TELEDYNE TECHNOLOGIES INC
Form 10-Q
August 09, 2016
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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 3, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-15295

TELEDYNE TECHNOLOGIES INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	25-1843385
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1049 Camino Dos Rios Thousand Oaks, California	91360-2362
(Address of principal executive offices)	(Zip Code)

(805) 373-4545
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 5, 2016
Common Stock, $.01 par value per share	34,656,748 shares

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements
TELEDYNE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
FOR THE SECOND QUARTER AND SIX MONTHS ENDED JULY 3, 2016 AND JUNE 28, 2015
(Unaudited - Amounts in millions, except per-share amounts)

	Second Quarter		Six Months	
	2016	2015	2016	2015
Net sales	$534.9	$573.6	$1,060.1	$1,135.1
Costs and expenses				
Cost of sales	331.8	353.9	651.8	696.6
Selling, general and administrative expenses	148.8	150.6	292.9	301.8
Total costs and expenses	480.6	504.5	944.7	998.4
Operating income	54.3	69.1	115.4	136.7
Interest expense, net	(5.9)	(6.0)	(11.6)	(11.9)
Other income, net	17.2	3.4	15.9	4.2
Income before income taxes	65.6	66.5	119.7	129.0
Provision for income taxes	19.5	18.4	35.1	37.0
Net income from continuing operations	46.1	48.1	84.6	92.0
Loss from discontinued operations, net of income taxes	(0.4)	(0.1)	(0.5)	(0.3)
Net income	$45.7	$48.0	84.1	91.7
Noncontrolling interest	—	0.3	—	0.3
Net income attributable to Teledyne	$45.7	$48.3	$84.1	$92.0
Amounts attributable to Teledyne:				
Net income from continuing operations	$46.1	$48.4	$84.6	$92.3
Loss from discontinued operations, net of income taxes	(0.4)	(0.1)	(0.5)	(0.3)
Net income attributable to Teledyne	$45.7	$48.3	$84.1	$92.0
Basic earnings per common share:				
Continuing operations	$1.34	$1.37	$2.45	$2.60
Discontinued operations	(0.01)	—	(0.01)	(0.01)
Basic earnings per common share	$1.33	$1.37	$2.44	$2.59
Weighted average common shares outstanding	34.4	35.3	34.4	35.5
Diluted earnings per common share:				
Continuing operations	$1.32	$1.34	$2.42	$2.54
Discontinued operations	(0.01)	—	(0.01)	(0.01)
Diluted earnings per common share	$1.31	$1.34	$2.41	$2.53
Weighted average diluted common shares outstanding	35.0	36.1	35.0	36.3

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

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TELEDYNE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
FOR THE SECOND QUARTER AND SIX MONTHS ENDED JULY 3, 2016 AND JUNE 28, 2015
(Unaudited - Amounts in millions)

	Second Quarter		Six Months	
	2016	2015	2016	2015
Net income	$45.7	$48.0	$84.1	$91.7
Other comprehensive (loss) income:				
Foreign exchange translation adjustment	(11.8)	20.8	11.3	(28.4)
Hedge activity, net of tax	0.9	1.8	5.5	(0.5)
Pension and postretirement benefit adjustments, net of tax	3.9	4.0	7.5	8.9
Other comprehensive (loss) income	(7.0)	26.6	24.3	(20.0)
Comprehensive income	38.7	74.6	108.4	71.7
Noncontrolling interest	—	0.3	—	0.3
Comprehensive income attributable to Teledyne	$38.7	$74.9	$108.4	$72.0

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

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TELEDYNE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited - Amounts in millions, except share amounts)

	July 3, 2016	January 3, 2016
Assets		
Current Assets		
Cash	$71.7	$85.1
Restricted cash	19.5	—
Accounts receivable, net	367.6	368.6
Inventories, net	319.0	304.1
Prepaid expenses and other current assets	40.9	59.4
Assets held for sale	11.8	12.1
Total current assets	830.5	829.3
Property, plant and equipment, at cost, net of accumulated depreciation and amortization of $453.1 at July 3, 2016 and $443.2 at January 3, 2016	321.9	318.8
Goodwill	1,186.5	1,140.2
Acquired intangibles, net	246.1	243.3
Prepaid pension assets	124.5	111.0
Other assets, net	71.0	74.5
Total Assets	$2,780.5	$2,717.1
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	$134.0	$134.2
Accrued liabilities	252.3	237.5
Current portion of long-term debt and capital leases	13.5	19.1
Liabilities held for sale	2.5	2.8
Total current liabilities	402.3	393.6
Long-term debt and capital leases	678.2	761.5
Other long-term liabilities	222.9	217.9
Total Liabilities	1,303.4	1,373.0
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, $0.01 par value; outstanding shares - none	—	—
Common stock, $0.01 par value; authorized 125,000,000 shares; issued shares: 37,697,865 at July 3, 2016 and 37,697,865 at January 3, 2016: outstanding shares: 34,619,385 at July 3, 2016 and 34,514,599 at January 3, 2016	0.4	0.4
Additional paid-in capital	351.0	345.3
Retained earnings	1,805.6	1,721.5
Treasury stock, 3,078,480 at July 3, 2016 and 3,183,266 at January 3, 2016	(291.0)	(309.9)
Accumulated other comprehensive loss	(388.9)	(413.2)
Total Stockholders' Equity	1,477.1	1,344.1
Total Liabilities and Stockholders' Equity	$2,780.5	$2,717.1

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

TELEDYNE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JULY 3, 2016 AND JUNE 28, 2015
(Unaudited - Amounts in millions)

	Six Months	
	2016	2015
Operating Activities		
Net income	$84.1	$91.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	42.6	45.8
Deferred income taxes	10.9	0.6
Stock option compensation expense	6.2	7.1
Excess income tax benefits from stock options exercised	(1.2)	(2.1)
Gain on sale of facility	(17.9)	—
Changes in operating assets and liabilities, excluding the effect of businesses acquired:		
Accounts receivable	6.8	2.9
Inventories	(12.6)	(20.9)
Prepaid expenses and other assets	0.7	(0.5)
Accounts payable	(2.1)	(18.1)
Accrued liabilities	16.2	(34.9)
Income taxes receivable/payable, net	24.8	6.1
Long-term assets	0.9	0.7
Other long-term liabilities	1.7	3.0
Pension and postretirement benefits	(9.3)	(6.8)
Other, net	0.4	(0.5)
Net cash provided by operating activities from continuing operations	152.2	74.1
Net cash provided by discontinued operations	0.5	1.6
Net cash provided by operating activities	152.7	75.7
Investing Activities		
Purchases of property, plant and equipment	(30.5)	(21.1)
Purchase of businesses and other investments, net of cash acquired	(58.3)	(62.4)
Proceeds from sale of assets	20.2	3.3
Sales proceeds transferred to escrow as restricted cash	(19.5)	—
Other, net	(0.5)	—
Net cash used in investing activities from continuing operations	(88.6)	(80.2)
Net cash used in discontinued operations	—	(0.2)
Net cash used in investing activities	(88.6)	(80.4)
Financing Activities		
Net (payments) proceeds on credit facility	(74.9)	75.0
Proceeds on other debt	6.4	—
Payments on other debt	(19.8)	(15.3)
Proceeds from exercise of stock options	9.6	10.8
Purchase of treasury stock	—	(142.0)
Excess income tax benefits from stock options exercised	1.2	2.1
Other, net	(0.4)	(0.5)
Net cash used in financing activities	(77.9)	(69.9)
Effect of exchange rate changes on cash	0.4	(5.5)
Decrease in cash	(13.4)	(80.1)
Cash—beginning of period	85.1	141.4

Cash—end of period	$71.7	$61.3

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

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TELEDYNE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
July 3, 2016

Note 1. General
Basis of Presentation
The accompanying unaudited condensed consolidated financial statements have been prepared by Teledyne Technologies Incorporated ("Teledyne" or the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in notes to consolidated financial statements have been condensed or omitted pursuant to such rules and regulations, but resultant disclosures are in accordance with accounting principles generally accepted in the United States as they apply to interim reporting. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes in Teledyne's Annual Report on Form 10-K for the fiscal year ended January 3, 2016 ("2015 Form 10-K").
In the opinion of Teledyne's management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly, in all material respects, Teledyne's consolidated financial position as of July 3, 2016 and the consolidated results of operations and consolidated comprehensive income for the three and six months then ended and cash flows for the six months then ended. The results of operations and cash flows for the period ended July 3, 2016 are not necessarily indicative of the results of operations or cash flows to be expected for any subsequent quarter or the full fiscal year.
In the third quarter of 2016, Teledyne sold assets of the Printed Circuit Technology business for $9.3 million in cash. As a result, these financial statements reflect the classification of our Printed Circuit Technology business as a discontinued operation. See Note 14 to these condensed consolidated financial statements for additional information.

Recent Accounting Pronouncements
In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which provides a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will supersede most current revenue recognition guidance. In July 2015, the FASB deferred the effective date by one year, but will allow early adoption as of the original adoption date. This new guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and can be adopted either retrospectively to each prior reporting period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is currently in the process of determining its implementation approach and evaluating the impact this guidance will have on the consolidated financial statements and footnote disclosures.

In March 2016, the FASB Issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting. The ASU is intended to simplify several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods, with early adoption permitted for any entity in any interim or annual period. The Company is currently evaluating the impact this guidance will have on the consolidated financial statements and footnote disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The new guidance will require lessees to recognize almost all leases on their balance sheet as a right-of-use asset and a lease liability, other than leases that meet the definition of a short- term lease. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. The new leasing standard will be effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition, requiring application at the beginning of the earliest comparative period presented. The Company is currently evaluating the impact this guidance will have on the consolidated financial statements and footnote disclosures.

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Note 2. Accumulated Other Comprehensive Income (Loss)
The changes in accumulated other comprehensive income ("AOCI") by component, net of tax, for the second quarter and six months ended July 3, 2016 and June 28, 2015 are as follows (in millions):

	Foreign Currency Translation	Cash Flow Hedges and Other	Pension and Postretirement Benefits	Total
Balance as of April 3, 2016	$ (151.1)	$ (2.1)	$ (228.7)	$(381.9)
Other comprehensive income (loss) before reclassifications	(11.8)	0.3	—	(11.5)
Amounts reclassified from AOCI	—	0.6	3.9	4.5
Net other comprehensive income (loss)	(11.8)	0.9	3.9	(7.0)
Balance as of July 3, 2016	$ (162.9)	$ (1.2)	$ (224.8)	$(388.9)

	Foreign Currency Translation	Cash Flow Hedges and Other	Pension and Postretirement Benefits	Total
Balance as of March 29, 2015	$ (139.8)	$ (7.6)	$ (222.4)	$(369.8)
Other comprehensive income before reclassifications	20.8	0.4	—	21.2
Amounts reclassified from AOCI	—	1.4	4.0	5.4
Net other comprehensive income	20.8	1.8	4.0	26.6
Balance as of June 28, 2015	$ (119.0)	$ (5.8)	$ (218.4)	$(343.2)

	Foreign Currency Translation	Cash Flow Hedges and Other	Pension and Postretirement Benefits	Total
Balance as of January 3, 2016	$ (174.2)	$ (6.7)	$ (232.3)	$(413.2)
Other comprehensive income before reclassifications	11.3	3.3	—	14.6
Amounts reclassified from AOCI	—	2.2	7.5	9.7
Net other comprehensive income	11.3	5.5	7.5	24.3
Balance as of July 3, 2016	$ (162.9)	$ (1.2)	$ (224.8)	$(388.9)

	Foreign Currency Translation	Cash Flow Hedges and Other	Pension and Postretirement Benefits	Total
Balance as of December 28, 2014	$ (90.6)	$ (5.3)	$ (227.3)	$(323.2)
Other comprehensive loss before reclassifications	(28.4)	(2.9)	—	(31.3)
Amounts reclassified from AOCI	—	2.4	8.9	11.3
Net other comprehensive income (loss)	(28.4)	(0.5)	8.9	(20.0)
Balance as of June 28, 2015	$ (119.0)	$ (5.8)	$ (218.4)	$(343.2)

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The reclassifications out of AOCI for the second quarter and six months ended July 3, 2016 and June 28, 2015 are as follows (in millions):

	Amount Reclassified from AOCI Three Months Ended July 3, 2016	Amount Reclassified from AOCI Three Months Ended June 28, 2015	Statement of Income Presentation
Loss on cash flow hedges:			
Loss recognized in income on derivatives	$ 0.8	$ 1.8	Cost of sales
Income tax benefit	(0.2)	(0.4)	Income tax benefit
Total	$ 0.6	$ 1.4	
Amortization of defined benefit pension and postretirement plan items:			
Amortization of prior service cost	$ (1.5)	$ (1.5)	Costs and expenses
Amortization of net actuarial loss	7.4	8.1	Costs and expenses
Total before tax	5.9	6.6	
Income tax benefit	(2.0)	(2.6)	Income tax benefit
Total	$ 3.9	$ 4.0	

	Amount Reclassified from AOCI Six Months Ended July 3, 2016	Amount Reclassified from AOCI Six Months Ended June 28, 2015	Statement of Income Presentation
Loss on cash flow hedges:			
Loss recognized in income on derivatives	$ 3.0	$ 3.2	Cost of sales
Income tax benefit	(0.8)	(0.8)	Income tax benefit
Total	$ 2.2	$ 2.4	
Amortization of defined benefit pension and postretirement plan items:			
Amortization of prior service cost	$ (3.0)	$ (3.0)	Costs and expenses
Amortization of net actuarial loss	14.5	17.1	Costs and expenses
Total before tax	11.5	14.1	
Income tax benefit	(4.0)	(5.2)	Income tax benefit
Total	$ 7.5	$ 8.9	

Note 3. Business Combinations, Dispositions, Goodwill and Acquired Intangible Assets

On May 3, 2016, Teledyne DALSA, a Canadian-based subsidiary, acquired CARIS, Inc. ("CARIS") for an initial payment of $26.6 million, net of cash acquired. Based in Fredericton, New Brunswick, CARIS is a leading developer of geospatial software designed for the hydrographic and marine community and is part of the Digital Imaging segment.

On April 15, 2016, Teledyne LeCroy, Inc., a U.S.-based subsidiary, acquired Quantum Data, Inc. ("Quantum Data") for an initial payment of $17.5 million. Based in Elgin, Illinois, Quantum Data provides electronic test and measurement instrumentation, is a market leader in video protocol analysis test tools and is part of the Instrumentation segment.

On April 6, 2016, Teledyne LeCroy, Inc., a U.S.-based subsidiary, acquired Frontline Test Equipment, Inc. (“Frontline”) for an initial payment of $14.2 million. Based in Charlottesville, Virginia, Frontline provides electronic test and measurement instrumentation, is a market leader in wireless protocol analysis test tools, and is part of the Instrumentation segment.
Each of the above acquisitions is subject to a working capital adjustment.

Teledyne spent $66.7 million on acquisitions and other investments in 2015, of which $62.4 million was spent in the first six months of 2015. In June 2015, Teledyne DALSA BV, a Netherlands-based subsidiary, acquired Industrial Control Machines SA (“ICM”). In April 2015, Teledyne DALSA, Inc. acquired the remaining 49% noncontrolling interest in the parent company of Optech Incorporated (“Optech”). On February 2015, Teledyne acquired Bowtech Products Limited (“Bowtech”) through a U.K.-based subsidiary. Also in 2015, Teledyne made an additional investment in Ocean Aero, Inc. (“Ocean Aero”).

Teledyne funded the purchases from borrowings under its credit facility and cash on hand. The results of the acquisitions have been included in Teledyne’s results since the dates of the respective acquisition.

For a further description of the Company’s acquisition activity for the fiscal year ended January 3, 2016, please refer to Note 3 of our 2015 Annual Report on Form 10-K (“2015 Form 10-K”).

Teledyne’s goodwill was $1,186.5 million at July 3, 2016 and $1,140.2 million at January 3, 2016. The increase in the balance of goodwill in 2016 included $40.4 million in goodwill from recent acquisitions and also the impact of exchange rate changes. Goodwill from the 2016 acquisitions will be deductible for tax purposes. Teledyne’s net acquired intangible assets were $246.1 million at July 3, 2016 and $243.3 million at January 3, 2016. The increase in the balance of acquired intangible assets in 2016 included $15.5 million from recent acquisitions and the impact of exchange rate changes, partially offset by amortization of $14.2 million. The Company is still in the process of specifically identifying the amount to be assigned to certain assets, including acquired intangible assets, and liabilities and the related impact on taxes and goodwill for the 2016 acquisitions. The Company made preliminary estimates as of July 3, 2016 since there was insufficient time between the acquisition dates and the end of the period to finalize the analysis.

See Note 14 to these condensed consolidated financial statements for additional information on the sale of the Printed Circuit Technology business.

In the second quarter of 2016, Teledyne sold a former operating facility in California for net proceeds of $19.5 million. The gain on the sale of $17.9 million is included in other income. In conjunction with the sale of this former operating facility, Teledyne entered into a like-kind exchange agreement under Section 1031 of the U.S. Internal Revenue Code with a qualified intermediary. Pursuant to the like-kind exchange agreement, the net proceeds of $19.5 million were placed into an escrow account administered by a qualified intermediary. Accordingly, the net proceeds of $19.5 million were classified as restricted cash on the condensed consolidated balance sheet as of July 3, 2016.

Note 4. Derivative Instruments

Teledyne transacts business in various foreign currencies and has international sales and expenses denominated in foreign currencies, subjecting the Company to foreign currency risk. The Company’s primary foreign currency risk management objective is to protect the United States dollar value of future cash flows and minimize the volatility of reported earnings. All derivatives are recorded on the balance sheet at fair value. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on the use of the derivative and whether it is designated and qualifies for hedge accounting. The Company utilizes foreign currency forward contracts to reduce the volatility of cash flows primarily related to forecasted revenues and expenses denominated in Canadian dollars for our Canadian companies, including DALSA. These contracts are designated and qualify as cash flow hedges.

Cash Flow Hedging Activities

The effectiveness of the cash flow hedge contracts, excluding time value, is assessed prospectively and retrospectively on a monthly basis using regression analysis, as well as using other timing and probability criteria. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedges and must be highly effective in offsetting changes to future cash flows on hedged transactions. The effective portion of the cash flow hedge contracts’ gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of AOCI in stockholders’ equity until the underlying hedged item is reflected in our consolidated statements of income, at which time the effective amount in AOCI is reclassified to cost of sales in our consolidated statements of income. Net deferred gains recorded in AOCI, net of tax, for contracts that will mature in the next twelve months total $0.8 million. These gains are expected to be offset by anticipated losses in the value of the forecasted underlying hedged item.

In the event that the gains or losses in AOCI are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to other income and expense. In the event that the underlying forecasted transactions do not occur, or it becomes remote that they will occur, within the defined hedge period, the gains or losses on the related cash flow hedges will be reclassified from AOCI to other income and expense. During the current reporting period, all forecasted transactions occurred and, therefore, there were no such gains or losses reclassified to other income and expense. As of July 3, 2016, Teledyne had foreign currency forward contracts designated as cash flow hedges to buy Canadian dollars and

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to sell U.S. dollars totaling $67.4 million. These foreign currency forward contracts have maturities ranging from September 2016 to February 2018.

The effect of derivative instruments designated as cash flow hedges in the condensed consolidated financial statements for the second quarter and six months ended July 3, 2016 and June 28, 2015 was as follows (in millions):

	Second Quarter		Six Months	
	2016	2015	2016	2015
Net gain (loss) recognized in AOCI (a)	$ 0.5	$ 0.7	$ 4.4	$ (3.9)
Net loss reclassified from AOCI into cost of sales (a)	$ (0.8)	$ (1.8)	$ (3.0)	$ (3.2)
Net foreign exchange gain (loss) recognized in other income and expense (b)	$ —	$ —	$ (0.2)	$ 0.3

a) Effective portion, pre-tax

b) Amount excluded from effectiveness testing

Non-Designated Hedging Activities

In addition, the Company utilizes foreign currency forward contracts to mitigate foreign exchange rate risk associated with foreign-currency-denominated monetary assets and liabilities, including intercompany receivables and payables. As of July 3, 2016, Teledyne had foreign currency contracts of this type in the following pairs (in millions):

Contracts to Buy		Contracts to Sell	
Currency	Amount	Currency	Amount
Canadian Dollars	C$ 13.3	U.S. Dollars	US$ 10.6
Canadian Dollars	C$ 11.8	Euros	€ 8.1
Euros	€ 10.5	U.S. Dollars	US$ 12.0
Great Britain Pounds	£ 1.2	Australian Dollars	A$ 2.4
Great Britain Pounds	£ 21.9	U.S. Dollars	US$ 31.6
Singapore Dollars	S$ 1.7	U.S. Dollars	US$ 1.2
U.S. Dollars	US$ 1.0	Japanese Yen	¥ 100.0

The above table includes non-designated hedges derived from terms contained in triggered or previously designated cash flow hedges. The gains and losses on these derivatives which are not designated as hedging instruments are intended to, at a minimum, partially offset the transaction gains and losses recognized in earnings. Teledyne does not use foreign currency forward contracts for speculative or trading purposes.

The effect of derivative instruments not designated as cash flow hedges recognized in other income and expense for the second quarter and six months ended July 3, 2016 was expense of $2.3 million and gain of $0.3 million. The effect of derivative instruments not designated as cash flow hedges in other income and expense for the second quarter and six months ended June 28, 2015 was expense of $2.5 million and gain of $2.3 million.

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Fair Value of Derivative Financial Instruments

The fair values of the Company’s derivative financial instruments are presented below. All fair values for these derivatives were measured using Level 2 information as defined by the accounting standard hierarchy (in millions):

Asset/(Liability) Derivatives	Balance sheet location	July 3, 2016	January 3, 2016
Derivatives designated as hedging instruments:			
Cash flow forward contracts	Other assets	$1.1	$—
Cash flow forward contracts	Accrued liabilities	—	(4.7)
Cash flow forward contracts	Other long-term liabilities	—	(1.3)
Total derivatives designated as hedging instruments		1.1	(6.0)
Derivatives not designated as hedging instruments:			
Non-designated forward contracts	Other current assets	0.9	0.2
Non-designated forward contracts	Accrued liabilities	(4.0)	(6.0)
Total derivatives not designated as hedging instruments		(3.1)	(5.8)
Total liability derivatives		$(2.0)	$(11.8)

Note 5. Earnings Per Share

Basic and diluted earnings per share were computed based on net earnings. The weighted average number of common shares outstanding during the period was used in the calculation of basic earnings per share. The calculation of diluted earnings per share is based on the weighted average number of common shares outstanding increased by contingent dilutive shares that could be issued under: 1) various compensation plans, including the dilutive effect of stock options based on the treasury stock method and 2) the forward contract feature of the accelerated repurchase program.

On February 2, 2015, the Company entered into a $142.0 million accelerated share repurchase (“ASR”) agreement with a financial institution (“ASR Counterparty”) in a privately negotiated transaction for 1,500,000 shares of the Company's common stock. Pursuant to the ASR agreement, in February 2015, the Company advanced $142.0 million to the ASR counterparty and received 1,425,000 shares of common stock, which used $134.9 million of the $142.0 million advanced. In November 2015, the February 2015 ASR was settled with the Company making a payment of $1.2 million. In November 2015, the Company entered into a $100.5 million ASR agreement with a financial institution in a privately negotiated transaction for 1,100,000 shares of the Company's common stock. Pursuant to the ASR agreement, the Company advanced $100.5 million to the ASR counterparty and received 1,045,000 shares of common stock. On February 19, 2016, the November 2015 ASR was settled and Teledyne received 135,374 shares of common stock. In 2015, the Company spent a total of $243.8 million to repurchase a total of 2,561,815 shares of its common stock.

On January 26, 2016, the Company’s Board of Directors authorized an additional stock repurchase program authorizing the Company to repurchase up to an additional 3,000,000 shares of its common stock. The 2015 and 2016 stock repurchase authorizations are expected to remain open continuously, with respect to the shares remaining thereunder, and the number of shares repurchased will depend on a variety of factors, such as share price, levels of cash and borrowing capacity available, alternative investment opportunities available immediately or longer-term, and other regulatory, market or economic conditions. Future repurchases are expected to be funded with cash on hand and borrowings under the Company's credit facility. For a further description of the Company’s stock repurchase program, please refer to Note 8 of the 2015 Form 10-K.

For the second quarter and the first six months of 2016, 498,895 and 504,686 stock options were excluded in the computation of diluted earnings per share because they had exercise prices that were greater than the weighted average market price of the Company’s common stock during the period. For the second quarter and the first six months of 2015, no stock options were excluded in the computation of diluted earnings per share.

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The weighted average number of common shares used in the calculation of basic and diluted earnings per share consisted of the following (in millions):

	Second Quarter		Six Months	
	2016	2015	2016	2015
Weighted average basic common shares outstanding	34.4	35.3	34.4	35.5
Effect of dilutive securities	0.6	0.8	0.6	0.8
Weighted average diluted common shares outstanding	35.0	36.1	35.0	36.3

Note 6. Stock-Based Compensation Plans

Teledyne has long-term incentive plans pursuant to which it has granted non-qualified stock options, restricted stock and performance shares to certain employees. The Company also has non-employee director stock compensation plans, pursuant to which non-qualified stock options and common stock, and beginning in 2015 restricted stock units, have been issued to its directors. After 2014, non-employee directors no longer receive non-qualified stock options.

Stock Incentive Plan

The following disclosures are based on stock options granted to Teledyne's employees and directors. Stock option compensation expense was \$2.9 million and \$6.2 million for the second quarter and first six months of 2016, respectively. Stock option compensation expense was \$3.3 million and \$7.1 million for the second quarter and first six months of 2015. Employee stock option grants are charged to expense evenly over the three year vesting period. Director stock option grants are charged to expense evenly over the one-year vesting period. For 2016, the Company currently expects approximately \$11.5 million in stock option compensation expense based on stock options currently outstanding. This amount can be impacted by employee retirements and terminations or stock options granted during the remainder of the year. The Company issues shares of common stock upon the exercise of stock options. No stock options were granted in 2015.

The following assumptions were used in the valuation of stock options granted in 2016:

	2016
Expected volatility	32.7 %
Risk-free interest rate	1.5 %
Expected life in years	7.2
Expected dividend yield	—
Weighted average fair value	$29.95

Stock option transactions for the second quarter and six months ended July 3, 2016 are summarized as follows:

	2016			
	Second Quarter		Six Months	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Beginning balance	2,823,506	$ 66.87	2,383,870	$ 63.74
Granted	2,000	$ 93.67	520,310	$ 78.46
Exercised	(132,002)	$ 53.61	(195,970)	$ 49.31
Canceled	(13,526)	$ 84.71	(28,232)	$ 81.79
Ending balance	2,679,978	$ 67.46	2,679,978	$ 67.46
Options exercisable at end of period	2,011,396	$ 62.57	2,011,396	$ 62.57

Performance Share Plan and Restricted Stock Award Program

In the first quarter of 2016, the Company issued 864 shares of Teledyne common stock under the 2012 to 2014 Performance Share Plan. A maximum of 1,883 shares remain to be issued in 2017 under the plan.

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The following table shows the restricted stock activity for fiscal year 2016:

Restricted stock:	Shares	Weighted average fair value per share
Balance, January 3, 2016	109,170	$ 83.58
Granted	47,409	$ 77.93
Issued	(48,891)	$ 75.30
Forfeited/Canceled	(152)	$ 64.46
Balance, July 3, 2016	107,536	$ 84.87

Note 7. Inventories

Inventories are stated at current cost net of reserves for excess, slow moving and obsolete inventory, less progress payments. Inventories are valued under the FIFO method, LIFO method and average cost method. Inventories at cost determined on the average cost or the FIFO methods were $229.8 million at July 3, 2016 and $239.0 million at January 3, 2016. The remainder of the inventories using the LIFO method were $108.8 million at July 3, 2016 and $91.6 million at January 3, 2016. Interim LIFO calculations are based on the Company's estimates of expected year-end inventory levels and costs since an actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Because these are subject to many factors beyond the Company's control, interim results are subject to the final year-end LIFO inventory valuation.

Inventories (in millions):	Balance at July 3, 2016	January 3, 2016
Raw materials and supplies	$143.3	$139.1
Work in process	149.5	146.1
Finished goods	45.8	45.4
	338.6	330.6
Progress payments	(5.9)	(12.3)
Reduction to LIFO cost basis	(13.7)	(14.2)
Total inventories, net	$319.0	$304.1

Note 8. Supplemental Balance Sheet Information

The following table presents the balance of selected components of Teledyne's balance sheet:

Balance sheet items (in millions)	Balance sheet classification	Balance at July 3, 2016	January 3, 2016
Income tax receivable	Prepaid expenses and other current assets	$6.7	$ 28.8
Deferred compensation assets	Other assets, net	$47.6	$ 47.9
Salaries and wages	Accrued liabilities	$83.0	$ 89.2
Customer deposits and credits	Accrued liabilities	$58.6	$ 37.6
Accrued pension obligation	Other long-term liabilities	$43.3	$ 46.7
Accrued postretirement benefits	Other long-term liabilities	$9.1	$ 9.6
Deferred compensation liabilities	Other long-term liabilities	$45.4	$ 43.9
Deferred tax liabilities	Other long-term liabilities	$46.7	$ 37.9

Some of the Company's products are subject to specified warranties, and the Company provides for the estimated cost of product warranties. The adequacy of the warranty reserve is assessed regularly, and the reserve is adjusted as necessary based on a review of historic warranty experience with respect to the applicable business or products, as well as the length and actual

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terms of the warranties. The warranty reserve is included in current and long-term accrued liabilities on the balance sheet.

	Six Months	
Warranty Reserve (in millions):	2016	2015
Balance at beginning of year	$17.1	$18.5
Accruals for product warranties charged to expense	3.5	3.7
Cost of product warranty claims	(3.4)	(4.0)
Acquisitions	0.3	0.2
Balance at end of period	$17.5	$18.4

Note 9. Income Taxes

The income tax provision is calculated using an estimated annual effective tax rate, based upon expected annual income, permanent items, statutory rates and planned tax strategies in the various jurisdictions in which the Company operates. However, losses in certain jurisdictions and discrete items, such as the resolution of uncertain tax positions, are treated separately.

The Company's effective income tax rate for the second quarter and first six months of 2016 was 29.7% and 29.3%, respectively. The Company's effective income tax rate for the second quarter and first six months of 2015 was 27.5% and 28.6%, respectively. The second quarter of 2016 included net discrete income tax expense of $6.9 million compared with net discrete income tax benefit of $1.3 million for the second quarter of 2015. The first six months of 2016 included $6.9 million in net discrete income tax expense, compared with net discrete income tax benefits of $1.1 million for the first six months of 2015. The net discrete tax expense of $6.9 million in both 2016 periods, includes $6.7 million in income tax expense related to the $17.9 million gain on the sale of the operating facility. Excluding net discrete income tax items in both periods, and the gain and related taxes on the facility sale in 2016, the effective tax rates would have been 26.4% for the second quarter and 27.7% for the first six months of 2016 and 29.5% for both the second quarter and first six months of 2015.

Note 10. Long-Term Debt, Capital Lease and Letters of Credit

	Balance at	
Long-Term Debt (in millions):	July 3, 2016	January 3, 2016
$750.0 million credit facility due March 2018, weighted average rate of 1.62% at July 3, 2016 and 1.67% at January 3, 2016	$75.6	$ 150.5
Term loans due through March 2019, weighted average rate of 1.71% at July 3, 2016 and 1.55% at January 3, 2016	185.0	190.0
4.74% Fixed Rate Senior Notes due September 2017	100.0	100.0
2.61% Fixed Rate Senior Notes due December 2019	30.0	30.0
5.30% Fixed Rate Senior Notes due September 2020	75.0	75.0
2.81% Fixed Rate Senior Notes due November 2020	25.0	25.0
3.09% Fixed Rate Senior Notes due December 2021	95.0	95.0
3.28% Fixed Rate Senior Notes due November 2022	100.0	100.0
Other debt at various rates due through 2018	0.2	—
Total debt	685.8	765.5
Less: current portion of long-term debt and debt issuance costs (a)	(13.8)	(11.4)
Total long-term debt	$672.0	$ 754.1

(a) Includes debt issue costs associated with the term loans and senior notes of $1.3 million at July 3, 2016 and $1.4 million at January 3, 2016.

Available borrowing capacity under the $750.0 million credit facility, which is reduced by borrowings and certain outstanding letters of credit, was $636.6 million at July 3, 2016. The credit agreements require the Company to comply with various financial and operating covenants and at July 3, 2016, the Company was in compliance with these covenants.

Teledyne estimates the fair value of its long-term debt based on debt of similar type, rating and maturity and at comparable interest rates. The Company’s long-term debt is considered a level 2 fair value hierarchy and is valued based on observable market data. The estimated fair value of Teledyne’s long-term debt at July 3, 2016 and January 3, 2016, approximated the carrying value.

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At July 3, 2016, the Company had $7.2 million in capital leases, of which $1.0 million is current. At January 3, 2016, the Company had $8.6 million in capital leases, of which $1.2 million was current. At July 3, 2016, Teledyne had $12.2 million in outstanding letters of credit.

Note 11. Lawsuits, Claims, Commitments, Contingencies and Related Matters

For a further description of the Company's commitments and contingencies, reference is made to Note 14 of the Company's financial statements as of and for the fiscal year ended January 3, 2016, included in the 2015 Form 10-K.

At July 3, 2016, the Company's reserves for environmental remediation obligations totaled $7.9 million, of which $4.4 million is included in current accrued liabilities. The Company periodically evaluates whether it may be able to recover a portion of future costs for environmental liabilities from its insurance carriers and from third parties. The timing of expenditures depends on a number of factors that vary by site, including the nature and extent of contamination, the number of potentially responsible parties, the timing of regulatory approvals, the complexity of the investigation and remediation, and the standards for remediation. The Company expects that it will expend present accruals over many years and will complete remediation of all sites with which it has been identified in up to 30 years.

A number of other lawsuits, claims and proceedings have been or may be asserted against the Company, including those pertaining to product liability, acquisitions, patent infringement, contracts, environmental, employment and employee benefits matters. While the outcome of litigation cannot be predicted with certainty, and some of these lawsuits, claims or proceedings may be determined adversely to the Company, management does not believe that the disposition of any such pending matters is likely to have a material adverse effect on the Company's financial statements.

Note 12. Pension Plans and Postretirement Benefits

Teledyne's pension income was $0.6 million for the second quarter and $1.1 million for first six months of 2016. Teledyne's pension expense was $1.1 million for the second quarter and $0.9 million for first six months of 2015. In the first quarter of 2015, Teledyne froze its non-qualified pension plan for top executives which resulted in a one-time gain of $1.2 million in the first quarter of 2015. For the domestic pension plan, the discount rate increased to 4.91 percent in 2016 compared with a 4.5 percent discount rate used in 2015. Pension expense allocated to contracts pursuant to U.S. Government Cost Accounting Standards ("CAS") was $3.4 million for both the second quarters of 2016 and 2015, respectively. Pension expense determined under CAS can generally be recovered through the pricing of products and services sold to the U.S. Government. Teledyne did not make any cash pension contributions to its domestic pension plan in the first six months of 2016 or in 2015. No cash pension contributions are planned for 2016 for the domestic pension plan. The Company sponsors several postretirement defined benefit plans that provide health care and life insurance benefits for certain eligible retirees.

	Second Quarter		Six Months	
Net periodic pension benefit income (in millions):	2016	2015	2016	2015
Service cost — benefits earned during the period	$2.8	$3.4	$5.6	$6.7
Interest cost on benefit obligation	10.1	9.8	20.2	19.7
Expected return on plan assets	(18.8)	(19.1)	(37.5)	(38.3)
Amortization of prior service cost	(1.5)	(1.5)	(3.0)	(3.0)
Amortization of net actuarial loss	6.8	8.5	13.6	17.0
Pension plan curtailment	—	—	—	(1.2)
Net periodic pension (income) expense	$(0.6)	$1.1	$(1.1)	$0.9

	Second Quarter		Six Months	
Net periodic postretirement benefits expense (in millions):	2016	2015	2016	2015
Interest cost on benefit obligation	$0.2	$0.2	$0.3	$0.3
Amortization of net actuarial gain	(0.1)	(0.1)	(0.2)	(0.1)
Net periodic postretirement expense	$0.1	$0.1	$0.1	$0.2

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Note 13. Segment Information

Teledyne is a leading provider of sophisticated instrumentation, digital imaging products and software, aerospace and defense electronics, and engineered systems. Our customers include government agencies, aerospace prime contractors, energy exploration and production companies, major industrial companies and airlines. The Company has four reportable segments: Instrumentation; Digital Imaging; Aerospace and Defense Electronics; and Engineered Systems.

Segment results include net sales and operating income by segment but excludes noncontrolling interest, equity income or loss, unusual non-recurring legal matter settlements, interest income and expense, gains and losses on the disposition of assets, sublease rental income and non-revenue licensing and royalty income, domestic and foreign income taxes and corporate office expenses. Corporate expense includes various administrative expenses relating to the corporate office and certain non-operating expenses not allocated to our segments.

During 2016, as part of a continuing effort to reduce costs and improve operating performance the Company took actions to consolidate and relocate certain facilities and reduce headcount across various businesses, reducing our exposure to weak end markets and high cost locations. In connection with these efforts, in the second quarter of 2016, the Company incurred pretax charges of $5.8 million in severance related expenses and $4.4 million in facility closure and relocation expenses and $0.6 million of asset impairment expense. The Company incurred $2.1 million of similar expenses in the second quarter of 2015. The second quarter of 2015 also included the reversal of similar reserves of $1.7 million that were no longer needed.

The following tables set forth details regarding severance and facility consolidation expenses incurred in 2016 and 2015 (in millions):

	2016			2015		
	First Quarter	Second Quarter	Year to Date	First Quarter	Second Quarter	Year to Date
Instrumentation	$0.6	$ 8.1	$8.7	$0.1	$ 1.3	$ 1.4
Digital Imaging	0.1	1.7	1.8	0.4	0.3	0.7
Aerospace and Defense Electronics	0.4	0.4	0.8	0.2	0.5	0.7
Total	$1.1	$ 10.2	$11.3	$0.7	$ 2.1	$ 2.8

	2016			2015		
	First Quarter	Second Quarter	Year to Date	First Quarter	Second Quarter	Year to Date
Severance	$0.8	$ 5.8	$6.6	$0.7	$ 2.1	$ 2.8
Facility consolidations	0.3	4.4	4.7	—	—	—
Total	$1.1	$ 10.2	$11.3	$0.7	$ 2.1	$ 2.8

	2016			2015		
	First Quarter	Second Quarter	Year to Date	First Quarter	Second Quarter	Year to Date
Cost of sales	$0.6	$ 4.6	$5.2	$0.4	$ 0.9	$ 1.3
Selling, general and administrative expenses	0.5	5.6	6.1	0.3	1.2	1.5
Total	$1.1	$ 10.2	$11.3	$0.7	$ 2.1	$ 2.8

At July 3, 2016, Teledyne had a liability of $3.6 million included in other current liabilities related to these charges.

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The following table presents Teledyne’s segment disclosures (dollars in millions).

	Second Quarter		%	Six Months		%
	2016	2015	Change	2016	2015	Change
Net sales(a):						
Instrumentation	$220.1	$271.3	(18.9)%	$443.8	$541.6	(18.1)%
Digital Imaging	99.4	90.8	9.5 %	189.3	181.2	4.5 %
Aerospace and Defense Electronics	153.2	142.9	7.2 %	300.5	280.6	7.1 %
Engineered Systems						