

AMETEK INC/
Form 10-Q
August 06, 2014

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 June 30, 2014

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 1-12981

AMETEK, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

14-1682544
(I.R.S. Employer
Identification No.)

1100 Cassatt Road

Berwyn, Pennsylvania
(Address of principal executive offices)

19312-1177
(Zip Code)

Registrant's telephone number, including area code: **(610) 647-2121**

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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 Smaller reporting company

(Do not check if a 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 of the registrant's common stock outstanding as of the latest practicable date was: Common Stock, \$0.01 Par Value, outstanding at July 28, 2014 was 245,783,262 shares.

AMETEK, Inc.

Form 10-Q

Table of Contents

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Statement of Income for the three and six months ended June 30, 2014 and 2013</u>	2
<u>Consolidated Statement of Comprehensive Income for the three and six months ended June 30, 2014 and 2013</u>	3
<u>Consolidated Balance Sheet at June 30, 2014 and December 31, 2013</u>	4
<u>Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2014 and 2013</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 4. Controls and Procedures</u>	22
<u>PART II. OTHER INFORMATION</u>	
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
<u>Item 6. Exhibits</u>	24
<u>SIGNATURES</u>	25

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AMETEK, Inc.

Consolidated Statement of Income

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net sales	\$ 990,718	\$ 878,809	\$ 1,966,010	\$ 1,761,662
Operating expenses:				
Cost of sales, excluding depreciation	630,645	567,598	1,255,815	1,141,672
Selling, general and administrative	113,316	94,912	225,941	192,520
Depreciation	15,029	13,686	30,895	27,622
Total operating expenses	758,990	676,196	1,512,651	1,361,814
Operating income	231,728	202,613	453,359	399,848
Other expenses:				
Interest expense	(18,981)	(18,154)	(37,819)	(36,477)
Other, net	(4,326)	(2,667)	(8,203)	(5,191)
Income before income taxes	208,421	181,792	407,337	358,180
Provision for income taxes	58,358	53,471	116,688	104,713
Net income	\$ 150,063	\$ 128,321	\$ 290,649	\$ 253,467
Basic earnings per share	\$ 0.61	\$ 0.53	\$ 1.19	\$ 1.04
Diluted earnings per share	\$ 0.61	\$ 0.52	\$ 1.18	\$ 1.03
Weighted average common shares outstanding:				
Basic shares	245,201	243,666	245,056	243,475
Diluted shares	247,403	246,104	247,316	245,757
Dividends declared and paid per share	\$ 0.09	\$ 0.06	\$ 0.15	\$ 0.12

See accompanying notes.

AMETEK, Inc.

Consolidated Statement of Comprehensive Income

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Total comprehensive income	\$ 157,529	\$ 136,720	\$ 297,828	\$ 229,977

See accompanying notes.

AMETEK, Inc.

Consolidated Balance Sheet

(In thousands)

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 282,771	\$ 295,203
Receivables, less allowance for possible losses	594,151	536,701
Inventories	538,287	452,848
Deferred income taxes	50,022	38,815
Other current assets	65,439	45,562
Total current assets	1,530,670	1,369,129
Property, plant and equipment, net	459,187	402,790
Goodwill	2,610,381	2,408,363
Other intangibles, net of accumulated amortization	1,658,208	1,473,926
Investments and other assets	226,557	223,694
Total assets	\$ 6,485,003	\$ 5,877,902
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	\$ 454,418	\$ 273,315
Accounts payable	382,574	347,638
Income taxes payable	45,532	40,007
Accrued liabilities	239,301	213,585
Total current liabilities	1,121,825	874,545
Long-term debt	1,148,248	1,141,750
Deferred income taxes	623,092	558,555
Other long-term liabilities	169,920	166,931
Total liabilities	3,063,085	2,741,781
Stockholders' equity:		
Common stock	2,586	2,581
Capital in excess of par value	471,135	448,700
Retained earnings	3,219,978	2,966,015
Accumulated other comprehensive loss	(58,060)	(65,239)
Treasury stock	(213,721)	(215,936)
Total stockholders' equity	3,421,918	3,136,121
Total liabilities and stockholders' equity	\$ 6,485,003	\$ 5,877,902

See accompanying notes.

AMETEK, Inc.

Condensed Consolidated Statement of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash provided by (used for):		
Operating activities:		
Net income	\$ 290,649	\$ 253,467
Adjustments to reconcile net income to total operating activities:		
Depreciation and amortization	66,179	57,396
Deferred income taxes	(1,030)	1,105
Share-based compensation expense	10,308	11,508
Net change in assets and liabilities, net of acquisitions	(46,821)	(34,185)
Pension contribution and other	(3,246)	(4,315)
Total operating activities	316,039	284,976
Investing activities:		
Additions to property, plant and equipment	(29,288)	(21,613)
Purchases of businesses, net of cash acquired	(458,683)	
Other	2,246	4,432
Total investing activities	(485,725)	(17,181)
Financing activities:		
Net change in short-term borrowings	181,142	(194,476)
Additional long-term borrowings		829
Reduction in long-term borrowings	(221)	(486)
Repurchases of common stock	(1,736)	(8,452)
Cash dividends paid	(36,686)	(29,155)
Excess tax benefits from share-based payments	5,299	7,415
Proceeds from employee stock plans	10,333	10,248
Total financing activities	158,131	(214,077)
Effect of exchange rate changes on cash and cash equivalents	(877)	(4,088)
(Decrease) increase in cash and cash equivalents	(12,432)	49,630
Cash and cash equivalents:		
As of January 1	295,203	157,984
As of June 30	\$ 282,771	\$ 207,614

See accompanying notes.

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

1. Basis of Presentation

The accompanying consolidated financial statements are unaudited. AMETEK, Inc. (the Company) believes that all adjustments (which primarily consist of normal recurring accruals) necessary for a fair presentation of the consolidated financial position of the Company at June 30, 2014, and the consolidated results of its operations for the three and six months ended June 30, 2014 and 2013 and its cash flows for the six months ended June 30, 2014 and 2013 have been included. Quarterly results of operations are not necessarily indicative of results for the full year. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In March 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity* (ASU 2013-05). ASU 2013-05 provides guidance for the treatment of the cumulative translation adjustment when an entity ceases to hold a controlling financial interest in a subsidiary or group of assets within a foreign entity. The Company adopted ASU 2013-05 effective January 1, 2014 and the adoption did not have a significant impact on the Company's consolidated results of operations, financial position or cash flows.

In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (ASU 2013-11). ASU 2013-11 provides guidance for the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The Company adopted ASU 2013-11 effective January 1, 2014 and the adoption did not have a significant impact on the Company's consolidated financial statement presentation.

In April 2014, the FASB issued ASU No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (ASU 2014-08). ASU 2014-08 revised guidance to only allow disposals of components of an entity that represent a strategic shift (e.g., disposal of a major geographical area, a major line of business, a major equity method investment, or other major parts of an entity) and that have a major effect on a reporting entity's operations and financial results to be reported as discontinued operations. The revised guidance also requires expanded disclosure in the financial statements for discontinued operations as well as for disposals of significant components of an entity that do not qualify for discontinued operations presentation. ASU 2014-08 is effective for interim and annual reporting periods beginning after December 15, 2014. The Company does not expect the adoption of ASU 2014-08 to have a significant impact on the Company's consolidated results of operations, financial position or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The objective of ASU 2014-09 is to establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will supersede most of the existing revenue recognition guidance. The core principle of ASU 2014-09 is that an entity recognizes revenue at the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the new guidance, the Company must (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the contract's performance obligations; and (5) recognize revenue when the Company satisfies a performance obligation. ASU 2014-09 applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. ASU 2014-09 is effective for interim and annual reporting periods beginning after December 15, 2016 and can be adopted by the Company using either a full retrospective or modified retrospective approach, with early adoption prohibited. The Company is currently evaluating ASU 2014-09 and has not determined the impact it may have on the Company's consolidated results of operations, financial position or cash flows nor decided upon the method of adoption.

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

3. Earnings Per Share

The calculation of basic earnings per share is based on the weighted average number of common shares considered outstanding during the periods. The calculation of diluted earnings per share reflects the effect of all potentially dilutive securities (principally outstanding stock options and restricted stock grants). The number of weighted average shares used in the calculation of basic earnings per share and diluted earnings per share was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Weighted average shares:				
Basic shares	245,201	243,666	245,056	243,475
Equity-based compensation plans	2,202	2,438	2,260	2,282
Diluted shares	247,403	246,104	247,316	245,757

4. Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) consisted of the following:

	Three Months Ended June 30, 2014			Three Months Ended June 30, 2013		
	Foreign Currency Items and Other	Defined Benefit Pension Plans	Total	Foreign Currency Items and Other	Defined Benefit Pension Plans	Total
	(In thousands)					
Balance at the beginning of the period	\$ (2,128)	\$ (63,398)	\$ (65,526)	\$ (65,599)	\$ (117,620)	\$ (183,219)
Other comprehensive income (loss) before reclassifications:						
Translation adjustments	10,140		10,140	(318)		(318)
Change in long-term intercompany notes	(5,493)		(5,493)	5,937		5,937
Net investment hedges	3,305		3,305	864		864
Gross amounts reclassified from accumulated other comprehensive income (loss)		1,031	1,031		3,411	3,411
Income tax benefit (expense)	(1,156)	(361)	(1,517)	(302)	(1,193)	(1,495)
Other comprehensive (loss) income, net of tax	6,796	670	7,466	6,181	2,218	8,399
Balance at the end of the period	\$ 4,668	\$ (62,728)	\$ (58,060)	\$ (59,418)	\$ (115,402)	\$ (174,820)

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	Six Months Ended June 30, 2014			Six Months Ended June 30, 2013		
	Foreign Currency Items and Other	Defined Benefit Pension Plans	Total	Foreign Currency Items and Other	Defined Benefit Pension Plans	Total
Balance at the beginning of the period	\$ (1,171)	\$ (64,068)	\$ (65,239)	\$ (31,492)	\$ (119,838)	\$ (151,330)
(In thousands)						
Other comprehensive income (loss) before reclassifications:						
Translation adjustments	4,359		4,359	(21,367)		(21,367)
Change in long-term intercompany notes	(1,136)		(1,136)	(1,473)		(1,473)
Net investment hedges	4,024		4,024	(7,825)		(7,825)
Gross amounts reclassified from accumulated other comprehensive income (loss)		2,062	2,062		6,822	6,822
Income tax benefit (expense)	(1,408)	(722)	(2,130)	2,739	(2,386)	353
Other comprehensive (loss) income, net of tax	5,839	1,340	7,179	(27,926)	4,436	(23,490)
Balance at the end of the period	\$ 4,668	\$ (62,728)	\$ (58,060)	\$ (59,418)	\$ (115,402)	\$ (174,820)

Reclassifications for the amortization of defined benefit pension plans are included in Cost of sales, excluding depreciation in the consolidated statement of income. See Note 12 for further details.

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

5. Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The Company utilizes a valuation hierarchy for disclosure of the inputs to the valuations used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on the Company's own assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides the Company's assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, consistent with the fair value hierarchy:

	Asset (Liability)	
	June 30, 2014	December 31, 2013
	Fair Value	Fair Value
	(In thousands)	
Fixed-income investments	\$ 9,823	\$ 8,234

The fair value of fixed-income investments, which are valued as level 1 investments, was based on quoted market prices. The fixed-income investments are shown as a component of long-term assets on the consolidated balance sheet.

For the six months ended June 30, 2014, gains and losses on the investments noted above were not significant. No transfers between level 1 and level 2 investments occurred during the six months ended June 30, 2014.

Financial Instruments

Cash, cash equivalents and fixed-income investments are recorded at fair value at June 30, 2014 and December 31, 2013 in the accompanying consolidated balance sheet.

The following table provides the estimated fair values of the Company's financial instruments, for which fair value is measured for disclosure purposes only, compared to the recorded amounts at June 30, 2014 and December 31, 2013:

	June 30, 2014		December 31, 2013	
	Recorded Amount	Fair Value	Recorded Amount	Fair Value
	(In thousands)			
Short-term borrowings	\$ (453,337)	\$ (453,337)	\$ (268,764)	\$ (268,764)
Long-term debt (including current portion)	(1,149,329)	(1,316,580)	(1,146,301)	(1,290,466)

The fair value of short-term borrowings approximates the carrying value. Short-term borrowings are valued as level 2 investments as they are corroborated by observable market data. The Company's long-term debt is all privately held with no public market for this debt, therefore, the fair value of long-term debt was computed based on comparable current market data for similar debt instruments and is considered to be a

level 3 liability.

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

Forward Contracts

At June 30, 2014, the Company had no forward contracts outstanding. For the three and six months ended June 30, 2014, realized gains and losses on foreign currency forward contracts were not significant. At December 31, 2013, the Company had two Euro forward contracts for a total of 21.7 million Euro (\$28 thousand fair value unrealized loss at December 31, 2013) and one 61.0 million Swiss franc forward contract (\$511 thousand fair value unrealized loss at December 31, 2013) outstanding. The Company has not designated its foreign currency forward contracts as hedges.

6. Hedging Activities

The Company has designated certain foreign-currency-denominated long-term borrowings as hedges of the net investment in certain foreign operations. As of June 30, 2014, these net investment hedges included British-pound- and Euro-denominated long-term debt. These borrowings were designed to create net investment hedges in each of the designated foreign subsidiaries. The Company designated the British-pound- and Euro-denominated loans referred to above as hedging instruments to offset translation gains or losses on the net investment due to changes in the British pound and Euro exchange rates. These net investment hedges are evidenced by management's contemporaneous documentation supporting the hedge designation. Any gain or loss on the hedging instrument (the debt) following hedge designation is reported in accumulated other comprehensive income in the same manner as the translation adjustment on the investment based on changes in the spot rate, which is used to measure hedge effectiveness.

At June 30, 2014, the Company had \$205.2 million of British-pound-denominated loans, which were designated as a hedge against the net investment in British pound functional currency foreign subsidiaries. At June 30, 2014, the Company had a \$68.4 million Euro-denominated loan, which was designated as a hedge against the net investment in Euro functional currency foreign subsidiaries. As a result of these British-pound- and Euro-denominated loans being designated and 100% effective as net investment hedges, \$5.9 million of currency remeasurement losses have been included in the foreign currency translation component of other comprehensive income for the six months ended June 30, 2014.

7. Inventories

	June 30, 2014	December 31, 2013
	(In thousands)	
Finished goods and parts	\$ 121,166	\$ 76,086
Work in process	96,491	85,518
Raw materials and purchased parts	320,630	291,244
Total inventories	\$ 538,287	\$ 452,848

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

8. Acquisitions

The Company spent \$458.7 million in cash, net of cash acquired, to acquire Teseq Group in January 2014, VTI Instruments (VTI) in February 2014, Luphos GmbH in May 2014 and Zygo Corporation in June 2014. Teseq is a manufacturer of test and measurement instrumentation for electromagnetic compatibility (EMC) testing. VTI is a manufacturer of high precision test and measurement instrumentation. Luphos' core technology is used in the measurement of complex aspheric optical surfaces and other surfaces through non-contact methods. Zygo is a provider of optical metrology solutions, high precision optics and optical assemblies for use in a wide range of scientific, industrial and medical applications. Teseq, VTI, Luphos and Zygo are part of AMETEK's Electronic Instruments Group.

The following table represents the preliminary allocation of the aggregate purchase price for the net assets of the above acquisitions based on their estimated fair values at acquisition (in millions):

Property, plant and equipment	\$ 58.4
Goodwill	194.3
Other intangible assets	219.3
Deferred income taxes	(63.0)
Net working capital and other*	49.7
Total purchase price	\$ 458.7

* Includes \$29.7 million in accounts receivable, whose fair value, contractual cash flows and expected cash flows are approximately equal. The amount allocated to goodwill is reflective of the benefits the Company expects to realize from the acquisitions as follows: Teseq manufactures a broad line of conducted and radiated EMC compliance testing systems and radio-frequency amplifiers for a wide range of industries, including aerospace, automotive, consumer electronics, medical equipment, telecommunications and transportation. Teseq provides the Company with opportunities for accelerating product innovation and market expansion worldwide. VTI broadens the Company's capabilities in the high end test and measurement market and provides additional technology differentiation. Luphos' technology expands the Company's metrology capabilities across a broader range of surface finishes and profiles. Zygo's position in non-contact optical metrology complements the Company's position in contact metrology and enables the Company to offer its customers a full range of metrology solutions. The Company expects approximately \$6.3 million of the goodwill recorded in connection with the 2014 acquisitions will be tax deductible in future years.

The Company is in the process of finalizing the measurement of certain tangible and intangible assets and liabilities for its 2014 acquisitions, as well as accounting for income taxes associated with its 2014 acquisitions and the 2013 acquisitions of Controls Southeast, Inc., Creaform, Inc. and Powervar, Inc.

At June 30, 2014, purchase price allocated to other intangible assets of \$219.3 million consists of \$46.6 million of indefinite-lived intangible trademarks and trade names, which are not subject to amortization. The remaining \$172.7 million of other intangible assets consist of \$128.0 million of customer relationships, which are being amortized over a period of five to 20 years, \$0.8 million of trade names, which are being amortized over a period of ten years and \$43.9 million of purchased technology, which is being amortized over a period of 15 to 17 years. Amortization expense for each of the next five years for the 2014 acquisitions listed above is expected to approximate \$9.7 million per year.

The 2014 acquisitions noted above had an immaterial impact on reported net sales, net income and diluted earnings per share for the three and six months ended June 30, 2014. Had the 2014 acquisitions been made at the beginning of 2014 or 2013, unaudited pro forma net sales, net income and diluted earnings per share for the three and six months ended June 30, 2014 and 2013, respectively, would not have been materially different than the amounts reported. Pro forma results are not necessarily indicative of the results that would have occurred if the acquisitions

had been completed at the beginning of 2014 or 2013.

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

Acquisitions Subsequent to June 30, 2014

In August 2014, the Company acquired Amptek, Inc., a privately held manufacturer of instrumentation and detectors used to identify composition of materials using x-ray fluorescence. Amptek was acquired for approximately \$115 million and has estimated annual sales of approximately \$30 million. Amptek broadens the Company's position in the process and analytical instrumentations markets and will join AMETEK's Electronic Instruments Group.

9. Goodwill

The changes in the carrying amounts of goodwill by segment were as follows:

	Electronic Instruments Group	Electro- mechanical Group (In millions)	Total
Balance at December 31, 2013	\$ 1,410.8	\$ 997.6	\$ 2,408.4
Goodwill acquired	194.3		194.3
Purchase price allocation adjustments and other	1.7		1.7
Foreign currency translation adjustments	3.8	2.2	6.0
Balance at June 30, 2014	\$ 1,610.6	\$ 999.8	\$ 2,610.4

10. Income Taxes

At June 30, 2014, the Company had gross unrecognized tax benefits of \$76.1 million, of which \$69.9 million, if recognized, would impact the effective tax rate.

The following is a reconciliation of the liability for uncertain tax positions (in millions):

Balance at December 31, 2013	\$ 55.2
Additions for tax positions	21.7
Reductions for tax positions	(0.8)
Balance at June 30, 2014	\$ 76.1

The Company recognizes interest and penalties accrued related to uncertain tax positions in income tax expense. The amounts recognized in income tax expense for interest and penalties during the three and six months ended June 30, 2014 and 2013 were not significant.

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

11. Share-Based Compensation

The fair value of each stock option grant is estimated on the date of grant using a Black-Scholes-Merton option pricing model. The following weighted average assumptions were used in the Black-Scholes-Merton model to estimate the fair values of stock options granted during the periods indicated:

	Six Months Ended June 30, 2014	Year Ended December 31, 2013
Expected volatility	23.9%	28.1%
Expected term (years)	5.0	5.0
Risk-free interest rate	1.63%	0.75%
Expected dividend yield	0.45%	0.57%
Black-Scholes-Merton fair value per stock option granted	\$ 12.21	\$ 10.17

Expected volatility is based on the historical volatility of the Company's stock. The Company used historical exercise data to estimate the stock options' expected term, which represents the period of time that the stock options granted are expected to be outstanding. Management anticipates that the future stock option holding periods will be similar to the historical stock option holding periods. The risk-free interest rate for periods within the contractual life of the stock option is based on the U.S. Treasury yield curve at the time of grant. Compensation expense recognized for all share-based awards is net of estimated forfeitures. The Company's estimated forfeiture rates are based on its historical experience.

Total share-based compensation expense was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Stock option expense	\$ 3,506	\$ 2,884	\$ 5,340	\$ 5,059
Restricted stock expense	2,636	1,854	4,968	6,449
Total pre-tax expense	6,142	4,738	10,308	11,508
Related tax benefit	(2,054)	(1,576)	(3,287)	(3,733)
Reduction of net income	\$ 4,088	\$ 3,162	\$ 7,021	\$ 7,775

Pre-tax share-based compensation expense is included in the consolidated statement of income in either Cost of sales, excluding depreciation or Selling, general and administrative expenses, depending on where the recipient's cash compensation is reported.

The following is a summary of the Company's stock option activity and related information:

Shares	Weighted Average Exercise	Weighted Average Remaining	Aggregate Intrinsic Value
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	(In thousands)	Price	Contractual Life (Years)	(In millions)
Outstanding at December 31, 2013	6,394	\$ 27.13		
Granted	973	53.13		
Exercised	(512)	21.46		
Forfeited	(83)	36.48		
Outstanding at June 30, 2014	6,772	\$ 31.18	4.1	\$ 143.7
Exercisable at June 30, 2014	4,135	\$ 23.46	2.9	\$ 119.2

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

The aggregate intrinsic value of stock options exercised during the six months ended June 30, 2014 was \$16.0 million. The total fair value of stock options vested during the six months ended June 30, 2014 was \$8.8 million. As of June 30, 2014, there was approximately \$20.2 million of expected future pre-tax compensation expense related to the 2.6 million nonvested stock options outstanding, which is expected to be recognized over a weighted average period of less than two years.

The following is a summary of the Company's nonvested restricted stock activity and related information:

	Shares (In thousands)	Weighted Average Grant Date Fair Value
Nonvested restricted stock outstanding at December 31, 2013	987	\$ 36.12
Granted	307	52.83
Vested	(97)	34.17
Forfeited	(35)	36.95
Nonvested restricted stock outstanding at June 30, 2014	1,162	\$ 40.67

The total fair value of restricted stock vested during the six months ended June 30, 2014 was \$3.3 million. As of June 30, 2014, there was approximately \$32.7 million of expected future pre-tax compensation expense related to the 1.2 million nonvested restricted shares outstanding, which is expected to be recognized over a weighted average period of approximately two years.

12. Retirement and Pension Plans

The components of net periodic pension benefit expense (income) were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Defined benefit plans:				
Service cost	\$ 1,644	\$ 1,628	\$ 3,280	\$ 3,262
Interest cost	7,262	6,516	14,495	13,048
Expected return on plan assets	(12,607)	(11,219)	(25,167)	(22,458)
Amortization of net actuarial loss and other	1,031	3,411	2,062	6,822
Pension (income) expense	(2,670)	336	(5,330)	674

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Other plans:				
Defined contribution plans	4,987	4,495	10,725	9,562
Foreign plans and other	1,484	1,283	2,772	2,555
Total other plans	6,471	5,778	13,497	12,117
Total net pension expense	\$ 3,801	\$ 6,114	\$ 8,167	\$ 12,791

For the six months ended June 30, 2014 and 2013, contributions to the Company's defined benefit pension plans were not significant.

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

13. Product Warranties

The Company provides limited warranties in connection with the sale of its products. The warranty periods for products sold vary widely among the Company's operations, but for the most part do not exceed one year. The Company calculates its warranty expense provision based on past warranty experience and adjustments are made periodically to reflect actual warranty expenses.

Changes in the accrued product warranty obligation were as follows:

	Six Months Ended June 30,	
	2014	2013
	(In thousands)	
Balance at the beginning of the period	\$ 28,036	\$ 27,792
Accruals for warranties issued during the period	3,865	2,132
Settlements made during the period	(5,880)	(4,979)
Warranty accruals related to acquired businesses and other during the period	3,617	(90)
Balance at the end of the period	\$ 29,638	\$ 24,855

Certain settlements of warranties made during the period were for specific nonrecurring warranty obligations. Product warranty obligations are reported as current liabilities in the consolidated balance sheet.

14. Contingencies*Asbestos Litigation*

The Company (including its subsidiaries) has been named as a defendant, along with many other companies, in a number of asbestos-related lawsuits. Many of these lawsuits either relate to businesses which were acquired by the Company and do not involve products which were manufactured or sold by the Company or relate to previously owned businesses of the Company which are under new ownership. In connection with many of these lawsuits, the sellers or new owners of such businesses, as the case may be, have agreed to indemnify the Company against these claims (the "Indemnified Claims"). The Indemnified Claims have been tendered to, and are being defended by, such sellers and new owners. These sellers and new owners have met their obligations, in all respects, and the Company does not have any reason to believe such parties would fail to fulfill their obligations in the future; however, one of these companies filed for bankruptcy liquidation in 2007. To date, no judgments have been rendered against the Company as a result of any asbestos-related lawsuit. The Company believes it has strong defenses to the claims being asserted and intends to continue to vigorously defend itself in these matters.

Environmental Matters

Certain historic processes in the manufacture of products have resulted in environmentally hazardous waste by-products as defined by federal and state laws and regulations. At June 30, 2014, the Company is named a Potentially Responsible Party ("PRP") at 15 non-AMETEK-owned former waste disposal or treatment sites (the "non-owned sites"). The Company is identified as a de minimis party in 13 of these sites based on the low volume of waste attributed to the Company relative to the amounts attributed to other named PRPs. In nine of these sites, the Company has reached a tentative agreement on the cost of the de minimis settlement to satisfy its obligation and is awaiting executed agreements. The tentatively agreed-to settlement amounts are fully reserved. In the other four sites, the Company is continuing to investigate the accuracy of the alleged volume attributed to the Company as estimated by the parties primarily responsible for remedial activity at the sites to establish an

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appropriate settlement amount. At the two remaining sites where the Company is a non-de minimis PRP, the Company is participating in the investigation and/or related required remediation as part of a PRP Group or investigating the PRP claim and reserves have been established sufficient to satisfy the Company's expected obligations. The Company historically has resolved these issues within established reserve levels and reasonably expects this result will continue. In addition to these non-owned sites, the Company has an ongoing practice of providing reserves for probable remediation activities at certain of its current or previously owned manufacturing locations (the "owned" sites). For claims and proceedings against the Company with respect to other environmental matters, reserves are established once the Company

AMETEK, Inc.

Notes to Consolidated Financial Statements

June 30, 2014

(Unaudited)

has determined that a loss is probable and estimable. This estimate is refined as the Company moves through the various stages of investigation, risk assessment, feasibility study and corrective action processes. In certain instances, the Company has developed a range of estimates for such costs and has recorded a liability based on the low end of the range. It is reasonably possible that the actual cost of remediation of the individual sites could vary from the current estimates and the amounts accrued in the consolidated financial statements; however, the amounts of such variances are not expected to result in a material change to the consolidated financial statements. In estimating the Company's liability for remediation, the Company also considers the likely proportionate share of the anticipated remediation expense and the ability of the other PRPs to fulfill their obligations.

Total environmental reserves at June 30, 2014 and December 31, 2013 were \$21.4 million and \$21.9 million, respectively, for both non-owned and owned sites. For the six months ended June 30, 2014, the Company recorded \$0.6 million in reserves. Additionally, the Company spent \$1.1 million on environmental matters for the six months ended June 30, 2014. The Company's reserves for environmental liabilities at June 30, 2014 and December 31, 2013 include reserves of \$13.0 million and \$13.3 million, respectively, for an owned site acquired in connection with the 2005 acquisition of HCC Industries (HCC). The Company is the designated performing party for the performance of remedial activities for one of several operating units making up a Superfund site in the San Gabriel Valley of California. The Company has obtained indemnifications and other financial assurances from the former owners of HCC related to the costs of the required remedial activities. At June 30, 2014, the Company had \$11.4 million in receivables related to HCC for probable recoveries from third-party escrow funds and other committed third-party funds to support the required remediation. Also, the Company is indemnified by HCC's former owners for approximately \$19.0 million of additional costs.

The Company has agreements with other former owners of certain of its acquired businesses, as well as new owners of previously owned businesses. Under certain of the agreements, the former or new owners retained, or assumed and agreed to indemnify the Company against, certain environmental and other liabilities under certain circumstances. The Company and some of these other parties also carry insurance coverage for some environmental matters. To date, these parties have met their obligations in all material respects.

The Company believes it has established reserves which are sufficient to perform all known responsibilities under existing claims and consent orders. The Company has no reason to believe that other third parties would fail to perform their obligations in the future. In the opinion of management, based upon presently available information and past experience related to such matters, an adequate provision for probable costs has been made and the ultimate cost resulting from these actions is not expected to materially affect the consolidated results of operations, financial position or cash flows of the Company.

15. Reportable Segments

The Company has two reportable segments, Electronic Instruments Group (EIG) and Electromechanical Group (EMG). The Company identifies its operating segments for segment reporting purposes primarily on the basis of product type, production processes, distribution methods and management organizations.

At June 30, 2014, there were no significant changes in identifiable assets of reportable segments from the amounts disclosed at December 31, 2013, other than those described in the acquisitions footnote (Note 8), nor were there any significant changes in the basis of segmentation or in the measurement of segment operating results. Operating information relating to the Company's reportable segments for the three and six months ended June 30, 2014 and 2013 can be found in the table included in Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q.

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

The following table sets forth net sales and income by reportable segment and on a consolidated basis:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Net sales(1):				
Electronic Instruments	\$ 573,289	\$ 483,339	\$ 1,145,683	\$ 967,840
Electromechanical	417,429	395,470	820,327	793,822
Consolidated net sales	\$ 990,718	\$ 878,809	\$ 1,966,010	\$ 1,761,662
Operating income and income before income taxes:				
Segment operating income(2):				
Electronic Instruments	\$ 151,499	\$ 129,575	\$ 301,818	\$ 261,321
Electromechanical	92,133	83,395	176,013	161,394
Total segment operating income	243,632	212,970	477,831	422,715
Corporate administrative and other expenses	(11,904)	(10,357)	(24,472)	(22,867)
Consolidated operating income	231,728	202,613	453,359	399,848
Interest and other expenses, net	(23,307)	(20,821)	(46,022)	(41,668)
Consolidated income before income taxes	\$ 208,421	\$ 181,792	\$ 407,337	\$ 358,180

- (1) After elimination of intra- and intersegment sales, which are not significant in amount.
(2) Segment operating income represents net sales less all direct costs and expenses (including certain administrative and other expenses) applicable to each segment, but does not include interest expense.

Results of operations for the second quarter of 2014 compared with the second quarter of 2013

For the quarter ended June 30, 2014, the Company established records for orders, sales, operating income, operating income margins, net income and diluted earnings per share. The Company achieved these results from strong internal sales growth in both the Electronic Instruments Group (EIG) and Electromechanical Group (EMG), contributions from the acquisitions of Zygo Corporation in June 2014, Lumphos GmbH in May 2014, VTI Instruments (VTI) in February 2014, Teseq Group in January 2014, Powervar, Inc. in December 2013, Creaform, Inc. in October 2013, and Controls Southeast (CSI) in August 2013, as well as our Operational Excellence initiatives. The full year impact of the 2014 and 2013 acquisitions and our continued focus on and implementation of Operational Excellence initiatives are expected to have a positive impact on the remainder of our 2014 results.

Net sales for the second quarter of 2014 were \$990.7 million, an increase of \$111.9 million or 12.7%, compared with net sales of \$878.8 million for the second quarter of 2013. The increase in net sales for the second quarter of 2014 was attributable to higher order rates which drove internal sales growth of approximately 4%, acquisitions added 8% and foreign currency translation was a favorable 1% effect.

Total international sales for the second quarter of 2014 were \$550.3 million or 55.5% of net sales, an increase of \$76.0 million or 16.0%, compared with international sales of \$474.3 million or 54.0% of net sales for the second quarter of 2013. The \$76.0 million increase in international sales resulted from higher sales growth and the acquisitions mentioned above, and includes the effect of foreign currency translation. Both reportable segments of the Company maintain strong international sales presences in Europe and Asia.

New orders for the second quarter of 2014 were \$1,078.6 million, an increase of \$183.7 million or 20.5%, compared with \$894.9 million for the second quarter of 2013. The increase in orders for the second quarter of 2014 was due to internal order growth of approximately 2%,

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acquisitions added 18% and foreign currency translation was a favorable 1% effect. As a result, the Company's backlog of unfilled orders was a record at June 30, 2014 of \$1,251.0 million, an increase of \$111.0 million or 9.7%, compared with \$1,140.0 million at December 31, 2013.

Results of Operations (continued)

Segment operating income for the second quarter of 2014 was \$243.6 million, an increase of \$30.6 million or 14.4%, compared with segment operating income of \$213.0 million for the second quarter of 2013. The increase in segment operating income resulted primarily from the acquisitions and internal sales growth mentioned above, as well as the benefits of the Company's Operational Excellence initiatives. Segment operating income, as a percentage of net sales, increased to 24.6% for the second quarter of 2014, compared with 24.2% for the second quarter of 2013. The increase in segment operating margins resulted primarily from the benefits of the Company's Operational Excellence initiatives.

Selling, general and administrative (SG&A) expenses fo