FIRST FARMERS & MERCHANTS CORP
Form PRER14A
March 25, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

SCHEDULE 14A

(Rule 14a-101)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Amendment No. 1)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement.

Preliminary Proxy Statement.

Confidential, for use of the Commission Only (as permitted by Rule 14a-6(e)(2)).

Definitive Proxy Statement.

Definitive Additional Materials.

Soliciting Material Pursuant to § 240.14a-12.

FIRST FARMERS AND MERCHANTS CORPORATION
(Name of Registrant as Specified in Its Charter)

N/A
(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies: Common Stock, $10 par value per share

(2) Aggregate number of securities to which transaction applies: 113,136

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11(set forth the amount on which the filing fee is calculated and state how it was determined):
$30.25

(4) Proposed maximum aggregate value of transaction: $3,422,364

(5) Total fee paid:
$345

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

FIRST FARMERS AND MERCHANTS CORPORATION

816 South Garden Street,

Columbia, Tennessee 38401

(931) 388-3145

March [•], 2016

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders of First Farmers and Merchants Corporation ("First Farmers" or the "Company") on April 19, 2016 beginning at 11:00 a.m., Central Time, to be held on the 2nd Floor, in the First Farmers and Merchants Bank Northside Office, 901 Nashville Highway, Columbia, Tennessee, 38401.

At the Annual Meeting of Shareholders, you will be asked to consider and vote on a proposal to approve an Agreement and Plan of Merger which provides for the merger of FFMC Merger Corporation, a newly formed, wholly-owned subsidiary of First Farmers, with and into First Farmers, with First Farmers as the surviving entity in what is commonly referred to as a "going private" transaction. The purpose of the merger is to reduce the number of First Farmers' shareholders of record to fewer than 1,200, which will permit First Farmers to suspend filing reports with the Securities and Exchange Commission, eliminating the burden and expense associated with those reports, and eliminate smaller shareholder accounts and the expense of maintaining those accounts.

If the merger agreement is approved and the merger is subsequently completed, shareholders owning fewer than 400 shares of First Farmers common stock (other than shareholders who properly exercise their rights as dissenting shareholders) will receive $30.25 in cash for each share they own as of the effective time of the merger. All other shares will remain outstanding and be unaffected by the merger.

At the Annual Meeting of Shareholders, you will also be asked to consider and vote on the election of 10 individuals to serve as directors of the Company until the Annual Meeting of Shareholders in 2017 or until their successors are qualified and elected.

The board of directors of First Farmers believes that the merger agreement and the election of the nominees as directors are in the best interests of First Farmers and its shareholders and unanimously recommends that you vote FOR approval of the merger agreement and FOR the election of each of the nominees for director. The approval of the merger agreement requires the affirmative vote of the holders of a majority of the outstanding shares of First Farmers common stock and directors are elected by a plurality of the votes cast by the shareholders of First Farmers common stock entitled to vote at the Annual Meeting of Shareholders. Whether or not you plan to attend the Annual Meeting of Shareholders, please complete and return the enclosed proxy card. If you sign, date and return your proxy card without indicating how you want to vote, your proxy will be counted as a vote FOR approval of the merger agreement and FOR approval of the election of the nominees as directors.

The enclosed Proxy Statement gives you detailed information about the Annual Meeting of Shareholders, the merger, the election of the nominees as directors and related matters. You are urged to carefully read the enclosed Proxy Statement, including the considerations discussed under “Special Factors” beginning on page 12, and the appendices to the Proxy Statement, which include the merger agreement. You may also obtain information about First Farmers from documents it has filed with the Securities and Exchange Commission. See “Where You Can Find More Information” on page 68.

As a shareholder of First Farmers, you have the right to dissent from the merger and obtain payment in cash of the fair value of your shares of First Farmers common stock under applicable provisions of Tennessee law. See “Proposal I—Approval of the Merger Agreement—Dissenters’ Rights of Shareholders” and *Appendix C*.

Sincerely,

T. Randy Stevens

Chairman and Chief Executive Officer

FIRST FARMERS AND MERCHANTS CORPORATION
816 South Garden Street, Columbia, Tennessee 38401

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To Be Held on April 19, 2016

To the Shareholders of First Farmers and Merchants Corporation:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of First Farmers and Merchants Corporation ("First Farmers" or the "Company") will be held on the 2nd Floor, in the First Farmers and Merchants Bank Northside Office, 901 Nashville Highway, Columbia, Tennessee, 38401 on April 19, 2016 at 11:00 a.m., Central Time, for the following purposes:

1. To consider and vote upon a proposal to approve the Agreement and Plan of Merger, dated as of February 16, 2016, by and between First Farmers and Merchants Corporation and FFMC Merger Corporation, a Tennessee corporation and wholly-owned subsidiary of First Farmers, pursuant to which FFMC Merger Corporation will merge with and into First Farmers, with First Farmers being the surviving corporation;
2. Election of Directors: Election of the following ten (10) nominees as directors of the Company:

M. Darlene Baxter	Timothy E. Pettus	Brian K. Williams
Jonathan M. Edwards	Patrick J. Riley	Dr. David S. Williams
Thomas Napier Gordon	Matthew M. Scoggins, Jr.	
Dalton M. Mounger	T. Randy Stevens	

3. To transact such other business as may properly come before the annual meeting or any adjournments or postponements thereof.

A list of all shareholders entitled to vote is available for inspection by a shareholder during regular business hours for 10 days prior to the Annual Meeting of Shareholders at the principal offices of First Farmers at 816 South Garden Street, Columbia, Tennessee 38401. This list will be available at the meeting.

This Proxy Statement and the Company's 2015 Annual Report to Shareholders are available at https://materials.proxyvote.com/320148.

Your vote is very important. Whether or not you plan to attend the Annual Meeting of Shareholders, you are urged to vote and submit your proxy by the Internet, telephone or mail in order to ensure the presence of a quorum. If you attend the meeting, you will have the right to revoke your proxy and vote your shares in person.

Shareholders of record may vote:

1. **By Internet: go to www.proxyvote.com; or**

2. **By phone: call 1-800-690-6903 (toll-free); or**

3. **By mail: complete the enclosed proxy card and return it in the postage prepaid envelope provided.**

Shareholders of record at the close of business on February 29, 2016 are entitled to notice of and to vote at the meeting.

By order of the Board of Directors,

Michelle D. Gardner
Corporate Secretary

March [•], 2016

PRELIMINARY COPY

FIRST FARMERS AND MERCHANTS CORPORATION

816 South Garden Street

Columbia, Tennessee 38401

PROXY STATEMENT

ANNUAL MEETING OF SHAREHOLDERS

To Be Held on April 19, 2016

The accompanying proxy is solicited by and on behalf of the Board of Directors of First Farmers and Merchants Corporation ("First Farmers" or the "Company") for use at the Annual Meeting of Shareholders to be held on April 19, 2016, at 11:00 a.m., Central Time, and any adjournment thereof (the "Annual Meeting"). The time and place of the Annual Meeting are set forth in the accompanying Notice of Annual Meeting of Shareholders. All expenses incurred in preparing, printing and mailing the proxy, notices of internet availability and all materials used in the solicitation of proxies will be borne by the Company. In addition to the use of the mail, proxies may be solicited in person or by telephone by directors, officers and other personnel of the Company or its subsidiary, First Farmers and Merchants Bank (the "Bank"), none of whom will receive additional compensation for such services. The Company will also request custodians and nominees to forward soliciting materials to the beneficial owners of the Company's common stock held of record by them and will pay reasonable expenses of such persons for forwarding such material.

PURPOSES OF THE MEETING

The Annual Meeting will be held for the purposes of (i) approving the merger agreement, (ii) electing directors, and (iii) transacting such other business as may properly come before the meeting or any adjournments or postponements thereof.

Pursuant to the merger agreement, FFMC Merger Corporation will merge with and into First Farmers, with First Farmers as the surviving corporation. If shareholders approve the merger agreement and the merger is subsequently completed, shareholders owning fewer than 400 shares of First Farmers common stock, in the aggregate, whether of record or in street name (other than shareholders who properly exercise their rights as dissenting shareholders), will receive $30.25 in cash for each share they own as of the effective time of the merger. All other shares will remain outstanding and be unaffected by the merger. After the merger, First Farmers anticipates that it will have fewer than 1,200 shareholders of record. As a result, First Farmers will be able to terminate its registration under the Securities Exchange Act of 1934, as amended, and suspend its reporting obligations, thereby eliminating the significant expense required to comply with the periodic reporting and related requirements under the Exchange Act.

The merger cannot occur unless the merger agreement is approved by the holders of a majority of the outstanding shares of First Farmers' common stock. As of the record date, the directors and executive officers of First Farmers (13 persons) were entitled to vote 296,001 shares, or 6.2% of the outstanding shares of First Farmers common stock entitled to vote at the Annual Meeting of Shareholders. These shares are expected to be voted for approval of the merger agreement and for the election of all nominees for directors.

QUORUM AND VOTING

At the close of business on February 29, 2016, the Company had 4,739,502 shares of common stock issued and outstanding. Only holders of record of common stock at the close of business on February 29, 2016 are entitled to notice of and to vote on matters that properly come before the Annual Meeting or any adjournment thereof. A shareholder is entitled to one vote at the Annual Meeting for each share of common stock held of record in his or her name, voted in person or by proxy.

The presence in person or by proxy of the holders of a majority of the outstanding shares of common stock entitled to vote at the Annual Meeting is necessary to constitute a quorum at the Annual Meeting or any adjournment thereof. Abstentions and broker non-votes are included for purposes of determining if a quorum exists. Abstentions will not constitute a vote “FOR” or to “WITHHOLD” the shareholder vote for the proposal for election of the nominees as directors presented for shareholder approval at the annual meeting and will be disregarded in the calculation of a plurality or of “votes cast” for such proposal. Because approval of the merger agreement requires the approval of at least a majority of the outstanding shares of common stock entitled to vote, abstentions and broker non-votes have the same effect as if you voted against the merger agreement, unless you attend the Annual Meeting and vote in person. Broker non-votes occur when a broker or nominee returns a proxy but does not have discretionary authority to vote on a particular proposal because the proposal does not concern a routine matter and the broker has not received voting instructions from the beneficial holder. Your broker or other nominee *will not* be able to vote your shares for the merger agreement or the election of directors, or any other matters properly brought before the Annual Meeting, without your specific instruction because these are not considered routine matters For purposes of determining the outcome of any matter as to which a broker or nominee has physically indicated on the proxy that it does not have discretionary authority to vote, those shares will be treated as not entitled to vote with respect to that matter.

If a quorum is not present at the time of the Annual Meeting, the Chairman of the meeting has the power to adjourn the Annual Meeting until a quorum is present or represented by proxy.

If the enclosed proxy is properly executed, returned and not revoked, it will be voted in accordance with the instructions, if any, given by the shareholder. Unless shares are held by a broker, if a proxy is executed and returned but no specification is made, the proxy will be voted "FOR" the merger agreement and "FOR" election of all nominees as directors of the Company. If any other business is properly presented at the meeting, the proxy holders will vote your proxy in accordance with their discretion.

Any shareholder has the power to revoke his or her proxy at any time, prior to the vote being taken at the Annual Meeting, by written notice or subsequently dated proxy received by the Company, or by revocation by the shareholder in person at the Annual Meeting or any adjournment thereof. If you wish to attend the Annual Meeting and need directions to the First Farmers and Merchants Northside Branch in Columbia, Tennessee, please contact Michelle Gardner, the Secretary of the Company, at (931) 388-3145.

Please see "Where You Can Find More Information" on page 68 for additional information about First Farmers on file with the Securities and Exchange Commission.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of this transaction, passed upon the merits or fairness of this transaction, or passed upon the accuracy or adequacy of the information contained in this Proxy Statement. Any representation to the contrary is a criminal offense.

Proxy Statement dated March **[•]**, 2016 and first mailed to First Farmers shareholders

on or about March **[•]**, 2016.

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SUMMARY TERM SHEET

The following summary term sheet, together with the "Questions and Answers" following this summary term sheet, highlight selected information from this Proxy Statement and may not contain all of the information that is important to you. We urge you to carefully read this entire document and the other documents that we refer to in this document. These documents will give you a more complete description of the transaction that we are proposing. We have included page references in this summary to direct you to other places in this Proxy Statement where you can find a more complete description of the matters that we have summarized.

Structure of the Merger (page 37)

The merger agreement provides for the merger of FFMC Merger Corporation with and into First Farmers, with First Farmers surviving the merger. FFMC Merger Corporation is a newly formed Tennessee corporation organized as a wholly owned subsidiary of First Farmers for the sole purpose of facilitating the merger. After the merger, we expect our business and operations to continue as they are currently being conducted. We will continue to operate as a bank holding company and the parent corporation for the Bank, but will no longer file reports with the Securities and Exchange Commission (the "SEC"). We expect to complete the merger in April 2016, although delays could occur.

We have attached the merger agreement to this document as Appendix A. Please read the merger agreement. It is the legal document that governs the merger.

What You Will Receive in the Merger (page 37)

If the merger is completed, shareholders who own fewer than 400 shares of First Farmers common stock in the aggregate, whether of record or in street name by a broker who holds in the aggregate fewer than 400 shares, except for dissenting shares, will receive $30.25 in cash for each share they own as of the effective time of the merger. Shareholders who own 400 or more shares of First Farmers common stock will continue to hold their shares of First Farmers common stock and will not be entitled to receive any cash payment from us upon completion of the merger, except for dissenting shares.

If you are the holder of fewer than 400 shares of our common stock, you must surrender your stock certificates representing your shares in order to receive the cash consideration for your shares. Do not send in your certificates until you receive written instructions regarding the certificate exchange process after the completion of the merger.

Determination of Shares Held (page 37)

A shareholder who owns fewer than 400 shares of First Farmers common stock in the aggregate, whether of record or in street name, will receive $30.25 per share in cash as a result of the merger. A shareholder “of record” is the shareholder whose name is listed on the front of the stock certificate, regardless of who ultimately has the power to vote or sell the shares. Shares held by a broker in “street name” on a shareholder’s behalf are held of record by the broker. Each broker holding less than 400 shares in the aggregate for the account of one or more beneficial holders will receive cash in the merger for those shares held in “street name.” Shares held by the First Farmers and Merchants Bank Profit Sharing Plan will not be affected in the merger or included for purposes of determining which shareholders are to receive cash in the merger.

Under the Securities Exchange Act of 1934, as amended (the Exchange Act) securities registered in substantially similar names where we have reason to believe, because of the address or other indications, that such names represent the same person, may be included as held of record by one person. If a shareholder holds any shares in street name, these shares may not be combined with shares held of record by the same shareholder for purposes of determining the number of shares owned.

There is a risk that the SEC may change its rules regarding shareholder counting with respect to beneficial holders and that First Farmers’ number of record shareholders could be higher than it had anticipated.

Fairness of the Transaction (page 17)

We believe that the merger is fair to our unaffiliated shareholders who will receive cash in the merger and to our unaffiliated and affiliated shareholders who will retain their shares. Our Board of Directors has approved the merger agreement and the transactions contemplated thereby. The Board’s decision is based on several factors, which are summarized beginning on page17. These factors include:

- *Independent Valuation:* According to an independent valuation prepared by Sheshunoff & Co., the “fair value” of our common stock as of December 31, 2015 as that term is used in the Tennessee statute governing dissenters’ rightswas between $28.50 and $30.60 per share.

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- *Opinion of Independent Financial Advisor:* Sheshunoff & Co. has delivered its opinion to our Board of Directors that the $30.25 per share price to be paid in the merger is fair, from a financial point of view, to our shareholders, both those who will receive cash in the merger and those who will retain their shares in the merger. A copy of the opinion is attached as *Appendix B*. See “Special Factors—Opinion of Independent Financial Advisor” on page 19 for additional information.

- *Historical Market Prices of First Farmers Common Stock:* Based on transactions of which we are aware, the low and high sales prices of our common stock over the past two years have ranged from $25.00 to $29.00 per share, with trades during 2015 within that same range. See “Information about First Farmers and its Affiliates— First Farmers Common Stock Purchase and Sale Information” on page 49, and “—Market for Common Stock and Dividends” on page 48 for more specific information regarding prices at which our shares have been sold.

- *Premium to Book Value:* The price per share to be paid in the merger reflects a multiple of 1.22 times our December 31, 2015 book value per share, representing a 21.8% premium over book value.

- *Going Concern Value:* The price per share to be paid in the merger reflects First Farmers’ value as a going concern and was not based on an amount that might be realized in a sale of 100% of our stock, because the merger will not result in a change in control of First Farmers.

- *Earnings Multiple:* The price per share to be paid in the merger reflects a multiple of 14.2 times our earnings per share for the year ended December 31, 2015.

- *Liquidity Event:* The merger will allow our shareholders owning fewer than 400 shares to liquidate their holdings without incurring brokerage costs. The Board believes this provides a benefit to our shareholders, particularly given the limited trading volume for our shares.

In addition, based on the same factors discussed above, each of the other persons who filed the Schedule 13E-3, which consists of each of the directors and executive officers of First Farmers and FFMC Merger Corporation, believe that the merger is fair to First Farmers’ unaffiliated shareholders who will receive cash in the merger and to unaffiliated shareholders who will retain their shares.

Effects of the Merger on Shareholders (pages 25 and 26)

The merger will have various effects on our shareholders:

For shareholders who retain their shares in the merger, these effects include:

- continued ownership of our common stock;

- decreased access to publicly available information about First Farmers;
- a reduction in book value as of December 31, 2015, on a pro forma basis;
- an increase in earnings per share for the year ended December 31, 2015, on a pro forma basis; and
- a slight increase in their respective percentage ownership of our common stock.

For shareholders receiving cash in the merger, these effects include:

- receipt of $30.25 per share in cash, the price determined by our Board;
- loss of their equity and voting interest in First Farmers and loss of the ability to sell their shares at the time and for the price they choose;
- federal income tax liability for any cash received in the merger;
- loss of future dividends; and
- liquidation of their ownership interest in First Farmers without incurring brokerage costs.

Additional Effects of the Merger on Affiliated Shareholders (page 26)

Because of their positions, the directors and executive officers of First Farmers and FFMC Merger Corporation are deemed affiliates engaged in the transaction and are filing persons on the Schedule 13E-3 transaction statement filed by First Farmers and FFMC Merger Corporation in connection with the merger. Our directors and executive officers have no financial interests in the merger that differ from the interests of our unaffiliated shareholders. The merger will, however, have the following additional effects on our directors and executive officers:

- elimination of individual reporting obligations under federal securities laws; and

- potential elimination of a “safe harbor” for dispositions of their shares under federal securities laws.

Effects of the Merger on First Farmers (page 23)

As a result of the merger:

- we will no longer be classified as a public company and will suspend indefinitely our filing of annual and periodic reports and proxy statements with the SEC;

- the number of record shareholders, measured as of February 29, 2016, will be reduced from approximately 2,099 to approximately 1,102, and the number of outstanding shares of our common stock will decrease from 4,739,502 to approximately 4,626,366;

- the percentage of ownership of our common stock beneficially held by executive officers and directors (13 persons) as a group as of February 29, 2016, will increase from 6.2% to approximately 6.4%;

- earnings per share of our common stock for the year ended December 31, 2015, would increase by approximately 2.8% from $2.13 on a historical basis to approximately $2.19 on a pro forma basis;

- total shareholders’ equity as of December 31, 2015, would be reduced from approximately $117.8million on a historical basis by approximately $3.4 million on a pro forma basis, assuming 113,136 shares are cashed out in the merger;

- the book value per share of our common stock as of December 31, 2015, would be reduced from $24.83 per share on a historical basis to approximately $24.71 per share on a pro forma basis, assuming 113,136 shares are cashed out in the merger; and

- the reduction in our shareholders’ equity described above will cause a corresponding decrease in our regulatory capital ratios. Assuming 113,136 shares are cashed out in the merger, our common equity tier 1 capital ratio would decrease from 13.28% as of December 31, 2015, to approximately 12.87% on a pro forma basis; our leverage capital ratio would decrease from 8.87% as of December 31, 2015, to approximately 8.57% on a pro forma basis; our tier 1 capital to risk-weighted assets ratio would be reduced from 13.28% as of December 31, 2015, to approximately 12.87% on a pro forma basis; and our total risk-based capital ratio would decrease from 14.32% as of December 31, 2015, to approximately 13.91% on a pro forma basis.

First Farmers Plans to Continue to Pay Semi-Annual Dividends (page 47)

Following the merger, subject to applicable statutory and regulatory restrictions, First Farmers intends to continue its practice of paying semi-annual cash dividends. For the semi-annual period ended December 31, 2015, First Farmers paid a cash dividend of $0.37 per share. First Farmers expects that because of the projected cost savings, the merger will have no adverse effect on First Farmers' ability to pay cash dividends in the near future.

Conditions to the Completion of the Merger (page 39)

The completion of the merger depends upon the satisfaction of a number of conditions, unless waived, including:

- approval of the merger agreement by the holders of a majority of the outstanding shares of our common stock;
- all of the representations and warranties made in the merger agreement must be true and correct in all material respects as of the effective time of the merger;
- absence of pending or threatened litigation regarding the merger; and
- that the aggregate number of shares to be cashed out in the merger, plus the number of shares held by shareholders who delivered their notice to exercise their rights to dissent from the merger pursuant to the provisions of the Tennessee Business Corporation Act ("TBCA"), does not exceed 350,000 shares.

Material U.S. Federal Income Tax Consequences (page 28)

The receipt of cash in the merger will be taxable for United States federal income tax purposes. You will be treated as either having sold your shares of our common stock for the cash received or as having received the cash as a dividend. In general, your receipt of cash in exchange for your shares of our common stock will be treated as a sale or exchange and you will recognize gain or loss in an amount equal to the cash received less your adjusted tax basis of your shares exchanged for such cash if you actually and constructively own no shares of our common stock immediately after the exchange. If you actually or constructively own shares of our common stock after the exchange, your receipt of cash in exchange for your shares of our common stock may be taxed as a dividend. Shareholders who do not receive cash should not recognize any gain or loss on continuing to hold their shares of First Farmers common stock as a result of the merger.

For a more complete description of the United States federal income tax consequences to you as a result of the merger, please read the discussion under "Special Factors—Material U.S. Federal Income Tax Consequences."

Reasons for the Merger (page 12)

Our principal reasons for effecting the merger are:

- the direct and indirect cost savings of approximately $250,000 per year that we expect to experience as a result of the deregistration of our common stock under the Exchange Act and suspension of our SEC filings; and
- our belief that our shareholders have not benefited proportionately from the costs relating to the registration of our common stock, principally as a result of the thin trading market for our stock.

Dissenters' Rights of Shareholders (page40)

As a shareholder of First Farmers, under the provisions of the TBCA you have the right to dissent from the merger. If the merger is approved by the shareholders and consummated, any shareholder who properly perfects his or her right to dissent to the merger will be entitled to receive an amount of cash equal to the fair value of his or her shares rather than the consideration provided by the merger agreement. Shareholders of First Farmers are cautioned that if they dissent, they may receive a "fair value" that is less than the value received by shareholders cashed out in the merger.

Shares Entitled to Vote and Vote Required (page 35)

Approval of the merger agreement requires the affirmative vote of the holders of a majority of the outstanding shares of our common stock on February 29, 2016, and directors are elected by a plurality of the votes cast by the shares of our common stock entitled to vote at the Annual Meeting. As of the close of business on February 29, 2016, there were 4,739,502 shares of our common stock entitled to notice of and to vote at the Annual Meeting. As of the record date, our directors and executive officers were entitled to vote 296,001 shares, or 6.2% of our outstanding common stock at the Annual Meeting. These shares are expected to be voted for approval of the merger agreement and for approval of the election of the nominees as directors. Accordingly, 2,073,751 shares held by unaffiliated shareholders, or 43.8% of our outstanding common stock, must be voted in favor of the merger agreement in order to approve the transaction.

Effective Time of the Merger (page 38)

The merger will be effective at the date and time specified in the Articles of Merger to be filed with the Secretary of State of Tennessee. As soon as practicable after shareholder approval of the merger agreement, we will file Articles of Merger with the Secretary of State of Tennessee and will send a Letter of Transmittal to all record holders of First Farmers common stock who are entitled to receive cash in the merger. We anticipate that this will occur on or around April 20, 2016, although delays could occur.

Financing of the Merger (page 39)

We estimate that approximately $3.4 million will be required to pay for the shares to be exchanged in the merger and that the expenses related to the merger will be approximately $165,000. We intend to use existing cash generated from our operations to fund the merger. Although it is not anticipated that we will need funds in excess of cash on hand to finance the merger, if additional funds are required, it is likely we will borrow such funds from the Federal Home Loan Bank of Cincinnati.

A WARNING ABOUT FORWARD LOOKING STATEMENTS

Some of the statements contained in this Proxy Statement discuss future expectations, contain projections of our plan of operation or financial condition or state other forward looking information. In this Proxy Statement, forward-looking statements are generally identified by the words such as “anticipate”, “plan”, “believe”, “expect”, “estimate”, and the like. Forward-looking statements involve future risks and uncertainties, there are factors that could cause actual results or plans to differ materially from those expressed or implied. These statements are subject to known and unknown risks, uncertainties, and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and is derived using numerous assumptions. A reader should not place undue reliance on these forward-looking statements, which apply only as of the date of this Proxy Statement. Important factors that may cause actual results to differ from projections include, for example:

- the success or failure of our efforts to implement our plan of operation;
- our ability to fund our operating expenses;
- our ability to compete with other companies that have a similar plan of operation;
- the effect of changing economic conditions impacting our plan of operation;
- changes in the interest rate environment may reduce our interest margins;
- our ability to meet the other risks as may be described in our filings with the SEC;
- deposit attrition, operating costs, customer loss and business disruption may be greater than expected;
- our actual cost savings resulting from the transaction are less than expected or we are unable to realize those cost savings as soon as expected;
- legislative or regulatory changes may adversely affect our businesses; and
- operational risks may occur, including data processing system failures or fraud.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We believe we have chosen these assumptions or bases in good faith and that they are reasonable. However, we caution you that assumptions or bases almost always vary from actual results, and the differences between assumptions or bases and actual results can be material. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this Proxy Statement, any supplement to this Proxy Statement and the documents we have incorporated by reference. We will not update these statements unless the securities laws require us to do so, such as in the event of a material change in information previously disclosed.

QUESTIONS AND ANSWERS

Q: What is the time and place of the Annual Meeting?

A: The Annual Meeting will be held on April 19, 2016, beginning at 11:00 a.m., Central Time, on the 2nd Floor, in the First Farmers and Merchants Bank Northside Office, 901 Nashville Highway, Columbia, Tennessee, 38401.

Q: What are the shareholders being asked to vote upon?

A: At the Annual Meeting, the shareholders are being asked:

- to consider and vote upon a proposal to approve the merger agreement that provides for the merger of FFMC Merger Corporation with and into First Farmers;
- to consider and vote upon a proposal to elect ten individuals to serve as directors of the Company until the annual meeting of shareholders in 2017 or until their successors are qualified and elected; and
- to act on any other matters that may be submitted to a vote at the Annual Meeting or any adjournments or postponements of the Annual Meeting.

Q: What votes are required for approval?

A: Approval of the merger agreement requires the affirmative vote of the holders of a majority of the outstanding shares of our common stock on February 29, 2016, and directors are elected by a plurality of the votes cast by the shares of our common stock entitled to vote at the Annual Meeting. As of this date, there were 4,739,502 shares of our common stock outstanding.

Q: How does the board of directors recommend that I vote?

A: Our board of directors has approved and authorized the merger agreement and recommends that you vote FOR approval of the merger agreement and FOR approval of the election of the nominees as directors.

In considering the recommendation of the Board of Directors, you should be aware that the members of our Board and the executive officers (13 persons) beneficially own approximately 6.2% of the outstanding shares of our common stock as of February 29, 2016, and all of such persons are expected to continue as shareholders and beneficially own approximately 6.4% of our common stock following the merger. Also, our current executive officers and directors will continue as our executive officers and directors following the merger. See “Special Factors—Interests of Executive Officers and Directors in the Merger” and “Information About First Farmers and its Affiliates—Security Ownership of Certain Beneficial Owners and Management.”

Q: What happens if I transfer my shares after the record date?

A: The record date for the Annual Meeting is earlier than the expected date of the merger. Therefore, if you transfer your shares of First Farmers common stock after the record date, but prior to the merger, you will retain the right to vote at the Annual Meeting, but the right to receive any merger consideration will transfer with the shares of our common stock.

Q: What do I need to do now?

A: After you have thoroughly reviewed this Proxy Statement, simply indicate on your proxy card how you want to vote and sign, date and complete your proxy card and mail it in the enclosed envelope so that your shares can be represented at the Annual Meeting. You may also vote by the Internet at www.proxyvote.com or by telephone by calling 1-800-6903.

Q: What happens if I don’t return a proxy card?

A: Because approval of the merger agreement requires the approval of at least a majority of the outstanding shares of our common stock entitled to vote, the failure to return your proxy card has the same effect as if you voted against the merger agreement, unless you attend the Annual Meeting and vote in person. The failure to return your proxy card will not constitute a vote “FOR” or to “WITHHOLD” the shareholder vote for the proposal for election of the nominees as directors presented for shareholder approval at the annual meeting and will be disregarded in the calculation of a plurality or of “votes cast” for such proposal.

Q: May I change my vote after I have mailed my signed proxy card?

A: Yes. Just send by mail a written revocation or a later-dated, completed and signed proxy card before the Annual Meeting or attend the Annual Meeting and notify the Secretary of the Company that you want to vote in person. You may not change your vote by facsimile or telephone.

Q: If my shares are held in "street name" by my broker, how will my shares be voted?

A: Your broker will vote your shares only if you provide instructions on how to vote. You should instruct your broker how to vote your shares, following the directions your broker provides. If you do not provide instructions to your broker, your shares will not be voted, which (i) will have the same effect as a vote against the merger agreement and (ii) will not constitute a vote "FOR" or to "WITHHOLD" the shareholder vote for the proposal for election of the nominees as directors presented for shareholder approval at the annual meeting and will be disregarded in the calculation of a plurality or of "votes cast" for such proposal.

Q: Will my shares held in "street name" or another form of record ownership be combined for voting purposes with shares I hold of record?

A: No. Because any shares you may hold in street name will be deemed to be held by a different shareholder than any shares you hold of record, any such shares will not be combined for voting purposes with shares you hold of record. Similarly, if you own shares in various registered forms, such as jointly with your spouse, as trustee of a trust or as custodian for a minor, you will receive, and will need to sign and return, a separate proxy card for those shares because they are held in a different form of record ownership. Shares held by corporation or business entity must be voted by an authorized officer of the entity, and shares held in an IRA account must be voted under the rules governing the account.

Q: Do I have any rights to avoid participating in the merger?

A: Yes. You have the right to withhold your vote for the merger agreement, dissent from the merger and seek the fair value of your shares as described in "Proposal I: Approval of the Merger Agreement—Dissenters' Rights of Shareholders" beginning on page 42. Shareholders of First Farmers are cautioned that if they dissent, they may receive a "fair value" that is less than the value received by shareholders cashed out in the merger. In order to perfect your right to dissent, you must provide us written notice of your intent to dissent from the merger prior to the Annual Meeting and you must not vote in favor of the merger agreement.

Q: If I am receiving cash in the merger, when will I get my money?

A: After the Annual Meeting and the completion of the merger, we will mail you instructions on how to exchange your stock certificate(s) for cash. After you sign the forms provided and return your stock certificate(s), we will send you your payment.

Q: If I hold shares in street name, how will they be treated in the merger?

A: Any shares you hold in street name will not be added to the number of shares you hold directly in record name in determining the number of shares you hold. Shares held of record by street name holders will be accounted for in the aggregate; a street name holder holding less than 400 shares in all accounts for beneficial holders will be cashed out. The merger agreement has detailed provisions regarding the treatment of shares held in street name. Please read the discussion under "Proposal I: Approval of the Merger Agreement—Conversion of Shares in the Merger" for a description of these provisions generally as well as the terms of the merger agreement.

Q: How will shares held by the First Farmers and Merchants Bank Profit Sharing Plan be treated in the merger?

A: Any shares held by the First Farmers and Merchants Bank Profit Sharing Plan will not be affected by the merger. Because the Plan is counted as a single record holder holding more than 400 shares of First Farmers common stock, the Plan will continue to hold those shares after the merger.

Q: What if I cannot find my stock certificate?

A: The materials we will send you will include an affidavit and indemnity agreement that you will need to sign attesting to the loss of your certificate. First Farmers and its transfer agent will also require that you provide a bond to cover any potential loss to First Farmers.

Q: Who can help answer my questions?

A: If you have additional questions about the merger or the Annual Meeting, you should contact Robert E. Krimmel, Chief Financial Officer and Treasurer, at First Farmers and Merchants Corporation, P.O. Box 1148, Columbia, Tennessee 38402-1148, telephone (931) 388-3145.

SPECIAL FACTORS

Purpose and Reasons for the Merger

The primary purpose of the merger is to enable us to terminate the registration of our common stock under Section 12(g) of the Exchange Act. Although we intend to keep our shareholders informed regarding our business operations and financial results after the merger, we anticipate that such termination will enable us to save significant legal, accounting and administrative expenses relating to our public disclosure and reporting requirements under the Exchange Act. As a secondary matter, it is likely to decrease the administrative expense we incur in servicing a large number of shareholders of record who own relatively small numbers of shares.

Our shares of common stock are registered with the SEC because we have over 1,200 common shareholders of record and more than $10 million in total assets. As a locally owned community bank holding company whose shares are not listed on any exchange or traded on any quotation system, we have incurred the costs associated with being a public company, while not enjoying many of the benefits associated with being a public company.

On April 5, 2012, the Jumpstart Our Business Startups Act (the “JOBS Act”) was enacted, which, among other things, raises the threshold for the number of shareholders that a company must have to be required to register a class of securities. The JOBS Act also raised the threshold number of shareholders that banks and bank holding companies must fall below to deregister their securities under the Exchange Act. Specifically, the JOBS Act amended the Exchange Act to permit banks and bank holding companies to deregister under the Exchange Act if their shares are held by less than 1,200 record holders.

We had approximately 2,099 shareholders of record as of February 29, 2016, but approximately 97.6% of the outstanding shares as of that date were held by approximately 1,102 shareholders of record. As a result, there is a limited market for our shares and our Board of Directors believes there is little likelihood that a more active market will develop. However, because we have more than 1,200 shareholders of record and our common stock is registered under Section 12(g) of the Exchange Act, we are required to comply with the disclosure and reporting requirements under the Exchange Act and the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”). These requirements include preparing and filing current and periodic reports with the SEC regarding our business, financial condition, Board of Directors and management team, having these reports reviewed by outside counsel and independent auditors and documenting our internal controls in preparation for an internal control assessment, the results of which must be filed with the SEC.

After the merger, we intend to keep our shareholders informed about our business operations and financial results by delivering annual audited financial statements and quarterly unaudited financial statements to them. We also plan to post these financial statements on our website at *www.myfirstfarmers.com*, which also contains other information about our business. Moreover, our business operations are primarily conducted through our banking subsidiary, First Farmers and Merchants Bank, which is required to file quarterly financial reports with the Federal Deposit Insurance Corporation (“FDIC”). These reports are available online at *www.fdic.gov*. Further, for a period of 90 days following the filing of a Form 15 with the SEC, we and our shareholders will continue to be subject to certain provisions of the Exchange Act, such as the reporting and short-swing profit provisions of Section 16 and the reporting obligations under Section 13 with respect to certain acquisitions of shares of our common stock.

We are currently required to comply with many of the same securities law requirements that apply to large public companies with substantially greater compliance resources. Our resources are more limited and securities law compliance activities represent a significant administrative and financial burden to a company of our relatively small size and market capitalization. Our efforts to comply with these requirements also cause us to incur less tangible, but nonetheless significant, costs in management time and attention that could otherwise be deployed toward revenue enhancing activities. The cost of compliance is substantial, representing an estimated direct and indirect annual cost to us of approximately $250,000. See page 13 for a detailed break-down of these estimated costs. In light of this expense and the limited trading volume in our common stock, our Board of Directors believes that we and our shareholders receive little relative benefit from being registered under the Exchange Act.

In light of the relatively small benefit we believe our shareholders have received as a result of our status as a public company, we believe the merger will provide a more efficient means of using our capital to benefit our shareholders. As a locally owned community bank holding company whose shares are not listed on any exchange or traded on any quotation system, we have incurred the costs associated with being a public company, while not enjoying many of the benefits associated with being a public company. We determined that the cost savings and reduced burden on management to be achieved by terminating registration of our common stock under the Exchange Act outweighed any potential detriment from terminating such registration.

The merger is designed to substantially reduce the number of our shareholders of record. As of February 29, 2016, we had approximately 997 shareholders who owned fewer than 400 shares of record. By reducing our number of record shareholders to fewer than 1,200, thereby allowing us to terminate our registration under the Exchange Act and suspend our reporting obligations, the merger will result in a reduction of the significant administrative, accounting, and legal expenses incurred in complying with disclosure, reporting and compliance requirements under the Exchange Act and the Sarbanes-Oxley Act.

In addition to relieving us of the administrative burden and costs associated with our public disclosure and otherwise complying with the periodic reporting requirements of the Exchange Act as well as decreasing the expense and burden of dealing with our large number of shareholders holding relatively small positions in our common stock, the merger will also allow us to:

- permit cashed-out shareholders to receive cash for their shares, without having to pay brokerage commissions, at a price that our Board believes to be fair that represents a premium of 4.3% over the most recent sales price reported to us of our common stock prior to announcement of the merger of $29.00 and a premium of 10.8% over the median sales price in the three-month period prior to announcement of the merger of $27.29. If the merger is completed, our executive officers and directors (and all other holders of 400 or more shares) will benefit by a slight increase in their percentage ownership of our common stock and an increase in earnings per share, although the net book value of their holdings will decrease; and

- increase management's flexibility to consider and initiate actions that may produce long-term benefits and growth.

Our Board of Directors considered that some shareholders may prefer to continue as shareholders of a public company. There are certain advantages to being a public company, including potentially a more active trading market and the enhanced ability to use company stock to raise capital or make acquisitions. There is a limited market for our common stock; therefore, a more active trading market has not been of benefit to our shareholders. Another potential advantage of being a public company is the ability to access capital to meet additional capital needs. Since becoming a SEC-reporting company in 1983, however, we have not made any public offerings of common stock or any other equity or debt securities. We used our common stock as consideration for a single acquisition which occurred in 1999.

Nonetheless, the Board believes that the disadvantages of having us continue to be a public company outweigh the advantages of being a public company. The Board has no present intention to raise capital through sales of securities in a public offering or to acquire other business entities using our stock as the consideration for any such acquisition. Accordingly, we are not likely to make use of any advantage that our status as a public company may offer.

We incur significant direct costs attributable to our compliance with the SEC's filing and reporting requirements imposed on public companies. We also incur substantial indirect costs as a result of, among other things, the executive time spent to prepare and review such filings. Although it is impossible to specifically quantify these indirect costs, we estimate that our management and staff spend an average of 4% of their time (equating to approximately 16 days per quarter) on activities directly related to compliance with federal securities laws such as preparing and reviewing SEC-compliant financial statements and periodic reports, maintaining and overseeing our disclosure and internal controls, monitoring and reporting transactions and other data related to insiders' stock ownership and consulting with independent auditors and counsel on compliance matters. Our direct and indirect costs related to being a public company are estimated to approximate $250,000 annually, as follows:

Direct Costs		
Independent registered public accounting firm	$	100,000
SEC counsel		30,000
Accounting/internal controls consulting fees		40,000

Other related services		18,000
Shareholder relations services		15,000
SEC filing service		12,000
Indirect Costs		
Management staff and time	$	35,000
Total Costs	$	250,000

Alternatives Considered

The 400-share level for shareholders to be cashed out was chosen by management and recommended to our Board of Directors based on an analysis of our shareholder list as of September 30, 2015. Because shareholders are free to buy or transfer shares until the effective time of the merger, we expect that some shareholders will acquire additional shares before the effective time through market purchases or other transactions in order to own more than the threshold number of shares and thus remain a shareholder after the merger. Because the number of shareholders above the threshold could increase before the effective time, it was necessary to select a threshold high enough to allow for possible changes in the composition of the shareholder list without defeating the purpose of the proposed transaction.

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In making our determination, we considered other means of achieving the same result, but rejected these alternatives because we believed that the merger would be the means that is most efficient, most cost-effective, and least disruptive to our shareholders and would be most likely to achieve the desired result. These other alternatives considered included:

- **Issuer Tender Offer**. We considered an issuer tender offer to repurchase shares of our outstanding common stock. Because acceptance of the tender offer would be voluntary, the results would be unpredictable and we were uncertain as to whether this alternative would result in participation by a sufficient number of shareholders to accomplish the going private objective. Accordingly, we rejected this alternative.

- **Reverse Stock Split**. We also considered the use of a process known as a reverse stock split as an alternative to the merger. In a reverse stock split, we would reduce the number of issued and outstanding shares of our common stock through an amendment to our charter, so that shareholders owning a certain number of shares would own less than one full share of our common stock, and we would pay cash for the resulting fractional share interests. While the reverse stock split and the merger would both achieve the same objective of reducing the number of shareholders in a predictable manner, we chose the merger because we concluded that a reverse stock split would be disruptive to all of our shareholders and cost us more in that we would have to pay cash to large shareholders for their fractional shares, even though they would remain shareholders after the transaction. We also considered structuring the transaction as a reverse stock split coupled with a forward stock split, but we determined these structures to be too expensive and disruptive to shareholders.

- **Share Reclassification**. In addition, the Board considered a share reclassification, which would involve authorization of a new class of stock and the exchange by certain shareholders of common stock for the new stock. However, the Board rejected this alternative because it would not provide any liquidity for shareholders owning a small number of shares and would not reduce our costs with respect to servicing a large number of shareholders.

- **Stock Repurchase Program**. We currently have in place a stock repurchase program that the Board has authorized the Company to purchase up to 200,000 shares at a market rate through December 31, 2016. Because the stock repurchase plan is voluntary, the Board concluded that it was highly unlikely the Company could acquire shares from a sufficient number of holders through a stock repurchase program to accomplish the Board's objectives.

We did not consider other methods to reduce expenses other than going private because (1) these types of transactions are inconsistent with the narrower purpose of the proposed transaction, which is to discontinue our SEC reporting obligations and (2) we were not aware of other methods of achieving expense reductions that were comparable with those reductions possible through the merger. In addition, we did not consider the possibility of a third-party buyout because we believe that we can best maximize shareholder value by remaining an independent banking organization. Remaining independent will enable us to focus our growth in our target markets and capitalize on our local market presence, which we believe will enhance our earnings.

Other Considerations. In approving and recommending the proposed merger transaction, our directors were aware of potential conflicts of interest, or appearances of conflicts of interest issues. The transaction will result in an increase in the percentage of ownership of all directors and executive officers. As a group, our directors and officers beneficially own approximately 6.2% of the outstanding shares of our common stock and following the effective time of the merger, our directors and executive officers would beneficially own approximately 6.4% of the shares. However, this benefit is shared proportionally by all remaining shareholders. In addition, it is expected that the transaction will, after it is concluded, reduce the risk of litigation and liability to which directors and officers of public companies are exposed.

While the foregoing narration of the factors considered by our Board of Directors is intended to discuss in reasonable detail the material factors on which the Board relied, it does not necessarily reflect all factors involved in the process. In view of the variety of factors considered in connection with the Board's evaluation of the merger proposal, we did not find it practicable to quantify or otherwise assign relative weights to the specific factors considered in reaching our determination. We considered all the factors as a whole in reaching our determination. In addition, individual members of our Board of Directors may have given different weights to different factors.

The merger proposal is being made at this time because the sooner the proposal can be implemented, the sooner we will cease to incur the expenses and burdens associated with the reporting requirements of the Exchange Act and the sooner shareholders who are to receive cash in the merger will receive and be able to reinvest or otherwise make use of such cash payments. We determined that the merger proposal was the best choice for the shareholders and us. We estimate that following the proposed merger approximately 1,102 shareholders of record will remain, which will leave us comfortably below the maximum of 1,200 shareholders of record necessary to terminate our registration under the Exchange Act and no longer be subject to the related reporting requirements.

Background of the Going Private Merger Proposal

First Farmers was incorporated under the laws of the State of Tennessee in 1982 to serve as the bank holding company for First Farmers and Merchants Bank, which was chartered as a bank in 1909.

As of December 31, 2015, there were 4,739,502 shares of First Farmers common stock issued and outstanding held by 2,099 record holders. Approximately 991 of these record shareholders held fewer than 400 shares (not including beneficial owners whose shares may be registered in "street" name). Collectively, these 991 record holders own an aggregate of approximately 112,491 shares, representing approximately 2.4% of our issued and outstanding shares. Additionally, based on available information, we estimate that approximately 645 shares are held in street name by brokers or other nominees who each hold in the aggregate fewer than 400 shares of our common stock. These shares will also be cashed out in the merger.

Our common stock has never traded on a national securities exchange and we have filed reports under the Exchange Act since 1983. These reports include: annual, quarterly and current reports presenting and analyzing our business, financial condition, results of operations and management structure; ongoing reports regarding insiders' stock transactions and potential short-swing profit liability; and proxy statements disclosing information about our directors and executive officers, their compensation and our corporate governance process. Although we have been subject to public reporting obligations since 1983, the costs of meeting all legal and accounting requirements for maintaining our status as a public company have grown significantly, particularly after passage of the Sarbanes-Oxley Act in 2002. As a result of a number of changes in federal law and regulations, we have become subject to heightened compliance and documentation requirements in a variety of areas, including disclosure and internal controls, internal and external audit relationships, and the duties and qualifications of our Board committees. We have also become subject to accelerated and expanded disclosure requirements relating to our corporate and trading activities. As a result of these new requirements, our cost of compliance has increased, particularly relative to our limited personnel resources and market capitalization. See "—Purpose and Reasons for the Merger" on page 12. Since becoming a public reporting company, however, we have not raised any capital through the issuance of equity or debt securities in public markets and have only used our common equity as acquisition currency in a single business combination that closed in 1999.

Before passage of the JOBS Act in April 2012, our senior management and Board of Directors began to discuss generally the relative benefits and costs, both direct and indirect, relating to continuing our status as a public company. The Board authorized a committee comprised of certain independent Board members and members of our senior management team to review First Farmers' options and to make recommendations to the Board as to alternatives. This committee considered the pros and cons of listing First Farmers' common stock on a national securities exchange, establishing an Employee Stock Ownership Plan, implementing a stock repurchase program, and effecting various "going private" strategies such as a reverse stock split, a recapitalization and an issuer tender offer. This effort was eventually abandoned, because a "going private" transaction prior to the JOBS Act would have had a larger impact on First Farmers' shareholder base (5,330,000 shares held by more than 2,200 record holders at the end of 2011) and capital position than the currently proposed transaction. The JOBS Act increased the number of record holders that bank holding companies can have before being required to file reports with the SEC from 300 to 1,200.

In July 2012 a newly formed Board committee (the Corporate Vision Committee) consisting of Board members Dalton Mounger, Jonathan Edwards and Lacy Upchurch was formed to consider various options to decrease the costs and management time associated with Exchange Act compliance in a post-JOBS Act environment. The Corporate Vision Committee consulted with outside legal counsel and other parties as to the advantages and disadvantages as well as the possible methods First Farmers could use to eliminate the burden of First Farmers' status as a public reporting company. This Committee explored the possibility of implementing a reverse stock split, then considered a cash merger, which would have applied to all holders of less than 1,000 shares, a threshold that would take the number of record holders below 1,200 with a reasonable cushion to absorb fluctuations in the record holder count. This transaction as proposed would have affected approximately 1,500 record holders owning approximately 423,000 shares. After considering this and other information provided by outside counsel, the Corporate Vision Committee recommended to the Board at a meeting on June 18, 2013, that First Farmers not proceed with a going private transaction at that time due to the number of shares that would need to be purchased and the number of record holders impacted. The Corporate Vision Committee was then dissolved.

In the second quarter of 2015, senior management began to re-evaluate the expense and burden of First Farmers' status as a public company against any benefits it was getting from this status. Management concluded that any benefits First Farmers received as a result of SEC registration was far outweighed by the expense and burden of being a public company. Management reviewed First Farmers' history and determined that, since becoming a public reporting company, First Farmers had not raised any capital through the issuance of equity or debt securities in public markets and had only used common equity as acquisition currency in a single business combination. After weighing the disadvantages of remaining public against the advantages, management consulted with outside legal counsel and other third parties and concluded that a going private transaction through a cash merger would be desirable. In addition, senior management examined the shareholder list of First Farmers to evaluate the effects of various cash-out thresholds.

At a Board meeting on October 27, 2015, First Farmers' senior management presented a report regarding its recommendation as to the appropriate cash-out threshold and on the costs and benefits of proceeding with a going private transaction. Management reported to the Board that management had considered the four alternative structures described under "Alternatives Considered" on page 15 in addition to the merger proposal, but determined that the merger proposal was the best choice for First Farmers and its shareholders. At that meeting, the Board authorized management to proceed with any additional steps necessary to bring this proposal to the point where it could be considered and voted upon. As a result, senior management selected Sheshunoff & Co. to prepare an initial "fair value" report for presentation at the November board meeting. Sheshunoff & Co. was selected based on senior management's prior experience with this firm, which includes prior consulting engagements on behalf of First Farmers, attendance by senior management at various conferences sponsored by Sheshunoff & Co. and its general reputation in the financial services industry.

Sheshunoff & Co. delivered a report dated November 17, 2015 on the “fair value” of First Farmers common stock as that term is described in the dissenters’ rights provisions of the Tennessee Business Corporation Act. Sheshunoff & Co.’s valuation indicated that the fair value of First Farmers common stock was between $28.25 and $29.30 per share. Sheshunoff & Co.’s report provided a detailed explanation of the financial analyses supporting the value. At a Board meeting held on November 17, 2015, members of senior management of First Farmers described to the Board their discussions with Sheshunoff & Co. and presented the preliminary “fair value” determination by Sheshunoff & Co. Management also described the additional steps it had taken since the October 27, 2015 meeting to prepare the merger proposal to be considered and voted upon by the Board. The Board then renewed its discussions as to whether it was in the best interests of First Farmers and its shareholders to engage in the going private transaction. Legal counsel apprised the Board members of their duties under Tennessee law in making this determination. Barry White, First Farmers General Counsel, reviewed the resolutions authorizing a going private transaction as proposed by management, following which the Board unanimously approved the going private transaction by means of a merger transaction and authorized the retention of Sheshunoff & Co. to serve as First Farmers' financial advisor based on the recommendation of senior management and Sheshunoff & Co.’s reputation as a nationally recognized investment banking firm with substantial expertise in transactions similar to the proposed transaction. The Board selected Sheshunoff & Co. based on its experience in rendering valuations and fairness opinions, its knowledge of the financial services industry and the business of First Farmers, and the overall terms, including fees, of the engagement. The Board also considered that Sheshunoff & Co. completes over 100 bank stock appraisals annually for public and private financial institutions with total assets ranging from $20 million to $9.6 billion.

In determining the number of shares a shareholder needed to own in order to remain a shareholder after the merger, the Board’s primary consideration was how best to achieve the goal of becoming a private company while cashing out the fewest number of shareholders. The Board selected 400 shares as the minimum number of shares required to remain as a shareholder because it provided a sufficient cushion in order to ensure that, after completion of the merger, the number of record shareholders would be less than the 1,200 shareholder limit necessary to terminate our registration under the Exchange Act, while at the same time providing that a relatively small number of shares (estimated at approximately 114,464, or 2.4% of our outstanding shares at the time of the meeting) would be cashed out in the proposed merger.

At its December 15, 2015 meeting, the Board discussed the possibility that our number of shareholders of record could increase following the merger as a result of certain share transfers, whether by sale, gift or otherwise. Under the provisions of the Exchange Act, if, after completion of the merger, the number of our shareholders of record did increase to 1,200 or greater, then we would be required to resume our reporting obligations under the Exchange Act. At this meeting, the Board discussed and approved management’s recommendation to continue the stock repurchase program in 2016 to help us control any potential future increases in the number of our record shareholders to enable us to avoid becoming subject to the reporting requirements under the Exchange Act in the future and to provide some potential for liquidity to our remaining shareholders after completion of the merger.

On February 16, 2016 Sheshunoff & Co. delivered to the Board of Directors its updated report based on year end 2015 preliminary numbers, on the “fair value” of First Farmers common stock. Sheshunoff & Co. reported that the fair value of First Farmers common stock was between $28.50 and $30.60 per share. Sheshunoff’s & Co. report provided the Board with a detailed explanation of the financial analyses supporting the range.

At the February 16, 2016 Board meeting, outside legal counsel advised the Board with respect to certain matters related to the transaction, including possibly forming an independent committee comprised of independent members of the Board to review and evaluate the proposed transaction on behalf of the shareholders as well as possibly structuring the transaction to include “neutralized voting,” whereby separate approval by a majority of those shareholders who are not executive officers or directors of First Farmers would be required in order to consummate the transaction. Following discussion, the Board unanimously determined not to form an independent committee to evaluate the proposed transaction because a majority of our Board of Directors is comprised of independent members and all of the directors (including all of our independent directors) held an interest in the transaction as shareholders who owned at least 400 shares of common stock. The Board also unanimously determined not to offer neutralized voting because the executive officers and directors own a relatively small amount of the outstanding common stock (6.2%) and because a neutralized voting requirement would usurp the power of the holders of all our outstanding shares to consider and approve the merger agreement as provided under Tennessee law, our charter documents and the terms of the merger agreement. We also considered such provision unnecessary in light of the rights of shareholders, whether affiliated or unaffiliated, to dissent from the merger under Tennessee corporate law, regardless of the number of shares that they own. While the Board of Directors believes that this procedural safeguard was not necessary in rendering its determination, the Board did consider that the members of the Board and our executive officers beneficially own approximately 6.2% of our outstanding common stock and would beneficially own an increased percentage following the merger. However, because affiliated and unaffiliated shareholders are treated identically under the terms of the transaction as proposed, the Board did not believe that this procedural safeguard was a necessary measure.

Outside legal counsel also reviewed in detail with the Board the definitive merger agreement and all related documents, copies of which were delivered to each director before the date of the meeting. After a discussion of these factors, and Sheshunoff & Co.'s February 16, 2016 valuation report, our Board of Directors, including the independent directors, unanimously approved the merger agreement pursuant to which shareholders owning fewer than 400 shares would receive cash for their shares of our common stock. Given the involuntary nature of the merger and the fact that the low and high sales prices of our common stock over the past two years have ranged from $25.00 to $29.00 per share, with trades during the last three months of 2015 ranging from $26.50 to $29.00, the Board set the cash-out price at $30.25. The Board also made a determination that the merger was fair, from a financial and procedural point of view, to our affiliated and unaffiliated shareholders receiving cash under the merger agreement and to our affiliated and unaffiliated shareholders retaining their shares, and directed that the merger agreement be submitted to the shareholders with a recommendation for approval.

On February 16**,** 2016, Sheshunoff & Co. also delivered its preliminary oral opinion to the Board stating that the $30.25 per share price to be paid in the merger was fair, from a financial point of view, to our shareholders, both those who will receive cash and those who will retain their shares in the merger. (See "—Opinion of Independent Financial Advisor"). In rendering its opinion, Sheshunoff & Co. reviewed, among other things, its written valuation report dated February 16**,** 2016. The written opinion was dated February 23, 2016, approximately one week later than the valuation report, because Sheshunoff & Co. could not prepare an opinion as to the fairness of the $30.25 per share cash out price until the Board established the cash-out price, which, as described above, did not occur until the February 16, 2016 Board meeting.

Recommendation of the Board of Directors; Fairness of the Merger Proposal

The structure and terms of the merger were determined by our current management and our Board of Directors. Our Board of Directors currently consists of ten (10) persons, eight (8) of whom are independent directors and two (2) of whom are officers of First Farmers or the Bank. We retained Sheshunoff & Co., an independent financial advisor experienced in the financial analysis of and valuation of financial institutions, to value our common stock. The cash consideration to be paid for our common stock under the merger was determined by us, based, in part, on Sheshunoff & Co.'s valuation report.

After considerable discussion, our Board of Directors unanimously determined and believes that the merger agreement is in the best interests of us and our shareholders. In reaching its conclusion, our Board of Directors also determined that the transaction is in the best interests of and substantively fair to shareholders who will receive cash in the merger as well as those shareholders who will retain their shares of common stock after the merger. Our Board of Directors also believes that the process by which the transaction was approved is fair to all of our shareholders, including unaffiliated shareholders receiving cash in the merger and unaffiliated shareholders who will retain their shares after the merger. Further, our Board unanimously approved the merger agreement, which included the $30.25 per share price to be paid to shareholders whose shares are cashed out in the merger. All of the members of our Board of Directors and our executive officers have expressed an intention to vote in favor of the merger agreement for the reasons described below. As of February 29, 2016, our directors and executive officers (13 persons) owned a total of 296,001 shares of our common stock, or approximately 6.2% of the total shares entitled to vote at the Annual Meeting. Accordingly, only the approval of shareholders owning an additional 2,073,751 shares is necessary for the approval of the merger agreement.

Our Board of Directors considered a number of factors in deciding to approve the merger agreement. The Board's primary reason for effecting the merger is to accomplish the going private transaction so that our shares will no longer be registered under the Exchange Act. We considered the views of management and that cost savings of approximately $250,000 per year could be achieved if we terminated the registration of our common stock under the Exchange Act, including indirect savings resulting from reductions in the time and effort currently required of management to comply with the reporting and other requirements associated with continued registration of our common stock under the Exchange Act. We also considered the effect that terminating the registration of our common stock would have on the market for our common stock and the ability of shareholders to buy and sell shares. As a locally owned community bank holding company whose shares are not listed on any exchange or traded on any quotation system, we have incurred the costs associated with being a public company, while not enjoying many of the benefits associated with being a public company. We determined that the cost savings and reduced burden on management to be achieved by terminating registration of our common stock under the Exchange Act outweighed any potential detriment from terminating such registration.

We considered numerous factors in reaching our conclusion as to the fairness of the merger to all of our shareholders, including the effects described under "—Effects of the Merger on First Farmers" on page 23, "—Effects of the Merger on Shareholders Generally" on page 25, "—Effects of the Merger on Affiliated Shareholders" on page 26 and "—Purposes and Reasons for the Merger" on page 12. The Board also reviewed the federal income tax and pro forma financial effects of the merger on us and our shareholders. We did not assign any specific weights to the factors listed below. Moreover, in their considerations individual directors may have given differing weights to different factors. The average tenure on the Company s board of directors is ten years and each member of the Company s board is familiar with the community banking industry. In addition, management of the Company provides the board with industry comparable information on at least a quarterly basis. The information includes earnings and stock prices of peer banks from which earning multiples are derived. In addition, during each of the last two years, Shesnunoff & Co. provided the Company s board with an independent third party report with industry comparable information, which included earnings and stock prices of peer banks.

- **Opinion of Independent Financial Advisor**. Our Board of Directors considered the presentation dated February 16, 2016 of Sheshunoff & Co. giving an updated valuation report as of December 31, 2015, as well as the written fairness opinion dated February 23, 2016, to the effect that, as of the date of such opinion and based upon and subject to certain matters stated therein, the cash consideration to be paid in the merger is fair, from a financial point of view, to all our shareholders, including unaffiliated shareholders who will receive cash in the merger as well as those shareholders who will retain their shares after the merger. The Board of Directors also reviewed and considered the financial analyses supporting the opinion of the financial advisor. You should read the discussion under "—Opinion of Independent Financial Advisor" and the copy of the opinion of Sheshunoff & Co., which is attached as *Appendix B* to this Proxy Statement.

- **Historical Market Prices of Our Common Stock**. Based on transactions of which we are aware, the low and high sales prices of our common stock over the past two years have ranged from $25.00 to $29.00 per share, with trades during the last three months of 2015 ranging from $26.50 to $29.00. You should read the discussion under "Information About First Farmers and its Affiliates—Market for Common Stock and Dividends" for more information about our stock prices. Based upon the limited trading history and the prices of our common stock prior to the public announcement of the merger, the Board of Directors believes that the price of $30.25 is fair to all of our shareholders.

- **Premium to Book Value**. As of December 31, 2015, our book value per share was $24.83. Although book value was a factor that was considered by our Board of Directors, among others, in determining the consideration to be paid to cashed-out shareholders in the merger, our Board of Directors determined that it was not directly relevant because it was the Board's view that our value as a going concern is greater than our book value. However, the Board of Directors noted that the per share cash price of $30.25 payable in the merger reflected a multiple of 1.22 times our $24.83 book value per share.

- **Going Concern Value**. In determining the cash amount to be paid to cashed-out shareholders in the merger, our Board of Directors valued our shares on the basis of a going concern, without giving effect to any anticipated effects of the merger. Also, the Board of Directors did not consider the amount per share that might be realized in a sale of 100% of our stock, as our Board of Directors determined that consideration of such an amount was inappropriate in the context of a transaction that would not result in a change of control of First Farmers. In determining the going concern value of our shares, the Board of Directors adopted the analyses and conclusions of our financial advisor, which are described under "—Opinion of Independent Financial Advisor".

- **Earnings Multiple**. Our Board of Directors reviewed our earnings for the previous three years. For the three years ended December 31, 2015, 2014 and 2013, we reported net income of approximately $10,306,000, $10,242,000 and $9,611,000, respectively. The price per share to be paid in the merger reflects a multiple of 14.2 times our earnings per share for the year ended December 31, 2015. From time to time, members of First Farmers' Board of Directors and management receive financial information from a variety of sources, including earnings and stock prices for peer banks in its market area from which earnings multiples are determined. Based on the Board's knowledge of the community banking industry in First Farmers' market, the Board believes that the price to be paid in the merger reflects a reasonable multiple to its earnings for the year ended December 31, 2015. Therefore, the Board viewed the earnings multiple as a factor, among others, which supported its decision to approve the merger agreement and its conclusion as to the fairness of the merger to unaffiliated shareholders, both those receiving cash for their shares and those retaining their shares following the merger.

- **Liquidity Event**. Our Board of Directors considered the opportunity that the merger presents for shareholders owning fewer than 400 shares to liquidate their holdings without incurring brokerage costs, particularly given the limited trading volume for shares of our common stock at a price that represents a premium over historical sales prices.

We also recognized that the merger consideration to be paid to the cashed-out shareholders in the merger reflected a premium over the purchase prices for our common stock prior to the announcement of the merger.

The Board of Directors also considered historical prices paid by First Farmers to repurchase its shares. Since January 1, 2014, we have repurchased a total of 281,510 shares at purchase prices ranging from $25.00 to $29.00 in negotiated transactions.

The Board of Directors did not consider transactions in our common stock which occurred following the announcement of the merger. Additionally, certain of our directors and executive officers have engaged in transactions involving shares of our common stock in the two years prior to the announcement of the going private transaction. The Board of Directors considered these trades, along with trades by unaffiliated shareholders, in its review of the historical prices of our common stock. Because the transactions in our common stock by directors and executive officers were effected in the same manner as were, to management's knowledge, trades by unaffiliated shareholders, the Board of Directors did not distinguish between transactions in our common stock involving our directors and executive officers and those involving unaffiliated shareholders.

Although it is quite rare for an insured depository institution to go into voluntary liquidation, the base valuation technique that relates to our book value is, for the most part, an assumed liquidation value. Because the price to be paid to the cashed-out shareholders in the merger is in excess of our book value and because we will continue to operate our business following completion of the merger, we did not consider our liquidation value an important factor in determining the fairness of the merger.

No firm offers have been made by an unaffiliated person during the preceding two years for (1) the merger or consolidation of us into or with such person, (2) the sale or other transfer of all or any substantial part of our assets or (3) the purchase of a number of shares of our common stock that would enable the holder thereof to exercise control of us.

The transaction is not structured so that approval of at least a majority of unaffiliated shareholders is required. Our Board determined that any such voting requirement would usurp the power of the holders of a majority of our outstanding shares to consider and approve the merger agreement as provided under Tennessee law, our charter documents and the terms of the merger agreement. We also considered such a provision unnecessary in light of the rights of shareholders, whether affiliated or unaffiliated to dissent from the merger pursuant to Tennessee corporate law, regardless of the number of shares they own. See “Proposal I: Approval of the Merger Agreement—Dissenters’ Rights of Shareholders.”

A majority of our Board of Directors is comprised of independent members, and, accordingly, there was no need to form a special committee or retain any unaffiliated representative(s) to represent unaffiliated shareholders, as our Board of Directors was able to adequately balance the competing interests of the non-continuing shareholders and the continuing shareholders in accordance with their fiduciary duties. Although all of the members of our Board of Directors own more than 400 shares of our common stock, the 400 share cutoff set in the merger agreement was determined without regard to the directors’ share ownership. As this represented the sole potential conflict of interest and the Board members will be treated identically to all other shareholders in the merger, we did not feel that any additional protections that may be afforded by a special committee would be significant. See “Special Factors—Interests of Executive Officers and Directors in the Merger” and “Special Factors—Conduct of First Farmers’ Business After the Merger.”

We have not made any provision in connection with the merger to grant unaffiliated shareholders access to our corporate files or to obtain counsel or appraisal services at our expense. With respect to unaffiliated shareholders’ access to our corporate files, we determined that this Proxy Statement, together with our other filings with the SEC, provide adequate information for unaffiliated shareholders to make an informed decision with respect to the merger. We also considered the fact that under Tennessee corporate law, and subject to certain conditions set forth under Tennessee law, shareholders have the right to review our relevant books and records of account. We did not consider these steps necessary to ensure the fairness of the merger proposal. We determined that such steps would be costly and would not provide any meaningful additional benefits. We noted the fact that the financial advisor engaged by us considered and rendered its opinion as to the fairness, from a financial point of view, of the consideration payable in the merger to our shareholders, including shareholders who will receive cash in the merger and those who will retain their shares after the merger.

After consideration of the factors described above, the Board believes that the transaction is substantively fair, notwithstanding the absence of such an unaffiliated shareholder approval requirement, independent committee or unaffiliated representative. The Board also believes that the transaction is procedurally fair because, after consideration of all aspects of the proposed transaction as described above, all of the directors, including all of the members of the Board who are not employees of First Farmers, approved the merger and the merger agreement.

Determination of Fairness by Merger Subsidiary and Filing Persons

The merger subsidiary was formed for the purpose of facilitating the going private transaction. Its sole shareholder is First Farmers and its directors are T. Randy Stevens, the Chairman and Chief Executive Officer of First Farmers, and Brian K. Williams, the President of First Farmers. Under certain applicable rules and regulations promulgated by the SEC, our directors and executive officers are deemed to be “filing persons” for the purposes of the going private transaction. As a result, each filing person is required to state whether he or she reasonably believes that the transaction is fair to unaffiliated security holders. The filing persons consist of the following individuals: M. Darlene Baxter, Jonathan M. Edwards, Thomas Napier Gordon, Dalton M. Mounger, Timothy E. Pettus, Patrick J. Riley, Matthew M. Scoggins, Jr., T. Randy Stevens, W. Lacy Upchurch, Brian K. Williams, Dr. David S. Williams, Barry B. White, and Robert E. Krimmel (collectively, the “Filing Persons”).

In forming their belief as to the fairness of the transaction to the unaffiliated shareholders, the merger subsidiary and each of the Filing Persons relied upon the factors considered by and have expressly adopted the analysis and conclusions of the Board of Directors of First Farmers, including the analyses performed and opinion delivered by Sheshunoff & Co. See "—Recommendation of the Board of Directors; Fairness of the Merger Proposal." Based on those factors, the merger subsidiary and each of the Filing Persons reasonably believes that the merger agreement and the process by which the transaction was approved are fair to each of the unaffiliated shareholders, including those who will receive cash in the merger and those who will retain their shares of common stock. Neither the merger subsidiary nor any of the Filing Persons have received any report, opinion or appraisal from an outside party that is materially related to the merger other than the report of Sheshunoff & Co. The belief of each of the Filing Persons is their individual belief and does not constitute investment advice. If shareholders are unsure of whether to vote in favor of the merger agreement, they should consider the recommendation of the Board of Directors or consult with their personal financial advisor.

During the last five years, neither FFMC Merger Corporation nor, to its knowledge, any of its directors or executive officers has been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) or was a party to a civil proceeding of a judicial or administrative body of competent jurisdiction as a result of which any such person was or is subject to a judgment, decree, or final order enjoining further violations of, or prohibiting activities subject to, federal or state securities laws or finding any violation of those laws. Each executive officer and director of First Farmers is a citizen of the United States of America. In addition, during the last five years, neither First Farmers nor, to its knowledge, any of its directors or executive officers has been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) or was a party to a civil proceeding of a judicial or administrative body of competent jurisdiction as a result of which any such person was or is subject to a judgment, decree, or final order enjoining further violations of, or prohibiting activities subject to, federal or state securities laws or finding any violation of those laws. Each executive officer and director of First Farmers is a citizen of the United States of America.

Opinion of Independent Financial Advisor

Our Board of Directors retained Sheshunoff & Co. as its financial advisor in connection with the merger because Sheshunoff & Co. is a nationally recognized investment banking firm with substantial expertise in transactions similar to the proposed transaction and is familiar with us and our business. As part of its investment banking activities, Sheshunoff & Co. is regularly engaged in the independent valuation of financial institutions and securities in connection with mergers, acquisitions, underwritings, sales and distributions of listed and unlisted securities, private placements and valuations for estate, corporate and other purposes.

Sheshunoff & Co. reported to our Board of Directors on February 16, 2016, that the fair value of the outstanding common stock of First Farmers was within a range of $28.50 to $30.60 per share and that the merger consideration of $30.25 per share is fair, from a financial point of view, to our shareholders that will be cashed out and to our shareholders that will remain following the merger. A copy of Sheshunoff & Co.'s opinion dated February 23, 2016 is attached as *Appendix B* to this Proxy Statement and should be read in its entirety.

No limitations were imposed by our Board of Directors upon Sheshunoff & Co. with respect to the investigations made or procedures followed in rendering its opinion. Sheshunoff & Co.'s fairness opinion is based on the financial analysis described below. Sheshunoff & Co.'s fairness opinion is directed to our Board of Directors and addresses only the fairness, from a financial point of view, of the merger consideration to the shareholders of First Farmers. Sheshunoff & Co.'s fairness opinion is not intended to be and does not constitute a recommendation to any shareholder as to how such shareholder should vote with respect to the proposed transaction. Sheshunoff & Co.'s fairness opinion does not address our underlying business decision to proceed with the proposed transaction.

In arriving at its opinion, Sheshunoff & Co. reviewed and analyzed, among other things, the following:

- a draft of the Agreement and Plan of Merger;
- our annual reports on Form 10-K for the years ended December 31, 2014, December 31, 2013 and December 31, 2012;
- our quarterly reports on Form 10-Q for the quarters ended September 30, 2015, June 30, 2015 and March 31, 2015;
- certain other information relating to us, including financial forecasts provided to Sheshunoff & Co. or discussed with Sheshunoff & Co. by us and information from meetings with our management to discuss past and current operations, financial condition and prospects, as well as the results of regulatory examinations;
- Operating results of banks headquartered in Tennessee with total assets between $500 million and $5 billion;
- the trading activity for our common stock;

- operating results of selected publicly traded banking institutions;
- the Tennessee Code definition of fair value provided by First Farmers General Counsel;
- the present value of the after-tax cash flows based on five year projections on a stand-alone basis;
- the market price of selected publicly traded banking institutions; and
- certain other information, financial studies, analyses and investigations and financial, economic and market criteria which Sheshunoff & Co. deemed relevant.

In conducting its review and in rendering its opinion, Sheshunoff & Co. relied upon and assumed the accuracy and completeness of the financial and other information provided to it or publicly available, and did not attempt to independently verify the same. Sheshunoff & Co. relied upon our management as to the reasonableness of the financial and operating forecasts and projections (and the assumptions and bases therefor) provided to it, and Sheshunoff & Co. assumed that such forecasts and projections reflect the best currently available estimates and judgments of our management.

We do not publicly disclose internal management forecasts, projections or estimates of the type furnished to Sheshunoff & Co. in connection with its analysis of the financial terms of the proposed transaction, and such forecasts and estimates were not prepared with a view towards public disclosure. These forecasts and estimates were based on numerous variables and assumptions which are inherently uncertain and which may not be within the control of management, including without limitation, the general economic, regulatory and competitive conditions. Accordingly, actual results could vary materially from those set forth in such forecasts and estimates.

Sheshunoff & Co. did not make an independent evaluation of the assets or liabilities (including any contingent, derivative or off-balance-sheet assets or liabilities) of the Company or obtain any evaluations or appraisals of our assets or liabilities. Sheshunoff & Co. is not an expert in the evaluation of loan portfolios for the purposes of assessing the adequacy of the allowance for loan and lease losses and assumed that such allowance for the Company is, in the aggregate, adequate to cover such losses. In addition, Sheshunoff & Co. did not review any individual credit or customer files or make an independent evaluation, appraisal or physical inspection of the assets or individual properties of the Company, nor has Sheshunoff & Co. been furnished with any such evaluations of appraisals. For purposes of its opinion, Sheshunoff & Co. assumed that the merger would have the tax, accounting and legal effects described in the merger agreement. Sheshunoff & Co.'s opinion as expressed herein is limited to the fairness of the proposed transaction, from a financial point of view, to our shareholders.

The opinion expressed by Sheshunoff & Co. was based upon market, economic and other relevant considerations as they existed and have been evaluated as of the date of the opinion and the information made available to it through that date. Events occurring after the date of issuance of the opinion including, but not limited to, changes affecting the securities markets, the results of operations or material changes in assets or liabilities, could materially affect the assumptions used in preparing the opinion. Sheshunoff & Co. assumed that there are no material changes in the assets, financial condition, results of operation, regulatory standing, business or prospects of the Company since their review of our last financial statements provided to them. Sheshunoff & Co. assumed that all of the representations and warranties contained in the merger agreement and any related agreements are true and correct, that each party to such agreements will perform all of the covenants required to be performed by such party under such agreements and that the conditions precedent in the merger agreement are not waived.

Summary of Analysis. The following is a summary of the material financial analyses performed by Sheshunoff & Co. in connection with the preparation of its opinion and does not purport to be a complete description of all the analyses performed by Sheshunoff & Co. Sheshunoff & Co. believes that its analyses must be considered as a whole and that selecting portions of such analyses and the factors considered therein, without considering all factors and analyses, could create an incomplete view of the analyses and the processes underlying its opinion. The preparation of a fairness opinion is a complex process involving subjective judgments and is not necessarily susceptible to partial analysis or summary description. In its analyses, Sheshunoff & Co. made numerous assumptions with respect to industry performance, business and economic conditions, and other matters, many of which are beyond the control of the Company and Sheshunoff & Co. Any estimates contained in Sheshunoff & Co.'s analyses are not necessarily indicative of future results or values, which may be significantly more or less favorable than such estimates. Estimates of values of companies do not purport to be appraisals or necessarily reflect the prices at which companies or their securities may actually be sold.

Sheshunoff used three approaches for analyzing the financial performance and condition of the Company, the fair value of and consequently the fairness, from a financial point of view of, to our shareholders, both those who will receive cash and those who will retain their shares in the merger.

Three approaches were used in conducting the analysis and providing the evidence in support of the fairness opinion as determined by the fair value standard of the Supreme Court of Tennessee's reliance on the "Delaware Block Method." They were:

- Income Approach: Using a discounted cash flow analysis;
- Market Approach: An analysis of publicly traded banks in the United States headquartered in either Tennessee, Kentucky, Alabama or Mississippi with total assets less than $5 billion and traded on a major national exchange (NYSE, NYSE MKT or NASDAQ); and
- Net Asset Value Approach: Sum of the total equity of the Company as of December 31, 2015 and off-balance-sheet assets or liabilities as reported by management of the Company.

Sheshunoff & Co. gave more weight to the income approach (40%) and market approach (40%) and less to the net asset value approach (20%). Sheshunoff & Co. gave more weight to the income approach as it is an effective method to capture the value of expected future earnings in terms of present value. Sheshunoff & Co. gave more weight to the market approach as there is readily available information for publicly traded financial institutions. It is generally possible to find comparable publicly traded guideline companies based on performance, size and geography and to determine market pricing multiples to serve as a proxy for pricing. The market approach captures the value of a financial institution based on historical financial performance at a specific point in time. The net asset value reflects the equity value with an adjustment for off balance sheet assets or liabilities but does not necessarily capture the market value of every assets and liability.

Per Share as of December 31, 2015	**Value**	**Weight**	**Per Share**
Income Approach	$27.70	40%	$11.08
Market Approach	$32.37	40%	$12.95
Net Asset Value Approach	$25.23	20%	$ 5.05
Estimated Fair Value			**$29.08**
Estimated Fair Value Range		**$28.50 - $30.60**	

Standard of Value: Sheshunoff & Co. review the merger consideration under the fair value standard. Sheshunoff & Co. discussed the appropriate valuation standard under Tennessee law with the Company’s General Counsel who provided the following definition of fair value detailed in Section 48-23-101(4) of the Tennessee Code:

"The fair value, with respect to a dissenter's shares, means the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action."

Income Approach - Discounted Cash Flow Analysis: The discounted cash flow analysis involves the estimation of the current or present value of expected future earnings for a firm or asset, based on an estimate of the risk those earnings, the growth rate of the earnings, and the time period and pattern on which those cash earnings are received.

Management provided projections on a stand-alone basis of assets, net income, and dividends over a five-year period. Based on management projections, the Company's future earnings to common shareholders, were determined by estimating the Company's optimum dividend-paying capacity to common shareholders. Optimum dividend capacity, or cash flows valued, consists of earnings available to common shareholders in excess of that which is necessary to maintain an 8% tangible common equity to tangible asset ratio but is no more than 100% of projected annual earnings. Discounting this optimum dividend-paying capacity to the common shareholders produces a going-concern value.

To capture the value of the Company's after the five year projection period, Sheshunoff & Co. estimated a terminal value for the Company by: (1) multiplying the final period projected earnings by one plus the assumed annual long-term growth rate of the earnings of the Company of 5% (or 1.05) and (2) dividing this product by the difference between the required rate of return of 12.25% as shown below and the assumed annual long-term growth rate of earnings of 5% (7.25%) in (1) above. Sheshunoff & Co. discounted the annual cash flow streams (defined as all earnings to common shareholders in excess of that which is required to maintain a tangible common equity to tangible asset ratio of 8%) and the terminal value using a discount rate of 12.25%. This discounted cash flow analysis indicated a value of approximately $27.70 per share based on 4,739,502 shares outstanding which is below the merger consideration of $30.25 per share.

In addition, Sheshunoff & Co. used the mid-year convention method in order to determine the net present value factors. The mid-year convention method reflects the fact that cash flows are earned continuously over the course of the year.

In determining the discount rate, Sheshunoff & Co. used the modified capital asset pricing model as follows:

Discount Rate Calculation – December 31, 2015	
Risk-free rate (20yr Treasury Constant)	2.61%
Equity Risk Premium (Duff & Phelps) * Beta[1] (7% * 0.777)	5.44%
Size Premium (Duff & Phelps)	3.74%
Company Specific Risk Premium	0.50%
Calculated Discount Rate	**12.29%**
Selected Discount Rate (Rounded)	**12.25%**

1 Beta calculated as Median of public U.S. banks between $1B and $2B in assets from 2013 through 2015

Market Approach – Publicly Traded Guideline Companies: The second approach used to estimate and test fairness was a comparison of the merger consideration multiples with select publicly traded companies. Sheshunoff & Co. performed an analysis of trading prices for a selected group of banking organizations in the U.S. with similar asset size and comparable characteristics to the Company (the "Guideline Companies"). The Guideline Companies consisted of 16 banks headquartered in either Tennessee, Kentucky, Alabama or Mississippi with total assets less than $5 billion (between $432.2 million and $4.23 billion) and traded on a major national exchange (NYSE, NYSE MKT or NASDAQ). Financial institutions that are broadly categorized as thrifts were excluded from this list.

A list of the Guideline Companies is as follows:

Auburn National Bancorp.	Community Trust Bancorp Inc.	HopFed Bancorp Inc.	Republic Bancorp Inc.
Citizens First Corp.	Farmers Capital Bank Corp.	National Commerce Corp.	SmartFinancial Inc.
Citizens Holding Co.	First Bancshares Inc.	Peoples Financial Corp.	Stock Yards Bancorp Inc.
Commerce Union Bancshares Inc.	Franklin Financial Network Inc	Porter Bancorp Inc.	United Security Bancshares

The analysis yielded trading multiples for the Guideline Companies as summarized below:

Comparable Public Pricing Multiples

	Book (x)	Tangible Book (x)	8% Tg. Book (x)	Core LTM EPS (x)	Assets	Deposits
Maximum	1.97	1.98	2.24	38.4	20.0%	23.8%
Minimum	0.50	0.50	0.11	9.4	4.1%	4.4%
Average	1.17	1.27	1.25	19.1	11.3%	14.3%
Median	1.15	1.27	1.22	15.2	11.4%	14.9%
FFMH*	0.90	0.97	0.97	10.9	8.4%	9.6%
First Farmers**	1.22	1.32	1.35	14.2	11.5%	13.0%

* Based on FFMH shares traded on the OTC Pink exchange

** Based on the merger consideration of $30.25 per share

The resulting multiples based on the Company's shares traded on the OTC Pink (ticker symbol: FFMH) exchange are significantly lower than the median multiples of the Guideline Companies. The resulting multiples at the merger consideration are similar to slightly higher than the median multiples of the Guideline Companies.

Market Approach:	
Price/Earnings Valuation at Estimated Price/Earnings Ratio	$154,405
Price/Tangible Book Valuation using Market Multiples:	
Tangible Book Value	$152,148
8% Tangible Book Value	$153,724
Average Market Approach Value	$153,425
Shares Outstanding	4,739,502
Market Approach Per Share Value ($153,425,000/4,739,502)	$32.37

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Net Asset Value Analysis. The net asset approach for determining value estimates a value by adjusting the reported values of assets and liabilities to their market values. As reported by management, the Company had off-balance-sheet assets of approximately $1.9 million. The off-balance sheet assets consisted of the market value of premises and land owned by the Company netted against their respective balance sheet values. The net off-balance-sheet value was added to the total equity of the Company of approximately $117.7 million as of December 31, 2015, resulting in a net asset value of $119.6 million (rounded) or $25.23 per share.

Fairness Opinion. After applying weighting, as determined by Sheshunoff & Co., to each of the three approaches described herein, the fair value range of the Company's common stock was determined to be $28.50 to $30.60 per share. The merger consideration of $30.25 per share meets the Tennessee fair value standard and falls within Sheshunoff & Co.'s estimated fair value range. The resulting pricing multiples of the merger consideration are similar to slightly higher than the median multiples for the Guideline Companies. Therefore, the merger consideration is a reasonable indication of fair value of the Company and, thus, meets the definition of fair value in Tennessee.

			Fair Value Range					
Comparative Multiples	OTC FFMH Market Multiples	Guideline Company Median Multiples	Resulting Value Multiples @ $28.50	Resulting Value Multiples @ $30.60	Resulting Multiples @ Merger Price $30.25			
Common Book	0.90x	1.15x	1.15x	Derivative financial instruments			20.0	20.0
Total assets		$	30.5			$ 25.3	$ 55.8	
Liabilities:								
Derivative financial instruments		$				$ 14.1	$ 14.1	

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company s derivative financial instruments consist of commodity forward contracts, foreign exchange forward contracts and interest rate swaps. These instruments are measured at fair value using the market method valuation technique. The inputs to this technique utilize information related to foreign exchange rates, commodity prices and interest rates published by third-party leading financial news and data providers. This is observable data; however, the valuation of these instruments is not based on actual transactions for the same instruments and, as such, these instruments are classified as Level 2. The Company s use of derivatives and hedging policies are more fully discussed in Note 12.

The Company has currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with accounting principles generally accepted in the United States.

The carrying amounts of other financial instruments not listed in the table below approximate fair value due to the short-term nature of these items.

The carrying amounts and estimated fair values of Carpenter s financial instruments not recorded at fair value in the financial statements were as follows:

	December 31, 2011		June 30, 2011	
($ in millions)	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current portion	$ 407.4	$ 407.3	$ 507.8	$ 515.9
Company-owned life insurance	$ 11.3	$ 11.3	$ 11.4	$ 11.4

The carrying amount for company-owned life insurance reflects cash surrender values based upon the market values of underlying securities, net of any outstanding policy loans. The carrying value associated with the cash surrender value of these policies is recorded in other assets in the accompanying consolidated balance sheets.

The fair values of long-term debt as of December 31, 2011 and June 30, 2011 were determined by using current interest rates for debt with terms and maturities similar to the Company s existing debt arrangements.

11. Other Income (Expense), Net

Other income (expense), net consisted of the following:

	Three Months Ended December 31,		Six Months Ended December 31,	
($ in millions)	2011	2010	2011	2010
Continued Dumping and Subsidy Offset Act receipt	$ 0.1	$ 0.4	$ 0.1	$ 0.4
Interest income	0.3	0.2	0.6	0.4
Unrealized gains (losses) on company owned life insurance contracts and investments held in rabbi trusts	0.7	1.3	(0.6)	1.9
Equity in earnings (losses) of unconsolidated subsidiaries	(1.1)	0.7	(0.3)	1.2
Other income (expense)	0.4	0.4	(0.2)	0.6

Total other income (expense), net	$ 0.4	$ 3.0	$ (0.4)	$ 4.5

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12. Derivatives and Hedging Activities

The Company uses commodity swaps and forwards, interest rate swaps and foreign currency forwards to manage risks generally associated with commodity price, interest rate and foreign currency rate fluctuations. The following explains the various types of derivatives and includes a recap about the impact the derivative instruments had on the Company s financial position, results of operations, and cash flows.

Cash Flow Hedging Commodity forward contracts: The Company enters into commodity forward contracts to fix the price of a portion of anticipated future purchases of certain critical raw materials and energy to manage the risk of cash flow variability associated with volatile commodity prices. The commodity forward contracts have been designated as cash flow hedges. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income to the extent effective, and reclassified to cost of sales in the period during which the hedged transaction affects earnings or it becomes probable that the forecasted transaction will not occur.

Cash Flow Hedging Forward interest rate swaps: Historically, the Company has entered into forward swap contracts to manage the risk of cash flow variability associated with fixed interest debt expected to be issued. The forward interest rate swaps have been designated as cash flow hedges. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income to the extent effective, and reclassified to interest expense in the period during which the hedged transaction affects earnings or it becomes probable that the forecasted transaction will not occur.

Cash Flow Hedging Foreign currency forward contracts: The Company uses foreign currency forward contracts to hedge a portion of anticipated future sales denominated in foreign currencies, principally the Euro and Pound Sterling, in order to offset the effect of changes in exchange rates. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income to the extent effective, and reclassified to net sales in the period during which the transaction affects earnings or it becomes probable that the forecasted transaction will not occur.

The Company also uses foreign currency forward contracts to protect certain short-term asset positions denominated in foreign currency against the effect of changes in exchange rates. These positions do not qualify for hedge accounting and accordingly, are marked-to-market at each reporting date through charges to other income and expense. As of December 31, 2011 and June 30, 2011, the fair value of the outstanding foreign currency forwards not designated as hedging instruments and the charges to income for changes in fair value for these contracts were not material.

Fair Value Hedging Interest rate swaps: The Company uses interest rate swaps to achieve a level of floating rate debt relative to fixed rate debt where appropriate. The Company has designated fixed to floating interest rate swaps as fair value hedges. Accordingly, the changes in the fair value of these instruments are immediately recorded in earnings. The mark-to-market values of both the fair value hedging instruments and the underlying debt obligations are recorded as equal and offsetting gains and losses in interest expense in the Consolidated Statements of Income. As of December 31, 2011 and June 30, 2011, the total notional amount of floating interest rate contracts was $45.0 million and $65.0 million, respectively. For the three months ended December 31, 2011 and 2010, net gains of $0.4 million and $0.6 million, respectively, were recorded as a reduction to interest expense. For the six

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months ended December 31, 2011 and 2010, net gains of $0.7 million and $1.2 million, respectively, were recorded as a reduction to interest expense. These amounts include the impact of previously terminated swaps which are being amortized over the remaining term of the underlying debt.

The fair value and location of outstanding derivative contracts recorded in the accompanying consolidated balance sheets were as follows as of December 31, 2011 and June 30, 2011:

December 31, 2011 ($ in millions)	Interest Rate Swaps	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:				
Derivatives designated as hedging instruments:				
Other current assets	$ 0.2	$ 2.5	$ 0.1	$ 2.8
Other assets	1.7		0.3	2.0
Total asset derivatives	$ 1.9	$ 2.5	$ 0.4	$ 4.8
Liability Derivatives:				
Derivatives designated as hedging instruments:				
Accrued liabilities	$	$ 0.8	$ 23.2	$ 24.0
Other liabilities		0.6	16.1	16.7
Total liability derivatives	$	$ 1.4	$ 39.3	$ 40.7

June 30, 2011 ($ in millions)	Interest Rate Swaps	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:				
Derivatives designated as hedging instruments:				
Other current assets	$ 0.8	$	$ 5.4	$ 6.2
Other assets	2.0		11.8	13.8
Total asset derivatives	$ 2.8	$	$ 17.2	$ 20.0
Liability Derivatives:				
Derivatives designated as hedging instruments:				
Accrued liabilities	$	$ 0.9	$ 6.8	$ 7.7
Other liabilities			6.4	6.4
Total liability derivatives	$	$ 0.9	$ 13.2	$ 14.1

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Cash Flow Hedges

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (AOCI) and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. The following is a summary of the (losses) gains related to cash flow hedges recognized during the three and six months ended December 31, 2011 and 2010:

	Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion)			
	Three Months Ended December 31,		Six Months Ended December 31,	
($ in millions)	2011	2010	2011	2010
Derivatives in Cash Flow Hedging Relationship:				
Commodity contracts	$ 13.4	$ 8.6	$ (40.3)	$ 21.5
Foreign exchange contracts	(1.2)	0.6	0.2	(0.9)
Forward interest rate swaps		6.8		6.0
Total	$ 12.2	$ 16.0	$ (40.1)	$ 26.6

($ in millions)		Amount of (Loss) Gain Reclassified from AOCI into Income (Effective Portion)		Amount of (Loss) Gain Reclassified from AOCI into Income (Effective Portion)	
	Location of (Loss) Gain Reclassified from AOCI into Income (Effective Portion)	Three Months Ended December 31,		Six Months Ended December 31,	
Derivatives in Cash Flow Hedging Relationship:		2011	2010	2011	2010
Commodity contracts	Cost of sales	$ (5.3)	$ 1.7	$ (6.8)	$ 1.4
Foreign exchange contracts	Net sales	0.4	(0.3)	0.4	(0.2)
Total		$ (4.9)	$ 1.4	$ (6.4)	$ 1.2

The Company estimates that $20.7 million of net derivative losses included in AOCI as of December 31, 2011 will be reclassified into earnings within the next 12 months. No significant cash flow hedges were discontinued during the quarter ended December 31, 2011. There was no ineffectiveness during the three months and six months ended December 31, 2011 and 2010.

The changes in AOCI associated with derivative hedging activities during the three months and six months ended December 31, 2011 and 2010 were as follows:

($ in millions)	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010	Six Months Ended December 31, 2011	Six Months Ended December 31, 2010
Balance at beginning	$ (29.9)	$ 4.2	$ 2.6	$ (2.4)
Current period changes in fair value, net of tax	3.5	11.2	(29.7)	17.3
Reclassification to earnings, net of tax	4.0	(1.2)	4.7	(0.7)
Balance at ending	$ (22.4)	$ 14.2	$ (22.4)	$ 14.2

According to the provisions of the Company s derivative arrangements, in the event that the fair value of outstanding derivative positions with certain counterparties exceeds certain thresholds, the Company may be required to issue cash collateral to the counterparties. The Company s contracts with these counterparties allow for netting of derivative instrument positions executed under each contract. As of December 31, 2011 and June 30, 2011, the Company had no cash collateral held by counterparties.

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The Company is exposed to credit loss in the event of nonperformance by counterparties on its derivative instruments as well as credit or performance risk with respect to its customer commitments to perform. Although nonperformance is possible, the Company does not anticipate nonperformance by any of the parties. In addition, various master netting arrangements are in place with counterparties to facilitate settlement of gains and losses on these contracts.

13. Income Taxes

The effective tax rate used for interim periods is the estimated annual effective consolidated tax rate, based on the current estimate of full year results, except that taxes related to specific events, if any, are recorded in the interim period in which they occur.

Income tax expense for the three months ended December 31, 2011 was $14.7 million, or 38.2 percent of pre-tax income as compared with $1.4 million, or 13.0 percent of pre-tax income for the three months ended December 31, 2010. For the six months ended December 31, 2011, income tax expense was $27.2 million, or 36.4 percent of pre-tax income, as compared with income tax expense of $5.2 million, or 23.4 percent of pre-tax income, for the six months ended December 31, 2010. The prior year periods included benefits for the retroactive extension of the research and development tax credit from the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act enacted in December of 2010. Income tax expense for the current periods were negatively impacted by a state tax legislative change and non-deductible expenses related to the Latrobe Merger.

14. Business Segments

In January 2012, the Company announced a change to its reportable segments. The Company now has two reportable segments, Specialty Alloys Operations (SAO) and Performance Engineered Products (PEP).

The SAO segment is comprised of the Company s major premium alloy and stainless steel manufacturing operations. This includes operations performed at mills primarily in Reading, Pennsylvania and the surrounding area, South Carolina, and the new premium products manufacturing facility being built in Limestone County, Alabama. The combined assets of the SAO operations will be managed in an integrated manner to optimize efficiency and profitability across the total system.

The PEP segment is comprised of the Company s differentiated operations. This includes the Dynamet titanium business, the Carpenter Powder Products business, and the Amega West business. The businesses in the PEP segment will be managed with an entrepreneurial structure to promote speed and flexibility and drive overall revenue and profit growth.

The service cost component of the Company s net pension expense, which represents the estimated cost of future pension liabilities earned associated with active employees, is included in the operating income of the business segments. The residual net pension expense, which is comprised of the expected return on plan assets, interest costs on the projected benefit obligations of the plans, and amortization of actuarial gains and losses and prior service costs, is included under the heading Pension earnings, interest & deferrals .

On a consolidated basis, there were no significant customers that accounted for more than 10 percent of the total net sales during the three months and six months ended December 31, 2011 and December 31, 2010.

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The historical segment information below for the three months and six months ended December 31, 2010 below was recast to conform to the fiscal 2012 presentation.

Segment Data ($ in millions)	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010	Six Months Ended December 31, 2011	Six Months Ended December 31, 2010
Net Sales:				
Specialty Alloys Operations	$ 360.5	$ 325.8	$ 696.3	$ 623.0
Performance Engineered Products	82.3	45.4	166.5	94.6
Other	9.5	9.2	19.6	18.5
Intersegment	(21.2)	(4.8)	(37.2)	(8.8)
Consolidated net sales	$ 431.1	$ 375.6	$ 845.2	$ 727.3
Operating Income:				
Specialty Alloys Operations	$ 50.9	$ 26.7	$ 97.2	$ 52.7
Performance Engineered Products	10.4	4.7	22.2	11.4
Other	0.7	0.2	1.2	0.4
Corporate costs	(12.6)	(10.6)	(22.8)	(20.5)
Pension earnings, interest & deferrals	(3.6)	(8.8)	(7.2)	(17.6)
Intersegment	(1.9)	(0.1)	(2.7)	(0.2)
Consolidated operating income	$ 43.9	$ 12.1	$ 87.9	$ 26.2
Depreciation and Amortization:				
Specialty Alloys Operations	$ 13.0	$ 12.4	$ 26.1	$ 24.8
Performance Engineered Products	4.3	1.4	8.5	2.8
Other	0.1	0.1	0.2	0.2
Corporate	1.3	1.2	2.6	2.3
Intersegment	(0.1)		(0.2)	
Consolidated depreciation and amortization	$ 18.6	$ 15.1	$ 37.2	$ 30.1
Capital Expenditures:				
Specialty Alloys Operations	$ 22.0	$ 7.1	$ 39.6	$ 13.7
Performance Engineered Products	10.2	1.7	18.8	2.7
Other		0.2		0.2
Corporate	1.5	0.6	3.3	1.1
Intersegment	(0.7)		(1.4)	
Consolidated capital expenditures	$ 33.0	$ 9.6	$ 60.3	$ 17.7

	December 31, 2011	June 30, 2011
Total Assets:		
Specialty Alloys Operations	$ 1,229.6	$ 1,186.2
Performance Engineered Products	341.2	319.6
Other	29.9	29.9
Corporate	283.1	471.7
Intersegment	(9.0)	(15.5)
Consolidated total assets	$ 1,874.8	$ 1,991.9

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15. Recent Accounting Standards

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05). ASU 2011-05 requires entities to present net income and other comprehensive income in either a single continuous statement or in two separate but consecutive statements of net income and other comprehensive income. ASU 2011-05 eliminates the option to present items of other comprehensive income in the statement of changes in equity. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and is required to be applied retrospectively. The Company is evaluating if other comprehensive income will be presented in a single continuous statement of comprehensive income or in two separate but consecutive statements and does not expect the adoption of ASU 2011-05 to have a significant impact on the Company s Consolidated Financial Statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Intangibles Goodwill and Other* (ASU 2011-08). ASU 2011-08 amends previous guidance on the testing of goodwill for impairment and is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The amended guidance provides entities with the option of first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If it is determined, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two-step impairment test would still be required. The adoption of ASU 2011-08 is not expected to have a significant impact on the Company s Consolidated Financial Statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-09, *Compensation Retirement Benefits Multiemployer Plans* (ASU 2011-09). ASU 2011-09 requires that employers that participate in multiemployer pension and postretirement plans provide additional enhanced separate quantitative and qualitative disclosures for such plans. The additional disclosures provide information about the overall health of the plan and the level of the employer s participation in the plan. The guidance in ASU 2011-09 is effective for public entities for fiscal years beginning after December 15, 2011, with early adoption permitted. Retrospective application of the guidance will be required upon adoption. The Company is evaluating the impact of the adoption of ASU 2011-09 and does not expect the adoption to have a significant impact on the Company s Consolidated Financial Statements.

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, *Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). ASU 2011-11 requires disclosures to provide information to help reconcile differences in offsetting requirements under U.S. GAAP and International Financial Reporting Standards (IFRS). The new disclosure requirements in ASU 2011-11 mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. The guidance in ASU 2011-11 is required to be applied for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The Company is evaluating the impact of the adoption of ASU 2011-11 and does not expect the adoption to have a significant impact on the Company s Consolidated Financial Statements.

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

Background and General

We are engaged in the manufacturing, fabrication, and distribution of specialty metals. We primarily process basic raw materials such as nickel, cobalt, titanium, manganese, chromium, molybdenum, iron scrap and other metal alloying elements through various melting, hot forming and cold working facilities to produce finished products in the form of billet, bar, rod, wire and narrow strip in many sizes and finishes. We also produce certain metal powders. Our sales are distributed directly from our production plants and distribution network as well as through independent distributors. Unlike many other specialty steel producers, we operate our own worldwide network of service/distribution centers. These service centers, located in the United States, Canada, Mexico, Europe and Asia allow us to work more closely with customers and to offer various just-in-time stocking programs. We are also a manufacturer and service provider of high-precision components for measurement while drilling (MWD) and logging while drilling (LWD), drill collars, stabilizers and other down-hole tools used for directional drilling. MWD and LWD technology is used to ensure critical data is obtained and transmitted to the surface to monitor progress of the well.

In January 2012, the Agreement and Plan of Merger dated June 20, 2011 pursuant to which we intend to acquire Latrobe Specialty Metals, Inc. (Latrobe) was amended (as amended, the Merger Agreement). According to the terms of the Merger Agreement, we will issue 8.1 million shares of our common stock to the current owners of Latrobe, subject to certain adjustments. We also expect to pay approximately $170 million in cash to eliminate Latrobe debt at closing and reimburse certain transaction costs. In August 2011, we announced that each party received a request for additional information from the U.S. Federal Trade Commission (FTC) in connection with this pending transaction. The request for information from the FTC, commonly referred to as a Second Request was issued as a result of the regulatory process under the Hart-Scott Rodino Antitrust Improvement Act of 1976 (HSR) and has resulted in the need for additional time to provide the additional information requested. The parties have worked to respond expeditiously to this Second Request and continue to work cooperatively with the FTC to obtain HSR clearance as promptly as possible. Closing of the transaction remains subject to the expiration or termination of the HSR waiting period and satisfaction of other customary closing conditions. We currently expect closing to occur during the third quarter of fiscal year 2012.

In the first quarter of fiscal year 2012, we announced our plans to construct a new 400,000 square foot state-of-the-art manufacturing facility in response to strong customer demand for premium products primarily in the fast-growing aerospace and energy industries. We expect that the new facility will ultimately be capable of producing approximately 27,000 tons per year of additional premium product and be operational in approximately 30 months. The facility is expected to be built on a 230 acre greenfield site located in Limestone County, Alabama at a total cost of approximately $500 million. The site selection process included analyzing state, county and local incentives, utility costs, and labor resources. The state of Alabama and local government entities put together a compelling package, including various tax initiatives, infrastructure grants, and training programs. The new facility will include forge, remelting and associated finishing and testing capabilities and will play a key role in further developing our capabilities in the production of our premium products.

As part of our overall business strategy, we have sought out and considered opportunities related to strategic acquisitions and joint collaborations aimed at broadening our offering to the marketplace. We have participated with other companies to explore potential terms and structure of such opportunities and we expect that we will continue to evaluate these opportunities.

Our discussions below in this Item 2 are based upon the more detailed discussions about our business, operations and financial condition included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011, under Item 8 thereof. Our discussions here focus on our results during or as of the three-month and six-month period ended December 31, 2011 and the comparable periods of fiscal year 2011, and, to the extent applicable, on material changes from information discussed in that Form 10-K or other important intervening developments or information that we have reported on Form 8-K. These discussions should be read in conjunction with that Form 10-K for detailed background information and with any such intervening Form 8-K.

Changes to Segment Reporting

In January 2012, we announced change to our reportable segments, beginning with our second quarter results of fiscal year 2012, to align with a new operating model in which its integrated steel mill operations will be managed distinctly from the collection of other differentiated business unit operations. Initially, there will be two reportable segments, Specialty Alloys Operations (SAO) and Performance Engineered Products (PEP). Once the Company completes its acquisition of Latrobe Specialty Metals, Latrobe will become a third reportable segment. Previously, the Company s reportable segments consisted of Premium Alloys Operations, Advanced Metals Operations and Emerging Ventures.

The SAO segment will be comprised of Carpenter s major premium alloy and stainless steel manufacturing operations. This includes operations performed at mills primarily in Reading, Pennsylvania and the surrounding area, South Carolina, and the new premium products manufacturing facility being built in Limestone County, Alabama. The combined assets of the SAO operations will be managed in an integrated manner to optimize efficiency and profitability across the total system.

The PEP segment will be comprised of Carpenter s differentiated operations. This includes the Dynamet titanium business, the Carpenter Powder Products business, and the Amega West business. The businesses in the PEP segment will be managed with an entrepreneurial structure to promote speed and flexibility, and drive overall revenue and profit growth.

In conjunction with the segment reporting changes, we also made a few modifications to our supplemental end-use market and product class reporting. For end-use market reporting, Aerospace end-use market sales was broadened to incorporate Aerospace and Defense. Industrial and Consumer end-use market sales was combined as Industrial and Consumer. The Automotive end-use market was broadened to Transportation to reflect sales in non-automotive markets like marine. All distribution businesses sales will be reported as a separate end-use market called Distribution. For product class reporting, sales of powder metal products were broken out and a new category of Alloy and Tool Steels was added. The changes are intended to better segregate growth areas of premium products such as high temperature nickel-based special alloys, titanium products and powder metals, while also reflecting the anticipated product classes and businesses expected to be gained through the anticipated Latrobe acquisition.

Impact of Raw Material Prices and Product Mix

We value most of our inventory utilizing the last-in, first-out (LIFO) inventory costing methodology. Under the LIFO inventory costing method, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period even though these materials may have been acquired at potentially significantly different values due to the length of time from the acquisition of the raw materials to the sale of the processed finished goods to the customers. In a period of rising raw material costs, the LIFO inventory valuation normally results in higher costs of sales. Conversely, in a period of decreasing raw material costs, the LIFO inventory valuation normally results in lower costs of sales.

The volatility of the costs of raw materials has impacted our operations over the past several years. We, and others in our industry, generally have been able to pass cost increases on major raw materials through to our customers using surcharges that are structured to recover increases in raw material costs. Generally, the formula used to calculate a surcharge is based on published prices of the respective raw materials for the previous month which correlates to the prices we pay for our raw material purchases. However, a portion of our surcharges to customers may be calculated using a different surcharge formula or may be based on the raw material prices at the time of order, which creates a lag between surcharge revenue and corresponding raw material costs recognized in costs of sales. The surcharge mechanism protects our net income on such sales except for the lag effect discussed above. However, surcharges have had a dilutive effect on our gross margin and operating margin percentages as described later in this report.

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Approximately 40 percent our net sales are sales to customers under firm price sales arrangements. Firm price sales arrangements involve a risk of profit margin fluctuations, particularly when raw material prices are volatile. In order to reduce the risk of fluctuating profit margins on these sales, we enter into commodity forward contracts to purchase certain critical raw materials necessary to produce the related products sold. Firm price sales arrangements generally include certain annual purchasing commitments and consumption schedules agreed to by the customers at selling prices based on raw material prices at the time the arrangements are established. If a customer fails to meet the volume commitments (or the consumption schedule deviates from the agreed-upon terms of the firm price sales arrangements), the Company may need to absorb the gains or losses associated with the commodity forward contracts on a temporary basis. Gains or losses associated with commodity forward contracts are reclassified to earnings/loss when earnings are impacted by the hedged transaction. Because we value most of our inventory under the LIFO costing methodology, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period attempting to match the most recently incurred costs with revenues. Gains or losses on the commodity forward contracts are reclassified from other comprehensive income together with the actual purchase price of the underlying commodities when the underlying commodities are purchased and recorded in inventory. To the extent that the total purchase price of the commodities, inclusive of the gains or losses on the commodity forward contracts, are higher or lower relative to the beginning of year costs, our costs of goods sold reflect such amounts. Accordingly, the gains and/or losses associated with commodity forward contracts may not impact the same period that the firm price sales arrangements revenue is recognized, and comparisons of gross profit from period to period may be impacted. These firm price sales arrangements are expected to continue as we look to strengthen our long-term customer relationships by expanding, renewing and in certain cases extending to a longer term, our customer long-term arrangements.

We produce hundreds of grades of materials, with a wide range of pricing and profit levels depending on the grade. In addition, our product mix within a period is subject to the fluctuating order patterns of our customers as well as decisions we may make on participation in certain products based on available capacity including the impacts of capacity commitments we may have under existing customer agreements. While we expect to see positive contribution from a more favorable product mix in our margin performance over time, the impact by period may fluctuate, and period-to-period comparisons may vary.

Net Pension Expense

Net pension expense, as we define it below, includes the net periodic benefit costs related to both our pension and other postretirement plans. The current quarter s results include non-cash net pension expense of $9.8 million or $0.13 per diluted share versus $15.1 million or $0.21 per diluted share in the same quarter last year. See the section Non-GAAP Financial Measures below for further discussions of these financial measures.

Net pension expense is recorded in accounts that are included in both the cost of sales and selling, general and administrative expenses lines of our Consolidated Statements of Income. The following is a summary of the classification of net pension expense for the three months and six months ended December 31, 2011 and 2010:

	Three Months Ended December 31,		Six Months Ended December 31,	
($ in millions)	2011	2010	2011	2010
Cost of sales	$ 7.2	$ 11.5	$ 14.5	$ 22.9
Selling, general and administrative expenses	2.6	3.6	5.2	7.4
Net pension expense	$ 9.8	$ 15.1	$ 19.7	$ 30.3

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Net pension expense is determined annually based on beginning of year balances, and is recorded ratably throughout the fiscal year, unless a significant re-measurement event occurs. We currently expect that the total net pension expense for fiscal year 2012 will be $39.4 million as compared with $60.8 million recorded in fiscal year 2011.

The service cost component of net pension expense represents the estimated cost of future pension liabilities earned associated with active employees. The pension earnings, interest and deferrals expense is comprised of the expected return on plan assets, interest costs on the projected benefit obligations of the plans, and amortization of actuarial gains and losses and prior service costs. The following is a summary of the components of net pension expense during the three months and six months ended December 31, 2011 and 2010:

	Three Months Ended December 31,		Six Months Ended December 31,	
($ in millions)	2011	2010	2011	2010
Service cost	$ 6.2	$ 6.3	$ 12.5	$ 12.7
Pension earnings, interest and deferrals	3.6	8.8	7.2	17.6
Net pension expense	$ 9.8	$ 15.1	$ 19.7	$ 30.3

Operating Performance Overview

For the quarter ended December 31, 2011, we reported net income attributable to Carpenter of $23.6 million, or $.52 per diluted share, compared with income attributable to Carpenter for the same period a year earlier of $9.3 million, or $0.21 per diluted share. Our second quarter results reflect continued execution of our strategy to optimize the core business by growing premium product volume and improving our overall profit per pound through pricing and mix management actions. Our success in driving more premium volume through our limited capacity and actions to improve our product mix enabled us to more than double our profit per pound from a year ago.

Results of Operations Three Months Ended December 31, 2011 vs. Three Months Ended December 31, 2010

Net Sales

Net sales for the three months ended December 31, 2011 were $431.1 million, which was a 15 percent increase over the same period a year ago. Excluding surcharge revenue, sales increased 19 percent. Overall, pounds shipped were 7 percent lower than the second fiscal quarter a year ago. Within our overall net sales results for our recent second quarter, our net sales excluding surcharge revenues increased 12 percent on 4 percent higher volume for our premium products, including special alloys, titanium and powder metals, while revenues excluding surcharge revenues for our stainless products increased 31 percent on 12 percent lower volume. The results reflect our deliberate actions to grow premium products and strengthen overall product mix.

Geographically, sales outside the United States increased 20 percent from the same period a year ago to $142.5 million. International growth was led by increased demand for materials used for aerospace, high value automotive applications and industrial gas turbines, particularly in net sales to customers in Europe, which increased 28 percent from a year ago. Total international sales in the quarter represented 33 percent of total net sales, compared with 32 percent in the prior year.

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Sales by End-Use Markets

We sell to customers across diversified end-use markets. The table below includes comparative information for our estimated sales by end-use markets:

($ in millions)	Three Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Aerospace and defense	$ 192.2	$ 152.8	$ 39.4	26 %
Industrial and consumer	105.0	113.5	(8.5)	(7)
Energy	61.3	41.3	20.0	48
Medical	31.7	26.0	5.7	22
Transportation	31.4	32.8	(1.4)	(4)
Distribution	9.5	9.2	0.3	3
Total net sales	$ 431.1	$ 375.6	$ 55.5	15 %

The following table includes comparative information for our estimated net sales by the same principal end-use markets, but excluding surcharge revenue:

($ in millions)	Three Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Aerospace and defense	$ 142.6	$ 114.4	$ 28.2	25 %
Industrial and consumer	75.8	76.1	(0.3)	(0)
Energy	51.7	32.7	19.0	58
Medical	28.2	21.7	6.5	30
Transportation	22.5	22.9	(0.4)	(2)
Distribution	9.5	9.2	0.3	3
Total net sales excluding surcharge revenues	$ 330.3	$ 277.0	$ 53.3	19 %

Sales to the aerospace and defense market increased 26 percent from the second quarter a year ago to $192.2 million. Excluding surcharge revenue, sales increased 25 percent from the second quarter a year ago on 12 percent higher shipment volume. Aerospace and defense results reflect strength in all areas. Demand for titanium fastener material is near record levels and demand for nickel and stainless fastener material has shown significant growth over the last year. Demand for engine components continues to be strong driven by high build rates. Increased sales of materials used in aerospace structural components contributed 11 points of the overall growth rate this quarter.

Industrial and consumer market sales decreased 7 percent from the second quarter a year ago to $105.0 million. Excluding surcharge revenue, sales remained relatively flat on a 19 percent decrease in shipment volume. The year-over-year results reflect the continued impact of mix management and pricing actions. The decline in shipment volume was mainly related to reduced sales of lower value materials used for general industrial, housing and appliance applications. The improvement in product mix resulted from increased sales of higher value alloys used in precision fittings, powder near-net-shape components and select magnetics applications.

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Sales to the energy market of $61.3 million reflected a 48 percent increase from the second quarter a year ago. Excluding surcharge revenue, sales increased 58 percent from a year ago on higher shipment volume of 23 percent. The revenue increase was driven primarily by the Amega West acquisition which contributed 34 percentage points to the revenue growth rate. The remaining revenue and the shipment volume growth are attributable to increased demand for materials used for industrial gas turbines and in the oil and gas sector. Activity in the industrial gas turbine continues to grow as natural gas prices remain low and utilities shift away from coal fired power plants. The oil and gas sector continued to grow with the directional drilling rig counts hitting another new peak this year.

Sales to the medical market increased 22 percent from a year ago to $31.7 million. Excluding surcharge revenue, sales increased 30 percent on higher shipment volume of 16 percent. Nearly half of the growth in shipment volumes is attributable to increased sales of higher value titanium products, which had a positive impact on product mix. The results also reflect broad based growth experienced across the balance of the product portfolio.

Transportation market sales decreased 4 percent from the second quarter a year ago to $31.4 million. Excluding surcharge revenue, sales decreased 2 percent on 18 percent lower shipment volume from the second quarter a year ago. The results reflect overall lower shipment volumes related to mix management actions that targeted a reduction in lower value products. These reductions in shipment volumes were offset by growth in sales for high value materials required in turbo charger, gasket and fuel system applications, used in smaller, higher efficiency turbo charged engines, particularly in Europe.

Sales by Product Class

The following table includes comparative information for our net sales by major product class:

($ in millions)	Three Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Special alloys	$ 205.7	$ 189.3	$ 16.4	9 %
Stainless steels	149.4	126.3	23.1	18
Titanium products	36.7	28.2	8.5	30
Powder metals	16.3	13.1	3.2	24
Alloy and Tool steel	5.2	6.3	(1.1)	(17)
Distribution and other	17.8	12.4	5.4	44
Total net sales	431.1	375.6	55.5	15 %

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The following table includes comparative information for our net sales by the same major product class, but excluding surcharge revenue:

($ in millions)	Three Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Special alloys	$ 136.3	$ 127.6	$ 8.7	7 %
Stainless steels	120.4	91.7	28.7	31
Titanium products	36.7	28.2	8.5	30
Powder metals	15.2	12.1	3.1	26
Alloy and Tool steel	4.1	5.0	(0.9)	(18)
Distribution and other	17.6	12.4	5.2	42
Total net sales excluding surcharge revenues	$ 330.3	$ 277.0	$ 53.3	19 %

Sales of special alloys products increased 9 percent from a year ago. Excluding surcharge revenues, sales increased 7 percent on a 1 percent increase in shipment volume. The results for the current quarter reflect overall sales increases in our higher value alloys used in the aerospace and energy markets as well as the positive impacts of our mix management initiatives.

Sales of stainless steels increased 18 percent from a year ago to $149.4 million. Excluding surcharge revenues, sales increased 31 percent on 12 percent lower shipment volume. Our Amega West business accounted for 12 percent of the year over year growth in net sales excluding surcharge revenues. In addition, the results reflect the benefits of strengthening product mix and pricing actions in the energy, medical, automotive and consumer markets.

Sales of titanium products increased 30 percent from a year ago on 17 percent higher volume to $36.7 million. The results reflect increased demand for titanium products used in the aerospace and medical end-use markets combined with the benefits of higher titanium prices, a shift in product mix and pricing actions.

Sales of powder metals increased 24 percent from a year ago to $16.3 million. Excluding surcharge revenues, sales increased 26 on a 15 percent increase in shipment volume. The results reflect strong demand in the industrial end-use market as well as the positive impacts of pricing and mix management initiatives aimed at improving product mix.

Sales of alloy and tool steel decreased 17 percent from a year ago to $5.2 million. Excluding surcharge revenues, sales decreased 18 percent on 27 percent lower shipment volumes. The results reflect the impacts of our pricing and mix management initiatives aimed at growing more premium products.

Gross Profit

Our gross profit in the second quarter increased 72 percent to $84.3 million, or 19.6 percent of net sales (25.5 percent of net sales excluding surcharges), as compared with $49.1 million, or 13.1 percent of net sales (17.7 percent of net sales excluding surcharges), in the same quarter a year ago. The higher gross profit in this year s second quarter was driven by an improved product mix, higher prices, as well as increased profit contributions from all of our PEP businesses.

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Our surcharge mechanism is structured to recover increases in raw material costs, although in certain cases with a lag effect as discussed above. While the surcharge generally protects the absolute gross profit dollars, it does have a dilutive effect on gross margin as a percent of sales. The following represents a summary of the dilutive impact of the surcharges on gross margin for the comparative three-month periods. See the section Non-GAAP Financial Measures below for further discussion of these financial measures.

	Three Months Ended December 31,	
($ in millions)	2011	2010
Net sales	$ 431.1	$ 375.6
Less: surcharge revenue	100.8	98.6
Net sales excluding surcharge revenues	$ 330.3	$ 277.0
Gross profit	$ 84.3	$ 49.1
Gross margin	19.6 %	13.1 %
Gross margin excluding dilutive effect of surcharge revenues	25.5 %	17.7 %

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $38.0 million were 8.8 percent of net sales (11.5 percent of net sales excluding surcharges) as compared with $36.3 million or 9.7 percent of net sales (13.1 percent of net sales excluding surcharges) in the same quarter a year ago. The increase principally reflects the inclusion of selling, general and administrative costs associated with Amega West.

Operating Income

Our operating income in the recent second quarter increased to $43.9 million as compared with $12.1 million in the same quarter a year ago. Excluding surcharge revenue and pension earnings, interest and deferrals, operating margin was 14.4 percent for the current quarter as compared with 7.5 percent a year ago.

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Operating income has been significantly impacted by our pension earnings, interest and deferrals (pension EID) expense, which may be volatile based on conditions in the financial markets. The following presents our operating income and operating margin, in each case excluding the impact of surcharges on net sales and excluding the impacts of pension EID expense from operating income. We present and discuss these financial measures because management believes removing the impact of volatile and non-recurring charges provides a more consistent and meaningful basis for comparing results of operations from period to period. See the section Non-GAAP Financial Measures below for further discussion of these financial measures.

($ in millions)	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010
Net sales	$ 431.1	$ 375.6
Less: surcharge revenue	100.8	98.6
Net sales excluding surcharges	$ 330.3	$ 277.0
Operating income	$ 43.9	$ 12.1
Add back: pension EID expense	3.6	8.8
Operating income excluding pension EID expense	$ 47.5	$ 20.9
Operating margin excluding surcharges and pension EID expense	14.4 %	7.5%

In addition to the impacts of the surcharge mechanism and pension EID expense, fluctuations in raw material prices (combined with fluctuations in inventory levels) and the lag effect of the surcharge mechanism have impacted our operating income from quarter to quarter. We estimate that the effect of such combined fluctuations negatively impacted operating margin, excluding surcharges, by 70 basis points during the recent second quarter and negatively impacted our operating margin, excluding surcharges, by 220 basis points during the prior year s second quarter.

Interest Expense

Interest expense for the quarter was $5.8 million compared with $4.3 million in the year-ago period due to the impact of our recent financing actions. The increase reflects the net impact of a higher debt level albeit at a lower average interest rate.

Other Income (Expense), Net

Other income was $0.4 million for the recent quarter compared with other income of $3.0 million in the second quarter a year ago. The decrease is due to the lower contributions from our joint ventures, a reduction in market value of assets supporting certain non-qualified retirement plans, and the elimination of receipts from the Continued Dumping and Subsidiary Offset Act of 2000.

Income Taxes

Income taxes in the recent second quarter were $14.7 million, or 38.2 percent of pre-tax income versus $1.4 million, or 13.0 percent of pre-tax income in the same quarter a year ago. Income tax expense for the current periods were negatively impacted by a state tax legislative change and non-deductible acquisition related expenses associated with the Latrobe merger. The prior year periods included benefits for the retroactive extension of the research and development tax credit from the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act enacted in December of 2010.

Business Segment Results

We have two reportable business segments: Specialty Alloys Operations (SAO) and Performance Engineered Products (PEP).

The following table includes comparative information for volumes by business segment:

(Pounds sold, in thousands)	Three Months Ended December 31, 2011	2010	$ (Decrease) Increase	% (Decrease) Increase
Specialty Alloys Operations	47,078	50,348	(3,270)	(6)
Performance Engineered Products	3,434	3,088	346	11
Intersegment	(1,470)	(704)	(766)	109
Consolidated pounds sold	49,042	52,732	(3,690)	(7) %

The following table includes comparative information for net sales by business segment:

($ in millions)	Three Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	$ 360.5	$ 325.8	$ 34.7	11 %
Performance Engineered Products	82.3	45.4	36.9	81
Other	9.5	9.2	0.3	3
Intersegment	(21.2)	(4.8)	(16.4)	342
Total net sales	$ 431.1	$ 375.6	$ 55.5	15 %

The following table includes comparative information for our net sales by business segment, but excluding surcharge revenues:

($ in millions)	Three Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	$ 258.1	$ 228.4	$ 29.7	13 %
Performance Engineered Products	81.2	44.3	36.9	83
Other	9.5	9.2	0.3	3
Intersegment	(18.5)	(4.9)	(13.6)	278
Total net sales excluding surcharge revenues	$ 330.3	$ 277.0	$ 53.3	19 %

Specialty Alloys Operations Segment

Net sales for the quarter ended December 31, 2011 for the SAO segment increased 11 percent to $360.5 million, as compared with $325.8 million in the same quarter a year ago. Excluding surcharge revenue, net sales increased 13 percent on 6 percent lower shipment volume from a year ago. The results reflect increased shipment volume in our premium products through our limited capacity as well as the positive impacts of our pricing actions and mix management efforts.

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Operating income for the SAO segment was $50.9 million or 14.1 percent of net sales (19.7 percent of net sales excluding surcharge revenue) in the recent second quarter, as compared with $26.7 million or 8.2 percent of net sales (11.7 percent of net sales excluding surcharge revenue) in the same quarter a year ago. The increase in operating income reflects the impacts of our pricing actions, a strong product mix and improvements to our operating cost performance.

Performance Engineered Products Segment

Net sales for the quarter ended December 31, 2011 for the PEP segment increased 81 percent to $82.3 million, as compared with $45.4 million in the same quarter a year ago. Excluding surcharge revenue, net sales increased 83 percent on 11 percent higher shipment volume from a year ago. The increase in net sales is due the contribution of our recently acquired Amega West business as well as strong demand in the aerospace, energy and medical markets.

Operating income for the PEP segment was $10.4 million or 12.6 percent of net sales (12.8 percent of net sales excluding surcharge revenue) in the recent second quarter, compared with $4.7 million or 10.4 percent of net sales (10.6 percent of net sales excluding surcharge revenue) in the same quarter a year ago. The increase in operating income in the current quarter as compared with the same period of the prior year reflects the impacts of the higher volumes particularly in premium products and the positive impacts of our mix management actions.

Results of Operations Six Months Ended December 31, 2011 vs. Six Months Ended December 31, 2010

Net Sales

Net sales for the six months ended December 31, 2011 were $854.2 million, which was a 16 percent increase over the same period a year ago. Excluding surcharge revenue, sales increased 19 percent. Overall, pounds shipped were 5 percent lower than the same period a year ago. The results reflect our focus on growing our premium product lines as well as the positive impacts of our pricing and mix management initiatives.

Geographically, sales outside the United States increased 25 percent from the same period a year ago to $280.7 million. International growth was led by Europe which experienced increased demand for materials used for aerospace engines, automotive fuel systems, and energy applications. In addition, Canada experienced demand growth in aerospace and oil and gas exploration. Total international sales in the current year represented 33 percent of total net sales, compared with 31 percent in the prior year.

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Sales by End-Use Markets

We sell to customers across diversified end-use markets. The table below includes comparative information for our estimated sales by end-use markets:

($ in millions)	Six Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Aerospace and defense	$ 366.9	$ 301.5	$ 65.4	22 %
Industrial and consumer	210.5	219.1	(8.6)	(4)
Energy	120.5	71.1	49.4	69
Medical	64.9	54.6	10.3	19
Transportation	62.8	62.5	0.3	
Distribution	19.6	18.5	1.1	6
Total net sales	$ 845.2	$ 727.3	$ 117.9	16 %

The following table includes comparative information for our estimated net sales by the same principal end-use markets, but excluding surcharge revenue:

($ in millions)	Six Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Aerospace and defense	$ 271.0	$ 224.6	$ 46.4	21 %
Industrial and consumer	149.3	149.3		
Energy	102.1	57.4	44.7	78
Medical	57.4	46.4	11.0	24
Transportation	44.5	44.5		
Distribution	19.6	18.5	1.1	6
Total net sales excluding surcharge revenues	$ 643.9	$ 540.7	$ 103.2	19 %

Sales to the aerospace and defense market increased 22 percent from the same period a year ago to $366.9 million. Excluding surcharge revenue, sales increased 21 percent from the same period a year ago on 11 percent higher shipment volume. Aerospace and defense results were driven by increased demand for materials used in fastener, engines, and structural components. Demand for titanium fastener material is expected to surpass prior peak levels within this fiscal year and demand for nickel and stainless fastener material has shown significant growth over the last year. Demand for engine components continues to be strong driven by high build rates.

Industrial and consumer market sales decreased 4 percent from the same period a year ago to $210.5 million. Excluding surcharge revenue, sales were flat on a 15 percent decrease in shipment volume. The year-over-year results reflect the impact of mix management and pricing actions that resulted in reduced sales of lower value materials used for general industrial applications and increased sales to meet demand growth for higher value materials for fittings and powder near-net-shape components.

Sales to the energy market of $120.5 million reflected a 69 percent increase from the same period a year ago. Excluding surcharge revenue, sales increased 78 percent from a year ago on 23 percent higher shipment volume. The Amega West acquisition contributed 49 percentage points to the net sales excluding surcharge revenue growth rate. The remaining revenue and the volume growth are attributable to increased demand for materials used for industrial gas turbines and in the oil and gas sector.

Sales to the medical market increased 19 percent from a year ago to $64.9 million. Excluding surcharge revenue, sales increased 24 percent on higher shipment volume of 12 percent. The results reflect increased demand, share gain and growth of higher priced titanium products and a richer product mix as compared with the same period in the prior year.

Transportation market sales remained relatively flat from the same period a year ago at $62.8 million. Excluding surcharge revenue, sales remained flat on 15 percent lower shipment volume from the same period a year ago. The revenue growth is again attributable to pricing and mix management efforts that resulted in increased participation in higher valve turbo charger and fuel system components, combined with a reduction in lower value products.

Sales by Product Class

The following table includes comparative information for our net sales by major product class:

	Six Months Ended December 31,		$ Increase	% Increase
($ in millions)	2011	2010	(Decrease)	(Decrease)
Special alloys	$ 401.7	$ 362.9	$ 38.8	11 %
Stainless steels	291.0	240.1	50.9	21
Titanium products	75.4	61.3	14.1	23
Powder metals	31.2	25.9	5.3	20
Alloy and Tool steel	12.0	12.4	(0.4)	(3)
Distribution and other	33.9	24.7	9.2	37
Total net sales	845.2	727.3	117.9	16 %

The following table includes comparative information for our net sales by the same major product class, but excluding surcharge revenue:

	Six Months Ended December 31,		$ Increase	% Increase
($ in millions)	2011	2010	(Decrease)	(Decrease)
Special alloys	$ 264.3	$ 244.3	$ 20.0	8 %
Stainless steels	232.2	176.8	55.4	31
Titanium products	75.4	61.3	14.1	23
Powder metals	29.0	23.8	5.2	22
Alloy and Tool steel	9.3	9.8	(0.5)	(5)
Distribution and other	33.7	24.7	9.0	36
Total net sales excluding surcharge revenues	$ 643.9	$ 540.7	$ 103.2	19 %

Sales of special alloy products increased 11 percent from a year ago. Excluding surcharge revenues, sales increased 8 percent on a 1 percent increase in shipment volume. The results for the current year reflect overall increases in our higher value alloys used in the aerospace and energy markets offset by declines in shipment volume of lower value materials.

Sales of stainless steels increased 21 percent from a year ago to $291.0 million. Excluding surcharge revenues, sales increased 31 percent on 8 percent lower shipment volume. The results reflect the benefits of strengthening product mix and pricing actions in the energy, medical, automotive and consumer markets.

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Sales of titanium products increased 23 percent from a year ago on 12 percent higher shipment volume to $75.4 million. The results reflect increased demand for titanium products used in the aerospace and medical end-use markets combined with the benefits of higher titanium prices, a shift in product mix and pricing actions.

Sales of powder metals increased 20 percent from a year ago to $31.2 million. Excluding surcharge revenues, sales increased 22 percent on 13 percent higher shipment volumes. The results reflect strong demand for powder products across the energy and consumer and industrial end-use markets as well as the positive impacts of pricing and mix management initiatives.

Sales of alloy and tool steel decreased 3 percent from a year ago to $12.0 million. Excluding surcharge revenues, sales decreased 5 percent on 20 percent lower shipment volume. The results reflect the impacts of our pricing and mix management initiatives aimed at growing more premium products and deliberate actions to reduce sales of lower value products.

Gross Profit

Our gross profit in the six months ended December 31, 2011 increased 67 percent to $165.5 million, or 19.6 percent of net sales (25.7 percent of net sales excluding surcharges), as compared with $98.9 million, or 13.6 percent of net sales (18.3 percent of net sales excluding surcharges), in the same period a year ago. The higher gross profit in the current period was driven by an improved product mix, higher prices and strong operating performance.

Our surcharge mechanism is structured to recover increases in raw material costs, although in certain cases with a lag effect as discussed above. While the surcharge generally protects the absolute gross profit dollars, it does have a dilutive effect on gross margin as a percent of sales. The following represents a summary of the dilutive impact of the surcharges on gross margin for the comparative six-month periods. See the section Non-GAAP Financial Measures below for further discussion of these financial measures.

	Six Months Ended December 31,	
($ in millions)	2011	2010
Net sales	$ 845.2	$ 727.3
Less: surcharge revenue	201.3	186.6
Net sales excluding surcharges	$ 643.9	$ 540.7
Gross profit	$ 165.5	$ 98.9
Gross margin	19.6%	13.6%
Gross margin excluding dilutive effect of surcharges	25.7%	18.3%

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $73.8 million were 8.7 percent of net sales (11.5 percent of net sales excluding surcharges) as compared with $72.0 million or 9.9 percent of net sales (13.3 percent of net sales excluding surcharges) in the same period a year ago. The results reflect increases associated with the addition of our recent acquisition of Amega West business. In addition, the reduction in total selling, general and administrative expenses as a percentage of net sales in the current year is consistent with our strategy to control overhead cost growth to well below the rate of revenue growth.

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Operating Income

For the six months ended December 31, 2011, our operating income increased to $87.9 million as compared with $26.2 million in the same period a year ago. Excluding surcharge revenue and pension earnings, interest and deferrals, operating margin was 14.8 percent for the six months ended December 31, 2011 as compared with 8.1 percent a year ago.

Operating income has been significantly impacted by our pension earnings, interest and deferrals (pension EID) expense, which may be volatile based on conditions in the financial markets. The following presents our operating income and operating margin, in each case excluding the impact of surcharges on net sales and excluding the impacts of pension EID expense from operating income. We present and discuss these financial measures because management believes removing the impact of volatile and non-recurring charges provides a more consistent and meaningful basis for comparing results of operations from period to period. See the section Non-GAAP Financial Measures below for further discussion of these financial measures.

($ in millions)	Six Months Ended December 31, 2011	Six Months Ended December 31, 2010
Net sales	$ 845.2	$ 727.3
Less: surcharge revenue	201.3	186.6
Net sales excluding surcharge revenues	$ 643.9	$ 540.7
Operating income	$ 87.9	$ 26.2
Add back: pension EID expense	7.2	17.6
Operating income excluding pension EID expense	$ 95.1	$ 43.8
Operating margin excluding surcharge revenues and pension EID expense	14.8%	8.1%

In addition to the impacts of the surcharge mechanism and pension EID expense, fluctuations in raw material prices (combined with fluctuations in inventory levels) and the lag effect of the surcharge mechanism have impacted our operating income from quarter to quarter. We estimate that the effect of such combined fluctuations had no impact on operating margin, excluding surcharges, during the six months ended December 31, 2011 and negatively impacted our operating margin, excluding surcharges, by 170 basis points during the same period in the prior year.

Interest Expense

Interest expense for the six months ended December 31, 2011 was $12.7 million compared with $8.5 million in the year-ago period due to the impact of our recent financing actions. This mainly represents the net impact of a higher debt level albeit at a lower average interest rate. A portion of the incremental debt was reduced as a $100 million note matured and was repaid in fiscal year 2012.

Other Income (Expense), Net

Other expense was $0.4 million for the six months ended December 31, 2011 compared with other income of $4.5 million for the comparable six month period of fiscal year 2011. The decrease is due to the reduction in market value of assets supporting certain non-qualified retirement plans, less receipts from the Continued Dumping and Subsidiary Offset Act of 2000 and lower contribution from our joint ventures.

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Income Taxes

Income taxes in the six months ended December 31, 2011 were $27.2 million, or 36.4 percent of pre-tax income versus $5.2 million, or 23.4 percent of pre-tax income for the six months ended December 31, 2010. Income tax expense for the current periods were negatively impacted by a state tax legislative change and non-deductible acquisition related expenses associated with the Latrobe merger. The prior year periods included benefits for the retroactive extension of the research and development tax credit from the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act enacted in December of 2010.

Business Segment Results

We have two reportable business segments: Special Alloys Operations (SAO) and Performance Engineered Products (PEP).

The following table includes comparative information for our volumes by business segment:

(Pounds sold, in thousands)	Six Months Ended December 31, 2011	2010	$ (Decrease) Increase	% (Decrease) Increase
Specialty Alloys Operations	91,288	95,952	(4,664)	(5)
Performance Engineered Products	6,872	6,330	542	9
Intersegment	(2,094)	(1,360)	(734)	54
Consolidated pounds sold	96,066	100,922	(4,856)	(5) %

The following table includes comparative information for our net sales by business segment:

($ in millions)	Six Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	$ 696.3	$ 623.0	$ 73.3	12%
Performance Engineered Products	166.5	94.6	71.9	76
Other	19.6	18.5	1.1	6
Intersegment	(37.2)	(8.8)	(28.4)	323
Total net sales	845.2	727.3	117.9	16%

The following table includes comparative information for our net sales by business segment, but excluding surcharge revenue:

($ in millions)	Six Months Ended December 31, 2011	2010	$ Increase (Decrease)	% Increase (Decrease)
Specialty Alloys Operations	$ 492.6	$ 438.7	$ 53.9	12%
Performance Engineered Products	164.2	92.3	71.9	78
Other	19.6	18.5	1.1	6
Intersegment	(32.5)	(8.8)	(23.7)	269
Total net sales excluding surcharge revenues	$ 643.9	$ 540.7	$ 103.2	19%

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Special Alloys Operations Segment

Net sales for the six months ended December 31, 2011 for the SAO segment increased 12 percent as compared to the same period a year ago to $696.3 million, Excluding surcharge revenue, net sales increased 12 percent on 5 percent lower shipment volume from a year ago. The results reflect increased shipment volume in our premium products through our limited capacity as well as the positive impacts of our pricing actions and mix management efforts.

Operating income for the six months ended December 31, 2011 for the SAO segment was $97.2 million or 14.0 percent of net sales (19.7 percent of net sales excluding surcharge revenue) in the six months ended December 31, 2011, as compared with $52.7 million or 8.5 percent of net sales (12.0 percent of net sales excluding surcharge revenue) in the same period a year ago. The increase in operating income reflects the impacts of our pricing actions, a strong product mix and improvements to our operating costs.

Performance Engineered Products Segment

Net sales for the six months ended December 31, 2011 for the PEP segment increased 76 percent to $166.5 million, as compared with $94.6 million in the same period a year ago. Excluding surcharge revenue, net sales increased 78 percent on 9 percent higher shipment volume from a year ago. The increase in net sales is due to the addition of the Amega West business and strong demand in the aerospace and energy markets.

Operating income for the PEP segment was $22.2 million or 13.3 percent of net sales (13.5 percent of net sales excluding surcharge revenue) in the six months ended December 31, 2011, compared with $11.4 million or 12.1 percent of net sales (12.4 percent of net sales excluding surcharge revenue) in the same period a year ago. The increase in operating income in the current period as compared with the same period of the prior year reflects the impacts of the higher volumes and sales and mix management actions.

Liquidity and Financial Condition

During the six months ended December 31, 2011, our free cash flow, which we define under Non-GAAP Financial Measures below, was negative $105.5 million as compared to negative $136.4 million for the same period a year ago. The negative free cash flow in the six months ended December 31, 2011 reflects the increase in working capital led by the higher inventory levels. The free cash flow results in the for the six months ended December 31, 2011 also reflect the payment of required pension contributions of $15.4 million and the Boarhead Farms settlement payment of $21.8 million. In addition, capital expenditures for plant, equipment and software were $60.3 million for the six months ended December 31, 2011, as compared with $17.7 million for the same period a year ago. The increase in capital spending principally reflects our capacity expansion projects. We expect to finish the fiscal year with about $175 million of capital expenditures.

Dividends during the six months ended December 31, 2011 were $16.2 million as compared to $16.0 million in the six months ended December 31, 2010, and were paid at the same quarterly rate of $0.18 per share of common stock in both periods.

We have demonstrated the ability to generate cash to meet our needs through cash flow from operations, management of working capital and the availability of outside sources of financing to supplement internally generated funds. We believe that our cash and cash equivalents of approximately $319 million as of December 31, 2011, together with cash generated from operations and available borrowing capacity of approximately $347 million under our credit facilities will be sufficient to fund our cash needs over the foreseeable future.

In June 2011, we issued $250 million of 5.20% senior notes due 2021 to take advantage of an attractive opportunity to refinance $100 million of notes that were due in August 2011. The issuance of these notes, together with the new Credit Agreement entered in to in June 2011 further discussed below, were completed in anticipation of our significant growth investments. We expect our current capital structure will be sufficient to support our business needs with minimal need to rely on borrowing under the Credit Agreement.

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We expect that our significant cash needs including the cost of our planned $500 million state-of-the-art manufacturing facility, repayment of $170 million of debt expected to be assumed in connection with the closing of the merger agreement with Latrobe, required minimum contributions to our pensions plan and investments in working capital, will result in modestly negative free cash flow over the next several fiscal years. Once we are beyond our peak capital expenditure spending levels principally associated with the new facility, we expect to generate consistently positive annual free cash flow.

We generally target minimum liquidity, consisting of cash and cash equivalents added to available borrowing capacity under our credit agreement, of $150 million. Our revolving credit facility contains a revolving credit commitment of $350 million and expires in June 2016. As of December 31, 2011, we had $3.5 million of issued letters of credit under the revolving credit facility. The balance of the revolving credit facility ($346.5 million) remains available to us. As of December 31, 2011, we had total liquidity of approximately $665 million, of which, we expect to use $170 million to repay Latrobe s debt at closing of the merger as well as fund the maturity of $101 million of long-term debt in fiscal year 2013, if necessary. We also evaluate liquidity needs for alternative uses including funding external growth opportunities as well as funding consistent dividend payments to stockholders. Over the last three fiscal years, we declared and paid quarterly cash dividends of $0.18 per share. We have historically authorized share repurchase programs. There are no current authorized share repurchase programs in order to preserve flexibility for our current priority to invest in attractive growth investments.

As of December 31, 2011, we had cash and cash equivalents of approximately $81 million held at various foreign subsidiaries. Our global cash deployment considers, among other things, the geographic location of our subsidiaries cash balances, the locations of our anticipated liquidity needs, and the cost to access international cash balances, as necessary. The repatriation of cash from certain foreign subsidiaries could have adverse tax consequences as we may be required to pay and record U.S. income taxes and foreign withholding taxes in various tax jurisdictions on these funds to the extent they were previously considered permanently reinvested. We are currently evaluating opportunities to repatriate cash from foreign jurisdictions. Our current plans consider repatriating cash only at levels that would result in minimal or no net adverse tax consequences in the near term.

We are subject to certain financial and restrictive covenants under the Credit Agreement, which, among other things, require the maintenance of a minimum interest coverage ratio (3.5 to 1.0 as of December 31, 2011). The interest coverage ratio is defined in the Credit Agreement as, for any period, the ratio of consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) to consolidated interest expense for such period. The Credit Agreement also requires the Company to maintain a debt to capital ratio of less than 55%. The debt to capital ratio is defined in the Credit Agreement as the ratio of consolidated indebtedness, defined as total long-term debt added to outstanding capital lease obligations and outstanding letters of credit, to consolidated capitalization, defined as consolidated indebtedness added to total equity. As of December 31, 2011, the Company was in compliance with all of the covenants of the Credit Agreement. As of December 31, 2011, we were in compliance with all the covenants of the credit facility.

The following table shows our actual ratio performance with respect to the financial covenants, as of December 31, 2011:

	Covenant Requirement	Actual Ratio
Consolidated interest coverage	3.50 to 1.00 (minimum)	13.76 to 1.00
Consolidated debt to capital	55% (maximum)	35%

We continue to believe that we will maintain compliance with the financial and restrictive covenants in future periods. To the extent that we do not comply with the covenants under the Credit Agreement, this could reduce our liquidity and flexibility due to potential restrictions on borrowings available to us unless we are able to obtain waivers or modification of the covenants.

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Non-GAAP Financial Measures

The following provides additional information regarding certain non-GAAP financial measures that we use in this report. Our definitions and calculations of these items may not necessarily be the same as those used by other companies.

Net Pension Expense Per Diluted Share

($ in millions, except per share data)	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010	Six Months Ended December 31, 2011	Six Months Ended December 31, 2010
Pension plans expense	$ 9.3	$ 13.4	$ 18.8	$ 26.9
Other postretirement benefit plans expense	0.5	1.7	0.9	3.4
	9.8	15.1	19.7	30.3
Income tax benefit	(3.8)	(5.6)	(7.5)	(11.3)
Net pension expense	$ 6.0	$ 9.5	$ 12.2	$ 19.0
Weighted average diluted common shares	45.1	44.7	45.1	44.6
Net pension expense per diluted share	$ 0.13	$ 0.21	$ 0.27	$ 0.43

Management believes that net pension expense per diluted share is helpful in analyzing the operational performance of the Company from period to period.

Net Sales and Gross Margin Excluding Surcharge Revenues

This report includes discussions of net sales and gross margin as adjusted to exclude the impact of raw material surcharges, which represent financial measures that have not been determined in accordance with U.S. GAAP. We present and discuss these financial measures because management believes removing the impact of raw material surcharges from net sales and gross margin provides a more consistent basis for comparing results of operations from period to period for the reasons discussed earlier in this report. See our earlier discussion of gross profit for a reconciliation of net sales and gross margin, excluding surcharges, to net sales as determined in accordance with U.S. GAAP.

Operating Income and Operating Margin Excluding Surcharges and Pension EID Expense

This report includes discussions of operating income and operating margin as adjusted to exclude the impact of raw material surcharges and pension EID expense, which represent financial measures that have not been determined in accordance with U.S. GAAP. We present and discuss these financial measures because management believes removing the impact of raw material surcharges from net sales provides a more consistent and meaningful basis for comparing results of operations from period to period for the reasons discussed earlier in this report. In addition, management believes that excluding pension earnings, interest and deferrals expense from operating income and operating margin is helpful in analyzing our operating performance particularly as pension EID expense may be volatile due to changes in the financial markets. See our earlier discussion of operating income for a reconciliation of operating income and operating margin excluding pension EID expense to operating income and operating margin determined in accordance with U.S. GAAP.

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Free Cash Flow

The following provides a reconciliation of free cash flow, as used in this report, to its most directly comparable U.S. GAAP financial measures:

($ in millions)	Six Months Ended December 31, 2011	Six Months Ended December 31, 2010
Net cash used for operating activities	$ (27.8)	$ (64.1)
Purchases of property, equipment, and software	(60.3)	(17.7)
Acquisition of business	(1.4)	(41.6)
Acquisition of equity method investment		(6.2)
Proceeds from disposals of property and equipment	0.2	0.1
Proceeds received from sale of noncontrolling interest		9.1
Dividends paid	(16.2)	(16.0)
Free cash flow	$ (105.5)	$ (136.4)

Management believes that the presentation of free cash flow provides useful information to investors regarding our financial condition because it is a measure of cash generated which management evaluates for alternative uses. It is management s current intention to use excess cash to fund investments in capital equipment, acquisition opportunities and consistent dividend payments. Free cash flow is not a U.S. GAAP financial measure and should not be considered in isolation of, or as a substitute for, cash flows calculated in accordance with U.S. GAAP.

Contingencies

Environmental

We are subject to various federal, state, local and international environmental laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. Although compliance with these laws and regulations may affect the costs of our operations, compliance costs to date have not been material. We have environmental remediation liabilities at some of our owned operating facilities and have been designated as a potentially responsible party (PRP) with respect to certain third-party Superfund waste-disposal sites and other third party owned sites. Additionally, we have been notified that we may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against us. Neither the exact amount of remediation costs nor the final method of their allocation among all designated PRP s at these Superfund sites has been determined. The liability for future environmental remediation costs is evaluated on a quarterly basis. We accrue amounts for environmental remediation costs that represent our best estimate of the probable and reasonably estimable costs related to environmental remediation. During the three and six months ended December 31, 2011, there were no changes to the environmental liability. The liabilities recorded for environmental remediation costs at Superfund sites, at other third party-owned sites and at company-owned current or former operating facilities remaining at December 31, 2011 and June 30, 2011, were $4.9 million.

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

Boarhead Farms

In June 2002, we were named as a defendant in a lawsuit filed by a group of plaintiffs in the District Court for the Eastern District of Pennsylvania titled *Boarhead Farm Agreement Group v. Advanced Environmental Technology Corporation et. al.* (since amended to include the individual members). The suit alleges that we and the other named defendants contributed to damages caused at Boarhead Farms, a Superfund site located in Bridgeton, Pennsylvania. The Boarhead Farms site was the home of a now defunct chemical and waste hauling company that we and many other companies engaged to dispose of certain wastes during the 1970 s. The plaintiff group was individually named as PRP s for the Boarhead site in the EPA s Record of Decision in November 1998. Their June of 2002 lawsuit against various defendants, including Carpenter, sought contributions for a portion of costs incurred for various site cleanup activities as well as contributions to future cleanup efforts. The suit went to trial in June 2008. Prior to trial, all of the named co-defendants, except for Carpenter, reached an out of court settlement with the plaintiffs. We denied the claims made by the plaintiff group. On August 18, 2008, the Court awarded the plaintiffs judgment against us for 80 percent of the plaintiffs past costs of remediating the site, including prejudgment interest from June 18, 2002 to January 1, 2008, and held us liable for 80 percent of future costs of the cleanup activities at the site. We appealed the Court s decision and oral arguments took place before the United States Court of Appeals for the Third Circuit on December 17, 2009. On April 12, 2010, the Court of Appeals for the Third Circuit vacated the previous judgment by the District Court and remanded the case for further proceedings. As of June 30, 2011, we recorded a liability related to this case of $21.8 million. On July 19, 2011, we entered into a settlement agreement providing for a dismissal of the lawsuit against us and a complete release in our favor by all parties to the litigation, in exchange for a payment by us of $21.8 million which we paid during in September 2011. We expect that no additional material liabilities will be incurred related to this matter.

Duty Drawback

Historically, we have participated in a program offered by U.S. Customs and Border Protection (U.S. Customs) known as duty drawback. Under the program, we claimed a refund of import duties on items manufactured and exported to customers in foreign countries. Certain vendors prepared certificates authorizing us to claim duty drawback refunds against imported goods purportedly shipped by the vendor to us. Because of the complexity of the program, we engaged a licensed U.S. customs broker specializing in duty drawback claims. The customs broker was responsible for performing the administration of the process which included maintaining and collecting various forms of supporting evidence for each claim including collecting appropriate certificates from vendors, as well as preparing and submitting the refund claims.

In fiscal year 2008, we received notice from U.S. Customs that we were under investigation related to claims previously filed by the customs broker on our behalf. The investigation alleged certain discrepancies and a lack of supporting documentation for the claims that had been filed by the broker. We initiated an internal review of the claims filed with U.S. Customs to determine the extent of claims that may have inadequate supporting documentation. We also engaged a new licensed U.S. customs broker. We have cooperated fully with the investigation of this matter and are currently engaged in settlement discussions with U.S. Customs.

Following discussions with U.S. Customs Houston Office, we negotiated a settlement offer of $1.1 million to resolve this matter. This settlement offer along with the $1.1 million in advance payments has been presented to U.S. Customs National Headquarters for approval with the endorsement of the Houston Office. In December 2011, we were notified that the settlement offer was accepted by U.S. Customs. We do not expect that any additional liabilities will be incurred related to this matter.

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Export Regulations Violations

In fiscal year 2008, we became aware of potential violations of federal export regulations at a business unit that had been divested. Upon investigation, we discovered that approximately 40 foreign nationals employed over time at the business unit s facility may have been exposed to protected technical data related to the production of various products for military applications. An export license from the Department of State and the Department of Commerce is required prior to the exporting of technical data for military applications. We have applied for and received similar applications for other business units, but did not have such a license for the divested business unit. Violations of federal export regulations can be subject to civil penalties depending upon the severity of the violation. We filed voluntary disclosures with the Department of State and the Department of Commerce before the divestiture of the business unit on March 31, 2008. The Department of State responded to the voluntary disclosure without assessing civil penalties. The Department of Commerce has not yet responded to the voluntary disclosure. It is not possible to determine the amount, if any, of civil penalties that may be assessed by the Department of Commerce. As a result, we have not recorded any liability for potential penalties as of December 31, 2011.

Other

We are defending various routine claims and legal actions that are incidental to our business, and we are subject to contingencies that are common to our operations, including those pertaining to product claims, commercial disputes, employment actions, employee benefits, compliance with domestic and foreign laws, personal injury claims and tax issues. We provide for costs relating to these matters when a loss is probable and the amount of the loss is reasonably estimable. The effect of the outcome of these matters on our future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount and timing (both as to recording future charges to operations and cash expenditures) of the resolution of such matters. While it is not feasible to determine the outcome of these matters, we believe that the total liability from these matters will not have a material effect on our financial position, results of operations or cash flows over the long-term. However, there can be no assurance that an increase in the scope of pending matters or that any future lawsuits, claims, proceedings or investigations will not be material to our financial position, results of operations or cash flows in a particular future quarter or year.

Critical Accounting Policies and Estimates

Inventories

Inventories are stated at the lower of cost or market. The cost of inventories is primarily determined using the last in, first out (LIFO) method. Costs include direct materials, direct labor and applicable manufacturing overhead, and other direct costs. Under the LIFO inventory valuation method, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period even though these materials and other costs may have been incurred at significantly different values due to the length of time of our production cycle. The prices for many of the raw materials we use have been volatile. Because we value most of our inventory utilizing the LIFO inventory costing methodology, rapid changes in raw material costs have an impact on our operating results. In a period of rising prices, cost of sales expense recognized under LIFO is generally higher than the cash costs incurred to acquire the inventory sold. Conversely, in a period of declining raw material prices, cost of sales recognized under LIFO is generally lower than cash costs incurred to acquire the inventory sold.

Other Critical Accounting Policies and Estimates

A summary of other significant accounting policies is discussed in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and in Note 1, Summary of Significant Accounting Policies, of the Notes to our Consolidated Financial Statements included in Part II, Item 8 of our Annual Report on Form 10-K for the year ended June 30, 2011.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains various Forward-looking Statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements, which represent our expectations or beliefs concerning various future events, include statements concerning future revenues, earnings and liquidity associated with continued growth in various market segments and cost reductions expected from various initiatives. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ from those projected, anticipated or implied. The most significant of these uncertainties are described in our annual report on Form 10-K for the year ended June 30, 2011. They include but are not limited to: (1) the cyclical nature of the specialty materials business and certain end-use markets, including aerospace, industrial, automotive, consumer, medical, and energy, or other influences on our business such as new competitors, the consolidation of competitors, customers, and suppliers or the transfer of manufacturing capacity from the United States to foreign countries; (2) our ability to achieve cost savings, productivity improvements or process changes; (3) the volatility of, and our ability to recoup increases in, the cost of energy, raw materials, freight or other factors; (4) domestic and foreign excess manufacturing capacity for certain metals; (5) fluctuations in currency exchange rates; (6) the degree of success of government trade actions; (7) the valuation of the assets and liabilities in our pension trusts and the accounting for pension plans; (8) possible labor disputes or work stoppages; (9) the potential that our customers may substitute alternate materials or adopt different manufacturing practices that replace or limit the suitability of our products; (10) the ability to successfully acquire and integrate acquisitions; (11) the availability and costs of financing and credit facilities to us, our customers or other members of the supply chain; (12) the ability to obtain energy or raw materials, especially from suppliers located in countries that may be subject to unstable political or economic conditions; (13) our manufacturing processes are dependent upon highly specialized equipment located primarily in one facility in Reading, Pennsylvania and for which there may be limited alternatives if there are significant equipment failures or catastrophic events; (14) our future success depends on the continued service and availability of key personnel, including members of our executive management team, management, metallurgists and other skilled personnel and the loss of these key personnel could affect our ability to perform until suitable replacements are found; (15) the ability to successfully close the Latrobe Specialty Metals, Inc. transaction as well as the timing of that closing and the synergies, costs and other anticipated financial impacts of the transaction; and (16) the ability to successfully build and operate our new Alabama greenfield facility to provide increased capacity and to meet anticipated customer demand for premium products. Any of these factors could have an adverse and/or fluctuating effect on Carpenter s results of operations. The forward-looking statements in this document are intended to be subject to the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We undertake no obligation to update or revise any forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We use derivative financial instruments to reduce certain types of financial risk. Firm price sales arrangements involve a risk of profit margin fluctuations particularly as raw material prices have been volatile. As discussed in Note 12 to the consolidated financial statements included in Part I, Item 1, Financial Statements , in order to reduce the risk of fluctuating profit margins on these sales, we enter into commodity forward contracts to purchase certain critical raw materials necessary to produce the products sold under the firm price sales arrangements. If a customer fails to perform its obligations under the firm price sales arrangements, we may realize losses as a result of the related commodity forward contracts. As of December 31, 2011, we had approximately $26.2 million of deferred losses related to commodity forward contracts to purchase certain raw materials. A large portion of this balance is related to commodity forward contracts to support firm price sales arrangements associated with many customers. However, approximately 47 percent of these deferred losses relate to commodity forward contracts entered into to support sales under firm price sales arrangements with one customer. Our customers have historically performed under these arrangements and we believe that they will honor such obligations in the future.

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

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

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

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

Our pension plan assets are invested in different asset classes including large-, mid- and small-cap growth and value funds, index and international equity funds, short-term and medium-term duration fixed-income funds and high yield funds. The plan s current allocation policy is to invest approximately 60 percent of plan assets in U.S. and international equities and 40 percent of plan assets in fixed income securities.

The status of our financial instruments as of December 31, 2011 is provided in Note 10 to the consolidated financial statements included in Part I, Item 1, Financial Statements of this Quarterly Report on Form 10-Q. Assuming on December 31, 2011, (a) an instantaneous 10 percent decrease in the price of raw materials and energy for which we have commodity forward contracts, and (b) a 10 percent strengthening of the U.S. dollar versus foreign currencies for which foreign exchange forward contracts existed, our results of operations would not have been materially affected in either scenario.

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Item 4. Controls and Procedures

(a) Evaluation of Effectiveness of Disclosure Controls and Procedures
The Company s management, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company s disclosure controls and procedures as defined in Rules 13a 15(e) and 15d 15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act), as of December 31, 2011. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures as of December 31, 2011 were effective in providing a reasonable level of assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods required under the Securities and Exchange Commission s rules and forms, including a reasonable level of assurance that information required to be disclosed by us in such reports is accumulated and communicated to the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting
There have been no changes in the Company s internal control over financial reporting that occurred during the quarter ended December 31, 2011 that have materially affected, or are likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Pending legal proceedings involve ordinary routine litigation incidental to our business, which we do not believe would have a material adverse effect on our business regardless of their outcome.

Item 1A. Risk Factors

We have evaluated the risks associated with our business and operations and determined that those risk factors included in Part 1, Item 1A of our 2011 Annual Report on Form 10-K adequately disclose the material risks that we face.

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Item 6. Exhibits

Exhibit No.	Description
31 (A)	Certification of Chief Executive Officer pursuant to Rule 13a 14(a) and Rule 15d 14(a) of the Securities Exchange Act, as amended. (filed herewith)
31 (B)	Certification of Chief Financial Officer pursuant to Rule 13a 14(a) and Rule 15d 14(a) of the Securities Exchange Act, as amended. (filed herewith)
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
101	The following financial information from this Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2011, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income; (iii) the Consolidated Statements of Comprehensive (Loss) Income; (iv) the Consolidated Statements of Cash Flows; (v) the Consolidated Statements of Changes in Equity; and (vi) the Notes to the Consolidated Financial Statements.

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SIGNATURE

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

	Carpenter Technology Corporation (Registrant)
Date: February 3, 2012	/s/ K. Douglas Ralph K. Douglas Ralph Senior Vice President and Chief Financial Officer
	(duly authorized officer and principal financial officer)

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