

WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORP
Form 10-Q
August 07, 2006
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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 June 30, 2006

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: 1-13782

WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

1001 Air Brake Avenue

Wilmerding, PA
(Address of principal executive offices)

25-1615902
(I.R.S. Employer
Identification No.)

15148
(Zip Code)

412-825-1000

(Registrant's telephone number, including area code)

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N/A

(Former name, former address and former fiscal year, if changed since last report)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Class	Outstanding at August 2, 2006
[Common Stock, \$.01 par value per share]	48,772,584 shares

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**WESTINGHOUSE AIR BRAKE
TECHNOLOGIES CORPORATION**

June 30, 2006 FORM 10-Q

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS**

<i>In thousands, except shares and par value</i>	Unaudited June 30, 2006	December 31, 2005
Assets		
Current Assets		
Cash and cash equivalents	\$ 238,907	\$ 141,365
Accounts receivable	162,993	206,891
Inventories	139,737	110,873
Deferred income taxes	15,612	15,838
Other current assets	12,444	7,959
Total current assets	569,693	482,926
Property, plant and equipment	372,344	358,759
Accumulated depreciation	(207,848)	(197,158)
Property, plant and equipment, net	164,496	161,601
Other Assets		
Goodwill	119,270	118,181
Other intangibles, net	38,100	39,129
Deferred income taxes	18,526	18,428
Other noncurrent assets	10,364	16,092
Total other assets	185,260	191,830
Total Assets	\$ 920,449	\$ 836,357
Liabilities and Shareholders Equity		
Current Liabilities		
Accounts payable	\$ 80,555	\$ 93,551
Accrued income taxes	11,557	4,427
Customer deposits	93,750	71,098
Accrued compensation	23,272	25,274
Accrued warranty	17,557	16,158
Other accrued liabilities	28,754	30,971
Total current liabilities	255,445	241,479
Long-term debt	150,000	150,000
Reserve for postretirement and pension benefits	43,347	44,428
Deferred income taxes	7,582	7,381
Other long-term liabilities	10,230	13,862
Total liabilities	466,604	457,150
Shareholders Equity		
Preferred stock, 1,000,000 shares authorized, no shares issued		

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Common stock, \$.01 par value; 100,000,000 shares authorized: 66,174,767 shares issued and 48,659,930 and 48,002,819 outstanding at June 30, 2006 and December 31, 2005, respectively.	662	662
Additional paid-in capital	309,944	294,209
Treasury stock, at cost, 17,514,837 and 18,171,948 shares, at June 30, 2006 and December 31, 2005, respectively	(217,253)	(225,483)
Retained earnings	376,974	336,744
Accumulated other comprehensive loss	(16,482)	(26,925)
Total shareholders' equity	453,845	379,207
Total Liabilities and Shareholders' Equity	\$ 920,449	\$ 836,357

The accompanying notes are an integral part of these statements.

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WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

<i>In thousands, except per share data</i>	Unaudited		Unaudited	
	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2006	2005	2006	2005
Net sales	\$ 261,902	\$ 266,297	\$ 524,311	\$ 508,097
Cost of sales	(185,161)	(200,122)	(372,480)	(384,910)
Gross profit	76,741	66,175	151,831	123,187
Selling, general and administrative expenses	(32,313)	(30,623)	(65,941)	(59,635)
Engineering expenses	(8,023)	(8,183)	(16,138)	(16,853)
Amortization expense	(859)	(1,073)	(1,726)	(2,044)
Total operating expenses	(41,195)	(39,879)	(83,805)	(78,532)
Income from operations	35,546	26,296	68,026	44,655
Other income and expenses				
Interest expense, net	(420)	(2,165)	(1,544)	(4,649)
Other expense, net	(1,623)	(687)	(1,503)	(1,836)
Income from continuing operations before income taxes	33,503	23,444	64,979	38,170
Income tax expense	(11,721)	(8,511)	(23,129)	(13,894)
Income from continuing operations	21,782	14,933	41,850	24,276
Discontinued operations				
(Loss) income from discontinued operations (net of tax)	(637)	218	(659)	123
Net income	\$ 21,145	\$ 15,151	\$ 41,191	\$ 24,399
Earnings Per Common Share				
Basic				
Income from continuing operations	\$ 0.45	\$ 0.32	\$ 0.87	\$ 0.52
(Loss) income from discontinued operations	(0.01)		(0.02)	0.01
Net income	\$ 0.44	\$ 0.32	\$ 0.85	\$ 0.53
Diluted				
Income from continuing operations	\$ 0.44	\$ 0.31	\$ 0.86	\$ 0.51
(Loss) income from discontinued operations	(0.01)	0.01	(0.02)	.01
Net income	\$ 0.43	\$ 0.32	\$ 0.84	\$ 0.52
Weighted average shares outstanding				
Basic	48,451	46,862	48,210	46,452
Diluted	49,092	47,544	48,851	47,157

The accompanying notes are an integral part of these statements.

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WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Unaudited	
	Six Months Ended	
	June 30,	
<i>In thousands</i>	2006	2005 Revised
Operating Activities		
Net income	\$ 41,191	\$ 24,399
Stock-based compensation expense	5,981	625
Adjustments to reconcile net income to net cash provided by operations:		
Discontinued operations	(1,154)	(20)
Depreciation and amortization	11,859	13,352
Excess income tax benefits from exercise of stock options	(4,215)	
Changes in operating assets and liabilities		
Accounts receivable	39,876	(18,812)
Inventories	(30,989)	(14,842)
Accounts payable	(12,755)	14,276
Accrued income taxes	22,279	10,189
Accrued liabilities and customer deposits	(10,977)	1,559
Other assets and liabilities	12,401	(437)
Net cash provided by operating activities	73,497	30,289
Investing Activities		
Purchase of property, plant and equipment	(8,969)	(11,452)
Disposals of property, plant and equipment		975
Acquisition of business, net of cash received		(36,405)
Sale of discontinued operations	3,018	
Discontinued operations		(2)
Net cash used for investing activities	(5,951)	(46,884)
Financing Activities		
Repayments of long term debt		(107)
Proceeds from the issuance of treasury stock for stock options and other benefit plans	9,895	16,500
Excess income tax benefits from exercise of stock options	4,215	
Cash dividends (\$0.02 per share for the six months ended June 30, 2006 and 2005)	(969)	(932)
Net cash provided by financing activities	13,141	15,461
Effect of changes in currency exchange rates	16,855	(7,271)
(Decrease) increase in cash	97,542	(8,405)
Cash, beginning of year	141,365	95,257
Cash, end of period	\$ 238,907	\$ 86,852

The accompanying notes are an integral part of these statements.

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WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)

1. BUSINESS

Wabtec is one of the world's largest providers of value-added, technology-based products and services for the global rail industry. Our products are found on virtually all U.S. locomotives, freight cars and passenger transit vehicles, as well as in more than 80 countries throughout the world. Our products enhance safety, improve productivity and reduce maintenance costs for customers, and many of our core products and services are essential in the safe and efficient operation of freight rail and passenger transit vehicles. Wabtec is a global company with operations in 11 countries. In the first six months of 2006, about 32 percent of the Company's revenues came from outside the U.S.

2. ACCOUNTING POLICIES

Basis of Presentation The unaudited condensed consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles and the rules and regulations of the Securities and Exchange Commission and include the accounts of Wabtec and its majority owned subsidiaries. These condensed interim financial statements do not include all of the information and footnotes required for complete financial statements. In management's opinion, these financial statements reflect all adjustments of a normal, recurring nature necessary for a fair presentation of the results for the interim periods presented. Results for these interim periods are not necessarily indicative of results to be expected for the full year.

The Company operates on a four-four-five week accounting quarter, and accordingly, the quarters end on or about March 31, June 30, September 30 and December 31.

The notes included herein should be read in conjunction with the audited consolidated financial statements included in Wabtec's Annual Report on Form 10-K for the year ended December 31, 2005. The December 31, 2005 information has been derived from the Company's December 31, 2005 Annual Report on Form 10-K.

Revenue Recognition Revenue is recognized in accordance with Staff Accounting Bulletins (SABs) 101, Revenue Recognition in Financial Statements and 104, Revision of Topic 13. Revenue is recognized when products have been shipped to the respective customers, title has passed and the price for the product has been determined.

The Company recognizes revenues on long-term contracts based on the percentage of completion method of accounting. The units-of-delivery method or other measures, as appropriate, are used to measure the progress toward completion of individual contracts. Contract revenues and cost estimates are reviewed and revised at a minimum quarterly and adjustments are reflected in the accounting period as such amounts are determined. Provisions are made currently for estimated losses on uncompleted contracts.

Certain pre-production costs relating to long-term production and supply contracts have been deferred and will be recognized over the life of the contracts. Deferred pre-production costs were \$6.9 million and \$4.9 million at June 30, 2006 and December 31, 2005, respectively.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from the estimates. On an ongoing basis, management reviews its estimates based on currently available information. Changes in facts and circumstances may result in revised estimates.

Table of Contents**WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)**

Stock-Based Compensation Effective January 1, 2006, Wabtec adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment, which requires the company to recognize compensation expense for stock-based compensation based on the grant date fair value. This expense must be recognized ratably over the requisite service period following the date of grant. Wabtec has elected the modified prospective transition method for adoption, and prior periods financial statements have not been restated. Prior to January 1, 2006, Wabtec accounted for stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, and related interpretations.

Pro Forma Effect Prior to the Adoption of SFAS No. 123(R) Wabtec's net income and earnings per share for 2005 would have been reduced to the pro forma amounts shown below if compensation expense had been determined based on the fair value at the grant dates in accordance with SFAS No. 123, Accounting for Stock-Based Compensation, and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123.

<i>In thousands, except per share</i>	Three months ended June 30, 2005	Six months ended June 30, 2005
Net income as reported	\$ 15,151	\$ 24,399
Stock based compensation expense under FAS123, net of tax of \$162 and \$348	283	604
Pro forma	\$ 14,868	\$ 23,795
Basic earnings per share		
As reported	\$ 0.32	\$ 0.53
Pro forma	0.32	0.51
Diluted earnings per share		
As reported	\$ 0.32	\$ 0.52
Pro forma	0.31	0.50

Stock-Based Plans Stock options have been granted at not less than market prices on the dates of grant. Generally, the options become exercisable over a three-year vesting period and expire ten years from the date of grant. In January 2006, Wabtec granted 32,000 stock options to certain individuals. The Company has now adopted a non-vested stock plan and issued 200,500 awards to executives in February 2006. The non-vested stock generally vests over four years from the date of grant. In addition, the Company established in 2004, a stock-based incentive plan for eligible employees. The plan provides stock awards which vest upon attainment of certain three year performance targets. Wabtec also sponsors an employee stock purchase plan, whereby participants can purchase the Company's common stock at a discount of about 15% of the lesser of fair market value on the first or last day of each offering period.

Stock based compensation was \$6.0 million and \$625,000 for the six months ended June 30, 2006 and 2005, respectively. This included \$5 million and \$625,000, respectively, related to non-vested stock and the stock awards under the incentive plan, the accounting for which was not impacted significantly by the adoption of SFAS No. 123(R). As a result of adopting SFAS No. 123(R), compensation expense increased by \$291,000 and \$670,000 for the three and six month periods ended June 30, 2006, respectively, and basic and diluted earnings per share decreased by about \$0.01 and \$0.01, respectively. At June 30, 2006, unamortized compensation expense related to those stock options, non-vested shares and stock awards expected to vest totaled \$15.3 million and will be recognized over a weighted average period of 1.8 years.

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WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)

Wabtec uses a Black-Scholes pricing model to estimate fair value at grant date for future option grants. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three and six months ended June 30,	
	2006	2005
Dividend yield	.3%	.3%
Risk-free interest rate	4.27%	4.6%
Stock price volatility	43.4	44.3
Expected life (years)	5.0	5.0

The dividend yield is based on the Company's dividend rate and the current market price of the underlying common stock at the date of grant. Expected life in years is determined from historical stock option exercise data. Expected volatility is based on the historical volatility of Wabtec stock. The risk-free interest rate is based on the U.S. Treasury bond rates for the expected life of the option.

The following table summarizes the stock option activity and related information for the period indicated:

	Options	Weighted Average Exercise Price	Weighted Average	
			Remaining Contractual Life	Aggregate intrinsic value
				(in thousands)
Beginning of year January 1, 2006	2,204,065	\$ 13.98		\$ 28,477
Granted	32,000	26.66		344
Exercised	(610,887)	14.37		12,071
Canceled				
Year to date June 30, 2006	1,625,178	\$ 14.08	5.8	\$ 37,896
Exercisable	1,346,156	\$ 13.23	5.3	\$ 32,535
Weighted average fair value of options granted during 2006	\$ 11.19			

The following table summarizes the non-vested stock and stock awards activity and related information for the period indicated:

	Non-Vested Stock	Stock Awards	Weighted Average FMV
Outstanding at January 1, 2006		518,666	\$ 15.83
Granted	200,500	187,000	34.06
Canceled		(4,000)	16.11

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Outstanding at June 30, 2006	200,500	701,666	\$	27.75
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As of June 30, 2006, stock awards issued under the incentive plan are awarded but not vested. These stock awards will vest based upon the achievement of certain financial goals for each three year periods ending December 31, 2006, 2007 and 2008, respectively. The stock awards included in the table above represent the maximum number of shares that may ultimately vest. As of June 30, 2006, based on the Company's performance, we estimate that the majority of these stock awards will vest and have recorded compensation expense

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accordingly. If our estimate of the number of these stock awards expected to vest changes in a future accounting period, compensation expense could be reduced and will be recognized over the remaining vesting period.

Financial Derivatives and Hedging Activities The Company has entered into foreign currency forward contracts to reduce the impact of changes in currency exchange rates. Forward contracts are agreements with counterparty to exchange two distinct currencies at a set exchange rate for delivery on a set date at some point in the future. There is no exchange of funds until the delivery date. At the delivery date the Company can either take delivery of the currency or settle on a net basis. All outstanding forward contracts are for the sale of U.S. Dollars (USD) and the purchase of Canadian Dollars (CAD). As of June 30, 2006, the Company had forward contracts with a notional value of \$30.0 million CAD (or \$25.2 million U.S.), with an average exchange rate of \$.84 USD per \$1 CAD, resulting in the recording of a current asset and an increase in comprehensive income of \$1.1 million, net of tax.

Foreign Currency Translation Assets and liabilities of foreign subsidiaries, except for the Company's Mexican operations whose functional currency is the U.S. Dollar, are translated at the rate of exchange in effect on the balance sheet date while income and expenses are translated at the average rates of exchange prevailing during the year. Foreign currency gains and losses resulting from transactions, and the translation of financial statements are recorded in the Company's consolidated financial statements based upon the provisions of SFAS No. 52, Foreign Currency Translation. The effects of currency exchange rate changes on intercompany transactions and balances of a long-term investment nature are accumulated and carried as a component of shareholders' equity. The effects of currency exchange rate changes on intercompany transactions that are non U.S. dollar denominated amounts are charged or credited to earnings. Foreign exchange loss was \$1.3 million and \$637,000 for the three months ended June 30, 2006 and 2005, respectively, and \$930,000 and \$1.6 million for the six months ended June 30, 2006 and 2005, respectively.

Other Comprehensive Income (Loss) Comprehensive income (loss) is defined as net income and all other non-owner changes in shareholders' equity. The Company's accumulated other comprehensive income (loss) consists of foreign currency translation adjustments, foreign currency hedges and pension related adjustments. Six month changes in the table below, adjust components of accumulated other comprehensive income (loss). Total comprehensive income was:

<i>In thousands</i>	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net income	\$ 21,145	\$ 15,151	\$ 41,191	\$ 24,399
Foreign currency translation adjustment	9,928	(5,203)	10,220	(7,281)
Unrealized loss on foreign exchange contracts, net of tax	492	(1,303)	224	(2,092)
Total comprehensive income	\$ 31,565	\$ 8,645	\$ 51,635	\$ 15,026

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WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)

As reflected on the balance sheet as a component of equity, components of accumulated other comprehensive income (loss) consisted of the following:

<i>In thousands</i>	June 30, 2006	December 31, 2005
Foreign currency translation adjustment	\$ 8,744	\$ (1,476)
Unrealized gains on foreign exchange contracts, net of tax	1,100	877
Additional minimum pension liability, net of tax	(26,326)	(26,326)
 Total accumulated comprehensive loss	 \$ (16,482)	 \$ (26,925)

Reclassifications Certain prior year amounts have been reclassified where necessary, to conform to the current year presentation.

Recent Accounting Pronouncements In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. FIN 48 is effective in the first quarter of 2007. Wabtec is currently evaluating the impact of this statement on the company.

3. ACQUISITIONS AND DISCONTINUED OPERATIONS

On February 1, 2005, the Company completed the acquisition of the assets of Rütgers Rail S.p.A, a business with operations in Italy, Germany, France and Spain. The acquisition was accounted for as a purchase and accordingly, the purchase price was allocated to the respective assets and liabilities based upon their estimated fair values as of the acquisition date. Operating results were included in the consolidated statement of operations from the acquisition date forward. The new company formed to hold the newly purchased assets of Rütgers Rail S.p.A. is named CoFren S.r.l. (CoFren). CoFren is one of the leading manufacturers of brake shoes, disc pads and interior trim components for rail applications in Europe. The purchase price was \$35.9 million, net of cash received, resulting in additional goodwill of \$5.7 million.

For pro forma purposes, this acquisition would only impact the results for the six months ended June 30, 2005, as CoFren was included in its entirety for all periods beginning afterwards. The following unaudited pro forma financial information presents income statement results as if the acquisition had occurred January 1, 2005:

<i>In thousands, except per share</i>	Six months ended June 30, 2005
Net sales	\$ 513,833
Gross profit	124,752
Net income	24,509
Diluted earnings per share	
As reported	\$ 0.53
Pro forma	0.52

With the acquisition of Rutgers Rail, S.p.A., the Company decided to offer for sale a non-core product division. As part of the purchase accounting, the net amount of this division had been revalued to its estimated net realizable value and had been classified as assets held for sale, which is included in other noncurrent assets on the balance sheet.

Table of Contents**WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)**

At March 31, 2006, the sale of this division was completed for approximately \$2.0 million in cash, subject to a working capital adjustment which is expected to be finalized with the buyer in the 3rd quarter. The assets sold primarily included transit car interior products and services for customers located in Europe. This sale resulted in a loss of approximately \$740,000 subject to the working capital adjustment mentioned earlier. Also, in the fourth quarter of 2005, the Company decided to liquidate its bus door joint venture in China.

In accordance with SFAS 144, Accounting for Impairment or Disposal of Long-Lived Assets, the operating results of these businesses have been classified as discontinued operations for all years presented and are summarized as of December 31, as follows:

<i>In thousands</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net sales	\$ 3	\$ 3,251	\$ 2,600	\$ 6,335
Income/(loss) before income taxes	(522)	377	(497)	253
Income tax expense	115	159	162	130
Loss from discontinued operations	\$ (637)	\$ 218	\$ (659)	\$ 123

4. INVENTORIES

The components of inventory, net of reserves, were:

<i>In thousands</i>	June 30, 2006	December 31, 2005
Raw materials	\$ 42,751	\$ 38,724
Work-in-process	74,716	54,953
Finished goods	22,270	17,196
Total inventory	\$ 139,737	\$ 110,873

5. RESTRUCTURING AND IMPAIRMENT CHARGES

In the first six months of 2005, the Company recorded restructuring and asset impairment charges totaling \$2.3 million related to consolidating two U.K. facilities into one, relocating a product line from Canada to the U.S., and completion of a data center migration. These charges consisted of severance costs of \$593,000 for 43 employees, relocation and other costs of \$469,000 and asset write-offs of \$1.2 million. All but \$475,000 of these costs were paid for in the first six months of 2005.

In the fourth quarter of 2005, the Company recorded restructuring charges related to consolidating facilities of about \$800,000. As of June 30, 2006, these costs have not been paid.

On July 19, 2006, the Board of Directors approved a restructuring plan to improve the profitability and efficiency of certain business units. As part of the plan, Wabtec will downsize two of its Canadian plants, in Stoney Creek and Wallaceburg, by moving certain products to lower-cost facilities and outsourcing. The restructuring plan will result in the recognition of \$11 million of expenses, pre-tax, primarily for pension-related curtailment and settlement charges and fixed asset write downs for idled assets. These expenses will be recognized in the second half of 2006

and the first half of 2007.

6. INTANGIBLES

Goodwill on the balance sheet is \$119.3 million at June 30, 2006 and \$118.2 million at December 31, 2005.

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WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)

As of June 30, 2006 and December 31, 2005, the Company's trademarks had a net carrying amount of \$20.0 million and \$19.9 million, respectively, and the Company believes these intangibles have an indefinite life. Intangible assets of the Company, other than goodwill and trademarks, consist of the following:

<i>In thousands</i>	June 30, 2006	December 31, 2005
Patents and other, net of accumulated amortization of \$26,232 and \$22,459	\$ 8,503	\$ 9,987
Customer relationships, net of accumulated amortization of \$242 and \$145	3,170	3,018
Covenants not to compete, net of accumulated amortization of \$8,324 and \$8,304		20
Intangible pension asset	6,457	6,457
Total	\$ 18,130	\$ 19,182

The weighted average useful life of patents was 13 years, customer relationships were 20 years and covenants not to compete was five years. Amortization expense for intangible assets was \$675,000 and \$1.4 million for the three and six months ended June 30, 2006, and \$859,000 and \$1.6 million for the three and six months ended June 30, 2005.

The change in the carrying amount of goodwill by segment for the six months ended June 30, 2006 is as follows:

<i>In thousands</i>	Freight Group	Transit Group	Total
Balance at December 31, 2005	\$ 100,055	\$ 18,126	\$ 118,181
Foreign currency impact	579	510	1,089
Balance at June 30, 2006	\$ 100,634	\$ 18,636	\$ 119,270

7. LONG-TERM DEBT

Long-term debt consisted of the following:

<i>In thousands</i>	June 30, 2006	December 31, 2005
6.875% Senior Notes	\$ 150,000	\$ 150,000
Total	\$ 150,000	\$ 150,000
Less current portion		
Long-term portion	\$ 150,000	\$ 150,000

Refinancing Credit Agreement

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In January 2004, the Company refinanced its existing unsecured revolving credit agreement with a consortium of commercial banks. This Refinancing Credit Agreement provided a \$175 million five-year revolving credit facility expiring in January 2009. In November 2005, the Company entered into an amendment to the Refinancing Credit Agreement which, among other things, extended the expiration of the agreement until

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WESTINGHOUSE AIR BRAKE TECHNOLOGIES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)

December 2010. At June 30, 2006, the Company had available borrowing capacity, net of \$23.9 million of letters of credit, of approximately \$151.1 million, subject to certain financial covenant restrictions.

Refinancing Credit Agreement borrowings bear variable interest rates indexed to the indices described below. The Company did not borrow under the Refinancing Credit Agreement during the six months ended June 30, 2006 or during the year ended December 31, 2005.

Under the Refinancing Credit Agreement, the Company may elect a base interest rate or an interest rate based on the London Interbank Offered Rates of Interest (LIBOR). The base rate is the greater of LaSalle Bank National Association's prime rate or the federal funds effective rate plus 0.5% per annum. The LIBOR rate is based on LIBOR plus a margin that ranges from 62.5 to 175 basis points depending on the Company's consolidated total indebtedness to cash flow ratios. The current margin is 62.5 basis points.

The Refinancing Credit Agreement limits the Company's ability to declare or pay cash dividends and prohibits the Company from declaring or making other distributions, subject to certain exceptions. The Refinancing Credit Agreement contains various other covenants and restrictions including the following limitations: incurrence of additional indebtedness; mergers, consolidations and sales of assets and acquisitions; additional liens; sale and leasebacks; permissible investments, loans and advances; certain debt payments; capital expenditures; and imposes a minimum interest expense coverage ratio and a maximum debt to cash flow ratio.

The Refinancing Credit Agreement contains customary events of default, including payment defaults, failure of representations or warranties to be true in any material respect, covenant defaults, defaults with respect to other indebtedness of the Company, bankruptcy, certain judgments against the Company, ERISA defaults and change of control of the Company. The Refinancing Credit Agreement includes the following covenants: a minimum interest coverage ratio of three, maximum debt to cash flow ratio of 3.25 and a minimum net worth of \$180 million plus 50% of consolidated net income since September 30, 2003. The Company is in compliance with these measurements and covenants.

6⁷/₈% Senior Notes Due August 2013

In August 2003, the Company issued \$150 million of Senior Notes due in 2013 (Notes). The Notes were issued at par. Interest on the Notes will accrue at a rate of 6.875% per annum and is payable semi-annually on January 31 and July 31 of each year. The proceeds were used to repay debt outstanding under the Company's existing credit agreement, and for general corporate purposes.

The Notes are senior unsecured obligations of the Company and rank pari passu with all existing and future senior debt and are senior to all our existing and future subordinated indebtedness of the Company. The indenture under which the Notes were issued contains covenants and restrictions which limit among other things, the following: the incurrence of indebtedness, payment of dividends and certain distributions, sale of assets, change in control, mergers and consolidations and the incurrence of liens.

On July 31, 2006, the Board of Directors authorized the repurchase of up to \$50 million of the Company's outstanding shares. The Company intends to purchase these shares on the open market or in negotiated or block trades. No time limit was set for the completion of the program which qualifies under the Refinancing Credit Agreement, as well as the 6⁷/₈% Senior Notes currently outstanding.

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8. EMPLOYEE BENEFIT PLANS

The Company sponsors defined benefit pension plans that cover certain U.S., Canadian and United Kingdom employees and which provide benefits of stated amounts for each year of service of the employee.

<i>In thousands, except percentages</i>	Pension Plans		Postretirement Plan	
	Three months ended		Three months ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net periodic benefit cost				
Service cost	\$ 1,085	\$ 703	\$ 325	\$ 279
Interest cost	1,996	1,939	656	543
Expected return on plan assets	(2,169)	(1,954)		
Net amortization/deferrals	918	886	272	(368)
 Net periodic benefit cost	 \$ 1,830	 \$ 1,574	 \$ 1,253	 \$ 454

Assumptions

Discount rate	5.21%	5.94%	5.43%	6.20%
Expected long-term rate of return	6.96%	7.20%	NA	NA
Rate of compensation increase	3.38%	4.10%	NA	NA

<i>In thousands, except percentages</i>	Pension Plans		Postretirement Plan	
	Six months ended		Six months ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net periodic benefit cost				
Service cost	\$ 2,153	\$ 1,647	\$ 648	\$ 476
Interest cost	3,967	3,903	1,310	1,206
Expected return on plan assets	(4,312)	(3,958)		
Net amortization/deferrals	1,828	1,902	543	482
 Net periodic benefit cost	 \$ 3,636	 \$ 3,494	 \$ 2,501	 \$ 2,164

Assumptions

Discount rate	5.21%	5.94%	5.43%	6.20%
Expected long-term rate of return	6.96%	7.20%	NA	NA
Rate of compensation increase	3.38%	4.10%	NA	NA

The Company's funding methods are based on governmental requirements and differ from those methods used to recognize pension expense. The Company expects to contribute \$9.4 million to the pension plans during 2006 but expects that this level of funding will decrease in future periods. Rebalancing of the asset allocation occurs on a quarterly basis.

In addition to providing pension benefits, the Company has provided certain unfunded postretirement health care and life insurance benefits for a portion of North American employees. The Company is not obligated to pay health care and life insurance benefits to individuals who had retired prior to 1990.

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9. INCOME TAXES

The overall effective income tax rate was 35.0% and 35.6% for the three and six months ended June 30, 2006 and 36.4% and 36.5% for the three and six months ended June 30, 2005, respectively.

10. EARNINGS PER SHARE

The computation of earnings per share is as follows:

<i>In thousands, except per share</i>	Three Months Ended June 30,	
	2006	2005
Basic earnings per share		
Income from continuing operations applicable to common shareholders	\$ 21,782	\$ 14,933
Divided by		
Weighted average shares outstanding	48,451	46,862
Basic earnings from continuing operations per share	\$ 0.45	\$ 0.32
 Diluted earnings per share		
Income from continuing operations applicable to common shareholders	\$ 21,782	\$ 14,933
Divided by sum of the		
Weighted average shares outstanding	48,451	46,862
Conversion of dilutive stock options	641	682
Diluted shares outstanding	49,092	47,544
Diluted earnings from continuing operations per share	\$ 0.44	\$ 0.31

<i>In thousands, except per share</i>	Six Months Ended June 30,	
	2006	2005
Basic earnings per share		
Income from continuing operations applicable to common shareholders	\$ 41,850	\$ 24,276
Divided by		
Weighted average shares outstanding	48,210	46,452
Basic earnings from continuing operations per share	\$ 0.87	\$ 0.52
 Diluted earnings per share		
Income from continuing operations applicable to common shareholders	\$ 41,850	\$ 24,276
Divided by sum of the		
Weighted average shares outstanding	48,210	46,452
Conversion of dilutive stock options	641	705
Diluted shares outstanding	48,851	47,157

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Diluted earnings from continuing operations per share

\$ 0.86 \$ 0.51

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11. WARRANTIES

The following table reconciles the changes in the Company's product warranty reserve:

<i>In thousands</i>	Six Months Ended June 30.	
	2006	2005
Balance at December 31, 2005 and 2004, respectively	\$ 16,158	\$ 17,413
Warranty provision	5,376	2,983
Warranty claim payments	(3,977)	(4,739)
Balance at June 30, 2006 and 2005, respectively	\$ 17,557	\$ 15,657

12. COMMITMENTS AND CONTINGENCIES

Claims have been filed against the Company and certain of its affiliates in various jurisdictions across the United States by persons alleging bodily injury as a result of exposure to asbestos-containing products. Since 2000, the number of such claims has increased and the resolution of these claims may take a significant period of time. Most of these claims have been made against our wholly owned subsidiary, Railroad Friction Products Corporation (RFPC), and are based on a product sold by RFPC prior to the time that the Company acquired any interest in RFPC. On April 17, 2005, a claim against the Company by a former stockholder of RFPC contending that the Company assumed that entity's liability for asbestos claims arising from exposure to RFPC's product was resolved in the Company's favor.

Most of these claims, including all of the RFPC claims, are submitted to insurance carriers for defense and indemnity or to non-affiliated companies that retain the liabilities for the asbestos-containing products at issue. We cannot, however, assure that all these claims will be fully covered by insurance or that the indemnitors will remain financially viable. Our ultimate legal and financial liability with respect to these claims, as is the case with other pending litigation, cannot be estimated.

It is Management's belief that the potential range of loss for asbestos-related bodily injury cases is not reasonably determinable at present for a variety of factors, including: (1) the limited asbestos case settlement history of the Company's wholly owned subsidiary, Railroad Friction Products Corporation (RFPC); (2) the unpredictable nature of personal injury litigation in general; and (3) the uncertainty of asbestos litigation in particular. Despite this uncertainty, and although the results of the Company's operations and cash flows for any given period could be adversely affected by asbestos-related lawsuits, Management believes that the final resolution of the Company's asbestos-related cases will not be material to the Company's overall financial position, results of operations and cash flows. In general, this belief is based upon: (1) Wabtec's and RFPC's limited history of settlements and dismissals of asbestos-related cases to date; (2) the inability of many plaintiffs to establish any exposure or causal relationship to RFPC's product; and (3) the inability of many plaintiffs to demonstrate any identifiable injury or compensable loss.

More specifically, as to RFPC, Management's belief that any losses due to asbestos-related cases would not be material is also based on the fact that RFPC owns insurance which provides coverage for asbestos-related bodily injury claims. To date, RFPC's insurers have provided RFPC with defense and indemnity in these actions. As to Wabtec and its divisions, Management's belief that asbestos-related cases will not have a material impact is also based on its position that it has no legal liability for asbestos-related bodily injury claims, and that the former owners of Wabtec's assets retained asbestos liabilities for the products at issue. To date, Wabtec has been able to successfully defend itself on this basis, including an arbitration decision and a judicial opinion, both of

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FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)

which confirmed Wabtec's position that it did not assume any asbestos liabilities from a former owner of a majority of Wabtec's assets. Although Wabtec has incurred defense and administrative costs in connection with asbestos bodily injury actions, these costs have not been material, and the company has no information that would suggest these costs would become material in the foreseeable future.

The GETS-GS litigation described in the Company's Annual Report on Form 10-K for the Year Ended December 31, 2005 was settled in April of 2006 for \$3.8 million, which had been reserved for in prior years.

In April 2005, Amtrak decided to suspend its Acela Express train service due to cracks in the spokes of some of the cars' brake discs. Amtrak's Acela service was resumed on a limited basis in July, 2005, and complete service was resumed in September, 2005. Wabtec did not design or supply the braking system for the Acela cars. The braking system was supplied by Knorr Brake Corporation and the brake discs were designed by Faiveley Transport. Wabtec did provide and machine approximately one-third of the brake discs for the cars and assisted Amtrak and others, including Bombardier Corporation, Alstom Transportation Inc., Knorr and Faiveley, in their evaluation and investigation of the brake disc cracks.

On July 11, 2005 Wabtec received a written notice of a potential claim for damages from Knorr and on March 2, 2006 received a notice from Knorr in which Knorr stated that Amtrak is of the view that it may have warranty claims against Wabtec, Knorr, and Faiveley. Neither Knorr notice specified any amount or range of claims against the Company, although Knorr has indicated that it expects the Company to participate in any financial settlement arising from the alleged defects and failures of the Acela brake discs. Wabtec, in turn, has forwarded Knorr's notices to Faiveley and has notified Faiveley of potential claims by Wabtec against Faiveley.

Bombardier recently reported to Wabtec and Faiveley that Bombardier and Knorr have incurred approximately \$48 million in costs and losses due to the suspension of Amtrak's Acela service, including the cost of compensating Amtrak. In turn, Wabtec has contacted Faiveley, asserting that Faiveley is fully responsible for the claims of Bombardier and Knorr. Wabtec does not believe that it has any material legal liability with regard to this matter.

In March 2006, management began an internal investigation related to business transactions conducted by a subsidiary, Pioneer Friction Limited (Pioneer), in West Bengal, India. Through an internal compliance review, management discovered that disbursements were made which may be in violation of applicable laws and regulations. Pioneer is a fourth-tier subsidiary of Wabtec; two of the intermediate subsidiaries are Australian companies which are, in turn, owned by a U.S. holding company.

While the transactions are inconsequential and not material to the overall operations of Wabtec, they may result in potential penalties. Management has concluded its initial investigation, and has notified Wabtec's Audit Committee, Board of Directors, and the appropriate authorities of its findings so far. Wabtec has not recorded a reserve related to this matter as of June 30, 2006; because the Company's potential exposure cannot be estimated based on management's current assessment of the situation.

The Company is subject to a number of other commitments and contingencies as described in its Annual Report on Form 10-K for the Year Ended December 31, 2005, filed on March 16, 2006. During the first six months of 2006, there were no material changes other than what is discussed above to the information described in Note 18 therein.

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FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006 (UNAUDITED)

13. SEGMENT INFORMATION

Wabtec has two reportable segments – the Freight Group and the Transit Group. The key factors used to identify these reportable segments are the organization and alignment of the Company’s internal operations, the nature of the products and services, and customer type. The business segments are:

Freight Group manufactures products and provides services geared to the production and operation of freight cars and locomotives, including braking control equipment, on-board electronic components and train coupler equipment. Revenues are derived from OEM sales, aftermarket sales and freight car repairs and services.

Transit Group consists of products for passenger transit vehicles and locomotives (typically subways, commuter rail and buses) that include braking, coupling, monitoring systems, climate control and door equipment engineered to meet individual customer specifications. Revenues are derived from OEM and aftermarket sales as well as from repairs and services.

The Company evaluates its business segments’ operating results based on income from operations. Corporate activities include general corporate expenses, elimination of intersegment transactions, interest income and expense and other unallocated charges. Since certain administrative and other operating expenses and other items have not been allocated to business segments, the results in the following tables are not necessarily a measure computed in accordance with generally accepted accounting principles and may not be comparable to other companies.

Beginning with the first quarter of 2006, the Company transferred certain operations from the Freight to the Transit Group to reflect a shift in the markets and customers served by those operations. For the three month period ended June 30, 2005, this reclassification increased Transit Group sales by about \$25 million and income from continuing operations before income taxes by \$4.4 million. For the six-month period ended June 30, 2005, this reclassification increased Transit Group sales by about \$41 million, and income from continuing operations before income taxes by \$5.3 million. Prior period results have been adjusted for comparability purposes.

Segment financial information for the three months ended June 30, 2006 is as follows:

<i>In thousands</i>	Freight Group	Transit Group	Corporate Activities	Total
Sales to external customers	\$ 187,751	\$ 74,151	\$	\$ 261,902
Intersegment sales/(elimination)	4,238	145	(4,383)	
Total sales	\$ 191,989	\$ 74,296	\$ (4,383)	\$ 261,902
Income (loss) from operations	\$ 41,237	\$ 4,291	\$ (9,982)	\$ 35,546
Interest expense and other			(2,043)	(2,043)
Income (loss) from continuing operations before income taxes	\$ 41,237	\$ 4,291	\$ (12,025)	\$ 33,503

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Segment financial information for the three months ended June 30, 2005 is as follows:

<i>In thousands</i>	Freight Group	Transit Group	Corporate Activities	Total
Sales to external customers	\$ 181,449	\$ 84,848	\$	\$ 266,297
Intersegment sales/(elimination)	2,169	82	(2,251)	
Total sales	\$ 183,618	\$ 84,930	\$ (2,251)	\$ 266,297
Income (loss) from operations	\$ 28,266	\$ 7,567	\$ (9,537)	\$ 26,296
Interest expense and other			(2,852)	(2,852)
Income (loss) from continuing operations before income taxes	\$ 28,266	\$ 7,567	\$ (12,389)	\$ 23,444

Segment financial information for the six months ended June 30, 2006 is as follows:

<i>In thousands</i>	Freight Group	Transit Group	Corporate Activities	Total
Sales to external customers	\$ 376,102	\$ 148,209	\$	\$ 524,311
Intersegment sales/(elimination)	7,525	262	(7,787)	
Total sales	\$ 383,627	\$ 148,471	\$ (7,787)	\$ 524,311
Income (loss) from operations	\$ 82,734	\$ 7,057	\$ (21,765)	\$ 68,026
Interest expense and other			(3,047)	(3,047)
Income (loss) from continuing operations before income taxes	\$ 82,734	\$ 7,057	\$ (24,812)	\$ 64,979

Segment financial information for the six months ended June 30, 2005 is as follows:

<i>In thousands</i>	Freight Group	Transit Group	Corporate Activities	Total
Sales to external customers	\$ 347,239	\$ 160,858	\$	\$ 508,097
Intersegment sales/(elimination)	4,623	140	(4,763)	
Total sales	\$ 351,862	\$ 160,998	\$ (4,763)	\$ 508,097
Income (loss) from operations	\$ 48,262	\$ 11,789	\$ (15,396)	\$ 44,655
Interest expense and other			(6,485)	(6,485)

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Income (loss) from continuing operations before income taxes	\$ 48,262	\$ 11,789	\$ (21,881)	\$ 38,170
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Sales by Product for the three months ended June 30, is as follows:

<i>In thousands</i>	Three Months Ended June 30.	
	2006	2005
Brake Products	\$ 99,965	\$ 93,260
Freight Electronics & Specialty Products	79,056	84,675
Remanufacturing, Overhaul & Build	47,637	58,921
Transit Products	26,725	28,437
Other	8,519	1,004
Total Sales	\$ 261,902	\$ 266,297

Sales by Product for the six months ended June 30, is as follows:

<i>In thousands</i>	Six Months Ended June 30.	
	2006	2005
Brake Products	\$ 202,160	\$ 180,334
Freight Electronics & Specialty Products	162,533	160,107
Remanufacturing, Overhaul & Build	90,847	96,357
Transit Products	54,628	64,446
Other	14,143	6,853
Total Sales	\$ 524,311	\$ 508,097

14. GUARANTOR SUBSIDIARIES FINANCIAL INFORMATION

Effective August 2003, the Company issued \$150 million of Senior Notes due in 2013 (Notes). The obligations under the Notes are fully and unconditionally guaranteed by all U.S. subsidiaries as guarantors. In accordance with positions established by the Securities and Exchange Commission, the following shows separate financial information with respect to the parent, the guarantor subsidiaries and the non-guarantor subsidiaries. The principal elimination entries eliminate investment in subsidiaries and certain intercompany balances and transactions.

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Balance Sheet as of June 30, 2006:

<i>In thousands</i>	Parent	Guarantors	Non-Guarantors	Elimination	Consolidated
Cash	\$ 166,524	\$ (6,492)	\$ 78,875	\$	\$ 238,907
Accounts Receivable	166	98,309	64,518		162,993
Inventories		93,703	46,034		139,737
Other Current Assets	19,390	5,539	3,127		28,056
Total Current Assets	186,080	&nb			