AMERICAN AXLE & MANUFACTURING HOLDINGS INC
Form 10-Q
October 26, 2012

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

FORM 10-Q

R	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2012

or

o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from _____________ to _____________

Commission File Number: 1-14303

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

(Do not check if a smaller reporting company)

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

As of October 24, 2012, the latest practicable date, the number of shares of the registrant's Common Stock, par value $0.01 per share, outstanding was 74,839,567 shares.

Internet Website Access to Reports

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

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2012
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FORWARD-LOOKING STATEMENTS

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

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

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

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions, except per share data)			
Net sales	$702.9	$647.6	$2,194.2	$1,979.4
Cost of goods sold	612.2	544.1	1,878.5	1,630.0
Gross profit	90.7	103.5	315.7	349.4
Selling, general and administrative expenses	60.6	59.0	177.9	174.5
Operating income	30.1	44.5	137.8	174.9
Interest expense	(25.3)	(19.7)	(72.7)	(61.5)
Investment income	0.2	0.3	0.6	0.9
Other income (expense)				
Debt refinancing and redemption costs	(10.1)	—	(10.1)	(3.1)
Other, net	(2.2)	(0.2)	(4.0)	0.1
Income (loss) before income taxes	(7.3)	24.9	51.6	111.3
Income tax expense	0.9	2.3	4.8	4.2
Net income (loss)	(8.2)	22.6	46.8	107.1
Net loss attributable to the noncontrolling interests	0.1	2.2	1.0	4.6
Net income (loss) attributable to AAM	$(8.1)	$24.8	$47.8	$111.7
Basic earnings (loss) per share	$(0.11)	$0.33	$0.64	$1.49
Diluted earnings (loss) per share	$(0.11)	$0.33	$0.63	$1.48

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Net income (loss)	$(8.2)	$22.6	$46.8	$107.1
Other comprehensive income (loss), net of tax				
Defined benefit plans	(102.7)	0.4	(117.2)	3.9
Foreign currency translation adjustments	4.9	(30.2)	(7.1)	(16.7)
Change in derivatives	2.2	(9.0)	7.6	(7.9)
Other comprehensive loss	(95.6)	(38.8)	(116.7)	(20.7)
Comprehensive income (loss)	(103.8)	(16.2)	(69.9)	86.4
Net loss attributable to noncontrolling interests	0.1	2.2	1.0	4.6
Foreign currency translation adjustments attributable to noncontrolling interests	—	0.5	(0.2)	(0.3)
Comprehensive income (loss) attributable to AAM	$(103.7)	$(13.5)	$(69.1)	$90.7

See accompanying notes to condensed consolidated financial statements.

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

	September 30, 2012 (Unaudited) (in millions)	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	$209.0	$169.2
Accounts receivable, net	465.3	333.3
Inventories, net	242.3	177.2
Prepaid expenses and other current assets	105.5	83.4
Total current assets	1,022.1	763.1
Property, plant and equipment, net	1,007.6	971.2
Goodwill	156.3	155.9
GM postretirement cost sharing asset	288.3	260.2
Other assets and deferred charges	199.9	178.3
Total assets	$2,674.2	$2,328.7
Liabilities and Stockholders’ Deficit		
Current liabilities		
Accounts payable	$429.5	$337.1
Accrued compensation and benefits	110.1	110.6
Deferred revenue	20.6	32.9
Accrued expenses and other current liabilities	89.6	95.5
Total current liabilities	649.8	576.1
Long-term debt	1,579.9	1,180.2
Deferred revenue	81.2	88.2
Postretirement benefits and other long-term liabilities	861.0	903.8
Total liabilities	3,171.9	2,748.3
Stockholders' deficit		
Common stock, par value $0.01 per share	0.8	0.8
Paid-in capital	599.8	597.2
Accumulated deficit	(595.7)	(643.5)
Treasury stock at cost, 6.0 million shares as of September 30, 2012 and 5.5 million shares as of December 31, 2011	(182.1)	(176.2)
Accumulated other comprehensive income (loss), net of tax		
Defined benefit plans	(332.8)	(215.6)
Foreign currency translation adjustments	10.2	17.3
Unrecognized gain (loss) on derivatives	2.1	(5.5)
Total AAM stockholders' deficit	(497.7)	(425.5)
Noncontrolling interest in subsidiaries	—	5.9
Total stockholders’ deficit	(497.7)	(419.6)
Total liabilities and stockholders' deficit	$2,674.2	$2,328.7

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2012	2011
	(in millions)	
Operating activities		
Net income	$46.8	$107.1
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization	112.4	103.8
Asset impairments and related indirect inventory obsolescence	—	8.7
Deferred income taxes	1.0	22.6
Stock-based compensation	1.3	3.8
Pensions and other postretirement benefits, net of contributions	(209.7)	(12.2)
Loss (gain) on disposal of property, plant and equipment, net	0.9	(6.3)
Debt refinancing and redemption costs	0.4	1.8
Changes in operating assets and liabilities		
Accounts receivable	(133.5)	(240.1)
Inventories	(67.2)	(29.5)
Accounts payable and accrued expenses	97.6	60.6
Deferred revenue	(19.2)	(57.6)
Other assets and liabilities	(27.4)	(28.1)
Net cash used in operating activities	(196.6)	(65.4)
Investing activities		
Purchases of property, plant and equipment	(143.7)	(111.0)
Proceeds from sale of property, plant and equipment	2.2	7.9
Net cash used in investing activities	(141.5)	(103.1)
Financing activities		
Net short-term borrowings (repayments) under credit facilities	(0.9)	70.0
Payments of long-term debt and capital lease obligations	(164.3)	(53.7)
Proceeds from issuance of long-term debt	562.2	24.3
Debt issuance costs	(10.1)	(5.7)
Purchase of noncontrolling interest	(4.0)	—
Purchase of treasury stock	(5.9)	(0.1)
Employee stock option exercises	0.1	4.6
Net cash provided by financing activities	377.1	39.4
Effect of exchange rate changes on cash	0.8	(1.1)
Net increase (decrease) in cash and cash equivalents	39.8	(130.2)
Cash and cash equivalents at beginning of period	169.2	244.6
Cash and cash equivalents at end of period	$209.0	$114.4
Supplemental cash flow information		

Interest paid	$79.6	$73.6
Income taxes paid, net of refunds	$12.4	$3.0

See accompanying notes to condensed consolidated financial statements.

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2012
(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

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

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

The balance sheet at December 31, 2011 presented herein has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete consolidated financial statements.

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

For further information, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2011.

Effect of New Accounting Standards On January 1, 2012, we adopted new accounting guidance on the presentation of comprehensive income. The new guidance allows an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. We have elected to present the components of other comprehensive income in a separate statement immediately following the statement of income. The guidance eliminates the previous option to report other comprehensive income and its components in the statement of changes in equity. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. Other than the change in presentation, the adoption of this new guidance has had no impact on our condensed consolidated financial statements.

On January 1, 2012, we also adopted new accounting guidance on testing goodwill for impairment. This new guidance allows us the option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this amendment, we are not required to calculate the fair value of a reporting unit unless we determine, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendment includes a number of events and circumstances to consider in conducting the qualitative assessment. We do not believe that the adoption of this new accounting guidance will have a significant effect on our goodwill impairment assessments in the future.

On July 27, 2012, the FASB issued new accounting guidance, which amends the previous accounting guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment. This new guidance allows us the option to first assess qualitative factors to determine whether it is necessary to calculate the fair value of the asset being tested. This new guidance will be effective for us as of January 1, 2013, with early adoption permitted. We do not believe that the adoption of this new accounting guidance will have a significant effect on our indefinite-lived intangible asset impairment assessments in the future.

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

2. RESTRUCTURING ACTIONS

A summary of the restructuring related activity for the nine months ended September 30, 2012 is shown below (in millions):

	One-time Termination Benefits	Asset Retirement Obligations	Other Restructuring Actions	Total
Accrual as of December 31, 2011	$0.3	$0.6	$—	$0.9
Charges	1.7	—	22.9	24.6
Cash utilization	(1.5)	(0.1)	(22.9)	(24.5)
Accrual adjustments	(0.4)	—	—	(0.4)
Accrual as of September 30, 2012	$0.1	$0.5	$—	$0.6

In the nine months ended September 30, 2012, we incurred charges for the redeployment of assets and other related costs associated with the closure of our Detroit Manufacturing Complex (DMC) and Cheektowaga Manufacturing Facility (CKMF). We expensed and paid $22.9 million in the first nine months of 2012, related to these actions.

We expect to make payments of approximately $0.1 million during the remainder of 2012 related to the remaining restructuring accrual.

3. INVENTORIES

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

Inventories consist of the following:

	September 30, 2012	December 31, 2011
	(in millions)	
Raw materials and work-in-progress	$237.9	$177.0
Finished goods	27.7	26.9
Gross inventories	265.6	203.9
Inventory valuation reserves	(23.3)	(26.7)
Inventories, net	$242.3	$177.2

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

4. LONG-TERM DEBT

Long-term debt consists of the following:

	September 30, 2012 (in millions)	December 31, 2011
Amended revolving credit facility	$—	$—
9.25% Notes, net of discount	379.5	379.0
7.875% Notes	300.0	300.0
7.75% Notes	200.0	200.0
6.625% Notes	550.0	—
5.25% Notes, net of discount	112.1	249.9
Foreign credit facilities	32.6	45.2
Capital lease obligations	5.7	6.1
Long-term debt	$1,579.9	$1,180.2

6.625% Notes In the third quarter of 2012, we issued $550.0 million of 6.625% senior unsecured notes due 2022 (6.625% Notes). Concurrently with the offering of the 6.625% Notes, we made a tender offer to repurchase our 5.25% Notes, of which the aggregate principal amount outstanding at the time of the tender offer was $250.0 million. Net proceeds from the 6.625% Notes were used to fund the purchase of $137.8 million of the outstanding 5.25% Notes pursuant to the tender offer, certain pension obligations and for other general corporate purposes. We also used the net proceeds to fund the redemption of the remaining 5.25% Notes outstanding as of September 30, 2012, including the payment of interest, and to redeem $42.5 million aggregate principal amount of our 9.25% Notes in the fourth quarter of 2012. We paid debt issuance costs of $8.6 million in the third quarter of 2012 related to the 6.625% Notes.

Amended Revolving Credit Facility On August 31, 2012, we amended and restated the Credit Agreement dated as of January 9, 2004 (as amended and restated, the “Amended and Restated Revolving Credit Agreement” and the facility thereunder, the “Amended Revolving Credit Facility”). As of September 30, 2012, the Amended Revolving Credit Facility provided up to $72.8 million of revolving bank financing commitments through June 2013 and $365.0 million of revolving bank financing commitments through June 30, 2016. At September 30, 2012, we had $412.9 million available under the Amended Revolving Credit Facility. This availability reflects a reduction of $24.9 million for standby letters of credit issued against the facility.

The Amended and Restated Revolving Credit Agreement, among other things, increased the aggregate commitments by approximately $116.0 million and increased the commitments maturing on June 30, 2016 (the class D facility) to $365.0 million. The class D facility includes loans held by lenders that agreed to extend and/or increase their respective commitments and new lenders to the facility. The Amended and Restated Revolving Credit Agreement also includes a class C loan facility of approximately $72.8 million, which matures on June 30, 2013. We expensed $0.3 million for the write-off of a proportionate amount of unamortized debt issuance costs related to the class C facility. We had been amortizing the debt issuance costs over the expected life of the borrowing. We paid debt issuance costs of $1.5 million in the third quarter of 2012 associated with the amendments and restatements of our Amended Revolving Credit Facility.

Borrowings under the Amended Revolving Credit Facility bear interest at rates based on adjusted LIBOR or an alternate base rate, plus an applicable margin. The applicable margin for the class C and class D facilities remains unchanged.

Under the Amended Revolving Credit Facility, certain negative covenants were revised to provide increased flexibility. In the event AAM achieves investment grade corporate credit ratings from S&P and Moody's, AAM may elect to release all of the collateral from the liens granted pursuant to the Collateral Agreement, subject to notice requirements and other conditions.

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

The Amended Revolving Credit Facility is secured on a first priority basis by all or substantially all of the assets of AAM and each guarantor under the Collateral Agreement dated as of November 7, 2008, as amended and restated as of December 18, 2009 and as further amended on June 30, 2011, among AAM and its domestic subsidiaries and JPMorgan Chase Bank, N.A., as collateral agent for the lenders under the Amended and Restated Revolving Credit Agreement and the secured noteholders under the Indenture dated as of December 18, 2009, among AAM, as issuer, the guarantors and U.S. Bank National Association, as trustee.

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

5.25% Notes On September 18, 2012, in connection with the cash tender offer, we purchased $137.8 million aggregate principal amount of the 5.25% Notes, and paid accrued interest. Upon purchase, we expensed $9.2 million related to a tender premium, $0.5 million of professional and underwriting fees and unamortized debt issuance costs of $0.1 million related to this debt. We had been amortizing the debt issuance costs over the expected life of the borrowing.

On October 3, 2012, we voluntarily redeemed the remaining 5.25% Notes outstanding as of September 30, 2012. This resulted in a principal payment of $112.2 million, a payment of $7.3 million related to a make-whole premium, as well as payment of accrued interest. Upon redemption, we expensed $0.2 million of unamortized debt discount and issuance costs related to this debt. We had been amortizing the debt discount and debt issuance costs over the expected life of the borrowing.

9.25% Notes On October 5, 2012, we voluntarily redeemed 10% of the original outstanding amount of our 9.25% Notes at a redemption price of 103% of the principal amount. This resulted in a principal payment of $42.5 million and a $1.3 million payment for the redemption premium, as well as payment of accrued interest. Upon redemption, we expensed $1.1 million for the write-off of a proportional amount of unamortized debt discount and issuance costs related to this debt. We had been amortizing the debt discount and debt issuance costs over the expected life of the borrowing.

We utilize local currency credit facilities to finance the operations of certain foreign subsidiaries. At September 30, 2012, $32.6 million was outstanding under these facilities and an additional $38.8 million was available.

The weighted-average interest rate of our long-term debt outstanding at September 30, 2012 was 7.8% and 8.0% as of December 31, 2011.

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

5. FAIR VALUE

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

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

Financial instruments The estimated fair value of our financial assets and liabilities that are recognized at fair value on a recurring basis, using available market information and other observable data, as of September 30, 2012, are as follows:

	September 30, 2012		December 31, 2011		
	Carrying Amount (in millions)	Fair Value	Carrying Amount (in millions)	Fair Value	Input
Balance Sheet Classification					
Cash equivalents	$20.0	$20.0	$36.0	$36.0	Level 1
Prepaid expenses and other current assets					
Currency forward contracts	2.3	2.3	0.1	0.1	Level 2
Other assets and deferred charges					
Currency forward contracts	0.2	0.2	0.1	0.1	Level 2
Other accrued expenses					
Currency forward contracts	0.4	0.4	5.6	5.6	Level 2

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

	September 30, 2012		December 31, 2011		
	Carrying Amount (in millions)	Fair Value	Carrying Amount (in millions)	Fair Value	Input
9.25% Notes	$379.5	$425.5	$379.0	$415.0	Level 2
7.875% Notes	300.0	312.0	300.0	295.5	Level 2
7.75% Notes	200.0	219.0	200.0	195.0	Level 2
6.625% Notes	550.0	556.9	—	—	Level 2
5.25% Notes	112.1	117.7	249.9	243.8	Level 2

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

6. DERIVATIVES

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

Currency forward contracts From time to time, we use foreign currency forward contracts to reduce the effects of fluctuations in exchange rates, primarily relating to the Mexican Peso, Euro, Pound Sterling and Brazilian Real. As of September 30, 2012, we have forward contracts outstanding with a notional amount of $45.7 million that hedge our exposure to changes in foreign currency exchange rates for our payroll expenses in Mexico.

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

	Location of Gain (Loss) Reclassified into Net Income (loss)	Gain (Loss) Reclassified Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011	Gain Expected to be Reclassified During the Next 12 Months
		(in millions)				
Currency forward contracts	Cost of Goods Sold	$(0.2)	$0.4	$(1.7)	$2.6	$1.9

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

7. EMPLOYEE BENEFIT PLANS

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

	Pension Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Service cost	$0.7	$1.2	$2.3	$3.4
Interest cost	8.9	9.2	26.5	27.6
Expected asset return	(8.0)	(7.9)	(24.0)	(23.7)
Amortized loss	1.9	1.1	5.5	3.3
Amortized prior service cost	0.1	—	0.1	—
Net periodic benefit cost	$3.6	$3.6	$10.4	$10.6

	Other Postretirement Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Service cost	$0.1	$0.2	$0.3	$0.6
Interest cost	3.8	4.3	11.6	12.9
Amortized loss	0.1	0.1	0.5	0.3
Amortized prior service credit	(0.3)	(0.8)	(1.3)	(2.4)
Curtailment gain	—	—	(21.8)	—
Settlement	—	—	(5.2)	—
Net periodic benefit cost (credit)	$3.7	$3.8	$(15.9)	$11.4

In the first quarter of 2012, we recorded a gain of $21.8 million in cost of goods sold for the curtailment of certain other postretirement benefits (OPEB). This resulted primarily from the reduction in expected future OPEB related to the DMC and CKMF hourly associates who have terminated employment from AAM as a result of our plant closures. These curtailment gains resulted in an increase in our accumulated other comprehensive loss of $21.8 million.

As a result of our election to apply the provisions of Moving Ahead for Progress in the 21st Century Act (MAP-21), in addition to certain actions we took during the third quarter of 2012, we agreed to provide pension and postretirement benefits to certain eligible UAW associates whose employment had been terminated in connection with the DMC and CKMF plant closures. In the nine months ended September 30, 2012, we recorded $28.7 million in cost of goods sold, of which $28.1 million was recorded in the second quarter of 2012, for these pension and postretirement benefits. In the third quarter of 2012, we reclassified the liability of $28.1 million originally recorded in the second quarter of 2012 from accrued expenses and other current liabilities to postretirement benefits and other long-term liabilities. These incremental pension and postretirement benefits were also agreed to in connection with the lawsuit filed by the International UAW against AAM. See Note 12 - Litigation for more detail on this pending lawsuit.

Also as a result of providing these incremental pension and postretirement benefits, we remeasured our U.S. hourly pension and OPEB plans as of September 30, 2012. These remeasurements resulted in an increase in postretirement and other long-term liabilities of $158.6 million, an increase in the GM postretirement cost sharing asset of $34.8 million and a decrease in our accumulated other comprehensive loss of $95.1 million on our Condensed Consolidated

Balance Sheet. These net adjustments relate to changes in actuarial assumptions since the January 1, 2012 valuation of the assets and liabilities of our U.S. hourly pension and OPEB plans.

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

Effective August 1, 2012, we amended our AAM Supplemental Executive Retirement Plan (SERP) to include an actuarial increase provision for participants that work past the age of 65, among other things. As a result of these plan amendments, we remeasured our SERP plan in the third quarter of 2012, which increased postretirement benefits and other long-term liabilities by $10.4 million on our Condensed Consolidated Balance Sheet.

In the second quarter of 2012, we notified hourly associates of the termination of a benefit plan, which provided legal services to certain eligible hourly associates represented by the International UAW. As a result of terminating this plan, we recorded a settlement gain of $5.2 million in cost of goods sold in the second quarter of 2012. Recognition of this settlement gain reduced postretirement benefits and other long-term liabilities by $4.7 million and also reduced our accumulated other comprehensive loss by $0.5 million.

We contributed $225.0 million to our pension trusts in the first nine months of 2012, which included our regulatory pension funding requirements of approximately $35 million. We contributed $26.2 million to our pension trusts in the first nine months of 2011.

On September 27, 2012, AAM and the Pension Benefit Guaranty Corporation entered into an agreement regarding any liability that may have arisen under the Employee Retirement Income Security Act of 1974 in connection with the closures of the DMC and CKMF. As part of this agreement, in September 2012, we contributed $114.7 million in excess of our statutory minimums to our hourly pension plan, which is included in the contributions described above.

We expect our cash outlay for other postretirement benefit obligations in 2012, net of GM cost sharing, to be approximately $16 million.

8. PRODUCT WARRANTIES

We record a liability for estimated warranty obligations at the dates our product are sold. These estimates are established using sales volumes and internal and external warranty data where there is no payment history and historical information about the average cost of warranty claims for customers with prior claims. We adjust our liability as necessary to reflect changes in estimates as additional information is gathered as part of our active management of warranty exposure with our customers.

As part of the 2009 Settlement and Commercial Agreement, AAM agreed to expanded warranty cost sharing with GM, which began on January 1, 2011.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Beginning balance	$24.5	$8.1	$13.4	$2.3
Accruals	2.8	3.0	17.2	9.2
Settlements	(0.3)	(0.1)	(0.7)	(0.6)
Adjustment to prior period accruals	(0.7)	—	(3.5)	—
Foreign currency translation and other	0.1	(0.2)	—	(0.1)
Ending balance	$26.4	$10.8	$26.4	$10.8

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

9. INCOME TAXES

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

Income tax expense was $0.9 million in the three months ended September 30, 2012 as compared to $2.3 million in the three months ended September 30, 2011. Our effective income tax rate was negative 12.9% in the third quarter of 2012 as compared to 9.3% in the third quarter of 2011.

Income tax expense was $4.8 million in the first nine months of 2012 as compared to $4.2 million in the first nine months of 2011. Our effective income tax rate was 9.3% in the first nine months of 2012 as compared to 3.8% in the first nine months of 2011.

Our income tax expense and effective tax rate for the three and nine months ended September 30, 2012 reflect the effect of recording a valuation allowance against our tax loss in the U.S. Our income tax expense and effective tax rate for the nine months ended September 30, 2012 also reflect a net tax expense of $1.3 million related to the amendment of state income tax returns as a result of the settlement of federal income tax audits for the tax years 2004 through 2007.

Our income tax expense and effective tax rate for the three and nine months ended September 30, 2011 reflect the effect of recognizing a net operating loss benefit against our taxable income in the U.S. Our income tax expense for the three and nine months ended September 30, 2011 also reflects net tax benefits of $2.8 million related to the favorable resolution of income tax audits and the reversal of state deferred tax liabilities due to Michigan tax legislation that was enacted.

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

10. EARNINGS PER SHARE (EPS)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions, except per share data)			
Numerator				
Net income (loss) attributable to AAM	$(8.1)	$24.8	$47.8	$111.7
Denominator				
Basic shares outstanding -				
Weighted-average shares outstanding	74.9	75.4	75.2	74.8
Effect of dilutive securities				
Dilutive stock-based compensation	—	—	—	0.1
Dilutive GM warrants	—	—	—	0.5
Diluted shares outstanding -				
Adjusted weighted-average shares after assumed conversions	74.9	75.4	75.2	75.4
Basic EPS	$(0.11)	$0.33	$0.64	$1.49
Diluted EPS	$(0.11)	$0.33	$0.63	$1.48

Certain exercisable stock options were excluded from the computations of diluted EPS because the exercise price of these options was greater than the average period market prices. The number of stock options outstanding, which were not included in the calculation of diluted EPS, was 3.3 million at September 30, 2012 and 4.1 million at September 30, 2011. The ranges of exercise prices related to the excluded exercisable stock options were $15.58 - $40.83 at September 30, 2012 and $15.56 - $40.83 at September 30, 2011.

The computation of diluted EPS for the three months ended September 30, 2012 excludes 1.0 million shares of unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents as we were in a loss position and these participating securities are not obligated to fund losses.

As part of the 2009 Settlement and Commercial Agreement, we issued to GM five year warrants, which entitled GM to purchase 4.1 million shares of AAM's common stock at an exercise price of $2.76 per share. In the first quarter of 2011, GM exercised these warrants. In accordance with the cashless exercise option available in the agreement, we issued 3.3 million net shares of common stock to GM.

11. INVESTMENT IN JOINT VENTURES

In the first quarter of 2012, we paid $4.0 million to acquire the remaining shares of e-AAM Driveline Systems AB (e-AAM). e-AAM, previously a joint venture between AAM and Saab Automobile AB (Saab), was created to design and commercialize electric all-wheel-drive (eAWD) systems designed to improve fuel efficiency, reduce CO_2 emissions and provide all-wheel-drive capability.

Under the purchase agreement, Saab's bankruptcy estate sold its minority ownership (33% of the shares) in the joint venture to AAM. e-AAM is now a wholly-owned subsidiary of AAM and continues to be a fully consolidated entity.

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

12. LITIGATION

In February 2012, the International UAW filed suit in the United States District Court for the Eastern District of Michigan, alleging that AAM violated certain provisions of the collective bargaining agreement covering represented hourly associates at the Detroit Manufacturing Complex and Cheektowaga Manufacturing Facility related to pension and postretirement benefits. In the nine months ended September 30, 2012, we recorded $28.7 million in cost of goods sold, of which $28.1 million was recorded in the second quarter of 2012, related to pension and postretirement benefits to be provided to certain eligible UAW associates as a result of our election to apply MAP-21 and the subsequent recertification of our U.S. hourly pension plan. See Note 7 - Employee Benefit Plans for more detail about these incremental benefit accruals.

We do not expect the resolution of this litigation to have a significant impact on our results of operations in future periods.

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

13. SUPPLEMENTAL GUARANTOR CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Holdings has no significant asset other than its 100% ownership in AAM, Inc. and no direct subsidiaries other than AAM, Inc. Holdings fully and unconditionally guarantees the 7.875% Notes and 5.25% Notes, which are senior unsecured obligations of AAM, Inc. The 9.25% Notes are senior secured obligations of AAM Inc. and the 7.75% Notes and 6.625% Notes are senior unsecured obligations of AAM Inc., all of which are fully and unconditionally guaranteed by Holdings and substantially all domestic subsidiaries of AAM, Inc.

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

Condensed Consolidating Statements of Operations and Comprehensive Income (Loss)
Three Months Ended September 30,
(in millions)

	Holdings	AAM Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elims	Consolidated
2012						
Net sales						
External	$—	$162.2	$55.4	$485.3	$—	$702.9
Intercompany	—	3.5	54.4	10.1	(68.0)	—
Total net sales	—	165.7	109.8	495.4	(68.0)	702.9
Cost of goods sold	—	164.3	97.7	418.2	(68.0)	612.2
Gross profit	—	1.4	12.1	77.2	—	90.7
Selling, general and administrative expenses	—	50.0	—	10.6	—	60.6
Operating income (loss)	—	(48.6)	12.1	66.6	—	30.1
Non-operating income (expense), net	—	(35.7)	0.1	(1.8)	—	(37.4)
Income (loss) before income taxes	—	(84.3)	12.2	64.8	—	(7.3)
Income tax expense	—	0.1	—	0.8	—	0.9
Earnings (loss) from equity in subsidiaries	(8.1)	34.5	(14.7)	—	(11.7)	—
Net income (loss) before royalties and dividends	(8.1)	(49.9)	(2.5)	64.0	(11.7)	(8.2)
Royalties and dividends	—	41.8	—	(41.8)	—	—
Net income (loss) after royalties and dividends	(8.1)	(8.1)	(2.5)	22.2	(11.7)	(8.2)
Net loss attributable to noncontrolling interests	—	—	—	0.1	—	0.1
Net income (loss) attributable to AAM	$(8.1)	$(8.1)	$(2.5)	$22.3	$(11.7)	$(8.1)
Other comprehensive income (loss)	(95.6)	(95.6)	4.1	5.8	85.7	(95.6)
	$(103.7)	$(103.7)	$1.6	$28.1	$74.0	$(103.7)

Comprehensive income (loss)
attributable to AAM

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

	Holdings	AAM Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elims	Consolidated
2011						
Net sales						
External	$—	$186.8	$48.2	$412.6	$—	$647.6
Intercompany	—	7.0	48.2	3.7	(58.9)	—
Total net sales	—	193.8	96.4	416.3	(58.9)	647.6
Cost of goods sold	—	182.4	84.2	336.4	(58.9)	544.1
Gross profit	—	11.4	12.2	79.9	—	103.5
Selling, general and administrative expenses	—	48.0	—	11.0	—	59.0
Operating income (loss)	—	(36.6)	12.2	68.9	—	44.5
Non-operating income (expense), net	—	(21.1)	0.4	1.1	—	(19.6)
Income (loss) before income taxes	—	(57.7)	12.6	70.0	—	24.9
Income tax expense (benefit)	—	(0.1)	—	2.4	—	2.3
Earnings (loss) from equity in subsidiaries	24.8	33.3	(13.1)	—	(45.0)	—
Net income (loss) before royalties and dividends	24.8	(24.3)	(0.5)	67.6	(45.0)	22.6
Royalties and dividends	—	49.1	—	(49.1)	—	—
Net income (loss) after royalties and dividends	24.8	24.8	(0.5)	18.5	(45.0)	22.6
Net loss attributable to noncontrolling interests	—	—	—	2.2	—	2.2
Net income (loss) attributable to AAM	$24.8	$24.8	$(0.5)	$20.7	$(45.0)	$24.8
Other comprehensive loss	(38.8)	(38.8)	(28.7)	(37.0)	104.5	(38.8)