Allison Transmission Holdings Inc
Form 10-Q
October 31, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2012

OR

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

Commission File No. 001-35456

ALLISON TRANSMISSION HOLDINGS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**26-0414014**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

One Allison Way

Indianapolis, IN 46222

(Address of Principal Executive Offices and Zip Code)

(317) 242-5000

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (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 x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of October 22, 2012, there were 182,666,614 shares of Common Stock and 1,185 shares of Non-voting Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Unaudited Condensed Consolidated Financial Statements

Allison Transmission Holdings, Inc.

Condensed Consolidated Balance Sheets

(unaudited, dollars in millions, except share data)

	September 30, 2012	December 31, 2011
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 81.9**	$ 314.0
Accounts receivable net of allowance for doubtful accounts of $1.9 and $1.3, respectively	**204.0**	194.7
Inventories	**187.0**	155.9
Deferred income taxes, net	**19.0**	3.4
Other current assets	**35.6**	34.7
Total Current Assets	**527.5**	702.7
Property, plant and equipment, net	**592.6**	581.8
Intangible assets, net	**1,753.6**	1,866.1
Goodwill	**1,941.0**	1,941.0
Deferred income taxes, net	**82.2**	0.8
Other non-current assets	**93.7**	100.2
TOTAL ASSETS	**$ 4,990.6**	$ 5,192.6
LIABILITIES		
Current Liabilities		
Accounts payable	**$ 176.2**	$ 162.6
Product warranty liability	**33.2**	33.9
Current portion of long-term debt	**16.5**	31.0
Notes payable		2.6
Deferred revenue	**20.7**	19.9
Other current liabilities	**166.3**	199.9
Total Current Liabilities	**412.9**	449.9
Product warranty liability	**73.3**	81.5
Deferred revenue	**43.1**	40.8
Long-term debt	**2,899.1**	3,345.0
Deferred income taxes	**0.0**	214.2
Other non-current liabilities	**238.0**	239.5
TOTAL LIABILITIES	**3,666.4**	4,370.9

Commitments and contingencies (see NOTE M)

STOCKHOLDERS EQUITY				
Common stock, $0.01 par value, 1,880,000,000 shares authorized, 182,320,110 issued and 182,296,410 outstanding		**1.8**		1.8
Non-voting common stock, $0.01 par value, 20,000,000 shares authorized, 1,185 issued and outstanding		**0.0**		0.0
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding				
Treasury stock		**(0.2)**		(0.2)
Paid in capital		**1,577.0**		1,560.8
Accumulated deficit		**(202.5)**		(683.7)
Accumulated other comprehensive loss, net of tax		**(51.9)**		(57.0)
TOTAL STOCKHOLDERS EQUITY		**1,324.2**		821.7
TOTAL LIABILITIES & STOCKHOLDERS EQUITY	**$**	**4,990.6**	$	5,192.6

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

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Allison Transmission Holdings, Inc.

Condensed Consolidated Statements of Comprehensive Income

(unaudited, dollars in millions, except share data)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net sales	**$ 493.5**	$ 574.0	**$ 1,654.8**	$ 1,646.7
Cost of sales	**269.1**	316.4	**894.7**	914.7
Gross profit	**224.4**	257.6	**760.1**	732.0
Selling, general and administrative expenses	**96.7**	101.6	**307.0**	299.1
Engineering research and development	**35.9**	31.9	**87.0**	90.4
Operating income	**91.8**	124.1	**366.1**	342.5
Interest income	**0.1**	0.2	**0.7**	0.6
Interest expense	**(40.9)**	(63.5)	**(116.3)**	(184.5)
Premiums and expenses on tender offer for long-term debt				(56.9)
Other expense, net	**(1.8)**	(3.7)	**(55.4)**	(0.9)
Income before income taxes	**49.2**	57.1	**195.1**	100.8
Income tax (expense) benefit	**(17.0)**	(18.3)	**307.9**	(42.3)
Net income	**$ 32.2**	$ 38.8	**$ 503.0**	$ 58.5
Basic earnings per share attributable to common stockholders	**$ 0.18**	$ 0.21	**$ 2.77**	$ 0.32
Diluted earnings per share attributable to common stockholders	**$ 0.17**	$ 0.21	**$ 2.70**	$ 0.32
Dividends declared per common share	**$ 0.06**	$	**$ 0.12**	$
Comprehensive income	**$ 38.6**	$ 28.2	**$ 508.0**	$ 61.4

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

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Allison Transmission Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited, dollars in millions)

	Nine months ended September 30, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 503.0**	$ 58.5
Add (deduct) items included in net income not using (providing) cash:		
Deferred income taxes	**(311.8)**	33.9
Amortization of intangible assets	**112.5**	114.0
Depreciation of property, plant and equipment	**76.0**	77.0
Loss on repurchases and redemptions of long-term debt	**21.6**	11.3
Unrealized (gain) loss on derivatives	**(17.3)**	27.7
Impairment loss on investments in technology-related initiatives	**14.4**	
Amortization of deferred financing costs	**11.3**	9.4
Stock-based compensation	**4.5**	6.4
Loss on re-measurement of employee benefit plan	**2.3**	
Excess tax benefit from stock based compensation	**(1.7)**	
Premiums and expenses on tender offer for long-term debt		56.9
Other	**0.9**	(1.4)
Changes in assets and liabilities:		
Accounts receivable	**(10.3)**	(52.3)
Inventories	**(31.6)**	(18.7)
Accounts payable	**13.6**	70.5
Other assets and liabilities	**(2.0)**	4.1
Net cash provided by operating activities	**385.4**	397.3
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions of long-lived assets	**(93.9)**	(55.3)
Investments in technology-related initiatives	**(14.4)**	
Collateral (increase) decrease for interest rate derivatives	**(0.7)**	37.5
Proceeds from disposal of assets	**0.5**	2.3
Net cash used for investing activities	**(108.5)**	(15.5)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of long-term debt		500.0
Repurchases and redemptions of long-term debt	**(326.9)**	(691.5)
Debt issuance costs		(15.0)
Debt financing fees	**(18.4)**	
Payments on long-term debt	**(150.5)**	(82.8)
Dividend payments	**(21.8)**	
Issuance of common stock	**10.1**	
Payments on notes payable	**(2.5)**	
Excess tax benefit from stock based compensation	**1.7**	
Net cash used for financing activities	**(508.3)**	(289.3)
Effect of exchange rate changes on cash	**(0.7)**	9.1
Net (decrease) increase in cash and cash equivalents	**(232.1)**	101.6
Cash and cash equivalents at beginning of period	**314.0**	252.2

Cash and cash equivalents at end of period	**$**	**81.9**	$	353.8
Supplemental disclosures:				
Interest paid	**$**	**120.6**	$	140.6
Income taxes paid	**$**	**9.0**	$	5.1

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

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Allison Transmission Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

NOTE A. OVERVIEW

Overview

Allison Transmission Holdings, Inc. and its subsidiaries (the Company, our, we or Allison), design and manufacture commercial and military fully-automatic transmissions.

The business was founded in 1915 and has been headquartered in Indianapolis, Indiana since inception. The Company has approximately 2,800 employees and 12 different transmission product lines. Although approximately 80% percent of revenues were generated in North America in 2011, the Company has a global presence by serving customers in Europe, Asia, South America and Africa. The Company serves customers through an independent network of approximately 1,500 independent distributor and dealer locations worldwide.

Since the introduction of the Company s first fully-automatic transmission over 60 years ago, the Company s products have gained acceptance in a wide variety of applications, including on-highway trucks (distribution, refuse, construction, fire and emergency), buses (primarily school, transit and hybrid-transit), motorhomes, off-highway vehicles and equipment (primarily energy, mining and construction) and military vehicles (wheeled and tracked). The Company has developed over 100 different product models that are used in more than 2,500 different vehicle configurations, which are compatible with more than 500 combinations of engine brands, models and ratings. The Company also sells support equipment and Allison-branded replacement parts for the Company s transmissions and remanufactured transmissions for use in the vehicle aftermarket.

Recent Developments

In August 2012, Allison Transmission, Inc. (ATI), a wholly-owned subsidiary of the Company, entered into an amendment under its Senior Secured Credit Facility (as defined under Note F) to extend the maturity of $850.0 million of term loan debt from August 7, 2014 to August 23, 2019 and to increase the applicable margin over the London Interbank Offered Rate (LIBOR) (but not less than 1.00%) for such extended term loan to either 3.00% or 3.25% subject to the Company s total leverage ratio. The amendment was treated as an extinguishment of debt under accounting principles generally accepted in the United States of America (GAAP), and thus the Company expensed $4.5 million of previously deferred financing fees and recorded $16.1 million of new deferred financing fees in the condensed consolidated financial statements.

In July 2012, the Company entered into a license and exclusivity agreement related to certain continuously variable planetary transmission technology of Fallbrook Technologies, Inc. (Fallbrook). Under the terms of the agreement, the Company purchased an exclusive, transferable license to certain patents and copyrighted materials to make, use, have made for it, sell or otherwise distribute and import licensed products in off-highway and on-highway commercial vehicles along with military vehicles and certain stationary equipment. In addition in July 2012, the Company purchased a non-controlling equity stake in Fallbrook.

Also in July 2012, the Company closed its purchase of a non-controlling equity stake in Odyne Systems LLC, a manufacturer of advanced hybrid control systems, to expand its position in transmission technologies.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The unaudited condensed consolidated financial statements as of and for the three and nine months ended September 30, 2012 and 2011 have been prepared in accordance with accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the unaudited condensed consolidated financial statements do not include all information and footnotes required by GAAP for complete financial statements. The information herein reflects all normal recurring material adjustments, which are, in the opinion of management, necessary for the fair presentation of the results for the periods presented. The condensed consolidated financial statements herein consist of all wholly-owned domestic and foreign subsidiaries with all intercompany transactions eliminated.

These condensed consolidated financial statements present the financial position, results of operations and cash flows of the Company. Certain immaterial reclassifications have been made to prior period amounts to conform to the presentation of the current period financial statements. These reclassifications have no impact on previously reported net income, total stockholders equity or cash flows.

The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2011 included in the Company s Registration Statement on Form S-1/A. The interim period financial results for the three and nine month periods presented are not necessarily indicative of results to be expected for any other interim period or for the entire year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Significant estimates include, but are not limited to, allowance for doubtful accounts, sales allowances, government price adjustments, fair market values and future cash flows associated with goodwill, indefinite-life intangibles, long-lived asset impairment tests, useful lives for depreciation and amortization, warranty liability, determination of discount rate and other

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assumptions for pension and other postretirement benefit expense, income taxes, lease classification, derivative valuation, and contingencies. The Company s accounting policies involve the application of judgments and assumptions made by management that include inherent risks and uncertainties. Actual results could differ materially from these estimates. Changes in estimates are recorded in results of operations in the period that the events or circumstances giving rise to such changes occur.

Recently Issued Accounting Pronouncements

In July 2012, the Financial Accounting Standards Board (FASB) issued authoritative accounting guidance on testing indefinite-lived intangibles for impairment. The guidance gives an entity the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If an entity concludes that it is more likely than not that the indefinite-lived intangible asset is impaired, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. However, if an entity concludes otherwise, then the entity is not required to take further action. The guidance is effective for interim and annual impairment tests performed for fiscal years beginning after September 15, 2012 with early adoption permitted. The Company is considering early adoption of this guidance in conjunction with the fiscal year 2012 annual indefinite-lived intangible impairment test. This guidance only changes the methodology of testing for impairment and will not affect the outcome of such testing. Therefore, the adoption of this guidance is not expected to have a material effect on our consolidated financial statements.

In December 2011, the FASB issued authoritative accounting guidance on enhancing disclosures to evaluate the effect or potential effect of netting arrangements on an entity s financial position. The guidance requires improved information and disclosures about gross and net amounts of recognized assets and liabilities of financial and derivative instruments that are offset in an entity s statement of financial position. The guidance is to be applied retrospectively for interim and annual reporting periods beginning on or after January 1, 2013. The adoption of this guidance is not expected to have a material effect on our condensed consolidated financial statements.

In September 2011, the FASB issued authoritative accounting guidance on testing goodwill for impairment. Under the revised guidance, entities testing goodwill for impairment have the option of performing a qualitative assessment before calculating fair value (i.e., Step 1 of the goodwill impairment test). If entities determine, on the basis of qualitative factors, that fair value is more likely than not less than carrying value, the two-step impairment test would be required. The guidance does not change how goodwill is calculated or assigned to reporting units, nor does it revise the requirement to test goodwill annually for impairment. In addition, it does not amend the requirement to test goodwill for impairment between annual tests if events or circumstances warrant; however, it does revise the examples of events and circumstances that an entity should consider. The guidance became effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption was permitted; however, the Company did not early adopt this guidance and continued to perform Step 1 of the goodwill impairment analysis for fiscal year 2011. The adoption of this guidance will occur in conjunction with the fiscal year 2012 annual goodwill impairment test. This guidance only changes the methodology of testing for impairment and will not affect the outcome of such testing. Therefore, the adoption of this guidance is not expected to have a material effect on our consolidated financial statements.

In June 2011, the FASB issued authoritative accounting guidance on improving comparability, consistency, and transparency of items reported in other comprehensive income. The guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders equity and requires either a single continuous statement of comprehensive income or in two separate but consecutive statements. In a single continuous statement, the entity is required to present the components of net income and total net income, the components of other comprehensive income and a total for other comprehensive income, along with the total of comprehensive income in that statement. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. In December 2011, the FASB issued additional authoritative accounting guidance indefinitely deferring the requirement to present reclassifications of items out of accumulated other comprehensive income. The accounting guidance also establishes a common approach with International Financial Reporting Standards (IFRS). The guidance is to be applied retrospectively for interim and annual reporting periods beginning after December 15, 2011 for public entities. The adoption of this guidance did not have a material effect on our condensed consolidated financial statements, but required a change in the presentation of comprehensive income from the notes of our condensed consolidated financial statements to the face of our Condensed Consolidated Statements of Comprehensive Income.

In May 2011, the FASB issued authoritative accounting guidance that amended wording used to describe many of the requirements in measuring fair value and disclosing information about fair value measurements. The changes are not intended to change the application of the requirements of fair value measurement, but to clarify the application and disclosure of information. The amendments to the accounting guidance also establish a common approach with IFRS. The guidance is to be applied prospectively for interim and annual reporting periods beginning after December 15, 2011. The adoption of this guidance did not have a material effect on our condensed consolidated financial statements.

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NOTE C. INVENTORIES

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

	September 30, 2012	December 31, 2011
Purchased parts and raw materials	**$ 84.1**	$ 71.3
Work in progress	**7.6**	7.6
Service parts	**48.1**	43.6
Finished goods	**47.2**	33.4
Total inventories	**$ 187.0**	$ 155.9

Inventory components shipped to third parties, primarily cores, parts to re-manufacturers, and parts to contract manufacturers, which the Company has an obligation to buy back, are included in purchased parts and raw materials, with an offsetting liability in Other current liabilities.

NOTE D. GOODWILL AND OTHER INTANGIBLE ASSETS

The following presents a summary of goodwill and other intangible assets (dollars in millions):

	Expected useful life (years)	September 30, 2012	December 31, 2011
Goodwill	Indefinite	**$ 1,941.0**	$ 1,941.0
Other intangible assets:			
Trade name	Indefinite	**$ 870.0**	$ 870.0
Customer relationships military	18.5	**62.3**	62.3
Customer relationships commercial	16.5	**831.8**	831.8
Proprietary technology	12.5	**476.3**	476.3
Non-compete agreement	10.0	**17.3**	17.3
Patented technology military	8.5	**28.2**	28.2
Tooling rights	6.0	**4.5**	4.5
Patented technology commercial	5.5	**260.6**	260.6
Other intangible assets gross		**2,551.0**	2,551.0
Less: accumulated amortization		**(797.4)**	(684.9)
Other intangible assets net		**$ 1,753.6**	$ 1,866.1

As of September 30, 2012 and December 31, 2011, the net carrying value of our Goodwill and other intangible assets was $3,694.6 million and $3,807.1 million, respectively.

NOTE E. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with the FASB s authoritative accounting guidance on fair value measurements, fair value is the price (exit price) that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements and utilizes the best available information that maximizes the use of observable inputs and minimizes the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs. The accounting guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by the relevant guidance are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, listed equities and publicly traded bonds.

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Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value. At each balance sheet date, the Company performs an analysis of all instruments subject to authoritative accounting guidance and includes, in Level 3, all of those whose fair value is based on significant unobservable inputs. As of September 30, 2012 and December 31, 2011, the Company did not have any Level 3 financial assets or liabilities.

The Company s assets and liabilities that are measured at fair value include cash equivalents, available-for-sale securities, derivative instruments, assets held in a rabbi trust and a deferred compensation obligation. The Company s cash equivalents consist of short-term U.S. Government backed securities. The Company s available-for-sale securities consist of ordinary shares of Torotrak plc (Torotrak) associated with a license and exclusivity agreement with Torotrak. Torotrak s listed shares are traded on the London Stock Exchange under the ticker symbol TRK. The Company s derivative instruments consist of interest rate swaps, foreign currency forward contracts and commodity swaps. The Company s assets held in the rabbi trust consist primarily of publicly available mutual funds and target date retirement funds. The Company s deferred compensation obligation is directly related to the fair value of assets held in the rabbi trust.

The Company s valuation techniques used to fair value cash equivalents, available-for-sale securities, assets held in the rabbi trust and the deferred compensation obligation represent a market approach in active markets for identical assets that qualifies as Level 1 in the fair value hierarchy. The Company s valuation techniques used to calculate the fair value of derivative instruments represent a market approach with observable inputs that qualify as Level 2 in the fair value hierarchy.

The foreign currency contracts consist of forward rate contracts which are intended to hedge exposure of transactions denominated in certain currencies and reduce the impact of currency price volatility on the Company s financial results. The commodity contracts consist of forward rate contracts which are intended to hedge exposure of transactions involving purchases of component parts containing aluminum and steel and natural gas to power our facilities, reducing the impact of commodity price volatility on the Company s financial results.

For its foreign currency derivatives, the Company uses independent valuations which use the current spot market data adjusted for the time value of money. The foreign currency hedges are accounted for within the authoritative accounting guidance set forth on accounting for derivative instruments and hedging activities and have been recorded at fair value based upon quoted market rates. The Company generally does not elect to apply hedge accounting under the authoritative accounting guidance and records the unrealized fair value adjustments and realized gains and losses associated with these contracts in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

For its commodity derivatives, the Company uses independent valuations which use current quoted market rates adjusted for the time value of money. The fair values are included in Other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company has not qualified for hedge accounting treatment for these commodity contracts, and as a result, unrealized fair value adjustments and realized gains and losses are recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.

For its interest rate derivatives, the Company uses independent valuations which approximate the current economic value of the swaps using prices and rates at the average of the estimated bid and offer for the respective underlying assets. The floating-to-fixed interest rate swaps are based on the LIBOR which is observable at commonly quoted intervals. The fair values are included in other current and non-current liabilities in the Condensed Consolidated Balance Sheets. The Company has not qualified for hedge accounting treatment for the interest rate swaps and, as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income.

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The following table summarizes the fair value of our financial assets and (liabilities) as of September 30, 2012 and December 31, 2011 (dollars in millions):

	Fair Value Measurements Using					
	Quoted Prices in Active Markets for Identical Assets (Level 1)		**Significant Other Observable Inputs (Level 2)**		**TOTAL**	
	September 30, 2012	**December 31, 2011**	**September 30, 2012**	**December 31, 2011**	**September 30, 2012**	**December 31, 2011**
Cash equivalents	**$ 5.0**	$ 125.9	**$**	$	**$ 5.0**	$ 125.9
Available-for-sale securities	**8.4**	8.1			**8.4**	8.1
Rabbi trust assets	**0.1**				**0.1**	
Deferred compensation obligation	**(0.1)**				**(0.1)**	
Derivative assets			**0.4**	0.0	**0.4**	0.0
Derivative liabilities			**(62.0)**	(78.9)	**(62.0)**	(78.9)
Total	**$ 13.4**	$ 134.0	**$ (61.6)**	$ (78.9)	**$ (48.2)**	$ 55.1

NOTE F. DEBT

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

	September 30, 2012	**December 31, 2011**
Long-term debt:		
Senior Secured Credit Facility Term B-1 Loan, variable, due 2014	**$ 801.3**	$ 2,594.9
Senior Secured Credit Facility Term B-2 Loan, variable, due 2017	**795.1**	
Senior Secured Credit Facility Term B-3 Loan, variable, due 2019	**847.9**	
Senior Cash Pay Notes, fixed 7.125%, due 2019	**471.3**	471.3
Senior Cash Pay Notes, fixed 11.0%, due 2015		309.8
Total long-term debt	**2,915.6**	3,376.0
Less: current maturities of long-term debt	**16.5**	31.0
Total long-term debt less current portion	**$ 2,899.1**	$ 3,345.0

As of September 30, 2012, the Company had $801.3 million of indebtedness associated with ATI s Senior Secured Credit Facility Term B-1 Loan due 2014 (Term B-1 Loan), $795.1 million of indebtedness associated with ATI s Senior Secured Credit Facility Term B-2 Loan due 2017 (Term B-2 Loan) and $847.9 million of indebtedness associated with ATI s Senior Secured Credit Facility Term B-3 Loan due 2019 (Term B-3 Loan), (together the Term B-1 Loan, Term B-2 Loan, Term B-3 Loan and revolving credit facility defined as the Senior Secured Credit Facility). The Company also had indebtedness of $471.3 million of ATI s 7.125% senior cash pay notes due May 2019 (7.125% Senior Notes).

The fair value of the Company s long-term debt obligations as of September 30, 2012 was $2,954.1 million. The fair value is based on quoted Level 1 market yields as of September 30, 2012. It is not expected that the Company would be able to repurchase a significant amount of its debt at these levels. The difference between the fair value and carrying value of the long-term debt is driven primarily by trends in the financial markets.

Senior Secured Credit Facility

In 2007, ATI entered into a Senior Secured Credit Facility having a term loan in the amount of $3,100.0 million with a maturity date of August 2014. In March 2012, ATI entered into an amendment with the term loan lenders under its Senior Secured Credit Facility to extend the maturity of $801.1 million in principal amount of term loan debt from August 7, 2014 to August 7, 2017 and to increase the applicable margin over the LIBOR for such extended term loan to 3.50%. As a result of the debt modification, the Company recorded an additional $2.3 million as deferred financing fees in the Condensed Consolidated Balance Sheets and extended the amortization period of $5.1 million of deferred financing fees from 2014 to 2017. In August 2012, ATI entered into an amendment with the term loan lenders under its Senior Secured Credit Facility to extend the maturity of $850.0 million of term loan debt from August 7, 2014 to August 23, 2019 and to increase the applicable margin over the LIBOR (but not less than 1%) for such extended term loan to either 3.00% or 3.25%, subject to the Company s total leverage ratio. The amendment was treated as an extinguishment of debt under GAAP, and thus the Company expensed $4.5 million of deferred financing fees and recorded $16.1 million of new deferred financing fees in the condensed consolidated financial statements.

The Senior Secured Credit Facility is collateralized by a lien on substantially all assets of the Company. Interest on the Term B-1 Loan is variable and currently equal to the LIBOR plus 2.75% based on the Company s total senior secured leverage ratio; interest on the Term B-2 Loan is variable and currently equal to the LIBOR plus 3.50%; and interest on the Term B-3 Loan is variable and currently equal to the LIBOR (but not less than 1.00%) plus 3.25% based on the Company s total leverage ratio. As of September 30, 2012, these rates were approximately 2.72%, 3.72% and 4.25% on the Term B-1 Loan, Term B-2 Loan and Term B-3 Loan, respectively, and the weighted average rate on the Senior Secured Credit Facility was approximately 3.58%. The Senior Secured Credit Facility requires minimum quarterly principal payments of $7.75 million on the term loans, which commenced December 2007, as well as prepayments from certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events and from a percentage of excess cash flow, if applicable. As of September 30, 2012, there had been no payments required for certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events. Due to voluntary prepayments, the Company has fulfilled all Term B-1 Loan required quarterly payments through its maturity date of 2014. The minimum required quarterly principal payments on the Term B-2 Loan and Term B-3 Loan are $2.0 million and $2.1 million, respectively, and remain through the maturity dates of 2017 and 2019, respectively. The remaining principal balance on each loan is due upon maturity.

In accordance with the Senior Secured Credit Facility, net cash proceeds of non-ordinary course asset sales and casualty and condemnation events will only be required to prepay the term loan if the Company does not reinvest or commit to reinvest such net cash proceeds in assets to be used in its business or to make certain other permitted investments within 15 months of the related transactions or events, subject to certain limitations. The Company must apply 50% of its annual excess cash flow (as defined in the Senior Secured Credit Facility) to the prepayment of the Senior Secured Credit Facility, however this percentage reduces to certain levels and eventually to zero upon achievement of certain total senior secured leverage ratios. For the year ended December 31, 2011, the excess cash flow percentage was 0%, and as a result, the Company was not required to make an excess cash flow payment.

The Senior Secured Credit Facility also provides for $400.0 million in revolving credit borrowings, net of an allowance for up to $50.0 million in outstanding letter of credit commitments. During the third quarter of 2012, the Company borrowed $7.5 million on its revolving credit facility as part of its debt management plans and subsequently repaid the amounts within the third quarter. As of September 30, 2012, the Company had $371.7 million available under the revolving credit facility, net of $28.3 million in letters of credit. Revolving credit borrowings bear interest at a variable base rate plus an applicable margin based on the Company s total senior secured leverage ratio. As of September 30, 2012, this rate would have been between approximately 2.97% and 5.00%. In addition, there is an annual commitment fee, based on the Company s total senior secured leverage ratio, which is currently equal to 0.375% of the average unused revolving credit borrowings available under the Senior Secured Credit Facility. Revolving credit borrowings are payable at the option of the Company throughout the term of the Senior Secured Credit Facility, with the balance due in August 2016, or August 2014 as long as the Term B-1 Loan is outstanding.

In November 2008, ATI entered into an amendment to its Senior Secured Credit Facility that permits it to make discounted voluntary prepayments of its term loan in an aggregated amount not to exceed $750.0 million pursuant to a modified Dutch auction. As part of the May 2011 amendment to the Senior Secured Credit Facility, the amount available for discounted voluntary prepayments of the term loan pursuant to a modified Dutch auction was reset to $750.0 million. This provision is available to the Company for so long as the term loans are outstanding. For the three and nine months ended September 30, 2012 and 2011, the Company did not repurchase any of its term loans under this amendment.

In May 2011, ATI effectively amended some of its terms under the revolving credit facility including extending the term from August 2013 to August 2016, or August 2014 as long as the Term B-1 Loan is outstanding, and increasing the borrowing capacity from $317.5 million to $400.0 million. As a result, the Company recorded an additional $4.2 million as deferred financing fees in the Condensed Consolidated Balance Sheets and $0.9 million as deferred financing fees expensed in the Condensed Consolidated Statements of Comprehensive Income. All deferred financing fees associated with the revolving credit facility will be amortized to Interest expense on a straight-line basis over the term of the revolving credit facility.

In addition, the Company made principal payments of $150.5 million and $82.8 million on the Senior Secured Credit Facility for the nine months ended September 30, 2012 and 2011, respectively. The principal payments made on the Senior Secured Credit Facility for the nine months ended September 30, 2012 and 2011 resulted in losses of $0.8 million and $0.6 million, respectively, associated with the write off of related deferred debt issuance costs.

The Senior Secured Credit Facility requires the Company to maintain a specified maximum total senior secured leverage ratio. As of September 30, 2012, the Company was in compliance with the maximum total senior secured leverage ratio achieving a 3.24x ratio versus a 5.50x requirement threshold. Within the terms of the Senior Secured Credit Facility, a senior secured leverage ratio below 3.50x results in elimination of excess cash flow payments on the term loan for the applicable year. This reduction remains in effect as long as the Company continues to achieve a senior secured leverage ratio below 3.50x.

In addition, the Senior Secured Credit Facility, among other things, includes customary restrictions (subject to certain exceptions) on the Company s ability to incur certain indebtedness, grant certain liens, make certain investments or declare or pay certain dividends. As of September 30, 2012, the Company is in compliance with all covenants under the Senior Secured Credit Facility.

Senior Notes

The Company may from time to time seek to retire the 7.125% Senior Notes through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions, contractual redemptions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions and other factors. The amounts involved may be material. Prior to May 15, 2015, the Company may redeem some or all of the 7.125% Senior Notes by paying the applicable make-whole premium. At any time on or after May 15, 2015, the Company may redeem some or all of the 7.125% Senior Notes at specified redemption prices in the governing indenture.

The 7.125% Senior Notes are unsecured and guaranteed by the subsidiaries that guarantee the Senior Secured Credit Facility and will be unconditionally guaranteed, jointly and severally, by any future domestic subsidiaries that guarantee the Senior Secured Credit Facility.

In February 2012, the Company redeemed $200.0 million of ATI s 11.0% senior cash pay notes due November 2015 (11.0% Senior Notes) resulting in a loss (the premium between the purchase price of the notes and the face value of such notes) of $13.5 million, including deferred financing fees written off.

In May 2012, the Company redeemed the remaining $109.8 million of the 11.0% Senior Notes resulting in a loss (the premium between the purchase price of the notes and the face value of such notes) of $7.3 million, including deferred financing fees written off.

Notes Payable

As of September 30, 2012 the Company had no short-term notes payable. As of December 31, 2011, the Company had Japanese Yen denominated unsecured short-term notes of 200 million Yen (approximately $2.6 million) with a weighted average interest rate of 1.24%.

NOTE G. DERIVATIVES

The Company is exposed to certain financial risk from volatility in interest rates, foreign exchange rates and commodity prices. The risk is managed through the use of financial derivative instruments including interest rate swaps, foreign currency forward contracts and commodity swaps. The Company s current derivative instruments are used strictly as an economic hedge and not for speculative purposes. As necessary, the Company adjusts the values of the derivative instruments for counter-party or credit risk.

Interest Rate

The maturities of the interest rate swaps outstanding as of September 30, 2012 and December 31, 2011 do not correspond with the maturity of the term loans, but the interest rate swaps are similar to the term loans in all other respects. The Company has not qualified for hedge accounting treatment for these derivatives, and as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income. A summary of the Company s interest rate derivatives as of September 30, 2012 and December 31, 2011 follows (dollars in millions):

	September 30, 2012		December 31, 2011	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest Rate Swap D, due 2013	**$ 125.0**	**$ (4.1)**	$ 125.0	$ (7.3)
Interest Rate Swap E, due 2013	**150.0**	**(3.2)**	150.0	(5.2)
Interest Rate Swap F, due 2013	**75.0**	**(1.5)**	75.0	(2.4)
Interest Rate Swap G, due 2013	**75.0**	**(1.8)**	75.0	(2.8)
Interest Rate Swap H, due 2014	**350.0**	**(22.1)**	350.0	(27.3)
Interest Rate Swap I, due 2014	**350.0**	**(22.1)**	350.0	(27.5)
Interest Rate Swap J, due 2014	**125.0**	**(3.3)**	125.0	(2.6)
Interest Rate Swap K, due 2014	**125.0**	**(3.4)**	125.0	(2.7)
	$ 1,375.0	**$ (61.5)**	$ 1,375.0	$ (77.8)

Certain of the Company s interest rate derivatives contain credit-risk and collateral contingent features under which downgrades in the Company s credit rating could require the Company to increase its collateral. Certain interest rate derivatives also contain provisions under which the Company may be required to post additional collateral if the LIBOR interest rate curve reaches certain levels.

As of September 30, 2012 and December 31, 2011, the Company had recorded collateral of $2.7 million and $2.0 million, respectively, in Other current assets in the Condensed Consolidated Balance Sheets, as the balances are subject to frequent change.

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Currency Exchange

The Company s business is subject to foreign exchange rate risk. As a result, the Company enters into various forward rate contracts that qualify as derivatives under the authoritative accounting guidance to manage certain of these exposures. Forward contracts are used to hedge forecasted transactions and known exposure of payables denominated in a foreign currency. The Company generally does not elect to apply hedge accounting under the authoritative accounting guidance and records the unrealized fair value adjustments and realized gains and losses associated with these contracts in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

The following table summarizes the outstanding foreign currency forward contracts as of September 30, 2012 and December 31, 2011 (amounts in millions):

	September 30, 2012		December 31, 2011	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Indian Rupee (INR)	N/A		81.0	$ (0.1)
British Pound (GBP)	N/A		£ 2.0	(0.0)
Canadian Dollar (CAD)	N/A		C$ 0.3	0.0
		$		$ (0.1)

Commodity

As a result of the Company s commodity price risk, primarily with component suppliers, it has chosen to manage steel, aluminum and natural gas exposure by entering into commodity swap contracts that qualify as derivatives under authoritative accounting guidance. The Company has not qualified for hedge accounting treatment for these commodity contracts and, as a result, unrealized fair value adjustments and realized gains and losses will be charged directly to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.

The following table summarizes the outstanding commodity swaps as of September 30, 2012 and December 31, 2011 (dollars in millions):

	September 30, 2012			December 31, 2011		
	Notional Amount	Quantity	Fair Value	Notional Amount	Quantity	Fair Value
Aluminum	$ 19.8	9,125 metric tons	$ 0.0	$ 17.0	7,725 metric tons	$ (1.0)
Steel	$ 0.7	1,420 metric tons	(0.2)	$ 0.5	900 metric tons	(0.0)
Natural Gas	$ 0.4	130,000 MMBtu	0.1	$ 0.3	80,000 MMBtu	(0.0)
			$ (0.1)			$ (1.0)

The following tabular disclosures further describe the Company s derivative instruments and their impact on the financial condition of the Company (dollars in millions):

	September 30, 2012		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments				
Foreign currency contracts	N/A	$	Other non-current liabilities	$ (0.1)
Commodity contracts	Other current and non-current assets	0.4	Other current and non-current liabilities	(1.0)

	Other current and non-current liabilities	**(0.5)**		
Interest rate contracts	**Other current and non-current liabilities**	**(61.5)**	Other current and non-current liabilities	(77.8)
Total derivatives not designated as hedging instruments		**$ (61.6)**		$ (78.9)

The fair values of the derivatives are recorded between Other current and non-current assets and Other current and non-current liabilities as appropriate in the Condensed Consolidated Balance Sheets. As of September 30, 2012, there were no foreign currency contracts outstanding. The amounts recorded to Other current and non-current assets and Other current and non-current liabilities for commodity contracts were $0.1 million, $0.3 million, ($0.5) million and ($0.0) million, respectively. The amounts recorded to Other current and non-current liabilities for interest rate contracts were ($34.4) million and ($27.1) million, respectively.

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As of December 31, 2011, the amount recorded to Other non-current liabilities for foreign currency contracts was ($0.1) million. The amounts recorded to Other current and non-current liabilities for commodity contracts were ($0.7) million and ($0.3) million, respectively. The amounts recorded to Other current and non-current liabilities for interest rate contracts were ($31.9) million and ($45.9) million, respectively.

The following tabular disclosures further describe the Company s derivative instruments and their impact on the results of operations of the Company (dollars in millions):

	Three months ended September 30, 2012		Three months ended September 30, 2011	
	Location of gain recognized on derivatives	**Amount of gain recognized on derivatives**	**Location of loss recognized on derivatives**	**Amount of loss recognized on derivatives**
Derivatives not designated as hedging instruments				
Foreign currency contracts	**Other expense, net**	**$ 0.0**	Other expense, net	$ (0.2)
Commodity contracts	**Other expense, net**	**1.5**	Other expense, net	(2.5)
Interest rate contracts	**Interest expense**	**5.0**	Interest expense	(12.5)
Total gain (loss) recognized on derivatives not designated as hedging instruments		**$ 6.5**		$ (15.2)

	Nine months ended September 30, 2012		Nine months ended September 30, 2011	
	Location of gain (loss) recognized on derivatives	**Amount of gain (loss) recognized on derivatives**	**Location of gain (loss) recognized on derivatives**	**Amount of gain (loss) recognized on derivatives**
Derivatives not designated as hedging instruments				
Foreign currency contracts	**Other expense, net**	**$ 0.3**	Other expense, net	$ 1.0
Commodity contracts	**Other expense, net**	**(0.0)**	Other expense, net	(1.7)
Interest rate contracts	**Interest expense**	**16.3**	Interest expense	(22.6)
Total gain (loss) recognized on derivatives not designated as hedging instruments		**$ 16.6**		$ (23.3)

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NOTE H. PRODUCT WARRANTY LIABILITIES

Product warranty liability activities consist of the following (dollars in millions):

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Beginning balance	**$ 111.1**	$ 120.8	**$ 115.4**	$ 128.5
Payments	**(12.4)**	(8.7)	**(34.6)**	(25.9)
Increase in liability (warranty issued during period)	**5.6**	7.0	**20.1**	20.3
Net adjustment to liability	**2.0**	(4.5)	**5.0**	(8.8)
Accretion (for predecessor liabilities)	**0.2**	0.2	**0.6**	0.7
Ending balance	**$ 106.5**	$ 114.8	**$ 106.5**	$ 114.8

As of September 30, 2012, the current and non-current liabilities were $33.2 million and $73.3 million, respectively. As of September 30, 2011, the current and non-current liabilities were $30.5 million and $84.3 million, respectively. During the second quarter of 2012, the Company completed an analysis of its Dual Power Inverter Module (DPIM) extended coverage program and determined, based on favorable claim rates, that the product warranty liability should be reduced by $7.9 million. This resulted in a $7.3 million reduction in the General Motors (GM) DPIM receivable and a $0.6 million favorable adjustment to the Condensed Consolidated Statements of Comprehensive Income. As part of the analysis, it was also determined that design issues related to the early introduction of the replacement DPIM unit resulted in a $10.0 million increase to the product warranty liability. As the replacement DPIM unit is the responsibility of the Company and not covered by the Asset Purchase Agreement (as defined in our Registration Statement on Form S-1/A), the Company recorded a $10.0 million charge to the Condensed Consolidated Statements of Comprehensive Income.

Deferred revenue for extended transmission coverage activity (dollars in millions):

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Beginning balance	**$ 63.6**	$ 59.2	**$ 60.7**	$ 56.2
Increases	**5.2**	3.9	**18.0**	13.6
Revenue earned	**(5.0)**	(3.9)	**(14.9)**	(10.6)
Ending balance	**$ 63.8**	$ 59.2	**$ 63.8**	$ 59.2

As of September 30, 2012, the current and non-current liabilities were $20.7 million and $43.1 million, respectively. As of September 30, 2011, the current and non-current liabilities were $18.9 million and $40.3 million, respectively.

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NOTE I. OTHER EXPENSE, NET

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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Loss on repurchases of long-term debt (see NOTE F)	**$ (0.5)**	$ (3.0)	**$ (21.6)**	$ (11.3)
Termination of Sponsor services agreement (see NOTE N)			**(16.0)**	
Impairment loss on investments in technology-related initiatives	**(6.4)**		**(14.4)**	
Grant Program income	**2.3**	5.0	**6.4**	11.8
Initial public offering fees and expenses	**0.0**		**(6.1)**	
Loss on re-measurement of employee benefit plans (see NOTE K)			**(2.3)**	
Gain (loss) on foreign exchange	**1.6**	(2.7)	**(1.4)**	(5.0)
Unrealized gain (loss) on derivative contracts (see NOTE G)	**2.1**	(4.1)	**1.1**	(5.1)
Realized (loss) gain on derivative contracts (see NOTE G)	**(0.6)**	1.5	**(0.8)**	4.5
Vendor settlement		(0.2)		3.7
Gain on sale of land				0.7
Other	**(0.3)**	(0.2)	**(0.3)**	(0.2)
Total	**$ (1.8)**	$ (3.7)	**$ (55.4)**	$ (0.9)

As discussed under Note A - Overview under Recent Developments , during 2012, the Company entered into co-development agreements with various companies to expand our position in transmission technologies. Due to various uncertainties surrounding these investments including, but not limited to, the startup nature of the underlying businesses, their continued negative cash flows, undercapitalization and unproven business plans, the Company has impaired these investments to zero as of September 30, 2012. The related charge of $6.4 million and $14.4 million was recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012, respectively.

In March 2012, the Company priced its initial public offering of common stock. All of the shares of common stock offered were sold by existing stockholders with the Company receiving no proceeds from the sale. As a result, approximately $6.1 million of fees and expenses related to the initial public offering have been recorded to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.

In 2009, the Company was notified by the U.S. Department of Energy that it was selected to receive matching funds up to $62.8 million from a grant program funded by the American Recovery and Reinvestment Act for the development of hybrid manufacturing capacity in the U.S. (the Grant Program). All applicable expenses associated with the Grant Program have been charged to Engineering research and development while the government s matching reimbursement is recorded to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income. Since inception of the Grant Program, the Company has recorded $35.8 million of Grant Program income to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income. All matching funds under the Grant Program are expected to be received by the end of 2013.

For the three months ended September 30, 2012 and 2011, the Company recorded $0.4 million and $2.0 million, respectively, as a reduction of the basis of capital assets purchased under the Grant Program. For the nine months ended September 30, 2012 and 2011, the Company recorded $2.6 million and $3.0 million, respectively, as a reduction of the basis of capital assets purchased under the Grant Program. Since inception of the Grant Program, the Company has placed approximately $7.3 million of assets in service under the Grant Program, resulting in related depreciation for the three months ended September 30, 2012 and 2011 of $0.2 million and $0.0 million, respectively, and for the nine months ended September 30, 2012 and 2011 of $0.5 million and $0.1 million, respectively.

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NOTE J. OTHER CURRENT LIABILITIES

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

	As of September 30, 2012	As of December 31, 2011
Payroll and related costs	**$ 39.9**	$ 49.9
Accrued derivative payable	**34.4**	31.9
Sales allowances	**27.7**	32.3
Accrued interest payable	**19.3**	19.1
Vendor buyback obligation	**16.6**	15.4
Taxes payable	**7.5**	17.1
Military price reduction reserve	**7.3**	17.6
Research and development payable		5.0
Other accruals	**13.6**	11.6
Total	**$ 166.3**	$ 199.9

NOTE K. EMPLOYEE BENEFIT PLANS

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

	Pension Plans Three months ended September 30,		Post-retirement Benefits Three months ended September 30,	
	2012	2011	2012	2011
Net periodic benefit expense:				
Service cost	**$ 3.5**	$ 3.6	**$ 1.0**	$ 1.0
Interest cost	**0.9**	1.0	**1.8**	1.7
Expected return on assets	**(1.4)**	(1.0)		
Prior service cost	**0.0**	0.0		
Loss	**0.3**	0.2		
Net periodic benefit expense	**$ 3.3**	$ 3.8	**$ 2.8**	$ 2.7

	Pension Plans Nine months ended September 30,		Post-retirement Benefits Nine months ended September 30,	
	2012	2011	2012	2011
Net periodic benefit expense:				
Service cost	**$ 11.7**	$ 11.0	**$ 2.9**	$ 2.8
Interest cost	**3.2**	3.0	**5.4**	5.3
Expected return on assets	**(4.5)**	(3.2)		
Prior service cost	**0.0**	0.2		
Loss	**1.0**	0.6		
Settlement loss	**2.3**			
Net periodic benefit expense	**$ 13.7**	$ 11.6	**$ 8.3**	$ 8.1

During the second quarter of 2012, the Company completed the transfer of its pension obligation for certain qualified hourly employees from the Company s hourly defined benefit pension plan to GM s pension plan as part of the Asset Purchase Agreement. The transfer required a re-measurement of the hourly defined benefit pension plan resulting in a one-time non-cash settlement charge of $2.3 million recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income for the nine months ended September 30, 2012 and a $4.2 million reduction to the Company s pension liability with corresponding adjustments to Accumulated other comprehensive loss, net of tax.

The Company s pension benefit costs were calculated using various actuarial assumptions and methodologies as prescribed by GAAP. These assumptions include discount rates, expected return on defined benefit pension plan assets, inflation, rate of compensation increases, mortality rates and other factors. All calculations for September 30, 2012 were made using the same assumptions used for December 31, 2011 financial reporting with the exception of the discount rate for the hourly pension plan, which changed from 4.6% to 4.1% due to the second quarter 2012 re-measurement. The Company s discount rate was determined by matching the plans projected cash flows to a yield curve based on long-term, fixed income debt instruments available as of the re-measurement date of June 30, 2012.

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NOTE L. INCOME TAXES

The effective tax rate for the three and nine months ended September 30, 2012 was (34.6%) and 157.8%, respectively. For the three and nine months ended September 30, 2012, the Company recorded total tax (expense) benefit of ($17.0) million and $307.9 million, respectively. The primary driver of the effective tax rate for the nine month period was the release of the Company s valuation allowance against its deferred tax asset resulting in an income tax benefit of $384.8 million in the second quarter of 2012. The pretax income recorded for the nine month period ended September 30, 2012 includes approximately $36.5 million of discrete expense items primarily related to the termination of the Company s services agreement with its Sponsors and transaction costs associated with the Company s initial public offering.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that all or some portion of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, tax planning strategies and results of recent operations in making this assessment.

Management has determined, based on the evaluation of both objective and subjective evidence available, that a valuation allowance is no longer necessary and that it is more likely than not that the deferred tax assets are fully realizable. The Company has reached a sustained period of profitability and believes its objectively measured positive evidence outweighs the negative evidence. Accordingly, the Company has recognized an income tax benefit as a result of the release of the valuation allowance which had previously been recorded against the deferred tax assets.

In accordance with the FASB s authoritative guidance on accounting for uncertainty in income taxes, the Company had no liability for unrecognized tax benefits as of September 30, 2012 and December 31, 2011. The accounting guidance prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. For the year ended December 31, 2011, the return will remain subject to examination by the various taxing authorities for the duration of the applicable statute of limitations (generally three years from the later of the date of filing or the due date of the return).

NOTE M. COMMITMENTS AND CONTINGENCIES

Claims, Disputes, and Litigation

The Company is party to various legal actions and administrative proceedings and subject to various claims arising in the ordinary course of business. These proceedings primarily involve commercial claims, product liability claims, personal injury claims and workers compensation claims. The Company believes that the ultimate liability, if any, in excess of amounts already provided for in the financial statements or covered by insurance on the disposition of these matters will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

NOTE N. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

On August 7, 2007, the Sponsors entered into a services agreement with ATI, pursuant to which ATI paid the Sponsors an annual fee of approximately $3.0 million (shared equally by the Sponsors) for certain advisory, consulting and other services to be performed by the Sponsors, exclusive of the reimbursements for certain out-of-pocket expenses incurred in connection with the performance of such services, and additional reasonable compensation for other services provided by the Sponsors from time to time, including consulting and other services with respect to acquisitions and divestitures or sales of equity or debt instruments. In March 2012, the Company and the Sponsors agreed to terminate the services agreement. The Company agreed to make a termination payment of $16.0 million, representing the present value of payments over the estimated term of the services agreement.

Senior Notes Held by Executive Officers

As of September 30, 2012, Lawrence E. Dewey, our Chairman, President and Chief Executive Officer, David S. Graziosi, our Executive Vice President, Chief Financial Officer and Treasurer, and Robert M. Price, our Vice President, Human Resources, held approximately $100,000, $450,000, and $150,000, respectively, in aggregate principal amount of the 7.125% Senior Notes.

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NOTE O. EARNINGS PER SHARE

The Company presents both basic and diluted earnings per share (EPS) amounts. Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted EPS is calculated by dividing net income by the weighted average number of common shares and common equivalent shares outstanding during the reporting period that are calculated using the treasury stock method for stock options. The treasury stock method assumes that the Company uses the proceeds from the exercise of awards to repurchase common stock at the average market price during the period. The assumed proceeds under the treasury stock method include the purchase price that the grantee will pay in the future, compensation cost for future service that the Company has not yet recognized and any tax benefits that would be credited to additional paid-in-capital when the award generates a tax deduction. If there would be a shortfall resulting in a charge to additional paid-in-capital, such an amount would be a reduction of the proceeds. For the three and nine months ended September 30, 2011, outstanding stock options were not included in the diluted EPS computation because they were anti-dilutive.

The following table reconciles the numerators and denominators used to calculate basic EPS and diluted EPS (in millions, except per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income	**$ 32.2**	$ 38.8	**$ 503.0**	$ 58.5
Weighted average shares of common stock outstanding	**181.9**	181.4	**181.6**	181.4
Dilutive effect stock-based awards	**3.6**		**4.4**	
Diluted weighted average shares of common stock outstanding	**185.5**	181.4	**186.0**	181.4
Basic earnings per share attributable to common stockholders	**$ 0.18**	$ 0.21	**$ 2.77**	$ 0.32
Diluted earnings per share attributable to common stockholders	**$ 0.17**	$ 0.21	**$ 2.70**	$ 0.32

NOTE P. SUBSEQUENT EVENTS

On October 4, 2012, ATI entered into an amendment with the term loan lenders under its Senior Secured Credit Facility to extend the maturity of $300.0 million of term loan debt from August 7, 2014 to August 23, 2019 and to increase the applicable margin over the LIBOR (but not less than 1.00%) for such extended term loan to either 3.00% or 3.25%, subject to the Company s total leverage ratio.

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

The following discussion and analysis is intended to help the reader understand our business, financial condition, results of operations, liquidity and capital resources. You should read this discussion in conjunction with our condensed consolidated interim financial statements and the related notes contained elsewhere in this Quarterly Report on Form 10-Q.

The statements in this discussion regarding industry trends, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in Cautionary Note Regarding Forward-Looking Statements and Part II, Item 1A. Risk Factors below. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

Overview

Allison Transmission Holdings, Inc. and its subsidiaries (the Company, our, us, we or Allison) design and manufacture fully-automatic transmissions for medium- and heavy-duty commercial vehicles, medium- and heavy-tactical U.S. military vehicles and hybrid-propulsion systems for transit buses. We generate our net sales primarily from the sale of transmissions, transmission parts, support equipment, military kits, engineering services and extended transmission warranty coverage to a wide array of original equipment manufacturers (OEMs), distributors and the U.S. government. Although approximately 80% of our net sales were generated in North America in 2011, we have a global presence, serving customers in Europe, Asia, South America and Africa. We have approximately 2,800 employees and 12 different transmission product lines. We serve customers through an established network of approximately 1,500 authorized independent distributors and dealers worldwide. Since the introduction of our first fully-automatic transmission over 60 years ago, our products have gained acceptance in a wide variety of applications, including on-highway trucks (distribution, refuse, construction, fire and emergency), buses (primarily school, transit and hybrid-transit), motorhomes, off-highway vehicles and equipment (primarily energy, mining and construction) and military vehicles (wheeled and tracked).

Recent Developments

In August 2012, Allison Transmission, Inc. (ATI), our wholly-owned subsidiary, entered into an amendment under its Senior Secured Credit Facility (as defined under Liquidity and Capital Resources below) to extend the maturity of $850.0 million of term loan debt from August 7, 2014 to August 23, 2019 and to increase the applicable margin over the London Interbank Offered Rate (LIBOR) (but not less than 1.00%) for such extended term loan to either 3.00% or 3.25% subject to the Company s total leverage ratio. The amendment was treated as an extinguishment of debt under accounting principles generally accepted in the United States of America (GAAP), and thus we expensed $4.5 million of previously deferred financing fees and recorded $16.1 million of new deferred financing fees in the condensed consolidated financial statements.

In July 2012, we entered into a license and exclusivity agreement related to certain continuously variable planetary transmission technology of Fallbrook Technologies, Inc, (Fallbrook). Under the terms of the agreement, we purchased an exclusive, transferable license to certain patents and copyrighted materials to make, use, have made for us, sell or otherwise distribute and import licensed products in off-highway and on-highway commercial vehicles along with military vehicles and certain stationary equipment. In addition in July 2012, we purchased a non-controlling equity stake in Fallbrook.

Also in July 2012, we closed our purchase of a non-controlling equity stake in Odyne Systems LLC, a manufacturer of advanced hybrid control systems, to expand our position in transmission technologies.

Trends Impacting Our Business

Our net sales are driven by commercial vehicle production, which tends to be highly correlated to macroeconomic conditions. According to America s Commercial Transportation Research, commercial truck and bus production volumes in our North American on-highway markets are projected to grow, but to remain below the 1998-2008 average production levels through 2014. However, we maintain a cautious approach to the fourth quarter given heightened market uncertainty by assuming year over year net sales reductions in North America Off-Highway, Global On-Highway, Tracked Military and Service Parts, Support Equipment & Other end markets partially offset by year over year net sales growth in Outside North America Off-Highway and North America Hybrid-Propulsion Systems for Transit Bus end markets.

Third Quarter Net Sales by End Market (in millions)

End Market	Q3 2012 Net Sales	Q3 2011 Net Sales	% Variance
North America On-Highway	$ 189	$ 199	(5%)
North America Hybrid-Propulsion Systems for Transit Bus	$ 30	$ 28	7%
North America Off-Highway	$ 22	$ 76	(71%)
Military	$ 74	$ 81	(9%)
Outside North America On-Highway	$ 73	$ 73	0%
Outside North America Off-Highway	$ 22	$ 24	(8%)
Service, Parts, Support Equipment & Other	$ 84	$ 93	(10%)
Total Net Sales	$ 494	$ 574	(14%)

North America On-Highway end market net sales were down 5% for the third quarter 2012 compared to the third quarter 2011. The decrease was principally driven by lower demand for Rugged Duty Series and Highway Series models. These reductions were partially offset by increased sales of Pupil Transport/Shuttle Series and Motorhome Series models.

North America Hybrid-Propulsion Systems for Transit Bus end market net sales were up 7% for the third quarter 2012 compared to the third quarter 2011 principally due to the timing of orders.

North America Off-Highway end market net sales were down 71% for the third quarter 2012 compared to the third quarter 2011. The decrease was principally driven by lower demand from hydraulic fracturing applications due to weakness in natural gas pricing.

Military end market net sales were down 9% for the third quarter 2012 compared to the third quarter 2011 principally due to lower wheeled and tracked product requirements consistent with reduced U.S. defense spending.

Outside North America On-Highway end market net sales for the third quarter 2012 were flat compared to the third quarter 2011 reflecting strength in China being offset by a weaker environment in Europe and Latin America.

Outside North America Off-Highway end market net sales were down 8% for the third quarter 2012 compared to the third quarter 2011 principally driven by weaker mining sector demand partially offset by stronger demand from the energy sector.

Service parts, support equipment & other end market net sales were down 10% for the third quarter 2012 compared to the third quarter 2011. The decrease was principally driven by lower demand for global off-highway service parts and reduced support equipment sales commensurate with decreased transmission unit volumes.

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Key Components of our Results of Operations

Net sales

We generate our net sales primarily from the sale of transmissions, transmission parts, support equipment, military kits, engineering services and extended transmission coverage to a wide array of OEMs, distributors and the U.S. government. Sales are recorded net of provisions for customer allowances and other rebates. Engineering services are recorded as net sales in accordance with the terms of the contract. The associated costs are recorded in cost of sales. We also have royalty agreements with third parties that provide net sales as a result of joint efforts in developing marketable products.

Cost of sales

Our most significant components of cost of sales are purchased parts, the overhead expense related to our manufacturing operations and direct labor associated with the manufacture and assembly of transmissions and parts. For the nine months ended September 30, 2012, direct material costs were approximately 71%, overhead costs were approximately 23%, and direct labor costs were approximately 6% of total cost of sales. We are subject to changes in our cost of sales caused by movements in underlying commodity prices. We seek to hedge against this risk by using commodity swap contracts and, beginning in 2011, long-term supply agreements. See Item 3 Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk.

Selling, general and administrative expenses

The principal components of our selling, general and administrative expenses are salaries and benefits for our office personnel, advertising and promotional expenses, product warranty expense, expenses relating to certain information technology systems and amortization of our intangibles.

Engineering research and development

We incur costs in connection with research and development programs that are expected to contribute to future earnings. Such costs are expensed as incurred. In 2009, we were notified by the Department of Energy (DOE) that we were selected to receive matching funds up to $62.8 million from a cost-share grant program funded by the American Recovery and Reinvestment Act for the development of hybrid-propulsion system manufacturing capacity in the U.S. (the Grant Program). Applicable costs associated with the Grant Program have been charged to engineering research and development. The DOE s matching reimbursement is recorded to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income included in Part I, Item 1 of this Quarterly Report on Form 10-Q, or in the case of capital expenditure, as a reduction in the cost basis of the capital asset.

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Non-GAAP Financial Measures

We use Adjusted net income to measure our overall profitability because it better reflects our cash flow generation by capturing the actual cash taxes paid rather than our tax expense as calculated under GAAP and excludes the impact of the non-cash annual amortization of certain intangible assets and other certain non-recurring items. We use Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin, Adjusted EBITDA margin excluding technology-related license expenses and Adjusted free cash flow to evaluate and control our cash operating costs and to measure our operating profitability. We believe the presentation of Adjusted net income, Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin, Adjusted EBITDA margin excluding technology-related license expenses and Adjusted free cash flow enhances our investors overall understanding of the financial performance and cash flow of our business.

You should not consider Adjusted net income, Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin and Adjusted EBITDA margin excluding technology-related license expenses as an alternative to net income, determined in accordance with GAAP, as an indicator of operating performance. You should not consider Adjusted free cash flow as an alternative to net cash provided by operating activities, determined in accordance with GAAP, as an indicator of our cash flow.

A directly comparable GAAP measure to Adjusted net income, Adjusted EBITDA and Adjusted EBITDA excluding technology-related license expenses, is Net income. A directly comparable GAAP measure to Adjusted free cash flow is Net cash provided by operating activities. The following is a reconciliation of Net income to Adjusted net income, Adjusted EBITDA, Adjusted EBITDA excluding technology-related license expenses, Adjusted EBITDA margin, and Adjusted EBITDA margin excluding technology-related license expenses, and a reconciliation of Net cash provided by operating activities to Adjusted free cash flow:

	For the three months ended September 30, (unaudited)		**For the nine months ended September 30, (unaudited)**	
(in millions)	**2012**	**2011**	**2012**	**2011**
Net income	$ 32.2	$ 38.8	$ 503.0	$ 58.5
plus:				
Interest expense, net	40.8	63.3	115.6	183.9
Cash interest	(31.8)	(25.8)	(120.6)	(140.6)
Income tax expense (benefit)	17.0	18.3	(307.9)	42.3
Cash income taxes	(2.6)	(1.4)	(9.0)	(5.1)
Fee to terminate services agreement with Sponsors (a)			16.0	
Technology-related investments expense (b)	6.4		14.4	
Initial public offering expenses (c)	0.0		6.1	
Amortization of intangible assets	37.5	38.0	112.5	114.0
Adjusted net income	$ 99.5	$ 131.2	$ 330.1	$ 253.0
Cash interest expense	31.8	25.8	120.6	140.6
Cash income taxes	2.6	1.4	9.0	5.1
Depreciation of property, plant and equipment	26.1	25.5	76.0	77.0
Loss on repurchases of long-term debt (d)	0.5	3.0	21.6	11.3
Dual power inverter module extended coverage (e)			9.4	
Benefit plan re-measurement (f)			2.3	
Unrealized (gain) loss on hedge contracts (g)	(2.1)	4.1	(1.1)	5.1
Premiums and expenses on tender offer for long-term debt (h)				56.9
Benefit plan adjustment (i)				(2.0)
Restructuring charges (j)		(0.6)		
Other (k)	1.1	3.0	5.3	8.7
Adjusted EBITDA	$ 159.5	$ 193.4	$ 573.2	$ 555.7
Adjusted EBITDA excluding technology-related license expenses (l)	171.5	193.4	585.2	555.7

Net sales