SMITH A O CORP
Form 10-Q
May 06, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013.

or

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

For the transition period from to

Commission File Number 1-475

A. O. Smith Corporation

(Exact name of registrant as specified in its charter)

Delaware	**39-0619790**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
11270 West Park Place, Milwaukee, Wisconsin	**53224-9508**
(Address of principal executive office)	**(Zip Code)**

(414)359-4000

(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. þ 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).

þ 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	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 Act.) ¨ Yes þ No

Class A Common Stock Outstanding as of April 30, 2013 6,619,395 shares

Common Stock Outstanding as of April 30, 2013 39,741,893 shares

(Outstanding shares do not give effect to a two-for-one stock split in the form of a 100 percent stock dividend to owners of record April 30, 2013 and payable May 15, 2013)

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A. O. Smith Corporation

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

A. O. SMITH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

Three Months Ended March 31, 2013 and 2012

(dollars in millions, except for per share data)

(unaudited)

	Three Months Ended March 31,	
	2013	2012
Net sales	$ 509.6	$ 468.6
Cost of products sold	330.3	319.5
Gross profit	179.3	149.1
Selling, general and administrative expenses	120.0	105.3
Restructuring, impairment and settlement expense - net	1.7	-
Interest expense	1.5	3.0
Other income	(1.0)	(29.1)
	57.1	69.9
Provision for income taxes	18.1	22.4
Net Earnings	$ 39.0	$ 47.5
Net Earnings Per Share of Common Stock	$ 0.42	$ 0.52
Diluted Net Earnings Per Share of Common Stock	$ 0.42	$ 0.51
Dividends Per Share of Common Stock	$ 0.10	$ 0.08

(Earnings per share and dividends per share above have been impacted by the two-for-one stock split in the form of a 100 percent stock dividend to owners of record on April 30, 2013 and payable May 15, 2013)

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

Three Months Ended March 31, 2013 and 2012

(dollars in millions)

(unaudited)

	Three Months Ended March 31,	
	2013	2012
Net earnings	$ 39.0	$ 47.5
Other comprehensive (loss) earnings		

Foreign currency translation adjustments	(1.5)	2.8
Unrealized net gain on cash flow derivative instruments, less related income tax provision of $(0.4) in 2013 and $(0.4) in 2012	0.7	0.6
Adjustment to additional minimum pension liability, less related income tax provision of $(3.9) in 2013	6.3	-
Reversal of unrealized gain on investments less related tax benefit of $0.7 in 2012	-	(1.2)
Comprehensive Earnings	$ 44.5	$ 49.7

See accompanying notes to unaudited condensed consolidated financial statements.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

A. O. SMITH CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

March 31, 2013 and December 31, 2012

(dollars in millions)

	(unaudited) March 31, 2013	December 31, 2012
Assets		
Current Assets		
Cash and cash equivalents	$ 306.9	$ 266.9
Marketable securities	144.5	196.0
Receivables	423.7	425.4
Inventories	169.8	163.4
Deferred income taxes	32.6	33.2
Other current assets	28.3	22.3
Total Current Assets	1,105.8	1,107.2
Property, plant and equipment	690.5	680.7
Less accumulated depreciation	344.5	335.0
Net property, plant and equipment	346.0	345.7
Goodwill	436.0	435.4
Other intangibles	337.2	338.7
Other assets	42.1	38.2
Total Assets	$ 2,267.1	$ 2,265.2
Liabilities		
Current Liabilities		
Trade payables	$ 306.0	$ 328.9
Accrued payroll and benefits	40.0	46.5
Income taxes	13.4	0.2
Accrued liabilities	51.3	57.0
Product warranties	43.2	43.2
Long-term debt due within one year	18.6	18.6
Current liabilities - discontinued operations	4.6	4.6
Total Current Liabilities	477.1	499.0
Long-term debt	210.5	225.1
Pension liabilities	186.6	190.1
Other liabilities	149.4	148.3
Long-term liabilities - discontinued operations	7.8	8.6
Total Liabilities	1,031.4	1,071.1
Stockholders Equity		
Class A Common Stock, $5 par value: authorized 14,000,000 shares; issued 13,304,280 and 13,309,876	66.6	66.6

Common Stock, $1 par value: authorized 120,000,000 shares; issued 82,033,936 and 82,049,542	82.0	82.0
Capital in excess of par value	583.1	580.5
Retained earnings	884.9	855.1
Accumulated other comprehensive loss	(315.0)	(320.5)
Treasury stock at cost	(65.9)	(69.6)
Total Stockholders Equity	1,235.7	1,194.1
Total Liabilities and Stockholders Equity	$ 2,267.1	$ 2,265.2

(Share related information above has been impacted by the two-for-one stock split in the form of 100 percent stock dividend to owners of record on April 30, 2013 and payable on May 15, 2013)

See accompanying notes to unaudited condensed consolidated financial statements

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

A. O. SMITH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months ended March 31, 2013 and 2012

(dollars in millions)

(unaudited)

	Three Months Ended March 31,	
	2013	2012
Operating Activities		
Net earnings	$ 39.0	$ 47.5
Adjustments to reconcile net earnings to cash provided by (used in) operating activities:		
Depreciation and amortization	14.1	13.4
Pension expense	6.9	3.3
Loss on disposal of assets	-	0.1
Gain on sale of investments	-	(27.2)
Net changes in operating assets and liabilities, net of acquisitions:		
Current assets and liabilities	(28.0)	(21.5)
Noncurrent assets and liabilities	4.6	(0.5)
Cash Provided by Operating Activities - continuing operations	36.6	15.1
Cash Used in Operating Activities - discontinued operations	(0.8)	(18.6)
Cash Provided by (Used in) Operating Activities	35.8	(3.5)
Investing Activities		
Capital expenditures	(18.4)	(13.1)
Acquisitions	(6.1)	-
Investment in marketable securities	(31.7)	(60.9)
Net proceeds from sale of securities	83.0	122.9
Cash Provided by Investing Activities	26.8	48.9
Financing Activities		
Long-term debt retired	(15.5)	(143.1)
Common stock repurchases	(3.5)	-
Net proceeds from stock option activity	5.8	8.8
Dividends paid	(9.4)	(7.3)
Cash Used in Financing Activities	(22.6)	(141.6)
Net increase (decrease) in cash and cash equivalents	40.0	(96.2)
Cash and cash equivalents - beginning of period	266.9	463.4
Cash and Cash Equivalents - End of Period	$ 306.9	$ 367.2

See accompanying notes to unaudited condensed consolidated financial statements

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

A. O. SMITH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2013

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2013 are not necessarily indicative of the results expected for the full year. It is suggested that the accompanying condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the company s latest Annual Report on Form 10-K filed with the SEC on February 27, 2013.

Except where otherwise indicated, amounts reflected in the financial statements or the notes thereto relate to the company s continuing operations.

On April 15, 2013, the company s stockholders approved a proposal to increase the company s authorized shares of Common Stock and the company s board of directors declared a two-for-one stock split of the company s Class A Common Stock and Common Stock (including treasury shares) in the form of a one hundred percent stock dividend to stockholders of record on April 30, 2013 and payable on May 15, 2013. All references in the financial statements and footnotes to the number of shares outstanding, price per share, per share amounts and stock based compensation data have been recast to reflect the split for all periods presented.

Certain other prior year amounts have been reclassified to conform to the 2013 presentation.

Recent Accounting Pronouncements

In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment. ASU 2012-02 allows an entity to first assess qualitative factors in determining whether events and circumstances indicate that it is more-likely-than not that an indefinite-lived intangible asset is impaired. If an entity determines that it is not more-likely-than not that the indefinite-lived intangible asset is impaired, then the entity is not required to perform a quantitative impairment test. ASU 2012-02 is effective for the year ending December 31, 2013. The adoption of this ASU will not have an impact on the company s consolidated financial condition, results of operations or cash flows.

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU No. 2013-02 sets requirements for presentation for significant items reclassified out of accumulated other comprehensive income to net income in reporting periods presented. ASU 2013-02 is effective prospectively beginning with the quarter ended March 31, 2013. The adoption of this guidance did not have an impact on the company s financial condition or results of operations but required additional disclosure in the notes to the company s financial statements. The company has complied with the disclosure requirements of ASU 2013-02 for the period ended March 31, 2013.

2. Acquisition

On February 14, 2013, the company acquired 100 percent of the shares of MIM Isitma Sogutma Havalandirma ve Aritma Sistemleri San. Tic. A.S. (MIM), a privately-held Turkish water treatment company. The addition of MIM expands the company s product offerings and gives the company access to Eastern Europe and Black Sea region water treatment markets. MIM is included in the Rest of World segment.

The company paid an aggregate cash purchase price of $6.1 million, subject to a finalization of working capital adjustments and contingent consideration, the fair value of which has been estimated at $1.0 million.

The fair value of the purchase price has preliminarily resulted in an allocation to acquired intangible assets totaling $4.8 million of which $2.0 million has been assigned to customer lists which are being amortized over ten years.

MIM s results of operations have been included in the company s financial statements from February 14, 2013, the date of acquisition. Revenues and pre-tax results associated with MIM included in results of operations in the quarter ended March 31, 2013 are not material to the company s net sales or pre-tax earnings.

3. Restructuring, Impairment and Settlement Expense - Net

In the first quarter 2013, the company announced a move of manufacturing operations from its Fergus, Ontario facility to other North American facilities and recognized $12.7 million of restructuring and impairment expenses, comprised of $5.2 million of severance costs and impairment charges related to long-lived assets totaling $7.5 million and a corresponding $3.2 million tax benefit related to the charge. The company anticipates the transition will be substantially completed by July 1, 2013.

On March 11, 2013, the company entered into a settlement agreement with a former supplier of a North American subsidiary regarding previous overcharges and warranty costs. The terms of the settlement agreement resulted in an $11.0 million cash payment to the company, a pre-tax gain of $11.0 million and a related $4.2 million tax expense.

The following table presents an analysis of the company s restructuring, impairment and settlement reserve as of and for three months ended March 31, 2013 (dollars in millions):

	Severance Costs	Asset Impairment	Settlement Income	Total
Balance at December 31, 2012	$ -	$ -	$ -	$ -
Expense (income) recognized	5.2	7.5	(11.0)	1.7
Asset write-down	-	(7.5)	-	(7.5)
Settlement income	-	-	11.0	11.0
Balance at March 31, 2013	$ 5.2	$ -	$ -	$ 5.2

4. Inventories

	(dollars in millions) March 31, 2013	December 31, 2012
Finished products	$ 78.6	$ 74.4
Work in process	13.0	12.0
Raw materials	101.2	100.0
	192.8	186.4
LIFO reserve	(23.0)	(23.0)
	$ 169.8	$ 163.4

5. Long-Term Debt

The company has a $400 million multi-currency revolving credit agreement with eight banks. The facility expires on December 12, 2017 and has an accordion provision which allows it to be increased up to $500 million if certain conditions (including lender approval) are satisfied. Interest rates on borrowings under the facility are determined in part based upon the company s leverage ratio.

Borrowings under bank credit lines and commercial paper borrowings are supported by the $400 million revolving credit agreement. As a result of the long-term nature of this facility, the commercial paper and credit line borrowings are classified as long-term debt at March 31, 2013.

6. Product Warranties

The company offers warranties on the sales of certain of its products and records an accrual for the estimated future claims. The following table presents the company s warranty liability activity.

	(dollars in millions) Three Months Ended March 31,	
	2013	2012
Balance at January 1	$ 129.6	$ 131.9
Expense	15.0	15.4
Claims settled	(15.7)	(15.3)
Balance at March 31	$ 128.9	$ 132.0

7. Earnings per Share of Common Stock

The numerator for the calculation of basic and diluted earnings per share is net earnings. The following table sets forth the computation of basic and diluted weighted-average shares used in the earnings per share calculations:

	Three Months Ended March 31,	
	2013	2012
Denominator for basic earnings per share - weighted average shares	92,551,062	92,206,386
Effect of dilutive stock options	633,828	770,286

Denominator for diluted earnings per share	93,184,890	92,976,672

Basic and diluted weighted-average shares give effect to a two-for-one stock split payable on May 15, 2013.

8. Stock Based Compensation

The company adopted the A. O. Smith Combined Incentive Compensation Plan (the plan) effective January 1, 2007. The plan is a continuation of the A. O. Smith Combined Executive Incentive Compensation Plan which was originally approved by stockholders in 2002. At the company s annual meeting of stockholders on April 16, 2012 the plan was reauthorized by stockholders and the number of shares available for granting of options or share units at March 31, 2013 was 2,785,974. All share references in this note give effect to a two-for-one stock split payable on May 15, 2013. Upon stock option exercise or share unit vesting, shares are issued from treasury stock.

Total stock based compensation cost recognized in the three month periods ended March 31, 2013 and 2012 was $4.0 million and $2.4 million, respectively.

Stock Options

The stock options granted in the three month periods ended March 31, 2013 and 2012, have three year pro-rata vesting from the date of grant. Stock options are issued at exercise prices equal to the fair value of Common Stock on the date of grant. For active employees, all options granted in 2013 and 2012 expire ten years after date of grant. Options are expensed ratably over the three year vesting period. Stock based compensation cost attributable to stock options in the three month periods ended March 31, 2013 and 2012 was $1.8 million and $1.1 million, respectively. Included in the stock option expense for the three month periods ended March 31, 2013 and 2012 is expense associated with the accelerated vesting of stock option awards for certain employees who either are retirement eligible or become retirement eligible during the vesting period.

Changes in option awards, all of which relate to Common Stock, were as follows for the three months ended March 31, 2013:

	Weighted-Avg. Per Share Exercise Price	Three Months Ended March 31, 2013	Average Remaining Contractual Life	Aggregate Intrinsic Value (dollars in millions)
Outstanding at January 1, 2013	$ 16.72	1,530,734		
Granted	34.96	352,200		
Exercised	13.37	(221,740)		
Forfeited	30.66	(1,866)		
Outstanding at March 31, 2013	21.01	1,659,328	8 years	$ 26.2
Exercisable at March 31, 2013	$ 15.34	957,222	7 years	$ 20.5

The weighted-average fair value per option at the date of grant during the three months ended March 31, 2013 and 2012 using the Black-Scholes option-pricing model was $12.45 and $8.26, respectively. Assumptions were as follows:

8. Stock Based Compensation (continued)

	Three Months Ended March 31,	
	2013	2012
Expected life (years)	6.1	6.2
Risk-free interest rate	2.0%	2.0%
Dividend yield	1.1%	1.4%
Expected volatility	38.4%	39.4%

The expected life is based on historical exercise behavior and the projected exercise of unexercised stock options. The risk free interest rate is based on the U.S. Treasury yield curve in effect on the date of grant for the expected life of the option. The expected dividend yield is based on the expected annual dividends divided by the grant date market value of our common stock. The expected volatility is based on the historical volatility of our common stock.

Restricted Stock and Share Units

Participants may also be awarded shares of restricted stock or share units under the plan. The company granted 141,200 and 167,600 share units under the plan in the three month periods ended March 31, 2013 and 2012, respectively. The share units were valued at $4.9 million and $3.9 million at the date of issuance in 2013 and 2012, respectively, based on the company s stock price at the date of grant and will be recognized as compensation expense ratably over the three-year vesting period. Share based compensation expense attributable to share units of $2.2 million and $1.3 million was recognized in the three month periods ended March 31, 2013 and 2012, respectively. Share based compensation expense recognized in the three month periods ended March 31, 2013 and 2012 included expense associated with accelerated vesting of share unit awards for certain employees who either are retirement eligible or will become retirement eligible during the vesting period.

A summary of share unit activity under the plan is as follows for the three months ended March 31, 2013:

	Number of Units	Weighted-Average Grant Date Value
Issued and unvested at January 1, 2013	469,012	$ 19.37
Granted	141,200	34.58
Vested	(157,732)	13.97
Forfeited/cancelled	(8,550)	27.23
Issued and unvested at March 31, 2013	443,930	$ 25.98

9. Pensions

The following table presents the components of the company s net pension expense.

	(dollars in millions) Three Months Ended March 31,	
	2013	2012
Service cost	$ 2.3	$ 2.0
Interest cost	9.8	10.8
Expected return on plan assets	(15.4)	(17.3)
Amortization of unrecognized loss	10.4	8.0
Amortization of prior service cost	(0.2)	(0.2)
Defined benefit plan expense	$ 6.9	$ 3.3

The company did not make a contribution to its U.S. pension plan in 2012 and does not anticipate making a contribution in 2013.

10. Operations by Segment

The company is comprised of two reporting segments: North America and Rest of World. The Rest of World segment is primarily comprised of China, India and Europe. Both segments manufacture and market comprehensive lines of residential gas, gas tankless and electric water heaters and commercial water heating equipment. Both segments primarily serve their respective regions of the world. The North America segment also manufactures and markets specialty commercial water heating equipment, condensing and non-condensing boilers and water system tanks. The Rest of World segment also manufactures and markets water treatment products, primarily in Asia.

	(dollars in millions) Three Months Ended March 31,	
	2013	2012
Net sales		
North America	$ 378.7	$ 353.3
Rest of World	138.3	124.2
Inter-segment sales	(7.4)	(8.9)
	$ 509.6	$ 468.6
Operating earnings		
North America (1) (3) (4)	$ 54.1	$ 42.2
Rest of World	18.2	14.2
	72.3	56.4
Corporate (expense) income (2) (5)	(13.7)	16.5
Interest expense	(1.5)	(3.0)
Earnings before income taxes	57.1	69.9
Provision for income taxes	18.1	22.4
Earnings from continuing operations	$ 39.0	$ 47.5
(1) Includes non-operating pension costs of:	$ (3.6)	$ (1.0)

(2) Includes non-operating pension costs of:	$ (1.2)	$ (0.6)
(3) Includes settlement income of:	$ 11.0	$ -
(4) Includes restructuring and impairment expense of:	$ (12.7)	$ -
(5) Includes net gain on shares of stock of:	$ -	$ 27.2

11. Fair Value Measurements

The company adopted Accounting Standards Codification (ASC) 820 Fair Value Measurements and Disclosures on January 1, 2008. ASC 820, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring basis or nonrecurring basis. ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on the market approach which are prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

Assets measured at fair value on a recurring basis are as follows (dollars in millions):

Fair Value Measurement Using	March 31, 2013	December 31, 2012
Quoted prices in active markets for identical assets (Level 1)	$ 146.8	$ 197.2
Significant other observable inputs (Level 2)	(0.1)	-
Total assets measured at fair value	$ 146.7	$ 197.2

There were no changes in our valuation techniques used to measure fair values on a recurring basis during the three months ended March 31, 2013.

12. Derivative Instruments

ASC 815 Derivatives and Hedging, as amended, requires that all derivative instruments be recorded on the balance sheet at fair value and establishes criteria for designation and effectiveness of the hedging relationships. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as a part of a hedging relationship and, further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the company must designate the hedging instrument, based upon the exposure hedged, as a fair value hedge, a cash flow hedge, or a hedge of a net investment in a foreign operation.

Equity Collar Contract

On August 22, 2011, the company sold its Electrical Products Company (EPC) to Regal Beloit Corporation (RBC) and received approximately 2.83 million shares of RBC common stock. The RBC share price appreciated in the first quarter of 2011 during which the company entered into an equity collar contract for 50 percent of the RBC shares to protect a portion of that appreciation. The put strike price of the equity collar was $63.29 and the call strike price of the collar was $77.32. The collar did not qualify for hedge accounting and therefore was adjusted to fair value on a quarterly basis through earnings from continuing operations. The mark to market accounting for the RBC shares and hedge continued until the equity collar contract expired in March 2012 with no value.

12. Derivative Instruments (continued)

The company designates that all of its hedging instruments, except for its equity collar contract relating to RBC shares, are cash flow hedges. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (OCI), net of tax, and is reclassified into earnings in the same line item associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings. The amount by which the cumulative change in the value of the hedge more than offsets the cumulative change in the value of the hedged item (i.e., the ineffective portion) is recorded in earnings, net of tax, in the period the ineffectiveness occurs.

The company utilizes certain derivative instruments to enhance its ability to manage currency as well as raw materials price risk and equity investment volatility. Derivative instruments are entered into for periods consistent with the related underlying exposures and do not constitute positions independent of those exposures. The company does not enter into contracts for speculative purposes. The contracts are executed with major financial institutions with no credit loss anticipated for failure of the counterparties to perform.

Foreign Currency Forward Contracts

The company is exposed to foreign currency exchange risk as a result of transactions in currencies other than the functional currency of certain subsidiaries. The company utilizes foreign currency forward purchase and sale contracts to manage the volatility associated with foreign currency purchases, sales and certain intercompany transactions in the normal course of business. Principal currencies include the Canadian dollar, Chinese renminbi, Euro and Mexican peso.

Gains and losses on these instruments are recorded in accumulated other comprehensive loss, net of tax, until the underlying transaction is recorded in earnings. When the hedged item is realized, gains or losses are reclassified from accumulated other comprehensive loss to the statement of earnings. The assessment of effectiveness for forward contracts is based on changes in the forward rates. These hedges have been determined to be effective.

The majority of the amounts in accumulated other comprehensive loss for cash flow hedges is expected to be reclassified into earnings within one year and all of the hedges will be reclassified into earnings no later than December 31, 2014.

The following table summarizes, by currency, the contractual amounts of the company s foreign currency forward contracts.

(dollars in millions)

	March 31,			
	2013		2012	
	Buy	Sell	Buy	Sell
British pound	$ -	$ 1.7	$ -	$ -
Canadian dollar	-	27.5	-	27.4
Chinese renminbi	-	-	5.7	-
Euro	17.2	1.5	12.2	0.9
Mexican peso	16.6			