TE Connectivity Ltd.
Form 10-Q
January 22, 2016

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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 December 25, 2015

Or

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

001-33260
(Commission File Number)

TE CONNECTIVITY LTD.

(Exact name of registrant as specified in its charter)

Switzerland	**98-0518048**
(Jurisdiction of Incorporation)	(I.R.S. Employer Identification No.)

Rheinstrasse 20
CH-8200 Schaffhausen, Switzerland
(Address of principal executive offices)

+41 (0)52 633 66 61
(Registrant's telephone number)

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 o

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

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

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of common shares outstanding as of January 15, 2016 was 369,677,636.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TE CONNECTIVITY LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	For the Quarters Ended December 25, 2015	December 26, 2014
	(in millions, except per share data)	
Net sales	$ 2,833	$ 3,049
Cost of sales	1,888	2,029
Gross margin	945	1,020
Selling, general, and administrative expenses	340	386
Research, development, and engineering expenses	162	160
Acquisition and integration costs	5	24
Restructuring and other charges, net	40	25
Operating income	398	425
Interest income	6	5
Interest expense	(30)	(34)
Other income (expense), net	8	(70)
Income from continuing operations before income taxes	382	326
Income tax (expense) benefit	(58)	109
Income from continuing operations	324	435
Income from discontinued operations, net of income taxes	29	37
Net income	$ 353	$ 472
Basic earnings per share:		
Income from continuing operations	$ 0.84	$ 1.07
Income from discontinued operations	0.08	0.09
Net income	0.92	1.16
Diluted earnings per share:		
Income from continuing operations	$ 0.83	$ 1.05
Income from discontinued operations	0.07	0.09
Net income	0.91	1.14
Dividends paid per common share	$ 0.33	$ 0.29
Weighted-average number of shares outstanding:		
Basic	385	407

Diluted	390	413

See Notes to Condensed Consolidated Financial Statements.

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TE CONNECTIVITY LTD.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	For the Quarters Ended	
	December 25, 2015	December 26, 2014
	(in millions)	
Net income.	$ 353	$ 472
Other comprehensive loss:		
Currency translation	(85)	(211)
Adjustments to unrecognized pension and postretirement benefit costs, net of income taxes	2	10
Losses on cash flow hedges, net of income taxes	(7)	(5)
Other comprehensive loss	(90)	(206)
Comprehensive income.	$ 263	$ 266

See Notes to Condensed Consolidated Financial Statements.

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TE CONNECTIVITY LTD.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	December 25, 2015	September 25, 2015
	(in millions, except share data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 2,223	$ 3,329
Accounts receivable, net of allowance for doubtful accounts of $18	1,878	2,120
Inventories	1,700	1,615
Prepaid expenses and other current assets	704	476
Deferred income taxes		345
Total current assets	6,505	7,885
Property, plant, and equipment, net	2,866	2,920
Goodwill	4,651	4,824
Intangible assets, net	1,468	1,555
Deferred income taxes	2,454	2,144
Receivable from Tyco International plc and Covidien plc	972	964
Other assets	307	297
Total Assets	$ 19,223	$ 20,589
Liabilities and Shareholders' Equity		
Current liabilities:		
Current maturities of long-term debt	$ 500	$ 498
Accounts payable	1,108	1,143
Accrued and other current liabilities	1,545	1,749
Deferred revenue	113	185
Total current liabilities	3,266	3,575
Long-term debt	3,370	3,386
Long-term pension and postretirement liabilities	1,307	1,327
Deferred income taxes	291	329
Income taxes	1,974	1,954
Other liabilities	438	433
Total Liabilities	10,646	11,004
Commitments and contingencies (Note 11)		
Shareholders' Equity:		
Common shares, 414,064,381 shares authorized and issued, CHF 0.57 par value	182	182
Contributed surplus	4,284	4,359
Accumulated earnings	7,026	6,673
Treasury shares, at cost, 38,370,435 and 20,071,089 shares, respectively	(2,452)	(1,256)
Accumulated other comprehensive loss	(463)	(373)
Total Shareholders' Equity	8,577	9,585

Total Liabilities and Shareholders' Equity	$	19,223	$	20,589

See Notes to Condensed Consolidated Financial Statements.

TE CONNECTIVITY LTD.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED)

	Common Shares		Treasury Shares				Accumulated Other	TE Connectivity Ltd.		
	Shares	Amount	Shares	Amount	Contributed Surplus	Accumulated Earnings	Comprehensive Loss	Shareholders' Equity	Non-controlling Interests	Total Equity
						(in millions)				
Balance at September 25, 2015	414	$ 182	(20)	$ (1,256)	$ 4,359	$ 6,673	$ (373)	$ 9,585	$	$ 9,585
Net income						353		353		353
Other comprehensive loss							(90)	(90)		(90)
Share-based compensation expense					23			23		23
Exercise of share options			1	34				34		34
Restricted share award vestings and other activity			1	88	(98)			(10)		(10)
Repurchase of common shares			(20)	(1,318)				(1,318)		(1,318)
Balance at December 25, 2015	414	$ 182	(38)	$ (2,452)	$ 4,284	$ 7,026	$ (463)	$ 8,577	$	$ 8,577
Balance at September 26, 2014	419	$ 184	(11)	$ (644)	$ 5,231	$ 4,253	$ (17)	$ 9,007	$ 6	$ 9,013
Net income						472		472		472
Other comprehensive loss							(206)	(206)		(206)
Share-based compensation expense					25			25		25
Exercise of share options				16				16		16
Restricted share award vestings and other activity			1	66	(75)			(9)		(9)
Repurchase of common shares			(2)	(141)				(141)		(141)
Balance at December 26, 2014	419	$ 184	(12)	$ (703)	$ 5,181	$ 4,725	$ (223)	$ 9,164	$ 6	$ 9,170

See Notes to Condensed Consolidated Financial Statements.

TE CONNECTIVITY LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	For the Quarters Ended December 25, 2015	For the Quarters Ended December 26, 2014
	(in millions)	
Cash Flows From Operating Activities:		
Net income	$ 353	$ 472
Income from discontinued operations, net of income taxes	(29)	(37)
Income from continuing operations	324	435
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	146	160
Non-cash restructuring charges	2	15
Deferred income taxes	(58)	(79)
Provision for losses on accounts receivable and inventories	21	18
Tax sharing (income) expense	(8)	69
Share-based compensation expense	22	23
Other	15	30
Changes in assets and liabilities, net of the effects of acquisitions and divestitures:		
Accounts receivable, net	237	34
Inventories	(99)	(161)
Prepaid expenses and other current assets	16	3
Accounts payable	(55)	8
Accrued and other current liabilities	(130)	(202)
Deferred revenue	(71)	(56)
Income taxes	28	(115)
Other	(23)	23
Net cash provided by continuing operating activities	367	205
Net cash provided by (used in) discontinued operating activities	(1)	90
Net cash provided by operating activities	366	295
Cash Flows From Investing Activities:		
Capital expenditures	(139)	(135)
Proceeds from sale of property, plant, and equipment	1	5
Acquisition of businesses, net of cash acquired		(1,511)
Other	17	(3)
Net cash used in continuing investing activities	(121)	(1,644)
Net cash used in discontinued investing activities		(7)
Net cash used in investing activities	(121)	(1,651)
Cash Flows From Financing Activities:		
Net increase in commercial paper		270
Repayment of long-term debt		(223)
Proceeds from exercise of share options	34	16
Repurchase of common shares	(1,249)	(155)
Payment of common share dividends to shareholders	(127)	(118)

Transfers (to) from discontinued operations	(1)	83
Other	(4)	1
Net cash used in continuing financing activities	(1,347)	(126)
Net cash provided by (used in) discontinued financing activities	1	(83)
Net cash used in financing activities	(1,346)	(209)
Effect of currency translation on cash	(5)	(24)
Net decrease in cash and cash equivalents	(1,106)	(1,589)
Cash and cash equivalents at beginning of period	3,329	2,457
Cash and cash equivalents at end of period	$ 2,223	$ 868

See Notes to Condensed Consolidated Financial Statements.

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

The unaudited Condensed Consolidated Financial Statements of TE Connectivity Ltd. ("TE Connectivity" or the "Company," which may be referred to as "we," "us," or "our") have been prepared in United States ("U.S.") dollars, in accordance with accounting principles generally accepted in the U.S. ("GAAP") and the instructions to Form 10-Q under the Securities Exchange Act of 1934, as amended. In management's opinion, the unaudited Condensed Consolidated Financial Statements contain all normal recurring adjustments necessary for a fair presentation of interim results. The results of operations reported for interim periods are not necessarily indicative of the results of operations for the entire fiscal year or any subsequent interim period.

The year-end balance sheet data was derived from audited financial statements, but does not include all of the information and disclosures required by GAAP. These financial statements should be read in conjunction with our audited Consolidated Financial Statements contained in our Annual Report on Form 10-K for the fiscal year ended September 25, 2015.

Unless otherwise indicated, references in the Condensed Consolidated Financial Statements to fiscal 2016 and fiscal 2015 are to our fiscal years ending September 30, 2016 and September 25, 2015, respectively.

2. Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued an update to Accounting Standards Codification ("ASC") 835, *Interest*, requiring that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This update is required to be applied on a retrospective basis and is effective for us in the first quarter of fiscal 2017. We elected to early adopt this update during the first quarter of fiscal 2016. Adoption did not have a material impact on the Condensed Consolidated Financial Statements.

In November 2015, the FASB issued an update to ASC 740, *Income Taxes*, requiring that deferred tax assets and liabilities be classified as non-current in a classified statement of financial position. This update is effective for us in the first quarter of fiscal 2018; however, we elected to early adopt this update on a prospective basis during the first quarter of fiscal 2016. Prior period amounts were not retrospectively adjusted. The impact of adoption was a $345 million decrease in deferred income taxes (current asset), a $313 million increase in deferred income taxes (non-current asset), a $33 million decrease in accrued and other current liabilities, and a $1 million increase in deferred income taxes (non-current liability) on the Condensed Consolidated Balance Sheet at December 25, 2015.

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

3. Restructuring and Other Charges, Net

Net restructuring and other charges consisted of the following:

	For the Quarters Ended December 25, 2015	December 26, 2014
	(in millions)	
Restructuring charges, net	$ 35	$ 25
Other charges, net	5	
	$ 40	$ 25

Net restructuring charges by segment were as follows:

	For the Quarters Ended December 25, 2015	December 26, 2014
	(in millions)	
Transportation Solutions	$ 15	$ 1
Industrial Solutions	9	2
Communications Solutions	11	22
Restructuring charges, net	$ 35	$ 25

Activity in our restructuring reserves during the first quarter of fiscal 2016 is summarized as follows:

	Balance at September 25, 2015	Charges	Cash Payments	Non-Cash Items	Currency Translation	Balance at December 25, 2015
			(in millions)			
Fiscal 2016 Actions:						
Employee severance	$	$ 30	$ (2)	$	$	$ 28
Facility and other exit costs		1	(1)			
Property, plant, and equipment		1		(1)		
Total		32	(3)	(1)		28
Fiscal 2015 Actions:						
Employee severance	45	1	(12)		(1)	33
Facility and other exit costs	1					1
Total	46	1	(12)		(1)	34

Pre-Fiscal 2015 Actions:						
Employee severance	24		(4)			20
Facility and other exit costs	14	1	(2)			13
Property, plant, and equipment		1		(1)		
Total	38	2	(6)	(1)		33
Total Activity	$ 84	$ 35	$ (21)	$ (2)	$ (1)	$ 95

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

3. Restructuring and Other Charges, Net (Continued)

Fiscal 2016 Actions

During fiscal 2016, we initiated a restructuring program associated with headcount reductions and product line closures impacting all segments. In connection with this program, during the quarter ended December 25, 2015, we recorded restructuring charges of $32 million. We expect to complete all restructuring actions commenced in the first quarter of fiscal 2016 by the end of fiscal 2019 and to incur total charges of approximately $65 million.

The following table summarizes expected, incurred, and remaining charges for the fiscal 2016 program by type:

	Total Expected Charges	Charges Incurred For the Quarter Ended December 25, 2015	Remaining Expected Charges
		(in millions)	
Employee severance	$ 55	$ 30	$ 25
Facility and other exit costs	6	1	5
Property, plant, and equipment	4	1	3
Total	$ 65	$ 32	$ 33

The following table summarizes expected, incurred, and remaining charges for the fiscal 2016 program by segment:

	Total Expected Charges	Charges Incurred For the Quarter Ended December 25, 2015	Remaining Expected Charges
		(in millions)	
Transportation Solutions	$ 21	$ 14	$ 7
Industrial Solutions	11	8	3
Communications Solutions	33	10	23
Total	$ 65	$ 32	$ 33

Fiscal 2015 Actions

During fiscal 2015, we initiated a restructuring program associated with headcount reductions and product line closures, primarily impacting the Communications Solutions and Industrial Solutions segments. In connection with this program, during the quarters ended December 25, 2015 and December 26, 2014, we recorded restructuring charges of $1 million and $25 million, respectively. We do not expect to incur any additional charges related to fiscal 2015 actions.

Pre-Fiscal 2015 Actions

During fiscal 2014, we initiated a restructuring program associated primarily with headcount reductions and manufacturing site and product line closures in the Communications Solutions segment.

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

3. Restructuring and Other Charges, Net (Continued)

During fiscal 2013, we initiated a restructuring program associated with headcount reductions and manufacturing site closures impacting all segments. During the quarter ended December 25, 2015, we recorded restructuring charges of $2 million related to pre-fiscal 2015 actions. We do not expect to incur any additional charges related to pre-fiscal 2015 actions.

Total Restructuring Reserves

Restructuring reserves included on the Condensed Consolidated Balance Sheets were as follows:

	December 25, 2015	September 25, 2015
	(in millions)	
Accrued and other current liabilities	$ 69	$ 60
Other liabilities	26	24
Restructuring reserves	$ 95	$ 84

4. Discontinued Operations and Divestiture

Discontinued Operations

During the fourth quarter of fiscal 2015, we sold our Broadband Network Solutions ("BNS") business for $3.0 billion in cash and recognized a pre-tax gain of $1,105 million on the transaction. In the first quarter of fiscal 2016, we recognized an additional pre-tax gain of $38 million on the divestiture, related primarily to pension and net working capital adjustments. The BNS business met the discontinued operations criteria and was reported as such in all periods presented on the Condensed Consolidated Financial Statements. Prior to reclassification to discontinued operations, the BNS business was included in the former Network Solutions segment.

The following table presents certain components of income from discontinued operations related to BNS and prior divestitures:

	For the Quarters Ended	
	December 25, 2015	December 26, 2014
	(in millions)	
Net sales from discontinued operations	$	$ 417
Pre-tax income (loss) from discontinued operations	$ (2)	$ 51
Pre-tax gain on sale of discontinued operations	38	
Income tax expense	(7)	(14)
Income from discontinued operations, net of income taxes	$ 29	$ 37

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

4. Discontinued Operations and Divestiture (Continued)

Planned Divestiture

On November 7, 2015, we entered into a definitive agreement to sell our Circuit Protection Devices ("CPD") business for $350 million in cash, subject to a final working capital adjustment. The transaction is expected to close during the second quarter of fiscal 2016 pending customary closing conditions and regulatory approvals. The net assets of the CPD business were approximately $200 million at December 25, 2015. The CPD business is currently reported in our Communications Solutions segment.

5. Acquisition

On October 9, 2014, we acquired 100% of the outstanding shares of Measurement Specialties, Inc. ("Measurement Specialties"). The following unaudited pro forma financial information reflects our consolidated results of operations had the Measurement Specialties acquisition occurred at the beginning of fiscal 2014:

	Pro Forma for the Quarter Ended December 26, 2014 (in millions, except per share data)
Net sales	$ 3,068
Net income.	493
Diluted earnings per share	$ 1.19

The pro forma financial information is based on our final allocation of the purchase price. The significant pro forma adjustments, which are described below, are net of income tax expense (benefit) at the statutory rate.

Pro forma results for the quarter ended December 26, 2014 were adjusted to exclude $16 million of acquisition costs, $15 million of share-based compensation expense incurred by Measurement Specialties as a result of the change in control of Measurement Specialties, $11 million of charges related to the fair value adjustment to acquisition-date inventories, $8 million of income tax expense based on the estimated impact of combining Measurement Specialties into our global tax position, and $5 million of charges related to acquired customer order backlog. Pro forma results for the quarter ended December 26, 2014 were also adjusted to include $1 million of interest expense based on pro forma changes in our capital structure.

Pro forma results do not include any anticipated synergies or other anticipated benefits of the acquisition. Accordingly, the unaudited pro forma financial information is not necessarily indicative of either future results of operations or results that might have been achieved had the Measurement Specialties acquisition occurred at the beginning of fiscal 2014.

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

6. Inventories

Inventories consisted of the following:

	December 25, 2015	September 25, 2015
	(in millions)	
Raw materials	$ 257	$ 261
Work in progress	635	581
Finished goods	808	773
Inventories	$ 1,700	$ 1,615

7. Goodwill

The changes in the carrying amount of goodwill by segment were as follows:

	Transportation Solutions	Industrial Solutions	Communications Solutions[2]	Total
		(in millions)		
September 25, 2015[1]	$ 1,863	$ 2,253	$ 708	$ 4,824
Currency translation and other	(22)	(27)	(124)	(173)
December 25, 2015[1]	$ 1,841	$ 2,226	$ 584	$ 4,651

(1) At December 25, 2015 and September 25, 2015, accumulated impairment losses for the Transportation Solutions and Industrial Solutions segments were $2,191 million and $669 million, respectively. Accumulated impairment losses for the Communications Solutions segment were $1,514 million and $1,626 million at December 25, 2015 and September 25, 2015, respectively.

(2) During fiscal 2016, in connection with the planned divestiture of our CPD business, net goodwill of $117 million was treated as assets held for sale and recorded in prepaid expenses and other current assets on the Condensed Consolidated Balance Sheet at December 25, 2015. See Note 4 for additional information.

8. Intangible Assets, Net

Intangible assets consisted of the following:

	December 25, 2015			September 25, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
			(in millions)			
Intellectual property	$ 1,086	$ (505)	$ 581	$ 1,150	$ (524)	$ 626

Customer relationships	1,028	(164)	864	1,053	(148)	905
Other	36	(13)	23	37	(13)	24
Total	$ 2,150	$ (682)	$ 1,468	$ 2,240	$ (685)	$ 1,555

Intangible asset amortization expense was $34 million and $42 million for the quarters ended December 25, 2015 and December 26, 2014, respectively.

TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

8. Intangible Assets, Net (Continued)

The aggregate amortization expense on intangible assets is expected to be as follows:

	(in millions)
Remainder of fiscal 2016	$ 102
Fiscal 2017	132
Fiscal 2018	132
Fiscal 2019	130
Fiscal 2020	126
Fiscal 2021	123
Thereafter	723
Total	$ 1,468

9. Debt

Tyco Electronics Group S.A. ("TEGSA"), our 100%-owned subsidiary, has a five-year unsecured senior revolving credit facility ("Credit Facility") with total commitments of $1,500 million. The Credit Facility was amended in December 2015 primarily to extend the maturity date from August 2018 to December 2020. TEGSA had no borrowings under the Credit Facility at December 25, 2015 and September 25, 2015.

Borrowings under the Credit Facility bear interest at a rate per annum equal to, at the option of TEGSA, (1) London interbank offered rate ("LIBOR") plus an applicable margin based upon the senior, unsecured, long-term debt rating of TEGSA, or (2) an alternate base rate equal to the highest of (i) Bank of America, N.A.'s base rate, (ii) the federal funds effective rate plus $^1/_2$ of 1%, and (iii) one-month LIBOR plus 1%, plus, in each case, an applicable margin based upon the senior, unsecured, long-term debt rating of TEGSA. TEGSA is required to pay an annual facility fee ranging from 5.0 to 12.5 basis points based upon the amount of the lenders' commitments under the Credit Facility and the applicable credit ratings of TEGSA.

The fair value of our debt, based on indicative valuations, was approximately $4,067 million and $4,115 million at December 25, 2015 and September 25, 2015, respectively.

10. Guarantees

Tax Sharing Agreement

Effective June 29, 2007, we became the parent company of the former electronics businesses of Tyco International plc ("Tyco International"). On June 29, 2007, Tyco International distributed all of our shares, as well as its shares of its former healthcare businesses ("Covidien"), to its common shareholders (the "separation"). On January 26, 2015, Covidien was acquired and now operates as a subsidiary of Medtronic plc.

Upon separation, we entered into a Tax Sharing Agreement, under which we share responsibility for certain of our, Tyco International's, and Covidien's income tax liabilities based on a sharing formula for periods prior to and including June 29, 2007. We, Tyco International, and Covidien share 31%, 27%, and 42%, respectively, of U.S. income tax liabilities that arise from adjustments made by tax

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

10. Guarantees (Continued)

authorities to our, Tyco International's, and Covidien's U.S. income tax returns. The effect of the Tax Sharing Agreement is to indemnify us for 69% of certain liabilities settled in cash by us with respect to unresolved pre-separation tax matters. Pursuant to that indemnification, we have made similar indemnifications to Tyco International and Covidien with respect to 31% of certain liabilities settled in cash by the companies relating to unresolved pre-separation tax matters. If any of the companies responsible for all or a portion of such liabilities were to default in its payment of costs or expenses related to any such liability, we would be responsible for a portion of the defaulting party or parties' obligation.

Our indemnification created under the Tax Sharing Agreement qualifies as a guarantee of a third party entity's debt under ASC 460, *Guarantees*. At December 25, 2015 and September 25, 2015, we had a liability of $17 million representing the indemnifications made to Tyco International and Covidien pursuant to the Tax Sharing Agreement.

Other Matters

In disposing of assets or businesses, we often provide representations, warranties, and/or indemnities to cover various risks including unknown damage to assets, environmental risks involved in the sale of real estate, liability for investigation and remediation of environmental contamination at waste disposal sites and manufacturing facilities, and unidentified tax liabilities and legal fees related to periods prior to disposition. We do not expect that these uncertainties will have a material adverse effect on our results of operations, financial position, or cash flows.

At December 25, 2015, we had outstanding letters of credit, letters of guarantee, and surety and appeal bonds in the amount of $504 million.

In the normal course of business, we are liable for contract completion and product performance. In the opinion of management, such obligations will not significantly affect our results of operations, financial position, or cash flows.

We generally record estimated product warranty costs when contract revenues are recognized under the percentage-of-completion method for construction related contracts; other warranty reserves are not significant. The estimation is based primarily on historical experience and actual warranty claims. Amounts accrued for warranty claims were $39 million and $35 million at December 25, 2015 and September 25, 2015, respectively.

11. Commitments and Contingencies

Legal Proceedings

In the normal course of business, we are subject to various legal proceedings and claims, including patent infringement claims, product liability matters, employment disputes, disputes on agreements, other commercial disputes, environmental matters, antitrust claims, and tax matters, including non-income tax matters such as value added tax, sales and use tax, real estate tax, and transfer tax. Although it is not feasible to predict the outcome of these proceedings, based upon our experience, current information, and applicable law, we do not expect that the outcome of these proceedings, either individually or in the aggregate, will have a material effect on our results of operations, financial position, or cash flows. However, the proceedings discussed below in "Income Tax Matters" could have a material effect on our results of operations, financial position, or cash flows.

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TE CONNECTIVITY LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

11. Commitments and Contingencies (Continued)

As previously reported, we had a contingent purchase price commitment of $80 million related to our fiscal 2001 acquisition of Com-Net. This represented the maximum amount payable to the former shareholders of Com-Net only after the construction and installation of a communications system was completed for and approved by the State of Florida in accordance with guidelines set forth in the contract. Under the terms of the purchase and sale agreement, we did not believe we had any obligation to the sellers. However, the sellers contested our position and initiated a lawsuit in June 2006 in the Court of Common Pleas in Allegheny County, Pennsylvania. Trial began in March 2015 and culminated in the entry of final judgment on October 8, 2015, in favor of the sellers and against us for $127 million plus costs. The judgment represents the $80 million contingent purchase price plus pre-judgment interest, which will continue to accrue until the judgment is paid in full. We are appropriately reserved for this matter and are proceeding with an appeal.

Income Tax Matters

The Tax Sharing Agreement generally governs our, Tyco International's, and Covidien's respective rights, responsibilities, and obligations with respect to taxes for periods prior to and including June 29, 2007. Pursuant to the Tax Sharing Agreement, we entered into certain guarantee commitments and indemnifications with Tyco International and Covidien. See Note 10 for additional information regarding the Tax Sharing Agreement.

In October 2012, the Internal Revenue Service ("IRS") issued special agreement Forms 870-AD, effectively settling its audit of all tax matters for the years 1997 through 2000, excluding one issue that remains in dispute involving the tax treatment of certain intercompany debt transactions. The IRS field examination asserted that certain intercompany loans originated during the years 1997 through 2000 did not constitute debt for U.S. federal income tax purposes and disallowed approximately $2.7 billion of related interest deductions recognized during the period on Tyco International's U.S. income tax returns. In addition, if the IRS is ultimately successful in asserting its claim, it is likely to disallow an additional $6.6 billion of interest deductions reflected on U.S. income tax returns in years subsequent to fiscal 2000. Tyco International contends that the intercompany financing qualified as debt for U.S. income tax purposes and that the interest deductions reflected on the income tax returns were appropriate. The IRS and Tyco International were unable to resolve this matter through the IRS appeals process. On June 20, 2013, Tyco International advised us that it had received Notices of Deficiency from the IRS for certain former U.S. subsidiaries of Tyco International increasing taxable income by approximately $2.9 billion in connection with the audit of Tyco International's fiscal years 1997 through 2000. The Notices of Deficiency assert that Tyco International owes additional taxes totaling $778 million, associated penalties of $154 million, and withholding taxes of $105 million. In addition, Tyco International received Final Partnership Administrative Adjustments for certain U.S. partnerships owned by former U.S. subsidiaries with respect to which Tyco International estimates an additional tax deficiency of approximately $30 million will be asserted. The amounts asserted by the IRS exclude any applicable deficiency interest, and do not reflect any impact to subsequent period tax liabilities in the event that the IRS were to prevail on some or all of its assertions. We understand that Tyco International strongly disagrees with the IRS position and has filed petitions in the U.S. Tax Court contesting the IRS's proposed adjustments. Tyco International has advised us that it believes there are meritorious defenses for the tax filings in question and that the IRS position with regard to this matter is inconsistent with the applicable tax laws and existing U.S. Treasury regulations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

11. Commitments and Contingencies (Continued)

The previously set U.S. Tax Court trial date of February 29, 2016 has been delayed at the request of the IRS, and trial is currently scheduled to commence during October 2016. The parties remain engaged in discovery. In accordance with the Tax Sharing Agreement, we, Tyco International, and Covidien would share 31%, 27%, and 42%, respectively, of any payments made in connection with this matter.

If the IRS were to prevail on its assertions, our share of the assessed tax, deficiency interest, and applicable withholding taxes and penalties could have a material adverse impact on our results of operations, financial position, and cash flows. We have reviewed the Notices of Deficiency, the relevant facts surrounding the intercompany debt transactions, relevant tax regulations, and applicable case law, and we continue to believe that we are appropriately reserved for this matter.

In the first quarter of fiscal 2015, the IRS issued general agreement Forms 870, effectively settling its audits of tax matters for the years 2001 through 2007, excluding the disputed issue discussed above. As a result of these developments, in the first quarter of fiscal 2015, we recognized an income tax benefit of $189 million, representing a reduction in tax reserves for the matters that were effectively settled, and other expense of $83 million, representing a reduction of associated indemnification receivables, pursuant to the Tax Sharing Agreement with Tyco International and Covidien.

Also during fiscal 2015, the IRS issued general agreement Forms 870, effectively settling its audits of tax matters for the years 2008 through 2010, excluding the disputed issue discussed above.

During the first quarters of fiscal 2016 and 2015, we made net payments of $1 million and $4 million, respectively, related to pre-separation U.S. tax matters.

At December 25, 2015 and September 25, 2015, we have reflected $20 million and $17 million, respectively, of income tax liabilities related to the audits of Tyco International's and our income tax returns in accrued and other current liabilities as certain of these matters could be resolved within the next twelve months.

We believe that the amounts recorded on the Condensed Consolidated Financial Statements relating to the matters discussed above are appropriate. However, the ultimate resolution is uncertain and could result in a material impact to our results of operations, financial position, or cash flows.

See Note 20 for additional information on developments subsequent to December 25, 2015 regarding income tax matters, including the disputed issue.