Allegion plc
Form 10-Q
July 30, 2014
Table of Contents

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

FORM 10-Q

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from to

Commission File Number 001-35971

ALLEGION PUBLIC LIMITED COMPANY
(Exact name of registrant as specified in its charter)

Ireland	98-1108930
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Block D
Iveagh Court
Harcourt Road
Dublin 2, Ireland
(Address of principal executive offices, including zip code)
+(353) (1) 2546200
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically 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 x 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	x	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 x

The number of ordinary shares outstanding of Allegion plc as of July 27, 2014 was 96,081,819.

Table of Contents

ALLEGION PLC
FORM 10-Q
INDEX

Table of Contents

PART I-FINANCIAL INFORMATION

Item 1. Financial Statements

ALLEGION PLC
CONDENSED AND CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
In millions, except per share amounts	2014	2013	2014	2013
Net revenues	$531.5	$528.7	$998.1	$996.9
Cost of goods sold	305.2	310.2	580.0	592.4
Selling and administrative expenses	136.6	118.5	261.0	235.0
Operating income	89.7	100.0	157.1	169.5
Interest expense	12.5	0.5	25.6	0.9
Other (gain) loss, net	(1.0)	(0.8)	(1.1)	6.7
Earnings before income taxes	78.2	100.3	132.6	161.9
Provision for income taxes	23.1	37.0	39.4	56.9
Earnings from continuing operations	55.1	63.3	93.2	105.0
Discontinued operations, net of tax	(8.1)	(0.8)	(8.8)	(1.5)
Net earnings	47.0	62.5	84.4	103.5
Less: Net earnings attributable to noncontrolling interests	3.5	2.2	5.3	3.8
Net earnings attributable to Allegion plc	$43.5	$60.3	$79.1	$99.7
Amounts attributable to Allegion plc ordinary shareholders:				
Continuing operations	$51.6	$61.1	$87.9	$101.2
Discontinued operations	(8.1)	(0.8)	(8.8)	(1.5)
Net earnings	$43.5	$60.3	$79.1	$99.7
Earnings per share attributable to Allegion plc ordinary shareholders:				
Basic:				
Continuing operations	$0.54	$0.64	$0.91	$1.05
Discontinued operations	(0.09)	(0.01)	(0.09)	(0.01)
Net earnings	$0.45	$0.63	$0.82	$1.04
Diluted:				
Continuing operations	$0.53	$0.64	$0.90	$1.05
Discontinued operations	(0.08)	(0.01)	(0.09)	(0.01)
Net earnings	$0.45	$0.63	$0.81	$1.04
Weighted-average shares outstanding				
Basic	96.3	96.0	96.3	96.0
Diluted	97.3	96.0	97.4	96.0
Dividends declared per ordinary share	$0.08	$—	$0.16	$—
Total comprehensive income	$52.7	$72.7	$76.1	$94.9
Less: Total comprehensive income attributable to noncontrolling interests	3.4	2.5	4.4	4.5
Total comprehensive income attributable to Allegion plc	$49.3	$70.2	$71.7	$90.4

See accompanying notes to condensed and consolidated financial statements.

1

ALLEGION PLC
CONDENSED AND CONSOLIDATED BALANCE SHEETS
(Unaudited)

In millions	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$193.2	$227.4
Restricted cash	—	40.2
Accounts and notes receivable, net	295.6	260.0
Costs in excess of billings on uncompleted contracts	148.2	158.8
Inventories	174.1	153.6
Other current assets	72.6	74.8
Assets held for sale	3.9	11.2
Total current assets	887.6	926.0
Property, plant and equipment, net	210.3	200.2
Goodwill	517.8	504.9
Intangible assets, net	144.9	146.1
Other noncurrent assets	207.5	202.7
Total assets	$1,968.1	$1,979.9
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$219.8	$211.3
Accrued expenses and other current liabilities	186.9	207.3
Short-term borrowings and current maturities of long-term debt	30.7	71.9
Total current liabilities	437.4	490.5
Long-term debt	1,256.9	1,272.0
Other noncurrent liabilities	285.0	273.1
Total liabilities	1,979.3	2,035.6
Equity:		
Allegion plc shareholders' equity (deficit):		
Ordinary shares	1.0	1.0
Capital in excess of par value	5.6	8.4
Retained earnings	55.5	0.4
Accumulated other comprehensive income (loss)	(104.3)	(96.6)
Total Allegion plc shareholders' equity	(42.2)	(86.8)
Noncontrolling interests	31.0	31.1
Total equity	(11.2)	(55.7)
Total liabilities and equity	$1,968.1	$1,979.9

See accompanying notes to condensed and consolidated financial statements.

Table of Contents

ALLEGION PLC
CONDENSED AND CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

In millions	Six months ended June 30, 2014	2013
Cash flows from operating activities:		
Net earnings	84.4	103.5
Discontinued operations, net of tax	8.8	1.5
Depreciation and amortization	24.4	22.9
Changes in assets and liabilities and other non-cash items	(52.2)	(66.9)
Net cash provided by continuing operating activities	65.4	61.0
Net cash used in discontinued operating activities	(1.6)	(1.8)
Net cash provided by operating activities	63.8	59.2
Cash flows from investing activities:		
Capital expenditures	(26.0)	(8.7)
Acquisition of businesses, net of cash acquired	(23.0)	—
Other investing activities, net	40.8	1.8
Net cash used in investing activities	(8.2)	(6.9)
Cash flows from financing activities:		
Net debt proceeds (repayments)	(55.2)	0.4
Dividends paid to ordinary shareholders	(14.9)	—
Repurchase of ordinary shares	(30.3)	—
Net transfers to former Parent and affiliates	—	(33.5)
Other financing activities, net	14.6	(2.8)
Net cash used in continuing financing activities	(85.8)	(35.9)
Effect of exchange rate changes on cash and cash equivalents	(4.0)	(11.7)
Net increase (decrease) in cash and cash equivalents	(34.2)	4.7
Cash and cash equivalents - beginning of period	227.4	317.5
Cash and cash equivalents - end of period	$193.2	$322.2

See accompanying notes to condensed and consolidated financial statements.

Table of Contents

ALLEGION PLC
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Basis of Presentation

The accompanying condensed and consolidated financial statements of Allegion plc, an Irish public limited company, and its consolidated subsidiaries ("Allegion" or "the Company"), reflect the consolidated operations of the Company and have been prepared in accordance with United States Securities and Exchange Commission ("SEC") interim reporting requirements. Accordingly, the accompanying condensed and consolidated financial statements do not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP") for full financial statements and should be read in conjunction with the consolidated financial statements included in the Allegion Annual Report on Form 10-K for the year ended December 31, 2013. In the opinion of management, the accompanying condensed and consolidated financial statements contain all adjustments, which include normal recurring adjustments, necessary to present fairly the consolidated unaudited results for the interim periods presented.

In the second quarter of 2014 management committed to a plan to sell a component of a business in the EMEIA region and reclassified historical results of the component to discontinued operations for all periods presented. See Note 16 - Discontinued Operations for more information.

Note 2 – Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements:

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-04, "Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date." ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements where the total obligation is fixed at the reporting date, and for which no specific guidance currently exists. This new guidance is effective for annual reporting periods beginning on or after December 15, 2013 and subsequent interim periods. The requirements of ASU 2013-04 do not have a significant impact on the Condensed and Consolidated Financial Statements.

In March 2013, the FASB issued ASU 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity." ASU 2013-05 clarifies the application of GAAP to the release of cumulative translation adjustments related to changes of ownership in or within foreign entities, including step acquisitions. This new guidance is effective for annual reporting periods beginning on or after December 15, 2013 and subsequent interim periods. The requirements of ASU 2013-04 do not have a significant impact on the Condensed and Consolidated Financial Statements.

In July 2013, the FASB issued ASU 2013-11 Income Taxes (Topic 740), "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss or a Tax Credit Carryforward Exists." With certain exceptions, ASU 2013-11 requires entities to present an unrecognized tax benefit, or portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward. The guidance is effective for interim and annual periods beginning after December 15, 2013 on either a prospective or retrospective basis with early adoption permitted. The requirements of ASU 2013-11 do not have a significant impact on the Condensed and Consolidated Financial Statements.

Recently Issued Accounting Pronouncements

In April 2014, the FASB issued ASU 2014-08 "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," which amends the definition of a discontinued operation in Accounting Standards Codification Topic 205-20 (Presentation of Financial Statements — Discontinued Operations) and requires entities to disclose additional information about disposal transactions that do not meet the discontinued operations criteria. ASU 2014-08 redefines a discontinued operation as a component or group of components of an entity that (1) has been disposed of by sale or other than by sale or is classified as held for sale and (2) represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results. According to the ASU, a strategic shift that has (or will have) a major effect on an entity’s operations and results includes the disposal of a major geographical area, a major line of business, a major equity investment, or other major parts of an entity. The ASU is effective prospectively for disposals or components classified as held for sale in periods on or after December 15, 2014. The Company has not assessed what impact, if any, the ASU 2014-08 will have on the Condensed and Consolidated Financial Statements.

ALLEGION PLC
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(Unaudited)

In May 2014, the FASB issued ASU 2014-09 "Revenue from Contracts with Customers." ASU 2014-09 is the result of a joint project between the FASB and International Accounting Standards Board ("IASB") to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that would remove inconsistencies and weaknesses in revenue requirements, provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets, provide more useful information to users of financial statements through improved disclosure requirements and simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company has not assessed what impact, if any, ASU 2014-09 will have on the Condensed and Consolidated Financial Statements.

In June 2014, the FASB issued ASU 2014-12 "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." ASU 2014-12 requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The ASU is effective for annual and interim reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Early application is permitted. The requirements of ASU 2014-12 are not expected to have a significant impact on the Condensed and Consolidated Financial Statements.

Note 3 – Inventories
Depending on the business, U.S. inventories are stated at the lower of cost or market using the last-in, first-out (LIFO) method or the lower of cost or market using the first-in, first-out (FIFO) method. Non-U.S. inventories are primarily stated at the lower of cost or market using the FIFO method.
The major classes of inventory were as follows:

In millions	June 30, 2014	December 31, 2013
Raw materials	$61.2	$68.3
Work-in-process	44.4	34.5
Finished goods	102.4	84.6
	208.0	187.4
LIFO reserve	(33.9)	(33.8)
Total	$174.1	$153.6

Note 4 – Goodwill
The changes in the carrying amount of goodwill for the six months ended June 30, 2014 were as follows:

In millions	Americas	EMEIA	Asia Pacific	Total
December 31, 2013 (gross)	$362.8	$540.0	$87.6	$990.4
Acquisitions	2.3	—	10.3	12.6
Currency translation	0.2	(0.5)	0.6	0.3
June 30, 2014 (gross)	365.3	539.5	98.5	1,003.3
Accumulated impairment *	—	(478.6)	(6.9)	(485.5)

Goodwill (net)	$365.3	$60.9	$91.6	$517.8

* The Company recorded a $137.6 million goodwill impairment charge in the EMEIA segment in the third quarter of 2013.

ALLEGION PLC
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(Unaudited)

Note 5 – Intangible Assets

The gross amount of the Company’s intangible assets and related accumulated amortization were as follows:

In millions	June 30, 2014 Gross carrying amount	June 30, 2014 Accumulated amortization	June 30, 2014 Net carrying amount	December 31, 2013 Gross carrying amount	December 31, 2013 Accumulated amortization	December 31, 2013 Net carrying amount
Completed technologies/patents	$30.2	$(24.3)	$5.9	$26.4	$(23.6)	$2.8
Customer relationships	106.4	(39.5)	66.9	107.8	(38.1)	69.7
Trademarks (finite-lived)	100.2	(38.4)	61.8	101.4	(36.8)	64.6
Other	12.6	(12.6)	—	13.4	(13.4)	—
Total finite-lived intangible assets	249.4	$(114.8)	134.6	249.0	$(111.9)	137.1
Trademarks (indefinite-lived)	10.3		10.3	9.0		9.0
Total	$259.7		$144.9	$258.0		$146.1

Intangible asset amortization expense was $4.9 million and $4.7 million for the six months ended June 30, 2014 and 2013, respectively. Future estimated amortization expense on existing intangible assets in each of the next five years amounts to approximately $10 million for full year 2014, $8 million for 2015, $8 million for 2016, $8 million for 2017, and $8 million for 2018.

Note 6 – Acquisitions

On January 2, 2014, the Company's wholly-owned subsidiary Allegion de Colombia completed the acquisition of certain assets of Schlage Lock de Colombia S.A., the second largest mechanical lock manufacturer in that country. On April 30, 2014, the Company completed the acquisition of Fire & Security Hardware Pty Limited (FSH), an electromechanical locking provider in Australia. Aggregate cash consideration paid for these acquisitions was approximately $23.0 million.

Note 7 – Debt and Credit Facilities

Long-term debt and other borrowings consisted of the following:

In millions	June 30, 2014	December 31, 2013
Term Loan A Facility due 2018	$487.5	$500.0
Term Loan B Facility due 2020	497.5	500.0
5.75% Senior notes due 2021	300.0	300.0
Other debt, including capital leases, maturing in various amounts through 2016	2.6	43.9
Total debt	1,287.6	1,343.9
Less: current portion of long term debt	30.7	71.9
	$1,256.9	$1,272.0

Senior Secured Credit Facilities

A wholly-owned subsidiary of the Company has a credit agreement providing for (i) $1.0 billion of Senior Secured Term Loan Facilities, consisting of a $500 million “tranche A” Term Loan Facility due in 2018 (the "Term Loan A Facility") and a $500 million "tranche B" Term Loan Facility due in 2020 (the "Term Loan B Facility," and together with the Term Loan A Facility, the "Term Facilities"), and (ii) a $500 million Senior Secured Revolving Credit

Facility (the "Revolver") maturing in 2018. The Company refers to these credit facilities as its "Senior Secured Credit Facilities." The Company repaid $15.0 million of principal on its Term Loan A and Term Loan B Facilities during the six months ended June 30, 2014 in accordance with the terms of its senior secured credit facility. At June 30, 2014, the Company did not have any borrowings outstanding under the Revolver and had $28.9 million of letters of credit outstanding, which reduces the availability under the Revolver.

Outstanding borrowings under the Senior Secured Credit Facilities currently accrue interest at LIBOR plus an applicable margin. The applicable margin for borrowings under the Term Loan B Facility is 2.25% as of June 30, 2014, with LIBOR for the Term Loan B Facility to be subject to a floor of 0.75% per annum. The applicable margin for borrowings under the Revolver and the Term Loan A Facility is subject to a credit facility rating-based pricing grid with the LIBOR ranging from 1.75% to 2.25%. The margin for Term Loan A Facility borrowings was 2.00% as of June 30, 2014.

Senior Notes

A wholly-owned subsidiary of the Company has issued $300 million of 5.75% senior notes due 2021 (the "Senior Notes"). The Senior Notes accrue interest at the rate of 5.75% per annum, payable semi-annually on April 1 and October 1 of each year, commencing on April 1, 2014. The Senior Notes mature on October 1, 2021.

At June 30, 2014, the weighted-average interest rate for borrowings was 2.6% under the Term Loan Facilities and 5.75% under the Senior Notes.

Note 8 – Financial Instruments

In the normal course of business, the Company uses various financial instruments, including derivative instruments, to manage the risks associated with interest and currency rate exposures. These financial instruments are not used for trading or speculative purposes.

On the date a derivative contract is entered into, the Company designates the derivative instrument as a cash flow hedge of a forecasted transaction, a cash flow hedge of a recognized asset or liability, or as an undesignated derivative. The Company formally documents its hedge relationships, including identification of the derivative instruments and the hedged items, as well as its risk management objectives and strategies for undertaking the hedge transaction. This process includes linking derivative instruments that are designated as hedges to specific assets, liabilities or forecasted transactions.

The fair market value of derivative instruments is determined through market-based valuations and may not be representative of the actual gains or losses that will be recorded when these instruments mature due to future fluctuations in the markets in which they are traded.

The Company assesses at inception and at least quarterly thereafter, whether the derivatives used in cash flow hedging transactions are highly effective in offsetting the changes in the cash flows of the hedged item. To the extent the derivative is deemed to be a highly effective hedge, the fair market value changes of the instrument are recorded to accumulated other comprehensive income (AOCI).

Any ineffective portion of a derivative instrument’s change in fair value is recorded in Net earnings in the period of change. If the hedging relationship ceases to be highly effective, or it becomes probable that a forecasted transaction is no longer expected to occur, the hedging relationship will be undesignated and any future gains and losses on the derivative instrument will be recorded in Net earnings.

Currency Hedging Instruments

The net notional amount of the Company’s currency derivatives was $162.7 million and $209.6 million at June 30, 2014 and December 31, 2013, respectively. At June 30, 2014 and December 31, 2013, a loss of $0.7 million and a gain of $0.5 million, net of tax, respectively, were included in AOCI related to the fair value of the Company’s currency derivatives designated as accounting hedges. The amount expected to be reclassified into Net earnings over the next twelve months is a loss of $0.7 million. The actual amounts that will be reclassified to Net earnings may vary from this amount as a result of changes in market conditions. Gains and losses associated with the Company's currency derivatives not designated as hedges are recorded in Net earnings as changes in fair value occur. At June 30, 2014, the maximum term of the Company's currency derivatives was approximately 12 months.

ALLEGION PLC
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(Unaudited)

Interest Rate Swaps

In June 2014, the Company entered into forward starting interest rate swaps for $300.0 million of the Company's variable rate $487.5 million Term Loan A Facility. Swaps with notional amounts totaling $275.0 million become effective in January 2015 and expire in September 2017 and swaps with notional amounts totaling $25.0 million become effective in January 2015 and expire in December 2016. These interest rate swaps met the criteria to be accounted for as cash flow hedges of variable rate interest payments. Consequently, the changes in fair value of the interest rate swaps were recognized in AOCI. At June 30, 2014, $0.4 million of losses were recorded in AOCI related to these interest rate swaps and none are expected to be reclassified into Interest expense over the next twelve months.

The fair values of derivative instruments included within the Condensed and Consolidated Balance Sheets were as follows:

	Asset derivatives		Liability derivatives	
In millions	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
Derivatives designated as hedges:				
Currency derivatives	$—	$ 0.7	$0.5	$ —
Interest rate swaps	—	—	0.4	—
Derivatives not designated as hedges:				
Currency derivatives	5.3	—	0.9	2.7
Total derivatives	$5.3	$ 0.7	$1.8	$ 2.7

Asset and liability derivatives included in the table above are recorded within Other current assets and Accrued expenses and other current liabilities, respectively.

The amounts associated with derivatives designated as hedges affecting Net earnings and AOCI for the six months ended June 30 were as follows:

	Amount of gain (loss) recognized in AOCI		Location of gain (loss) reclassified from AOCI and recognized into Net earnings	Amount of gain (loss) reclassified from AOCI and recognized into Net earnings	
In millions	2014	2013		2014	2013
Currency derivatives	$(0.7)	$2.0	Cost of goods sold	$0.6	$0.6
Interest rate swaps	(0.4)	—	Interest expense	—	—
Total	$(1.1)	$2.0		$0.6	$0.6

Concentration of Credit Risk

The counterparties to the Company’s forward contracts and swaps consist of a number of investment grade major international financial institutions. The Company could be exposed to losses in the event of nonperformance by the counterparties. However, the credit ratings and the concentration of risk in these financial institutions are monitored on a continuous basis and present no significant credit risk to the Company.

Note 9 – Pensions and Postretirement Benefits Other than Pensions

The Company sponsors several U.S. defined benefit and defined contribution plans covering substantially all of its U.S. employees. Additionally, the Company has non-U.S. defined benefit and defined contribution plans covering eligible non-U.S. employees. Postretirement benefits, other than pensions, provide healthcare benefits, and in some instances, life insurance benefits for certain eligible employees.

Pension Plans

The noncontributory defined benefit pension plans covering non-collectively bargained U.S. employees provide benefits on an average pay formula while most plans for collectively bargained U.S. employees provide benefits on a flat dollar benefit formula.

ALLEGION PLC
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(Unaudited)

The non-U.S. pension plans generally provide benefits based on earnings and years of service. The Company also maintains additional other supplemental plans for officers and other key employees.
The components of the Company’s net periodic pension benefit costs for the three and six months ended