PALL CORP
Form 10-Q
February 25, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
R Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended January 31, 2015
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: 001- 04311
PALL CORPORATION
(Exact name of registrant as specified in its charter)

New York (State or other jurisdiction of incorporation or organization)	11-1541330 (I.R.S. Employer Identification No.)
25 Harbor Park Drive, Port Washington, NY (Address of principal executive offices)	11050 (Zip Code)

(516) 484-5400
(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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The number of shares of the registrant's common stock outstanding as of February 23, 2015 was 106,645,105.

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.
PALL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
(Unaudited)

	Jan 31, 2015	Jul 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$1,029,673	$964,110
Accounts receivable	527,847	615,713
Inventory	377,210	404,878
Other current assets	153,897	152,522
Total current assets	2,088,627	2,137,223
Property, plant and equipment	741,845	805,327
Goodwill	469,643	491,462
Intangible assets	218,776	242,423
Other non-current assets	149,017	176,078
Total assets	$3,667,908	$3,852,513
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$724,796	$424,943
Accounts payable	140,991	165,373
Accrued liabilities	265,954	328,397
Income taxes payable	56,542	60,775
Current portion of long-term debt	76,412	87,955
Dividends payable	32,518	30,203
Total current liabilities	1,297,213	1,097,646
Long-term debt, net of current portion	375,342	375,826
Income taxes payable – non-current	151,339	150,484
Deferred taxes	54,241	67,303
Other non-current liabilities	239,641	265,897
Total liabilities	2,117,776	1,957,156
Stockholders’ equity:		
Common stock, par value $.10 per share	12,796	12,796
Capital in excess of par value	353,255	327,301
Retained earnings	2,618,509	2,512,961
Treasury stock, at cost	(1,232,024)	(942,780)
Accumulated other comprehensive income/(loss)	(202,404)	(14,921)
Total stockholders’ equity	1,550,132	1,895,357
Total liabilities and stockholders’ equity	$3,667,908	$3,852,513

See accompanying notes to condensed consolidated financial statements.

PALL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Six Months Ended	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Net sales	$673,794	$676,969	$1,370,286	$1,306,748
Cost of sales	332,776	332,710	667,860	636,775
Gross profit	341,018	344,259	702,426	669,973
Selling, general and administrative expenses	191,834	196,299	394,490	391,183
Research and development	24,458	24,979	49,235	48,246
Restructuring and other charges, net	11,534	9,170	20,774	18,368
Interest expense, net	6,238	5,195	12,940	11,172
Earnings before income taxes	106,954	108,616	224,987	201,004
Provision for income taxes	22,555	24,950	52,315	45,825
Net earnings	$84,399	$83,666	$172,672	$155,179
Earnings per share:				
Basic	$0.79	$0.76	$1.60	$1.39
Diluted	$0.78	$0.75	$1.59	$1.38
Dividends declared per share	$0.305	$—	$0.610	$0.275
Average shares outstanding:				
Basic	107,139	110,720	107,639	111,263
Diluted	108,507	111,980	108,896	112,532

See accompanying notes to condensed consolidated financial statements.

PALL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)
(In thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Net earnings	$84,399	$83,666	$172,672	$155,179
Other comprehensive income/(loss), net of income taxes:				
Foreign currency translation	(119,915)	(21,938)	(201,212)	21,289
Pension liability adjustment	7,211	(71)	13,563	(665)
Unrealized investment gains/(losses)	61	(292)	(571)	(374)
Unrealized gains/(losses) on derivatives	1,953	3,126	737	5,581
Total other comprehensive income/(loss), net of income taxes	(110,690)	(19,175)	(187,483)	25,831
Comprehensive income/(loss)	$(26,291)	$64,491	$(14,811)	$181,010

See accompanying notes to condensed consolidated financial statements.

PALL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended	
	Jan 31, 2015	Jan 31, 2014
OPERATING ACTIVITIES		
Net cash provided by operating activities	$238,166	$205,595
INVESTING ACTIVITIES		
Capital expenditures	(25,240)	(34,663)
Acquisition of businesses, net of cash acquired	(1,741)	(5,299)
Purchases of retirement benefit assets	(38,506)	(14,312)
Proceeds from retirement benefit assets	40,913	19,946
Proceeds from sale of assets	2,200	1,953
Other	(4,565)	(3,278)
Net cash used by investing activities	(26,939)	(35,653)
FINANCING ACTIVITIES		
Notes payable	299,853	134,963
Dividends paid	(62,796)	(58,408)
Repayments of short-term debt	—	(3,927)
Repayments of long-term debt	(280)	(375)
Net proceeds from stock plans	8,169	7,130
Additions to deferred financing costs	(1,535)	—
Purchase of treasury stock	(304,105)	(250,000)
Excess tax benefits from stock-based compensation arrangements	2,475	9,444
Other	(1,458)	—
Net cash used by financing activities	(59,677)	(161,173)
Effect of exchange rate changes on cash and cash equivalents	(85,987)	6,179
Net increase in cash and cash equivalents	65,563	14,948
Cash and cash equivalents at beginning of year	964,110	936,886
Cash and cash equivalents at end of period	$1,029,673	$951,834
Supplemental Disclosures		
Interest paid	$12,715	$11,844
Income taxes paid (net of refunds)	41,683	31,772

See accompanying notes to condensed consolidated financial statements.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share data)
(Unaudited)

NOTE 1 – BASIS OF PRESENTATION

The condensed consolidated financial information of Pall Corporation and its subsidiaries (hereinafter collectively called the "Company") included herein is unaudited. Such information reflects all adjustments of a normal recurring nature, which are, in the opinion of Company management, necessary to present fairly the Company's consolidated financial position, results of operations and cash flows as of the dates and for the periods presented herein. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes set forth in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2014 ("2014 Form 10-K").

NOTE 2 – BALANCE SHEET DETAILS

The following tables provide details of selected balance sheet items:

	Jan 31, 2015	Jul 31, 2014
Accounts receivable:		
Billed	$464,175	$556,928
Unbilled	77,250	72,681
Total	541,425	629,609
Less: Allowances for doubtful accounts	(13,578)	(13,896)
	$527,847	$615,713

Unbilled receivables principally relate to revenues accrued for long-term contracts recorded under the percentage-of-completion method of accounting.

	Jan 31, 2015	Jul 31, 2014
Inventory:		
Raw materials and components	$132,458	$117,581
Work-in-process	94,056	112,824
Finished goods	150,696	174,473
	$377,210	$404,878

	Jan 31, 2015	Jul 31, 2014
Property, plant and equipment:		
Property, plant and equipment	$1,690,242	$1,776,983
Less: Accumulated depreciation and amortization	(948,397)	(971,656)
	$741,845	$805,327

NOTE 3 – GOODWILL AND INTANGIBLE ASSETS

The following table presents changes in the carrying value of goodwill, allocated by reportable segment:

	Life Sciences	Industrial	Total
Balance at July 31, 2014	$269,758	$221,704	$491,462
Acquisitions	—	2,617	2,617
Foreign currency translation / other	(18,572)	(5,864)	(24,436)
Balance at January 31, 2015	$251,186	$218,457	$469,643

Increase in acquisitions primarily related to working capital adjustment for acquisition of Filter Specialists, Inc.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

Intangible assets consist of the following:

January 31, 2015	Gross	Accumulated Amortization	Net
Patents and unpatented technology	$158,103	$68,661	$89,442
Customer-related intangibles	158,372	38,854	119,518
Trademarks	16,473	7,593	8,880
Other	3,477	2,541	936
	$336,425	$117,649	$218,776

July 31, 2014	Gross	Accumulated Amortization	Net
Patents and unpatented technology	$165,727	$66,126	$99,601
Customer-related intangibles	165,759	33,845	131,914
Trademarks	16,971	7,130	9,841
Other	3,647	2,580	1,067
	$352,104	$109,681	$242,423

Intangible assets were primarily impacted by changes in the foreign exchange rates used to translate intangible assets of foreign subsidiaries.

Amortization expense for intangible assets for the three and six months ended January 31, 2015 was $6,029 and $12,246, respectively. Amortization expense for intangible assets for the three and six months ended January 31, 2014 was $4,655 and $9,379, respectively. Amortization expense is estimated to be approximately $10,819 for the remainder of fiscal year 2015, $21,521 in fiscal year 2016, $21,232 in fiscal year 2017, $21,098 in fiscal year 2018, $18,969 in fiscal year 2019, and $17,642 in fiscal year 2020.

NOTE 4 – TREASURY STOCK

The following table highlights the share repurchase authorizations in effect during fiscal year 2015:

	Date of Authorization			
	Jan 17, 2013	Jul 17, 2014	Oct 9, 2014	Total
Amount available for repurchases as of July 31, 2014	$81,873	$600,000	$—	$681,873
New authorizations	—	—	200,000	200,000
Utilized	(81,873)	(222,232)	—	(304,105)
Amount available for repurchases as of January 31, 2015	$—	$377,768	$200,000	$577,768

The Company’s shares may be purchased over time as market and business conditions warrant. There is no time restriction on these authorizations. In August 2014, the Company entered into an Accelerated Share Repurchase (“ASR”) agreement with a third-party financial institution to repurchase $300,000 of the Company’s common stock. This transaction was completed in the second quarter of fiscal year 2015. Under the agreement, the Company paid $300,000 to the financial institution. Upon completion of the transaction, the Company received a total of 3,461 shares with an average price per share of $86.67. In addition, during the three months ended January 31, 2015, the Company purchased 44 shares on the open market for a total cost of $4,105 and an average price per share of $94.26.

During the six months ended January 31, 2015, 275 shares were issued under the Company’s stock-based compensation plans. At January 31, 2015, the Company held 21,341 treasury shares.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 5 – CONTINGENCIES AND COMMITMENTS

With respect to the matters described in Note 14, Contingencies and Commitments, to the Company's consolidated financial statements included in the Company's 2014 Form 10-K and below, the Company has assessed the ultimate resolution of these matters and has reflected appropriate contingent liabilities in the condensed consolidated financial statements as of January 31, 2015 and July 31, 2014.

The Company and its subsidiaries are subject to certain other legal actions that arise in the normal course of business. Other than those legal proceedings and claims discussed in the 2014 Form 10-K and this Note, the Company is not facing any other legal proceedings and claims that would individually or in the aggregate have a reasonably possible material adverse effect on its financial condition or operating results. As such, any reasonably possible loss or range of loss, other than those legal proceedings discussed in the 2014 Form 10-K and this Note, is immaterial. However, the results of legal proceedings cannot be predicted with certainty. If the Company failed to prevail in several of these legal matters in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Environmental Matters

The Company's condensed consolidated balance sheet at January 31, 2015 includes liabilities for environmental matters of $18,098 which relate primarily to the environmental proceedings discussed in the 2014 Form 10-K and as updated in this Note. In the opinion of management, the Company is in substantial compliance with applicable environmental laws and its current accruals for environmental remediation are adequate. However, as regulatory standards under environmental laws are becoming increasingly stringent, there can be no assurance that future developments, additional information and experience gained will not cause the Company to incur material environmental liabilities or costs beyond those accrued in its condensed consolidated financial statements.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 6 – RESTRUCTURING AND OTHER CHARGES, NET
The following tables summarize the restructuring and other charges ("ROTC") recorded in the three and six months ended January 31, 2015 and January 31, 2014:

	Three Months Ended Jan 31, 2015			Six Months Ended Jan 31, 2015		
	Restructuring (1)	Other Charges/(Gains) (2)	Total	Restructuring (1)	Other Charges/(Gains) (2)	Total
Severance benefits and other employment contract obligations	$6,271	$ —	$6,271	$15,021	$ —	$15,021
Professional fees and other costs, net of receipt of insurance claim payments	438	197	635	990	245	1,235
Impairment of assets	4,334	1,620	5,954	4,334	1,620	5,954
Reversal of excess restructuring reserves	(1,326)	—	(1,326)	(1,436)	—	(1,436)
	$9,717	$ 1,817	$11,534	$18,909	$ 1,865	$20,774
Cash	$5,383	$ 197	$5,580	$14,575	$ 245	$14,820
Non-cash	4,334	1,620	5,954	4,334	1,620	5,954
	$9,717	$ 1,817	$11,534	$18,909	$ 1,865	$20,774

	Three Months Ended Jan 31, 2014			Six Months Ended Jan 31, 2014		
	Restructuring (1)	Other Charges/(Gains) (2)	Total	Restructuring (1)	Other Charges/(Gains) (2)	Total
Severance benefits and other employment contract obligations	$7,347	$ (844)	$6,503	$10,462	$ (402)	$10,060
Professional fees and other costs, net of receipt of insurance claim payments	894	2,053	2,947	2,137	2,195	4,332
Impairment of assets	—	—	—	—	160	160
Environmental matters	—	—	—	—	4,440	4,440
Reversal of excess restructuring reserves	(280)	—	(280)	(624)	—	(624)
	$7,961	$ 1,209	$9,170	$11,975	$ 6,393	$18,368
Cash	$7,961	$ 1,209	$9,170	$11,975	$ 6,233	$18,208
Non-cash	—	—	—	—	160	160
	$7,961	$ 1,209	$9,170	$11,975	$ 6,393	$18,368

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

(1) Restructuring:
In fiscal year 2012, the Company announced a multi-year strategic cost reduction initiative ("structural cost improvement initiative"). This initiative impacts both segments as well as the Corporate Services Group. The goal of this initiative is to properly position the Company's cost structure globally to perform in the current economic environment without adversely impacting its growth or innovation potential.
Key components of the structural cost improvement initiative include:
the strategic alignment of manufacturing, sales and R&D facilities to cost-effectively deliver high-quality products and superior service to the Company's customers worldwide,
creation of regional and global shared financial services centers for the handling of accounting transaction processing and other accounting functions,
reorganization of sales functions, to more cost-efficiently deliver superior service to the Company's customers globally, and
reductions in headcount across all functional areas, enabled by efficiencies gained through the Company's ERP systems, as well as in order to align to economic conditions.
Restructuring charges recorded in the three and six months ended January 31, 2015 and January 31, 2014 primarily reflect the expenses incurred in connection with the Company's structural cost improvement initiative as discussed above. Restructuring charges recorded in the three and six months ended January 31, 2015 also include the impairment of assets related to the exit of an immaterial product line.
(2) Other Charges/(Gains):
Severance benefits and other employment contract obligations: In the three and six months ended January 31, 2014, the Company recorded adjustments related to certain employment contract obligations.
Professional fees and other: In the three months ended January 31, 2014, the Company recorded acquisition related legal and other professional fees.
Impairment of assets: In the three months ended January 31, 2015, the Company recorded an impairment related to a redundant software project.
Environmental matters: In the six months ended January 31, 2014, the Company increased its previously established environmental reserve related to a matter in Pinellas Park, Florida.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

The following table summarizes the activity related to restructuring liabilities recorded for the Company's structural cost improvement initiative which began in fiscal year 2012:

	Severance	Other	Total
Original charge	$61,852	$3,448	$65,300
Utilized	(27,365)	(2,798)	(30,163)
Translation	(123)	(47)	(170)
Balance at July 31, 2012	$34,364	$603	$34,967
Additions	21,637	2,840	24,477
Utilized	(29,574)	(1,936)	(31,510)
Reversal of excess reserves	(500)	(57)	(557)
Translation	313	23	336
Balance at July 31, 2013	$26,240	$1,473	$27,713
Additions	27,803	4,419	32,222
Utilized	(26,178)	(4,596)	(30,774)
Reversal of excess reserves	(1,923)	(107)	(2,030)
Translation	230	39	269
Balance at July 31, 2014	$26,172	$1,228	$27,400
Additions	15,021	990	16,011
Utilized	(17,997)	(1,207)	(19,204)
Reversal of excess reserves	(1,429)	(7)	(1,436)
Translation	(2,563)	(103)	(2,666)
Balance at January 31, 2015	$19,204	$901	$20,105

NOTE 7 – INCOME TAXES

The Company's effective tax rates for the six months ended January 31, 2015 and January 31, 2014 were 23.3% and 22.8%, respectively. For the six months ended January 31, 2015 and January 31, 2014, the effective tax rate varied from the U.S. federal statutory rate primarily due to the benefits of foreign operations.

At January 31, 2015 and July 31, 2014, the Company had gross unrecognized income tax benefits of $200,144 and $202,564, respectively. During the six months ended January 31, 2015, the amount of gross unrecognized tax benefits decreased by $2,420, primarily due to the recognition of a tax position taken in a prior year and the impact of foreign currency translation partially offset by tax positions taken during the current period. As of January 31, 2015, the amount of net unrecognized income tax benefits that, if recognized, would impact the effective tax rate was $163,857. At January 31, 2015 and July 31, 2014, the Company had liabilities of $15,343 and $14,556, respectively, for potential payment of interest and penalties.

Due to the potential resolution of tax examinations and the expiration of various statutes of limitation, the Company believes that it is reasonably possible that the gross amount of unrecognized tax benefits may decrease within the next twelve months by a range of zero to $43,963.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 8 – COMPONENTS OF NET PERIODIC PENSION COST

Net periodic pension benefit cost for the Company's defined benefit pension plans includes the following components:

	Three Months Ended					
	U.S. Plans		Foreign Plans		Total	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Service cost	$2,589	$2,170	$883	$997	$3,472	$3,167
Interest cost	2,896	3,027	3,771	4,321	6,667	7,348
Expected return on plan assets	(2,484)	(2,324)	(3,640)	(3,542)	(6,124)	(5,866)
Amortization of prior service cost/(credit)	364	395	1	(10)	365	385
Amortization of actuarial loss	1,019	1,345	1,299	1,425	2,318	2,770
Net periodic benefit cost	$4,384	$4,613	$2,314	$3,191	$6,698	$7,804

	Six Months Ended					
	U.S. Plans		Foreign Plans		Total	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Service cost	$5,178	$4,340	$1,838	$1,993	$7,016	$6,333
Interest cost	5,792	6,055	7,759	8,525	13,551	14,580
Expected return on plan assets	(4,967)	(4,649)	(7,484)	(6,980)	(12,451)	(11,629)
Amortization of prior service cost/(credit)	729	790	2	(21)	731	769
Amortization of actuarial loss	2,038	2,689	2,673	2,811	4,711	5,500
Net periodic benefit cost	$8,770	$9,225	$4,788	$6,328	$13,558	$15,553

NOTE 9 – STOCK-BASED PAYMENT

The Company currently has three stock-based employee and director compensation plans — the Pall Corporation 2012 Stock Compensation Plan, under which the Company may grant stock options, restricted shares, restricted units, performance shares, and performance units; the Management Stock Purchase Plan ("MSPP"); and the Employee Stock Purchase Plan ("ESPP"). These three plans are more fully described in Note 15, Common Stock, to the consolidated financial statements included in the 2014 Form 10-K.

The detailed components of stock-based compensation expense recorded in the condensed consolidated statements of earnings for the three and six months ended January 31, 2015 and January 31, 2014 are reflected in the table below:

	Three Months Ended		Six Months Ended	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Restricted stock units	$5,100	$6,254	$13,323	$10,447
Stock options	1,949	1,965	3,903	3,486
MSPP	1,454	972	2,519	1,164
ESPP	263	273	537	498
	$8,766	$9,464	$20,282	$15,595

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 10 – EARNINGS PER SHARE

The condensed consolidated statements of earnings present basic and diluted earnings per share. Basic earnings per share is determined by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share considers the potential effect of dilution on basic earnings per share assuming potentially dilutive shares that meet certain criteria, such as those issuable upon exercise of stock options, were outstanding. The treasury stock method reduces the dilutive effect of potentially dilutive securities as it assumes that any cash proceeds (from the issuance of potentially dilutive securities) are used to buy back shares at the average share price during the period. Equity awards aggregating 477 and 506 were not included in the computation of diluted shares for the three months ended January 31, 2015 and January 31, 2014, respectively, because their effect would have been antidilutive. For the six months ended January 31, 2015 and January 31, 2014, 190 and 921 antidilutive shares, respectively, were excluded. The following is a reconciliation between basic shares outstanding and diluted shares outstanding:

	Three Months Ended		Six Months Ended	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Basic shares outstanding	107,139	110,720	107,639	111,263
Effect of stock plans	1,368	1,260	1,257	1,269
Diluted shares outstanding	108,507	111,980	108,896	112,532

NOTE 11 – FAIR VALUE MEASUREMENTS

The Company records certain of its financial assets and liabilities at fair value, which is the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date.

The current authoritative guidance discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). Authoritative guidance utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1: Use of observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Use of inputs other than quoted prices included in Level 1, which are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3: Use of inputs that are unobservable.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

The following table presents, for each of these hierarchy levels, the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of January 31, 2015:

	Fair Value Measurements As of Jan 31, 2015	Level 1	Level 2	Level 3
Financial Assets Carried at Fair Value				
Money market funds	$6,951	$6,951	$—	$—
Available-for-sale securities:				
Equity securities	860	860	—	—
Debt securities:				
Corporate	28,898	—	28,898	—
U.S. Treasury	10,663	—	10,663	—
Federal agency	12,591	—	12,591	—
Mortgage-backed	8,218	—	8,218	—
Trading securities	817	817	—	—
Derivative financial instruments:				
Foreign exchange forward contracts	7,893	—	7,893	—
Financial Liabilities Carried at Fair Value				
Derivative financial instruments:				
Foreign exchange forward contracts	3,351	—	3,351	—

The following table presents, for each of these hierarchy levels, the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of July 31, 2014:

	Fair Value Measurements As of Jul 31, 2014	Level 1	Level 2	Level 3
Financial Assets Carried at Fair Value				
Money market funds	$4,860	$4,860	$—	$—
Available-for-sale securities:				
Equity securities	4,748	4,748	—	—
Debt securities:				
Corporate	30,243	—	30,243	—
U.S. Treasury	9,724	—	9,724	—
Federal agency	13,719	—	13,719	—
Mortgage-backed	11,405	—	11,405	—
Trading securities	819	819	—	—
Derivative financial instruments:				
Foreign exchange forward contracts	5,931	—	5,931	—
Financial Liabilities Carried at Fair Value				
Derivative financial instruments:				
Foreign exchange forward contracts	1,726	—	1,726	—

The Company's money market funds and equity securities are valued using quoted market prices and, as such, are classified within Level 1 of the fair value hierarchy.

15

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

The fair value of the Company's investments in debt securities are valued utilizing third party pricing services and verified by management. The pricing services use inputs to determine fair value which are derived from observable market sources including reportable trades, benchmark curves, credit spreads, broker/dealer quotes, bids, offers, and other industry and economic events. These investments are included in Level 2 of the fair value hierarchy.
The fair values of the Company's foreign currency forward contracts are valued using pricing models, with all significant inputs derived from or corroborated by observable market data such as yield curves, currency spot and forward rates, and currency volatilities. These investments are included in Level 2 of the fair value hierarchy.
NOTE 12 – INVESTMENT SECURITIES
The following is a summary of the Company's available-for-sale investment securities by category which are classified within other non-current assets in the Company's condensed consolidated balance sheets. Contractual maturity dates of debt securities held by the benefits protection trusts at January 31, 2015 range from 2015 to 2046.

January 31, 2015	Cost/Amortized Cost Basis	Fair Value	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Net Unrealized Holding Gains/(Losses)
Equity securities	$ 703	$ 860	$ 157	$—	$ 157
Debt securities:					
Corporate	27,843	28,898	1,061	(6)	1,055
U.S. Treasury	10,391	10,663	280	(8)	272
Federal agency	11,716	12,591	875	—	875
Mortgage-backed	8,147	8,218	72	(1)	71
	$ 58,800	$ 61,230	$ 2,445	$ (15)	$ 2,430

July 31, 2014	Cost/Amortized Cost Basis	Fair Value	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Net Unrealized Holding Gains/(Losses)
Equity securities	$ 4,160	$ 4,748	$ 588	$—	$ 588
Debt securities:					
Corporate	28,987	30,243	1,259	(3)	1,256
U.S. Treasury	9,478	9,724	246	—	246
Federal agency	12,778	13,719	941	—	941
Mortgage-backed	11,219	11,405	190	(4)	186
	$ 66,622	$ 69,839	$ 3,224	$ (7)	$ 3,217

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

The following table shows the gross unrealized losses and fair value of the Company's available-for-sale investments with unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

January 31, 2015	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses
Debt securities:						
Corporate	$1,701	$(6)	$—	$—	$1,701	$(6)
U.S. Treasury	906	(8)	—	—	906	(8)
Mortgage-backed	1,381	(1)	—	—	1,381	(1)
	$3,988	$(15)	$—	$—	$3,988	$(15)

July 31, 2014	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses	Fair Value	Gross Unrealized Holding Losses
Debt securities:						
Corporate	$3,384	$(3)	$—	$—	$3,384	$(3)
Mortgage-backed	1,919	(4)	—	—	1,919	(4)
	$5,303	$(7)	$—	$—	$5,303	$(7)

The following table shows the proceeds and gross gains and losses from the sale of available-for-sale and trading investments primarily related to the Company's benefits protection trust for the three and six months ended January 31, 2015 and January 31, 2014:

	Three Months Ended		Six Months Ended	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Proceeds from sales	$17,693	$2,558	$33,749	$3,058
Realized gross gains on sales	515	84	573	84
Realized gross losses on sales	7	99	12	100

The following is a summary of the Company's trading securities by category which are classified within other non-current assets in the Company's condensed consolidated balance sheets.

	Jan 31, 2015	Jul 31, 2014
Equity securities	$817	$819
Total trading securities	$817	$819

The following table shows the net gains and losses recognized on trading securities for the three and six months ended January 31, 2015 and January 31, 2014:

	Three Months Ended		Six Months Ended	
	Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Gains/(losses), net recognized for securities held	$(4)	$7	$(32)	$23
Gains/(losses), net recognized for securities sold	—	—	1	—
Total gains/(losses), net recognized	$(4)	$7	$(31)	$23

17

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 13 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company manages certain financial exposures through a risk management program that includes the use of foreign exchange derivative financial instruments. Derivatives are executed with counterparties with a minimum credit rating of “A” by Standard & Poors and “A2” by Moody’s Investor Services, in accordance with the Company’s policies. The Company does not utilize derivative instruments for trading or speculative purposes. As of January 31, 2015, the Company had foreign currency forward contracts outstanding with notional amounts aggregating $390,756, whose fair values were a net asset of $4,542.

Foreign Exchange Related

a. Derivatives Not Designated as Hedging Instruments

The risk management objective of holding foreign exchange derivatives is to mitigate volatility to earnings and cash flows due to changes in foreign exchange rates. The Company and its subsidiaries conduct transactions in currencies other than their functional currencies. These transactions include non-functional intercompany and external sales as well as intercompany and external purchases. The Company uses foreign exchange forward contracts, matching the notional amounts and durations of the receivables and payables resulting from the aforementioned underlying foreign currency transactions, to mitigate the exposure to earnings and cash flows caused by the changes in fair value of these receivables and payables from fluctuating foreign exchange rates. The notional amount of foreign currency forward contracts not designated as hedging instruments entered into during the three and six months ended January 31, 2015 was $565,333 and $1,387,104, respectively. The notional amount of foreign currency forward contracts outstanding that were not designated as hedging instruments as of January 31, 2015 was $308,896.

b. Cash Flow Hedges

The Company uses foreign exchange forward contracts for cash flow hedging on its future transactional exposure to the Euro due to changes in market rates to exchange Euros for British Pounds. The hedges cover a British subsidiary (British Pound functional) with Euro revenues and a Swiss subsidiary (Euro functional) with British Pound expenses. The probability of the occurrence of these transactions is high and the Company’s assessment is based on observable facts including the frequency and amounts of similar past transactions. The objective of the cash flow hedges is to lock a portion of the British Pound equivalent amount of Euro sales for the British subsidiary and a portion of the Euro equivalent amount of British Pound expenses for the Swiss subsidiary at the agreed upon exchange rates in the foreign exchange forward contracts. The notional amount of foreign currency forward contracts designated as hedging instruments entered into during the three and six months ended January 31, 2015 was $18,975 and $39,404, respectively. The notional amount of foreign currency forward contracts outstanding designated as hedging instruments as of January 31, 2015 was $81,859 and covers certain monthly transactional exposures through February 2016.

c. Net Investment Hedges

The risk management objective of designating the Company’s foreign currency loan as a hedge of a portion of its net investment in a wholly owned Japanese subsidiary is to mitigate the change in the fair value of the Company’s net investment due to changes in foreign exchange rates. The Company uses a JPY loan outstanding to hedge its equity of the same amount in the Japanese wholly owned subsidiary. The hedge of net investment consists of a JPY 9 billion loan.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

The fair values of the Company's derivative financial instruments included in the condensed consolidated balance sheets are presented as follows:

January 31, 2015	Asset Derivatives Balance Sheet Location	Fair Value	Liability Derivatives Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange forward contracts	Other current assets	$5,729	Other current liabilities	$—
Derivatives not designated as hedging instruments				
Foreign exchange forward contracts	Other current assets	$2,164	Other current liabilities	$3,351
Total derivatives		$7,893		$3,351
Nonderivative instruments designated as hedging instruments				
Net investment hedge			Current portion of Long-term debt	$76,086

July 31, 2014	Asset Derivatives Balance Sheet Location	Fair Value	Liability Derivatives Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange forward contracts	Other current assets	$4,755	Other current liabilities	$3
Derivatives not designated as hedging instruments				
Foreign exchange forward contracts	Other current assets	$1,176	Other current liabilities	$1,723
Total derivatives		$5,931		$1,726
Nonderivative instruments designated as hedging instruments				
Net investment hedge			Current portion of Long-term debt	$87,570

The amounts of the gains and losses related to the Company's derivative financial instruments designated as hedging instruments for the three and six months ended January 31, 2015 and January 31, 2014 are presented as follows:

Derivatives in cash flow hedging relationships	Amount of Gain/(Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) (a)	
	Three Months Ended			Three Months Ended	
	Jan 31, 2015	Jan 31, 2014		Jan 31, 2015	Jan 31, 2014
	$3,806	$3,489	Net sales	$560	$113

Foreign exchange forward contracts					
			Cost of sales	847	(46)
Total derivatives	$3,806	$3,489		$1,407	$67

Derivatives in cash flow hedging relationships	Amount of Gain/(Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) (a)	
	Six Months Ended			Six Months Ended	
	Jan 31, 2015	Jan 31, 2014		Jan 31, 2015	Jan 31, 2014
Foreign exchange forward contracts	$4,397	$5,310	Net sales	$1,120	$112
			Cost of sales	1,938	(866)
Total derivatives	$4,397	$5,310		$3,058	$(754)

(a) There were no gains or losses recognized in earnings related to the ineffective portion of the hedging relationship or related to the amount excluded from the assessment of hedge effectiveness for the three and six months ended January 31, 2015 and January 31, 2014.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

The amounts of the gains and losses related to the Company's derivative financial instruments not designated as hedging instruments for the three and six months ended January 31, 2015 and January 31, 2014 are presented as follows:

Derivatives not designated as hedging relationships	Location of Gain/(Loss) Recognized in Earnings on Derivatives	Amount of Gain/(Loss) Recognized in Earnings on Derivatives			
		Three Months Ended		Six Months Ended	
		Jan 31, 2015	Jan 31, 2014	Jan 31, 2015	Jan 31, 2014
Foreign exchange forward contracts	Selling, general and administrative expenses	$(5,910)	$(2,793)	$(10,420)	$(2,343)

The amounts of the gains and losses related to the Company's nonderivative financial instruments designated as hedging instruments for the three and six months ended January 31, 2015 and January 31, 2014 are presented as follows:

Nonderivatives designated as hedging relationships	Amount of Gain/(Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) (b)	
	Three Months Ended			Three Months Ended	
	Jan 31, 2015	Jan 31, 2014		Jan 31, 2015	Jan 31, 2014
Net investment hedge	$6,336	$3,735	N/A	$—	$—

Nonderivatives designated as hedging relationships	Amount of Gain/(Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion) (b)	
	Six Months Ended			Six Months Ended	
	Jan 31, 2015	Jan 31, 2014		Jan 31, 2015	Jan 31, 2014
Net investment hedge	$11,484	$4,176	N/A	$—	$—

(b) There were no gains or losses recognized in earnings related to the ineffective portion of the hedging relationship or related to the amount excluded from the assessment of hedge effectiveness for the three and six months ended January 31, 2015 and January 31, 2014.

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 14 – ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)
Changes in accumulated other comprehensive income/(loss) by component are presented below:

	Foreign Currency Translation	Defined Benefit Pension Plan	Unrealized Investment Gains/(Losses)	Unrealized Gains/(Losses) on Derivatives	Accumulated Other Comprehensive Income/(Loss)
Balance at July 31, 2014	$98,689	$(121,280)	$ 2,880	$ 4,790	$(14,921)
Other comprehensive income/(loss) before reclassifications	(201,212)	—	(259)	3,540	(197,931)
Amounts reclassified from accumulated other comprehensive income/(loss)	—	3,822	(312)	(2,803)	707
Foreign exchange adjustments and other	—	9,741	—	—	9,741
Balance at January 31, 2015	$(102,523)	$(107,717)	$ 2,309	$ 5,527	$(202,404)