Allison Transmission Holdings Inc
Form 10-Q
April 23, 2019
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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 March 31, 2019
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File No. 001-35456
ALLISON TRANSMISSION HOLDINGS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	26-0414014
(State of Incorporation)	(I.R.S. Employer Identification Number)
One Allison Way Indianapolis, IN	46222
(Address of Principal Executive Offices)	(Zip Code)

(317) 242-5000
(Registrant's Telephone Number, Including Area Code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 x No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
As of April 15, 2019, there were 125,280,595 shares of Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements
Allison Transmission Holdings, Inc.
Condensed Consolidated Balance Sheets
(unaudited, dollars in millions, except share and per share data)

	March 31, 2019	December 31, 2018
ASSETS		
Current Assets		
Cash and cash equivalents	$324	$ 231
Accounts receivable – net of allowance for doubtful accounts of $1	332	279
Inventories	189	170
Other current assets	36	45
Total Current Assets	881	725
Property, plant and equipment, net	473	466
Intangible assets, net	1,044	1,066
Goodwill	1,941	1,941
Other non-current assets	53	39
TOTAL ASSETS	$4,392	$ 4,237
LIABILITIES		
Current Liabilities		
Accounts payable	$209	$ 169
Product warranty liability	27	26
Current portion of long-term debt	5	—
Deferred revenue	34	34
Other current liabilities	190	197
Total Current Liabilities	465	426
Product warranty liability	37	40
Deferred revenue	97	88
Long-term debt	2,514	2,523
Deferred income taxes	339	329
Other non-current liabilities	194	172
TOTAL LIABILITIES	3,646	3,578
Commitments and contingencies (see NOTE P)		
STOCKHOLDERS' EQUITY		
Common stock, $0.01 par value, 1,880,000,000 shares authorized, 125,255,892 shares issued and outstanding and 126,251,266 shares issued and outstanding, respectively	1	1
Non-voting common stock, $0.01 par value, 20,000,000 shares authorized, none issued and outstanding	—	—
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding	—	—
Paid in capital	1,788	1,788
Accumulated deficit	(1,010)	(1,100)
Accumulated other comprehensive loss, net of tax	(33)	(30)
TOTAL STOCKHOLDERS' EQUITY	746	659
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$4,392	$ 4,237

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

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Allison Transmission Holdings, Inc.
Condensed Consolidated Statements of Comprehensive Income
(unaudited, dollars in millions, except per share data)

	Three months ended March 31,	
	2019	2018
Net sales	$675	$663
Cost of sales	316	321
Gross profit	359	342
Selling, general and administrative	84	92
Engineering — research and development	31	28
Operating income	244	222
Interest expense, net	(36)	(30)
Other income (expense), net	3	(1)
Income before income taxes	211	191
Income tax expense	(44)	(40)
Net income	$167	$151
Basic earnings per share attributable to common stockholders	$1.33	$1.09
Diluted earnings per share attributable to common stockholders	$1.32	$1.08
Dividends declared per common share	$0.15	$0.15
Comprehensive income, net of tax	$164	$155

The accompanying notes are an integral part of the condensed consolidated financial statements.
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Allison Transmission Holdings, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited, dollars in millions)

	Three months ended March 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$167	$151
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	22	22
Depreciation of property, plant and equipment	18	20
Deferred income taxes	13	12
Expenses related to long-term debt refinancing	5	—
Stock-based compensation	3	3
Amortization of deferred financing costs	1	2
Other	(1)	2
Changes in assets and liabilities:		
Accounts receivable	(54)	(90)
Inventories	(18)	(16)
Accounts payable	34	44
Other assets and liabilities	4	3
Net cash provided by operating activities	194	153
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions of long-lived assets	(19)	(10)
Net cash used for investing activities	(19)	(10)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(1,148)	(3)
Issuance of long-term debt	1,148	—
Repurchases of common stock	(50)	(125)
Dividend payments	(19)	(21)
Debt financing fees	(10)	(1)
Taxes paid related to net share settlement of equity awards	(4)	(2)
Proceeds from exercise of stock options	—	3
Net cash used for financing activities	(83)	(149)
Effect of exchange rate changes on cash	1	2
Net increase (decrease) in cash and cash equivalents	93	(4)
Cash and cash equivalents at beginning of period	231	199
Cash and cash equivalents at end of period	$324	$195
Supplemental disclosures:		
Interest paid	$14	$10
Income taxes paid	$6	$1

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

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Allison Transmission Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(UNAUDITED)

NOTE A. OVERVIEW

Overview

Allison Transmission Holdings, Inc. and its subsidiaries (“Allison” or the “Company”) design and manufacture commercial and defense fully-automatic transmissions. The business was founded in 1915 and has been headquartered in Indianapolis, Indiana since inception. Allison was an operating unit of General Motors Corporation from 1929 until 2007, when Allison once again became a stand-alone company. In March 2012, Allison began trading on the New York Stock Exchange under the symbol, “ALSN”.

The Company has approximately 2,900 employees and 12 different transmission product lines. Although approximately 77% of revenues were generated in North America in 2018, the Company has a global presence by serving customers in Europe, Asia, South America and Africa. The Company serves customers through an independent network of approximately 1,400 independent distributor and dealer locations worldwide.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements have been prepared in accordance with accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the condensed consolidated financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America (“GAAP”) for complete financial statements. The information herein reflects all normal recurring material adjustments, which are, in the opinion of management, necessary for the fair statement of the results for the periods presented. The condensed consolidated financial statements herein consist of all wholly-owned domestic and foreign subsidiaries with all significant intercompany transactions eliminated.

These condensed consolidated financial statements present the financial position, results of comprehensive income and cash flows of the Company. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company’s Form 10-K for the year ended December 31, 2018 as filed with the Securities and Exchange Commission (“SEC”) on February 26, 2019. Certain immaterial reclassifications have been made in the condensed consolidated financial statements of prior periods to conform to the current period presentation. The interim period financial results for the three month periods presented are not necessarily indicative of results to be expected for any other interim period or for the entire year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Estimates include, but are not limited to, sales allowances, government price adjustments, fair market values and future cash flows associated with goodwill, indefinite life intangibles, long-lived asset impairment tests, useful lives for depreciation and amortization, warranty liabilities, environmental liabilities, determination of discount and other assumptions for pension and other postretirement benefit expense, determination of discount and period for leases, income taxes and deferred tax valuation allowances, derivative valuation and contingencies. The Company’s accounting policies involve the application of judgments and assumptions made by management that include inherent risks and uncertainties. Actual results could differ materially from these estimates. Changes in estimates are recorded in results of operations in the period that the events or circumstances giving rise to such changes occur.

Recently Adopted Accounting Pronouncements

In June 2018, the Financial Accounting Standards Board ("FASB") issued authoritative accounting guidance on accounting for nonemployee awards for goods or services received by a company. The Company adopted this guidance effective January 1, 2019. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

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In February 2018, the FASB issued authoritative accounting guidance on transfers of stranded balances in accumulated other comprehensive loss ("AOCL") to retained earnings. The passage of the U.S. Tax Cuts and Jobs Act by the U.S. federal government in December 2017 and existing GAAP requirements to adjust deferred tax assets and liabilities for changes in tax laws or rates created stranded balances in AOCL on deferred tax assets and liabilities previously recorded as a component to AOCL. The guidance applies to companies affected by these stranded balances and allows a reclassification of these balances to retained earnings. The Company adopted this guidance effective January 1, 2019. As a result of the adoption of this guidance, the Company recorded an adjustment that reclassified $7 million of AOCL to retained earnings as of January 1, 2019.

In February 2016, the FASB issued authoritative accounting guidance on lease accounting, which guidance was subsequently amended. The guidance requires lessees to present right-of-use assets and lease liabilities on the balance sheet for all leases not considered short-term leases. Short-term leases are leases with a lease term of 12 months or less as long as the leases do not include options to purchase the underlying assets that the lessee is reasonably certain to exercise. The guidance also introduces new disclosure requirements for leasing arrangements. In July 2018, the FASB issued additional authoritative guidance on this topic giving lessees an optional adoption approach under which the impact of the adoption of the guidance would be shown as of the date of adoption. Management elected to adopt the guidance using this optional alternative method. The Company adopted this guidance effective January 1, 2019. The Company recorded non-financial right-of-use ("ROU") assets of $14 million, including $1 million of assets transferred from the balance recorded as prepaid lease expense under the prior guidance, and current and non-current lease liabilities of $4 million and $9 million, respectively. The adoption of this guidance did not have a material impact on the Company's opening retained earnings. See Note K, "Leases" for further details.

Recently Issued Accounting Pronouncements

In August 2018, the FASB issued authoritative accounting guidance on accounting for implementation costs in hosting arrangements to align these costs with existing guidance for internally developed software. The stage of implementation must be assessed to determine if costs should be capitalized or expensed, and capitalized costs should be expensed during the noncancellable term of the agreement. The guidance will be effective for the Company in fiscal year 2020, and the Company does not plan to early adopt. Management does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In August 2018, the FASB issued authoritative accounting guidance amending disclosure requirements for the Company's defined benefit pension plans and other postretirement benefit plan. The guidance will be effective for the Company in fiscal year 2021, but early adoption is permitted. Management is currently evaluating the impact of this guidance on the Company's consolidated financial statements.

In August 2018, the FASB issued authoritative accounting guidance amending disclosure requirements for certain assets subject to fair value measurement. The guidance allows the Company to reduce the amount of disclosure on transfers between Level 1 and Level 2 assets. The guidance will be effective for the Company in fiscal year 2020, and the Company does not plan to early adopt. Management does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued authoritative accounting guidance on the presentation of financial assets at the net amount expected to be collected. The guidance also requires the disclosure of financing receivables disaggregated by the year of origination. The guidance will be effective for the Company in fiscal year 2020. Management is currently evaluating the impact of this guidance on the Company's consolidated financial statements.

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NOTE C. REVENUE

Revenue is recognized as each distinct performance obligation within a contract is satisfied. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. The Company enters into long-term supply agreements (“LTSAs”) and distributor agreements with certain customers. The LTSAs and distributor agreements do not include committed volumes until underlying purchase orders are issued; therefore, the Company determined that purchase orders are the contract with a customer. A contract’s transaction price is allocated to each distinct performance obligation and recognized as revenue when the performance obligation is satisfied, as there is no right of return.

Some of the Company's contracts include multiple performance obligations, most commonly the sale of both a transmission and Extended Transmission Coverage ("ETC"). The Company allocates the contract’s transaction price to each performance obligation based on the standalone selling price of each distinct good or service in the contract.

The Company may also use volume based discounts and rebates as marketing incentives in the sales of both transmissions and service parts, which are accounted for as variable consideration. The Company records the impact of the incentives as a reduction to revenue when it is determined that the adjustment is not likely to reverse, historically on a quarterly basis. The Company estimates the impact of all other incentives based on the related sales and market conditions in the end market vocation. The Company recorded no adjustments based on variable consideration during the three months ended March 31, 2019 and 2018.

Net sales are made on credit terms, generally 30 days, based on an assessment of the customer’s creditworthiness. For certain goods or services, the Company receives consideration prior to satisfying the related performance obligation. Such consideration is recorded as a contract liability in current and non-current Deferred Revenue as of March 31, 2019 and December 31, 2018. See Note J, “Deferred Revenue” for more information including the amount of revenue earned during the three months ended March 31, 2019 that had been previously deferred. The Company had no contract assets as of March 31, 2019 and December 31, 2018.

The following presents disaggregated revenue by categories that best depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors (dollars in millions):

	Three months ended March 31,	
	2019	2018
North America On-Highway*	$377	$339
North America Off-Highway	14	33
Defense	32	37
Outside North America On-Highway	94	91
Outside North America Off-Highway	27	12
Service Parts, Support Equipment and Other	131	151
Total Net Sales	$675	$663

* North America On-Highway end market net sales are inclusive of net sales for North America Electric Hybrid-Propulsion Systems for Transit Bus

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NOTE D. INVENTORIES

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

	March 31, 2019	December 31, 2018
Purchased parts and raw materials	$ 100	$ 82
Work in progress	9	8
Service parts	50	48
Finished goods	30	32
Total inventories	$ 189	$ 170

Inventory components shipped to third parties, primarily cores, parts to re-manufacturers, and parts to contract manufacturers, which the Company has an obligation to buy back, are included in purchased parts and raw materials, with an offsetting liability in Other Current Liabilities. See NOTE L, "Other Current Liabilities" for more information.

NOTE E. GOODWILL AND OTHER INTANGIBLE ASSETS

As of both March 31, 2019 and December 31, 2018, the carrying amount of the Company's Goodwill was $1,941 million.

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

	March 31, 2019			December 31, 2018		
	Intangible assets, gross	Accumulated amortization	Intangible assets, net	Intangible assets, gross	Accumulated amortization	Intangible assets, net
Other intangible assets:						
Trade name	$790	$ —	$ 790	$790	$ —	$ 790
Customer relationships — commercial	832	(630)	202	832	(619)	213
Proprietary technology	476	(444)	32	476	(434)	42
Customer relationships — defense	62	(42)	20	62	(41)	21
Total	$2,160	$ (1,116)	$ 1,044	$2,160	$ (1,094)	$ 1,066

As of March 31, 2019 and December 31, 2018, the net carrying value of the Company's Goodwill and Other intangible assets, net was $2,985 million and $3,007 million, respectively.

Amortization expense related to other intangible assets for the next five fiscal years is expected to be (dollars in millions):

	2020	2021	2022	2023	2024
Amortization expense	$ 50	$ 45	$ 43	$ 42	$ 7

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NOTE F. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Level 1