

Allison Transmission Holdings Inc  
Form 10-Q  
July 28, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2016**

**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**  
**(State of Incorporation)**

**26-0414014**  
**(I.R.S. Employer**

**Identification Number)**

**One Allison Way**  
**Indianapolis, IN**  
**(Address of Principal Executive Offices)**

**46222**  
**(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  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of July 14, 2016, there were 167,539,470 shares of Common Stock outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****Allison Transmission Holdings, Inc.****Condensed Consolidated Balance Sheets****(unaudited, dollars in millions, except per share data)**

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 364.4	\$ 251.6
Accounts receivable net of allowance for doubtful accounts of \$0.5 and \$0.4, respectively	200.0	195.0
Inventories	150.4	141.4
Other current assets	29.3	28.8
Total Current Assets	744.1	616.8
Property, plant and equipment, net	460.1	479.7
Intangible assets, net	1,288.5	1,334.8
Goodwill	1,941.0	1,941.0
Other non-current assets	29.4	36.1
TOTAL ASSETS	\$ 4,463.1	\$ 4,408.4
<b>LIABILITIES</b>		
Current Liabilities		
Accounts payable	\$ 138.6	\$ 126.2
Product warranty liability	28.4	24.9
Current portion of long-term debt	24.5	24.5
Deferred revenue	24.0	22.9
Other current liabilities	125.3	106.1
Total Current Liabilities	340.8	304.6
Product warranty liability	42.0	53.4
Deferred revenue	60.3	56.4

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Long-term debt	<b>2,343.9</b>	2,352.7
Deferred income taxes	<b>257.6</b>	204.6
Other non-current liabilities	<b>255.8</b>	248.1
<b>TOTAL LIABILITIES</b>	<b>3,300.4</b>	3,219.8
Commitments and contingencies (see NOTE N)		
<b>STOCKHOLDERS EQUITY</b>		
Common stock, \$0.01 par value, 1,880,000,000 shares authorized, 168,058,218 shares issued and outstanding and 171,157,004 shares issued and outstanding, respectively	<b>1.7</b>	1.7
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	<b>1,696.9</b>	1,690.2
Accumulated deficit	<b>(478.6)</b>	(444.5)
Accumulated other comprehensive loss, net of tax	<b>(57.3)</b>	(58.8)
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>1,162.7</b>	1,188.6
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS EQUITY</b>	<b>\$ 4,463.1</b>	\$ 4,408.4

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		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Net sales	\$ 474.9	\$ 511.0	\$ 937.0	\$ 1,014.6
Cost of sales	248.2	274.7	495.2	539.1
<b>Gross profit</b>	<b>226.7</b>	236.3	<b>441.8</b>	475.5
Selling, general and administrative expenses	77.8	75.6	160.4	149.0
Engineering research and development	21.8	23.2	43.6	45.4
Loss associated with impairment of long-lived assets				1.3
<b>Operating income</b>	<b>127.1</b>	137.5	<b>237.8</b>	279.8
Interest income	0.2	0.2	0.4	0.4
Interest expense	(28.0)	(23.3)	(62.3)	(60.4)
Premiums and expenses on tender offer and redemption of long-term debt		(25.1)		(25.1)
Other (expense) income, net	(0.2)	(2.2)	(0.3)	0.6
<b>Income before income taxes</b>	<b>99.1</b>	87.1	<b>175.6</b>	195.3
Income tax expense	(38.3)	(32.7)	(66.5)	(72.5)
<b>Net income</b>	<b>\$ 60.8</b>	\$ 54.4	<b>\$ 109.1</b>	\$ 122.8
<b>Basic earnings per share attributable to common stockholders</b>	<b>\$ 0.36</b>	\$ 0.30	<b>\$ 0.64</b>	\$ 0.68
<b>Diluted earnings per share attributable to common stockholders</b>	<b>\$ 0.36</b>	\$ 0.30	<b>\$ 0.64</b>	\$ 0.68
<b>Dividends declared per common share</b>	<b>\$ 0.15</b>	\$ 0.15	<b>\$ 0.30</b>	\$ 0.30
<b>Comprehensive income, net of tax</b>	<b>\$ 59.7</b>	\$ 55.3	<b>\$ 110.6</b>	\$ 111.8

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

**Table of Contents****Allison Transmission Holdings, Inc.****Condensed Consolidated Statements of Cash Flows****(unaudited, dollars in millions)**

	<b>Six months ended June 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	<b>\$ 109.1</b>	\$ 122.8
Add (deduct) items included in net income not using (providing) cash:		
Deferred income taxes	<b>54.0</b>	67.3
Amortization of intangible assets	<b>46.4</b>	48.6
Depreciation of property, plant and equipment	<b>41.7</b>	43.4
Premiums and expenses on tender offer and redemption of long-term debt		25.1
Excess tax benefit from stock-based compensation	<b>(0.3)</b>	(8.0)
Unrealized loss on derivatives	<b>13.3</b>	6.8
Stock-based compensation	<b>4.3</b>	4.7
Amortization of deferred financing costs	<b>4.0</b>	3.8
Loss associated with impairment of long-lived assets		1.3
Other	<b>2.0</b>	(0.3)
Changes in assets and liabilities:		
Accounts receivable	<b>(3.6)</b>	(23.2)
Inventories	<b>(7.0)</b>	(14.2)
Accounts payable	<b>12.1</b>	(9.1)
Other assets and liabilities	<b>11.9</b>	(26.3)
Net cash provided by operating activities	<b>287.9</b>	242.7
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions of long-lived assets	<b>(22.6)</b>	(14.9)
Proceeds from disposal of assets	<b>0.1</b>	0.2
Net cash used for investing activities	<b>(22.5)</b>	(14.7)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repurchase and redemption of long-term debt		(491.0)
Issuance of long-term debt		470.0
Repurchases of common stock	<b>(92.3)</b>	(114.7)
Payments on long-term debt	<b>(12.2)</b>	(104.6)
Dividend payments	<b>(51.0)</b>	(53.9)
Proceeds from exercise of stock options	<b>2.5</b>	21.8
Excess tax benefit from stock-based compensation	<b>0.3</b>	8.0
Debt financing fees		(7.5)
Taxes paid related to net share settlement of equity awards	<b>(0.3)</b>	(0.5)
Net cash used for financing activities	<b>(153.0)</b>	(272.4)

Effect of exchange rate changes on cash	<b>0.4</b>	(1.8)
Net increase (decrease) in cash and cash equivalents	<b>112.8</b>	(46.2)
Cash and cash equivalents at beginning of period	<b>251.6</b>	263.0
Cash and cash equivalents at end of period	<b>\$ 364.4</b>	\$ 216.8
Supplemental disclosures:		
Interest paid	<b>\$ 43.1</b>	\$ 53.6
Income taxes paid	<b>\$ 7.6</b>	\$ 3.9

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, the Company or we ) 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 ( Old GM ) 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 2,700 employees and 13 different transmission product lines. Although approximately 81% of revenues were generated in North America in 2015, the Company has a global presence by serving customers in Europe, Asia, South America and Africa. The Company serves customers through a 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 Regulations 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 statements 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, 2015 as filed with the Securities and Exchange Commission ( SEC ) on February 19, 2016. The Company revised its condensed consolidated statements of cash flows for the prior period due to changes in how foreign currency exchange rate movements on cash were calculated. The revision resulted in a decrease to the Effect of exchange rate changes on cash with a corresponding increase to Net cash provided by operating activities for the six months ended June 30, 2015. Management believes the revision is immaterial to the condensed consolidated financial statements. The revision had no impact on previously reported net income, total stockholders' equity or cash. The interim period financial results for the three and six 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. Significant 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, 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.

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### ***Recently Issued Accounting Pronouncements***

In March 2016, the Financial Accounting Standards Board ( FASB ) issued authoritative accounting guidance on share-based payment awards to employees. The guidance involves several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the Statement of Cash Flows. The guidance will be effective for the Company in fiscal year 2017, but early adoption is permitted.

In February 2016, the FASB issued authoritative accounting guidance on lease accounting. 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 new guidance also introduces new disclosure requirements for leasing arrangements. The guidance will be effective for the Company in fiscal year 2019, but early adoption is permitted. Management is currently evaluating the impact of this guidance on the Company s consolidated financial statements.

In January 2016, the FASB issued authoritative accounting guidance on the classification of equity securities with readily determinable fair values into different categories (e.g. trading or available-for-sale) and the requirement for equity securities to be measured at fair value with changes in fair value recognized in net income. The guidance will be effective prospectively for the Company in fiscal year 2018 and early adoption is limited to certain provisions. Upon adoption, a cumulative-effect adjustment to retained earnings in the statement of financial position will be reclassified to beginning retained earnings in the year of adoption. Management is currently evaluating the impact of this guidance on the Company s consolidated financial statements.

In July 2015, the FASB issued authoritative accounting guidance to simplify the measurement of inventory. The guidance requires that inventory be measured at the lower of cost and net realizable value. When evidence exists that the net realizable value of inventory is lower than its cost, the difference shall be recognized as a loss in earnings in the period in which it occurs. Inventory measured using last-in, first-out and the retail inventory method are not impacted by the new guidance. The guidance will be effective for the Company in fiscal year 2017, but can be early-adopted. Management is assessing the potential impact of the adoption of this guidance on the Company s consolidated financial statements.

In August 2014, the FASB issued authoritative accounting guidance on the disclosure of uncertainties about an entity s ability to continue as a going concern. The guidance requires management to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that financial statements are available to be issued when applicable) and to provide related footnote disclosures. The guidance became effective prospectively for the Company as of January 1, 2016. The adoption of this guidance did not have an effect on the Company s condensed consolidated financial statements.

In May 2014, the FASB issued authoritative accounting guidance on a company s accounting for revenue from contracts with customers. The guidance applies to all companies that enter into contracts with customers to transfer goods, services or nonfinancial assets. The guidance requires these companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires disclosures regarding the nature, timing, amount and uncertainty of revenue that is recognized. The guidance allows either full or modified retrospective adoption. The guidance will be effective for the Company for the annual and interim periods beginning January 1, 2018. Management is currently evaluating the impact this guidance will have on the Company s revenue

sources including assessing the impact of both methods of adoption on the Company's consolidated financial statements.

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

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Purchased parts and raw materials	\$ 66.0	\$ 69.5
Work in progress	7.2	5.1
Service parts	45.5	45.8
Finished goods	31.7	21.0
<b>Total inventories</b>	<b>\$ 150.4</b>	<b>\$ 141.4</b>

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 J, Other Current Liabilities for more information.

**NOTE D. GOODWILL AND OTHER INTANGIBLE ASSETS**

As of June 30, 2016 and December 31, 2015, the carrying amount of the Company's Goodwill was \$1,941.0 million. The following presents a summary of other intangible assets (dollars in millions):

	<b>June 30, 2016</b>			<b>December 31, 2015</b>		
	<b>Intangible assets, gross</b>	<b>Accumulated amortization</b>	<b>Intangible assets, net</b>	<b>Intangible assets, gross</b>	<b>Accumulated amortization</b>	<b>Intangible assets, net</b>
Other intangible assets:						
Trade name	\$ 790.0	\$	\$ 790.0	\$ 790.0	\$	\$ 790.0
Customer relationships - defense	62.3	(33.0)	29.3	62.3	(31.3)	31.0
Customer relationships - commercial	831.8	(501.7)	330.1	831.8	(477.3)	354.5
Proprietary technology	476.3	(339.1)	137.2	476.3	(320.1)	156.2
Non-compete agreement	17.3	(15.4)	1.9	17.3	(14.6)	2.7
Patented technology - defense	28.2	(28.2)		28.2	(27.9)	0.3
Tooling rights	4.5	(4.5)		4.5	(4.4)	0.1
<b>Total</b>	<b>\$ 2,210.4</b>	<b>\$ (921.9)</b>	<b>\$ 1,288.5</b>	<b>\$ 2,210.4</b>	<b>\$ (875.6)</b>	<b>\$ 1,334.8</b>

As of June 30, 2016 and December 31, 2015, the net carrying value of our Goodwill and other intangibles was \$3,229.5 million and \$3,275.8 million, respectively.

Amortization expense related to other intangible assets for the next five years and thereafter is as follows (dollars in millions):

	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>Thereafter</b>
Amortization expense	\$ 89.7	\$ 87.2	\$ 85.7	\$ 49.9	\$ 44.7	\$ 95.2

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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** Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, listed equities and publicly traded bonds.

**Level 2** Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes financial instruments that are valued using quoted prices in markets that are not active and those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

**Level 3** Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. At each balance sheet date, the Company performs an analysis of all instruments subject to authoritative accounting guidance and includes, in Level 3, all of those whose fair value is based on significant unobservable inputs. As of June 30, 2016 and December 31, 2015, the Company did not have any Level 3 financial assets or liabilities.

The Company's assets and liabilities that are measured at fair value include cash and cash equivalents, available-for-sale securities, derivative instruments, assets held in a rabbi trust and a deferred compensation obligation. The Company's cash equivalents consist of short-term U.S. government backed securities. The Company's available-for-sale securities consist of ordinary shares of Torotrak plc (Torotrak) associated with a license and exclusivity agreement with Torotrak. Torotrak's listed shares are traded on the London Stock Exchange under the ticker symbol TRK. The Company's derivative instruments consist of interest rate swaps and commodity swaps. The Company's assets held in the rabbi trust consist principally of publicly available mutual funds and target date retirement funds. The Company's deferred compensation obligation is directly related to the fair value of assets held in the rabbi trust.

The Company's valuation techniques used to calculate the fair value of cash and cash equivalents, available-for-sale securities, assets held in the rabbi trust and the deferred compensation obligation represent a market approach in active markets for identical assets that qualify as Level 1 in the fair value hierarchy. The Company's valuation techniques

used to calculate the fair value of derivative instruments represent a market approach with observable inputs that qualify as Level 2 in the fair value hierarchy.

The commodity swaps consist of forward rate contracts which are intended to hedge exposure of transactions involving purchases of component parts and energy to power our facilities, reducing the impact of commodity price volatility on the Company's financial results.

For the fair value measurement of commodity derivatives, the Company uses forward prices received from the issuing financial institution. These rates are periodically corroborated by comparing to third-party broker quotes. The commodity derivatives are accounted for within the authoritative accounting guidance set forth on accounting for derivative instruments and hedging activities and have been recorded at fair value based upon quoted market rates. The fair values are included in Other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company has either not qualified for or not elected hedge accounting treatment for these commodity swaps, and as a result, unrealized fair value adjustments and realized gains and losses are recorded in Other expense, net in the Condensed Consolidated Statements of Comprehensive Income.



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For the fair value measurement of interest rate derivatives, the Company uses valuations from the issuing financial institution. The Company corroborates the valuation through the use of third-party valuation services using a standard replacement valuation model. The floating-to-fixed interest rate swaps are based on the London Interbank Offered Rate ( LIBOR ) which is observable at commonly quoted intervals. The fair values are included in other current and non-current assets and liabilities in the Condensed Consolidated Balance Sheets. The Company has not qualified for hedge accounting treatment for the interest rate swaps and, as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income.

The following table summarizes the fair value of the Company's financial assets and (liabilities) as of June 30, 2016 and December 31, 2015 (dollars in millions):

	Fair Value Measurements Using					
	Quoted Prices in Active		Significant Other		TOTAL	
	Markets for Identical		Observable Inputs (Level 2)			
	Assets (Level 1)	Assets (Level 1)	Observable Inputs (Level 2)	Observable Inputs (Level 2)	TOTAL	TOTAL
June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015	
Cash equivalents	\$ 150.1	\$ 100.0	\$	\$	\$ 150.1	\$ 100.0
Available-for-sale securities	2.9	2.9			2.9	2.9
Rabbi trust assets	5.9	4.8			5.9	4.8
Deferred compensation obligation	(5.9)	(4.8)			(5.9)	(4.8)
Derivative assets			0.4		0.4	
Derivative liabilities			(43.8)	(30.1)	(43.8)	(30.1)
<b>Total</b>	<b>\$ 153.0</b>	<b>\$ 102.9</b>	<b>\$ (43.4)</b>	<b>\$ (30.1)</b>	<b>\$ 109.6</b>	<b>\$ 72.8</b>

**Table of Contents****NOTE F. DEBT**

Long-term debt and maturities are as follows (dollars in millions):

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Long-term debt:		
Senior Secured Credit Facility Term B-3 Loan, variable, due 2019	<b>\$ 2,390.6</b>	\$ 2,402.8
Less: current maturities of long-term debt	<b>24.5</b>	24.5
deferred financing costs, net	<b>22.2</b>	25.6
<b>Total long-term debt, net</b>	<b>\$ 2,343.9</b>	<b>\$ 2,352.7</b>

As of June 30, 2016, the Company had \$2,390.6 million of indebtedness associated with Allison Transmission, Inc.'s (ATI), the Company's wholly-owned subsidiary, Senior Secured Credit Facility Term B-3 Loan due 2019 (Term B-3 Loan), and together with the revolving credit facility, defined as the Senior Secured Credit Facility.

The fair value of the Company's long-term debt obligations as of June 30, 2016 was \$2,387.6 million. The fair value is based on quoted Level 2 market prices of the Company's debt as of June 30, 2016. It is not expected that the Company would be able to repurchase a significant amount of its debt at these levels. The difference between the fair value and carrying value of the long-term debt is driven primarily by trends in the financial markets.

The Senior Secured Credit Facility is collateralized by a lien on substantially all assets of the Company including all of ATI's capital stock and all of the capital stock or other equity interest held by the Company, ATI and each of the Company's existing and future U.S. subsidiary guarantors (subject to certain limitations for equity interests of foreign subsidiaries and other exceptions set forth in the terms of the Senior Secured Credit Facility). Interest on the Term B-3 Loan, as of June 30, 2016, is either (a) 2.50% over the LIBOR (which may not be less than 1.00%) or (b) 1.50% over the greater of the prime lending rate provided by the British Banking Association or the federal funds effective rate published by the Federal Reserve Bank of New York. As of June 30, 2016, the interest rate was approximately 3.50% on the Term B-3 Loan. The Senior Secured Credit Facility requires minimum quarterly principal payments on the Term B-3 Loan as well as prepayments from certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events and from a percentage of excess cash flow, if applicable. The minimum required quarterly principal payment on the Term B-3 Loan is \$6.1 million and remains through its maturity date of August 2019. As of June 30, 2016, there had been no payments required for certain net cash proceeds of non-ordinary course asset sales and casualty and condemnation events. The remaining principal balance is due upon maturity.

The Senior Secured Credit Facility also provides for a revolving credit borrowing. As of June 30, 2016, the Company had \$462.4 million available under the revolving credit facility, net of \$2.6 million in letters of credit. Revolving credit borrowings bear interest at a variable base rate plus an applicable margin based on the Company's total leverage ratio. In addition, there is an annual commitment fee, based on the Company's total leverage ratio, on the average unused revolving credit borrowings available under the Senior Secured Credit Facility. Revolving credit borrowings are payable at the option of the Company throughout the term of the Senior Secured Credit Facility with the balance due in January 2019.

The revolving portion of the Senior Secured Credit Facility requires the Company to maintain a specified maximum total senior secured leverage ratio of 5.50x when revolving loan commitments remain outstanding at the end of a fiscal quarter. As of June 30, 2016, the Company had no revolving loans outstanding; however, the Company would have been in compliance with the maximum total senior secured leverage ratio, achieving a 2.98x ratio. Additionally within the terms of the Senior Secured Credit Facility, a senior secured leverage ratio at or below 3.50x results in the elimination of excess cash flow payments on the Senior Secured Credit Facility for the applicable year. The Senior Secured Credit Facility also provides certain financial incentives based on our total leverage ratio. A total leverage ratio at or below 4.00x results in a 25 basis point reduction to the applicable margin on the revolving credit facility, and a total leverage ratio at or below 3.50x results in a 12.5 basis point reduction to the revolving credit facility commitment fee and an additional 25 basis point reduction to the applicable margin on the revolving credit facility. A total leverage ratio at or below 3.25x results in a 25 basis point reduction to the applicable margin on ATI's Term B-3 Loan. These reductions would remain in effect as long as the Company achieves a total leverage ratio at or below the related threshold. As of June 30, 2016, the total leverage ratio was 2.98x.

In addition, the Senior Secured Credit Facility, among other things, includes customary restrictions (subject to certain exceptions) on the Company's ability to incur certain indebtedness, grant certain liens, make certain investments, declare or pay certain dividends, or repurchase shares of the Company's common stock. As of June 30, 2016, the Company is in compliance with all covenants under the Senior Secured Credit Facility.

**Table of Contents****NOTE G. DERIVATIVES**

The Company is exposed to certain financial risk from volatility in interest rates, foreign exchange rates and commodity prices. The risk is managed through the use of financial derivative instruments including interest rate swaps, foreign currency swaps and commodity swaps, when appropriate. The Company's current derivative instruments are used strictly as an economic hedge and not for speculative purposes. As necessary, the Company adjusts the values of the derivative instruments for counter-party or credit risk.

**Interest Rate**

The Company is subject to interest rate risk related to the Senior Secured Credit Facility and enters into interest rate swap contracts that are based on the LIBOR to manage a portion of this exposure. The Company has not elected hedge accounting treatment for these derivatives, and as a result, fair value adjustments are charged directly to Interest expense in the Condensed Consolidated Statements of Comprehensive Income. A summary of the Company's interest rate derivatives as of June 30, 2016 and December 31, 2015 is as follows (dollars in millions):

	June 30, 2016		December 31, 2015	
	Notional Amount	Fair Value	Notional Amount	Fair Value
3.44% Interest Rate Swap L, Aug 2016 Aug 2019*	\$ 75.0	\$ (5.0)	\$ 75.0	\$ (3.6)
3.43% Interest Rate Swap M, Aug 2016 Aug 2019*	100.0	(6.7)	100.0	(4.8)
3.37% Interest Rate Swap N, Aug 2016 Aug 2019*	75.0	(4.9)	75.0	(3.5)
3.19% Interest Rate Swap O, Aug 2016 Aug 2019*	75.0	(4.5)	75.0	(3.1)
3.08% Interest Rate Swap P, Aug 2016 Aug 2019*	75.0	(4.2)	75.0	(2.8)
2.99% Interest Rate Swap Q, Aug 2016 Aug 2019*	50.0	(2.7)	50.0	(1.7)
2.98% Interest Rate Swap R, Aug 2016 Aug 2019*	50.0	(2.7)	50.0	(1.7)
2.73% Interest Rate Swap S, Aug 2016 Aug 2019*	50.0	(2.3)	50.0	(1.4)
2.74% Interest Rate Swap T, Aug 2016 Aug 2019*	75.0	(3.5)	75.0	(2.1)
2.66% Interest Rate Swap U, Aug 2016 Aug 2019*	50.0	(2.2)	50.0	(1.2)
2.60% Interest Rate Swap V, Aug 2016 Aug 2019*	50.0	(2.0)	50.0	(1.2)
2.40% Interest Rate Swap W, Aug 2016 Aug 2019*	25.0	(0.9)	25.0	(0.5)
2.25% Interest Rate Swap X, Aug 2016 Aug 2019*	50.0	(1.6)	50.0	(0.8)
* includes LIBOR floor of 1.00%	\$ 800.0	\$ (43.2)	\$ 800.0	\$ (28.4)

**Commodity**

The Company's business is subject to commodity price risk, primarily with component suppliers. As a result, the Company enters into various commodity swaps that qualify as derivatives under the authoritative accounting guidance to manage certain of these exposures. Swap contracts are used to hedge forecasted transactions either of the commodity or of components containing the commodity. The Company has not qualified for hedge accounting treatment for these commodity swaps, and as a result, unrealized fair value adjustments and realized gains and losses associated with these contracts were charged directly to Other expense, net in the Condensed Consolidated Statements of Comprehensive Income during the period of change.

The following table summarizes the outstanding commodity swaps as of June 30, 2016 and December 31, 2015 (dollars in millions):

	June 30, 2016			December 31, 2015		
	Notional Amount	Quantity	Fair Value	Notional Amount	Quantity	Fair Value
Aluminum	\$ 11.0	6,450 metric tons	\$ (0.3)	\$ 13.7	8,150 metric tons	\$ (1.7)
Natural Gas	\$ 0.7	231,200 MMBtu	0.1	\$ 0.2	70,000 MMBtu	
			\$ (0.2)			\$ (1.7)

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The following tabular disclosures further describe the Company's derivative instruments and their impact on the financial condition of the Company (dollars in millions):

	June 30, 2016		December 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments				
	<b>Other current and non-current assets</b>	\$ 0.4		
Commodity swaps	<b>Other current and non-current liabilities</b>	(0.6)	Other current and non-current liabilities	\$ (1.7)
Interest rate swaps	<b>Other current and non-current liabilities</b>	(43.2)	Other current and non-current liabilities	(28.4)
Total derivatives not designated as hedging instruments		\$ (43.4)		\$ (30.1)

The fair values of the derivatives are recorded between Other current and non-current assets and Other current and non-current liabilities as appropriate in the Condensed Consolidated Balance Sheets. As of June 30, 2016, the amounts recorded to Other current and non-current assets for commodity swaps were \$0.3 million and \$0.1 million, respectively. The amounts recorded to Other current and non-current liabilities for commodity swaps were (\$0.5) million and (\$0.1) million, respectively. The amounts recorded to Other current and non-current liabilities for interest rate swaps were (\$13.2) million and (\$30.0) million, respectively.

As of December 31, 2015, the amounts recorded to Other current and non-current liabilities for commodity swaps were (\$1.1) million and (\$0.6) million, respectively. The amounts recorded to Other current and non-current liabilities for interest rate swaps were (\$3.9) million and (\$24.5) million, respectively.

The following tabular disclosure describes the location and impact on the Company's results of operations related to unrealized (loss) gain on interest rate derivatives (dollars in millions):

	Three months ended		Six months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Location of impact on results of operations				
Interest Expense	\$ (4.2)	\$ 1.1	\$ (14.8)	\$ (7.2)

**NOTE H. PRODUCT WARRANTY LIABILITIES**

As of June 30, 2016, the current and non-current product warranty liabilities were \$28.4 million and \$42.0 million, respectively. As of June 30, 2015, the current and non-current product warranty liabilities were \$21.0 million and \$52.7 million, respectively.

Product warranty liability activities consist of the following (dollars in millions):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Beginning balance	\$ 75.9	\$ 77.1	\$ 78.3	\$ 83.6
Payments	(10.3)	(7.9)	(19.2)	(16.3)
Increase in liability (warranty issued during period)	4.1	5.3	8.4	11.2
Net adjustments to liability	0.5	(0.9)	2.6	(5.0)
Accretion (for predecessor liabilities)	0.2	0.1	0.3	0.2
Ending balance	\$ 70.4	\$ 73.7	\$ 70.4	\$ 73.7

**Table of Contents****NOTE I. DEFERRED REVENUE**

As of June 30, 2016, the current and non-current deferred revenue for Extended Transmission Coverage ( ETC ) were \$24.0 million and \$60.3 million, respectively. As of June 30, 2015, the current and non-current deferred revenue for ETC were \$21.9 million and \$52.8 million, respectively.

Deferred revenue for ETC activity (dollars in millions):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Beginning balance	\$ 80.4	\$ 72.2	\$ 79.3	\$ 69.0
Increases	9.7	8.3	16.3	16.5
Revenue earned	(5.8)	(5.8)	(11.3)	(10.8)
Ending balance	\$ 84.3	\$ 74.7	\$ 84.3	\$ 74.7

**NOTE J. OTHER CURRENT LIABILITIES**

Other current liabilities consist of the following (dollars in millions):

	As of	As of
	June 30,	December 31,
	2016	2015
Payroll and related costs	\$ 32.2	\$ 31.5
Sales allowances	26.1	24.3
Taxes payable	17.4	12.6
Derivative liabilities	13.7	5.0
Vendor buyback obligation	12.9	12.1
Defense price reduction reserve	9.1	8.7
Accrued interest payable	0.7	0.6
Environmental liabilities	0.5	0.5
Other liabilities	12.7	10.8
Total	\$ 125.3	\$ 106.1



**Table of Contents****NOTE K. EMPLOYEE BENEFIT PLANS**

Components of net periodic benefit cost consist of the following (dollars in millions):

	Pension Plans		Post-retirement Benefits	
	Three months ended June 30,		Three months ended June 30,	
	2016	2015	2016	2015
Net periodic benefit cost:				
Service cost	\$ 3.1	\$ 3.6	\$ 0.5	\$ 0.6
Interest cost	1.5	1.3	1.7	1.3
Expected return on assets	(1.7)	(2.1)		
Prior service cost	0.1		(0.9)	(0.9)
Gain				
Net periodic benefit cost	\$ 3.0	\$ 2.8	\$ 1.3	\$ 1.0

	Pension Plans		Post-retirement Benefits	
	Six months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net periodic benefit cost:				
Service cost	\$ 6.2	\$ 7.2	\$ 1.0	\$ 1.2
Interest cost	3.0	2.6	3.3	2.7
Expected return on assets	(3.4)	(4.2)		
Prior service cost	0.1		(1.8)	(1.8)
Gain	(0.1)			
Net periodic benefit cost	\$ 5.8	\$ 5.6	\$ 2.5	\$ 2.1

**NOTE L. INCOME TAXES**

For the three and six months ended June 30, 2016, the Company recorded total tax expense of \$38.3 million and \$66.5 million, respectively. The effective tax rate for the three and six months ended June 30, 2016 and 2015 was 38.6% and 37.9%, respectively. For the three and six months ended June 30, 2015, the Company recorded total tax expense of \$32.7 million and \$72.5 million, respectively. The effective tax rate for the three and six months ended June 30, 2015 was 37.5% and 37.1%, respectively.

The need to establish a valuation allowance against the deferred tax assets is assessed periodically based on a more-likely-than-not realization threshold, in accordance with authoritative accounting guidance. Appropriate consideration is given to all positive and negative evidence related to that realization. This assessment considers, among other matters, the nature, frequency and severity of recent losses, forecasts of future profitability, the duration of statutory carry forward periods, experience with tax attributes expiring unused, and tax planning alternatives. The weight given to these considerations depends upon the degree to which they can be objectively verified.

The Company has determined, based on the evaluation of both objective and subjective evidence available, that a domestic valuation allowance is not necessary and that it is more likely than not that the deferred tax assets are fully realizable. The Company has reached a sustained period of profitability and believes its objectively measured positive evidence outweighs the negative evidence. The Company continues to provide for a valuation allowance on certain of its foreign deferred tax assets.

In accordance with the FASB's authoritative guidance on accounting for uncertainty in income taxes, the Company has recorded a liability for unrecognized tax benefits related to a 2010 Research & Development Credit as of June 30, 2016 and December 31, 2015. The accounting guidance prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. All of the Company's returns will remain subject to examination by the various taxing authorities for the duration of the applicable statute of limitations (generally three years from the later of the date of filing or the due date of the return).

**Table of Contents****NOTE M. ACCUMULATED OTHER COMPREHENSIVE LOSS**

The following tables reconcile changes in Accumulated other comprehensive loss ( AOCL ) by component (net of tax, dollars in millions):

	<b>Three months ended</b>			<b>Total</b>
	<b>Available-for- sale securities</b>	<b>Defined benefit pension items</b>	<b>Foreign currency items</b>	
AOCL as of March 31, 2015	\$ (3.3)	\$ (17.6)	\$ (30.5)	\$ (51.4)
Other comprehensive (loss) income before reclassifications	(0.9)		1.9	1.0
Amounts reclassified from AOCL		(0.9)		(0.9)
Income tax	0.4	0.4		0.8
Net current period other comprehensive (loss) income	\$ (0.5)	\$ (0.5)	\$ 1.9	\$ 0.9
AOCL as of June 30, 2015	\$ (3.8)	\$ (18.1)	\$ (28.6)	\$ (50.5)
AOCL as of March 31, 2016	\$ (5.3)	\$ (20.7)	\$ (30.2)	\$ (56.2)
Other comprehensive loss before reclassifications	(0.7)		(0.1)	(0.8)
Amounts reclassified from AOCL		(0.9)		(0.9)
Income tax	0.2	0.4		0.6
Net current period other comprehensive loss	\$ (0.5)	\$ (0.5)	\$ (0.1)	\$ (1.1)
AOCL as of June 30, 2016	\$ (5.8)	\$ (21.2)	\$ (30.3)	\$ (57.3)

	<b>Six months ended</b>			<b>Total</b>
	<b>Available-for- sale securities</b>	<b>Defined benefit pension items</b>	<b>Foreign currency items</b>	
AOCL as of December 31, 2014	\$ (0.9)	\$ (17.0)	\$ (21.6)	\$ (39.5)
Other comprehensive loss before reclassifications	(4.7)		(7.0)	(11.7)
Amounts reclassified from AOCL		(1.8)		(1.8)
Income tax	1.8	0.7		2.5

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Net current period other comprehensive loss	\$ (2.9)	\$ (1.1)	\$ (7.0)	\$ (11.0)
AOCL as of June 30, 2015	\$ (3.8)	\$ (18.1)	\$ (28.6)	\$ (50.5)
AOCL as of December 31, 2015	\$ (5.7)	\$ (20.0)	\$ (33.1)	\$ (58.8)
Other comprehensive (loss) income before reclassifications	(0.1)		2.8	2.7
Amounts reclassified from AOCL		(1.9)		(1.9)
Income tax		0.7		0.7
Net current period other comprehensive (loss) income	\$ (0.1)	\$ (1.2)	\$ 2.8	\$ 1.5
AOCL as of June 30, 2016	\$ (5.8)	\$ (21.2)	\$ (30.3)	\$ (57.3)

Amounts reclassified from AOCL

AOCL Components	Three months ended June 30, 2016	Three months ended June 30, 2015	Affected line item in the Condensed Consolidated Statements of Comprehensive Income
Amortization of defined benefit pension items:			
Prior service cost	\$ 0.8	\$ 0.8	Cost of sales
		0.1	Selling, general and administrative
Actuarial loss	0.1		Cost of sales
Total reclassifications, before tax	\$ 0.9	0.9	Income before income taxes
Income tax	(0.4)	(0.4)	Tax expense
Total reclassifications	\$ 0.5	\$ 0.5	Net of tax

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AOCL Components	Amounts reclassified from AOCL		Affected line item in the Condensed Consolidated Statements of Comprehensive Income
	Six months ended June 30, 2016	Six months ended June 30, 2015	
Amortization of defined benefit pension items:			
Prior service cost	\$ 1.6	\$ 1.6	Cost of sales
	0.1	0.2	Selling, general and administrative
Actuarial loss	0.2		Cost of sales
Total reclassifications, before tax	\$ 1.9	1.8	Income before income taxes
Income tax	(0.7)	(0.7)	Tax expense
Total reclassifications	\$ 1.2	\$ 1.1	Net of tax

Prior service cost and actuarial loss are included in the computation of the Company's net periodic benefit cost. Please see NOTE K for additional details.

**NOTE N. COMMITMENTS AND CONTINGENCIES*****Environmental Matters***

In accordance with the asset purchase agreement with Old GM, General Motors Company ( GM ), as successor to Old GM's obligations, performed remediation activities relating to historical soil and groundwater contamination at the Company's Indianapolis, Indiana manufacturing facilities (the Corrective Action ) under a voluntary corrective action agreement with the U.S. Environmental Protection Agency ( EPA ). Pursuant to the asset purchase agreement, once the EPA issued a final decision on GM's remediation plan for the Corrective Action, the Company would assume all responsibility for operating, monitoring and maintaining the Corrective Action.

During the third quarter of 2015, the Company recorded approximately \$14.0 million for the estimated undiscounted environmental liabilities related to the Corrective Action, to be paid out over the next 30 years, including approximately \$0.5 million recorded to Other current liabilities and approximately \$13.5 million to Other non-current liabilities. The Company expects to fund the expenditures for these activities from operating cash flow.

During the first quarter of 2016, EPA issued a final decision and the Company assumed all responsibility for the Corrective Action. The EPA also asked the Company to enter into an administrative order of consent that requires the Company to provide financial assurance to complete the operation, monitoring and maintenance in the event the Company fails to do so. This financial assurance can take a variety of forms including, but not limited to meeting certain financial metrics, providing a letter of credit, or securing a bond or an insurance policy. The amount and method by which the Company will be required to provide financial assurance is expected to be determined in 2016.

***Claims, Disputes, and Litigation***

The Company is party to various legal actions and administrative proceedings and subject to various claims arising in the ordinary course of business. These proceedings primarily involve commercial claims, product liability claims, personal injury claims and workers' compensation claims. The Company believes that the ultimate liability, if any, in

excess of amounts already provided for in the condensed consolidated financial statements or covered by insurance on the disposition of these matters will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

Table of Contents**NOTE O. EARNINGS PER SHARE**

The Company presents both basic and diluted earnings per share ( EPS ) amounts. Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted EPS is calculated by dividing net income by the weighted average number of common shares and common equivalent shares outstanding during the reporting period that are calculated using the treasury stock method for stock-based awards. The treasury stock method assumes that the Company uses the proceeds from the exercise of awards to repurchase common stock at the average market price during the period. The assumed proceeds under the treasury stock method include the purchase price that the grantee will pay in the future, compensation cost for future service that the Company has not yet recognized and any tax benefits that would be credited to additional paid-in-capital when the award generates a tax deduction. If there would be a shortfall resulting in a charge to additional paid-in-capital, such an amount would be a reduction of the proceeds to the extent of the gains. The diluted weighted-average common shares outstanding exclude the anti-dilutive effect of certain stock options since such options had an exercise price in excess of the monthly average market value of our common stock. For the three months and six months ended June 30, 2016 and 2015, 0.6 million outstanding anti-dilutive stock options were not included in the diluted EPS calculation because they were anti-dilutive. For the three months and six months ended June 30, 2015, 0.2 million outstanding anti-dilutive stock options were not included in the diluted EPS calculation because they were anti-dilutive.

The following table reconciles the numerators and denominators used to calculate basic EPS and diluted EPS (in millions, except per share data):

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Net income	<b>\$ 60.8</b>	\$ 54.4	<b>\$ 109.1</b>	\$ 122.8
Weighted average shares of common stock outstanding	<b>169.0</b>	178.5	<b>169.8</b>	179.3
Dilutive effect stock-based awards	<b>1.0</b>	1.1	<b>1.0</b>	1.8
Diluted weighted average shares of common stock outstanding	<b>170.0</b>	179.6	<b>170.8</b>	181.1
Basic earnings per share attributable to common stockholders	<b>\$ 0.36</b>	\$ 0.30	<b>\$ 0.64</b>	\$ 0.68
Diluted earnings per share attributable to common stockholders	<b>\$ 0.36</b>	\$ 0.30	<b>\$ 0.64</b>	\$ 0.68

**NOTE P. COMMON STOCK**

The Company's current stock repurchase program was announced on October 30, 2014. The Board authorized management to repurchase up to \$500.0 million of its common stock on the open market or through privately negotiated transactions through December 31, 2016. The timing and amount of stock purchases are subject to market conditions and corporate needs. This stock repurchase program may be extended, modified, suspended or discontinued at any time at the Company's discretion. During the three and six months ended June 30, 2016, the Company repurchased approximately \$59.0 million and \$92.3 million of its common stock under the repurchase program, respectively.





**Table of Contents****ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis is intended to help the reader understand our business, financial condition, results of operations, liquidity and capital resources. You should read this discussion in conjunction with our condensed consolidated interim financial statements and the related notes contained elsewhere in this Quarterly Report on Form 10-Q.*

*The statements in this discussion regarding industry trends, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in Cautionary Note Regarding Forward-Looking Statements and Part II, Item 1A Risk Factors below. Our actual results may differ materially from those contained in or implied by any forward-looking statements.*

**Overview**

Allison Transmission Holdings, Inc. and its subsidiaries (Allison, the Company or we) 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.

We have approximately 2,700 employees and 13 different transmission product lines. Although approximately 81% of revenues were generated in North America in 2015, we have a global presence by serving customers in Europe, Asia, South America and Africa. We serve customers through a network of approximately 1,400 independent distributor and dealer locations worldwide.

**Trends Impacting Our Business**

Our net sales are driven by commercial vehicle production, which tends to be highly correlated to macroeconomic conditions. The 2016 reductions in global Off-Highway, North America On-Highway and Service Parts, Support Equipment and Other end markets net sales are consistent with the previously contemplated impact of low energy and commodity prices and tempering demand conditions in the North America On-Highway end market. We anticipate no meaningful relief from the global Off-Highway end markets challenges and further weakening in North America On-Highway demand.

***Second Quarter Net Sales by End Market (in millions)*****End Market****% Variance**

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	<b>Q2 2016</b>	<b>Q2 2015</b>	
	<b>Net Sales</b>	<b>Net Sales</b>	
North America On-Highway	\$ 264	\$ 277	(5%)
North America Hybrid Propulsion Systems for Transit Bus	16	20	(20%)
North America Off-Highway	1	10	(90%)
Defense	28	29	(3%)
Outside North America On-Highway	74	73	1%
Outside North America Off-Highway	3	8	(63%)
Service Parts, Support Equipment and Other	89	94	(5%)
 Total Net Sales	 \$ 475	 \$ 511	 (7%)

North America On-Highway end market net sales were down 5% for the second quarter 2016 compared to the second quarter 2015, principally driven by lower demand for Highway Series and Rugged Duty Series models, partially offset by higher demand for Pupil Transport/Shuttle Series models.

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North America Hybrid-Propulsion Systems for Transit Bus end market net sales were down 20% for the second quarter 2016 compared to the second quarter 2015, principally driven by lower demand due to engine emissions improvements and non-hybrid alternatives.

North America Off-Highway end market net sales were down 90% for the second quarter 2016 compared to the second quarter of 2015, principally driven by lower demand from hydraulic fracturing applications.

Defense end market net sales were down 3% for the second quarter 2016 compared to the second quarter 2015, principally driven by lower demand for Tracked Defense, partially offset by higher demand for Wheeled Defense.

Outside North America On-Highway end market net sales were up 1% for the second quarter 2016 compared to the second quarter 2015, principally driven by higher demand in Europe, partially offset by lower demand in China and India.

Outside North America Off-Highway end market net sales were down 63% for the second quarter 2016 compared to the second quarter 2015, principally driven by lower demand in the energy and mining sectors.

Service parts, support equipment and other end market net sales were down 5% for the second quarter 2016 compared to the second quarter 2015, principally driven by lower demand for global Off-Highway service parts and North America support equipment.

## **Key Components of our Results of Operations**

### ***Net sales***

We generate our net sales primarily from the sale of transmissions, transmission parts, support equipment, defense kits, engineering services, royalties and Extended Transmission Coverage to a wide array of original equipment manufacturers, distributors and the U.S. government. Sales are recorded net of provisions for customer allowances and other rebates. Engineering services are recorded as net sales in accordance with the terms of the contract. The associated costs are recorded in cost of sales. We also have royalty agreements with third parties that provide net sales as a result of joint efforts in developing marketable products.

### ***Cost of sales***

Our primary components of cost of sales are purchased parts, the overhead expense related to our manufacturing operations and direct labor associated with the manufacture and assembly of transmissions and parts. For the six months ended June 30, 2016, direct material costs were approximately 68%, overhead costs were approximately 25%, and direct labor costs were approximately 7% of total cost of sales. We are subject to changes in our cost of sales caused by movements in underlying commodity prices. We seek to hedge against this risk by using commodity swap contracts and long-term supply agreements ( LTSA's ). See Part I, Item 3 Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk included below.

### ***Selling, general and administrative expenses***

The principal components of our selling, general and administrative expenses are salaries and benefits for our office personnel, advertising and promotional expenses, product warranty expense, expenses relating to certain information technology systems and amortization of our intangibles.

***Engineering research and development***

We incur costs in connection with research and development programs that are expected to contribute to future earnings. Such costs are expensed as incurred.

**Table of Contents****Non-GAAP Financial Measures**

We use Adjusted EBITDA and Adjusted EBITDA margin to measure our operating profitability. We believe that Adjusted EBITDA and Adjusted EBITDA margin provide management, investors and creditors with useful measures of the operational results of our business and increase the period-to-period comparability of our operating profitability and comparability with other companies. Adjusted EBITDA margin is also used in the calculation of management's incentive compensation program. The most directly comparable U.S. generally accepted accounting principles (GAAP) measure to Adjusted EBITDA is Net income. Adjusted EBITDA is calculated as the earnings before interest expense, income tax expense, amortization of intangible assets, depreciation of property, plant and equipment and other adjustments as defined by our debt agreement. Adjusted EBITDA margin is calculated as Adjusted EBITDA divided by net sales.

We use Adjusted free cash flow to evaluate the amount of cash generated by our business that, after the capital investment needed to maintain and grow our business, can be used for repayment of debt, shareholder distributions and strategic opportunities, including investing in our business and strengthening our balance sheet. We believe that Adjusted free cash flow enhances the understanding of the cash flows of our business for management, investors and creditors. Adjusted free cash flow is also used in the calculation of management's incentive compensation program. The most directly comparable GAAP measure to Adjusted free cash flow is Net cash provided by operating activities.

The following is a reconciliation of Net income to Adjusted EBITDA and Adjusted EBITDA margin, and a reconciliation of Net cash provided by operating activities to Adjusted free cash flow:

<i>(unaudited, in millions)</i>	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
<b>Net income (GAAP)</b>	<b>\$ 60.8</b>	<b>\$ 54.4</b>	<b>\$ 109.1</b>	<b>\$ 122.8</b>
plus:				
Interest expense, net	27.8	23.1	61.9	60.0
Income tax expense	38.3	32.7	66.5	72.5
Amortization of intangible assets	23.0	24.3	46.4	48.6
Depreciation of property, plant and equipment	21.0	22.0	41.7	43.4
Stock-based compensation expense (a)	2.1	2.6	4.3	4.7
Stockholder activism expenses (b)	0.1		3.7	
Unrealized loss (gain) on foreign exchange (c)	1.2	1.1	1.8	(1.2)
Dual power inverter module units extended coverage (d)			1.5	(1.8)
Unrealized (gain) loss on commodity hedge contracts (e)	(1.0)	0.2	(1.5)	
Premiums and expenses on tender offer and redemption of long-term debt (f)		25.1		25.1
Loss associated with impairment of long-lived assets (g)				1.3
Loss on repayments of long-term debt (h)				0.2
<b>Adjusted EBITDA (Non-GAAP)</b>	<b>\$ 173.3</b>	<b>\$ 185.5</b>	<b>\$ 335.4</b>	<b>\$ 375.6</b>

<b>Net sales (GAAP)</b>	<b>\$ 474.9</b>	\$ 511.0	<b>\$ 937.0</b>	\$ 1,014.6
<b>Adjusted EBITDA margin (Non-GAAP)</b>	<b>36.5%</b>	36.3%	<b>35.8%</b>	37.0%
<b>Net cash provided by operating activities (GAAP)</b>	<b>\$ 170.0</b>	\$ 151.7	<b>\$ 287.9</b>	\$ 242.7
(Deductions) or additions to reconcile to Adjusted free cash flow:				
Additions of long-lived assets	<b>(16.2)</b>	(13.6)	<b>(22.6)</b>	(14.9)
Stockholder activism expenses (b)	<b>2.6</b>		<b>3.6</b>	
Excess tax benefit from stock-based compensation (i)	<b>0.3</b>	0.2	<b>0.3</b>	8.0
<b>Adjusted free cash flow (Non-GAAP)</b>	<b>\$ 156.7</b>	\$ 138.3	<b>\$ 269.2</b>	\$ 235.8

- (a) Represents stock-based compensation expense (recorded in Cost of sales, Selling, general and administrative expenses, and Engineering research and development).
- (b) Represents expenses of \$0.1 million and \$3.7 million (recorded in Selling, general and administrative expenses) for the three months and six months ended June 30, 2016, respectively, and payments of \$2.6 million and \$3.6 million for the three months and six months ended June 30, 2016, respectively, directly associated with stockholder activism activity including the notice, and subsequent withdrawal, of director nomination and governance proposals by Ashe Capital Management, LP.
- (c) Represents losses (gains) (recorded in Other (expense) income, net) on the mark-to-market of our foreign currency hedge contracts and on intercompany financing transactions related to investments in plant assets for our India facility.

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- (d) Represents an adjustment (recorded in Selling, general and administrative expenses) associated with the Dual Power Inverter Module ( DPIM ) extended coverage program liability. The DPIM liability will continue to be reviewed for any changes in estimates as additional claims data and field information become available.
- (e) Represents unrealized (gains) losses (recorded in Other (expense) income, net) on the mark-to-market of our commodity hedge contracts.
- (f) Represents premiums and expenses related to the tender offer and redemption of Allison Transmission, Inc. s ( ATI ), our wholly owned subsidiary, 7.125% Senior Notes due 2019.
- (g) Represents a charge associated with the impairment of long-lived assets related to the production of the H3000 and H4000 hybrid-propulsion systems.
- (h) Represents losses (recorded in Other (expense) income, net) realized on the repayments of ATI s long-term debt.
- (i) Represents the amount of tax benefit (recorded in Income tax expense) related to stock-based compensation adjusted from cash flows from operating activities to cash flows from financing activities.

**Table of Contents****Results of Operations****Comparison of three months ended June 30, 2016 and 2015**

The following table sets forth certain financial information for the three months ended June 30, 2016 and 2015. The following table and discussion should be read in conjunction with the information contained in our condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

<i>(unaudited, dollars in millions)</i>	Three months ended June 30,			
	2016	% of net sales	2015	% of net sales
Net sales	\$ 474.9	100%	\$ 511.0	100%
Cost of sales	248.2	52	274.7	54
Gross profit	226.7	48	236.3	46
Operating expenses:				
Selling, general and administrative expenses	77.8	16	75.6	15
Engineering research and development	21.8	5	23.2	4
Total operating expenses	99.6	21	98.8	19
Operating income	127.1	27	137.5	27
Interest expense, net	(27.8)	(6)	(23.1)	(5)
Premiums and expenses on tender offer and redemption of long-term debt			(25.1)	(5)
Other expense, net	(0.2)		(2.2)	
Income before income taxes	99.1	21	87.1	17
Income tax expense	(38.3)	(8)	(32.7)	(6)
Net income	\$ 60.8	13%	\$ 54.4	11%

**Net sales**

Net sales for the quarter ended June 30, 2016 were \$474.9 million compared to \$511.0 million for the quarter ended June 30, 2015, a decrease of 7%. The decrease was principally driven by a \$13.0 million, or 5%, decrease in net sales of North America On-Highway commercial products driven by lower demand for Highway Series and Rugged Duty Series models partially offset by higher demand for Pupil Transport/Shuttle Series models, a \$9.0 million, or 90%, decrease in net sales of North America Off-Highway products driven by lower demand from hydraulic fracturing applications, a \$5 million, or 63%, decrease in net sales of Outside North America Off-Highway products driven by lower demand in the energy and mining sectors, a \$5.0 million, or 5%, decrease in net sales of parts and other products driven by lower demand for global Off-Highway service parts and North America support equipment, a \$4.0 million, or 20%, decrease in net sales of North America hybrid-propulsion systems for transit buses driven by lower demand due to engine emissions improvements and non-hybrid alternatives and a \$1.0 million, or 3%, decrease in net sales of defense products principally driven by lower demand for Tracked Defense partially offset by higher demand



for Wheeled Defense, partially offset by a \$1.0 million, or 1%, increase in net sales of Outside North America On-Highway products driven by higher demand in Europe partially offset by lower demand in China and India.

***Cost of sales***

Cost of sales for the quarter ended June 30, 2016 was \$248.2 million compared to \$274.7 million for the quarter ended June 30, 2015, a decrease of 10%. The decrease was principally driven by decreased direct material costs commensurate with decreased net sales, \$6.0 million of lower manufacturing expense commensurate with decreased net sales, \$2.0 million of favorable direct material costs and consistent with historical trends and management's expectations given the respective change in sales volume.

***Gross profit***

Gross profit for the quarter ended June 30, 2016 was \$226.7 million compared to \$236.3 million for the quarter ended June 30, 2015, a decrease of 4%. The decrease was principally driven by \$20.0 million related to decreased net sales, partially offset by \$6.0 million of lower manufacturing expense commensurate with decreased net sales, \$2.0 million of favorable direct material costs and \$2.0 million of price increases on certain products. Gross profit as a percent of net sales for the quarter was higher than for the same period in 2015 principally driven by favorable direct material costs and price increases on certain products.

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**Table of Contents*****Selling, general and administrative expense***

Selling, general and administrative expenses for the quarter ended June 30, 2016 were \$77.8 million compared to \$75.6 million for the quarter ended June 30, 2015, an increase of 3%. The increase was principally driven by \$3.4 million of favorable 2015 product warranty adjustments, partially offset by \$1.3 million of lower intangible asset amortization.

***Engineering research and development***

Engineering expenses for the quarter ended June 30, 2016 were \$21.8 million compared to \$23.2 million for the quarter ended June 30, 2015, a decrease of 6%. The decrease was principally driven by decreased product initiatives spending.

***Interest expense, net***

Interest expense, net for the quarter ended June 30, 2016 was \$27.8 million compared to \$23.1 million for the quarter ended June 30, 2015, an increase of 20%. The increase was principally driven by \$5.3 million of unfavorable mark-to-market adjustments for our interest rate derivatives, \$1.4 million of higher interest expense as a result of the addition of \$470.0 million to ATI's Senior Secured Credit Facility Term B-3 Loan due 2019 (the "Term B-3 Loan"), and together with the revolving credit facility, defined as the "Senior Secured Credit Facility") during the second quarter of 2015, partially offset by \$0.9 million of lower interest expense as a result of the repurchase and redemption of ATI's 7.125% senior cash pay notes due May 2019 ("7.125% Senior Notes") during the second quarter of 2015, \$1.0 million of lower interest expense as a result of debt repayments and \$0.1 million of lower amortization of deferred financing charges.

***Premiums and expenses on tender offer and redemption of long-term debt***

In April 2015, we completed a cash tender offer to purchase any and all of the outstanding 7.125% Senior Notes. The tender offer resulted in the repurchase of \$420.9 million of the 7.125% Senior Notes in April 2015. In May 2015, we redeemed the remaining \$50.4 million of the outstanding 7.125% Senior Notes, resulting in premiums and expenses totaling \$25.1 million for the second quarter of 2015.

***Other expense, net***

Other expense, net for the quarter ended June 30, 2016 was \$0.2 million compared to \$2.2 million for the quarter ended June 30, 2015. The decrease in other expense, net was principally driven by \$1.0 million of unrealized gains on derivative contracts, \$0.2 million of lower realized losses on derivative contracts, \$0.2 million of unfavorable 2015 foreign exchange and lower miscellaneous expenses.

***Income tax expense***

Income tax expense for the quarter ended June 30, 2016 was \$38.3 million resulting in an effective tax rate of 38.6% versus an effective tax rate of 37.5% for the quarter ended June 30, 2015. The increase in income tax expense was principally driven by an increase in estimated taxable income for certain foreign entities.

**Table of Contents****Comparison of six months ended June 30, 2016 and 2015**

The following table sets forth certain financial information for the six months ended June 30, 2016 and 2015. The following table and discussion should be read in conjunction with the information contained in our condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

<i>(unaudited, dollars in millions)</i>	Six months ended June 30,			
	2016	% of net sales	2015	% of net sales
Net sales	\$ 937.0	100%	\$ 1,014.6	100%
Cost of sales	495.2	53	539.1	53
Gross profit	441.8	47	475.5	47
Operating expenses:				
Selling, general and administrative expenses	160.4	17	149.0	15
Engineering research and development	43.6	5	45.4	5
Loss associated with impairment of long-lived assets			1.3	
Total operating expenses	204.0	22	195.7	20
Operating income	237.8	25	279.8	27
Interest expense, net	(61.9)	(6)	(60.0)	(6)
Premiums and expenses on tender offer and redemption of long-term debt			(25.1)	(2)
Other (expense) income, net	(0.3)		0.6	
Income before income taxes	175.6	19	195.3	19
Income tax expense	(66.5)	(7)	(72.5)	(7)
Net income	\$ 109.1	12%	\$ 122.8	12%

**Net sales**

Net sales for the six months ended June 30, 2016 were \$937.0 million compared to \$1,014.6 million for the six months ended June 30, 2015, a decrease of 8%. The decrease was principally driven by a \$26.0 million, or 81%, decrease in net sales of North American Off-Highway products driven by lower demand from hydraulic fracturing applications, a \$24.0 million, or 4%, decrease in net sales of North America On-Highway commercial products driven by lower demand from Rugged Duty Series and Highway Series models partially offset by higher demand for Pupil Transport/Shuttle Series models, an \$18.0 million, or 75%, decrease in net sales of Outside North America Off-Highway products driven by lower demand from the energy and mining sectors, an \$18.0 million, or 9%, decrease in net sales of parts and other products driven by lower demand for global Off-Highway service parts partially offset by higher demand for global On-Highway service parts, a \$5.0 million, or 13%, decrease in net sales of North America hybrid-propulsion systems for transit buses driven by lower demand due to engine emissions improvements and non-hybrid alternatives and a \$1.0 million, or 2%, decrease in net sales of defense products principally driven by

lower demand for Tracked Defense partially offset by higher demand for Wheeled Defense, partially offset by a \$14.0 million, or 11%, increase in net sales of Outside North America On-Highway products driven by higher demand in Europe and Japan partially offset by lower demand in China and India.

***Cost of sales***

Cost of sales for six months ended June 30, 2016 was \$495.2 million compared to \$539.1 million for six months ended June 30, 2015, a decrease of 8%. The decrease was principally driven by decreased direct material costs commensurate with decreased sales, \$10.0 million of lower manufacturing cost commensurate with decreased sales, \$7.0 million of favorable direct material costs and consistent with historical trends and management's expectations given the respective change in sales volume.

***Gross profit***

Gross profit for the six months ended June 30, 2016 was \$441.8 million compared to \$475.5 million for the six months ended June 30, 2015, a decrease of 7%. The decrease was principally driven by \$53.0 million related to decreased net sales, partially offset by \$10.0 million of lower manufacturing expense commensurate with decreased net sales, \$7.0 million of favorable direct material costs and \$2.0 million of price increases on certain products. Gross profit as a percent of net sales for the six months was higher than for the same period in 2015 principally driven by favorable direct material costs and price increases on certain products.

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**Table of Contents*****Selling, general and administrative expenses***

Selling, general and administrative expenses for the six months ended June 30, 2016 were \$160.4 million compared to \$149.0 million for the six months ended June 30, 2015, an increase of 8%. The increase was principally driven by \$6.4 million of favorable 2015 product warranty adjustments, \$3.6 million of stockholder activism expenses and \$3.3 million of unfavorable adjustments related to the DPIM extended coverage program, partially offset by \$2.2 million of lower intangible asset amortization and reduced global commercial spending activities.

***Engineering research and development***

Engineering expenses for the six months ended June 30, 2016 were \$43.6 million compared to \$45.4 million for the six months ended June 30, 2015, a decrease of 4%. The decrease was principally driven by decreased product initiatives spending.

***Loss associated with impairment of long-lived assets***

During the first quarter of 2015, we recorded an approximately \$1.3 million impairment loss associated with the production of the H3000 and H4000 hybrid-propulsion systems. The loss included \$1.0 million of accrued expenses and a \$0.3 million impairment of long-lived assets.

***Interest expense, net***

Interest expense, net for the six months ended June 30, 2016 was \$61.9 million compared to \$60.0 million for the six months ended June 30, 2015, an increase of 3%. The increase was principally driven by \$7.6 million of unfavorable mark-to-market adjustments for our interest rate derivatives, \$5.5 million of higher interest expense as a result of the addition of \$470.0 million to ATI's Term B-3 Loan during the second quarter of 2015, partially offset by \$9.3 million of lower interest expense as a result of the repurchase and redemption of our 7.125% Senior Notes in the second quarter of 2015, \$1.5 million of lower interest expense as a result of debt repayments and \$0.3 million of lower amortization of deferred financing charges.

***Premiums and expenses on tender offer and redemption of long-term debt***

In April 2015, we completed a cash tender offer to purchase any and all of the outstanding 7.125% Senior Notes. The tender offer resulted in the repurchase of \$420.9 million of the 7.125% Senior Notes in April 2015. In May 2015, we redeemed the remaining \$50.4 million of the outstanding 7.125% Senior Notes, resulting in premiums and expenses totaling \$25.1 million for the second quarter of 2015.

***Other (expense) income, net***

Other (expense) income, net for the six months ended June 30, 2016 was (\$0.3) million compared to \$0.6 million for the six months ended June 30, 2015. The change in other (expense) income, net was principally driven by \$2.7 million of higher foreign exchange losses on intercompany financing and \$0.5 million of lower favorable foreign exchange, partially offset by \$1.2 million of unrealized gains on derivative contracts, a \$0.2 million loss on 2015 debt repayments and lower miscellaneous expenses.

***Income tax expense***

Income tax expense for the six months ended June 30, 2016 was \$66.5 million resulting in an effective tax rate of 37.9% versus an effective tax rate of 37.1% for the six months ended June 30, 2015. The increase in income tax expense was principally driven by an increase in estimated taxable income for certain foreign entities.

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**Table of Contents****Liquidity and Capital Resources**

We generate cash primarily from our operating activities to fund our operating, investing and financing activities. Our principal uses of cash are operating expenses, capital expenditures, debt service, stock repurchases, dividends on common stock and working capital needs. We had total available cash and cash equivalents of \$364.4 million and \$251.6 million as of June 30, 2016 and December 31, 2015, respectively. Of the available cash and cash equivalents, approximately \$214.3 million and \$151.6 million were deposited in operating accounts while approximately \$150.1 million and \$100.0 million were invested in U.S. government backed securities as of June 30, 2016 and December 31, 2015, respectively.

As of June 30, 2016, the total of cash and cash equivalents held by foreign subsidiaries was \$45.5 million, the majority of which was located in Europe and China. The geographic location of our cash aligns with our business growth strategy. We manage our worldwide cash requirements considering available funds among the subsidiaries through which we conduct our business and the cost effectiveness with which those funds can be accessed. As a result, we do not anticipate any local liquidity restrictions to preclude us from funding our targeted expectations or operating needs with local resources.

If we distribute our foreign cash balance to the U.S. or to other foreign subsidiaries, we could be required to accrue and pay U.S. taxes. For example, we would be required to accrue and pay additional U.S. taxes if we repatriate earnings from certain foreign subsidiaries whose earnings we have asserted are permanently reinvested outside of the U.S. Foreign earnings for which we assert permanent reinvestment outside the U.S. consists primarily of earnings of our Europe and China subsidiaries. We currently do not foresee a need to repatriate any earnings from these subsidiaries for which we have asserted permanent reinvestment.

Our liquidity requirements are significant, primarily due to our debt service requirements. As of June 30, 2016, we had \$2,390.6 million of indebtedness associated with ATI's Term B-3 Loan.

Our ability to make payments on and to refinance our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future. This is subject to general economic, financial, competitive, legislative, regulatory and other factors that may be beyond our control. We made principal payments of \$6.1 million and \$12.2 million on the Senior Secured Credit Facility for the three and six months ended June 30, 2016, respectively. We made principal payments of \$52.9 million and \$104.6 million on the Senior Secured Credit Facility for the three months and six months ended June 30, 2015, respectively.

The Senior Secured Credit Facility also provides for \$465.0 million in revolving credit borrowings, net of an allowance for up to \$75.0 million in outstanding letters of credit commitments. As of June 30, 2016, we had \$462.4 million available under the revolving credit facility, net of \$2.6 million in letters of credit. Additionally within the terms of the Senior Secured Credit Facility, a senior secured leverage ratio at or below 3.50x results in the elimination of excess cash flow payments on the Senior Secured Credit Facility for the applicable year. The Senior Secured Credit Facility provides certain financial incentives based on our total leverage ratio. A total leverage ratio at or below 4.00x results in a 25 basis point reduction to the applicable margin on our revolving credit facility, and a total leverage ratio at or below 3.50x results in a 12.5 basis point reduction to the revolving credit facility commitment fee and an additional 25 basis point reduction to the applicable margin on our revolving credit facility. A total leverage ratio at or below 3.25x results in a 25 basis point reduction to the applicable margin on ATI's Term B-3 Loan. These reductions would remain in effect as long as we achieve a total leverage ratio at or below the related threshold. As of June 30, 2016, the total leverage ratio was 2.98x.

In addition to the maximum total senior secured leverage ratio for the revolving portion of the Senior Secured Credit Facility, the Senior Secured Credit Facility includes, among other things, customary restrictions (subject to certain exceptions) on our ability to incur certain indebtedness or liens, make certain investments, declare or pay certain dividends, or repurchase shares of our common stock. As of June 30, 2016, we are in compliance with all covenants under the Senior Secured Credit Facility.

Our credit ratings are reviewed regularly by major debt ratings agencies such as Standard and Poor's, Moody's Investors Service and Fitch Ratings. In March 2015, Standard and Poor's raised our corporate rating to BB from BB- and assigned BB+ to the incremental Term B-3 Loan. Also in March 2015, Moody's raised our corporate rating to Ba2 from Ba3 and assigned Ba2 to the incremental Term B-3 Loan. In August 2015, Fitch ratings assigned BB to the incremental Term B-3 Loan and raised our corporate rating to BB+ from BB.

On October 30, 2014, our Board of Directors authorized us to purchase up to \$500.0 million of our common stock under a stock repurchase program. For the three and six months ended June 30, 2016, we repurchased approximately \$59.0 million and \$92.3 million, respectively, of our common stock under the repurchase program.



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The following table shows our sources and uses of funds for the six months ended June 30, 2016 and 2015 (in millions):

<i>Statements of Cash Flows Data</i>	<b>Six months ended</b>	
	<b>June,</b>	
	<b>2016</b>	<b>2015</b>
Cash flows from operating activities	<b>\$ 287.9</b>	\$ 242.7
Cash flows used for investing activities	<b>\$ (22.5)</b>	\$ (14.7)
Cash flows used for financing activities	<b>\$ (153.0)</b>	\$ (272.4)

Generally, cash provided by operating activities has been adequate to fund our operations. Due to fluctuations in our cash flows and the growth in our operations, it may be necessary from time to time in the future to borrow under the Senior Secured Credit Facility to meet cash demands. We anticipate cash provided by operating activities, cash and cash equivalents and borrowing capacity under the Senior Secured Credit Facility will be sufficient to meet our cash requirements for the next twelve months.

We continue to utilize net operating loss carryforwards for U.S. federal income tax purposes. If we continue to generate taxable income, we expect to utilize the remaining U.S. federal net operating loss carryforwards by as early as the end of 2016.

***Cash provided by operating activities***

Operating activities for the six months ended June 30, 2016 generated \$287.9 million of cash compared to \$242.7 million for the six months ended June 30, 2015. The increase was principally driven by higher accounts payable, lower accounts receivable commensurate with decreased net sales, lower inventories, lower incentive compensation payments, decreased excess tax benefit from stock-based compensation, lower interest expense as a result of debt repayments and refinancing, favorable direct material costs and higher other liabilities, net, partially offset by decreased net sales.

***Cash used for investing activities***

Investing activities for the six months ended June 30, 2016 used \$22.5 million of cash compared to \$14.7 million for the six months ended June 30, 2015. The increase was principally driven by an increase of \$7.7 million in capital expenditures. The increase in capital expenditures was principally driven by higher product initiatives spending and intra-year movement in the timing of spending related to investments in productivity and replacement programs.

***Cash used for financing activities***

Financing activities for the six months ended June 30, 2016 used \$153.0 million of cash compared to \$272.4 million for the six months ended June 30, 2015. The decrease was principally driven by \$113.4 million of decreased payments on long-term debt, \$22.4 million of lower stock repurchases, \$7.5 million of decreased debt financing fees associated with our amendment to our Senior Secured Credit Facility in the second quarter of 2015 and \$2.9 million of decreased dividend payments, partially offset by \$19.3 million of decreased proceeds from the exercise of stock options and \$7.7 million of decreased excess tax benefit from stock-based compensation.



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### **Contingencies**

We are a party to various legal actions and administrative proceedings and subject to various claims arising in the ordinary course of business, including those relating to commercial transactions, product liability, personal injury and workers' compensation, safety, health, taxes, environmental and other matters. For more information, see NOTE N of our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

### **Critical Accounting Policies and Significant Accounting Estimates**

A discussion of our critical accounting policies and significant accounting estimates are described in Part II, Item 7 Management's Discussion and Analysis section in our Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the Securities and Exchange Commission on February 19, 2016. The preparation of the condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of some assets and liabilities and, in some instances, the reported amounts of revenues and expenses during the applicable reporting period. 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. Within the context of these critical accounting estimates, we are not currently aware of any reasonably likely events or circumstances that would result in different policies or estimates being reported for the six months ended June 30, 2016.

### **Off-Balance Sheet Arrangements**

We are not a party to any off-balance sheet arrangements.

### **Recently Issued Accounting Pronouncements**

Refer to NOTE B, Summary of Significant Accounting Policies in Part I, Item 1, of this Quarterly Report on Form 10-Q.

### **Cautionary Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements. The words "believe," "expect," "anticipate," "intend," "estimate" and other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters identify forward-looking statements. You should not place undue reliance on these forward-looking statements. Although forward-looking statements reflect management's good faith beliefs, reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements speak only as of the date the statements are made. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changed circumstances or otherwise. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to: our participation in markets that are competitive; the highly cyclical industries in which certain of our end users operate; general economic and industry conditions; the failure of markets outside North America to increase adoption of fully-automatic transmissions; the concentration of our net sales in our top five customers and the loss of any one of these; future reductions or changes in government subsidies and other external factors impacting demand for hybrid vehicles; U.S. defense spending; the discovery of defects in our products, resulting in delays in new model launches, recall campaigns and/or increased warranty costs and reduction in future sales or damage to our brand and reputation; brand and reputational risks; our ability to prepare for, respond to and

successfully achieve our objectives relating to technological and market developments and changing customer needs; risks associated with our international operations; labor strikes, work stoppages or similar labor disputes, which could significantly disrupt our operations or those of our principal customers; risks related to our substantial indebtedness; and our intention to pay dividends and repurchase shares of our common stock.

Important factors that could cause actual results to differ materially from our expectations are disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the Securities and Exchange Commission on February 19, 2016. All written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements as well as other cautionary statements that are made from time to time in our public communications. You should evaluate all forward-looking statements made in this Quarterly Report on Form 10-Q in the context of these risks and uncertainties.

**Table of Contents****ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

Our exposure to market risk consists of changes in interest rates, foreign currency rate fluctuations and movements in commodity prices.

***Interest Rate Risk***

We are subject to interest rate market risk in connection with our long-term debt. Our principal interest rate exposure relates to outstanding amounts under our Senior Secured Credit Facility. As of June 30, 2016, our Senior Secured Credit Facility provides for variable rate borrowings of up to \$2,853.0 million including \$462.4 million under our revolving credit facility, net of \$2.6 million of letters of credit. A one-eighth percent change in assumed interest rates for the Senior Secured Credit Facility, if fully drawn, as of June 30, 2016 would have an impact of approximately \$0.6 million on interest expense with the 1.00% LIBOR floor in effect on our Term B-3 Loan. Should LIBOR exceed 1.00%, a one-eighth percent change in assumed interest rates for the Senior Secured Credit Facility, if fully drawn, as of June 30, 2016 would have an impact of approximately \$3.6 million on interest expense. As of June 30, 2016, we had no outstanding borrowings against the revolving credit facility.

From time to time, we enter into interest rate swap agreements to hedge our variable interest rate debt. Below is a list of our interest rate swaps as of June 30, 2016:

	<b>Counterparty</b>	<b>Effective Date</b>	<b>Notional Amount (in millions)</b>	<b>LIBOR Fixed Rate</b>
Interest Rate Swap L*	Barclays	Aug 2016 - Aug 2019	\$ 75.0	3.44%
Interest Rate Swap M*	JP Morgan	Aug 2016 - Aug 2019	\$ 100.0	3.43%
Interest Rate Swap N*	Bank of America	Aug 2016 - Aug 2019	\$ 75.0	3.37%
Interest Rate Swap O*	Deutsche Bank	Aug 2016 - Aug 2019	\$ 75.0	3.19%
Interest Rate Swap P*	Barclays	Aug 2016 - Aug 2019	\$ 75.0	3.08%
Interest Rate Swap Q*	Barclays	Aug 2016 - Aug 2019	\$ 50.0	2.99%
Interest Rate Swap R*	Deutsche Bank	Aug 2016 - Aug 2019	\$ 50.0	2.98%
Interest Rate Swap S*	Deutsche Bank	Aug 2016 - Aug 2019	\$ 50.0	2.73%
Interest Rate Swap T*	Bank of America	Aug 2016 - Aug 2019	\$ 75.0	2.74%
Interest Rate Swap U*	Fifth Third Bank	Aug 2016 - Aug 2019	\$ 50.0	2.66%
Interest Rate Swap V*	Fifth Third Bank	Aug 2016 - Aug 2019	\$ 50.0	2.60%
Interest Rate Swap W*	Fifth Third Bank	Aug 2016 - Aug 2019	\$ 25.0	2.40%
Interest Rate Swap X*	Huntington Bank	Aug 2016 - Aug 2019	\$ 50.0	2.25%

\* includes LIBOR floor of 1.00%

We are exposed to increased interest expense if a counterparty defaults. Refer to NOTE F and NOTE G of the notes to our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

***Exchange Rate Risk***

While our net sales and costs are denominated primarily in U.S. Dollars, net sales, costs, assets and liabilities are generated in other currencies including Japanese Yen, Euro, Indian Rupee, Brazilian Real, Chinese Yuan Renminbi, Canadian Dollar and Hungarian Forint. The expansion of our business outside North America may further increase the risk that cash flows resulting from these activities may be adversely affected by changes in currency exchange rates.

Assuming current levels of foreign currency transactions, a 10% aggregate increase or decrease in the Japanese Yen, Euro, Indian Rupee, Chinese Yuan Renminbi and Canadian Dollar would correspondingly change our earnings, net of tax, by an estimated \$1 million per year. All other exposure to foreign currencies is considered immaterial.

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***Commodity Price Risk***

We are subject to changes in our cost of sales caused by movements in underlying commodity prices. Approximately two-thirds of our cost of sales consists of purchased components with significant raw material content. A substantial portion of the purchased parts are made of aluminum and steel. The cost of aluminum parts include an adjustment factor on future purchases for fluctuations in aluminum prices based on accepted industry indices. In addition, a substantial amount of steel-based contracts also include an index-based component. As our costs change, we are able to pass through a portion of the changes in commodity prices to certain of our customers according to our LTSAs. We historically have not entered into long-term purchase contracts related to the purchase of aluminum and steel. We currently hold commodity swaps that are intended to hedge forecasted aluminum purchases. Based on our forecasted demand for 2016 and 2017, as of June 30, 2016, the hedge contracts cover approximately 33% and 24% of our aluminum requirements, respectively. We do not hold financial instruments for trading or speculative purposes.

Assuming current levels of commodity purchases, a 10% increase or decrease in the price of aluminum and steel would correspondingly change our earnings, net of tax, by approximately \$1 million and \$2 million per year, respectively. This includes the partial offset of our hedging contracts described above.

Many of our LTSAs have incorporated a cost-sharing arrangement related to potential future commodity price fluctuations. Our hedging policy is that we hedge our exposure and do not hedge any portion of the customers exposure. For purposes of the sensitivity analysis above, the impact of these cost sharing arrangements has not been included.

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**ITEM 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this report. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on the evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are a party to various legal actions in the normal course of our business, including those related to commercial transactions, product liability, personal injury and workers' compensation, safety, health, taxes, environmental and other matters. See NOTE N in the notes to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

**Item 1A. Risk Factors**

There have been no material changes from our risk factors as previously reported in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the Securities and Exchange Commission on February 19, 2016.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table sets forth information related to our repurchases of our common stock on a monthly basis in the three months ended June 30, 2016:

		<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(1)</sup></b>	<b>Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans<sup>(1)</sup></b>
April 1	April 30, 2016	172,164	\$ 26.35	172,164	\$ 156,552,453
May 1	May 31, 2016	938,362	\$ 27.79	938,362	\$ 130,472,094
June 1	June 30, 2016	1,011,142	\$ 28.00	1,011,142	\$ 102,160,199
Total		2,121,668	\$ 27.77	2,121,668	

- <sup>(1)</sup> These values reflect repurchases made under the stock repurchase program approved by our Board of Directors on October 30, 2014 authorizing \$500 million of repurchases through December 31, 2016.

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## (a) Exhibits

<b>Exhibit Number</b>	<b>Description</b>
3.1	Amendment to Second Amended and Restated Certificate of Incorporation of Allison Transmission Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed May 18, 2016)
3.2	Fifth Amended and Restated Bylaws of Allison Transmission Holdings, Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed May 18, 2016)
10.1	Amendment to Employment Agreement between Allison Transmission, Inc. and Lawrence E. Dewey dated May 11, 2016 (filed herewith)
10.2	Amendment to Employment Agreement between Allison Transmission, Inc. and David S. Graziosi dated May 11, 2016 (filed herewith)
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.1	Certification of Periodic Report by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**ALLISON TRANSMISSION HOLDINGS, INC.**

Date: July 28, 2016

By: /s/ Lawrence E. Dewey  
Name: Lawrence E. Dewey  
Chairman of the Board and Chief Executive  
Title: Officer (Principal Executive Officer)

Date: July 28, 2016

By: /s/ David S. Graziosi  
Name: David S. Graziosi  
Title: President, Chief Financial Officer and Treasurer  
(Principal Financial Officer and Principal  
Accounting Officer)