

PHOTONIC PRODUCTS GROUP INC

Form EFFECT

May 05, 2009

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Continuing operations

\$

4.19

\$

4.00

\$

3.97

\$

3.84

\$

3.15

\$

3.10

Earnings Per Share

\$

3.94

\$

3.75

\$

3.45

\$

3.32

\$

1.94

\$

1.89

Earnings Per Share Attributable to Esterline - Diluted:

Continuing operations

\$

4.15

\$

3.96

\$

3.93

\$

3.80

\$

3.10

\$

3.05

Earnings Per Share

\$

3.91

\$

3.72

\$

3.42

\$

3.29

\$

1.91

\$

1.86

61

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In the consolidated financial statements, the impact of the restatement in fiscal 2014 are reflected in this Amendment as an adjustment of \$0.9 million to beginning retained earnings for fiscal 2015.

A summary of the effects of the Restatement as of September 29, 2017, September 30, 2016, and October 2, 2015, is as follows:

In Thousands	2017		2016		2015	
	(As Reported)	(Restated)	(As Reported)	(Restated)	(As Reported)	(Restated)
<b>Consolidated Balance Sheet</b>						
Accounts receivable, net	\$437,963	\$430,524	\$422,073	\$421,511	\$380,748	\$380,450
Inventories	482,701	477,969	450,206	447,095	446,768	442,315
Prepaid expenses	18,816	19,239	17,909	18,378	23,008	23,156
Deferred income tax benefits	55,355	56,793	75,409	75,790	28,979	27,982
Accounts payable	133,101	138,595	121,816	126,607	117,976	118,734
Accrued liabilities	229,610	230,007	238,163	235,649	259,734	256,147
U.S. and foreign income taxes	6,111	582	10,932	9,695	2,404	1,861
Other liabilities	17,658	18,838	21,968	23,026	29,367	30,174
Deferred income tax liabilities	43,978	43,978	53,798	54,325	73,849	73,106
Total Shareholders' Equity	1,847,128	1,835,276	1,611,131	1,605,865	1,547,791	1,545,496

The Company did not present tables for the adjustments within the consolidated statement of cash flows, since all of the foregoing adjustments were within the operating activities section of the consolidated statement of cash flows. These adjustments did not affect total cash flows from operating activities, financing activities or investing activities for any period presented. Additionally, changes to the Consolidated Statement of Comprehensive Income (Loss), Consolidated Statement of Shareholders' Equity and Noncontrolling Interests as well as additional footnotes were a result of the above adjustments.

NOTE 3: Allowance for Doubtful Accounts

The allowance for doubtful accounts reflects the best estimate of probable losses inherent in the accounts receivable balance and is based on known past due accounts, historical experience and other currently available evidence. Activity in the allowance for doubtful accounts was as follows:

In Thousands	2017	2016	2015
Beginning balance	\$17,028	\$10,050	\$10,023
Charged to expense	1,647	9,690	1,502
Other <sup>1</sup>	-	-	378
Write-offs	(2,640)	(2,712)	(1,853)

\$16,035 \$17,028 \$10,050

<sup>1</sup> Other includes balances acquired and balances reclassified to assets held for sale.

## NOTE 4: Inventories

Inventories at the end of fiscal 2017 and 2016 consisted of the following:

In Thousands	2017 (Restated)	2016 (Restated)
Raw materials and purchased parts	\$ 194,034	\$ 176,438
Work in progress	167,543	156,191
Inventory costs under long-term contracts	10,648	12,844
Finished goods	105,744	101,622
	\$ 477,969	\$ 447,095

## NOTE 5: Goodwill

The following table summarizes the changes in goodwill by segment for fiscal 2017 and 2016:

In Thousands	Avionics & Controls	Sensors & Systems	Advanced Materials	Total
Balance, October 2, 2015	\$450,599	\$387,707	\$203,685	\$1,041,991
Goodwill adjustments	(1,732 )	-	-	(1,732 )
Foreign currency translation adjustment	(6,073 )	(2,140 )	(7,379 )	(15,592 )
Balance, September 30, 2016	442,794	385,567	196,306	1,024,667
Foreign currency translation adjustment	13,224	14,266	1,416	28,906
Balance, September 29, 2017	\$456,018	\$399,833	\$197,722	\$1,053,573

## NOTE 6: Intangible Assets

Intangible assets at the end of fiscal 2017 and 2016 were as follows:

In Thousands	Weighted Average Years Useful Life	2017 Gross Carrying Amount	Accum. Amort.	2016 Gross Carrying Amount	Accum. Amort.
Amortized Intangible Assets:					
Programs	16	\$625,470	\$339,920	\$607,276	\$293,223
Core technology	12	15,926	13,123	15,926	11,778
Patents and other	12	89,736	60,335	86,286	51,250
Total		\$731,132	\$413,378	\$709,488	\$356,251
Indefinite-lived Intangible Assets:					
Trademarks		\$41,412		\$39,798	

Programs represent the valuation of systems or components sold under long-term supply agreements with aerospace companies, military contractors, and OEM manufacturers using similar technology. The valuation of the program includes the values of the program-specific technology, the backlog of contracts, and the relationship with customers which lead to potential future contracts. The valuation of the program is based upon its discounted cash flow at a market-based discount rate.

Amortization of intangible assets from continuing operations was \$44.2 million, \$49.4 million, and \$44.0 million in fiscal 2017, 2016, and 2015, respectively. Amortization of intangible assets related to discontinued operations was

\$1.2 million in fiscal 2015.

Estimated amortization expense related to intangible assets for each of the next five fiscal years is as follows:

In Thousands

Fiscal Year	
2018	\$45,953
2019	45,076
2020	42,941
2021	41,555
2022	35,355

## NOTE 7: Accrued Liabilities

Accrued liabilities at the end of fiscal 2017 and 2016 consisted of the following:

In Thousands	2017 (Restated)	2016 (Restated)
Payroll and other compensation	\$ 120,428	\$ 107,132
Commissions	4,442	5,901
Casualty and medical	16,067	14,933
Interest	6,592	6,397
Warranties	14,689	13,365
State and other tax accruals	5,222	4,737
Customer deposits	20,593	22,302
Deferred revenue	18,666	24,125
Contract reserves	5,109	8,051
Forward foreign exchange contracts	4,387	12,036
Litigation reserves	1,454	4,006
Environmental reserves	645	646
Deferred rent	1,645	1,925
Other	10,068	10,093
	\$ 230,007	\$ 235,649

Accrued liabilities are recorded to reflect the Company's contractual obligations relating to warranty commitments to customers. Warranty coverage of various lengths and terms is provided to customers depending on standard offerings and negotiated contractual agreements. An estimate for warranty expense is recorded at the time of sale based on the length of the warranty, historical warranty return rates and repair costs.

Changes in the carrying amount of accrued product warranty costs are summarized as follows:

In Thousands	2017	2016
Balance, beginning of year	\$ 13,365	\$ 14,658
Warranty costs incurred	(1,875 )	(2,423 )
Product warranty accrual	4,658	6,850
Release of reserves	(1,907 )	(5,700 )
Foreign currency translation adjustment	448	(20 )
Balance, end of year	\$ 14,689	\$ 13,365

## NOTE 8: Retirement Benefits

Approximately 40% of U.S. employees have a defined benefit earned under the Esterline pension plan.

Under the Esterline defined benefit plan, pension benefits are earned under a cash balance formula with annual pay credits ranging from 2% to 6% effective January 1, 2003. Prior to 2003, pension benefits are based on years of service

and five-year average compensation for the highest five consecutive years' compensation during the last ten years of employment. Participants elected either to continue earning benefits under the prior plan formula or to earn benefits under the cash balance formula. Effective January 1, 2003, all new participants are enrolled in the cash balance formula. Esterline also has an unfunded supplemental retirement plan for key executives providing for periodic payments upon retirement.

CMC sponsors defined benefit pension plans and other retirement benefit plans for its employees in Canada. Pension benefits are based upon years of service and final average salary. Other retirement benefit plans are non-contributory health care and life insurance plans.

The Company sponsors a number of other non-U.S. defined benefit pension plans primarily in Belgium, France and Germany. These defined benefit plans generally provide benefits to employees based on formulas recognizing length of service and earnings.

The Company accounts for pension expense using the end of the fiscal year as its measurement date. In addition, the Company makes actuarially computed contributions to these plans as necessary to adequately fund benefits. The Company's funding policy is consistent with the minimum funding requirements of ERISA.

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The accumulated benefit obligation and projected benefit obligation for Esterline's U.S. plans are \$309.2 million and \$321.2 million, respectively, with plan assets of \$294.4 million as of September 29, 2017. The underfunded status for the Esterline plans is \$26.8 million at September 29, 2017, of which \$22.4 million is for the unfunded supplemental retirement plan for key executives. Contributions to the Esterline non-qualified plans totaled \$1.4 million both in fiscal 2017 and 2016. There is no funding requirement for fiscal 2018 for the qualified U.S. pension plans maintained by Esterline.

The accumulated benefit obligation and projected benefit obligation for the CMC plans are \$137.5 million and \$138.5 million, respectively, with plan assets of \$140.2 million as of September 29, 2017. The funded status for these CMC plans is \$1.7 million at September 29, 2017. Contributions to the CMC plans totaled \$3.5 million and \$5.6 million in fiscal 2017 and 2016, respectively. The expected funding requirement for fiscal 2018 for the CMC plans is \$3.9 million.

The accumulated benefit obligation and projected benefit obligation for the other non-U.S. plans are \$39.3 million and \$49.6 million, respectively, with plan assets of \$23.0 million as of September 29, 2017. The underfunded status for these other non-U.S. plans is \$26.6 million at September 29, 2017. Contributions to the other non-U.S. plans totaled \$1.8 million and \$5.0 million in fiscal 2017 and 2016, respectively. The expected funding requirement for fiscal 2018 for the other non-U.S. plans is \$1.0 million.

Principal assumptions of the Esterline, CMC and other non-U.S. plans are as follows:

	Esterline U.S. Defined Benefit Pension Plans		CMC Defined Benefit Pension Plans		Other Non-U.S. Defined Benefit Pension Plans	
	2017	2016	2017	2016	2017	2016
Principal assumptions as of year end:						
Discount rate	3.75%	3.60%	3.76%	3.22%	1.40 - 8.75%	0.90 - 7.75%
Rate of increase in future compensation levels	4.48%	4.28%	2.75%	2.75%	2.96 - 10.29%	2.96 - 10.13%
Assumed long-term rate of return on plan assets	7.00%	7.00%	5.19%	5.66%	3.25 - 8.25%	3.25 - 8.00%
					Esterline U.S. Post-Retirement Pension Plans	CMC Post-Retirement Pension Plans
					2017	2016
Principal assumptions as of year end:						
Discount rate					3.75%	3.60%
Initial weighted average health care trend rate					6.00%	6.00%
Ultimate weighted average health care trend rate					6.00%	6.00%
					5.80%	6.00%
					4.10%	4.20%

The Company uses discount rates developed from a yield curve established from high-quality corporate bonds and matched to plan-specific projected benefit payments. Although future changes to the discount rate are unknown, had the discount rate increased or decreased by 25 basis points, pension liabilities in total would have decreased \$13.7 million or increased \$14.4 million, respectively. If all other assumptions are held constant, the estimated effect on fiscal 2017 pension expense from a hypothetical 25 basis points increase or decrease in both the discount rate and expected long-term rate of return on plan assets would not have a material effect on our pension expense. Management is not aware of any legislative or other initiatives or circumstances that will significantly impact the Company's pension obligations in fiscal 2018.

The assumed health care trend rate can have a significant impact on the Company's post-retirement benefit obligations. The Company's health care trend rate was based on the experience of its plans and expectations for the future. A 100 basis points increase in the health care trend rate would increase the post-retirement benefit obligation by \$1.4 million. A 100 basis points decrease in the health care trend rate would decrease the post-retirement benefit obligation by \$1.2 million. Assuming all other assumptions are held constant, the estimated effect on fiscal 2016 post-retirement benefit expense from a hypothetical 100 basis points increase or decrease in the health care trend rate would not have a material effect on our post-retirement benefit expense.

Plan assets are invested in a diversified portfolio of equity and debt securities consisting primarily of common stocks, bonds and government securities. The objective of these investments is to maintain sufficient liquidity to fund current benefit payments and achieve targeted risk-adjusted returns. Management periodically reviews allocations of plan assets by investment type and evaluates external sources of information regarding the long-term historical returns and expected future returns for each investment

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type, and accordingly, the 3.25% to 8.25% assumed long-term rate of return on plan assets is considered to be appropriate. Allocations by investment type are as follows:

	Target	Actual 2017	2016
Plan assets allocation as of fiscal year end:			
Equity securities	35 - 70%	58.4 %	56.4 %
Debt securities	30 - 65%	35.3 %	37.1 %
Cash	0%	6.3 %	6.5 %
Total		100.0%	100.0%

The following table presents the fair value of the Company's Pension Plan assets as of September 29, 2017, by asset category segregated by level within the fair value hierarchy, as described in Note 9.

In Thousands	Fair Value Hierarchy		
	Level 1	Level 2	Total
Asset category:			
Equity Funds:			
Registered Investment Company Funds - U.S. Equity	\$113,997	\$-	\$113,997
U.S. Equity Securities	54,640	-	54,640
Non-U.S. Equity Securities	50,395	-	50,395
Commingled Trust Funds - Non-U.S. Securities	-	48,377	48,377
Fixed Income Securities:			
Commingled Trust Funds - Fixed Income	-	83,387	83,387
Non-U.S. Foreign Commercial and Government Bonds	-	77,931	77,931
Cash and Cash Equivalents	28,848	-	28,848
Total	\$247,880	\$209,695	\$457,575

The following table presents the fair value of the Company's Pension Plan assets as of September 30, 2016, by asset category segregated by level within the fair value hierarchy, as described in Note 9.

In Thousands	Fair Value Hierarchy		
	Level 1	Level 2	Total
Asset category:			
Equity Funds:			
Registered Investment Company Funds - U.S. Equity	\$104,075	\$-	\$104,075
U.S. Equity Securities	55,196	-	55,196
Non-U.S. Equity Securities	28,031	-	28,031
Commingled Trust Funds - Non-U.S. Securities	-	52,973	52,973
Fixed Income Securities:			
Commingled Trust Funds - Fixed Income	-	82,627	82,627
Non-U.S. Foreign Commercial and Government Bonds	-	75,414	75,414
Cash and Cash Equivalents	27,465	-	27,465

Total	\$214,767	\$211,014	\$425,781
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#### Valuation Techniques

Level 1 Equity Securities are actively traded on U.S. and non-U.S. exchanges and are either valued using the market approach at quoted market prices on the measurement date or at the net asset value of the shares held by the plan on the measurement date based on quoted market prices.

Level 2 fixed income securities are primarily valued using the market approach at either quoted market prices, pricing models that use observable market data, or bids provided by independent investment brokerage firms.

Level 2 primarily consists of commingled trust funds that are primarily valued at the net asset value provided by the fund manager. Net asset value is based on the fair value of the underlying investments.

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Cash and cash equivalents include cash which is used to pay benefits and cash invested in a short-term investment fund that holds securities with values based on quoted market prices, but for which the funds are not valued on quoted market basis.

Net periodic pension cost for the Company's defined benefit plans at the end of each fiscal year consisted of the following:

In Thousands	Defined Benefit Pension Plans			Post-Retirement Benefit Plans		
	2017	2016	2015	2017	2016	2015
Components of Net Periodic Cost						
Service cost	\$15,108	\$12,861	\$11,811	\$385	\$342	\$359
Interest cost	15,553	18,095	16,159	335	473	464
Expected return on plan assets	(25,866)	(24,491)	(23,872)	-	-	-
Settlement	21	2	3,522	-	-	-
Amortization of prior service cost	490	487	404	(5 )	(17 )	(63 )
Amortization of actuarial						
(gain) loss	7,643	6,590	5,165	-	-	-
Net periodic cost (benefit)	\$12,949	\$13,544	\$13,189	\$715	\$798	\$760

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The funded status of the defined benefit pension and post-retirement plans at the end of fiscal 2017 and 2016 were as follows:

In Thousands	Defined Benefit Pension Plans		Post-Retirement Benefit Plans	
	2017	2016	2017	2016
<b>Benefit Obligations</b>				
Beginning balance	\$505,298	\$453,283	\$13,236	\$12,187
Currency translation adjustment	9,340	268	665	26
Service cost	15,108	12,861	385	342
Interest cost	15,553	18,095	335	473
Plan participants contributions	318	376	-	-
Actuarial (gain) loss	(11,420 )	44,136	(529 )	738
Other adjustments	(1,254 )	(859 )	-	-
Benefits paid	(23,687 )	(22,862 )	(550 )	(530 )
Ending balance	\$509,256	\$505,298	\$13,542	\$13,236
<b>Plan Assets - Fair Value</b>				
Beginning balance	\$425,781	\$389,461	\$-	\$-
Currency translation adjustment	8,170	341	-	-
Realized and unrealized gain (loss) on plan assets	41,566	45,817	-	-
Plan participants contributions	318	376	-	-
Company contribution	6,681	12,041	550	530
Other adjustments	-	1,466	-	-
Expenses paid	(1,254 )	(859 )	-	-
Benefits paid	(23,687 )	(22,862 )	(550 )	(530 )
Ending balance	\$457,575	\$425,781	\$-	\$-
<b>Funded Status</b>				
Fair value of plan assets	\$457,575	\$425,781	\$-	\$-
Benefit obligations	(509,256)	(505,298)	(13,542)	(13,236)
Net amount recognized	\$(51,681 )	\$(79,517 )	\$(13,542)	\$(13,236)
<b>Amount Recognized in the Consolidated Balance Sheet</b>				
Non-current asset	\$4,267	\$2,395	\$-	\$-
Current liability	(1,840 )	(1,912 )	(669 )	(716 )
Non-current liability	(54,108 )	(80,000 )	(12,873)	(12,520)
Net amount recognized	\$(51,681 )	\$(79,517 )	\$(13,542)	\$(13,236)
<b>Amounts Recognized in Accumulated Other Comprehensive Income</b>				
Net actuarial loss (gain)	\$78,713	\$112,420	\$476	\$975
Prior service cost	2,593	2,951	-	-
Ending balance	\$81,306	\$115,371	\$476	\$975

The accumulated benefit obligation for all pension plans was \$486.0 million at September 29, 2017, and \$482.2 million at September 30, 2016.



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Estimated future benefit payments expected to be paid from the pension and post-retirement benefit plans or from the Company's assets are as follows:

In Thousands

Fiscal Year

2018	\$28,083
2019	29,835
2020	31,087
2021	33,212
2022	33,715
2023 - 2027	180,157

Employees may participate in certain defined contribution plans. The Company's contribution expense under these plans totaled \$10.1 million, \$10.7 million, and \$9.5 million in fiscal 2017, 2016, and 2015, respectively. The Company contributes a matching amount that varies by participating company and employee group based on the first 6% of earnings contributed. The three formulas used are: 25% of the first 6%; or 50% of the first 6%; or 100% of the first 2% and 50% on the next 4%.

In fiscal 2014 the Company offered vested terminated participants in the Esterline plan a one-time opportunity to elect a lump-sum payment from the plan in lieu of a lifetime annuity. In the first fiscal quarter of 2015, the Company paid \$16.6 million in lump-sum payments to vested terminated pension plan participants from the plan, which resulted in an actuarial settlement charge of \$3.0 million. During the remainder of fiscal 2015, an additional \$1.4 million in lump-sum payments was distributed to cash balance participants under the ongoing terms of the plan, which resulted in an additional settlement charge of \$0.5 million in fiscal 2015.

### NOTE 9: Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The hierarchy of fair value measurements is described below:

Level 1 – Valuations are based on quoted prices that the Company has the ability to obtain in actively traded markets for identical assets and liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market or exchange traded market, a valuation of these instruments does not require a significant degree of judgment.

Level 2 – Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuations are based on model-based techniques for which some or all of the assumptions are obtained from indirect market information that is significant to the overall fair value measurement and which require a significant

degree of management judgment.

The following table sets forth the Company's financial assets and liabilities that were measured at fair value on a recurring basis by level within the fair value hierarchy at the end of fiscal 2017 and 2016:

In Thousands	Level 2	
	2017	2016 (Restated)
Assets:		
Derivative contracts designated as hedging instruments	\$13,932	\$ 3,130
Derivative contracts not designated as hedging instruments	284	143
Embedded derivatives	746	2,485
Liabilities:		
Derivative contracts designated as hedging instruments	\$464	\$ 7,473
Derivative contracts not designated as hedging instruments	2,440	6,720
Embedded derivatives	2,239	985

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In Thousands	Level 3	
	2017	2016
Assets:		
Estimated value of assets held for sale	\$19,835	\$26,850