

CARPENTER TECHNOLOGY CORP

Form 10-Q

November 02, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the transition period from to



Commission File Number 1-5828

CARPENTER TECHNOLOGY CORPORATION

(Exact name of Registrant as specified in its Charter)

Delaware
(State or other jurisdiction of incorporation or organization)

23-0458500
(I.R.S. Employer Identification No.)

P.O. Box 14662

Reading, Pennsylvania
(Address of principal executive offices)

19610
(Zip Code)

610-208-2000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 No

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the issuer's common stock as of October 26, 2012 was 52,634,883

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Table of Contents**PART I****Item 1. Financial Statements****CARPENTER TECHNOLOGY CORPORATION****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

(in millions, except share data)

	September 30, 2012	June 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 112.6	\$ 211.0
Accounts receivable, net	319.5	354.2
Inventories	722.2	642.0
Deferred income taxes	-	10.6
Other current assets	37.6	31.9
Total current assets	1,191.9	1,249.7
Property, plant and equipment, net	959.7	924.6
Goodwill	261.2	260.5
Other intangibles, net	106.5	109.9
Other assets	83.8	83.1
Total assets	\$ 2,603.1	\$ 2,627.8
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 235.8	\$ 236.1
Accrued liabilities	179.6	217.1
Deferred income taxes	2.5	-
Current portion of long-term debt	101.0	101.0
Total current liabilities	518.9	554.2
Long-term debt, net of current portion	305.6	305.9
Accrued pension liabilities	340.1	377.3
Accrued postretirement benefits	178.7	179.8
Deferred income taxes	32.2	31.4
Other liabilities	52.2	66.1
Total liabilities	1,427.7	1,514.7
Contingencies and commitments (see Note 9)		
STOCKHOLDERS EQUITY		
Common stock		
authorized 100,000,000 shares; issued 54,866,322 shares at September 30, 2012 and 54,809,735 shares at June 30, 2012; outstanding 52,632,511 shares at September 30, 2012 and 52,412,967 shares at June 30, 2012	274.3	274.0

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Capital in excess of par value	247.9	252.7
Reinvested earnings	1,139.2	1,109.6
Common stock in treasury (2,233,811 shares and 2,396,768 shares at September 30, 2012 and June 30, 2012, respectively), at cost	(111.7)	(120.0)
Accumulated other comprehensive loss	(384.1)	(412.5)
Total Carpenter stockholders' equity	1,165.6	1,103.8
Noncontrolling interest	9.8	9.3
Total equity	1,175.4	1,113.1
Total liabilities and equity	\$ 2,603.1	\$ 2,627.8

See accompanying notes to consolidated financial statements

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

(in millions, except per share data)

	Three Months Ended September 30,	
	2012	2011
NET SALES	\$ 544.9	\$ 414.1
Cost of sales	435.6	333.0
Gross profit	109.3	81.1
Selling, general and administrative expenses	47.7	35.7
Acquisition related costs	-	1.4
Operating income	61.6	44.0
Interest expense	(5.2)	(7.0)
Other income (expense), net	2.7	(0.7)
Income before income taxes	59.1	36.3
Income tax expense	19.6	12.6
Net income	39.5	23.7
Less: Net (income) loss attributable to noncontrolling interest	(0.3)	0.1
NET INCOME ATTRIBUTABLE TO CARPENTER	\$ 39.2	\$ 23.8
EARNINGS PER COMMON SHARE:		
Basic	\$ 0.74	\$ 0.53
Diluted	\$ 0.74	\$ 0.53
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	52.8	44.3
Diluted	53.4	45.1
Cash dividends per common share	\$ 0.18	\$ 0.18

See accompanying notes to consolidated financial statements

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(Unaudited)**

(\$ in millions)

	Three Months Ended September 30,	
	2012	2011
Net income	\$ 39.5	\$ 23.7
Other comprehensive income (loss), net of tax Pension and post-retirement benefits, net of tax of \$(2.6) and \$(1.2), respectively	4.4	2.0
Net gain (loss) on derivative instruments, net of tax of \$(11.6) and \$19.9, respectively	19.7	(32.5)
Unrealized loss on marketable securities, net of tax of \$0.0 and \$0.1, respectively	-	(0.1)
Foreign currency translation	4.5	(11.4)
Other comprehensive income (loss)	28.6	(42.0)
Comprehensive income (loss)	68.1	(18.3)
Less: Comprehensive (income) loss attributable to the noncontrolling interest	(0.5)	0.7
Comprehensive income (loss) attributable to Carpenter	\$ 67.6	\$ (17.6)

See accompanying notes to consolidated financial statements

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CARPENTER TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(\$ in millions)

		Three Months Ended September 30,		2011
	2012			
OPERATING ACTIVITIES				
Net income	\$	39.5	\$	23.7
Adjustments to reconcile net income to net cash used for operating activities:				
Depreciation and amortization		25.5		18.5
Deferred income taxes		0.1		6.1
Net pension expense		17.2		9.9
Net loss on disposal of property and equipment		0.1		-
Changes in working capital and other:				
Accounts receivable		36.1		0.8
Inventories		(78.7)		(94.9)
Other current assets		(4.7)		(1.6)
Accounts payable		(0.5)		9.3
Accrued liabilities		(23.5)		(13.4)
Pension plan contributions		(48.1)		(11.6)
Boarhead Farms settlement		-		(21.8)
Other, net		0.3		1.0
Net cash used for operating activities		(36.7)		(74.0)
INVESTING ACTIVITIES				
Purchases of property, equipment and software		(56.4)		(27.3)
Proceeds from disposals of property and equipment		-		0.2
Proceeds from sales and maturities of marketable securities		-		30.4
Net cash (used for) provided from investing activities		(56.4)		3.3
FINANCING ACTIVITIES				
Payments on long-term debt		-		(100.0)
Dividends paid		(9.6)		(8.1)
Tax benefits on share-based compensation		3.0		0.6
Proceeds from stock options exercised		1.1		0.7
Net cash used for financing activities		(5.5)		(106.8)
Effect of exchange rate changes on cash and cash equivalents		0.2		(0.2)
DECREASE IN CASH AND CASH EQUIVALENTS		(98.4)		(177.7)
Cash and cash equivalents at beginning of period		211.0		492.5
Cash and cash equivalents at end of period	\$	112.6	\$	314.8

See accompanying notes to consolidated financial statements

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CARPENTER TECHNOLOGY CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

(Unaudited)

(\$ in millions, except per share data)

	Common Stock		Carpenter Stockholders Equity		Accumulated Other Comprehensive Loss	Noncontrolling interest	Total Equity
	Par Value Of \$5	Capital in Excess of Par Value	Reinvested Earnings	Common Stock in Treasury			
Balances at June 30, 2012	\$ 274.0	\$ 252.7	\$ 1,109.6	\$ (120.0)	\$ (412.5)	\$ 9.3	\$ 1,113.1
Net income			39.2			0.3	39.5
Pension and post-retirement benefits, net of tax					4.4		4.4
Net gain on derivative instruments, net of tax					19.7		19.7
Foreign currency translation					4.3	0.2	4.5
Cash Dividends:							
Common @ \$0.18 per share			(9.6)				(9.6)
Share-based compensation plans		(8.6)		8.3			(0.3)
Stock options exercised	0.3	0.8					1.1
Treasury shares issued in connection with acquisition of business				-			-
Tax windfall on share-based compensation		3.0					3.0
Other							-
Balances at September 30, 2012	\$ 274.3	\$ 247.9	\$ 1,139.2	\$ (111.7)	\$ (384.1)	\$ 9.8	\$ 1,175.4
	Common Stock		Carpenter Stockholders Equity		Accumulated Other Comprehensive Loss	Noncontrolling interest	Total Equity
	Par Value Of \$5	Capital in Excess of Par Value	Reinvested Earnings	Common Stock in Treasury			
Balances at June 30, 2011	\$ 273.7	\$ 235.4	\$ 1,022.1	\$ (532.2)	\$ (233.3)	\$ 10.3	\$ 776.0
Net income			23.8			(0.1)	23.7
Pension and post-retirement benefits, net of tax					2.0		2.0
Net loss on derivative instruments, net of tax					(32.5)		(32.5)
Unrealized loss on marketable securities, net of tax					(0.1)		(0.1)
Foreign currency translation					(10.8)	(0.6)	(11.4)
Cash Dividends:							
Common @ \$0.18 per share			(8.1)				(8.1)

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Share-based compensation plans		(0.9)		2.1				1.2
Stock options exercised	0.1	0.6						0.7
Tax windfall on share-based compensation		0.6						0.6
Balances at September 30, 2011	\$ 273.8	\$ 235.7	\$ 1,037.8	\$ (530.1)	\$ (274.7)	\$ 9.6	\$ 752.1	

See accompanying notes to consolidated financial statements

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, considered necessary for a fair statement of the results are reflected in the interim periods presented. The June 30, 2012 consolidated balance sheet data was derived from audited financial statements, but does not include all the disclosures required by U.S. generally accepted accounting principles. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in Carpenter's annual report on Form 10-K for the year ended June 30, 2012 (the 2012 Form 10-K). Operating results for the three months ended September 30, 2012 are not necessarily indicative of the operating results for any future period.

As used throughout this report, unless the context requires otherwise, the terms Carpenter, the Company, Registrant, Issuer, we and our refer to Carpenter Technology Corporation.

2. Acquisition

Latrobe Specialty Metals, Inc.

On February 29, 2012, the Company completed the acquisition of Latrobe Specialty Metals, Inc. (Latrobe) for a total purchase price of \$427.0 million, net of cash acquired (the Latrobe Acquisition). The purchase price includes the issuance of 8.1 million shares of the Company's common stock to former Latrobe stockholders in exchange for their Latrobe capital stock and \$11.5 million of cash paid at closing, net of cash acquired of \$2.5 million, to satisfy certain costs of the sellers. The fair value of the shares issued as part of the consideration paid for Latrobe was determined based on the closing market price of the Company's shares on the acquisition date. The Company also assumed \$153.7 million of indebtedness which was paid off in cash concurrently with the closing of the acquisition.

Latrobe manufactures and distributes high-performance specialty metals serving customers across end-use markets including the aerospace and defense, energy and industrial markets. The manufacturing operations of Latrobe are based principally in Latrobe, Pennsylvania.

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following is a summary of the preliminary purchase price allocation in connection with the Latrobe Acquisition. During the three months ended September 30, 2012, the Company increased the amounts allocated to Accounts payable and accrued liabilities by \$0.9 million, decreased amounts allocated to deferred income taxes by \$0.3 million, and increased amounts allocated to goodwill by \$0.6 million as a result of additional information that became available during the quarter ended September 30, 2012. The amounts in the preliminary purchase price allocation are not yet final and are subject to change. The final allocation of the purchase price is expected to be completed during the second quarter of fiscal year 2013 when all the necessary information is obtained to complete the analysis, which is principally associated with obtaining and analyzing certain income tax information for the acquired business.

(\$ in millions)		
Accounts receivable	\$	67.3
Inventory		241.2
Property, plant and equipment		172.4
Intangible assets		87.1
Other		10.6
Accounts Payable and accrued liabilities		(64.8)
Long-term debt		(153.7)
Pension and other postretirement liabilities		(100.8)
Deferred income taxes		(47.4)
Total identifiable net assets		211.9
Goodwill		215.1
Total purchase price, net of cash acquired	\$	427.0

The goodwill recognized in connection with the Latrobe Acquisition consists of the value associated with the immediate increase in the Company's premium melt capacity to meet strong customer demand, improvements in the Company's position in attractive end use markets such as aerospace and defense and energy, the complementary asset capabilities which the Company expects will lead to enriched, higher margin product mix and operating cost synergies as well as the capabilities for commercialization of new Carpenter products under development. None of the goodwill recognized is deductible for income tax purposes.

In connection with the Latrobe Acquisition, the Company incurred approximately \$11.7 million and \$2.4 million of acquisition-related costs during the fiscal years ended June 30, 2012 and 2011, respectively. These costs were expensed as incurred and represent incremental legal, accounting and investment banking fees incurred in connection with the transaction as well as approximately \$5.2 million of liability for costs associated with the sale of certain Latrobe assets necessary to obtain approval for the transaction from the Federal Trade Commission (FTC). As part of the FTC approval, the Company entered into a consent decree to transfer assets and technical knowledge to Eramet S.A. and its subsidiaries, Aubert & Duval and Brown Europe, which will allow them to become a second manufacturer of two specific alloys in order to provide customers with a supply alternative in the marketplace.

The consolidated net sales for the three months ended September 30, 2012 includes approximately \$127.7 million of net sales related to the Latrobe business. The Company's operating income for the three months ended September 30, 2012 includes approximately \$16.3 million related to the operations of the acquired Latrobe business.

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The unaudited pro forma results presented below include the effects of the Latrobe Acquisition as if it had occurred as of July 1, 2011. The unaudited pro forma results reflect certain adjustments related to the acquisition, such as the depreciation and amortization associated with estimates for the fair value of the property and equipment and acquired intangible assets and the impacts of the elimination of Latrobe debt that was repaid at closing. The supplemental proforma earnings were adjusted to exclude acquisition-related costs in the three months ended September 30, 2011.

(\$ in millions)	Three Months Ended September 30,	
	2012	2011
Revenue	\$ 544.9	\$ 542.3
Earnings	\$ 39.2	\$ 23.5
Earnings per Common Share		
Basic	\$ 0.74	\$ 0.45
Diluted	\$ 0.74	\$ 0.44

The pro forma results do not include any anticipated synergies or other expected benefits of the acquisition. Accordingly, the unaudited pro forma financial information above is not necessarily indicative of either future results of operations or results that might have been achieved had the acquisition been completed on the dates indicated.

3. Earnings Per Common Share

The Company calculates basic earnings per share using the two class method. Under the two class method, earnings are allocated to common stock and participating securities (nonvested restricted shares and units that receive non-forfeitable dividends) according to their participation rights in dividends and undistributed earnings. The earnings available to each class of stock is divided by the weighted average number of shares for the period in each class. Because the participating securities have no obligation to share in net losses, losses are not allocated to the participating securities in this calculation.

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The calculations of basic and diluted earnings per common share for the three months ended September 30, 2012 and 2011 were as follows:

(in millions, except per share data)	Three Months Ended September 30,	
	2012	2011
Net income attributable to Carpenter	\$ 39.2	\$ 23.8
Less: earnings and dividends allocated to participating securities	(0.2)	(0.2)
Earnings available to Carpenter common stockholders	\$ 39.0	\$ 23.6
Weighted average number of common shares outstanding, basic	52.8	44.3
Effect of shares issuable under share based compensation plans	0.6	0.8
Weighted average number of common shares outstanding, diluted	53.4	45.1
Basic earnings per common share	\$ 0.74	\$ 0.53
Diluted earnings per common share	\$ 0.74	\$ 0.53

The following awards issued under share-based compensation plans were excluded from the above calculations of diluted earnings per share because their effects were anti-dilutive:

(in millions)	Three Months Ended September 30,	
	2012	2011
Stock options	0.1	0.1

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The fair value of the Company's marketable securities was based on quoted market prices or estimates of fair value as of September 30, 2012 and June 30, 2012. The following is a summary of marketable securities, all of which were classified as available-for-sale as of September 30, 2012 and June 30, 2012:

September 30, 2012 (\$ in millions)	Cost	Unrealized Losses	Estimated Fair Value
Non-current Municipal auction rate securities	\$ 6.0	\$ (1.0)	\$ 5.0
June 30, 2012 (\$ in millions)	Cost	Unrealized Losses	Estimated Fair Value
Non-current Municipal auction rate securities	\$ 6.0	\$ (1.0)	\$ 5.0

For the three months ended September 30, 2012 and 2011, proceeds from sales and maturities of marketable securities were \$0.0 million and \$30.4 million, respectively.

5. Inventories

Inventories consisted of the following components as of September 30, 2012 and June 30, 2012:

(\$ in millions)	September 30, 2012	June 30, 2012
Raw materials and supplies	\$ 140.4	\$ 114.1
Work in process	352.7	312.4
Finished and purchased products	229.1	215.5
Total inventory	\$ 722.2	\$ 642.0

Inventories are valued at the lower of cost or market. Cost for inventories is principally determined using the last-in, first-out (LIFO) method.

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Accrued liabilities consisted of the following as of September 30, 2012 and June 30, 2012:

(\$ in millions)	September 30, 2012	June 30, 2012
Accrued pension liabilities	\$ 65.9	\$ 70.0
Accrued compensation	30.1	50.1
Accrued postretirement benefits	17.2	17.2
Derivative financial instruments	15.0	26.5
Other	51.4	53.3
Total accrued liabilities	\$ 179.6	\$ 217.1

7. Pension and Other Postretirement Benefits

The components of the net periodic benefit cost related to the Company's pension and other postretirement benefits for the three months ended September 30, 2012 and 2011 were as follows:

Three months ended September 30, (\$ in millions)	Pension Plans		Other Postretirement Plans	
	2012	2011	2012	2011
Service cost	\$ 8.1	\$ 5.6	\$ 1.1	\$ 0.7
Interest cost	13.3	12.3	3.0	2.7
Expected return on plan assets	(13.7)	(13.0)	(1.6)	(1.6)
Amortization of net loss	7.0	0.2	0.8	0.6
Amortization of prior service cost (benefit)	0.2	4.4	(1.0)	(2.0)
Net pension expense	\$ 14.9	\$ 9.5	\$ 2.3	\$ 0.4

During the three months ended September 30, 2012 and 2011, the Company made \$48.1 million and \$11.6 million, respectively of required contributions to its defined benefit pension plans. The Company currently expects to make \$33.4 million in required contributions to its defined benefit pension plans during the remainder of fiscal year 2013.

8. Revolving Credit Agreement

The Company has a \$350.0 million syndicated credit agreement (Credit Agreement) that extends to June 2016. Interest on the borrowings under the Credit Agreement accrue at variable rates, based upon LIBOR or a defined Base Rate, both determined based upon the rating of the Company s senior unsecured long-term debt (the Debt Rating). The applicable margin to be added to LIBOR ranges from 0.65% to 1.95% (1.20% as of September 30, 2012), and for Base Rate-determined loans, from 0.0% to 0.95% (0.2% as of September 30, 2012). The Company also pays a quarterly facility fee ranging from 0.10% to 0.45% (0.2% as of September 30, 2012), determined based upon the Debt Rating, of the \$350 million commitment under the Credit Agreement. In addition, the Company must pay certain letter of credit fees, ranging from 0.65% to 1.95% (1.20% as of September 30, 2012), with respect to letters-of-credit issued under the Credit Agreement. The Company has the right to voluntarily prepay and reborrow loans and to terminate or reduce the commitments under the facility. As of September 30, 2012, the Company had \$7.2 million of issued letters of credit under the Credit Agreement, with the balance of \$342.8 million available for future borrowings.

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company is subject to certain financial and restrictive covenants under the Credit Agreement, which, among other things, require the maintenance of a minimum interest coverage ratio (3.5 to 1.0 for September 30, 2012). The interest coverage ratio is defined in the Credit Agreement as, for any period, the ratio of consolidated earnings before interest, taxes, depreciation and amortization, and non-cash net pension expense (EBITDA) to consolidated interest expense for such period. The Credit Agreement also requires the Company to maintain a debt to capital ratio of less than 55%. The debt to capital ratio is defined in the Credit Agreement as the ratio of consolidated indebtedness, as defined therein, to consolidated capitalization, as defined therein. As of September 30, 2012 and June 30, 2012, the Company was in compliance with all of the covenants of the Credit Agreement.

9. Contingencies and Commitments

Environmental

The Company is subject to various federal, state, local and international environmental laws and regulations relating to pollution, protection of public health and the environment, natural resource damages and occupational safety and health. Although compliance with these laws and regulations may affect the costs of the Company's operations, compliance costs to date have not been material. The Company has environmental remediation liabilities at some of its owned operating facilities and has been designated as a potentially responsible party (PRP) with respect to certain third-party Superfund waste-disposal sites and other third party-owned sites. Additionally, the Company has been notified that it may be a PRP with respect to other Superfund sites as to which no proceedings have been instituted against the Company. Neither the exact amount of remediation costs nor the final method of their allocation among all designated PRP's at these Superfund sites has been determined. The liability for future environmental remediation costs is evaluated by management on a quarterly basis. The Company accrues amounts for environmental remediation costs that represent management's best estimate of the probable and reasonably estimable undiscounted future costs related to environmental remediation. During the three months ended September 30, 2012, no additional accruals were recorded. The liabilities recorded for environmental remediation costs at Superfund sites, at other third party-owned sites and at Company-owned current or former operating facilities were \$4.9 million and \$4.9 million at September 30, 2012 and June 30, 2012, respectively.

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

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CARPENTER TECHNOLOGY CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Boarhead Farms

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

Export Regulations Violations

During fiscal year 2008, the Company became aware of potential violations of federal export regulations at a business unit that had been recently divested. Upon investigation, the Company discovered that approximately 40 foreign nationals employed over time at the business unit s facility may have been exposed to protected technical data related to the production of various products for military applications. An export license from the Department of State and the Department of Commerce is required prior to the exporting of technical data for military applications. The Company has applied for and received similar applications for other business units, but did not have such a license for the divested business unit. Violations of Federal export regulations can be subject to civil penalties depending upon the severity of the violation. The Company filed voluntary disclosures with the Department of State and the Department of Commerce before the divestiture of the business unit on March 31, 2008. The Department of State responded to the voluntary disclosure without assessing civil penalties. The Department of Commerce has not yet responded to the voluntary disclosure. It is not possible to determine the amount, if any, of civil penalties that may be assessed by the Department of Commerce. As a result, the Company has not recorded any liability for potential penalties as of September 30, 2012.

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Other

The Company is defending various routine claims and legal actions that are incidental to its business, and are common to its operations, including those pertaining to product claims, commercial disputes, patent infringement, employment actions, employee benefits, compliance with domestic and foreign laws, personal injury claims and tax issues. Like many other manufacturing companies in recent years, from time to time, the Company has been named as a defendant in lawsuits alleging personal injury as a result of exposure to chemicals and substances in the workplace. The Company provides for costs relating to these matters when a loss is probable and the amount of the loss is reasonably estimable. The effect of the outcome of these matters on the Company's future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount and timing (both as to recording future charges to operations and cash expenditures) of the resolution of such matters. While it is not feasible to determine the outcome of these matters, management believes that the total liability from these matters will not have a material effect on the Company's financial position, results of operations or cash flows over the long-term. However, there can be no assurance that an increase in the scope of pending matters or that any future lawsuits, claims, proceedings or investigations will not be material to the Company's financial position, results of operations or cash flows in a particular future quarter or year.

10. Fair Value Measurements

The fair value hierarchy has three levels based on the inputs used to determine fair value. Level 1 refers to quoted prices in active markets for identical assets or liabilities. Level 2 refers to observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. Level 3 refers to unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs. Currently, the Company does not use Level 3 inputs.

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The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy.

September 30, 2012 (\$ in millions)	Fair Value Measurements Using Input Type		
	Level 1	Level 2	Total
Assets:			
Marketable securities			
Municipal auction rate securities	\$ -	\$ 5.0	\$ 5.0
Derivative financial instruments	-	5.4	5.4
Total assets	\$ -	\$ 10.4	\$ 10.4
Liabilities:			
Derivative financial instruments	\$ -	\$ 29.1	\$ 29.1

June 30, 2012 (\$ in millions)	Fair Value Measurements Using Input Type		
	Level 1	Level 2	Total
Assets:			
Marketable securities			
Municipal auction rate securities	-	5.0	5.0
Derivative financial instruments	-	2.6	2.6
Total assets	\$ -	\$ 7.6	\$ 7.6
Liabilities:			
Derivative financial instruments	\$ -	\$ 56.5	\$ 56.5

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

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

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

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

(\$ in millions)	September 30, 2012		June 30, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current portion	\$ 406.6	\$ 430.2	\$ 406.9	\$ 427.7
Company-owned life insurance	\$ 11.5	\$ 11.5	\$ 11.0	\$ 11.0

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

The fair values of long-term debt as of September 30, 2012 and June 30, 2012 were determined by using current interest rates for debt with terms and maturities similar to the Company's existing debt arrangements.

11. Other Income (Expense), Net

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

(\$ in millions)	Three Months Ended	
	September 30, 2012	September 30, 2011
Gains (losses) on company owned life insurance contracts and investments held in rabbi trusts	\$ 2.6	\$ (1.7)
Equity in (losses) earnings of unconsolidated subsidiaries	(0.6)	0.7
Interest income	0.1	0.3
Other income	0.6	-
Total other income (expense), net	\$ 2.7	\$ (0.7)

12. Derivatives and Hedging Activities

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

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CARPENTER TECHNOLOGY CORPORATION

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

Cash Flow Hedging Forward interest rate swaps: From time to time, the Company has entered into forward interest rate swap contracts to manage the risk of cash flow variability associated with fixed interest debt expected to be issued. The forward interest rate swaps have been designated as cash flow hedges. The qualifying hedge contracts are marked-to-market at each reporting date and any unrealized gains or losses are included in accumulated other comprehensive income to the extent effective, and reclassified to interest expense in the period during which the hedged transaction affects earnings or it becomes probable that the forecasted transaction will not occur. As of September 30, 2012 and June 30, 2012, the total notional amount of forward interest rate swaps was \$150.0 million and \$0.0 million, respectively.

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

The Company also uses foreign currency forward contracts to protect certain short-term asset positions denominated in foreign currency against the effect of changes in exchange rates. These positions do not qualify for hedge accounting and accordingly, are marked-to-market at each reporting date through charges to other income and expense. As of September 30, 2012 and June 30, 2012, the fair value of the outstanding foreign currency forwards not designated as hedging instruments and the charges to income for changes in fair value for these contracts were not material.

Fair Value Hedging - Interest rate swaps: The Company uses interest rate swaps to achieve a level of floating rate debt relative to fixed rate debt where appropriate. The Company has designated fixed to floating interest rate swaps as fair value hedges. Accordingly, the changes in the fair value of these instruments are immediately recorded in earnings. The mark-to-market values of both the fair value hedging instruments and the underlying debt obligations are recorded as equal and offsetting gains and losses in interest expense in the Consolidated Statements of Income. As of September 30, 2012 and June 30, 2012, the total notional amount of floating interest rate contracts was \$45.0 million and \$45.0 million, respectively. For the three months ended September 30, 2012 and 2011, net gains of \$0.3 million and \$0.2 million, respectively, were recorded as a reduction to interest expense. These amounts include the impact of previously terminated swaps which are being amortized over the remaining term of the underlying debt.

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The fair value and location of outstanding derivative contracts recorded in the accompanying consolidated balance sheets were as follows as of September 30, 2012 and June 30, 2012:

September 30, 2012 (\$ in millions)	Interest Rate Swaps	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:				
<i>Derivatives designated as hedging instruments:</i>				
Other current assets	\$ (0.9)	\$ 0.3	\$ 2.5	\$ 1.9
Other assets	0.9	-	2.6	3.5
Total asset derivatives	\$ -	\$ 0.3	\$ 5.1	\$ 5.4
Liability Derivatives:				
<i>Derivatives designated as hedging instruments:</i>				
Accrued liabilities	\$ -	\$ 1.9	\$ 13.1	\$ 15.0
Other liabilities	-	0.3	13.8	14.1
Total liability derivatives	\$ -	\$ 2.2	\$ 26.9	\$ 29.1
June 30, 2012 (\$ in millions)	Interest Rate Swaps	Foreign Currency Contracts	Commodity Contracts	Total Derivatives
Asset Derivatives:				
<i>Derivatives designated as hedging instruments:</i>				
Other current assets	\$ 0.2	\$ 1.2	\$ -	\$ 1.4
Other assets	1.2	-	-	1.2
Total asset derivatives	\$ 1.4	\$ 1.2	\$ -	\$ 2.6
Liability Derivatives:				
<i>Derivatives designated as hedging instruments:</i>				
Accrued liabilities	\$ -	\$ 1.5	\$ 25.0	\$ 26.5
Other liabilities	-	0.4	29.6	30.0
Total liability derivatives	\$ -	\$ 1.9	\$ 54.6	\$ 56.5

Table of Contents**CARPENTER TECHNOLOGY CORPORATION****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)*****Cash Flow Hedges***

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (AOCI) and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. The following is a summary of the (losses) gains related to cash flow hedges recognized during the three ended September 30, 2012 and 2011:

(\$ in millions)	Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion)	
	Three Months Ended September 30,	
Derivatives in Cash Flow Hedging Relationship:	2012	2011
Commodity contracts	\$ 24.0	\$ (55.3)
Foreign exchange contracts	(0.1)	1.4
Forward interest rate swaps	(1.7)	-
Total	\$ 22.2	\$ (53.9)

(\$ in millions)	Location of (Loss) Gain Reclassified from AOCI into Income (Effective Portion)	Amount of (Loss) Gain Reclassified from AOCI into Income (Effective Portion)	
		Three Months Ended September 30,	
Derivatives in Cash Flow Hedging Relationship:		2012	2011
Commodity contracts	Cost of sales	\$ (9.2)	\$ (1.6)
Foreign exchange contracts	Net sales	0.1	-
Total		\$ (9.1)	\$ (1.6)

The Company estimates that \$11.1 million of net derivative losses included in AOCI as of September 30, 2012 will be reclassified into earnings within the next 12 months. No significant cash flow hedges were discontinued during the quarter ended September 30, 2012. There was no ineffectiveness during the three months ended September 30, 2012 and 2011.

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The changes in AOCI associated with derivative hedging activities during the three months ended September 30, 2012 and 2011 were as follows:

(\$ in millions)	September 30,	
	2012	2011
Balance at July 1	\$ (32.8)	\$ 2.6
Current period changes in fair value, net of tax	14.0	(33.5)
Reclassification to earnings, net of tax	5.7	1.0
Balance at September 30	\$ (13.1)	\$ (29.9)

According to the provisions of the Company's derivative arrangements, in the event that the fair value of outstanding derivative positions with certain counterparties exceeds certain thresholds, the Company may be required to issue cash collateral to the counterparties. The Company's contracts with these counterparties allow for netting of derivative instrument positions executed under each contract. As of September 30, 2012 and June 30, 2012, the Company had no cash collateral held by counterparties.

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

13. Income Taxes

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

The income tax expense for the three months ended September 30, 2012 was \$19.6 million, or 33.2 percent of pre-tax income, as compared with \$12.6 million, or 34.7 percent of pre-tax income, for the three months ended September 30, 2011.

14. Business Segments

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In January 2012, the Company changed its reportable segments, beginning with the second quarter results of fiscal year 2012, to align with a new operating model in which the integrated steel mill operations are managed distinctly from the collection of other differentiated business unit operations. In addition, during the first quarter of fiscal year 2013, the Company moved the Specialty Steel Supply (SSS) business acquired in connection with the Latrobe Acquisition from the Latrobe segment to the Performance Engineered Products segment. The Company has three reportable segments, Specialty Alloys Operations (SAO), Latrobe, and Performance Engineered Products (PEP). Previously, the Company s reportable segments consisted of Premium Alloys Operations, Advanced Metals Operations and Emerging Ventures.

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CARPENTER TECHNOLOGY CORPORATION

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(Unaudited)

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

The Latrobe segment is comprised of the operations of the Latrobe business acquired effective February 29, 2012. The Latrobe segment provides management with the focus and visibility into the business performance of these newly acquired operations. The Latrobe segment also includes the results of Carpenter's distribution business in Mexico. As the Latrobe business becomes integrated with Carpenter, its results will likely be combined and reported together with the SAO business segment sometime in the future.

The PEP segment is comprised of the Company's differentiated operations. This includes the Dynamet titanium business, the Carpenter Powder Products business, the Amega West business and the SSS distribution business that was acquired in connection with the Latrobe Acquisition. The businesses in the PEP segment are managed with an entrepreneurial structure to promote speed and flexibility and drive overall revenue and profit growth.

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

On a consolidated basis, there were no significant individual customers that accounted for more than 10 percent of the total net sales during the three months ended September 30, 2012 and 2011, respectively.

The historical segment information for the three months ended September 30, 2011, which is set forth below, was recast to conform to the fiscal year 2013 presentation.

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Segment Data (\$ in millions)	Three Months Ended September 30,	
	2012	2011
Net Sales:		
Specialty Alloys Operations	\$ 361.8	\$ 335.8
Latrobe	121.8	10.2
Performance Engineered Products	98.7	84.2
Intersegment	(37.4)	(16.1)
Consolidated net sales	\$ 544.9	\$ 414.1
Operating Income:		
Specialty Alloys Operations	\$ 54.4	\$ 46.3
Latrobe	15.7	0.6
Performance Engineered Products	11.5	11.8
Corporate costs	(10.4)	(10.2)
Pension earnings, interest & deferrals	(8.0)	(3.6)
Intersegment	(1.6)	(0.9)
Consolidated operating income	\$ 61.6	\$ 44.0
Depreciation and Amortization:		
Specialty Alloys Operations	\$ 13.7	\$ 13.1
Latrobe	5.6	0.1
Performance Engineered Products	4.8	4.2
Corporate	1.5	1.2
Intersegment	(0.1)	(0.1)
Consolidated depreciation and amortization	\$ 25.5	\$ 18.5
Capital Expenditures:		
Specialty Alloys Operations	\$ 38.6	\$ 17.6
Latrobe	8.2	-
Performance Engineered Products	8.5	8.7
Corporate	1.6	1.7
Intersegment	(0.5)	(0.7)
Consolidated capital expenditures	\$ 56.4	\$ 27.3
	September 30, 2012	June 30, 2012
Total Assets:		
Specialty Alloys Operations	\$ 1,317.9	\$ 1,293.3
Latrobe	808.1	807.5
Performance Engineered Products	405.7	394.7
Corporate	93.2	151.0
Intersegment	(21.8)	(18.7)
Consolidated total assets	\$ 2,603.1	\$ 2,627.8

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15. Recent Accounting Standards

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

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

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

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02). The guidance in ASU 2012-02 is intended to reduce the cost and complexity of testing indefinite-lived intangible assets other than goodwill for impairment by providing entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The guidance includes examples of events and circumstances that might indicate that it is more likely than not that an indefinite-lived intangible assets is impaired. The qualitative assessment may be performed on none, some or all of its indefinite-lived intangible assets. An entity may also choose to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to the quantitative impairment test and then choose to perform the qualitative assessment in any subsequent period. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 with early adoption permitted. The adoption of ASU 2011-08 is not expected to have a significant impact on the Company's Consolidated Financial Statements.

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

Background and General

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

On February 29, 2012, following approval of the acquisition by the U.S. Federal Trade Commission (FTC), we completed the acquisition of Latrobe Specialty Metals, Inc. (Latrobe) through the merger of a wholly-owned subsidiary of the Company with and into Latrobe (the Latrobe Acquisition). In connection with the Latrobe Acquisition, former owners of Latrobe received 8.1 million shares of Carpenter stock. In addition, pursuant to the terms of the related merger agreement, Carpenter paid \$11.5 million in cash at closing, net of \$2.5 million of cash acquired, in addition to a payment of approximately \$154 million in order to pay off Latrobe debt. A key benefit of the Latrobe Acquisition is a substantial increase in production which will increase Carpenter's capacity to meet strong customer demand for premium products. As a condition of the FTC approval, Carpenter entered into a consent decree (the Consent Decree) to transfer certain assets and technical knowledge to Eramet S.A and its subsidiaries, Aubert & Duval and Brown Europe (collectively, the Transferees), which will allow the Transferees, as a group, to become a second manufacturer of two specific alloys in order to provide customers with a supply alternative in the marketplace. The alloys have minimal sales impact and will cause no material change to the economics of the Latrobe Acquisition. As part of the Consent Decrees, Carpenter agreed to transfer certain assets as well as fund the cost of acquiring assets in an amount up to approximately \$5 million; Carpenter recorded a charge for this liability in the quarter ended March 31, 2012.

In August 2012, we announced that we have commenced a process to sell the Latrobe and Mexico distribution businesses. As of September 30, 2012, we have not met the criteria to qualify to report those businesses as held for sale or discontinued operations. If successful, we intend to eventually reinvest the proceeds from the sales of the businesses in other, more strategic businesses.

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

Our discussions below in this Item 2 are based upon the more detailed discussions about our business, operations and financial condition included in Item 8 of our 2012 Form 10-K. Our discussions here focus on our results during or as of the three-month period ended September 30, 2012 and the comparable periods of fiscal year 2012, and, to the extent applicable, on material changes from information discussed in the 2012 Form 10-K or other important intervening developments or information that we have reported on Form 8-K. These discussions should be read in conjunction with the 2012 Form 10-K for detailed background information and with any such intervening Form 8-K.

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Changes to Segment Reporting

In January 2012, we changed our reportable segments, beginning with our second quarter results of fiscal year 2012, to align with a new operating model in which our integrated steel mill operations are managed distinctly from the collection of other differentiated business unit operations. In addition, during the first quarter of fiscal year 2013, we moved the Specialty Steel Supply (SSS) business acquired in connection with the Latrobe Acquisition from the Latrobe segment to the Performance Engineered Products segment. We now have three reportable segments, Specialty Alloys Operations (SAO), Latrobe and Performance Engineered Products (PEP). Previously, the Company's reportable segments consisted of Premium Alloys Operations, Advanced Metals Operations and Emerging Ventures.

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

The Latrobe segment is comprised of the operations of the Latrobe business acquired effective February 29, 2012. The Latrobe segment provides management with the focus and visibility into the business performance of these newly acquired operations. The Latrobe segment also includes the results of Carpenter's distribution business in Mexico, which is being managed together with the Latrobe distribution business. As the Latrobe business becomes integrated with Carpenter, its results will likely be combined and reported together with the SAO business segment sometime in the future.

The PEP segment will be comprised of Carpenter's differentiated operations. This includes the Dynamet business, the Carpenter Powder Products business, the Amega West business and the SSS business that was acquired in connection with the Latrobe Acquisition. The businesses in the PEP segment are managed with an entrepreneurial structure to promote speed and flexibility, and drive overall revenue and profit growth.

In conjunction with the segment reporting changes, we also made a few modifications to our supplemental end-use market and product class reporting. For end-use market reporting, Aerospace end-use market sales was broadened to incorporate Aerospace and Defense. Industrial and Consumer end-use market sales were combined as Industrial and Consumer. The Automotive end-use market was broadened to Transportation to reflect sales in non-automotive markets like marine. All distribution businesses sales will be reported as a separate end-use market called Distribution. For product class reporting, sales of powder metal products were broken out and a new category of Alloy and Tool Steels was added. The changes are intended to better segregate growth areas of premium products such as high temperature nickel-based special alloys, titanium products and powder metals, while also reflecting the product classes and businesses gained through the Latrobe Acquisition. All prior period information has been reclassified to conform to the fiscal year 2013 presentation.

Impact of Raw Material Prices and Product Mix

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

higher costs of sales. Conversely, in a period of decreasing raw material costs, the LIFO inventory valuation normally results in lower costs of sales.

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

Approximately 25 percent our net sales are sales to customers under firm price sales arrangements. Firm price sales arrangements involve a risk of profit margin fluctuations, particularly when raw material prices are volatile. In order to reduce the risk of fluctuating profit margins on these sales, we enter into commodity forward contracts to purchase certain critical raw materials necessary to produce the related products sold. Firm price sales arrangements generally include certain annual purchasing commitments and consumption schedules agreed to by the customers at selling prices based on raw material prices at the time the arrangements are established. If a customer fails to meet the volume commitments (or the consumption schedule deviates from the agreed-upon terms of the firm price sales arrangements), the Company may need to absorb the gains or losses associated with the commodity forward contracts on a temporary basis. Gains or losses associated with commodity forward contracts are reclassified to earnings/loss when earnings are impacted by the hedged transaction. Because we value most of our inventory under the LIFO costing methodology, changes in the cost of raw materials and production activities are recognized in cost of sales in the current period attempting to match the most recently incurred costs with revenues. Gains or losses on the commodity forward contracts are reclassified from other comprehensive income together with the actual purchase price of the underlying commodities when the underlying commodities are purchased and recorded in inventory. To the extent that the total purchase price of the commodities, inclusive of the gains or losses on the commodity forward contracts, are higher or lower relative to the beginning of year costs, our costs of goods sold reflect such amounts. Accordingly, the gains and/or losses associated with commodity forward contracts may not impact the same period that the firm price sales arrangements revenue is recognized, and comparisons of gross profit from period to period may be impacted. These firm price sales arrangements are expected to continue as we look to strengthen our long-term customer relationships by expanding, renewing and in certain cases extending to a longer term, our customer long-term arrangements.

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

Net Pension Expense

Net pension expense, as we define it below, includes the net periodic benefit costs related to both our pension and other postretirement plans. The current quarter's results include non-cash net pension expense of \$17.2 million, or \$0.21 per diluted share, versus \$9.9 million, or \$0.14 per diluted share, in the same quarter last year. See the section **Non-GAAP Financial Measures** below for further discussions of these financial measures.

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Net pension expense is recorded in accounts that are included in both the cost of sales and selling, general and administrative expenses lines of our Consolidated Statements of Income. The following is a summary of the classification of net pension expense for the three months ended September 30, 2012 and 2011:

(\$ in millions)	Three Months Ended	
	September 30,	
	2012	2011
Cost of sales	\$ 12.8	\$ 7.2
Selling, general and administrative expenses	4.4	2.7
Net pension expense	\$ 17.2	\$ 9.9

Net pension expense is determined annually based on beginning of year balances and is recorded ratably throughout the fiscal year, unless a significant re-measurement event occurs. We currently expect that the total net pension expense for fiscal year 2013 will be \$68.3 million as compared with \$42.1 million recorded in fiscal year 2012.

The service cost component of net pension expense represents the estimated cost of future pension liabilities earned associated with active employees. The pension earnings, interest and deferrals expense is comprised of the expected return on plan assets, interest costs on the projected benefit obligations of the plans, and amortization of actuarial gains and losses and prior service costs. The following is a summary of the components of net pension expense during the three months ended September 30, 2012 and 2011:

(\$ in millions)	Three Months Ended	
	September 30,	
	2012	2011
Service cost	\$ 9.2	\$ 6.3
Pension earnings, interest and deferrals	8.0	3.6
Net pension expense	\$ 17.2	\$ 9.9

Latrobe Acquisition Impacts

We closed the Latrobe Acquisition on February 29, 2012. After seven months of ownership, the Latrobe results remain strong and we continue to track ahead of our deal economics. The integration teams are doing an outstanding job of delivering operational synergies from the combined operation that we believe will lead to higher volumes, improved costs and a richer mix. The net accretion from Latrobe's operating results offset by a higher share count, contributed \$0.07 per diluted share for the three months ended September 30, 2012. This accretion excludes the synergies realized on our existing SAO business. These measures below have not been determined in accordance with U.S. GAAP. See further discussion of these measures in the Non-GAAP Financial Measures discussion below.

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Operating Performance Overview

For the quarter ended September 30, 2012, we reported net income attributable to Carpenter of \$39.2 million, or \$0.74 per diluted share, compared with income attributable to Carpenter for the same period a year earlier of \$23.8 million, or \$0.53 per diluted share. Our strong first quarter results demonstrate that we are continuing to execute well against our strategic plan. While there are some areas where customer demand has softened recently, our overall business continues to be well positioned in attractive end-use markets with strong demand for our ultra-premium and premium products. This is evident in our strong top line results that further reflect a positive spread between revenue and volume growth. We remain on track to achieve the financial targets we set for our full fiscal year and expect strong shipment levels in the second half of the fiscal year. Strong customer demand for the ultra-premium and premium parts of our product line, combined with our large backlog, is consuming our full available premium capacity.

There are several initiatives that will have an impact on our results this fiscal year, including costs associated with the following: (i.) the start-up of our Athens, Alabama premium products manufacturing facility, (ii.) manufacturing footprint optimization opportunities, and (iii.) an inventory reduction initiative. See below for further discussion of these costs. During the three months ended September 30, 2012, these initiatives impacted our operating margin by 0.4 percent (\$1.6 million) and negatively impacted our diluted earnings per share by \$0.02 per diluted share.

In the first quarter of fiscal year 2012, we announced our plans to construct a new 400,000 square foot state-of-the-art manufacturing facility in response to strong customer demand for premium products primarily in the fast-growing aerospace and energy industries. We expect that the new facility will ultimately be capable of producing approximately 27,000 tons per year of additional premium product and be operational by April 2014. The facility is being built on a 230 acre greenfield site located in Limestone County, Alabama at a total cost of approximately \$500 million. The new facility will include forge, re-melting and associated finishing and testing capabilities and will play a key role in further developing our capabilities in the production of our premium products. During the three months ended September 30, 2012, we incurred \$0.9 million of facility start-up costs and expect to incur approximately \$6.0 million for the full fiscal year.

We are currently evaluating opportunities with respect to manufacturing footprint optimization principally as a result of the Latrobe Acquisition and other changes we believe are necessary to manage our business as an integrated steel mill operation. In August 2012, we announced plans to close our wire production facility in Orangeburg, South Carolina and move certain assets as we expand the Wauseon, Ohio facility acquired in connection with the Latrobe Acquisition. We are currently evaluating other, smaller consolidation opportunities related to the Latrobe acquisition and continue to evaluate opportunities to optimize the broader footprint of our mill assets. Total costs incurred in connection with the footprint optimization were approximately \$0.1 million during the three months ended September 30, 2012.

In connection with the Latrobe Acquisition, we initiated a third party consulting study to identify opportunities to potentially reduce inventory levels across our integrated mill system, including Latrobe. Our inventory turns performance is below average as compared with peers in our industry, with Latrobe at even lower average turns than our SAO business. The consulting study is approaching its conclusion and we believe there are potential opportunities to reduce inventory levels and improve our inventory turns performance from historical levels. Upon completion of the consulting study, specific action plans will be developed, and we expect to see the benefits of improvements in our inventory performance during the second half of our fiscal year 2013. We expect that a reduction in inventory levels may result in earnings impacts during fiscal year 2013 that we are unable to estimate at this time. During the three months ended September 30, 2012, we incurred \$0.6 million of costs associated with the inventory reduction initiative which consists of consulting costs associated with the study.

Table of Contents**Results of Operations Three Months Ended September 30, 2012 vs. Three Months Ended September 30, 2011****Net Sales**

Net sales for the three months ended September 30, 2012 were \$544.9 million, which was a 32 percent increase over the same period a year ago. Excluding surcharge revenue, sales increased 41 percent. Overall, pounds shipped were 36 percent higher than the first fiscal quarter a year ago. Excluding the Latrobe impact, our recent first quarter net sales excluding surcharge revenues increased 9 percent on 4 percent higher volume. Net sales excluding surcharge revenues in our SAO segment increased 16 percent on 7 percent higher volume, while net sales excluding surcharge revenues in our PEP segment increased 17 percent on 2 percent lower shipment volume. The results reflect our continued deliberate actions to grow premium products and strengthen overall product mix.

Geographically, sales outside the United States increased 19 percent from the same period a year ago to \$163.8 million. International growth was led by 41 percent growth in Asia-Pacific sales and 14 percent increase in European sales. Growth in Asia-Pacific was led by sales into aerospace and energy end markets. Growth in Europe was led by increased demand for materials used for aerospace and high value automotive applications. Total international sales in the quarter represented 30 percent of total net sales, compared with 33 percent in the prior year.

Sales by End-Use Markets

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

(\$ in millions)	Three Months Ended		\$	%
	September 30,			
	2012	2011	Increase (Decrease)	Increase (Decrease)
Aerospace and defense	\$ 252.6	\$ 174.8	\$ 77.8	45%
Industrial and consumer	113.9	105.4	8.5	8
Energy	77.4	59.1	18.3	31
Medical	30.4	33.2	(2.8)	(8)
Transportation	34.5	31.4	3.1	