National Bank Holdings Corp
Form 10-Q
August 07, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2015
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: 001-35654

NATIONAL BANK HOLDINGS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	27-0563799
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7800 East Orchard, Suite 300, Greenwood Village, Colorado 80111
(Address of principal executive offices) (Zip Code)
Registrant's telephone, including area code: (720) 529-3336

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 ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "accelerated filer." and "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	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 ý
APPLICABLE ONLY TO CORPORATE ISSUERS:
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
As of August 6, 2015, the registrant had outstanding 35,055,362 shares of Class A voting common stock, each with $0.01 par value per share, excluding 1,037,564 shares of restricted Class A common stock issued but not yet vested. Additionally, the registrant expects to repurchase approximately 4,651,162 shares pursuant to its previously announced self-tender offer that expired on July 31, 2015. Immediately following the repurchase, the registrant

expects to have approximately 30,404,200 shares of Class A common stock outstanding, excluding 1,037,564 shares of restricted Class A common stock issued but not yet vested.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, notwithstanding that such statements are not specifically identified. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as “anticipate,” “believe,” “can,” “would,” “should,” “could,” “may,” “predict,” “seek,” “potential,” “will,” “estimate,” “t “continuing,” “ongoing,” “expect,” “intend” and similar words or phrases. These statements are only predictions and involve estimates, known and unknown risks, assumptions and uncertainties. We have based these statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, liquidity, results of operations, business strategy and growth prospects.

Forward-looking statements involve certain important risks, uncertainties and other factors, any of which could cause actual results to differ materially from those in such statements and, therefore, you are cautioned not to place undue reliance on such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- our ability to execute our business strategy, as well as changes in our business strategy or development plans;
- business and economic conditions generally and in the financial services industry;
- economic, market, operational, liquidity, credit and interest rate risks associated with our business;
- effects of any changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;
- changes imposed by regulatory agencies to increase our capital to a level greater than the current level required for well-capitalized financial institutions (including the impact of the joint final rules promulgated by the Federal Reserve Board, Office of the Comptroller of the Currency and the FDIC revising certain regulatory capital requirements to align with the Basel III capital standards and meet certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act);
- effects of inflation, as well as, interest rate, securities market and monetary supply fluctuations;
- changes in the economy or supply-demand imbalances affecting local real estate values;
- changes in consumer spending, borrowings and savings habits;
- our ability to identify potential candidates for, obtain regulatory approval for, and consummate, acquisitions of financial institutions on attractive terms, or at all;
- our ability to integrate acquisitions and to achieve synergies, operating efficiencies and/or other expected benefits within expected time-frames, or at all, or within expected cost projections, and to preserve the goodwill of acquired financial institutions;
- our ability to successfully convert core operating systems, at the estimated cost, without significant business interruption and to realize the anticipated benefits;
- our ability to achieve organic loan and deposit growth and the composition of such growth;
- changes in sources and uses of funds, including loans, deposits and borrowings;
- increased competition in the financial services industry, nationally, regionally or locally, resulting in, among other things, lower returns;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;
- the trading price of shares of the Company's stock;
- our ability to realize deferred tax assets or the need for a valuation allowance;
- continued consolidation in the financial services industry;
- our ability to maintain or increase market share and control expenses;
- costs and effects of changes in laws and regulations and of other legal and regulatory developments, including, but not limited to, changes in regulation that affect the fees that we charge, the resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations, reviews or other inquiries;
- technological changes;
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- the timely development and acceptance of new products and services and perceived overall value of these products and services by our clients;
- changes in our management personnel and our continued ability to hire and retain qualified personnel;
- ability to implement and/or improve operational management and other internal risk controls and processes and our reporting system and procedures;
- regulatory limitations on dividends from our bank subsidiary;
- changes in estimates of future loan reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;

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- widespread natural and other disasters, dislocations, political instability, acts of war or terrorist activities, cyberattacks or international hostilities through impacts on the economy and financial markets generally or on us or our counterparties specifically;
- impact of reputational risk on such matters as business generation and retention;
- other risks and uncertainties listed from time to time in the Company's reports and documents filed with the Securities and Exchange Commission; and
- our success at managing the risks involved in the foregoing items.

Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events or circumstances, except as required by applicable law.

PART I: FINANCIAL INFORMATION
Item 1: FINANCIAL STATEMENTS
NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Financial Condition (Unaudited)
(In thousands, except share and per share data)

	June 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$57,880	$61,461
Due from banks	174,481	185,463
Interest bearing bank deposits	10,080	10,055
Cash and cash equivalents	242,441	256,979
Securities purchased under agreements to resell	50,000	—
Investment securities available-for-sale (at fair value)	1,316,829	1,479,214
Investment securities held-to-maturity (fair value of $476,519 and $534,637 at June 30, 2015 and December 31, 2014, respectively)	472,605	530,590
Non-marketable securities	27,050	27,045
Loans (including covered loans of $167,149 and $193,697 at June 30, 2015 and December 31, 2014, respectively)	2,328,524	2,162,409
Allowance for loan losses	(20,241)	(17,613)
Loans, net	2,308,283	2,144,796
Loans held for sale	10,037	5,146
Federal Deposit Insurance Corporation (“FDIC”) indemnification asset, net	23,215	39,082
Other real estate owned	20,367	29,120
Premises and equipment, net	102,228	106,341
Goodwill	59,630	59,630
Intangible assets, net	14,210	16,883
Other assets	130,955	124,820
Total assets	$4,777,850	$4,819,646
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing demand deposits	$777,727	$732,580
Interest bearing demand deposits	389,270	386,121
Savings and money market	1,327,953	1,290,436
Time deposits	1,267,539	1,357,051
Total deposits	3,762,489	3,766,188
Securities sold under agreements to repurchase	187,314	133,552
Federal Home Loan Bank advances	40,000	40,000
Due to FDIC	38,195	42,011
Other liabilities	31,586	43,320
Total liabilities	4,059,584	4,025,071
Shareholders’ equity:		
Common stock, par value $0.01 per share: 400,000,000 shares authorized; 52,374,349 and 52,223,460 shares issued; 35,053,339 and 38,884,953 shares outstanding at June 30, 2015 and December 31, 2014, respectively	513	512
Additional paid in capital	994,454	993,212
Retained earnings	36,709	40,528
Treasury stock of 16,277,782 and 12,383,109 shares at June 30, 2015 and December 31, 2014, respectively, at cost	(317,854)	(245,516)

Accumulated other comprehensive income, net of tax	4,444	5,839
Total shareholders’ equity	718,266	794,575
Total liabilities and shareholders’ equity	$4,777,850	$4,819,646

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations (Unaudited)
(In thousands, except share and per share data)

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Interest and dividend income:				
Interest and fees on loans	$32,166	$33,054	$64,147	$66,301
Interest and dividends on investment securities	9,764	12,606	20,336	25,774
Dividends on non-marketable securities	317	270	644	659
Interest on interest-bearing bank deposits	270	75	477	156
Total interest and dividend income	42,517	46,005	85,604	92,890
Interest expense:				
Interest on deposits	3,451	3,556	6,850	7,062
Interest on borrowings	211	26	420	58
Total interest expense	3,662	3,582	7,270	7,120
Net interest income before provision for loan losses	38,855	42,423	78,334	85,770
Provision for loan losses	1,858	1,660	3,311	3,429
Net interest income after provision for loan losses	36,997	40,763	75,023	82,341
Non-interest income:				
FDIC indemnification asset amortization	(7,283)	(5,959)	(14,953)	(13,567)
FDIC loss sharing income (expense)	1,138	(649)	328	(1,606)
Service charges	3,697	3,870	7,024	7,410
Bank card fees	2,699	2,559	5,249	4,933
Gain on sales of mortgages, net	546	202	946	410
Bank-owned life insurance income	402	—	796	—
Other non-interest income	1,321	896	2,093	1,721
Gain on previously charged-off acquired loans	39	232	97	528
OREO related write-ups and other income	188	1,010	688	1,978
Total non-interest income	2,747	2,161	2,268	1,807
Non-interest expense:				
Salaries and benefits	21,156	20,428	41,233	41,202
Occupancy and equipment	6,069	6,209	12,158	12,683
Telecommunications and data processing	2,578	2,982	5,640	6,130
Marketing and business development	1,252	1,762	2,261	2,785
FDIC deposit insurance	1,032	1,035	2,073	2,080
ATM/debit card expenses	789	762	1,546	1,513
Professional fees	962	688	2,082	1,326
Other non-interest expense	2,493	2,749	4,735	5,158
Other real estate owned expense (income)	406	1,402	(12)	3,035
Problem loan expenses	723	1,082	1,522	1,767
Intangible asset amortization	1,336	1,336	2,672	2,672
Loss (gain) from the change in fair value of warrant liability	508	(580)	118	(1,478)
Banking center closure related expenses	1,089	—	1,089	—
Total non-interest expense	40,393	39,855	77,117	78,873
(Loss) income before income taxes	(649)	3,069	174	5,275
Income tax expense	692	940	269	1,715
Net (loss) income	$(1,341)	$2,129	$(95)	$3,560
(Loss) income per share—basic	$(0.04)	$0.05	$0.00	$0.08
(Loss) income per share—diluted	$(0.04)	$0.05	$0.00	$0.08

Weighted average number of common shares outstanding:				
Basic	36,164,617	43,868,164	37,091,412	44,341,276
Diluted	36,164,617	43,880,263	37,091,412	44,364,639

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive (Loss) Income (Unaudited)
(In thousands)

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Net (loss) income	$(1,341)	$2,129	$(95)	$3,560
Other comprehensive (loss) income, net of tax:				
Securities available-for-sale:				
Net unrealized (losses) gains arising during the period, net of tax benefit (expense) of $4,299 and $(3,343) for the three months ended June 30, 2015 and 2014, respectively; and net of tax expense of $0 and $8,305 for the six months ended June 30, 2015 and 2014, respectively.	(6,989)	5,436	—	13,505
Amortization of net unrealized holding gains on securities transferred between available-for-sale to held-to-maturity, net of tax benefit of $401 and $509 for the three months ended June 30, 2015 and 2014, respectively; and net of tax benefit of $857 and $1,029 for the six months ended June 30, 2015 and 2014, respectively.	(652)	(829)	(1,395)	(1,673)
Other comprehensive (loss) income	(7,641)	4,607	(1,395)	11,832
Comprehensive (loss) income	$(8,982)	$6,736	$(1,490)	$15,392

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
Six Months Ended June 30, 2015 and 2014
(In thousands, except share and per share data)

	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive income (loss), net	Total
Balance, December 31, 2013	$512	$990,216	$39,966	$(126,146)	$ (6,756)	$897,792
Net income	—	—	3,560	—	—	3,560
Stock-based compensation	—	1,603	—	—	—	1,603
Issuance under equity compensation plan, including tax benefit of $4	—	(379)	—	—	—	(379)
Repurchase of 2,310,595 shares	—	—	—	(45,968)	—	(45,968)
Dividends paid ($0.10 per share)	—	—	(4,507)	—	—	(4,507)
Other comprehensive income	—	—	—	—	11,832	11,832
Balance, June 30, 2014	$512	$991,440	$39,019	$(172,114)	$ 5,076	$863,933
Balance, December 31, 2014	$512	$993,212	$40,528	$(245,516)	$ 5,839	$794,575
Net loss	—	—	(95)	—	—	(95)
Stock-based compensation	—	1,510	—	—	—	1,510
Issuance under equity compensation plan, including tax benefit of $8	1	(268)	—	—	—	(267)
Repurchase of 3,894,673 shares	—	—	—	(72,338)	—	(72,338)
Dividends paid ($0.10 per share)	—	—	(3,724)	—	—	(3,724)
Other comprehensive loss	—	—	—	—	(1,395)	(1,395)
Balance, June 30, 2015	$513	$994,454	$36,709	$(317,854)	$ 4,444	$718,266

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	For the six months ended June 30,	
	2015	2014
Cash flows from operating activities:		
Net (loss) income	$(95)	$3,560
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Provision for loan losses	3,311	3,429
Depreciation and amortization	7,754	8,368
Current income tax receivable	112	13,510
Deferred income tax asset	(3,111)	(11,230)
Discount accretion, net of premium amortization on securities	2,163	2,534
Loan accretion	(26,360)	(34,020)
Net gains on sales of mortgage loans	(946)	(410)
Originations of loans held for sale, net of repayments	(48,137)	(17,179)
Proceeds from sales of loans held for sale	44,192	18,616
Bank-owned life insurance income	(796)	—
Amortization of indemnification asset	14,953	13,567
Gains on the sales of other real estate owned, net	(2,103)	(1,028)
Impairment on other real estate owned	757	880
Losses (gains) on sales of fixed assets	6	(123)
Impairment on fixed assets related to banking center closures	1,089	—
Stock-based compensation expense	1,510	1,603
Decrease in due to FDIC, net	(3,816)	(7,699)
Increase in other assets	(1,504)	(469)
(Decrease) increase in other liabilities	(11,801)	3,636
Net cash used in operating activities	(22,822)	(2,455)
Cash flows from investing activities:		
Proceeds from redemptions of FHLB stock	234	619
(Purchases) proceeds from redemptions of FRB stock	(239)	9,390
Maturities of investment securities held-to-maturity	55,411	50,561
Maturities of investment securities available-for-sale	160,542	157,870
Increase in securities purchased under agreements to resell	(50,000)	—
Net increase in loans	(153,060)	(202,059)
Purchases of premises and equipment, net	(2,063)	(347)
Proceeds from sales of loans	11,702	1,103
Proceeds from sales of other real estate owned	11,019	16,307
Increase (decrease) in FDIC indemnification asset	914	(529)
Net cash provided by investing activities	34,460	32,915
Cash flows from financing activities:		
Net (decrease) increase in deposits	(3,699)	18,024
Increase (decrease) in repurchase agreements	53,762	(14,115)
Issuance of stock under equity compensation plans	(420)	(383)
Proceeds from exercise of stock options	160	—
Excess tax benefit on stock-based compensation	8	4
Payment of dividends	(3,649)	(4,423)
Repurchases of shares	(72,338)	(45,968)
Net cash used in financing activities	(26,176)	(46,861)

Decrease in cash and cash equivalents	(14,538)	(16,401)
Cash and cash equivalents at beginning of the year	256,979	189,460
Cash and cash equivalents at end of period	$242,441	$173,059
Supplemental disclosure of cash flow information during the period:		
Cash paid for interest	$7,228	$6,754
Net tax payments (refunds)	$3,194	$(542)
Supplemental schedule of non-cash investing activities:		
Loans transferred to other real estate owned at fair value	$920	$1,477
FDIC indemnification asset claims transferred to other liabilities	$(2,495)	$(987)
Loans purchased but not settled	$—	$16,019

See accompanying notes to the unaudited consolidated interim financial statements.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
June 30, 2015

Note 1 Basis of Presentation

National Bank Holdings Corporation ("NBHC" or the "Company") is a bank holding company that was incorporated in the State of Delaware in June 2009 with the intent to acquire and operate financial services franchises and other complementary businesses in targeted markets. The Company is headquartered immediately south of Denver, in Greenwood Village, Colorado, and its primary operations are conducted through its wholly owned subsidiary, NBH Bank, N.A. (the "Bank"). The Company provides a variety of banking products to both commercial and consumer clients through a network of 97 banking centers located in Colorado, the greater Kansas City area and Texas, and through on-line and mobile banking products.

The accompanying interim unaudited consolidated financial statements serve to update the National Bank Holdings Corporation Annual Report on Form 10-K for the year ended December 31, 2014 and include the accounts of the Company and the Bank. The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and where applicable, with general practices in the banking industry or guidelines prescribed by bank regulatory agencies. However, they may not include all information and notes necessary to constitute a complete set of financial statements under GAAP applicable to annual periods and accordingly should be read in conjunction with the financial information contained in the Company's most recent Form 10-K. The unaudited consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results presented. All such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications of prior years' amounts are made whenever necessary to conform to current period presentation. The results of operations for the interim period is not necessarily indicative of the results that may be expected for the full year or any other interim period. All amounts are in thousands, except share data, or as otherwise noted.

GAAP requires management to make estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. By their nature, estimates are based on judgment and available information. Management has made significant estimates in certain areas, such as the amount and timing of expected cash flows from assets, the valuation of the FDIC indemnification asset and clawback liability, the valuation of other real estate owned (“OREO”), the fair value adjustments on assets acquired and liabilities assumed, the valuation of core deposit intangible assets, the evaluation of investment securities for other-than-temporary impairment (“OTTI”), the valuation of stock-based compensation, the fair values of financial instruments, the allowance for loan losses (“ALL”), and contingent liabilities. Because of the inherent uncertainties associated with any estimation process and future changes in market and economic conditions, it is possible that actual results could differ significantly from those estimates.

The Company's significant accounting policies followed in the preparation of the unaudited consolidated financial statements are disclosed in note 2 of the audited financial statements and notes for the year ended December 31, 2014 and are contained in the Company's Annual Report on Form 10-K. There have not been any significant changes to the application of significant accounting policies since December 31, 2014, with the exception of the following:

Income taxes - For the three and six months ended June 30, 2015, the Company has utilized the discrete effective tax rate method, as allowed by Accounting Standards Codification (“ASC”) 740-270-30-18, “Income Taxes-Interim Reporting,” to calculate its interim income tax provision. The discrete method is applied when the application of the estimated annual effective tax rate is impractical because it is not possible to reliably estimate the annual effective tax rate. The discrete method treats the year to date period as if it was the annual period and determines the income tax expense or benefit on that basis. The Company believes that, at this time, the use of this discrete method is more appropriate than the annual effective tax rate method as the estimated annual effective tax rate method is not reliable due to (1) the levels of tax-exempt income in relation to pre-tax income, (2) the impact of the warrant liability which is non-taxable and (3) the impact and variability of FDIC Indemnification amortization on our pre-tax income.

The income tax rate for the three and six months ended June 30, 2015 was 106.6% and 154.6%, respectively, based on application of the discrete approach. The quarterly tax rate differs from the federal statutory rate primarily due to interest income from tax-exempt lending, tax-exempt bank-owned life insurance income, non-taxable warrant liability fair value adjustment and the relationship of each of these items to our pre-tax income (loss). Furthermore, we recorded $1.7 million tax expense related to the write-off of deferred tax assets on certain stock-based compensation awards granted to former executives which expired in the quarter.

We are currently in an open IRS examination for the tax year 2012.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
June 30, 2015

Note 2 Recent Accounting Pronouncements
Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure - In January 2014, the FASB issued Accounting Standards Update ("ASU") 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. This update amends ASC Topic 310-40 and clarifies that an “in substance repossession or foreclosure” has occurred upon the creditor obtaining either legal title to the property upon completion of foreclosure, or the borrower conveying all interest in the property through completion of a deed in lieu of foreclosure. Upon occurrence, the creditor derecognizes the loan receivable and recognizes the collateralized real estate property. The amendments in the ASU became effective for the Company for interim and annual periods beginning after December 15, 2014. Early adoption was permitted. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements, results of operations or liquidity.
Revenue from Contracts with Customers - In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." This update supersedes revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification. The new guidance stipulates that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides specific steps that entities should apply in order to achieve this principle. In July 2015, the FASB voted to approve deferring the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). Early adoption is permitted, but not before the original effective date (i.e., interim and annual reporting periods beginning after December 15, 2016). The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.
Note 3 Investment Securities
The Company’s investment securities portfolio is comprised of available-for-sale and held-to-maturity investment securities. These investment securities totaled $1.8 billion at June 30, 2015 and were comprised of $1.3 billion of available-for-sale securities and $0.5 billion of held-to-maturity securities. At December 31, 2014, investment securities totaled $2.0 billion and were comprised of $1.5 billion of available-for-sale securities and $0.5 billion of held-to-maturity securities.
Available-for-sale
Available-for-sale investment securities are summarized as follows as of the dates indicated:

	June 30, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities (“MBS”):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$349,760	$8,279	$(206)	$357,833
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	971,933	6,471	(19,827)	958,577
Other securities	419	—	—	419
Total	$1,322,112	$14,750	$(20,033)	$1,316,829

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
June 30, 2015

	December 31, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$395,244	$9,014	$(43)	$404,215
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	1,088,834	7,464	(21,718)	1,074,580
Other securities	419	—	—	419
Total	$1,484,497	$16,478	$(21,761)	$1,479,214

At June 30, 2015 and December 31, 2014, mortgage-backed securities represented primarily all of the Company's available-for-sale investment portfolio and all mortgage-backed securities were backed by government sponsored enterprises ("GSE") collateral such as Federal Home Loan Mortgage Corporation ("FHLMC") and Federal National Mortgage Association ("FNMA"), and the government sponsored agency Government National Mortgage Association ("GNMA").

The table below summarizes the unrealized losses as of the dates shown, along with the length of the impairment period:

	June 30, 2015					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$90,176	$(206)	$—	$—	$90,176	$(206)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	86,125	(1,912)	577,337	(17,915)	663,462	(19,827)
Total	$176,301	$(2,118)	$577,337	$(17,915)	$753,638	$(20,033)

	December 31, 2014					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$17	$—	$89,749	$(43)	$89,766	$(43)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	88,854	(2,053)	667,368	(19,665)	756,222	(21,718)

Total	$88,871	$(2,053)	$757,117	$(19,708)	$845,988	$(21,761)

Management evaluated all of the available-for-sale securities in an unrealized loss position and concluded that no other-than-temporary impairment existed at June 30, 2015 or December 31, 2014. The unrealized losses in the Company's investments issued or guaranteed by U.S. government agencies or sponsored enterprises at June 30, 2015 were caused by changes in interest rates. The portfolio included 57 securities, having an aggregate fair value of $0.8 billion, which were in an unrealized loss position at June 30, 2015, compared to 62 securities, with a fair value of $0.8 billion, at December 31, 2014.

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The Company had no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

Certain securities are pledged as collateral for public deposits, securities sold under agreements to repurchase and to secure borrowing capacity at the Federal Reserve Bank, if needed. The fair value of available-for-sale investment securities pledged as collateral totaled $344.8 million at June 30, 2015 and $274.4 million December 31, 2014. The increase in pledged available-for-sale investment securities was primarily attributable to an increase in average deposit account balances and client repurchase account balances during the six months ended June 30, 2015. Certain investment securities may also be pledged as collateral for the line of credit at the Federal Home Loan Bank ("FHLB") of Des Moines; however, no investment securities were pledged for this purpose at June 30, 2015 or December 31, 2014.

Mortgage-backed securities do not have a single maturity date and actual maturities may differ from contractual maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average life of the available-for-sale mortgage-backed securities portfolio was 3.7 years as of June 30, 2015 and 3.5 years as of December 31, 2014. This estimate is based on assumptions and actual results may differ. Other securities of $0.4 million have no stated contractual maturity date as of June 30, 2015.

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Held-to-maturity
At June 30, 2015 and December 31, 2014, the Company held $472.6 million and $530.6 million of held-to-maturity investment securities, respectively. Held-to-maturity investment securities are summarized as follows as of the dates indicated:

	June 30, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$374,915	$5,287	$(148)	$380,054
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	97,690	346	(1,571)	96,465
Total investment securities held-to-maturity	$472,605	$5,633	$(1,719)	$476,519

	December 31, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$422,622	$5,773	$(72)	$428,323
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	107,968	217	(1,871)	106,314
Total investment securities held-to-maturity	$530,590	$5,990	$(1,943)	$534,637

The table below summarizes the unrealized losses as of the dates shown, along with the length of the impairment period:

	June 30, 2015					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$30,744	$(112)	$1,902	$(36)	$32,646	$(148)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	18,762	(55)	50,233	(1,516)	68,995	(1,571)
Total	$49,506	$(167)	$52,135	$(1,552)	$101,641	$(1,719)

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June 30, 2015

	December 31, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$—	$—	$35,139	$(72)	$35,139	$(72)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	—	—	75,139	(1,871)	75,139	(1,871)
Total	$—	$—	$110,278	$(1,943)	$110,278	$(1,943)

The portfolio included 13 securities, having an aggregate fair value of $0.1 billion, which were in an unrealized loss position at June 30, 2015, compared to 12 securities, with a fair value of $0.1 billion, at December 31, 2014. Management evaluated all of the held-to-maturity securities in an unrealized loss position and concluded that no other-than-temporary impairment existed at June 30, 2015 or December 31, 2014. The unrealized losses in the Company's investments issued or guaranteed by U.S. government agencies or sponsored enterprises at June 30, 2015 were caused by changes in interest rates. The Company had no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

The carrying value of held-to-maturity investment securities pledged as collateral totaled $92.2 million and $88.3 million at June 30, 2015 and December 31, 2014, respectively.

Actual maturities of mortgage-backed securities may differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average expected life of the held-to-maturity mortgage-backed securities portfolio as of June 30, 2015 and December 31, 2014 was 3.7 years and 3.4 years, respectively. This estimate is based on assumptions and actual results may differ.

Note 4 Loans

The loan portfolio is comprised of loans originated by the Company and loans that were acquired in connection with the Company's acquisitions of Bank of Choice and Community Banks of Colorado in 2011, and Hillcrest Bank and Bank Midwest in 2010. The majority of the loans acquired in the Hillcrest Bank and Community Banks of Colorado transactions are covered by loss sharing agreements with the FDIC, and covered loans are presented separately from non-covered loans due to the FDIC loss sharing agreements associated with these loans. Covered loans comprised 7.2% of the total loan portfolio at June 30, 2015, compared to 9.0% of the total loan portfolio at December 31, 2014.

The table below shows the loan portfolio composition including carrying value by segment of loans accounted for under ASC Topic 310-30 Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality and loans not accounted for under this guidance, which includes our originated loans. The table also shows the amounts covered by the FDIC loss sharing agreements as of June 30, 2015 and December 31, 2014. The carrying value of loans are net of discounts, fees and costs on loans excluded from ASC 310-30 of $8.3 million and $10.5 million as of June 30, 2015 and December 31, 2014, respectively:

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
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June 30, 2015

	June 30, 2015				
	ASC 310-30 loans	Non 310-30 loans	Total loans	% of total	
Commercial	$21,417	$895,309	$916,726	39.4	%
Agriculture	18,486	122,468	140,954	6.1	%
Commercial real estate	166,481	416,885	583,366	25.0	%
Residential real estate	31,162	623,167	654,329	28.1	%
Consumer	3,749	29,400	33,149	1.4	%
Total	$241,295	$2,087,229	$2,328,524	100.0	%
Covered	$139,250	$27,899	$167,149	7.2	%
Non-covered	102,045	2,059,330	2,161,375	92.8	%
Total	$241,295	$2,087,229	$2,328,524	100.0	%

	December 31, 2014				
	ASC 310-30 loans	Non 310-30 loans	Total loans	% of total	
Commercial	$22,956	$772,440	$795,396	36.8	%
Agriculture	19,063	118,468	137,531	6.4	%
Commercial real estate	192,330	369,264	561,594	26.0	%
Residential real estate	40,761	591,939	632,700	29.2	%
Consumer	4,535	30,653	35,188	1.6	%
Total	$279,645	$1,882,764	$2,162,409	100.0	%
Covered	$160,876	$32,821	$193,697	9.0	%
Non-covered	118,769	1,849,943	1,968,712	91.0	%
Total	$279,645	$1,882,764	$2,162,409	100.0	%

Included in commercial loans are $144.2 million and $161.8 million of energy-related loans at June 30, 2015 and December 31, 2014, respectively. Energy prices declined significantly during 2014 and prolonged or further pricing pressure could increase stress on energy clients and ultimately the credit quality of this portfolio. However, loans have been structured to mitigate credit loss under a variety of circumstances, including the impact on energy loans as a result of depressed oil prices for a sustained period. Also included in the commercial segment are tax exempt loans totaling $256.4 million and $112.6 million at June 30, 2015 and December 31, 2014, respectively.

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement remains unpaid after the due date of the scheduled payment. Pooled loans accounted for under ASC 310-30 that are 90 days or more past due and still accreting are generally considered to be performing and are included in loans 90 days or more past due and still accruing. Non-accrual loans include troubled debt restructurings on non-accrual status. Total non-accrual loans excluded from the scope of ASC 310-30 totaled $15.1 million and $10.8 million at June 30, 2015 and December 31, 2014, respectively. Loan delinquency for all loans is shown in the following tables at June 30, 2015 and December 31, 2014, respectively:

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
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	Total Loans June 30, 2015							
	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total loans	Loans > 90 days past due and still accruing	Non-accrual
Loans excluded from ASC 310-30								
Commercial	$5,998	$134	$1,089	$7,221	$888,088	$895,309	$22	$10,311
Agriculture	135	—	—	135	122,333	122,468	—	265
Commercial real estate								
Construction	—	—	—	—	10,772	10,772	—	—
Acquisition/development	—	—	—	—	4,001	4,001	—	—
Multifamily	—	—	—	—	17,120	17,120	—	—
Owner-occupied	—	—	113	113	146,396	146,509	—	726
Non owner-occupied	1,383	208	—	1,591	236,892	238,483	—	49
Total commercial real estate	1,383	208	113	1,704	415,181	416,885	—	775
Residential real estate								
Senior lien	653	—	1,250	1,903	568,038	$ (18)	Product sales	
Tax expense	3	Income tax expense						
Net of tax	$ (15)							

Note (1) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see Note 7 for additional details).

All noncontrolling interests with redemption features, such as put options, that are not solely within our control (redeemable noncontrolling interests) are reported in the mezzanine section of the Condensed Consolidated Balance Sheet, between liabilities and equity, at the greater of redemption value or initial carrying value. A summary of the changes in redeemable noncontrolling interest recorded in the mezzanine section of the Condensed Consolidated Balance Sheet for the quarters ended March 31, 2014 and 2013 is provided below:

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Redeemable noncontrolling interest, beginning of period	$111	$238
Net income	6	—
Foreign currency translation, net	(2)	(4)
Dividends attributable to noncontrolling interest	(3)	(2)
Redeemable noncontrolling interest reclassification to noncontrolling interest	25	23
Redeemable noncontrolling interest, end of period	$137	$255

Changes in noncontrolling interests that do not result in a change of control and where there is a difference between fair value and carrying value are accounted for as equity transactions. A summary of these changes in ownership interests in subsidiaries and the pro-forma effect on Net income attributable to common shareowners had they been recorded through net income for the quarters ended March 31, 2014 and 2013 is provided below:

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	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Net income attributable to common shareowners	$1,213	$1,266
Transfers to noncontrolling interests:		
Increase in common stock for sale of subsidiary shares	4	—
Decrease in common stock for purchase of subsidiary shares	(3)	(1)
Net income attributable to common shareowners after transfers to noncontrolling interests	$1,214	$1,265

Note 13: Guarantees

We extend a variety of financial, market value and product performance guarantees to third parties. Following the sale of substantially all operations of Rocketdyne on June 14, 2013, certain guarantees of Rocketdyne's performance under then existing contracts remained in place, which resulted in an increase in our performance guarantees of approximately $97 million, with no associated significant carrying amount of a liability as of March 31, 2014. There have been no other material changes to guarantees outstanding since December 31, 2013.

The changes in the carrying amount of service and product warranties and product performance guarantees for the quarters ended March 31, 2014 and 2013 are as follows:

(Dollars in millions)	2014	2013
Balance as of January 1	$1,360	$1,332
Warranties and performance guarantees issued	79	94
Settlements made	(71)	(76)
Other	(39)	(14)
Balance as of March 31	$1,329	$1,336

Note 14: Contingent Liabilities

Summarized below are the matters previously described in Note 17 of the Notes to the Consolidated Financial Statements in our 2013 Annual Report, incorporated by reference in our 2013 Form 10-K, updated as applicable. Except as otherwise noted, while we are unable to predict the final outcome, based on information currently available, we do not believe that resolution of any of the following matters will have a material adverse effect upon our competitive position, results of operations, cash flows or financial condition.

Environmental. Our operations are subject to environmental regulation by federal, state and local authorities in the United States and regulatory authorities with jurisdiction over our foreign operations. As described in Note 1 to the Consolidated Financial Statements in our 2013 Annual Report, we have accrued for the costs of environmental remediation activities and periodically reassess these amounts. We believe that the likelihood of incurring losses materially in excess of amounts accrued is remote. Additional information pertaining to environmental matters is included in Note 1 to the Consolidated Financial Statements in our 2013 Annual Report.

Government. We are now, and believe that, in light of the current U.S. Government contracting environment, we will continue to be the subject of one or more U.S. Government investigations. If we or one of our business units were charged with wrongdoing as a result of any of these investigations or other government investigations (including violations of certain environmental or export laws) the U.S. Government could suspend us from bidding on or receiving awards of new U.S. Government contracts pending the completion of legal proceedings. If convicted or found liable, the U.S. Government could fine and debar us from new U.S. Government contracting for a period generally not to exceed three years. The U.S. Government could void any contracts found to be tainted by fraud.

Our contracts with the U.S. Government are also subject to audits. Like many defense contractors, we have received audit reports, which recommend that certain contract prices should be reduced to comply with various government regulations. Some of these audit reports involved substantial amounts. We have made voluntary refunds in those cases we believe appropriate, have settled some allegations and continue to litigate certain cases. In addition, we accrue for liabilities associated with those matters that are probable and can be reasonably estimated. The most likely settlement amount to be incurred is accrued based upon a range of estimates. Where no amount within a range of estimates is more likely, then we accrued the minimum amount.

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Legal Proceedings.

F100 Engine Litigation

As previously disclosed, the United States government sued us in 1999 in the United States District Court for the Southern District of Ohio, claiming that Pratt & Whitney violated the civil False Claims Act and common law. The claims relate to the “Fighter Engine Competition” between Pratt & Whitney's F100 engine and General Electric's F110 engine. The government alleged that it overpaid for F100 engines under contracts awarded by the U.S. Air Force in fiscal years 1985 through 1990 because Pratt & Whitney inflated its estimated costs for some purchased parts and withheld data that would have revealed the overstatements. At trial, which ended in April, 2005, the government claimed Pratt & Whitney's liability to be approximately $624 million. On August 1, 2008, the trial court held that the Air Force had not suffered any actual damages because Pratt & Whitney had made significant price concessions after the alleged overstatements were made. However, the trial court judge found that Pratt & Whitney violated the False Claims Act due to inaccurate statements contained in its 1983 initial engine pricing proposal. In the absence of actual damages, the trial court awarded the government the maximum civil penalty of approximately $7 million, or $10,000 for each of the 709 invoices Pratt & Whitney submitted in 1989 and later under the contracts. In September 2008, both the government and UTC appealed the decision to the United States Court of Appeals for the Sixth Circuit. On November 18, 2010, the Sixth Circuit affirmed Pratt & Whitney's liability under the False Claims Act, but remanded the case to the trial court for further proceedings on the issues of False Claims Act damages and common law liability and damages.

On June 18, 2012, the trial court found that Pratt & Whitney had breached obligations imposed by common law based on the same conduct with respect to which the court previously found liability under the False Claims Act. Under the common law claims, the U.S. Air Force is entitled to seek damages for events occurring before March 3, 1989, which are not recoverable under the False Claims Act.

On June 17, 2013, the trial court awarded the government approximately $473 million in damages and penalties, plus prejudgment interest in an amount to be determined. On July 1, 2013, the trial court, after determining the amount of prejudgment interest, entered judgment in favor of the government in the amount of approximately $664 million. The trial court also awarded postjudgment interest on the full amount of the judgment to accrue from July 2, 2013, at the federal variable interest rate determined pursuant to 28 U.S.C. § 1961. The judgment included four different components of damages: (1) common law damages of approximately $109 million; (2) prejudgment interest on common law damages of approximately $191 million; (3) False Claims Act treble damages of approximately $357 million; and (4) penalties of approximately $7 million. The penalty component of the judgment previously was affirmed by the United States Court of Appeals in 2010.

We strongly disagree with the trial court's analysis and conclusions. We filed an appeal from the judgment to the United States Court of Appeals for the Sixth Circuit on August 26, 2013. Based on our analysis, we continue to believe that there is no basis for any common law liability for the inaccurate statements. We also believe that the government suffered no actual damages as a result of the inaccurate statements made in 1983 and, therefore, there is no basis in fact or law for the award of common law damages, prejudgment interest or False Claims Act treble damages. If, contrary to our expectations, all or any portion of the judgment should ultimately be affirmed, we estimate a range of reasonably possible loss from approximately $24 million to $657 million in excess of amounts previously accrued, plus postjudgment interest. The outcome of this matter could result in a material adverse effect on our results of operations in the period in which a liability would be recognized and cash flows for the period in which damages would be paid.

Cost Accounting Standards Claims

As previously disclosed, in December 2008, the Department of Defense (DOD) issued a contract claim against Sikorsky to recover overpayments the DOD alleges that it made to Sikorsky since January 2003 in connection with cost accounting changes approved by the DOD and implemented by Sikorsky in 1999 and 2006. These changes relate to the calculation of material overhead rates in government contracts. The DOD claimed that Sikorsky's liability was approximately $98 million (including interest through March 31, 2014). We believed this claim was without merit and Sikorsky filed an appeal in December 2009 with the U.S. Court of Federal Claims. Trial in the matter concluded in January 2013 and on March 22, 2013, the U.S. Court of Federal Claims issued a written decision in favor of Sikorsky determining that the DOD had failed to prove its claims because Sikorsky's calculation of material overhead complied with the cost accounting standards. The DOD has appealed this decision.

By letter dated December 24, 2013, a Divisional Administrative Contracting Officer of the Unites States Defense Contract Management Agency asserted a claim and demand for payment of $210,968,414 against Pratt & Whitney. The claim is based on Pratt & Whitney's alleged noncompliance with cost accounting standards from January 1, 2005 to December 31, 2012, due to its method of determining the cost of collaborator parts used in the calculation of material overhead costs for government contracts. We believe this claim is without merit. On March 18, 2014, Pratt & Whitney filed an appeal to the Armed Services Board of Contract Appeals.

German Tax Office Appeal

As previously disclosed, UTC has been involved in administrative review proceedings with the German Tax Office, which concern €203 million (approximately $280 million) of tax benefits that we have claimed related to a 1998 reorganization of the corporate structure of Otis operations in Germany. Upon audit, these tax benefits were disallowed by the German Tax Office. On August 3, 2012, we filed suit in the local German Tax Court (Berlin-Brandenburg). In 2008 the German Federal Tax Court ("FTC") denied benefits to another taxpayer in a case involving a German tax law relevant to our reorganization. The determination of the FTC on this other matter was appealed to the European Court of Justice ("ECJ") to determine if the underlying German tax law is violative of European Union (EU) principles. On September 17, 2009, the ECJ issued an opinion in this case that is generally favorable to the other taxpayer and referred the case back to the FTC for further consideration of certain related issues. In May 2010, the FTC released its decision, in which it resolved certain tax issues that may be relevant to our suit and remanded the case to a lower court for further development. In 2012, the lower court decided in favor of the other taxpayer and the government appealed the findings to the FTC. After consideration of the ECJ decision, the latest FTC decision and the lower court decision, we continue to believe that it is more likely than not that the relevant German tax law is violative of EU principles and we have not accrued for this matter. We intend to litigate vigorously the matter to conclusion.

Other.

As described in Note 16 to the Consolidated Financial Statements in our 2013 Annual Report, we extend performance and operating cost guarantees beyond our normal warranty and service policies for extended periods on some of our products. We have accrued our estimate of the liability that may result under these guarantees and for service costs that are probable and can be reasonably estimated.

We have accrued for environmental investigatory, remediation, operating and maintenance costs, performance guarantees and other litigation and claims based on our estimate of the probable outcome of these matters. While it is possible that the outcome of these matters may differ from the recorded liability, we believe that resolution of these matters will not have a material impact on our competitive position, results of operations, cash flows or financial condition.

We also have other commitments and contingent liabilities related to legal proceedings, self-insurance programs and matters arising out of the normal course of business. We accrue contingencies based upon a range of possible outcomes. If no amount within this range is a better estimate than any other, then we accrue the minimum amount.

We are also subject to a number of routine lawsuits, investigations and claims (some of which involve substantial amounts) arising out of the ordinary course of our business. We do not believe that these matters will have a material adverse effect upon our competitive position, results of operations, cash flows or financial condition.

Note 15: Segment Financial Data

Our operations are classified into five principal segments: Otis, UTC Climate, Controls & Security, Pratt & Whitney, UTC Aerospace Systems and Sikorsky. The segments are generally based on the management structure of the businesses and the grouping of similar operating companies, where each management organization has general operating autonomy over diversified products and services.

Results for the quarters ended March 31, 2014 and 2013 are as follows:

	Net Sales		Operating Profits		Operating Profit Margins	
(Dollars in millions)	2014	2013	2014	2013	2014	2013
Otis	$2,955	$2,814	$570	$575	19.3 %	20.4 %
UTC Climate, Controls & Security	3,851	3,837	537	520	13.9 %	13.6 %
Pratt & Whitney	3,329	3,402	388	406	11.7 %	11.9 %
UTC Aerospace Systems	3,450	3,263	590	501	17.1 %	15.4 %
Sikorsky	1,361	1,249	86	90	6.3 %	7.2 %
Total segments	14,946	14,565	2,171	2,092	14.5 %	14.4 %
Eliminations and other	(201)	(166)	39	21		
General corporate expenses	—	—	(112)	(107)		
Consolidated	$14,745	$14,399	$2,098	$2,006	14.2 %	13.9 %

See Note 8 to the Condensed Consolidated Financial Statements for a discussion of restructuring costs included in segment operating results.

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Note 16: Accounting Pronouncements

In April 2014, the FASB issued ASU No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." This ASU relates to discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have, or will have, a major effect on an entity's operations and financial results. The standard expands the disclosures for discontinued operations and requires new disclosures related to individually material disposals that do not meet the definition of a discontinued operation. The provisions of this ASU are effective for interim and annual periods beginning after December 15, 2014. This ASU is not expected to have an impact on our financial statements or disclosures.

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With respect to the unaudited condensed consolidated financial information of UTC for the quarters ended March 31, 2014 and 2013, PricewaterhouseCoopers LLP (PricewaterhouseCoopers) reported that it has applied limited procedures in accordance with professional standards for a review of such information. However, its report dated April 25, 2014, appearing below, states that the firm did not audit and does not express an opinion on that unaudited condensed consolidated financial information. PricewaterhouseCoopers has not carried out any significant or additional audit tests beyond those that would have been necessary if their report had not been included. Accordingly, the degree of reliance on its report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers is not subject to the liability provisions of Section 11 of the Securities Act of 1933, as amended (the Act) for its report on the unaudited condensed consolidated financial information because that report is not a “report” or a “part” of a registration statement prepared or certified by PricewaterhouseCoopers within the meaning of Sections 7 and 11 of the Act.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareowners of United Technologies Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of United Technologies Corporation and its subsidiaries as of March 31, 2014 and the related condensed consolidated statements of comprehensive income for the three-month periods ended March 31, 2014 and 2013 and the condensed consolidated statement of cash flows for the three-month periods ended March 31, 2014 and 2013. This interim financial information is the responsibility of the Corporation's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2013, and the related consolidated statements of operations, of comprehensive income, of cash flows, and of changes in equity for the year then ended (not presented herein), and in our report dated February 6, 2014, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2013, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
Hartford, Connecticut
April 25, 2014

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
BUSINESS OVERVIEW
We are a global provider of high technology products and services to the building systems and aerospace industries. Our operations are classified into five principal business segments: Otis, UTC Climate, Controls & Security, Pratt & Whitney, UTC Aerospace Systems and Sikorsky. Otis and UTC Climate, Controls & Security are referred to as the "commercial businesses," while Pratt & Whitney, UTC Aerospace Systems and Sikorsky are collectively referred to as the "aerospace businesses." On September 23, 2013, we announced the formation of UTC Building and Industrial Systems, a new organizational structure consisting of Otis and UTC Climate, Controls & Security. This new organizational structure is expected to enhance our ability to deliver more integrated solutions to our customers and accelerate innovation in smart building technologies and sustainable designs. Otis and UTC Climate, Controls & Security each continue to report their financial and operational results as separate segments, which is consistent with how we allocate resources and measure the financial performance of these businesses.
Certain reclassifications have been made to the prior year amounts to conform to the current year presentation. The current status of significant factors affecting our business environment in 2014 is discussed below. For additional discussion, refer to the "Business Overview" section in Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2013 Annual Report, which is incorporated by reference in our 2013 Form 10-K.
General
Our worldwide operations can be affected by industrial, economic and political factors on both a regional and global level. To limit the impact of any one industry, or the economy of any single country on our consolidated operating results, our strategy has been, and continues to be, the maintenance of a balanced and diversified portfolio of businesses. Our operations include original equipment manufacturing (OEM) and extensive related aftermarket parts and services in both our commercial and aerospace businesses. Our business mix also reflects the combination of shorter cycles at UTC Climate, Controls & Security and in our commercial aerospace aftermarket businesses, and longer cycles at Otis and in our aerospace OEM businesses. Our customers include companies in the private sector and governments, and our businesses reflect an extensive geographic diversification that has evolved with the continued globalization of world economies.
Growth in emerging markets continues to be led by China, where our sales for the quarter grew 15% over the prior year. Growth in China, along with U.S. economic expansion, is expected to drive global growth throughout 2014. The economic environment in North America has continued to rebound on improving consumer sentiment, lower unemployment rates, and an improving housing market. Although European economic conditions have continued to improve, rising political tensions in Eastern Europe may temper growth if escalation continues. UTC's sales to customers in Russia in 2013 were approximately $500 million, and while Russia is a key supplier of certain commodities, we are taking steps to minimize the potential for disruption to our business. To date, we have not seen any significant signs of disruption, although we continue to closely monitor developments in the region.
U.S. Government deficit reduction measures continue to pressure U.S. Department of Defense spending and adversely affect our military businesses. Total sales to the U.S. Government were $2.1 billion and $2.3 billion, or 14% and 16% of total UTC sales in the first quarter of 2014 and 2013, respectively. The defense portion of our aerospace business is affected by changes in market demand and the global political environment. Our participation in long-term production and development programs for the U.S. Government has, and is expected to contribute positively to our results in 2014.
Disposition Activity
As previously disclosed, we disposed of a number of businesses in 2013. On February 12, 2013, we completed the disposition of UTC Power to ClearEdge Power, and on June 14, 2013, we completed the sale of substantially all operations of Pratt & Whitney Rocketdyne (Rocketdyne) to GenCorp Inc. The results from these businesses were reclassified to Discontinued Operations in our Condensed Consolidated Statements of Comprehensive Income and Cash Flows. On May 17, 2013, we completed the sale of the Pratt & Whitney Power Systems business to Mitsubishi Heavy Industries (MHI) and entered into a long-term engineering and manufacturing agreement with MHI. Pratt & Whitney Power Systems was not reclassified to Discontinued Operations due to our level of continuing involvement in the business post-sale.

In connection with regulatory approval of the Goodrich acquisition, regulatory authorities required UTC to dispose of the Goodrich electric power systems and the pumps and engine controls businesses. Pursuant to these regulatory obligations, these businesses had been held separately from UTC's and Goodrich's ongoing businesses since the acquisition of Goodrich by UTC. On March 18, 2013, we completed the sale of the Goodrich pumps and engine controls business to Triumph Group, Inc., and on March 26, 2013, we completed the sale of the Goodrich electric power systems business to Safran S.A. Combined proceeds from the sales of the two businesses were approximately $600 million.

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Acquisition Activity

Our growth strategy contemplates acquisitions. Our operations and results can be affected by the rate and extent to which appropriate acquisition opportunities are available, acquired businesses are effectively integrated, and anticipated synergies or cost savings are achieved. During the quarter ended March 31, 2014, our cash investment in business acquisitions was approximately $17 million and consisted of a number of small acquisitions primarily in our commercial businesses. We expect cash investment in businesses of approximately $1 billion in 2014. However, actual acquisition spending may vary depending upon the timing, availability and value of acquisition opportunities.

Other

Government legislation, policies and regulations can have a negative impact on our worldwide operations. Government regulation of refrigerants and energy efficiency standards, elevator safety codes and fire protection regulations are important to our commercial businesses. Government and market-driven safety and performance regulations, restrictions on aircraft engine noise and emissions, and government procurement practices can impact our aerospace and defense businesses.

Commercial airline financial distress and consolidation, global economic conditions, changes in raw material and commodity prices, interest rates, foreign currency exchange rates, energy costs, and the impact from natural disasters and weather conditions create uncertainties that could impact our earnings outlook for the remainder of 2014. See Part I, Item 1A, “Risk Factors” in our 2013 Form 10-K for further discussion.

CRITICAL ACCOUNTING ESTIMATES

Preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales and expenses. We believe the most complex and sensitive judgments, because of their significance to the Consolidated Financial Statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Management’s Discussion and Analysis of Financial Condition and Results of Operations and Note 1 to the Consolidated Financial Statements in our 2013 Annual Report, incorporated by reference in our 2013 Form 10-K, describe the significant accounting estimates and policies used in preparation of the Consolidated Financial Statements. Actual results in these areas could differ from management’s estimates. There have been no significant changes in our critical accounting estimates during the quarter ended March 31, 2014.

RESULTS OF OPERATIONS

Net Sales

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Net Sales	$14,745	$14,399

The factors contributing to the total percentage change year-over-year in total net sales for the quarter ended March 31, 2014 are as follows:

	Quarter Ended March 31, 2014	
Organic change	5	%
Foreign currency translation	(1	)%
Acquisitions and divestitures, net	(2	)%
Other	—	
Total % Change	2	%

During the quarter ended March 31, 2014, all five business segments experienced organic sales growth led by Sikorsky (9%), Otis (6%), and UTC Aerospace Systems (6%). Organic sales growth at Sikorsky was led by higher international military and commercial aircraft sales volume. Organic growth at Otis was primarily due to higher new equipment sales volume in the U.S. and China, while organic growth at UTC Aerospace Systems was due to higher commercial OEM and aftermarket volumes. Organic sales growth was also driven by Pratt & Whitney (4%) and by UTC Climate, Controls & Security (3%). See the Segment Review section of Management's Discussion and Analysis for further discussion of segment performance.

The sales decrease from divestitures for the quarter ended March 31, 2014 was primarily a result of the disposition of the Pratt & Whitney Power Systems business and portfolio transformation initiatives at UTC Climate, Controls & Security in 2013.

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Cost of Products and Services Sold

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Cost of products sold	$8,081	$7,848
Percentage of product sales	75.6 %	76.5 %
Cost of services sold	$2,609	$2,617
Percentage of service sales	64.4 %	63.2 %
Total cost of products and services sold	$10,690	$10,465

The factors contributing to the percentage change year-over-year for the quarter ended March 31, 2014 in total cost of products and services sold are as follows:

	Quarter Ended March 31, 2014
Organic change	4 %
Foreign currency translation	(1)%
Acquisitions and divestitures, net	(2)%
Restructuring	1 %
Other	—
Total % Change	2 %

The organic increase in total cost of products and services sold (4%) in the quarter ended March 31, 2014 was driven by the organic sales increase noted above, partially offset by the benefits of previous restructuring actions and lower commodity costs, particularly within UTC Climate, Controls & Security. The decrease in “Acquisitions and divestitures, net” (2%) is attributable to the disposition of the Pratt & Whitney Power Systems business and portfolio transformation initiatives at UTC Climate, Controls & Security in 2013.

Gross Margin

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Gross margin	$4,055	$3,934
Percentage of net sales	27.5 %	27.3 %

The 20 basis point increase in gross margin as a percentage of sales for the quarter ended March 31, 2014 is due to the benefits of previous restructuring actions and lower commodity costs and productivity gains at UTC Climate, Controls & Security (30 basis points) and the favorable gross margin impact of higher aftermarket sales at Pratt & Whitney (20 basis points) partially offset by higher restructuring costs.

Research and Development

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Company-funded	$624	$610
Percentage of net sales	4.2 %	4.2 %
Customer-funded	$523	$543
Percentage of net sales	3.5 %	3.8 %

Research and development spending is subject to the variable nature of program development schedules and, therefore, year-over-year fluctuations in spending levels are expected. The majority of the company-funded spending is incurred by the aerospace businesses. The year-over-year increase in company-funded research and development (2%) in the quarter ended March 31, 2014 is primarily related to higher research and development spending within the UTC Aerospace Systems segment on increased spending on several commercial aerospace programs.

Customer-funded research and development decreased (4%) due to lower customer-funded spending at UTC Aerospace Systems primarily on U.S. military and space programs (7%) and within U.S. Government programs at Sikorsky (6%), offset by higher customer-funded spending at Pratt & Whitney on U.S. military and commercial programs (10%).

We expect company-funded research and development for the full year 2014 to remain consistent with 2013 levels.

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Selling, General and Administrative

(Dollars in millions)	Quarter Ended March 31, 2014		2013	
Selling, general and administrative expenses	$1,596		$1,627	
Percentage of net sales	10.8	%	11.3	%

Selling, general and administrative expenses declined 2% in the quarter ended March 31, 2014 due to the impact of divestitures completed over the preceding twelve months (2%), lower divestiture costs (1%) and the benefit from savings from previous restructuring actions, all of which were partially offset by higher restructuring costs (1%).

Other Income, Net

(Dollars in millions)	Quarter Ended March 31, 2014	2013
Other income, net	$263	$309

Other income, net includes equity earnings in unconsolidated entities, royalty income, foreign exchange gains and losses as well as other ongoing and non-recurring items. The year-over-year decrease in other income, net in the quarter ended March 31, 2014 (15%) is a result of the absence of a settlement with an engine program partner recognized in the first quarter of 2013 (13%) and net gains related to the UTC Climate, Controls & Security portfolio transformation (12%), which included a net gain in the first quarter of 2013 of $38 million primarily on the sale of a business in Hong Kong. These factors were partially offset by higher licensing income (11%) and normal recurring operational activity as disclosed above.

Interest Expense, Net

(Dollars in millions)	Quarter Ended March 31, 2014		2013	
Interest expense	$243		$255	
Interest income	(18	)	(19	)
Interest expense, net	$225		$236	
Average interest expense rate	4.2	%	4.0	%

The decrease in interest expense in the quarter ended March 31, 2014 is a result of lower average debt balances as a result of debt repayments made since March 31, 2013, partially offset by slightly higher average interest expense rates year-over-year.

Income Taxes

	Quarter Ended March 31, 2014		2013	
Effective tax rate	30.3	%	23.6	%

The increase in the effective tax rate for the quarter ended March 31, 2014, primarily reflects the absence of a $95 million tax benefit recorded during the first quarter of 2013, related to the retroactive impact of the legislative corporate tax extenders enacted in January 2013, as part of the American Taxpayer Relief Act of 2012.

We estimate our full year annual effective income tax rate in 2014 to be approximately 30%, absent one-time adjustments. We anticipate some variability in the tax rate quarter-to-quarter in 2014.

Net Income Attributable to Common Shareowners from Continuing Operations

(Dollars in millions, except per share amounts)	Quarter Ended March 31, 2014	2013
Income from continuing operations attributable to common shareowners	$1,213	$1,270
Diluted earnings per share from continuing operations	$1.32	$1.39

Net income attributable to common shareowners from continuing operations for the quarter ended March 31, 2014 includes restructuring charges, net of tax benefit, of $83 million. The net effect on diluted earnings per share of restructuring charges was $0.09 per share. The results for the quarter ended March 31, 2013 included a $0.11 per share benefit from non-recurring items net of restructuring charges. The impact of foreign currency translation and hedging generated a favorable effect of $0.01 per diluted share on our operational performance in the quarter ended March 31, 2014.

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Restructuring Costs

(Dollars in millions, except per share amounts)	Quarter Ended March 31, 2014	2013
Restructuring costs	$125	$50

Restructuring actions are an essential component of our operating margin improvement efforts and relate to both existing operations and those recently acquired. We now expect to incur restructuring costs in 2014 of approximately $375 million, including trailing costs related to prior actions associated with our continuing cost reduction efforts and the integration of acquisitions. The expected adverse impact on earnings in 2014 from anticipated additional restructuring costs is expected to be offset by the beneficial impact from gains and other items that are outside the normal operating activities of the Company. Although no specific plans for significant other actions have been finalized at this time, we continue to closely monitor the economic environment and may undertake further restructuring actions to keep our cost structure aligned with the demands of the prevailing market conditions.

As described below, the charges incurred in the quarter ended March 31, 2014 primarily relate to actions initiated during 2014 and 2013, while the charges incurred in the quarter ended March 31, 2013 primarily relate to actions initiated during 2013 and 2012.

2014 Actions. During the quarter ended March 31, 2014, we recorded net pre-tax restructuring charges of $90 million relating to ongoing cost reduction actions initiated in 2014. The charges include severance related to workforce reductions and asset write-downs and facility exit and lease termination costs related to the consolidation of field and manufacturing operations.

We are targeting the majority of the remaining workforce and facility related cost reduction actions for completion during 2014. Approximately 45% of the total pre-tax charge will require cash payments, which we have funded and expect to continue to fund with cash generated from operations. During the quarter ended March 31, 2014, we had cash outflows of approximately $8 million related to the 2014 actions. We expect to incur additional restructuring and other charges of $58 million to complete these actions. We expect recurring pre-tax savings to increase over the two-year period subsequent to initiating the actions to approximately $140 million annually.

2013 Actions. During the quarters ended March 31, 2014 and 2013, we recorded net pre-tax restructuring charges of $32 million and $20 million, respectively, for actions initiated in 2013. The 2013 actions relate to ongoing cost reduction efforts, including severance related to workforce reductions and asset write-downs and facility exit and lease termination costs related to the consolidation of field and manufacturing operations.

We are targeting to complete in 2014 the majority of the remaining workforce and all facility related cost reduction actions initiated in 2013. Approximately 75% of the total pre-tax charge will require cash payments, which we have and expect to continue to fund with cash generated from operations. During the quarter ended March 31, 2014, we had cash outflows of approximately $49 million related to the 2013 actions. We expect to incur additional restructuring charges of $34 million to complete these actions. We expect recurring pre-tax savings to increase over the two-year period subsequent to initiating the actions to approximately $425 million annually, of which, approximately $88 million was realized during the quarter ended March 31, 2014.

For additional discussion of restructuring, see Note 8 to the Condensed Consolidated Financial Statements.

Segment Review

Segments are generally based on the management structure of the businesses and the grouping of similar operating companies, where each management organization has general operating autonomy over diversified products and services. Adjustments to reconcile segment reporting to the consolidated results for the quarters ended March 31, 2014 and 2013 are included in “Eliminations and other” below, which also includes certain smaller subsidiaries. We attempt to quantify material cited factors within our discussion of the results of each segment whenever those factors are determinable. However, in some instances, the factors we cite within our segment discussion are based upon input measures or qualitative information that does not lend itself to quantification when discussed in the context of the financial results measured on an output basis and are not, therefore, quantified in the below discussions.

Commercial Businesses

Our commercial businesses generally serve customers in the worldwide commercial and residential property industries, and UTC Climate, Controls & Security also serves customers in the commercial and transport refrigeration industries. Sales in the commercial businesses are influenced by a number of external factors, including fluctuations in residential and commercial

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construction activity, regulatory changes, interest rates, labor costs, foreign currency exchange rates, customer attrition, raw material and energy costs, credit markets and other global and political factors. UTC Climate, Controls & Security's financial performance can also be influenced by production and utilization of transport equipment, and, in the case of its residential business, weather conditions. To ensure adequate supply of products in the distribution channel, UTC Climate, Controls & Security customarily offers its customers incentives to purchase products. The principal incentive program provides reimbursements to distributors for offering promotional pricing on UTC Climate, Controls & Security products. We account for incentive payments made as a reduction to sales.
Within the UTC Climate, Controls & Security segment, North American residential heating, ventilation, and air conditioning (HVAC) orders increased 19% in the first quarter as the housing market continued to improve and distributors build stock for the summer season. Global commercial HVAC orders increased 2% with increases in Europe (15%) and Asia (4%) partially offset by lower order levels in North America (4%). Within the Otis segment, new equipment orders increased 9% in the first quarter of 2014 with growth in North America (37%) and in China (27%) due, in part, to several large product orders in the quarter. New equipment orders declined in Europe (5%) largely due to fewer large project orders in Russia.
Summary performance for each of the commercial businesses for the quarters ended March 31, 2014 and 2013 was as follows:

	Otis			UTC Climate, Controls & Security		
(Dollars in millions)	2014	2013	Change	2014	2013	Change
Net Sales	$2,955	$2,814	5 %	$3,851	$3,837	— %
Cost of Sales	2,008	1,872	7 %	2,726	2,754	(1)%
	947	942	1 %	1,125	1,083	4 %
Operating Expenses and Other	377	367	3 %	588	563	4 %
Operating Profits	$570	$575	(1)%	$537	$520	3 %
Operating Profit Margins	19.3 %	20.4 %		13.9 %	13.6 %	

Otis –
Quarter Ended March 31, 2014 Compared with Quarter Ended March 31, 2013

	Factors contributing to total % Change				
	Organic / Operational	FX Translation	Acquisitions / Divestitures, net	Restructuring Costs	Other
Net Sales	6 %	(2)%	1 %	—	—
Cost of Sales	8 %	(2)%	1 %	—	—
Operating Profits	3 %	(1)%	—	(1)%	(2)%

Organic sales increased in the quarter (6%) due to higher new equipment sales primarily in China (2%), U.S. (2%) and Russia (1%). Service sales were consistent with prior year levels.
The operational profit increase in the quarter (3%) was due to higher new equipment volume (5%), partially offset by continued pricing pressure and costs from our North America factory transformation (2%). Service contribution is consistent with prior year levels.

UTC Climate, Controls & Security –
Quarter Ended March 31, 2014 Compared with Quarter Ended March 31, 2013

	Factors contributing to total % Change				
	Organic / Operational	FX Translation	Acquisitions / Divestitures, net	Restructuring Costs	Other
Net Sales	3 %	—	(3)%	—	—
Cost of Sales	1 %	—	(3)%	1 %	—
Operating Profits	17 %	—	(2)%	(4)%	(8)%

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Organic sales increased 3% primarily reflecting growth in Americas (2%), driven by the U.S. residential HVAC business, and the transport refrigeration business (1%). An organic sales increase in China (1%) was offset by lower sales in other Asian countries. The decrease in "Acquisitions and divestitures, net" (3%) reflects the year-over-year impact of divestitures completed in the preceding twelve months associated with UTC Climate, Controls & Security's portfolio transformation.

The 17% operational profit increase was driven largely by positive volume, mix and pricing (combined 9%), the benefits of restructuring actions and cost productivity (combined 5%) and favorable commodity costs (3%). The 8% decrease in "Other" primarily reflects net year-over-year impact from UTC Climate, Controls & Security's portfolio transformation.

Aerospace Businesses

The aerospace businesses serve both commercial and government aerospace customers. In addition, Pratt & Whitney also serves customers in the industrial markets. Revenue passenger miles (RPMs), U.S. Government military and space spending, and the general economic health of airline carriers are all barometers for our aerospace businesses. Performance in the general aviation sector is closely tied to the overall health of the economy and is positively correlated to corporate profits.

Airline traffic, as measured by RPMs, grew over 5% in 2013 and has shown continued growth in 2014. We continue to benefit from a strong airline industry with airlines' profitability forecasted by third party analysts to be almost $19 billion in 2014. Commercial aerospace spares orders at Pratt & Whitney’s large commercial engine business increased 11% in the first quarter of 2014 as compared to the same period of 2013, while UTC Aerospace Systems spares orders increased 9% over the same period. Lower U.S. Government defense spending levels have constrained military sales growth and we expect U.S. Government deficit reduction measures to continue to adversely affect our military aerospace businesses in 2014.

We record changes in contract estimates using the cumulative catch-up method in accordance with the Revenue Recognition Topic of the FASB Accounting Standards Codification. Operating profit included significant changes in aerospace contract estimates of $17 million in the quarter ended March 31, 2014.

As previously reported, Sikorsky is developing the CH-148 derivative of the H-92 helicopter (the "Cyclone"), a military variant of the S-92 helicopter, for the Canadian Government. The Cyclone is being developed under a fixed-price contract that provides for the development and production of 28 helicopters, and a related in-service support contract through March 2028 (collectively, the "Arrangements"). The current contract values of the Arrangements are estimated to be $4.2 billion and are subject to changes in underlying variables such as the timing of deliveries, future flight hours and fluctuations in foreign currency exchange rates. Delivery of the final configuration aircraft, which was scheduled to begin in 2012, has not occurred due to a number of disputes between the Canadian Government and Sikorsky related to contractual requirements and contract performance.

In December 2013, Sikorsky and the Canadian Government signed a Principles of Agreement, and on April 2, 2014 a second agreement was signed by the parties. Together, these Principles of Agreement (the "POA") establish a framework to restructure the Arrangements while providing a new governance and project structure. Sikorsky is engaging in ongoing formal contract negotiations with the Canadian Government under the POA. The objective of the negotiations is the mutual agreement on contractual amendments that memorialize the key understandings documented in the POA. These amendments are expected to substantially change the timing and scope of the aircraft, while securing Sikorsky's role as the in-service support provider for these aircraft for an extended period of years. As such, the amendments are expected to require us to reassess our current accounting judgments and estimates to reflect the new proposed contractual structure. Based upon the progress of the negotiations to date and the changes envisioned, we anticipate recording a significant charge upon execution of the proposed contractual amendments as they will require us to accelerate our costs and revenue recognition using a cost-to-cost method to recognize our cumulative efforts to date on the aircraft, in addition to higher costs associated with scope changes and a phased-delivery approach that supports the timing of the retirement of the Sea King helicopters beginning in 2015. Any such revenues and losses recorded could have a material impact on the consolidated results of operations in the period recognized. Similarly, failure to reach an agreement with the Canadian Government on the contractual amendments could also lead to a material adverse impact on the consolidated results of operations. However, we do not believe that the amendments, nor failure to reach agreement on the amendments, will result in a material adverse effect on our financial condition.

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Summary performance for each of the aerospace businesses for the quarters ended March 31, 2014 and 2013 was as follows:

	Pratt & Whitney			UTC Aerospace Systems			Sikorsky		
(Dollars in millions)	2014	2013	Change	2014	2013	Change	2014	2013	Change
Net Sales	$3,329	$3,402	(2)%	$3,450	$3,263	6 %	$1,361	$1,249	9 %
Cost of Sales	2,546	2,636	(3)%	2,464	2,332	6 %	1,155	1,039	11 %
	783	766	2 %	986	931	6 %	206	210	(2)%
Operating Expenses and Other	395	360	10 %	396	430	(8)%	120	120	—
Operating Profits	$388	$406	(4)%	$590	$501	18 %	$86	$90	(4)%
Operating Profit Margins	11.7 %	11.9 %		17.1 %	15.4 %		6.3 %	7.2 %	

Pratt & Whitney –
Quarter Ended March 31, 2014 Compared with Quarter Ended March 31, 2013

	Factors contributing to total % Change				
	Organic / Operational	FX Translation*	Acquisitions / Divestitures, net	Restructuring Costs	Other
Net Sales	4 %	—	(6)%	—	—
Cost of Sales	3 %	(1)%	(6)%	1 %	—
Operating Profits	5 %	2 %	(3)%	(9)%	1 %

* For Pratt & Whitney only, the transactional impact of foreign exchange hedging at Pratt & Whitney Canada has been netted against the translational foreign exchange impact for presentation purposes in the above tables. For all other segments, these foreign exchange transactional impacts are included within the organic/operational caption in their respective tables. Due to its potential significance to Pratt & Whitney’s overall operating results, we believe it is useful to segregate the foreign exchange transactional impact in order to clearly identify the underlying financial performance.

The organic sales increase (4%) was driven by higher commercial aftermarket (6%) and industrial engines (2%) sales, partially offset by lower engines and aftermarket sales in the military business (3%). Sales decreased (6%) as a result of the divestiture of Pratt & Whitney Power Systems in 2013.

Pratt & Whitney's operating profit benefited from lower pension costs and restructuring savings across its businesses. The operational profit increase (5%) was due to the net volume increase (20%) and favorable military contract performance (6%), partially offset by the absence of a settlement with an engine program partner (10%), higher negative commercial engine margins (7%), and a decline in contract termination benefits (4%). Operating profit decreased (3%) as a result of the divestiture of Pratt & Whitney Power Systems in 2013.

UTC Aerospace Systems –
Quarter Ended March 31, 2014 Compared with Quarter Ended March 31, 2013

	Factors contributing to total % Change				
	Organic / Operational	FX Translation	Acquisitions / Divestitures, net	Restructuring Costs	Other
Net Sales	6 %	—	—	—	—
Cost of Sales	6 %	—	—	—	—
Operating Profits	17 %	1 %	—	1 %	(1)%

The organic sales growth (6%) is due to an increase in commercial aerospace OEM and commercial aftermarket sales volumes (6%).

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The operational profit increase (17%) primarily reflects the profit contribution from higher commercial aftermarket sales volumes (13%), higher income from licensing agreements (4%), and lower selling, general and administrative expenses (4%) including lower pension expense and the benefit of synergies, partially offset by higher research and development costs (2%) and lower profits on commercial OEM sales (2%) driven by adverse mix.

Sikorsky –

Quarter Ended March 31, 2014 Compared with Quarter Ended March 31, 2013

	Factors contributing to total % Change				
	Organic / Operational	FX Translation	Acquisitions / Divestitures, net	Restructuring Costs	Other
Net Sales	9 %	—	—	—	—
Cost of Sales	10 %	—	—	1 %	—
Operating Profits	9 %	—	—	(13)%	—

The organic sales increase (9%) reflects increased commercial sales (4%) primarily due to S-92 aircraft volume partially offset by a decrease in S-76 volume, higher international military sales volume (7%) and favorable military aftermarket contract performance (1%). These increases were offset partially by lower U.S. Government sales volume (1%) and lower volume on customer funded development programs (3%).

The operational profit increase (9%) is driven by profitability in military aftermarket (41%) primarily due to favorable contract performance and higher international military aircraft volume (11%). These increases were partially offset by lower profitability on U.S. Government aircraft contracts (17%) due to less favorable contract performance, lower profits from customer funded development programs (22%), and lower commercial aftermarket profitability (4%).

Eliminations and other –

	Net Sales		Operating Profits	
	Quarter Ended March 31,		Quarter Ended March 31,	
(Dollars in millions)	2014	2013	2014	2013
Eliminations and other	$(201)	$(166)	$39	$21
General corporate expenses	—	—	(112)	(107)

Eliminations and other reflects the elimination of sales, other income and operating profit transacted between segments, as well as the operating results of certain smaller businesses. The year-over-year change in sales for the quarter ended March 31, 2014, as compared with the same period of 2013, reflects an increase in the amount of inter-segment sales eliminations. The year-over-year change in operating profit for the first quarter of 2014, as compared with the first quarter of 2013, reflects lower divestiture costs in 2014.

LIQUIDITY AND FINANCIAL CONDITION

(Dollars in millions)	March 31, 2014	December 31, 2013	March 31, 2013
Cash and cash equivalents	$4,477	$4,619	$4,767
Total debt	20,043	20,241	22,824
Net debt (total debt less cash and cash equivalents)	15,566	15,622	18,057
Total equity	33,695	33,219	27,563
Total capitalization (debt plus equity)	53,738	53,460	50,387
Net capitalization (debt plus equity less cash and cash equivalents)	49,261	48,841	45,620
Debt to total capitalization	37 %	38 %	45 %
Net debt to net capitalization	32 %	32 %	40 %

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We assess our liquidity in terms of our ability to generate cash to fund our operating, investing and financing activities. Our principal source of liquidity is operating cash flows of continuing operations, which, after netting out capital expenditures, we target to equal or exceed net income attributable to common shareowners from continuing operations. In addition to operating cash flows, other significant factors that affect our overall management of liquidity include: capital expenditures, customer financing requirements, investments in businesses, dividends, common stock repurchases, pension funding, access to the commercial paper markets, adequacy of available bank lines of credit, and the ability to attract long-term capital at satisfactory terms.

The global economic environment has been improving. Strengthening air traffic and airline profitability have offset continued weakness in defense spending. In the U.S., the outlook for housing and commercial construction remains encouraging. The economic environment in Europe has been trending positively, with strengthening economic sentiment offsetting continued unemployment concerns, while in China, there has been some slowing of construction starts and property transactions. In light of these circumstances, we continue to assess our current business and closely monitor the impact on our customers and suppliers, and have determined that overall there was not a significant adverse impact on our financial position, results of operations or liquidity during the first quarter of 2014.

Our domestic pension funds experienced a positive return on assets of 3.65% during the first quarter of 2014. Approximately 89% of these domestic pension plans' funds are invested in readily-liquid investments, including equity, fixed income, asset-backed receivables and structured products. The balance of these domestic pension plans' funds (11%) is invested in less-liquid but market-valued investments, including real estate and private equity. Across our global pension plans, the absence of prior pension investment losses, impact of a higher discount rate, and the positive returns experienced during 2013 are expected to result in decreased pension expense in 2014 of approximately $500 million as compared to 2013.

Our strong debt ratings and financial position have historically enabled us to issue long-term debt at favorable market rates. Our ability to obtain debt financing at comparable risk-based interest rates is partly a function of our existing debt-to-total-capitalization level as well as our credit standing.

On April 1, 2014, we redeemed all remaining outstanding 2016 Goodrich 6.290% notes, representing approximately $188 million in aggregate principal, under our redemption notice issued on February 28, 2014. We expect full year 2014 debt repayments to be approximately $1 billion.

On September 27, 2013, we redeemed all remaining outstanding 2021 Goodrich 3.600% notes, representing $294 million in aggregate principal, under our redemption notice issued on August 28, 2013. On August 23, 2013, we redeemed all remaining outstanding 2019 Goodrich 6.125% notes, representing $202 million in aggregate principal, under our redemption notice issued on July 24, 2013. On June 24, 2013 we redeemed all remaining outstanding 2015 UTC 1.200% Senior Notes, representing $327 million in aggregate principal, under our redemption notice issued on May 24, 2013. On May 7, 2013, we commenced cash tender offers for two series of outstanding notes issued by Goodrich and the 2015 UTC 1.200% Senior Notes. A total of $874 million principal amount of all notes subject to the tender offers, and $36 million of the fair value adjustment related to the notes assumed in the Goodrich acquisition, were repaid, including approximately $103 million principal amount of the 2016 Goodrich 6.290% notes, approximately $98 million principal amount of the 2019 Goodrich 6.125% notes, and approximately $674 million principal amount of the 2015 UTC 1.200% Senior Notes. Total payments under these tender offers were approximately $935 million including principal, premium and interest.

Tax payments related to discontinued operations, primarily the December 2012 sale of the legacy Hamilton Sundstrand Industrial businesses, were approximately $665 million for the quarter ended March 31, 2013. We do not expect tax payments in 2014 related to these discontinued operations to be significant.

At March 31, 2014, we had revolving credit agreements with various banks permitting aggregate borrowings of up to $4 billion pursuant to a $2 billion revolving credit agreement and a $2 billion multicurrency revolving credit agreement, both of which expire in November 2016. As of March 31, 2014, there were no borrowings under either of these revolving credit agreements. The undrawn portions of our revolving credit agreements are also available to serve as backup facilities for the issuance of commercial paper. As of March 31, 2014, our maximum commercial paper borrowing authority as set by our Board of Directors was $4 billion. We use our commercial paper borrowings for general corporate purposes, including the funding of acquisitions and repurchases of our common stock.

We continue to have access to the commercial paper markets and our existing credit facilities, and continue to expect strong generation of operating cash flows. While the impact of market volatility cannot be predicted, we believe we have sufficient operating flexibility, cash reserves and funding sources to maintain adequate amounts of liquidity and to meet our future operating cash needs.

Given our extensive international operations, most of our cash is denominated in foreign currencies and held outside of the U.S. We manage our worldwide cash requirements by reviewing available funds among the many subsidiaries through

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which we conduct our business and the cost effectiveness with which those funds can be accessed. The repatriation of cash balances from certain of our subsidiaries could have adverse tax consequences or be subject to capital controls; however, those balances are generally available without legal restrictions to fund ordinary business operations. With few exceptions, U.S. income taxes have not been provided on undistributed earnings of our international subsidiaries. Our intention is to reinvest these earnings permanently or to repatriate the earnings only when it is tax effective to do so.

On occasion, we are required to maintain cash deposits with certain banks with respect to contractual obligations related to acquisitions or divestitures or other legal obligations. As of March 31, 2014 and December 31, 2013, the amount of such restricted cash was approximately $32 million and $47 million, respectively.

We believe our future operating cash flows will be sufficient to meet our future operating cash needs. Further, our ability to obtain debt or equity financing, as well as the availability under committed credit lines, provides additional potential sources of liquidity should they be required or appropriate.

Cash Flow - Operating Activities of Continuing Operations

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Net cash flows provided by operating activities of continuing operations	$1,335	$1,409

Cash generated from operating activities of continuing operations in the quarter ended March 31, 2014 was $74 million lower than the same period in 2013, including lower income from continuing operations of $46 million, offset by higher non-cash charges of $97 million. During the quarter ended March 31, 2014, the net increase in working capital resulted in a cash outflow of $521 million, an increase in cash outflow of $323 million over the quarter ended March 31, 2013. The 2014 cash outflows for working capital were primarily driven by increases in inventory to support deliveries and other contractual commitments across the aerospace businesses, inventory increases to support seasonal demand at UTC Climate, Controls & Security, increases in accounts receivable within our commercial businesses primarily attributable to seasonal maintenance billing cycles, and conversion of customer advances at Pratt & Whitney. These working capital increases were partially offset by increases in accounts payable and accrued liabilities, primarily at Pratt & Whitney, Otis and Sikorsky, an increase in domestic tax accruals, and increases in customer advances at Otis and Sikorsky.

The funded status of our defined benefit pension plans is dependent upon many factors, including returns on invested assets and the level of market interest rates. We can contribute cash or company stock to our plans at our discretion, subject to applicable regulations. Total cash contributions to our global defined benefit pension plans during the quarters ended March 31, 2014 and 2013 were $84 million and $29 million, respectively. We expect to make total cash contributions of approximately $275 million to our global defined benefit pension plans in 2014. Our domestic pension plans are approximately 95% funded on a projected benefit obligation basis as of March 31, 2014, and we are not required to make additional contributions through the end of 2016. Contributions to our global defined benefit pension plans in 2014 are expected to meet or exceed the current funding requirements.

Cash Flow - Investing Activities of Continuing Operations

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Net cash flows (used in) provided by investing activities of continuing operations	$(442)	$339

Cash flows used in investing activities of continuing operations for the quarter ended March 31, 2014 primarily reflect capital expenditures of approximately $333 million and payments related to our collaboration intangible assets and contractual rights to provide product on new aircraft platforms of approximately $148 million. Cash flows provided by investing activities of continuing operations for the quarter ended March 31, 2013 includes proceeds of approximately $746 million from the disposition of certain businesses, including the sale of the legacy Goodrich pumps and engine controls business to Triumph Group, Inc. on March 18, 2013, the sale of the legacy Goodrich electric power systems business to Safran S.A. on March 26, 2013.

During the quarter ended March 31, 2014, we increased our collaboration intangible assets by approximately $142 million, including net payments of $70 million made under our 2012 agreement to acquire Rolls-Royce's collaboration interest in IAE. Capital expenditures for the quarter ended March 31, 2014 primarily relate to investments in new programs at Pratt & Whitney and UTC Aerospace Systems, as well as continuing Goodrich integration activities at UTC Aerospace

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Systems. Investments in businesses in the quarter ended March 31, 2014 included a number of small acquisitions, primarily in our commercial businesses. We expect total cash investments for acquisitions in 2014 to approximate $1 billion, including acquisitions completed during the quarter ended March 31, 2014. However, actual acquisition spending may vary depending upon the timing, availability and appropriate value of acquisition opportunities.
Customer financing activities were a net source of cash of $12 million and $31 million for the quarters ended March 31, 2014 and 2013, respectively. While we expect that 2014 customer financing activity will be a net use of funds, actual funding is subject to usage under existing customer financing commitments during the remainder of the year. We may also arrange for third-party investors to assume a portion of our commitments. We had commercial aerospace financing and other contractual commitments of approximately $11 billion at March 31, 2014 related to commercial aircraft and certain contractual rights to provide product on new aircraft platforms, of which up to $1.2 billion may be required to be disbursed during the remainder of 2014. We had commercial aerospace financing and other contractual commitments of approximately $11 billion at December 31, 2013.
Cash Flow - Financing Activities of Continuing Operations

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Net cash flows used in financing activities of continuing operations	$(995)	$(1,019)

The timing and levels of certain cash flow activities, such as acquisitions and repurchases of our stock, have resulted in the issuance of both long-term and short-term debt. Commercial paper borrowings and revolving credit facilities provide short-term liquidity to supplement operating cash flows and are used for general corporate purposes, including the funding of potential acquisitions and repurchases of our stock. We had no outstanding commercial paper at March 31, 2014.
At March 31, 2014, management had authority to repurchase approximately 48.3 million shares under the share repurchase program announced on February 4, 2013. Under this program, shares may be purchased on the open market, in privately negotiated transactions and under plans complying with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended. We may also reacquire shares outside of the program from time to time in connection with the surrender of shares to cover taxes on vesting of restricted stock. During the quarter ended March 31, 2014, we repurchased approximately 2.9 million shares of our common stock for approximately $335 million. We expect 2014 full year share repurchases to be approximately $1 billion. Our share repurchase levels are influenced by various factors, including the level of other investing activities.
We paid dividends on Common Stock of $0.59 per share in the first quarter of 2014 totaling $514 million in the aggregate.
We have an existing universal shelf registration statement filed with the SEC for an indeterminate amount of debt and equity securities for future issuance, subject to our internal limitations on the amount of debt to be issued under this shelf registration statement.
Cash Flow - Discontinued Operations

	Quarter Ended March 31,	
(Dollars in millions)	2014	2013
Net cash flows used in discontinued operations	$—	$(766)

Cash flows used in discontinued operations for the quarter ended March 31, 2013 primarily relate to the completed divestiture of the legacy Hamilton Sundstrand Industrial businesses in December 2012. In connection with this sale, tax payments of approximately $665 million were made during the three months ended March 31, 2013. Net cash flows used in discontinued operations for the three months ended March 31, 2013 also included cash flows from the operating activities of Rocketdyne and of UTC Power, through its date of disposition of February 12, 2013, as well as payments made in settlement of liabilities, transaction costs, and interim funding of UTC Power and of Clipper Windpower, which was divested in 2012. There were no discontinued operations in the quarter ended March 31, 2014.

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Off-Balance Sheet Arrangements and Contractual Obligations

In our 2013 Annual Report, incorporated by reference in our 2013 Form 10-K, we disclosed our off-balance sheet arrangements and contractual obligations. As of March 31, 2014, there have been no material changes to these off-balance sheet arrangements and contractual obligations outside the ordinary course of business except as noted below.

During the first quarter of 2014, Sikorsky signed agreements with the Turkish government and certain Turkish aerospace contractors to provide manufacturing kits and licenses that will allow Turkey’s aerospace industry to assemble 109 T-70 helicopters (Turkish variants of Sikorsky’s S-70i International Black Hawk helicopter) for sale to and operation by various Turkish government entities. Under the program, the aircraft will be assembled in Turkey by Turkish Aerospace Industries, Inc. ("TAI") and will include kit components supplied by Sikorsky and other companies. Sikorsky has a purchase commitment of $1.4 billion, which is expected to be fulfilled by the purchase of various Black Hawk parts, components, and services by Sikorsky over a thirty-year period from TAI and other Turkish companies.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no significant change in our exposure to market risk during the quarter ended March 31, 2014. For discussion of our exposure to market risk, refer to Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk,” contained in our 2013 Form 10-K.

Item 4. Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, we carried out an evaluation under the supervision and with the participation of our management, including the Chairman & Chief Executive Officer (CEO), the Senior Vice President and Chief Financial Officer (CFO) and the Acting Controller and Assistant Controller, Financial Reporting (Controller), of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2014. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, our CEO, our CFO and our Controller have concluded that, as of March 31, 2014, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our CEO, our CFO and our Controller, as appropriate, to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting during the three months ended March 31, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Cautionary Note Concerning Factors That May Affect Future Results

This Form 10-Q contains statements which, to the extent they are not statements of historical or present fact, constitute "forward-looking statements" under the securities laws. From time to time, oral or written forward-looking statements may also be included in other materials released to the public. These forward-looking statements are intended to provide management's current expectations or plans for our future operating and financial performance, based on assumptions currently believed to be valid. Forward-looking statements can be identified by the use of words such as "believe," "expect," "expectations," "plans," "strategy," "prospects," "estimate," "project," "target," "anticipate," "will "guidance," "confident" and other words of similar meaning in connection with a discussion of future operating or financial performance. Forward-looking statements may include, among other things, statements relating to future sales, earnings, cash flow, results of operations, uses of cash and other measures of financial performance. All forward-looking statements involve risks, uncertainties and other factors that may cause actual results to differ materially from those expressed or implied in the forward-looking statements. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the U.S. Private Securities Litigation Reform Act of 1995. Such risks, uncertainties and other factors include, without limitation:

- the effect of economic conditions in the industries and markets in which we operate in the U.S. and globally and any changes therein, including financial market conditions, fluctuations in commodity prices, interest rates and foreign currency exchange rates, levels of end market demand in construction and in both the commercial and defense segments of the aerospace industry, levels of air travel, financial difficulties (including bankruptcy) of commercial airlines, the impact of weather conditions and natural disasters and the financial condition of our customers and suppliers;
- our ability to realize the intended benefits of recently announced organizational changes;
- future levels of indebtedness and capital spending and research and development spending;
- future availability of credit and factors that may affect such availability, including credit market conditions and our capital structure;
- delays and disruption in delivery of materials and services from suppliers;
- new business opportunities;
- customer and Company directed cost reduction efforts and restructuring costs and savings and other consequences thereof;
- the scope, nature, impact or timing of acquisition and divestiture activity, including among other things integration of acquired businesses into our existing businesses and realization of synergies and opportunities for growth and innovation;
- the development, production, delivery, support, performance and anticipated benefits of advanced technologies and new products and services;
- the anticipated benefits of diversification and balance of operations across product lines, regions and industries;
- the impact of the negotiation of collective bargaining agreements and labor disputes;
- the outcome of legal proceedings, investigations and other contingencies;
- future repurchases of our common stock;
- pension plan assumptions and future contributions; and
- the effect of changes in tax, environmental, regulatory (including among other things import/export) and other laws and regulations or political conditions in the U.S. and other countries in which we operate or with which we conduct business.

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In addition, this Form 10-Q includes important information as to risks, uncertainties and other factors that may cause actual results to differ materially from those expressed or implied in the forward-looking statements. See the "Notes to Consolidated Financial Statements" under the heading "Contingent Liabilities," the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the headings "Business Overview," "Results of Operations," "Liquidity and Financial Condition," and "Critical Accounting Estimates," and the section titled "Risk Factors" in this Form 10-Q and in our 2013 Annual Report. This Form 10-Q also includes important information as to these factors in the "Business" section under the headings "General," "Description of Business by Segment" and "Other Matters Relating to Our Business as a Whole," and in the "Legal Proceedings" section. Additional important information as to these factors is included in our 2013 Annual Report in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the headings "Restructuring Costs," "Environmental Matters" and "Governmental Matters." The forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law. Additional information as to factors that may cause actual results to differ materially from those expressed or implied in the forward-looking statements is disclosed from time to time in our other filings with the SEC.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

Telephone Consumer Protection Act

UTC Fire & Security Americas Corporation, Inc. (UTCFS) has been named as a defendant in three putative class actions that were filed on behalf of purported classes of persons who allege that third-party entities placed "robocalls" and/or placed calls to numbers listed on the "Do Not Call Registry" on behalf of UTCFS in contravention of the Telephone Consumer Protection Act. In each putative class action suit, plaintiffs seek injunctive relief and monetary damages. Each violation under the TCPA provides for $500 in statutory damages or up to $1,500 for any willful violation. We assert that the third-party entities that initiated the calls were not acting on our behalf in making any such calls. We believe that UTCFS has meritorious defenses to these claims. We are presently unable to estimate the damages for which UTCFS could be liable in the event plaintiffs prevail in one or more of these cases.

Non-Employee Sales Representative Investigation

In December 2013 and January 2014, UTC made voluntary disclosures to the United States Department of Justice, the Securities and Exchange Commission Division of Enforcement and the United Kingdom's Serious Fraud Office to report the status of its internal investigation regarding a non-employee sales representative retained by United Technologies International Operations, Inc. (UTIO) and International Aero Engines (IAE) for the sale of Pratt & Whitney and IAE engines and aftermarket services, respectively, in China. On April 7, 2014, the SEC notified UTC that it is conducting a formal investigation and issued a subpoena to UTC seeking production of documents related to the disclosures. UTC is cooperating fully with the investigation. Because the investigation is at an early stage, we cannot predict its outcome or the consequences thereof at this time.

At the outset of the internal investigation, UTIO and IAE suspended all commission payments to the sales representative, and UTIO and IAE have not resumed making any payments. This led to two claims by the sales representative for unpaid commissions: a civil lawsuit filed against UTIO and UTC and an arbitration claim against IAE. We are contesting the lawsuit and the arbitration claim. We do not believe that the resolution of the lawsuit or the arbitration will have a material adverse effect on our competitive position, results of operations, cash flows or financial condition.

See Note 14, Contingent Liabilities, for discussion regarding other legal proceedings.

Except as otherwise noted above, there have been no material developments in legal proceedings. For a description of previously reported legal proceedings refer to Part I, Item 3, "Legal Proceedings," of our 2013 Form 10-K.

Item 1A. Risk Factors

There have been no material changes in the Company's risk factors from those disclosed in Part I, Item 1A, Risk Factors, in our 2013 Form 10-K.

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

Issuer Purchases of Equity Securities

The following table provides information about our purchases during the quarter ended March 31, 2014 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act.

2014	Total Number of Shares Purchased (000's)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program (000's)	Maximum Number of Shares that may yet be Purchased Under the Program (000's)
January 1 - January 31	2,948	$113.67	2,948	48,313
February 1 - February 28	—	—	—	48,313
March 1 - March 31	3	116.76	—	48,313
Total	2,951	$113.67	2,948	

We repurchase shares under a program announced on February 4, 2013, which authorized the repurchase of up to 60 million shares of our common stock. Under this current program, shares may be purchased on the open market, in privately negotiated transactions and under plans complying with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended. We may also reacquire shares outside of the program from time to time in connection with the surrender of shares to cover taxes on vesting of restricted stock. Approximately 3,000 shares were reacquired in transactions outside the program during the quarter ended March 31, 2014.

Item 3. Defaults Upon Senior Securities

None.

Item 6. Exhibits

Exhibit Number	Exhibit Description
12	Statement re: computation of ratio of earnings to fixed charges.*
15	Letter re: unaudited interim financial information.*
31	Rule 13a-14(a)/15d-14(a) Certifications.*
32	Section 1350 Certifications.*
101.INS	XBRL Instance Document.* (File name: utx-20140331.xml)
101.SCH	XBRL Taxonomy Extension Schema Document.* (File name: utx-20140331.xsd)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.* (File name: utx-20140331_cal.xml)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.* (File name: utx-20140331_def.xml)

101.LAB	XBRL Taxonomy Extension Label Linkbase Document.* (File name: utx-20140331_lab.xml)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.* (File name: utx-20140331_pre.xml)

Notes to Exhibits List:
* Submitted electronically herewith.

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Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Statements of Comprehensive Income for the quarters ended March 31, 2014 and 2013, (ii) Condensed Consolidated Balance Sheets as of March 31, 2014 and December 31, 2013, (iii) Condensed Consolidated Statements of Cash Flows for the quarters ended March 31, 2014 and 2013, and (iv) Notes to Condensed Consolidated Financial Statements.

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SIGNATURES

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

	UNITED TECHNOLOGIES CORPORATION (Registrant)
Dated: April 25, 2014	by: /s/ GREGORY J. HAYES Gregory J. Hayes Senior Vice President and Chief Financial Officer (on behalf of the Registrant and as the Registrant's Principal Financial Officer and Principal Accounting Officer)
Dated: April 25, 2014	by: /s/ JOHN E. STANTIAL John E. Stantial Acting Controller and Assistant Controller, Financial Reporting (on behalf of the Registrant)

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