AMERICAN AXLE & MANUFACTURING HOLDINGS INC
Form 10-Q
August 01, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

þ 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

o 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: 1-14303

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	38-3161171 (I.R.S. Employer Identification No.)
One Dauch Drive, Detroit, Michigan (Address of Principal Executive Offices)	48211-1198 (Zip Code)

(313) 758-2000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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 þ No o

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 definition of “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

(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 o No þ

As of July 30, 2014, the latest practicable date, the number of shares of the registrant's Common Stock, par value $0.01 per share, outstanding was 75,757,139 shares.

Internet Website Access to Reports

The website for American Axle & Manufacturing Holdings, Inc. is www.aam.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13 or 15(d) of the Exchange Act are available free of charge through our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission (SEC). The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2014
TABLE OF CONTENTS

			Page Number
FORWARD-LOOKING STATEMENTS			1
Part I		FINANCIAL INFORMATION	2
	Item 1	Financial Statements	2
		Condensed Consolidated Statements of Income	2
		Condensed Consolidated Statements of Comprehensive Income	3
		Condensed Consolidated Balance Sheets	4
		Condensed Consolidated Statements of Cash Flows	5
		Notes to Condensed Consolidated Financial Statements	6
	Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	24
	Item 3	Quantitative and Qualitative Disclosures About Market Risk	30
	Item 4	Controls and Procedures	30
Part II		OTHER INFORMATION	30
	Item 1A	Risk Factors	30
	Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	31
	Item 6	Exhibits	31
		Signatures	32
		Exhibit Index	33
		Ex. 31.1 Certification - CEO - Rule 13a-14(a)	
		Ex. 31.2 Certification - CFO - Rule 13a-14(a)	
		Ex. 32 Section 906 Certifications	
		Ex. 101 Instance Document	
		Ex. 101 Schema Document	
		Ex. 101 Calculation Linkbase Document	
		Ex. 101 Label Linkbase Document	
		Ex. 101 Presentation Linkbase Document	
		Ex. 101 Definition Linkbase Document	

FORWARD-LOOKING STATEMENTS

In this Quarterly Report on Form 10-Q (Quarterly Report), we make statements concerning our expectations, beliefs, plans, objectives, goals, strategies, and future events or performance. Such statements are “forward-looking” statements within the meaning of the Private Securities Litigation Reform Act of 1995 and relate to trends and events that may affect our future financial position and operating results. The terms such as “will,” “may,” “could,” “would,” “plan,” “believe,” “expect,” “anticipate,” “intend,” “project,” "target," and similar words or expressions, as well as statements in future tense, are intended to identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made and/or management’s good faith belief as of that time with respect to future events and are subject to risks and may differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause such differences include, but are not limited to:

- reduced purchases of our products by General Motors Company (GM), Chrysler Group LLC (Chrysler) or other customers;
- reduced demand for our customers' products (particularly light trucks and sport utility vehicles (SUVs) produced by GM and Chrysler);
- our ability or our customers' and suppliers' ability to successfully launch new product programs on a timely basis;
- our ability to realize the expected revenues from our new and incremental business backlog;
- our ability to develop and produce new products that reflect market demand;
- lower-than-anticipated market acceptance of new or existing products;
- our ability to attract new customers and programs for new products;
- our ability to respond to changes in technology, increased competition or pricing pressures;
- our ability to achieve the level of cost reductions required to sustain global cost competitiveness;
- supply shortages or price increases in raw materials, utilities or other operating supplies for us or our customers as a result of natural disasters or otherwise;
- global economic conditions, including the impact of the continued market weakness in the Euro-zone;
- risks inherent in our international operations (including adverse changes in political stability, taxes and other law changes, potential disruptions of production and supply, and currency rate fluctuations);
- liabilities arising from warranty claims, product recall or field actions, product liability and legal proceedings to which we are or may become a party, or the impact of product recall or field actions on our customers;
- price volatility in, or reduced availability of, fuel;
- our ability to successfully implement upgrades to our enterprise resource planning systems;
- our ability to maintain satisfactory labor relations and avoid work stoppages;
- our suppliers', our customers' and their suppliers' ability to maintain satisfactory labor relations and avoid work stoppages;
- our ability to attract and retain key associates;
- availability of financing for working capital, capital expenditures, research and development (R&D) or other general corporate purposes, including our ability to comply with financial covenants;
- our customers' and suppliers' availability of financing for working capital, capital expenditures, R&D or other general corporate purposes;
- changes in liabilities arising from pension and other postretirement benefit obligations;
- risks of noncompliance with environmental laws and regulations or risks of environmental issues that could result in unforeseen costs at our facilities;

- adverse changes in laws, government regulations or market conditions affecting our products or our customers' products (such as the Corporate Average Fuel Economy (CAFE) regulations);
- our ability to consummate and integrate acquisitions and joint ventures;
- our ability or our customers' and suppliers' ability to comply with the Dodd-Frank Act and other regulatory requirements and the potential costs of such compliance; and
- other unanticipated events and conditions that may hinder our ability to compete.

It is not possible to foresee or identify all such factors and we make no commitment to update any forward-looking statement or to disclose any facts, events or circumstances after the date hereof that may affect the accuracy of any forward-looking statement.

1

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in millions, except per share data)			
Net sales	$946.9	$799.6	$1,805.7	$1,555.2
Cost of goods sold	797.9	677.4	1,534.8	1,328.7
Gross profit	149.0	122.2	270.9	226.5
Selling, general and administrative expenses	61.5	60.5	118.6	120.1
Operating income	87.5	61.7	152.3	106.4
Interest expense	(25.1)	(28.8)	(50.1)	(57.9)
Investment income	0.3	0.2	0.6	0.3
Other income (expense)				
Debt refinancing and redemption costs	—	0.1	—	(11.2)
Other, net	0.8	(2.0)	1.3	(1.5)
Income before income taxes	63.5	31.2	104.1	36.1
Income tax expense	11.3	5.4	18.3	3.0
Net income	52.2	25.8	85.8	33.1
Basic earnings per share	$0.67	$0.34	$1.11	$0.43
Diluted earnings per share	$0.67	$0.34	$1.11	$0.43

See accompanying notes to condensed consolidated financial statements.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in millions)			
Net income	$52.2	$25.8	$85.8	$33.1
Other comprehensive income (loss), net of tax				
Defined benefit plans, net of tax [(a)]	0.6	1.7	5.7	0.6
Foreign currency translation adjustments	3.6	(21.7)	11.4	(16.8)
Change in derivatives	0.5	(2.1)	1.4	(1.6)
Other comprehensive income (loss)	4.7	(22.1)	18.5	(17.8)
Comprehensive income	$56.9	$3.7	$104.3	$15.3

(a) Amounts are net of tax of $(0.2) million and $(2.9) million for the three and six months ended June 30, 2014, respectively, and $(0.8) million and $(0.1) million for the three and six months ended June 30, 2013, respectively.

See accompanying notes to condensed consolidated financial statements.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2014 (Unaudited) (in millions)	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	$128.9	$154.0
Accounts receivable, net	648.2	458.5
Inventories, net	255.7	261.8
Prepaid expenses and other current assets	114.0	123.5
Total current assets	1,146.8	997.8
Property, plant and equipment, net	1,077.0	1,058.5
Deferred income taxes	333.0	341.8
Goodwill	156.2	156.4
GM postretirement cost sharing asset	234.9	242.0
Other assets and deferred charges	253.5	232.5
Total assets	$3,201.4	$3,029.0
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$509.7	$445.8
Accrued compensation and benefits	92.3	110.1
Deferred revenue	22.5	17.0
Accrued expenses and other current liabilities	97.0	94.2
Total current liabilities	721.5	667.1
Long-term debt	1,545.7	1,559.1
Deferred revenue	106.4	76.4
Postretirement benefits and other long-term liabilities	684.4	692.8
Total liabilities	3,058.0	2,995.4
Stockholders' equity		
Common stock, par value $0.01 per share	0.8	0.8
Paid-in capital	618.6	612.8
Accumulated deficit	(95.5)	(181.3)
Treasury stock at cost, 6.1 million shares as of June 30, 2014 and 6.0 million shares as of December 31, 2013	(182.8)	(182.5)
Accumulated other comprehensive income (loss), net of tax		
Defined benefit plans	(192.2)	(197.9)
Foreign currency translation adjustments	(7.2)	(18.6)
Unrecognized gain on derivatives	1.7	0.3
Total stockholders' equity	143.4	33.6
Total liabilities and stockholders' equity	$3,201.4	$3,029.0

See accompanying notes to condensed consolidated financial statements.

4

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2014	2013
	(in millions)	
Operating activities		
Net income	$85.8	$33.1
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	95.0	83.7
Deferred income taxes	4.9	(1.5)
Stock-based compensation	4.6	3.2
Pensions and other postretirement benefits, net of contributions	1.4	5.9
Gain on disposal of property, plant and equipment, net	(4.0)	(3.5)
Debt refinancing and redemption costs	—	2.5
Changes in operating assets and liabilities		
Accounts receivable	(187.3)	(99.1)
Inventories	8.4	(12.3)
Accounts payable and accrued expenses	53.1	51.1
Deferred revenue	35.6	(3.8)
Other assets and liabilities	(15.1)	(26.1)
Net cash provided by operating activities	82.4	33.2
Investing activities		
Purchases of property, plant and equipment	(103.7)	(121.5)
Proceeds from sale of property, plant and equipment	8.3	4.9
Proceeds from sale-leaseback of equipment	—	16.0
Net cash used in investing activities	(95.4)	(100.6)
Financing activities		
Net short-term repayments under credit facilities	(2.0)	(12.0)
Payments of long-term debt and capital lease obligations	(14.2)	(307.3)
Proceeds from issuance of long-term debt	2.8	410.0
Debt issuance costs	(0.3)	(6.6)
Purchase of treasury stock	(0.3)	(0.1)
Employee stock option exercises	1.2	0.8
Net cash provided by (used in) financing activities	(12.8)	84.8
Effect of exchange rate changes on cash	0.7	(0.9)
Net increase (decrease) in cash and cash equivalents	(25.1)	16.5
Cash and cash equivalents at beginning of period	154.0	62.4
Cash and cash equivalents at end of period	$128.9	$78.9
Supplemental cash flow information		
Interest paid	$41.9	$55.9

Income taxes paid, net of refunds	$5.7	$8.2

See accompanying notes to condensed consolidated financial statements.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2014
(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization American Axle & Manufacturing Holdings, Inc. (Holdings) and its subsidiaries (collectively, we, our, us or AAM) is a Tier I supplier to the automotive industry. We manufacture, engineer, design and validate driveline and drivetrain systems and related components and chassis modules for light trucks, sport utility vehicles (SUVs), passenger cars, crossover vehicles and commercial vehicles. Driveline and drivetrain systems include components that transfer power from the transmission and deliver it to the drive wheels. Our driveline, drivetrain and related products include axles, chassis modules, driveshafts, power transfer units, transfer cases, chassis and steering components, driveheads, transmission parts and metal-formed products. In addition to locations in the United States (U.S.) (Michigan, Ohio, Indiana and Pennsylvania), we also have offices or facilities in Brazil, China, Germany, India, Japan, Luxembourg, Mexico, Poland, Scotland, South Korea, Sweden and Thailand.

Basis of Presentation We have prepared the accompanying interim condensed consolidated financial statements in accordance with the instructions to Form 10-Q under the Securities Exchange Act of 1934. These condensed consolidated financial statements are unaudited but include all normal recurring adjustments, which we consider necessary for a fair presentation of the information set forth herein. Results of operations for the periods presented are not necessarily indicative of the results for the full fiscal year.

The balance sheet at December 31, 2013 presented herein has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete consolidated financial statements.

In order to prepare the accompanying interim condensed consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts and disclosures in our interim condensed consolidated financial statements. Actual results could differ from those estimates.

For further information, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2013.

Revenue Recognition In the first quarter of 2014, we reached an agreement with General Motors Company (GM) to increase installed capacity and adjust product mix for our largest vehicle program. As a result of this agreement, we received $20.6 million in the first six months of 2014 and recorded a receivable for the remaining $13.7 million that we expect to receive in two equal installments over the next two quarters of 2014. We initially recorded deferred revenue of $34.4 million related to this agreement. We will recognize this deferred revenue into sales over the life of the program on a straight line basis over approximately 5 years, which is the period we expect GM to benefit from this capacity and mix change. In the first six months of 2014, we recognized revenue of $2.1 million related to this agreement. As of June 30, 2014, we have $7.2 million of deferred revenue that is classified as a current liability and $25.1 million of deferred revenue that is recorded as a noncurrent liability on our Condensed Consolidated Balance Sheet.

Also in the first quarter of 2014, we reached an agreement with GM to recover certain costs related to the delay of another major product program. We received $9.3 million in the first six months of 2014 related to this agreement. As of June 30, 2014, we recorded deferred revenue of $9.3 million, $1.1 million of which is classified as a current liability and $8.2 million is recorded as a noncurrent liability on our Condensed Consolidated Balance Sheet. We will recognize this deferred revenue into sales over the life of the program on a straight-line basis over approximately 8 years, which is the period we expect GM to benefit from this agreement. We will begin recognizing this deferred revenue as revenue in the third quarter of 2014 when this program is launched in certain markets.

Effect of New Accounting Standards On January 1, 2014, new accounting guidance became effective regarding financial statement presentation of an unrecognized tax benefit when a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward exists. The new guidance requires entities to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for an NOL carryforward, a similar tax loss, or a tax credit carryforward, except when one is not available as of the reporting date or the entity does not intend to use the deferred tax asset for this purpose. This guidance does not affect the tabular reconciliation of the total amounts of unrecognized tax benefits, as the tabular reconciliation presents the gross amount of unrecognized tax benefits. The adoption of this new guidance has had no impact on our condensed consolidated financial statements.

In May 2014, new accounting guidance was issued that outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The guidance is based on the principle that an entity should recognize revenue to depict the transfer of 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. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. Entities have the option of using either a full retrospective or a modified retrospective approach for the adoption of the new standard. This guidance becomes effective for AAM at the beginning of our 2017 fiscal year and early adoption is not permitted. We are currently assessing the impact that this standard will have on our consolidated financial statements.

2. INVENTORIES

We state our inventories at the lower of cost or market. The cost of our inventories is determined using the FIFO method. When we determine that our gross inventories exceed usage requirements, or if inventories become obsolete or otherwise not saleable, we record a provision for such loss as a component of our inventory accounts.

Inventories consist of the following:

	June 30, 2014	December 31, 2013
	(in millions)	
Raw materials and work-in-progress	$252.0	$263.4
Finished goods	31.5	25.7
Gross inventories	283.5	289.1
Inventory valuation reserves	(27.8)	(27.3)
Inventories, net	$255.7	$261.8

3. LONG-TERM DEBT

Long-term debt consists of the following:

	June 30, 2014	December 31, 2013
	(in millions)	
Revolving Credit Facility	$—	$—
Term Facility	146.3	150.0
7.75% Notes	200.0	200.0
6.625% Notes	550.0	550.0
6.25% Notes	400.0	400.0
5.125% Notes	200.0	200.0
Foreign credit facilities	44.3	53.8
Capital lease obligations	5.1	5.3
Long-term debt	$1,545.7	$1,559.1

Revolving Credit Facility and Term Facility As of June 30, 2014, the revolving credit facility provided up to $523.5 million of revolving bank financing commitments through September 13, 2018. At June 30, 2014, we had $501.7 million available under the revolving credit facility. This availability reflects a reduction of $21.8 million for standby letters of credit issued against the facility. We paid remaining debt issuance costs of $0.1 million in the first six months of 2014 related to the revolving credit facility and term facility.

The revolving credit facility provides back-up liquidity for our foreign credit facilities. We intend to use the availability of long-term financing under the revolving credit facility to refinance any current maturities related to such debt agreements that are not otherwise refinanced on a long-term basis in their local markets.

In the first six months of 2014, we made principal payments of $3.7 million on our term facility.

In the first quarter of 2013, we terminated our class C loan facility of $72.8 million, which would have matured on June 30, 2013. Upon termination, we expensed $0.5 million of unamortized debt issuance costs related to the class C facility. We had been amortizing the debt issuance costs over the expected life of the borrowing.

6.25% Notes In the first quarter of 2013, we issued $400.0 million of 6.25% senior unsecured notes due 2021 (6.25% Notes). Net proceeds from the 6.25% Notes were used to purchase and redeem the entire $300.0 million outstanding of our 7.875% senior unsecured notes due 2017 (7.875% Notes) and for other general corporate purposes. We paid debt issuance costs of $6.6 million in the first six months of 2013 related to the 6.25% Notes.

7.875% Notes In the first quarter of 2013, we expensed $8.5 million related to tender and redemption premiums, $0.1 million of professional fees and unamortized debt issuance costs of $2.1 million related to the purchase and redemption of the 7.875% Notes. We had been amortizing the debt issuance costs for the 7.875% Notes over the expected life of the borrowing.

5.125% Notes In the fourth quarter of 2013, we issued $200.0 million of 5.125% senior unsecured notes due 2019 (5.125% Notes). Net proceeds from the 5.125% Notes were used to redeem the remaining $190.0 million outstanding under our 9.25% senior secured notes due 2017. We paid remaining debt issuance costs of $0.2 million in the first six months of 2014 related to the 5.125% Notes.

We utilize local currency credit facilities to finance the operations of certain foreign subsidiaries. At June 30, 2014, $44.3 million was outstanding under these facilities and an additional $53.0 million was available.

The weighted-average interest rate of our long-term debt outstanding was 6.4% at June 30, 2014 and 6.3% as of December 31, 2013.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. FAIR VALUE

The fair value accounting guidance defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." The definition is based on an exit price rather than an entry price, regardless of whether the entity plans to hold or sell the asset. This guidance also establishes a fair value hierarchy to prioritize inputs used in measuring fair value as follows:

- Level 1: Observable inputs such as quoted prices in active markets;
- Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Financial instruments The estimated fair value of our financial assets and liabilities that are recognized at fair value on a recurring basis, using available market information and other observable data, as of June 30, 2014, are as follows:

	June 30, 2014		December 31, 2013		
	Carrying Amount (in millions)	Fair Value	Carrying Amount (in millions)	Fair Value	Input
Balance Sheet Classification					
Cash equivalents	$25.8	$25.8	$6.1	$6.1	Level 1
Prepaid expenses and other current assets					
Currency forward contracts	1.6	1.6	0.7	0.7	Level 2
Other assets and deferred charges					
Currency forward contracts	0.1	0.1	—	—	Level 2
Other accrued expenses					
Currency forward contracts	—	—	0.4	0.4	Level 2

The carrying values of our cash, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to the short-term maturities of these instruments. The carrying values of our borrowings under the foreign credit facilities approximate their fair value due to the frequent resetting of the interest rates. We estimated the fair value of the amounts outstanding on our debt using available market information and other observable data, to be as follows:

	June 30, 2014		December 31, 2013		
	Carrying Amount (in millions)	Fair Value	Carrying Amount (in millions)	Fair Value	Input
Revolving Credit Facility	$—	$—	$—	$—	Level 2
Term Facility	146.3	144.8	150.0	147.8	Level 2
7.75% Notes	200.0	229.5	200.0	227.5	Level 2
6.625% Notes	550.0	602.3	550.0	578.9	Level 2
6.25% Notes	400.0	429.0	400.0	423.0	Level 2
5.125% Notes	200.0	210.0	200.0	206.0	Level 2

9

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. DERIVATIVES

Our business and financial results are affected by fluctuations in world financial markets, including interest rates and currency exchange rates. Our hedging policy has been developed to manage these risks to an acceptable level based on management's judgment of the appropriate trade-off between risk, opportunity and cost. We do not hold financial instruments for trading or speculative purposes.

Currency forward contracts From time to time, we use foreign currency forward contracts to reduce the effects of fluctuations in exchange rates, primarily relating to the Mexican Peso, Euro, Swedish Krona, Polish Zloty and Pound Sterling. As of June 30, 2014, we have currency forward contracts outstanding with a notional amount of $78.9 million that hedge our exposure to changes in foreign currency exchange rates for our payroll expenses, indirect inventory and other working capital items.

The following table summarizes the reclassification of pre-tax derivative gains into net income from accumulated other comprehensive income (loss):

	Location of Gain Reclassified into Net Income	Gain Reclassified Three Months Ended June 30, 2014	2013	Six Months Ended June 30, 2014	2013	Gain Expected to be Reclassified During the Next 12 Months
		(in millions)				
Currency forward contracts	Cost of Goods Sold	$0.2	$0.9	$0.2	$2.1	$1.6

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. EMPLOYEE BENEFIT PLANS

The components of net periodic benefit cost (credit) are as follows:

	Pension Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in millions)			
Service cost	$0.9	$0.9	$1.8	$1.8
Interest cost	9.0	8.5	18.0	17.0
Expected asset return	(12.1)	(11.5)	(24.2)	(23.0)
Amortized loss	1.3	2.4	2.6	4.8
Amortized prior service cost	—	0.3	—	0.6
Net periodic benefit cost (credit)	$(0.9)	$0.6	$(1.8)	$1.2

	Other Postretirement Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in millions)			
Service cost	$0.1	$0.1	$0.2	$0.2
Interest cost	3.8	3.3	7.6	6.6
Amortized loss	0.2	0.2	0.4	0.4
Amortized prior service credit	(0.7)	(0.5)	(1.4)	(0.9)
Net periodic benefit cost	$3.4	$3.1	$6.8	$6.3

Due to the availability of our prefunding balances (previous contributions in excess of prior required pension contributions), we are not required to make any cash payments in 2014. We expect our cash payments for other postretirement benefit obligations in 2014, net of GM cost sharing, to be approximately $17 million.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

7. PRODUCT WARRANTIES

We record a liability for estimated warranty obligations at the dates our products are sold. These estimates are established using sales volumes and internal and external warranty data where there is no payment history and historical information about the average cost of warranty claims for customers with prior claims. We estimate our costs based on the contractual arrangements with our customers, existing customer warranty terms and internal and external warranty data, which includes a determination of our warranty claims and take actions to improve product quality and minimize warranty claims. We continuously evaluate these estimates and our customers' administration of their warranty programs. We closely monitor actual warranty claim data and adjust the liability, as necessary, on a quarterly basis.

The following table provides a reconciliation of changes in the product warranty liability:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in millions)			
Beginning balance	$18.0	$22.9	$14.3	$29.1
Accruals	2.2	2.5	6.4	5.7
Settlements	(0.2)	(1.3)	(1.0)	(10.5)
Adjustment to prior period accruals, net	(1.8)	(0.7)	(1.6)	(0.9)
Foreign currency translation	—	(0.2)	0.1	(0.2)
Ending balance	$18.2	$23.2	$18.2	$23.2

8. INCOME TAXES

We are required to adjust our effective tax rate each quarter to estimate our annual effective tax rate. We must also record the tax impact of certain discrete, unusual or infrequently occurring items, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, in the interim period in which they occur. In addition, jurisdictions with a projected loss for the year or a year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings versus annual projections.

Income tax expense was $11.3 million in the three months ended June 30, 2014 as compared to $5.4 million in the three months ended June 30, 2013. Our effective income tax rate was 17.8% in the second quarter of 2014 as compared to 17.2% in the second quarter of 2013.

Income tax expense was $18.3 million in the first six months of 2014 as compared to $3.0 million in the first six months of 2013. Our effective income tax rate was 17.6% in the first six months of 2014 as compared to 8.3% in the first six months of 2013.

Our income tax expense and effective tax rate for the three and six months ended June 30, 2014 and June 30, 2013 primarily reflect favorable foreign tax rates, along with our inability to realize a tax benefit for current foreign losses. Additionally, in the first quarter of 2013, we recorded a tax benefit of $1.5 million relating to the release of a prior year unrecognized tax benefit due to the expiration of the applicable statute of limitations and a tax benefit of $3.3 million relating to an election we made in the first six months of 2013 regarding the treatment of foreign exchange gains and losses in a foreign jurisdiction.

In the three months ended June 30, 2013, we settled a transfer pricing examination of our 2006 income tax return with the Mexican tax authorities. This settlement resulted in a reduction of our liability for unrecognized income tax benefits and a cash payment of $4.7 million.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. EARNINGS PER SHARE (EPS)

The following table sets forth the computation of our basic and diluted EPS:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in millions, except per share data)			
Numerator				
Net income	$52.2	$25.8	$85.8	$33.1
Denominator				
Basic shares outstanding -				
Weighted-average shares outstanding	77.4	76.8	77.2	76.5
Effect of dilutive securities				
Dilutive stock-based compensation	0.1	0.1	0.1	—
Diluted shares outstanding -				
Adjusted weighted-average shares after assumed conversions	77.5	76.9	77.3	76.5
Basic EPS	$0.67	$0.34	$1.11	$0.43
Diluted EPS	$0.67	$0.34	$1.11	$0.43

Certain exercisable stock options were excluded from the computations of diluted EPS because the exercise price of these options was greater than the average period market prices. The number of stock options outstanding, which were not included in the calculation of diluted EPS, was 1.0 million at June 30, 2014 and 2.3 million at June 30, 2013. The range of exercise prices related to the excluded exercisable stock options was $19.54 - $40.83 at June 30, 2014 and $15.58 - $40.83 at June 30, 2013.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. RECLASSIFICATIONS OUT OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Reclassification adjustments and other activity impacting accumulated other comprehensive income (loss) during the three months ended June 30, 2014 and June 30, 2013 are as follows (in millions):

	Defined Benefit Plans		Foreign Currency Translation Adjustments	Unrecognized Gain on Derivatives		Total
Balance at March 31, 2014	$(192.8)		$(10.8)	$1.2		$(202.4)
Other comprehensive income (loss) before reclassifications	—		3.6	0.7		4.3
Amounts reclassified from accumulated other comprehensive income (loss)	0.6	(a)(b)	—	(0.2)	(c)	0.4
Net current period other comprehensive income (loss)	0.6		3.6	0.5		4.7
Balance at June 30, 2014	$(192.2)		$(7.2)	$1.7		$(197.7)

	Defined Benefit Plans		Foreign Currency Translation Adjustments	Unrecognized Gain on Derivatives		Total
Balance at March 31, 2013	$(275.6)		$12.5	$2.8		$(260.3)
Other comprehensive loss before reclassifications	—		(21.7)	(1.2)		(22.9)
Amounts reclassified from accumulated other comprehensive income (loss)	1.7	(a)(b)	—	(0.9)	(c)	0.8
Net current period other comprehensive income (loss)	1.7		(21.7)	(2.1)		(22.1)
Balance at June 30, 2013	$(273.9)		$(9.2)	$0.7		$(282.4)

(a) The amounts are net of tax of $(0.2) million for the amounts reclassified from AOCI for the three months ended June 30, 2014, and $(0.8) million for the three months ended June 30, 2013.

(b) The net amount reclassified from AOCI included $0.8 million in cost of goods sold (COGS) and $(0.2) million in selling, general & administrative expenses (SG&A) for the three months ended June 30, 2014 and $1.2 million in COGS and $0.5 million in SG&A for the three months ended June 30, 2013.

(c) The amounts reclassified from AOCI are included in COGS.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Reclassification adjustments and other activity impacting accumulated other comprehensive income (loss) during the six months ended June 30, 2014 and June 30, 2013 are as follows (in millions):

	Defined Benefit Plans	Foreign Currency Translation Adjustments	Unrecognized Gain on Derivatives	Total
Balance at December 31, 2013	$(197.9)	$(18.6)	$0.3	$(216.2)
Other comprehensive income (loss) before reclassifications	4.5 (a)	11.4	1.6	17.5
Amounts reclassified from accumulated other comprehensive income (loss)	1.2 (a)(b)	—	(0.2) (c)	1.0
Net current period other comprehensive income (loss)	5.7	11.4	1.4	18.5
Balance at June 30, 2014	$(192.2)	$(7.2)	$1.7	$(197.7)

	Defined Benefit Plans	Foreign Currency Translation Adjustments	Unrecognized Gain on Derivatives	Total
Balance at December 31, 2012	$(274.5)	$7.6	$2.3	$(264.6)
Other comprehensive income (loss) before reclassifications	(2.7) (a)	(16.8)	0.5	(19.0)
Amounts reclassified from accumulated other comprehensive income (loss)	3.3 (a)(b)	—	(2.1) (c)	1.2
Net current period other comprehensive income (loss)	0.6	(16.8)	(1.6)	(17.8)
Balance at June 30, 2013	$(273.9)	$(9.2)	$0.7	$(282.4)

(a) The amounts are net of tax of $(2.4) million and $(0.5) million for other comprehensive income before reclassifications and the amounts reclassified from AOCI, respectively, for the six months ended June 30, 2014, and $1.5 million and $(1.6) million, respectively, for the six months ended June 30, 2013.

(b) The net amount reclassified from AOCI included $1.7 million in COGS and $(0.5) million in SG&A for the six months ended June 30, 2014 and $2.3 million in COGS and $1.0 million in SG&A for the six months ended June 30, 2013.

(c) The amounts reclassified from AOCI are included in COGS.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. SUPPLEMENTAL GUARANTOR CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Holdings has no significant assets other than its 100% ownership in AAM, Inc. and no direct subsidiaries other than AAM, Inc. The 7.75% Notes, 6.625% Notes, 6.25% Notes and 5.125% Notes are senior unsecured obligations of AAM Inc.; all of which are fully and unconditionally guaranteed by Holdings and substantially all domestic subsidiaries of AAM, Inc, which are 100% indirectly owned by Holdings.

These Condensed Consolidating Financial Statements are prepared under the equity method of accounting whereby the investments in subsidiaries are recorded at cost and adjusted for the parent's share of the subsidiaries' cumulative results of operations, capital contributions and distributions, and other equity changes.

Condensed Consolidating Statements of Income
Three Months Ended June 30,
(in millions)

	Holdings	AAM Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elims	Consolidated
2014						