	\$ 870.0
Customer relationships - defense	62.3	(29.6)	32.7	62.3	(27.9)	34.4
Customer relationships - commercial	831.8	(452.1)	379.7	831.8	(426.9)	404.9
Proprietary technology	476.3	(301.0)	175.3	476.3	(282.0)	194.3
Non-compete agreement	17.3	(13.7)	3.6	17.3	(12.8)	4.5
Patented technology - defense	28.2	(26.2)	2.0	28.2	(24.5)	3.7
Tooling rights	4.5	(4.4)	0.1	4.5	(4.3)	0.2
Patented technology - commercial	260.6	(260.6)		260.6	(260.6)	
Total	\$ 2,551.0	\$ (1,087.6)	\$ 1,463.4	\$ 2,551.0	\$ (1,039.0)	\$ 1,512.0

As of June 30, 2015 and December 31, 2014, the net carrying value of our Goodwill and other intangibles was \$3,404.4 million and \$3,453.0 million, respectively.

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

	2016	2017	2018	2019	2020	Thereafter
Amortization expense	\$ 92.4	\$ 89.7	\$ 87.2	\$ 85.7	\$ 49.9	\$ 140.6

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 financial instruments that are valued using quoted prices in markets that are not active and 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, 2015 and December 31, 2014, 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 qualify 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, 2015 and December 31, 2014 (dollars in millions):

	Fair Value Measurements Using					
	Quoted Prices in Active		Significant Other		TOTAL	
	Markets for Identical		Observable Inputs (Level 2)			
	Assets (Level 1)	Assets (Level 1)	Observable Inputs (Level 2)	Observable Inputs (Level 2)	TOTAL	TOTAL
June 30, 2015	December 31, 2014	June 30, 2015	December 31, 2014	June 30, 2015	December 31, 2014	
Cash equivalents	\$ 101.0	\$ 55.0	\$	\$	\$ 101.0	\$ 55.0
Available-for-sale securities	3.9	8.6			3.9	8.6
Rabbi trust assets	4.6	2.9			4.6	2.9
Deferred compensation obligation	(4.6)	(2.9)			(4.6)	(2.9)
Derivative assets			0.0	0.0	0.0	0.0
Derivative liabilities			(22.6)	(15.4)	(22.6)	(15.4)
Total	\$ 104.9	\$ 63.6	\$ (22.6)	\$ (15.4)	\$ 82.3	\$ 48.2

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

	June 30, 2015	December 31, 2014
Long-term debt:		
Senior Secured Credit Facility Term B-2 Loan, variable, due 2017	\$ 189.0	\$ 283.6
Senior Secured Credit Facility Term B-3 Loan, variable, due 2019	2,225.6	1,765.6
Senior Notes, fixed 7.125%, due 2019		471.3
Total long-term debt	\$ 2,414.6	\$ 2,520.5
Less: current maturities of long-term debt	22.6	17.9
Total long-term debt less current portion	\$ 2,392.0	\$ 2,502.6

As of June 30, 2015, the Company had \$189.0 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 \$2,225.6 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 fair value of the Company's long-term debt obligations as of June 30, 2015 was \$2,417.6 million. The fair value is based on quoted Level 2 market prices of the Company's debt as of June 30, 2015. 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.

On March 18, 2015, ATI commenced a cash tender offer to purchase its outstanding 7.125% senior cash pay notes due May 2019 (7.125% Senior Notes). In connection with the cash tender offer, ATI solicited consents to enter into a supplemental indenture to eliminate substantially all of the restrictive covenants, certain events of default and related provisions contained in the indenture dated as of May 6, 2011 (the Indenture) governing the 7.125% Senior Notes. On March 31, 2015, ATI received valid consents from holders with an aggregate principal amount of \$420.9 million of the 7.125% Senior Notes. Accordingly, ATI entered into a first supplemental indenture to the Indenture contingent on the execution of an amendment with the term loan lenders under its Senior Secured Credit Facility.

On April 7, 2015, ATI entered into an amendment with the term loan lenders under its Senior Secured Credit Facility to add up to an additional \$470.0 million of Term B-3 Loan commitments and incur term loans in an aggregate principal amount of \$470.0 million. The amendment also, among other things, (i) permits prepayment, repurchase or redemption of Allison's 7.125% Senior Notes with the proceeds of the financing and (ii) resets the period for which a prepayment premium of 1.00% will apply in the event of a repricing transaction to the six-month anniversary of the closing date of the financing. With the exception of the items noted above, the terms (including maturity and pricing) of the financing are materially the same as the terms of the existing Term B-3 Loan outstanding. As a result of the newly structured Senior Secured Credit Facility, ATI recorded approximately \$7.5 million as deferred financing fees in the Condensed Consolidated Balance Sheets. Immediately following the financing, ATI purchased \$420.9 million

of the tendered 7.125% Senior Notes using the proceeds from the financing in a cash payment equal to \$1,042 per \$1,000 aggregate principal amount of the 7.125% Senior Notes plus accrued and unpaid interest. Upon the payment, the supplemental indenture to the Indenture became operative. The purchase resulted in a loss (the premium between the purchase price of the notes and the face value of such notes) of \$22.7 million including deferred financing fees written off.

In May 2015, ATI redeemed the remaining \$50.4 million of its outstanding 7.125% Senior Notes, at the redemption price equal to 103.563% of the principal amount plus any accrued and unpaid interest, using the remaining proceeds from the financing and cash on hand, resulting in a loss (the premium between the purchase price of the notes and the face value of such notes) of \$2.4 million including deferred financing fees written off.

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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). Interest on the Term B-2 Loan, as of June 30, 2015, 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%. Interest on the Term B-3 Loan, as of June 30, 2015, is equal to the LIBOR (which may not be less than 1.00%) plus 2.50% based on the Company's total leverage ratio. As of June 30, 2015, these rates were approximately 2.94% and 3.50% 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 3.46%. 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. For the three months and six months ended June 30, 2015, the Company made principal payments of \$47.2 million and \$94.6 million on the Term B-2 loan, respectively, resulting in a total loss of \$0.2 million associated with the write off of related deferred debt issuance costs. The minimum required quarterly principal payment on the Term B-3 Loan is \$5.6 million and remains through its maturity date of 2019. As of June 30, 2015, 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 a revolving credit facility of \$465.0 million, net of an allowance for up to \$75.0 million in outstanding letters of credit commitments. As of June 30, 2015, the Company had \$455.8 million available under the revolving credit facility, net of \$9.2 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, 2015, this rate would have been approximately 1.63%. In addition, there is an annual commitment fee, based on the Company's total leverage ratio, which as of June 30, 2015, was equal to 0.25% 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. In March 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, 2015, 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 2.88x 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, 2015, the total leverage ratio was 2.88x.

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,

declare or pay certain dividends or repurchase shares of the Company's common stock. As of June 30, 2015, the Company is in compliance with all covenants under the Senior Secured Credit Facility.

Table of Contents**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, 2015 and December 31, 2014 follows (dollars in millions):

		June 30, 2015		December 31, 2014	
		Notional	Fair Value	Notional	Fair Value
		Amount		Amount	
3.44% Interest Rate Swap L, Aug 2016	Aug 2019*	\$ 75.0	\$ (3.0)	\$ 75.0	\$ (2.3)
3.43% Interest Rate Swap M, Aug 2016	Aug 2019*	100.0	(3.9)	100.0	(3.0)
3.37% Interest Rate Swap N, Aug 2016	Aug 2019*	75.0	(2.8)	75.0	(2.1)
3.19% Interest Rate Swap O, Aug 2016	Aug 2019*	75.0	(2.5)	75.0	(1.7)
3.08% Interest Rate Swap P, Aug 2016	Aug 2019*	75.0	(2.2)	75.0	(1.5)
2.99% Interest Rate Swap Q, Aug 2016	Aug 2019*	50.0	(1.3)	50.0	(0.9)
2.98% Interest Rate Swap R, Aug 2016	Aug 2019*	50.0	(1.3)	50.0	(0.9)
2.73% Interest Rate Swap S, Aug 2016	Aug 2019*	50.0	(1.0)	50.0	(0.5)
2.74% Interest Rate Swap T, Aug 2016	Aug 2019*	75.0	(1.4)	75.0	(0.8)
2.66% Interest Rate Swap U, Aug 2016	Aug 2019*	50.0	(0.9)	50.0	(0.4)
2.60% Interest Rate Swap V, Aug 2016	Aug 2019*	50.0	(0.8)	50.0	(0.3)
2.40% Interest Rate Swap W, Aug 2016	Aug 2019*	25.0	(0.2)	25.0	0.0
2.25% Interest Rate Swap X, Aug 2016	Aug 2019*	50.0	(0.3)		
* includes LIBOR floor of 1.00%		\$ 800.0	\$ (21.6)	\$ 750.0	\$ (14.4)

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, 2015 and December 31, 2014 (amounts in millions):

	June 30, 2015		December 31, 2014	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Japanese Yen (JPY)	¥600.0	\$ 0.0	¥300.0	\$ (0.3)
		\$ 0.0		\$ (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.

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The following table summarizes the outstanding commodity swaps as of June 30, 2015 and December 31, 2014 (dollars in millions):

	June 30, 2015			December 31, 2014		
	Notional Amount	Quantity	Fair Value	Notional Amount	Quantity	Fair Value
Aluminum	\$ 8.7	4,650 metric tons	\$ (1.0)	\$ 11.3	6,200 metric tons	\$ (0.7)
Natural Gas	N/A	N/A		\$ 0.2	60,000 MMBtu	0.0
			\$ (1.0)			\$ (0.7)

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, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments				
Foreign currency contracts	Other current assets	\$ 0.0	Other current liabilities	\$ (0.3)
Commodity contracts	Other current and non-current liabilities	(1.0)	Other current and non-current liabilities	(0.7)
Interest rate contracts	Other non-current liabilities	(21.6)	Other non-current liabilities	(14.4)
Total derivatives not designated as hedging instruments		\$ (22.6)		\$ (15.4)

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, 2015, the amounts recorded to Other current and non-current liabilities for commodity contracts were (\$0.6) million and (\$0.4) million, respectively.

As of December 31, 2014, the amounts recorded to Other current and non-current liabilities for commodity contracts were (\$0.6) million and (\$0.1) 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 (loss) on interest rate derivatives (dollars in millions):

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Location of impact on results of operations				
Interest Expense	\$ 1.1	\$ 2.6	\$ (7.2)	\$ 6.5

Table of Contents**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,	
	2015	2014	2015	2014
Beginning balance	\$ 77.1	\$ 90.4	\$ 83.6	\$ 90.5
Payments	(7.9)	(10.7)	(16.3)	(19.1)
Increase in liability (warranty issued during period)	5.3	6.5	11.2	12.8
Net adjustments to liability	(0.9)	0.3	(5.0)	2.2
Accretion (for Predecessor liabilities)	0.1	0.2	0.2	0.3
Ending balance	\$ 73.7	\$ 86.7	\$ 73.7	\$ 86.7

As of June 30, 2015, the current and non-current product warranty liabilities were \$21.0 million and \$52.7 million, respectively. As of June 30, 2014, the current and non-current product warranty liabilities were \$23.2 million and \$63.5 million, respectively.

NOTE I. DEFERRED REVENUE

As of June 30, 2015, the current and non-current deferred revenue for Extended Transmission Coverage (ETC) were \$21.9 million and \$52.8 million, respectively. As of June 30, 2014, the current and non-current deferred revenue for ETC were \$19.7 million and \$47.1 million, respectively.

Deferred revenue for ETC activity (dollars in millions):

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Beginning balance	\$ 72.2	\$ 63.8	\$ 69.0	\$ 63.6
Increases	8.3	8.3	16.5	13.8
Revenue earned	(5.8)	(5.3)	(10.8)	(10.6)
Ending balance	\$ 74.7	\$ 66.8	\$ 74.7	\$ 66.8

Deferred revenue recorded in current liabilities related to unearned net sales for defense contracts as of June 30, 2015 and 2014 was approximately \$0.0 million and \$2.3 million, respectively.

NOTE J. OTHER (EXPENSE) INCOME, NET

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

Three months ended June 30, 2015

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	2015	2014	2015	2014
(Loss) gain on intercompany foreign exchange	\$ (1.3)	\$ (1.8)	\$ 0.9	\$ (1.8)
Realized loss on derivative contracts (see NOTE G)	(0.4)	(0.4)	(0.7)	(1.0)
(Loss) gain on foreign exchange	(0.2)		0.9	(0.5)
Unrealized (loss) gain on derivative contracts (see NOTE G)	(0.1)	1.3	0.2	1.5
Loss on repayments of long-term debt	(0.0)		(0.2)	
Grant program income		0.8		1.4
Public offering fees and expenses		(0.8)		(1.1)
Other	(0.2)		(0.5)	0.2
Total	\$ (2.2)	\$ (0.9)	\$ 0.6	\$ (1.3)

For the three months and six months ended June 30, 2015, the Company recorded a loss of (\$1.3) million and a gain of \$0.9 million resulting from intercompany financing transactions related to investments in plant assets for the Company's India facility.

Table of Contents**NOTE K. OTHER CURRENT LIABILITIES**

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

	As of June 30, 2015	As of December 31, 2014
Payroll and related costs	\$ 30.9	\$ 50.9
Sales allowances	28.1	25.5
Defense price reduction reserve	11.2	16.2
Vendor buyback obligation	11.1	13.2
Taxes payable	10.1	8.5
Stock repurchases obligation	9.4	
Accrued interest payable	0.8	5.2
Derivative liabilities	0.2	0.8
Other accruals	12.1	11.4
Total	\$ 113.9	\$ 131.7

NOTE L. EMPLOYEE BENEFIT PLANS

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

	Pension Plans		Post-retirement Benefits	
	Three months ended June 30, 2015	2014	Three months ended June 30, 2015	2014
Net periodic benefit cost:				
Service cost	\$ 3.6	\$ 3.3	\$ 0.6	\$ 0.6
Interest cost	1.3	1.2	1.3	1.4
Expected return on assets	(2.1)	(1.9)		
Prior service cost	0.0	0.0	(0.9)	(0.9)
Gain	(0.0)			(0.2)
Net periodic benefit cost	\$ 2.8	\$ 2.6	\$ 1.0	\$ 0.9

	Pension Plans		Post-retirement Benefits	
	Six months ended June 30, 2015	2014	Six months ended June 30, 2015	2014
Net periodic benefit cost:				
Service cost	\$ 7.2	\$ 6.6	\$ 1.2	\$ 1.1
Interest cost	2.6	2.5	2.7	2.9
Expected return on assets	(4.2)	(3.8)		

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Prior service cost	0.0	0.0	(1.8)	(1.8)
Gain	(0.0)			(0.4)
Net periodic benefit cost	\$ 5.6	\$ 5.3	\$ 2.1	\$ 1.8

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NOTE M. INCOME TAXES

For the three and six months ended June 30, 2015, the Company recorded total tax expense of \$32.7 million and \$72.5 million, respectively. The effective tax rate for the three and six months ended June 30, 2015 was 37.5% and 37.1%, respectively. 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.

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 carry forward 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 a 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 believes its objectively measured positive evidence outweighs 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 has recorded a liability of \$2.3 million for unrecognized tax benefits related to a 2010 Research & Development Credit as of June 30, 2015 and December 31, 2014. 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, 2014, 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).

Table of Contents**NOTE N. ACCUMULATED OTHER COMPREHENSIVE LOSS**

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

	Three months ended			Total
	Available-for- sale securities	Defined benefit pension items	Foreign currency items	
AOCL as of March 31, 2014	\$ 1.2	\$ (8.6)	\$ (11.5)	\$ (18.9)
Other comprehensive (loss) income before reclassifications	(0.9)		0.9	
Amounts reclassified from AOCL		(0.9)		(0.9)
Income tax	0.3	0.4		0.7
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)
AOCL as of March 31, 2015	\$ (3.3)	\$ (17.6)	\$ (30.5)	\$ (51.4)
Other comprehensive (loss) income before reclassifications	(0.9)		1.9	1.0
Amounts reclassified from AOCL		(0.9)		(0.9)
Income tax	0.4	0.4		0.8
Net current period other comprehensive (loss) income	\$ (0.5)	\$ (0.5)	\$ 1.9	\$ 0.9
AOCL as of June 30, 2015	\$ (3.8)	\$ (18.1)	\$ (28.6)	\$ (50.5)
	Six months ended			Total
	Available-for- sale securities	Defined benefit pension items	Foreign currency items	
AOCL as of December 31, 2013	\$ 1.1	\$ (7.9)	\$ (14.2)	\$ (21.0)
Other comprehensive (loss) income before reclassifications	(0.7)		3.6	2.9
Amounts reclassified from AOCL		(2.0)		(2.0)
Income tax	0.2	0.8		1.0
Net current period other comprehensive (loss) income	\$ (0.5)	\$ (1.2)	\$ 3.6	\$ 1.9

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AOCL as of June 30, 2014	\$ 0.6	\$ (9.1)	\$ (10.6)	\$ (19.1)
AOCL as of December 31, 2014	\$ (0.9)	\$ (17.0)	\$ (21.6)	\$ (39.5)
Other comprehensive loss before reclassifications	(4.7)		(7.0)	(11.7)
Amounts reclassified from AOCL		(1.8)		(1.8)
Income tax	1.8	0.7		2.5
Net current period other comprehensive loss	\$ (2.9)	\$ (1.1)	\$ (7.0)	\$ (11.0)
AOCL as of June 30, 2015	\$ (3.8)	\$ (18.1)	\$ (28.6)	\$ (50.5)

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

AOCL Components	Amounts reclassified from AOCL		Affected line item in the Condensed Consolidated Statements of Comprehensive Income
	Three months ended June 30, 2015	Three months ended June 30, 2014	
Amortization of defined benefit pension items:			
Prior service cost	\$ 0.8	\$ 0.8	Cost of sales
	0.1	0.0	Selling, general and administrative
	0.0	0.0	Engineering research and development
Actuarial loss		0.1	Cost of sales
		0.0	Selling, general and administrative
		0.0	Engineering research and development
Total reclassifications, before tax	\$ 0.9	\$ 0.9	Income before income taxes
Income tax expense	(0.4)	(0.4)	Tax expense
Total reclassifications	\$ 0.5	\$ 0.5	Net of tax

AOCL Components	Amounts reclassified from AOCL		Affected line item in the Condensed Consolidated Statements of Comprehensive Income
	Six months ended June 30, 2015	Six months ended June 30, 2014	
Amortization of defined benefit pension items:			
Prior service cost	\$ 1.6	\$ 1.6	Cost of sales
	0.2	0.1	Selling, general and administrative
	0.0	0.0	Engineering research and development
Actuarial loss		0.3	Cost of sales
		0.0	Selling, general and administrative
		0.0	Engineering research and development
Total reclassifications, before tax	\$ 1.8	\$ 2.0	Income before income taxes
Income tax expense	(0.7)	(0.8)	Tax expense
Total reclassifications	\$ 1.1	\$ 1.2	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.

NOTE P. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

In May 2015, the Company redeemed \$100,000 and \$450,000 of 7.125% Senior Notes held by Lawrence E. Dewey, our Chairman, President and Chief Executive Officer, and David S. Graziosi, our Executive Vice President, Chief Financial Officer and Treasurer, respectively, at the specified redemption price in the governing indenture equal to 103.563% of the principal amount plus any accrued and unpaid interest. Refer to NOTE F for additional details.

Table of Contents**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 diluted weighted-average common shares outstanding exclude the anti-dilutive effect of certain stock options since such options had an exercise price in excess of the monthly average market value of our common stock. For both the three months and six months ended June 30, 2015, 0.2 million of outstanding stock options were not included in the diluted EPS computation because they were anti-dilutive.

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,	
	2015	2014	2015	2014
Net income	\$ 54.4	\$ 57.2	\$ 122.8	\$ 109.3
Weighted average shares of common stock outstanding	178.5	178.8	179.3	180.5
Dilutive effect stock-based awards	1.1	2.8	1.8	3.2
Diluted weighted average shares of common stock outstanding	179.6	181.6	181.1	183.7
Basic earnings per share attributable to common stockholders	\$ 0.30	\$ 0.32	\$ 0.68	\$ 0.61
Diluted earnings per share attributable to common stockholders	\$ 0.30	\$ 0.31	\$ 0.68	\$ 0.59

NOTE R. COMMON STOCK

The Company's current stock repurchase program was announced on October 30, 2014. The Board authorized management to repurchase up to \$500.0 million of its common stock on the open market or through privately negotiated transactions through December 31, 2016. The timing and amount of stock repurchases are subject to market conditions and corporate needs. This stock repurchase program may be extended, modified, suspended or discontinued at any time at the Company's discretion. During the three months and six months ended June 30, 2015, the Company repurchased approximately \$85.2 million and \$124.1 million, respectively, of its common stock under the repurchase program. As a result of timing between the repurchase transactions and the settlement of the repurchases, \$79.3 million was settled in cash during the second quarter of 2015. The remaining \$9.4 million, or 317,900 shares, was recorded to Other current liabilities in the Condensed Consolidated Balance Sheets for June 30, 2015 and settled the following month.

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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 (Allison, the Company or we) design and manufacture commercial and defense fully-automatic transmissions. The business was founded in 1915 and has been headquartered in Indianapolis, Indiana since inception. Allison was an operating unit of General Motors Corporation from 1929 until 2007, when Allison once again became a stand-alone company. In March 2012, Allison began trading on the New York Stock Exchange under the symbol, ALSN.

We have approximately 2,700 employees and 13 different transmission product lines. Although approximately 80% of revenues were generated in North America in 2014, we have a global presence by serving customers in Europe, Asia, South America and Africa. We serve customers through an independent network of approximately 1,400 independent distributor and dealer locations worldwide.

Trends Impacting Our Business

We expect our full year 2015 net sales to decrease year-over-year principally due to a continued recovery in the North America On-Highway end market being more than offset by the elevated level of uncertainty and dearth of near-term visibility in the global Off-Highway and Service Parts, Support Equipment and Other end markets, previously considered reductions in U.S. defense spending, continued weakness in the Outside North America On-Highway end market and lower demand for North America Hybrid-Propulsion Systems for Transit Bus due to engine emissions improvements and non-hybrid alternatives. We also expect third quarter net sales to be lower than the same period in 2014. The anticipated year-over-year decrease in third quarter net sales is expected to occur due to higher demand in the North America On-Highway end market being more than offset by lower demand in other end markets.

Second Quarter Net Sales by End Market (in millions)

End Market	Q2 2015 Net Sales	Q2 2014 Net Sales	% Variance
North America On-Highway	\$ 277	\$ 243	14%
North America Hybrid-Propulsion Systems for Transit Bus	20	28	(29%)
North America Off-Highway	10	23	(57%)
Defense	29	49	(41%)
Outside North America On-Highway	73	62	18%
Outside North America Off-Highway	8	24	(67%)
Service Parts, Support Equipment and Other	94	107	(12%)
Total Net Sales	\$ 511	\$ 536	(5%)

North America On-Highway end market net sales were up 14% for the second quarter 2015 compared to the second quarter 2014, principally driven by higher demand for Rugged Duty Series and Highway Series models.

North America Hybrid-Propulsion Systems for Transit Bus end market net sales were down 29% for the second quarter 2015 compared to the second quarter 2014, principally driven by lower demand due to engine emissions improvements and non-hybrid alternatives that generally require a fully-automatic transmission (e.g. xNG).

North America Off-Highway end market net sales were down 57% for the second quarter 2015 compared to the second quarter of 2014, principally driven by lower demand from hydraulic fracturing applications.

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Defense end market net sales were down 41% for the second quarter 2015 compared to the second quarter 2014, principally driven by the recognition of previously deferred revenue in 2014 totaling \$15.8 million commensurate with the shipment of certain tracked transmissions at the request of the U.S. government and reductions in U.S. defense spending to longer term averages experienced during periods without active conflicts.

Outside North America On-Highway end market net sales were up 18% for the second quarter 2015 compared to the second quarter 2014, principally driven by higher demand in Europe, Japan and India.

Outside North America Off-Highway end market net sales were down 67% for the second quarter 2015 compared to the second quarter 2014, principally driven by lower demand in the energy and mining sectors.

Service parts, support equipment and other end market net sales were down 12% for the second quarter 2015 compared to the second quarter 2014, principally driven by lower demand for North America service parts.

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, royalties 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.

Cost of sales

Our primary 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, 2015, direct material costs were approximately 68%, overhead costs were approximately 25%, and direct labor costs were approximately 7% 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 (LTSA's). 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.

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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:

(unaudited, in millions)	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Net income	\$ 54.4	\$ 57.2	\$ 122.8	\$ 109.3
plus:				
Interest expense, net	23.1	36.6	60.0	71.7
Cash interest expense	(35.1)	(39.2)	(53.6)	(68.6)
Income tax expense	32.7	3		