

HARMAN INTERNATIONAL INDUSTRIES INC /DE/

Form 10-Q

November 01, 2011

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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 September 30, 2011

OR

.. **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: 1-9764

Harman International Industries, Incorporated

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
400 Atlantic Street, Suite 1500
Stamford, CT
(Address of principal executive offices)

11-2534306
(I.R.S. Employer
Identification No.)
06901
(Zip code)

(203) 328-3500
(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

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

(Check one):

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 October 28, 2011, 70,104,886 shares of common stock, par value \$.01, were outstanding.

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HARMAN INTERNATIONAL INDUSTRIES, INCORPORATED AND SUBSIDIARIES

Form 10-Q

September 30, 2011

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References to Harman International, the Company, we, us, and our in this Form 10-Q refer to Harman International Industries, Incorporated and its subsidiaries unless the context requires otherwise.

Harman International, the Harman International logo, and the Harman International products and brand names referred to herein are either the trademarks or the registered trademarks of Harman International. All other trademarks are the property of their respective owners.

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Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. You should not place undue reliance on these statements. Forward-looking statements include information concerning possible or assumed future results of operations, cash flows, capital expenditures, the outcome of pending legal proceedings and claims, goals and objectives for future operations, including descriptions of our business strategies and purchase commitments from customers. These statements are typically identified by words such as believe, anticipate, expect, plan, intend, estimate, should, similar expressions. We base these statements on particular assumptions that we have made in light of our industry experience, as well as our perception of historical trends, current conditions, expected future developments and other factors that we believe are appropriate under the circumstances. As you read and consider the information in this report, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties and assumptions. In light of these risks and uncertainties, we cannot assure you that the results and events contemplated by the forward-looking statements contained in, or incorporated by reference into, this report will in fact transpire.

You should carefully consider the risks described below and the other information in this report because they identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. Our operating results may fluctuate significantly and may not meet our expectations or those of securities analysts or investors. The price of our stock would likely decline if this occurs. Factors that may cause fluctuations in our operating results include, but are not limited to, the following:

our ability to maintain profitability in our infotainment division if there are delays in our product launches which may give rise to significant penalties and increased engineering expense;

the loss of one or more significant customers, or the loss of a significant platform with an automotive customer;

warranty obligations for defects in our products;

fluctuations in currency exchange rates, particularly with respect to the value of the U.S. Dollar and the Euro;

our ability to successfully implement our global footprint initiative, including achieving cost reductions and other benefits in connection with the restructuring of our manufacturing, engineering, procurement and administrative organizations;

fluctuations in the price and supply of raw materials including, without limitation, petroleum, copper, steel, aluminum, synthetic resins, rare metals and rare-earth minerals, or shortages of materials, parts and components;

the inability of our suppliers to deliver products at the scheduled rate and disruptions arising in connection therewith;

our ability to attract and retain qualified senior management and to prepare and implement an appropriate succession plan for our critical organizational positions;

our failure to implement and maintain a comprehensive disaster recovery program;

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our failure to comply with governmental rules and regulations, including the Foreign Corrupt Practices Act and U.S. export control laws, and the cost of complying with such laws;

our ability to maintain a competitive technological advantage through innovation and leading product designs;

our failure to maintain the value of our brands and implementing a sufficient brand protection program;

the outcome of pending or future litigation and other claims, including, but not limited to, the current stockholder and Employee Retirement Income Security Act of 1974 lawsuits; and

our ability to enforce or defend our ownership and use of intellectual property rights.

Although we believe that these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect our actual results of operations and could cause actual results to differ materially from those expressed in the forward-looking statements. As a result, the foregoing factors should not be construed as exhaustive, and should be read together with the other cautionary statements included in this and other reports we file with the Securities and Exchange Commission including the information in Item 1A, under the caption

Risk Factors of Part I to our Annual Report on Form 10-K for the fiscal year ended June 30, 2011. We undertake no obligation to publicly update or revise any forward-looking statement (except as required by law).

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****HARMAN INTERNATIONAL INDUSTRIES, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

(in thousands)	September 30, 2011	June 30, 2011
Assets		
Current assets		
Cash and cash equivalents	\$ 398,418	\$ 603,892
Short-term investments	291,560	317,322
Receivables, net	664,774	579,272
Inventories, net	484,322	423,137
Other current assets	222,740	184,532
Total current assets	2,061,814	2,108,155
Property, plant and equipment, net	442,569	470,300
Goodwill	184,876	119,357
Deferred tax assets, long-term	194,723	229,941
Other assets	152,399	130,742
Total assets	\$ 3,036,381	\$ 3,058,495
Liabilities and Shareholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 381	\$ 386
Short-term debt	231	1,785
Accounts payable	468,433	473,486
Accrued liabilities	395,572	436,537
Accrued warranties	119,722	122,396
Income taxes payable	14,810	12,991
Total current liabilities	999,149	1,047,581
Convertible senior notes	382,587	378,401
Other non-current liabilities	237,430	208,855
Total liabilities	1,619,166	1,634,837
Commitments and contingencies		
Preferred stock	0	0
Common stock	957	956
Additional paid-in capital	916,670	915,433
Accumulated other comprehensive income	85,930	136,733
Retained earnings	1,461,228	1,418,106
Less: Common stock held in treasury	(1,047,570)	(1,047,570)
Total shareholders' equity	1,417,215	1,423,658

Total liabilities and shareholders equity	\$ 3,036,381	\$ 3,058,495
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See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents**HARMAN INTERNATIONAL INDUSTRIES, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

(In thousands, except per share data)	Three Months Ended	
	September 30,	
	2011	2010
Net sales	\$ 1,050,603	\$ 836,946
Cost of sales	762,961	612,375
Gross profit	287,642	224,571
Selling, general and administrative expenses	213,752	181,825
Sale of intellectual property	(288)	0
Operating income	74,178	42,746
Other expenses:		
Interest expense, net	5,276	6,146
Foreign exchange losses, net	4,224	104
Miscellaneous, net	1,444	1,423
Income before income taxes	63,234	35,073
Income tax expense, net	14,867	7,685
Net income	\$ 48,367	\$ 27,388
Earnings per share:		
Basic	\$ 0.68	\$ 0.39
Diluted	\$ 0.67	\$ 0.39
Weighted average shares outstanding:		
Basic	71,283	70,655
Diluted	71,882	71,094

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents**HARMAN INTERNATIONAL INDUSTRIES, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Three Months Ended September 30,	
	2011	2010
Cash Flows from operating activities:		
Net income	\$ 48,367	\$ 27,388
Adjustments to reconcile net income to net cash provided by operating activities, net of acquired businesses:		
Depreciation and amortization	31,483	28,157
Deferred income taxes	26,643	(290)
Gain on disposition of assets	83	252
Share-based compensation	2,541	4,353
Non-cash interest expense	4,853	4,868
Changes in operating assets and liabilities, net of acquired businesses:		
Decrease (increase) in:		
Receivables, net	(111,211)	1,693
Inventories, net	(80,883)	(58,878)
Other current assets	(38,005)	6,935
Increase (decrease) in:		
Accounts payable	10,427	(16,782)
Accrued warranties	(2,674)	19,805
Accrued other liabilities	21,660	(37,122)
Income taxes payable	2,660	2,351
Other operating activities	(18,125)	(4,720)
Net cash used in operating activities	(102,181)	(21,990)
Cash flows from investing activities:		
Purchases of short-term investments	(66,938)	(81,804)
Maturities of short-term investments	92,700	0
Acquisitions, net of cash acquired	(70,535)	(1,770)
Proceeds from asset dispositions	5	31
Capital expenditures	(23,482)	(11,550)
Other items, net	(12)	404
Net cash used in investing activities	(68,262)	(94,689)
Cash flows from financing activities:		
Net decrease in short-term borrowings	(1,343)	(9,573)
Other (decrease) increase in long-term debt	(3,394)	2,083
Dividends to shareholders	(5,245)	0
Share-based payment arrangements	(1,287)	306
Net cash used in financing activities	(11,269)	(7,184)
Effect of exchange rate changes on cash	(23,762)	45,969
Net decrease in cash and cash equivalents	(205,474)	(77,894)
Cash and cash equivalents at beginning of period	603,892	645,570
Cash and cash equivalents at end of period	\$ 398,418	\$ 567,676

Supplemental disclosure of cash flow information:

Interest (received) paid, net	\$ (6)	\$ 354
Income taxes paid	\$ 8,040	\$ 1,636

Non-Cash Investing Activities:

Accrued and contingent acquisition-related liabilities	\$ 28,123	\$ 3,001
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See accompanying Notes to the Condensed Consolidated Financial Statements

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HARMAN INTERNATIONAL INDUSTRIES, INCORPORATED AND SUBSIDIARIES

Notes to the Condensed Consolidated Financial Statements

(In thousands, except per-share data and where otherwise noted)

(Unaudited)

Note 1 Basis of Presentation

Basis of Presentation

References to we, us, our, the Company and Harman refer to Harman International Industries, Incorporated and its consolidated subsidiaries unless the context specifically requires otherwise.

Our unaudited, condensed consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (the SEC). These unaudited condensed consolidated financial statements have been prepared in accordance with the accounting policies described in our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011 (our 2011 Annual Report) and do not include all information and footnote disclosures included in our audited financial statements. In the opinion of management, the accompanying unaudited, condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary to present fairly, in all material respects, the consolidated financial condition, results of operations and cash flows for the periods presented. Operating results for the three months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2012 due to seasonal, economic and other factors. Where necessary, information for prior periods has been reclassified to conform to the consolidated financial statement presentation for the corresponding periods in the current fiscal year. These unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and accompanying notes included in our 2011 Annual Report.

Effective July 1, 2011, we revised our business segments in order to better align them with our strategic approach to the markets and customers we serve. Refer to Note 17 *Business Segment Data* for further information. Prior period segment amounts throughout the Notes to the Condensed Consolidated Financial Statements have been reclassified to the new segment structure. The reclassification of historical business segment information had no impact on our basic financial statements.

The methods, estimates and judgments we use in applying our accounting policies, in conformity with generally accepted accounting principles in the United States (GAAP), have a significant impact on the results we report in our financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. The estimates affect the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

Foreign currency exchange gains and losses resulting from the remeasurement of certain foreign currency denominated monetary assets and liabilities are included in Foreign exchange losses, net in our Condensed Consolidated Statements of Income. Effective July 1, 2011, we changed the functional currency of two of our foreign subsidiaries to the U.S. Dollar to reflect a change in the currency such subsidiaries primarily generate and expend cash. As a result, the amount of transaction gains and losses resulting from remeasurement have increased. We also include gains and losses from forward points on certain derivative foreign currency forward contracts that are excluded from hedge effectiveness testing in Foreign exchange losses, net in our Condensed Consolidated Statements of Income. Refer to Note 13 *Derivatives* for more information.

Note 2 New Accounting Standards

Recently Adopted Accounting Standards

Goodwill Impairment Testing: In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment. The new guidance is intended to simplify how entities test goodwill for impairment. It includes provisions that permit an entity to first assess qualitative factors in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. The new guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. We adopted the provisions of this new guidance in September 2011. The adoption of the new provisions did not have any impact on our financial condition or results of operations.

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Intangibles, Goodwill and Other: In December 2010, the FASB issued ASU 2010-28, Intangibles – Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. The new guidance requires that reporting units with zero or negative carrying amounts perform Step 2 of the goodwill impairment test if it

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is more likely than not that a goodwill impairment exists. The new guidance is effective for us for fiscal years beginning after December 15, 2010. We adopted the provisions of this new guidance on July 1, 2011. The adoption of the new provisions did not have any impact on our financial condition or results of operations, as we had no reporting units with zero or negative carrying amounts.

Business Combinations: In December 2010, the FASB issued ASU 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. The new guidance specifies that when comparative financial statements are presented, the revenue and earnings of the combined entity should be disclosed as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The new guidance applies prospectively to us for business combinations, which occur on or after July 1, 2011. We adopted the new provisions on July 1, 2011. The impact of these new provisions on our consolidated financial statements will depend upon the nature, terms and size of the acquisitions we consummate in the future.

Recently Issued Accounting Standards

Fair Value: In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The new guidance does not extend the use of fair value accounting, but provides guidance on how to apply fair value accounting, where its use is already required, or permitted by other standards within GAAP or International Financial Reporting Standards (IFRSs). The new guidance also changes the wording used to describe many requirements in GAAP for measuring fair value and for disclosing information about fair value measurements and it clarifies the FASB's intent about the application of existing fair value measurements. The new guidance applies prospectively and is effective for interim and annual periods beginning after December 15, 2011. We will adopt the provisions of this new guidance on January 1, 2012. We do not expect the adoption of the new provisions to have a material impact on our financial condition or results of operations.

Comprehensive Income: In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The new guidance requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both cases, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. If presented in a single continuous statement, the entity is required to present the components of net income and total net income, the components of other comprehensive income and a total for other comprehensive income, along with the total of comprehensive income in that statement. If presented in the two-statement approach, the first statement which is the statement of net income, should present components of net income and total net income followed consecutively by a second statement which is the statement of other comprehensive income, that should present the components of other comprehensive income, total other comprehensive income and a total amount for comprehensive income. Regardless of the method used, the entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. The new guidance is effective retrospectively for fiscal years, and interim periods within those fiscal years beginning after December 15, 2011. We will adopt the provisions of this new guidance on July 1, 2012. We do not expect the adoption of the new provisions to have a material impact on our financial condition or results of operations.

Note 3 - Allowance for Doubtful Accounts

We reserve an estimated amount for accounts receivable that may not be collected. Methodologies for estimating the allowance for doubtful accounts are based primarily on specific identification of uncollectible accounts. Historical collection rates and customer credit worthiness are considered in determining specific reserves. At September 30, 2011 and June 30, 2011, we had \$6.9 million and \$7.0 million, respectively, reserved for possible uncollectible accounts receivable.

Note 4 Inventories, net

Inventories, net consist of the following:

	September 30, 2011	June 30, 2011
Finished goods	\$ 188,697	\$ 153,469
Work in process	75,764	67,534
Raw materials	219,861	202,134

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Inventories, net	\$	484,322	\$	423,137
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At September 30, 2011 and June 30, 2011, our inventory reserves were \$69.2 million and \$73.3 million, respectively.

Table of Contents**Note 5 Property, Plant and Equipment, net**

Property, plant and equipment consist of the following:

	Estimated Useful Lives (in Years)	September 30, 2011	June 30, 2011
Land		\$ 11,288	\$ 11,974
Buildings and improvements	1-50	265,639	280,053
Machinery and equipment	3-20	1,024,303	1,050,892
Furniture and fixtures	3-10	26,604	30,769
Property, plant and equipment, gross		1,327,834	1,373,688
Less accumulated depreciation and amortization		(885,265)	(903,388)
Property, plant and equipment, net		\$ 442,569	\$ 470,300

Depreciation expense for the three months ended September 30, 2011 and 2010 was \$28.6 million and \$26.4 million, respectively.

Note 6 Accrued Warranties

We warrant our products to be free from defects in materials and workmanship for periods ranging from six months to six years from the date of purchase, depending on the business segment and product. Our dealers and warranty service providers normally perform warranty service in field locations and regional service centers, using parts and replacement finished goods we supply on an exchange basis. Our dealers and warranty service providers also install updates we provide to correct defects covered by our warranties. Estimated warranty liabilities are based upon past experience with similar types of products, the technological complexity of certain products, replacement cost and other factors. If estimates of warranty provisions are no longer adequate based on our analysis of current activity, incremental provisions are recorded as warranty expense in our Condensed Consolidated Statement of Income. We take these factors into consideration when assessing the adequacy of our warranty provision for periods still open to claim.

Details of our accrued warranties are as follows:

	Three Months Ended September 30,	
	2011	2010
Accrued warranties, June 30	\$ 122,396	\$ 99,329
Warranty expense	13,583	13,417
Warranty payments (cash or in-kind)	(7,349)	(4,098)
Other ⁽¹⁾	(8,908)	10,486
Accrued warranties, September 30	\$ 119,722	\$ 119,134

⁽¹⁾ Other primarily represents foreign currency translation.

Note 7 Earnings Per Share

The following table presents the calculation of basic and diluted earnings per share of common stock outstanding:

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	Three Months Ended September 30,			
	2011		2010	
	Basic	Diluted	Basic	Diluted
Numerator for Basic and Diluted Earnings per Share:				
Net income	\$ 48,367	\$ 48,367	\$ 27,388	\$ 27,388
Denominator for Basic and Diluted Earnings per Share:				
Weighted average shares outstanding	71,283	71,283	70,655	70,655
Employee stock options	0	599	0	439
Total weighted average shares outstanding	71,283	71,882	70,655	71,094
Earnings per Share:				
Earnings per share	\$ 0.68	\$ 0.67	\$ 0.39	\$ 0.39

Options to purchase 1,438,471 and 2,612,241 shares of our common stock with exercise prices ranging from \$31.74 to \$126.94 and \$28.51 to \$126.94 per share at September 30, 2011 and 2010, respectively, were outstanding and excluded from the computation of diluted earnings per share because they would have been antidilutive. In addition 3,969 and 158,653 of restricted shares at September 30, 2011 and 2010, respectively, were outstanding and excluded from the computation of diluted earnings per share as they also would have been antidilutive.

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The conversion terms of our \$400 million of 1.25 percent convertible senior notes due October 15, 2012 (the *Convertible Senior Notes*) will affect the calculation of diluted earnings per share if the price of our common stock exceeds the conversion price of the *Convertible Senior Notes*. The initial conversion price of the *Convertible Senior Notes* was approximately \$104 per share, subject to adjustment in specified circumstances as described in the indenture governing the *Convertible Senior Notes* (the *Indenture*). Upon conversion, a holder of the *Convertible Senior Notes* will receive an amount per *Convertible Senior Note* in cash equal to the lesser of \$1,000 or the conversion value of the *Convertible Senior Notes*, determined in the manner set forth in the *Indenture*. If the conversion value exceeds \$1,000, we will deliver \$1,000 in cash and, at our option, cash or common stock or a combination of cash and common stock for the conversion price in excess of \$1,000. The conversion option is indexed to our common stock and therefore is classified as equity. The conversion option will not result in an adjustment to net income in calculating diluted earnings per share. The dilutive effect of the conversion option will be calculated using the treasury stock method. Therefore, conversion settlement shares will be included in diluted shares outstanding if the price of our common stock exceeds the conversion price of the *Convertible Senior Notes*. The *Convertible Senior Notes* had no effect on the computation of diluted earnings per share for the three months ended September 30, 2011 and 2010. Refer to Note 9 *Debt* for further information.

Note 8 Goodwill

We test for impairment at the reporting unit level on an annual basis as of April 30th of every year and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. The impairment test for goodwill is a two-step process. The first step compares the fair value of each reporting unit to its carrying value, with fair value of each reporting unit determined using established valuation techniques, specifically the market and income approaches. Should the results of the first step indicate that the fair value of a reporting unit is less than its carrying value, the second step of this test is conducted wherein the amount of any impairment is determined by comparing the implied fair value of goodwill in a reporting unit to the recorded amount of goodwill for that reporting unit. The implied fair value of goodwill is calculated as the excess of fair value of the reporting unit over the amounts assigned to its assets and liabilities. Should the fair value of the goodwill so calculated be less than the carrying value, an impairment is recognized. The annual goodwill impairment tests conducted as of April 30, 2011 and April 30, 2010 indicated that the fair value of each reporting unit was substantially in excess of its carrying value and, as such, no impairments were deemed to exist. We did not recognize any impairment charges in our Consolidated Statements of Income in the three months ended September 30, 2011 and 2010.

During the three months ended September 30, 2011, we recorded \$79.8 million of goodwill associated with the acquisition of the MWM Acoustics group of companies (*MWM Acoustics*), which was recorded in our Lifestyle segment. A further discussion of the MWM Acoustics acquisition is provided in Note 20 *Acquisition*.

As discussed more fully in Note 17 *Business Segment Data*, the Company revised its segment and reporting unit structure effective July 1, 2011. Under this new structure, our reportable segments consist of the Infotainment, Lifestyle, Professional and Other segments. Our reporting units are the same as our reportable segments with the exception of Lifestyle, which consists of two reporting units, automotive audio and home audio. In connection with this realignment, we reallocated our goodwill to our new reporting units based on each reporting unit's relative fair value. We also performed a goodwill impairment test as of July 1, 2011 using our new reporting units. We determined that the fair value of each of our reporting units exceeded its carrying value and, as such, no impairments were deemed to exist as of this date.

Note 9 Debt***Short Term Borrowings***

At September 30, 2011 and June 30, 2011, we had \$0.2 million and \$1.8 million of short-term borrowings outstanding, respectively, and we maintained lines of credit of \$18.6 million and \$20.8 million, in the aggregate, respectively, in Hungary, the U.S., Austria and Brazil.

Revolving Credit Facility

On December 1, 2010 Harman and Harman Holding GmbH & Co., KG, our wholly-owned subsidiary (*Harman KG*), entered into a Multi-Currency Credit Agreement with a group of banks (the *Credit Agreement*). At September 30, 2011 and June 30, 2011, we had no borrowings under the *Credit Agreement* and had outstanding letters of credit of \$7.3 million. At September 30, 2011 and June 30, 2011, unused available credit under the *Credit Agreement* was \$542.7 million. If we do not meet the forecast in our budgets, we could violate our debt covenants and, absent a waiver from our lenders or an amendment to the *Credit Agreement*, we could be in default under the *Credit Agreement*. As a result, our debt under the *Credit Agreement* could become due, which would have a material adverse effect on our financial condition and results of operations. A default under the *Credit Agreement* could also lead to an event of default under the *Indenture*, as amended, and the acceleration of the *Convertible Senior Notes*. As of September 30, 2011, we were in

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compliance with all the financial covenants of the Credit Agreement. Debt issuance costs of \$7.0 million were recorded in connection with this transaction and are included in Other assets in our Condensed Consolidated Balance Sheets and are also being amortized to Interest expense, net in our Condensed Consolidated Statements of Income over the expected remaining term of the Credit Agreement.

Guarantee and Collateral Agreement

In connection with the Credit Agreement, we and Harman KG entered into a guarantee and collateral agreement (the Guarantee and Collateral Agreement), which provides, among other things, that the obligations under the Credit Agreement are guaranteed by us and each of the subsidiary guarantors party thereto, and that the obligations generally are secured by liens on substantially all of our assets and certain of our subsidiary guarantors' assets.

The term of the Guarantee and Collateral Agreement corresponds with the term of the Credit Agreement, which matures on December 1, 2015. Under the terms of the Guarantee and Collateral Agreement, we have effectively guaranteed the payment of the full amount of borrowings under the Credit Agreement, including outstanding letters of credit, upon maturity. The potential amount of future payments that we would be required to pay under the Guarantee and Collateral Agreement is the amount that we have borrowed under the Credit Agreement, including outstanding letters of credit. At September 30, 2011, we had no borrowings under the Credit Agreement and had outstanding letters of credit of \$7.3 million.

Convertible Senior Notes

We had \$400 million of Convertible Senior Notes outstanding at September 30, 2011 and June 30, 2011 which were issued on October 23, 2007 (the Issuance Date) and are due on October 15, 2012. The Convertible Senior Notes were issued at par and we pay interest at a rate of 1.25 percent per annum on a semiannual basis. The initial conversion rate on the Convertible Senior Notes is 9.6154 shares of our common stock per \$1,000 principal amount of the Convertible Senior Notes (which is equal to an initial conversion price of approximately \$104 per share). The conversion rate is subject to adjustment in specified circumstances described in the Indenture.

Accounting guidance issued by the FASB requires the issuer of convertible debt instruments with cash settlement features to account separately for the liability and equity components of the instrument. Under this guidance, the debt is recognized at the present value of its cash flows discounted using the issuer's nonconvertible debt borrowing rate at the time of issuance and the equity component is recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability, net of taxes. The reduced carrying value on the convertible debt results in a debt discount that is accreted back to the convertible debt's principal amount through the recognition of noncash interest expense, over the expected life of the debt, which results in recognizing interest expense on these borrowings at effective rates approximating what we would have incurred had nonconvertible debt with otherwise similar terms been issued.

In accordance with this guidance, we measured the fair value of the debt components of the Convertible Senior Notes at the Issuance Date using an effective interest rate of 5.6 percent. As a result, we attributed \$75.7 million of the proceeds received to the conversion feature of the Convertible Senior Notes at the Issuance Date, which is netted against the face value of the Convertible Senior Notes as a debt discount. This amount represents the excess proceeds received over the fair value of the Convertible Senior Notes at the Issuance Date and is being accreted back to the principal amount of the Convertible Senior Notes through the recognition of noncash interest expense over the expected life of the Convertible Senior Notes. In addition, we recorded \$48.3 million within additional paid-in capital in our Condensed Consolidated Balance Sheets representing the equity component of the Convertible Senior Notes, which is net of deferred taxes. The effect of this guidance has resulted in a decrease to net income and earnings per share for all periods presented; however, there is no effect on our cash interest payments.

The principal amounts, unamortized discount and net carrying amounts of the liability components and the equity components for the Convertible Senior Notes as of September 30, 2011 and June 30, 2011 are as follows:

	Principal Balance	Unamortized Discount	Net Carrying Amount	Equity Component
September 30, 2011	\$ 400,000	\$ (17,413)	\$ 382,587	\$ 48,323
June 30, 2011	\$ 400,000	\$ (21,599)	\$ 378,401	\$ 48,323

At September 30, 2011, the unamortized discount is recognized as a reduction in the carrying value of the Convertible Senior Notes in the Consolidated Balance Sheets and is being amortized to Interest expense, net in our Consolidated Statement of Income over the expected remaining term of the Convertible Senior Notes of 13 months as of September 30, 2011.

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Debt issuance costs of \$4.8 million were recorded in connection with this transaction and are included in Other assets in our Consolidated Balance Sheets and are also being amortized to Interest expense, net in our Consolidated Statements of Income over the expected remaining term of the Convertible Senior Notes. The unamortized balance of debt issuance costs at September 30, 2011 and June 30, 2011 was \$0.8 million and \$1.1 million, respectively.

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Total interest expense related to the Convertible Senior Notes for the three months ended September 30, 2011 and 2010, includes \$1.3 million in both periods for contractual cash interest expense, and an additional \$4.2 million and \$4.0 million of noncash interest expense, respectively, related to the amortization of the discount and \$0.2 million in both periods related to the amortization of debt issuance costs.

At September 30, 2011, we were in compliance with all covenants under the Indenture, as amended.

Note 10 Income Taxes

Our provision for income taxes is based on an estimated annual tax rate for the year applied to federal, state and foreign income. Income tax expense for the three months ended September 30, 2011 was \$14.9 million, compared to \$7.7 million for the same period in the prior year. The effective tax rate for the three months ended September 30, 2011 was 23.5 percent, compared to 21.9 percent for the same period in the prior year. The change in the effective tax rate for the three months ended September 30, 2011 compared to the same period in the prior year was primarily due to higher income in the United States that is subject to a tax rate greater than our key foreign jurisdictions.

During the three months ended September 30, 2011 we recorded tax reserves and interest on uncertain tax positions in the amount of \$0.5 million and \$0.1 million, respectively, all of which would affect the tax rate if recognized.

Note 11 Shareholders Equity

Preferred Stock

As of September 30, 2011 and June 30, 2011, we had no shares of preferred stock outstanding. We are authorized to issue 5 million shares of preferred stock, \$0.01 par value.

Common Stock

We have 200 million authorized shares of common stock, \$0.01 par value. At September 30, 2011 and June 30, 2011, we had 95,691,936 and 95,520,068 shares issued; 25,599,817 shares in treasury stock in each period, and 70,092,119 and 69,920,251 outstanding (net of treasury stock), respectively.

Table of Contents**Changes in Equity:**

The following is a summary of the changes in Accumulated Other Comprehensive Income (AOCI) and changes in equity for the three months ended September 30, 2011 and 2010:

	Preferred Stock	Common Stock	Additional Paid-in Capital	AOCI	Retained Earnings	Treasury Stock	Total Equity
Balance at June 30, 2011	\$ 0	\$ 956	\$ 915,433	\$ 136,733	\$ 1,418,106	\$ (1,047,570)	\$ 1,423,658
Net income	0	0	0	0	48,367	0	48,367
Foreign currency translation	0	0	0	(84,142)	0	0	(84,142)
Unrealized gain on hedging derivatives	0	0	0	33,767	0	0	33,767
Pension liability adjustment	0	0	0	(250)	0	0	(250)
Unrealized loss on available-for-sale securities	0	0	0	(178)	0	0	(178)
Comprehensive loss							(2,436)
Exercise of stock options, net of shares received	0	1	(1,288)	0	0	0	(1,287)
Share-based compensation, net	0	0	2,525	0	0	0	2,525
Dividends (\$0.30 per share)	0	0	0	0	(5,245)	0	(5,245)
Balance at September 30, 2011	\$ 0	\$ 957	\$ 916,670	\$ 85,930	\$ 1,461,228	\$ (1,047,570)	\$ 1,417,215

	Preferred Stock	Common Stock	Additional Paid-in Capital	AOCI	Retained Earnings	Treasury Stock	Total Equity
Balance at June 30, 2010	\$ 0	\$ 952	\$ 892,129	\$ 3,666	\$ 1,285,715	\$ (1,047,570)	\$ 1,134,892
Net income	0	0	0	0	27,388	0	27,388
Foreign currency translation	0	0	0	92,349	0	0	92,349
Unrealized loss on hedging derivatives	0	0	0	(40,622)	0	0	(40,622)
Pension liability adjustment	0	0	0	(355)	0	0	(355)
Unrealized gain on available-for-sale securities	0	0	0	1,974	0	0	1,974
Comprehensive income							80,734
Exercise of stock options, net of shares received	0	0	306	0	0	0	306
Share-based compensation, net	0	0	4,337	0	0	0	4,337
Balance at September 30, 2010	\$ 0	\$ 952	\$ 896,772	\$ 57,012	\$ 1,313,103	\$ (1,047,570)	\$ 1,220,269

At September 30, 2011 and June 30, 2011, AOCI consisted of the following:

Income/(Loss):	September 30, 2011	June 30, 2011
Cumulative translation adjustment	\$ 97,992	\$ 182,134

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Pension liability adjustment	(18,553)	(18,303)
Unrealized gain (loss) on hedging derivatives	10,583	(23,184)
Unrealized loss on available-for-sale securities	(4,092)	(3,914)
Total AOCI	\$ 85,930	\$ 136,733

We have approximately \$1.7 million and \$1.9 million of investments at September 30, 2011 and June 30, 2011, respectively, included in Other current assets in our Condensed Consolidated Balance Sheets that have been classified as available-for-sale securities. These securities are recorded at fair value with realized gains and losses recorded in income and unrealized gains and losses recorded in AOCI, net of taxes.

Table of Contents**Note 12 Share-Based Compensation**

On September 30, 2011, we had one share-based compensation plan with shares available for future grants, the Amended and Restated 2002 Stock Option and Incentive Plan, as amended (the 2002 Plan). On December 8, 2010, we amended the 2002 Plan to increase the number of shares available under the 2002 Plan for the grant of stock options, stock appreciation rights, restricted stock and restricted stock units by 1,100,000 to an aggregate amount not to exceed 7,860,000 shares of our common stock. During the three months ended September 30, 2011, options to purchase 445,967 shares of our common stock and 618,919 restricted stock units were granted under the 2002 Plan. During the three months ended September 30, 2010, options to purchase 301,006 shares of our common stock and 672,381 restricted stock units were granted under the 2002 Plan.

Share-based compensation expense, net was \$2.5 million and \$4.4 million for the three months ended September 30, 2011 and 2010, respectively. The total income tax benefit recognized in the Condensed Consolidated Statements of Income for share-based compensation arrangements was \$0.7 million and \$1.1 million for the three months ended September 30, 2011 and 2010, respectively.

Fair Value Determination

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model, which uses the assumptions noted in the following table.

	Three Ended September 30,	
	2011	2010
Expected volatility	48.7% - 65.7%	63.8% - 73.1%
Weighted-average volatility	59.5%	69.2%
Expected annual dividend	\$ 0.30	\$ 0.00
Expected term (in years)	1.70 - 3.82	1.80 - 3.80
Risk-free rate	0.2% - 0.7%	0.6% - 1.2%

Groups of option holders (directors, executives and non-executives) that have similar historical behavior are considered separately for valuation purposes. Expected volatilities are based on historical closing prices of our common stock over the expected option term. We use historical data to estimate option exercises and employee terminations within the valuation model. The expected term of options granted is derived using the option valuation model and represents the estimated period of time from the date of grant that the option is expected to remain outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Stock Option Activity

A summary of option activity under our stock option plans as of September 30, 2011 and changes during the three months ended September 30, 2011 is presented below:

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at June 30, 2011	2,489,998	\$ 56.39	6.36	\$ 19,270
Granted	445,967	34.74		
Exercised	(14,367)	27.53		
Forfeited or expired	(64,301)	57.45		
Outstanding at September 30, 2011	2,857,297	\$ 53.13	6.86	\$ 1,025
Exercisable at September 30, 2011	1,798,412	\$ 59.53	5.83	\$ 375

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The weighted-average grant-date fair value of options granted for the three months ended September 30, 2011 and 2010 was \$13.18 and \$14.24, respectively. The total intrinsic value of options exercised for the three months ended September 30, 2011 and 2010 was \$0.1 million and \$0.1 million, respectively.

Modification of Certain Stock Option Awards

Prior to fiscal year 2011, certain of the award agreements under the 2002 Plan stated that vested options not exercised were forfeited upon termination of employment for any reason other than death or disability. However, such award agreements provided that the Compensation and Option Committee of our Board of Directors (the Compensation and Option Committee) could extend the time period to exercise vested options 90 days beyond the employment termination date for certain employees. During the three months ended September 30, 2011 and 2010, the Compensation and Option Committee used this authority. This action represented a

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modification of the terms or conditions of an equity award and therefore was accounted for as an exchange of the original award for a new award. No incremental share-based compensation cost was recognized for the excess of the fair value of the new award over the fair value of the original award.

Grant of Stock Options with Market Conditions

We granted 330,470 stock options containing a market condition to employees on March 21, 2008. The options vested on March 21, 2011, which was three years from the date of grant based on a comparison of Harman's total shareholder return (TSR) to the TSR of a selected peer group of publicly listed multinational companies. TSR was measured as the annualized increase in the aggregate value of a company's stock price plus the value of dividends, assumed to be reinvested into shares of the company's stock at the time of dividend payment. The base price used for the TSR calculation of \$42.19 is the 20-day trading average from February 6, 2008 through March 6, 2008. The ending price used for the TSR calculation of \$49.81 was the 20-day trading average prior to and through March 6, 2011. The grant date fair value of \$4.2 million was calculated using a combination of Monte Carlo simulation and lattice-based models. There was no compensation expense for these awards in the three months ended September 30, 2011, since the awards had vested in a prior period. Share-based compensation expense for these awards was \$0.4 million for the three months ended September 30, 2010.

Restricted Stock Awards

A summary of the status of our nonvested restricted stock as of September 30, 2011 and changes during the three months ended September 30, 2011, is presented below:

	Shares	Weighted Average Grant-Date Fair Value
Nonvested at June 30, 2011	26,000	\$ 42.71
Vested	(8,000)	64.26
Nonvested at September 30, 2011	18,000	\$ 33.13

As of September 30, 2011, there was \$0.1 million of total unrecognized compensation cost related to nonvested restricted stock-based compensation arrangements granted under the 2002 Plan. The weighted average recognition period was 0.4 years. At September 30, 2011, a total of 18,000 shares of restricted stock were outstanding of which 15,000 were granted under the 2002 Plan and 3,000 were granted outside of the 2002 Plan.

Restricted Stock Units

In the three months ended September 30, 2011, we granted 118,546 restricted stock units with earnings per share (EPS) performance conditions, 118,546 restricted stock units with return on invested capital (ROIC) performance conditions and 118,546 restricted stock units with market conditions, under the 2002 Plan. The restricted stock units with EPS performance conditions cliff vest three years from the date of grant based on the achievement of certain cumulative EPS levels from fiscal years 2012 through 2014. The restricted stock units with ROIC conditions cliff vest three years from the date of grant based on the achievement of ROIC levels in 2014. The restricted stock units with market conditions cliff vest three years from the date of grant based on a comparison of our TSR to the TSR of a selected peer group of publicly listed multinational companies. The grant date fair value of \$3.3 million was calculated using a Monte Carlo simulation model. Compensation expense, for both the restricted stock units with performance conditions and the restricted stock units with market conditions, is recognized ratably over the three-year vesting period based on the grant date fair value and our assessment of the probability that the applicable targets will be met. The probability is reassessed each reporting period for the restricted stock units with performance conditions.

In the three months ended September 30, 2010, we granted 191,721 restricted stock units with EPS performance conditions and 191,715 restricted stock units with market conditions, under the 2002 Plan. The restricted stock units with EPS performance conditions cliff vest three years from the date of grant based on the attainment of a certain EPS level in fiscal year 2013. The restricted stock units with market conditions cliff vest three years from the date of grant based on a comparison of our TSR to the TSR of a selected peer group of publicly listed multinational companies. The grant date fair value of \$5.2 million was calculated using a Monte Carlo simulation model. Compensation expense, for both the restricted stock units with performance conditions and the restricted stock units with market conditions, is recognized ratably over the three-year vesting period based on the grant date fair value and our assessment of the probability that the applicable targets will

be met. The probability is reassessed each reporting period for the restricted stock units with performance conditions.

In the three months ended September 30, 2009, we granted 380,400 restricted stock units with performance conditions, under the 2002 Plan. The restricted stock units cliff vest three years from the date of grant based on the attainment of certain performance targets in fiscal year 2012. Compensation expense is recognized ratably over the three-year vesting period, on a straight-line basis, based on the grant date fair value and our assessment of the probability that the performance targets will be met. We have recognized compensation expense based on our estimate of the probability of achieving the targets.

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In the three months ended September 30, 2008, we granted 133,507 restricted stock units with performance conditions, under the 2002 Plan. These restricted stock units vested in September 2011, based on the attainment of certain performance targets in fiscal years 2011. Compensation expense was recognized ratably over the three-year vesting period, on a straight-line basis, based on the grant date fair value and our assessment of the probability that the performance targets will be met. We recognized compensation expense based on our estimate of the probability of achieving the targets. Approximately 50 percent of the restricted stock units vested based on actual attainment of certain targets. In the three months ended September 30, 2011 and 2010, we also granted 263,281 and 288,945 restricted stock units, respectively, under the 2002 Plan that vest three years from the date of grant.

In January and September 2008, we granted 34,608 and 28,344 cash-settled restricted stock units, respectively, outside the 2002 Plan. These restricted stock units are accounted for as liability awards and are recorded at the fair value at the end of the reporting period in accordance with their vesting schedules. During the three months ended September 30, 2011 and 2010, 1,608 and 9,647 of these restricted stock units were settled, respectively, at a cost of \$0.1 million and \$0.3 million, respectively. At September 30, 2011, and 2010, 1,608 and 3,216 cash-settled restricted stock units were outstanding.

A summary of equity classified restricted stock unit activity as of September 30, 2011 and changes during the three months ended September 30, 2011 is presented below:

	Shares
Nonvested at June 30, 2011	1,665,873
Granted	618,919
Vested	(207,015)
Forfeited	(114,565)
Nonvested at September 30, 2011	1,963,212

At September 30, 2011, the aggregate intrinsic value of equity classified restricted stock units was \$56.2 million and there was \$34.3 million of total unrecognized compensation cost related to restricted stock unit compensation arrangements. The weighted average recognition period was 1.91 years.

Note 13 Derivatives

We are exposed to market risk from changes in foreign currency exchange rates and interest rates, which could affect our operating results, financial condition and cash flows. We manage our exposure to these risks through our regular operating and financial activities and, when appropriate, through the use of derivative financial instruments. These derivative instruments are utilized to hedge economic exposures, as well as to reduce earnings and cash flow volatility resulting from shifts in market rates. We enter into limited types of derivative contracts, including foreign currency spot, forward and option contracts and an interest rate swap, to manage foreign currency and interest rate exposures. Our primary foreign currency exposure is the Euro. The fair market values of all our derivative contracts change with fluctuations in interest rates and currency rates and are designed so that any changes in their values are offset by changes in the values of the underlying exposures. Derivative financial instruments are held solely as risk management tools and not for trading or speculative purposes.

We record all derivative instruments as either assets or liabilities at fair value in our Condensed Consolidated Balance Sheets. Certain of these derivative contracts have been designated as cash flow hedges, whereby gains and losses are reported within AOCI in our Condensed Consolidated Balance Sheets, until the underlying transaction occurs, at which point they are reported in earnings as gains and losses in our Condensed Consolidated Statements of Income. Certain of our derivatives, for which hedge accounting is not applied, are effective as economic hedges. These derivative contracts are required to be recognized each period at fair value, with gains and losses reported in earnings in our Condensed Consolidated Statements of Income and therefore do result in some level of earnings volatility. The level of volatility will vary with the type and amount of derivative hedges outstanding, as well as fluctuations in the currency and interest rate markets during the period. The related cash flow impacts of all our derivative activities are reflected as cash flows from operating activities.

Derivatives, by their nature, involve varying degrees of market and credit risk. The market risk associated with these instruments resulting from currency exchange and interest rate movements is expected to offset the market risk of the underlying transactions, assets and liabilities being hedged. We do not believe there is significant risk of loss in the event of non-performance by the counterparties associated with these instruments, because these transactions are executed with a diversified group of major financial institutions. Furthermore, our policy is to contract only with counterparties having a minimum investment grade or better credit rating. Credit risk is managed through the continuous

monitoring of exposure to such counterparties.

Table of Contents**Foreign Exchange Risk Management**

We use foreign exchange contracts to hedge the price risk associated with foreign denominated forecasted purchases of materials used in our manufacturing process and to manage currency risk associated with operating costs in certain operating units, including foreign currency denominated intercompany loans and other foreign currency denominated assets. These contracts generally mature in one year or less. The majority of these contracts are designated as cash flow hedges.

At September 30, 2011 and June 30, 2011, we had outstanding foreign exchange contracts, including forward and option contracts, which are summarized below:

	September 30, 2011		June 30, 2011	
	Gross Notional Value	Fair Value Asset/ Liability ⁽¹⁾	Gross Notional Value	Fair Value Asset/ Liability ⁽¹⁾
Currency Hedged (Buy/Sell):				
U.S. Dollar/Euro	\$ 599,700	\$ 17,542	\$ 612,400	\$ (33,760)
Swiss Franc/U.S. Dollar	38,538	(2,565)	41,647	516
British Pound/U.S. Dollar	18,300	(619)	20,700	(152)
British Pound/Swiss Franc	10,753	142	15,408	(574)
Euro/British Pound	2,677	(31)	11,604	163
U.S. Dollar/Brazilian Real	10,400	392	10,400	(1,249)
U.S. Dollar/British Pound	7,500	131	8,500	(76)
Chinese Yuan/U.S. Dollar	26,923	(38)	6,188	84
Euro/U.S. Dollar	48,650	(3,174)	8,200	146
U.S. Dollar/Japanese Yen	1,350	(48)	900	(22)
Total	\$ 764,791	\$ 11,732	\$ 735,947	\$ (34,924)

⁽¹⁾ Represents the net receivable/(payable) included in our Condensed Consolidated Balance Sheets.

Cash Flow Hedges

We designate a portion of our foreign currency derivative contracts as cash flow hedges of foreign currency denominated purchases. As of September 30, 2011 and June 30, 2011, we had \$542.1 million and \$528.4 million of forward and option contracts maturing through September 2012 and June 2012, respectively. These contracts are recorded at fair value in the accompanying Condensed Consolidated Balance Sheets. The changes in fair value for these contracts on a spot to spot basis are reported in AOCI, and are reclassified to either Cost of sales or Selling, general and administrative expense (SG&A), depending on the nature of the underlying asset or liability that is being hedged, in our Condensed Consolidated Statements of Income, in the period or periods during which the underlying transaction occurs. If it becomes apparent that an underlying forecasted transaction will not occur, the amount recorded in AOCI related to the hedge is reclassified to Foreign exchange losses, net in our Condensed Consolidated Statements of Income in the then-current period. Amounts relating to such reclassifications were immaterial in each of the three months ended September 30, 2011 and 2010.

Changes in the fair value of the derivatives are highly effective in offsetting changes in the cash flows of the hedged items because the amounts and the maturities of the derivatives approximate those of the forecasted exposures. Any ineffective portion of the derivative is recognized in the current period in our Condensed Consolidated Statements of Income, in the same line item in which the foreign currency gain or loss on the underlying hedged transaction was recorded. No amount of ineffectiveness was recognized in the Condensed Consolidated Statements of Income for the three months ended September 30, 2011 and 2010. All components of each derivative's gain or loss, with the exception of forward points (see below), were included in the assessment of hedge ineffectiveness. At September 30, 2011 and June 30, 2011, the fair value of these contracts was a net asset of \$13.2 million and a net liability of \$25.2 million, respectively. The amount associated with these hedges that is expected to be reclassified from AOCI to earnings within the next 12 months is a gain of \$14.6 million.

We elected to exclude forward points from the effectiveness assessment. At the end of the reporting period, we calculate the excluded amount, which is the fair value relating to the change in forward points that is recorded in current earnings as Foreign exchange losses, net in our

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Condensed Consolidated Statements of Income. For the three months ended September 30, 2011 and 2010, we recognized \$3.6 million and \$0.8 million of net losses, respectively, related to the change in forward points.

Economic Hedges

When hedge accounting is not applied to derivative contracts, or after former cash flow hedges have been de-designated as balance sheet hedges, we recognize the gain or loss on the associated contracts directly in current period earnings in either Foreign exchange losses, net or Cost of sales according to the underlying exposure, in our Condensed Consolidated Statements of Income, as unrealized

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exchange gains/(losses). As of September 30, 2011 and June 30, 2011, we had \$222.7 million and \$207.5 million, respectively, of forward contracts maturing through June 2012, in various currencies to hedge foreign currency denominated intercompany loans and other foreign currency denominated assets. At September 30, 2011 and June 30, 2011, the fair value of these contracts was a liability of \$1.4 million and \$9.7 million, respectively. Adjustments to the carrying value of the foreign currency forward contracts offset the gains and losses on the underlying loans and other foreign denominated assets in other non-operating income.

Interest Rate Risk Management

We have one interest rate swap contract with a notional amount of \$22.3 million and \$24.5 million at September 30, 2011 and June 30, 2011, respectively, in order to manage our interest rate exposure and effectively convert interest on an operating lease from a variable rate to a fixed rate. The objective of the swap is to offset changes in rent expenses caused by interest rate fluctuations. The interest rate swap contract is designated as a cash flow hedge. At the end of each reporting period, the discounted fair value of the swap contract is calculated and recorded in AOCI and reclassified as rent expense, within SG&A in our Condensed Consolidated Statements of Income, in the then-current period. If the hedge is determined to be ineffective, the ineffective portion will be reclassified from AOCI and recorded as rent expense, within SG&A. We recognized less than \$0.1 million in each of the three month periods ended September 30, 2011 and 2010, in our Condensed Consolidated Statement of Income. All components of the derivative loss were included in the assessment of the hedged effectiveness. The amount associated with the swap contract that is expected to be recorded as rent expense in the next 12 months is a loss of \$0.6 million.

Fair Value of Derivatives

The following tables provide a summary of the fair value amounts of our derivative instruments at September 30, 2011 and June 30, 2011:

	Balance Sheet Location	Fair Value	
		September 30, 2011	June 30, 2011
Derivatives Designated as Cash Flow Hedges, Gross:			
Other assets:			
Foreign exchange contracts	Other current assets	\$ 15,167	\$ 95
Other liabilities:			
Foreign exchange contracts	Accrued liabilities	1,992	25,335
Interest rate swap	Accrued liabilities	630	625
Interest rate swap	Other non-current liabilities	658	554
Total liabilities		3,280	26,514
Net asset (liability) for derivatives designated as hedging instruments		11,887	(26,419)
Derivatives Designated as Economic Hedges, Gross:			
Other assets:			
Foreign exchange contracts	Other current assets	3,633	1,032
Other liabilities:			
Foreign exchange contracts	Accrued liabilities	5,077	10,716
Net liability for economic hedges:		(1,444)	(9,684)
Total net derivative asset (liability)		\$ 10,443	\$ (36,103)

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Derivative Activity

The following table shows derivative activity for derivatives designated as cash flow hedges for the three months ended September 30, 2011 and 2010:

Derivative	Location of Derivative Gain/(Loss) Recognized in Income	Gain/(Loss) Reclassified from AOCI into Income (Effective Portion)	Gain/(Loss) Recogniz
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