

PARKER HANNIFIN CORP
Form 10-Q
February 03, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended December 31, 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 1-4982

PARKER-HANNIFIN CORPORATION
(Exact name of registrant as specified in its charter)

OHIO 34-0451060
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)

6035 Parkland Blvd., Cleveland, Ohio 44124-4141
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (216) 896-3000

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

Number of Common Shares outstanding at December 31, 2015 135,102,576

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PARKER-HANNIFIN CORPORATION
CONSOLIDATED STATEMENT OF INCOME
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2015	2014	2015	2014
Net sales	\$2,705,590	\$3,134,993	\$5,574,938	\$6,404,925
Cost of sales	2,140,624	2,401,584	4,341,528	4,861,449
Gross profit	564,966	733,409	1,233,410	1,543,476
Selling, general and administrative expenses	314,666	379,804	684,880	780,644
Interest expense	34,297	27,645	70,057	48,606
Other (income), net	(13,877)	(17,306)	(27,056)	(25,675)
Income before income taxes	229,880	343,266	505,529	739,901
Income taxes	46,743	75,931	127,366	192,395
Net income	183,137	267,335	378,163	547,506
Less: Noncontrolling interest in subsidiaries' earnings	155	83	203	165
Net income attributable to common shareholders	\$182,982	\$267,252	\$377,960	\$547,341
Earnings per share attributable to common shareholders:				
Basic	\$1.35	\$1.84	\$2.78	\$3.72
Diluted	\$1.33	\$1.80	\$2.74	\$3.66
Cash dividends per common share	\$0.63	\$0.63	\$1.26	\$1.11
See accompanying notes to consolidated financial statements.				

PARKER-HANNIFIN CORPORATION
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2015	2014	2015	2014
Net income	\$183,137	\$267,335	\$378,163	\$547,506
Less: Noncontrolling interests in subsidiaries' earnings	155	83	203	165
Net income attributable to common shareholders	182,982	267,252	377,960	547,341
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment and other	(91,177)	(216,913)	(203,357)	(518,940)
Retirement benefits plan activity	28,221	25,064	57,117	51,922
Other comprehensive (loss)	(62,956)	(191,849)	(146,240)	(467,018)
Less: Other comprehensive (loss) for noncontrolling interests	(34)	(52)	(131)	(153)
Other comprehensive (loss) attributable to common shareholders	(62,922)	(191,797)	(146,109)	(466,865)
Total comprehensive income attributable to common shareholders	\$120,060	\$75,455	\$231,851	\$80,476

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION
CONSOLIDATED BALANCE SHEET
(Dollars in thousands)

	(Unaudited) December 31, 2015	June 30, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,047,494	\$ 1,180,584
Marketable securities and other investments	820,682	733,490
Trade accounts receivable, net	1,419,934	1,620,194
Non-trade and notes receivable	293,913	364,534
Inventories	1,279,760	1,300,459
Prepaid expenses	141,030	241,684
Deferred income taxes	148,198	142,147
Total current assets	5,151,011	5,583,092
Plant and equipment	4,775,462	4,862,611
Less: Accumulated depreciation	3,177,277	3,198,589
	1,598,185	1,664,022
Other assets	1,116,315	1,091,805
Intangible assets, net	975,515	1,013,439
Goodwill	2,913,065	2,942,679
Total assets	\$ 11,754,091	\$ 12,295,037
LIABILITIES		
Current liabilities:		
Notes payable and long-term debt payable within one year	\$ 574,302	\$ 223,142
Accounts payable, trade	948,157	1,092,138
Accrued payrolls and other compensation	279,119	409,762
Accrued domestic and foreign taxes	109,495	140,295
Other accrued liabilities	457,026	484,793
Total current liabilities	2,368,099	2,350,130
Long-term debt	2,724,860	2,723,960
Pensions and other postretirement benefits	1,475,351	1,699,197
Deferred income taxes	76,405	77,967
Other liabilities	306,655	336,214
Total liabilities	6,951,370	7,187,468
EQUITY		
Shareholders' equity:		
Serial preferred stock, \$.50 par value; authorized 3,000,000 shares; none issued	—	—
Common stock, \$.50 par value; authorized 600,000,000 shares; issued 181,046,128 shares at December 31 and June 30	90,523	90,523
Additional capital	639,921	622,729
Retained earnings	10,047,759	9,841,885
Accumulated other comprehensive (loss)	(1,884,727	) (1,738,618
Treasury shares, at cost; 45,943,552 shares at December 31 and 42,487,389 shares at June 30	(4,094,070	) (3,712,232
Total shareholders' equity	4,799,406	5,104,287
Noncontrolling interests	3,315	3,282

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Total equity	4,802,721	5,107,569
Total liabilities and equity	\$ 11,754,091	\$ 12,295,037
See accompanying notes to consolidated financial statements.		

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PARKER-HANNIFIN CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended December 31,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$378,163	\$547,506
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	96,675	103,671
Amortization	59,418	56,954
Share incentive plan compensation	39,026	52,217
Deferred income taxes	(20,899)	(35,253)
Foreign currency transaction loss (gain)	8,169	(23,186)
(Gain) loss on sale of plant and equipment	(336)	8,092
Gain on sale of businesses	—	(5,791)
Gain on sale of marketable securities	(158)	—
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	173,590	211,530
Inventories	3,346	(155,335)
Prepaid expenses	99,511	(33,655)
Other assets	(20,673)	(4,175)
Accounts payable, trade	(135,070)	(53,990)
Accrued payrolls and other compensation	(124,866)	(113,482)
Accrued domestic and foreign taxes	(31,962)	(81,483)
Other accrued liabilities	(31,669)	(826)
Pensions and other postretirement benefits	(120,488)	79,332
Other liabilities	(25,149)	(13,629)
Net cash provided by operating activities	346,628	538,497
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions (net of cash of \$3,814 in 2015 and \$3,979 in 2014)	(67,552)	(18,640)
Capital expenditures	(75,419)	(109,781)
Proceeds from sale of plant and equipment	8,506	3,902
Proceeds from sale of businesses	—	22,779
Purchases of marketable securities and other investments	(575,183)	(971,606)
Maturities of marketable securities and other investments	527,819	475,851
Other	(41,450)	(43,239)
Net cash (used in) investing activities	(223,279)	(640,734)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options	80	2,724
Payments for common shares	(400,070)	(871,567)
Tax benefit from share incentive plan compensation	5,960	16,319
Proceeds from (payments for) notes payable, net	574,299	(815,172)
Proceeds from long-term borrowings	1,689	1,485,505
Payments for long-term borrowings	(219,397)	(358)
Dividends	(171,707)	(164,758)
Net cash (used in) financing activities	(209,146)	(347,307)
Effect of exchange rate changes on cash	(47,293)	(88,704)

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Net (decrease) in cash and cash equivalents	(133,090) (538,248)
Cash and cash equivalents at beginning of year	1,180,584	1,613,555	
Cash and cash equivalents at end of period	\$ 1,047,494	\$ 1,075,307	

See accompanying notes to consolidated financial statements.

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PARKER-HANNIFIN CORPORATION
BUSINESS SEGMENT INFORMATION

(Dollars in thousands)

(Unaudited)

The Company operates in two reportable business segments: Diversified Industrial and Aerospace Systems.

Diversified Industrial - This segment produces a broad range of motion-control and fluid systems and components used in all kinds of manufacturing, packaging, processing, transportation, mobile construction, refrigeration and air conditioning, agricultural and military machinery and equipment and has a significant portion of international operations. Sales are made directly to major original equipment manufacturers (OEMs) and through a broad distribution network to smaller OEMs and the aftermarket.

Aerospace Systems - This segment designs and manufactures products and provides aftermarket support for commercial, business jet, military and general aviation aircraft, missile and spacecraft markets. The Aerospace Systems Segment provides a full range of systems and components for hydraulic, pneumatic and fuel applications.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Net sales				
Diversified Industrial:				
North America	\$1,160,774	\$1,389,207	\$2,447,104	\$2,861,019
International	992,464	1,187,400	2,030,911	2,450,897
Aerospace Systems	552,352	558,386	1,096,923	1,093,009
Total net sales	\$2,705,590	\$3,134,993	\$5,574,938	\$6,404,925
Segment operating income				
Diversified Industrial:				
North America	\$153,581	\$226,888	\$366,329	\$491,124
International	95,367	136,525	224,662	326,330
Aerospace Systems	81,764	66,817	155,767	132,166
Total segment operating income	330,712	430,230	746,758	949,620
Corporate general and administrative expenses	31,210	51,360	84,261	106,804
Income before interest expense and other expense	299,502	378,870	662,497	842,816
Interest expense	34,297	27,645	70,057	48,606
Other expense	35,325	7,959	86,911	54,309
Income before income taxes	\$229,880	\$343,266	\$505,529	\$739,901

PARKER-HANNIFIN CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Dollars in thousands, except per share amounts

1. Management representation

In the opinion of the management of the Company, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company's financial position as of December 31, 2015, the results of operations for the three and six months ended December 31, 2015 and 2014 and cash flows for the six months then ended. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's 2015 Annual Report on Form 10-K and its previously filed fiscal 2016 Form 10-Q. Interim period results are not necessarily indicative of the results to be expected for the full fiscal year.

The Company has evaluated subsequent events that have occurred through the date these financial statements were issued. No subsequent events have occurred that required adjustment to these financial statements.

2. New accounting pronouncements

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-01, "Recognition and Measurement of Financial Assets and Liabilities." ASU 2016-01 requires equity investments (excluding equity method investments and investments that are consolidated) to be measured at fair value with changes in fair value recognized in net income. Equity investments that do not have a readily determinable fair value may be measured at cost, adjusted for impairment and observable price changes. The ASU also simplifies the impairment assessment of equity investments, eliminates the disclosure of the assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at cost on the balance sheet and requires the exit price to be used when measuring fair value of financial instruments for disclosure purposes. Under ASU 2016-01, changes in fair value (resulting from instrument-specific credit risk) will be presented separately in other comprehensive income for liabilities measured using the fair value option and financial assets and liabilities will be presented separately by measurement category and type either on the balance sheet or in the financial statement disclosures. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company has not yet determined the effect that ASU 2016-01 will have on its results of operations, statement of financial position or financial statement disclosures.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes - Balance Sheet Classification of Deferred Taxes." ASU 2015-17 requires companies to present deferred tax assets and deferred tax liabilities as noncurrent in the statement of financial position. ASU 2015-17 is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted at the beginning of an interim or annual reporting period. The Company has not yet determined the effect that ASU 2015-17 will have on its statement of financial position or financial statement disclosures.

In July 2015, the FASB issued ASU 2015-11, "Inventory - Simplifying the Measurement of Inventory." ASU 2015-11 requires companies to measure inventory (valued using first-in, first-out or average cost methods) at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The measurement of inventory valued using the last-in, first-out method is unchanged. ASU 2015-11 is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The Company has not yet determined the effect that ASU 2015-11 will have on its results of operations, statement of financial position or financial statement disclosures.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest." ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in the ASU. ASU 2015-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company does not expect ASU

2015-03 will have a material impact on its statement of financial position or financial statement disclosures. In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration that a company expects to be entitled to in exchange for the goods or services. To achieve this principle, a company must apply five steps including identifying the contract with a customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to the performance obligations, and recognizing revenue when (or as) the company satisfies the performance obligations. Additional quantitative and qualitative disclosure to enhance the understanding

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2. New accounting pronouncements, cont'd

about the nature, amount, timing, and uncertainty of revenue and cash flows is also required. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company has not yet determined the effect that ASU 2014-09 will have on its results of operations, statement of financial position or financial statement disclosures.

In September 2015, the FASB issued ASU 2015-16, "Business Combinations - Simplifying the Accounting for Measurement-Period Adjustments." ASU 2015-16 requires the recognition of adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustments are determined. The effects of the adjustments to provisional amounts on depreciation, amortization or other income effects should be recognized in current-period earnings as if the accounting had been completed at the acquisition date. Disclosure of the portion of the adjustment recorded in current-period earnings that would have been reported in prior reporting periods if the adjustment to the provisional amounts had been recognized at the acquisition date is also required. During the first quarter of fiscal 2016, the Company adopted ASU 2015-16. The adoption of ASU 2015-16 did not materially affect the Company's results of operations, statement of financial position or financial statement disclosures.

3. Earnings per share

The following table presents a reconciliation of the numerator and denominator of basic and diluted earnings per share for the three and six months ended December 31, 2015 and 2014.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Numerator:				
Net income attributable to common shareholders	\$ 182,982	\$ 267,252	\$ 377,960	\$ 547,341
Denominator:				
Basic - weighted average common shares	135,373,356	145,493,247	136,108,930	147,116,038
Increase in weighted average common shares from dilutive effect of equity-based awards	1,692,091	2,689,530	1,679,289	2,347,242
Diluted - weighted average common shares, assuming exercise of equity-based awards	137,065,447	148,182,777	137,788,219	149,463,280
Basic earnings per share	\$ 1.35	\$ 1.84	\$ 2.78	\$ 3.72
Diluted earnings per share	\$ 1.33	\$ 1.80	\$ 2.74	\$ 3.66

For the three months ended December 31, 2015 and 2014, 3,534,042 and 873,214 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive. For the six months ended December 31, 2015 and 2014, 2,894,106 and 1,004,789 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive.

4. Share repurchase program

The Company has a program to repurchase its common shares. On October 22, 2014, the Board of Directors of the Company approved an increase in the overall number of shares authorized for repurchase under the program so that, beginning on such date, the aggregate number of shares authorized for repurchase was 35 million. There is no limitation on the number of shares that can be repurchased in a fiscal year. Repurchases may be funded primarily from operating cash flows and commercial paper borrowings and the shares are initially held as treasury stock. During the three-month period ended December 31, 2015, the Company repurchased 893,010 shares at an average price, including commissions, of \$100.78 per share. During the six-month period ended December 31, 2015, the Company repurchased 3,663,634 shares at an average price, including commissions, of \$109.18 per share.

5. Trade accounts receivable, net

Trade accounts receivable are initially recorded at their net collectible amount and are generally recorded at the time the revenue from the sales transaction is recorded. Receivables are written off to bad debt primarily when, in the judgment of the Company, the receivable is deemed to be uncollectible due to the insolvency of the debtor. Allowance for doubtful accounts was \$8,269 and \$9,284 at December 31, 2015 and June 30, 2015, respectively.

6. Non-trade and notes receivable

The non-trade and notes receivable caption in the Consolidated Balance Sheet is comprised of the following components:

	December 31, 2015	June 30, 2015
Notes receivable	\$101,675	\$90,470
Reverse repurchase agreements	48,874	113,558
Accounts receivable, other	143,364	160,506
Total	\$293,913	\$364,534

Reverse repurchase agreements are collateralized lending arrangements and have a maturity longer than three months from the date of purchase. The Company does not record an asset or liability for the collateral associated with the reverse repurchase agreements.

7. Inventories

The inventories caption in the Consolidated Balance Sheet is comprised of the following components:

	December 31, 2015	June 30, 2015
Finished products	\$514,415	\$526,708
Work in process	681,699	688,727
Raw materials	83,646	85,024
Total	\$1,279,760	\$1,300,459

8. Business realignment charges

The Company incurred business realignment charges in fiscal 2016 and fiscal 2015.

Business realignment charges by business segment are as follows:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2015	2014	2015	2014
Diversified Industrial	\$22,956	\$9,084	\$42,999	\$14,933
Aerospace Systems	235	—	1,980	—

Work force reductions in connection with such business realignment charges by business segment are as follows:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2015	2014	2015	2014
Diversified Industrial	890	72	2,054	174
Aerospace Systems	9	—	66	—

8. Business realignment charges, cont'd

The charges primarily consist of severance costs related to actions taken under the Company's Simplification initiative aimed at reducing organizational and process complexity, as well as plant closures, with the majority of the charges incurred in Europe and North America. Also, during the current-year quarter, \$80 of severance costs for two people were included in the corporate general and administrative expenses caption in the Business Segment Information. In addition, asset write-downs of \$116 and \$1,915 for the six months ended December 31, 2015 and 2014, respectively, were recognized in connection with plant closures in the Diversified Industrial Segment and are reflected in the other expense caption in the Business Segment Information. In connection with a plant closure, the Company recognized an expense associated with enhanced retirement benefits (refer to Note 11 for further discussion). The Company believes the realignment actions will positively impact future results of operations but will not have a material effect on liquidity and sources and uses of capital.

The business realignment charges are presented in the Consolidated Statement of Income as follows:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2015	2014	2015	2014
Cost of sales	\$18,258	\$5,489	\$32,931	\$10,607
Selling, general and administrative expenses	5,013	3,595	12,128	4,326
Other (income), net	—	—	116	1,915

As of December 31, 2015, approximately \$23 million in severance payments had been made relating to charges incurred during fiscal 2016, the remainder of which are expected to be paid by December 31, 2016. Severance payments relating to prior-year actions are being made as required. Remaining severance payments related to current-year and prior-year actions of approximately \$36 million are primarily reflected within the other accrued liabilities caption in the Consolidated Balance Sheet. Additional charges may be recognized in future periods related to the realignment actions described above, the timing and amount of which are not known at this time.

9. Equity

Changes in equity for the three months ended December 31, 2015 and 2014 are as follows:

	Shareholders' Equity	Noncontrolling Interests	Total Equity
September 30, 2015	\$4,851,518	\$3,233	\$4,854,751
Net income	182,982	155	183,137
Other comprehensive (loss)	(62,922)	(34)	(62,956)
Dividends paid	(85,681)	(39)	(85,720)
Stock incentive plan activity	3,509	—	3,509
Shares purchased at cost	(90,000)	—	(90,000)
Balance at December 31, 2015	\$4,799,406	\$3,315	\$4,802,721

	Shareholders' Equity	Noncontrolling Interests	Total Equity
September 30, 2014	\$6,579,003	\$3,361	\$6,582,364
Net income	267,252	83	267,335
Other comprehensive (loss)	(191,797)	(52)	(191,849)
Dividends paid	(93,151)	—	(93,151)
Stock incentive plan activity	12,141	—	12,141
Shares purchased at cost	(816,699)	—	(816,699)
Balance at December 31, 2014	\$5,756,749	\$3,392	\$5,760,141

9. Equity, cont'd

Changes in equity for the six months ended December 31, 2015 and 2014 are as follows:

	Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance at June 30, 2015	\$5,104,287	\$3,282	\$5,107,569
Net income	377,960	203	378,163
Other comprehensive (loss)	(146,109)	) (131	) (146,240
Dividends paid	(171,668)	) (39	) (171,707
Stock incentive plan activity	34,936	—	34,936
Shares purchased at cost	(400,000)	) —	(400,000
Balance at December 31, 2015	\$4,799,406	\$3,315	\$4,802,721

	Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance at June 30, 2014	\$6,659,428	\$3,380	\$6,662,808
Net income	547,341	165	547,506
Other comprehensive income (loss)	(466,865)	) (153	) (467,018
Dividends paid	(164,758)	) —	(164,758
Stock incentive plan activity	48,302	—	48,302
Shares purchased at cost	(866,699)	) —	(866,699
Balance at December 31, 2014	\$5,756,749	\$3,392	\$5,760,141

Changes in accumulated other comprehensive (loss) in shareholders' equity by component for the six months ended December 31, 2015 and 2014 are as follows:

	Foreign Currency Translation Adjustment and Other	Retirement Benefit Plans	Total
Balance at June 30, 2015	\$(641,018)	) \$(1,097,600)	) \$(1,738,618)
Other comprehensive (loss) income before reclassifications	(203,133)	) —	(203,133)
Amounts reclassified from accumulated other comprehensive (loss)	(93)	) 57,117	57,024
Balance at December 31, 2015	\$(844,244)	) \$(1,040,483)	) \$(1,884,727)

	Foreign Currency Translation Adjustment and Other	Retirement Benefit Plans	Total
Balance at June 30, 2014	\$124,392	) \$(947,890)	) \$(823,498)
Other comprehensive (loss) before reclassifications	(518,889)	) —	(518,889)
Amounts reclassified from accumulated other comprehensive (loss)	102	) 51,922	52,024

Balance at December 31, 2014 \$(394,395) \$(895,968) \$(1,290,363)

9. Equity, cont'd

Significant reclassifications out of accumulated other comprehensive (loss) in shareholders' equity for the three and six months ended December 31, 2015 and 2014 are as follows:

Details about Accumulated Other Comprehensive (Loss) Components	Income (Expense) Reclassified from Accumulated Other Comprehensive (Loss)		Consolidated Statement of Income Classification
	Three Months Ended	Six Months Ended	
	December 31, 2015	December 31, 2015	
Retirement benefit plans			
Amortization of prior service cost and initial net obligation	\$ (1,643	) \$ (3,686	) See Note 11
Recognized actuarial loss	(42,577	) (85,824	) See Note 11
Total before tax	(44,220	) (89,510)
Tax benefit	15,999	32,393	Income taxes
Net of tax	\$ (28,221	) \$ (57,117)

Details about Accumulated Other Comprehensive (Loss) Components	Income (Expense) Reclassified from Accumulated Other Comprehensive (Loss)		Consolidated Statement of Income Classification
	Three Months Ended	Six Months Ended	
	December 31, 2014	December 31, 2014	
Retirement benefit plans			
Amortization of prior service cost and initial net obligation	\$ (1,900	) \$ (4,544	) See Note 11
Recognized actuarial loss	(37,548	) (77,227	) See Note 11
Total before tax	(39,448	) (81,771)
Tax benefit	14,384	29,849	Income taxes
Net of tax	\$ (25,064	) \$ (51,922)

10. Goodwill and intangible assets

The changes in the carrying amount of goodwill for the six months ended December 31, 2015 are as follows:

	Diversified Industrial Segment	Aerospace Systems Segment	Total
Balance at June 30, 2015	\$2,844,045	\$98,634	\$2,942,679
Acquisitions	31,134	—	31,134
Foreign currency translation and other	(60,741	) (7	) (60,748
Balance at December 31, 2015	\$2,814,438	\$98,627	\$2,913,065

Acquisitions represent the original goodwill allocation and final adjustments to purchase price allocations during the measurement period subsequent to the applicable acquisition dates. The impact of final purchase price allocation adjustments on the Company's results of operations and financial position were immaterial.

10. Goodwill and intangible assets cont'd

Intangible assets are amortized on the straight-line method over their legal or estimated useful lives. The following summarizes the gross carrying value and accumulated amortization for each major category of intangible assets:

	December 31, 2015		June 30, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patents	\$ 150,579	\$ 91,131	\$ 149,066	\$ 88,540
Trademarks	341,997	171,325	355,108	172,187
Customer lists and other	1,361,048	615,653	1,369,380	599,388
Total	\$ 1,853,624	\$ 878,109	\$ 1,873,554	\$ 860,115

Total intangible amortization expense for the six months ended December 31, 2015 was \$55,024. The estimated amortization expense for the five years ending June 30, 2016 through 2020 is \$101,542, \$97,228, \$92,425, \$84,899 and \$77,274, respectively.

Intangible assets are evaluated for impairment whenever events or circumstances indicate that the undiscounted net cash flows to be generated by their use over their expected useful lives and eventual disposition may be less than their net carrying value. No such events or circumstances occurred during the six months ended December 31, 2015.

11. Retirement benefits

Net pension benefit cost recognized included the following components:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Service cost	\$23,406	\$24,583	\$47,519	\$49,657
Interest cost	45,663	44,305	91,734	90,798
Special termination cost	7,088	—	7,088	—
Expected return on plan assets	(55,566	) (54,961	) (111,215	) (110,189
Amortization of prior service cost	1,669	1,927	3,738	4,597
Amortization of net actuarial loss	42,299	37,297	85,268	76,725
Amortization of initial net obligation	4	4	8	9
Net pension benefit cost	\$64,563	\$53,155	\$124,140	\$111,597

During the three months ended December 31, 2015 and 2014, the Company recognized \$5,608 and \$1,118, respectively, in expense related to other postretirement benefits. During the six months ended December 31, 2015 and 2014, the Company recognized \$6,695 and \$2,236, respectively, in expense related to other postretirement benefits. During the current-year quarter, the Company provided enhanced retirement benefits in connection with a plant closure, which resulted in an increase in net pension benefit cost of \$7,088 and an increase in expense related to other postretirement benefits of \$4,521.

12. Income taxes

The Company and its subsidiaries file federal and state income tax returns in the U.S. and in various foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities throughout the world. The Company is open to assessment of its federal income tax returns by the U.S. Internal Revenue Service for fiscal years after 2011. The Company is also open to assessment for all significant state, local and foreign jurisdictions for fiscal years after 2006. Unrecognized tax benefits reflect the difference between positions taken or expected to be taken on income tax returns and the amounts reflected in the financial statements.

12. Income taxes, cont'd

As of December 31, 2015, the Company had gross unrecognized tax benefits of \$130,830. The total amount of gross unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$74,195. If recognized, a significant portion of the gross unrecognized tax benefits would be offset against an asset currently recorded in the Consolidated Balance Sheet. The accrued interest related to the gross unrecognized tax benefits, excluded from the amounts above, is \$10,375. It is reasonably possible that within the next 12 months the amount of gross unrecognized tax benefits could be reduced by up to approximately \$100,000 as a result of the revaluation of existing uncertain tax positions arising from developments in the examination process or the closure of tax statutes. Any increase in the amount of gross unrecognized tax benefits within the next 12 months is expected to be insignificant.

13. Financial instruments

The Company's financial instruments consist primarily of cash and cash equivalents, marketable securities and other investments, accounts receivable and long-term investments as well as obligations under accounts payable, trade, notes payable and long-term debt. Due to their short-term nature, the carrying values for cash and cash equivalents, accounts receivable, accounts payable, trade and notes payable approximate fair value.

Marketable securities and other investments include deposits, which are recorded at cost, and investments classified as available-for-sale, which are recorded at fair value with unrealized gains and losses recorded in accumulated other comprehensive (loss). Gross unrealized gains and losses were not material as of December 31, 2015 and June 30, 2015. All available-for-sale investments in an unrealized loss position have been in that position for less than 12 months. There were no facts or circumstances that indicated the unrealized losses were other than temporary.

The contractual maturities of available-for-sale investments at December 31, 2015 and June 30, 2015 are as follows:

	December 31, 2015		June 30, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less than one year	\$14,141	\$14,141	\$13,561	\$13,555
One to three years	184,281	184,115	188,539	188,057
Above three years	11,696	11,598	15,673	15,587

Actual maturities of available-for-sale investments may differ from their contractual maturities as the Company has the ability to liquidate the available-for-sale investments after giving appropriate notice to the issuer.

The carrying value of long-term debt and estimated fair value of long-term debt are as follows:

	December 31, 2015	June 30, 2015
Carrying value of long-term debt	\$2,724,862	\$2,947,102
Estimated fair value of long-term debt	2,892,998	3,107,735

The fair value of long-term debt was determined based on observable market prices in the active market in which the security is traded and is classified within level 2 of the fair value hierarchy.

The Company utilizes derivative and non-derivative financial instruments, including, forward exchange contracts, costless collar contracts, cross-currency swap contracts and certain foreign denominated debt designated as net investment hedges, to manage foreign currency transaction and translation risk. The derivative financial instrument contracts are with major investment grade financial institutions and the Company does not anticipate any material non-performance by any of the counterparties. The Company does not hold or issue derivative financial instruments for trading purposes.

13. Financial instruments cont'd

The Company's Euro bonds, which matured in November 2015, and Japanese Yen credit facility have each been designated as a hedge of the Company's net investment in certain foreign subsidiaries. The translation of the Euro bonds and Japanese Yen credit facility into U.S. dollars is recorded in accumulated other comprehensive (loss) and remains there until the underlying net investment is sold or substantially liquidated.

Derivative financial instruments are recognized on the Consolidated Balance Sheet as either assets or liabilities and are measured at fair value.

The following summarizes the location and fair value of significant derivative financial instruments reported in the Consolidated Balance Sheet as of December 31, 2015 and June 30, 2015:

	Balance Sheet Caption	December 31, 2015	June 30, 2015
Net investment hedges			
Cross-currency swap contracts	Other assets	\$25,695	\$17,994
Cash flow hedges			
Costless collar contracts	Non-trade and notes receivable	4,354	5,627
Costless collar contracts	Other accrued liabilities	2,887	1,970

The cross-currency swap and costless collar contracts are reflected on a gross basis in the Consolidated Balance Sheet. The Company has not entered into any master netting arrangements.

Gains or losses on derivatives that are not hedges are adjusted to fair value through the cost of sales caption in the Consolidated Statement of Income. Gains or losses on derivatives that are hedges are adjusted to fair value through accumulated other comprehensive (loss) in the Consolidated Balance Sheet until the hedged item is recognized in earnings.

Cross-currency swap contracts have been designated as hedging instruments. Costless collar contracts and forward exchange contracts have not been designated as hedging instruments and are considered to be economic hedges of forecasted transactions.

Gains (losses) on derivative financial instruments that were recorded in the Consolidated Statement of Income for the three and six months ended December 31, 2015 and 2014 were not material.

Gains (losses) on derivative and non-derivative financial instruments that were recorded in accumulated other comprehensive (loss) in the Consolidated Balance Sheet are as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Cross-currency swap contracts	\$4,630	\$10,233	\$7,793	\$22,128
Foreign denominated debt	5,407	9,255	4,273	25,145

There was no ineffectiveness of the cross-currency swap contracts or foreign denominated debt, nor was any portion of these financial instruments excluded from the effectiveness testing, during the six months ended December 31, 2015 and 2014.

13. Financial instruments cont'd

A summary of financial assets and liabilities that were measured at fair value on a recurring basis at December 31, 2015 and June 30, 2015 are as follows:

	Fair Value at December 31, 2015	Quoted Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Equity securities	\$1,618	\$1,618	\$—	\$—
Government bonds	16,667	16,667	—	—
Corporate bonds	185,837	185,837	—	—
Asset-backed and mortgage-backed securities	7,350	—	7,350	—
Derivatives	28,886	—	28,886	—
Investments measured at net asset value	246,042			
Liabilities:				
Derivatives	2,887	—	2,887	—

	Fair Value at June 30, 2015	Quoted Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Government bonds	\$60,512	\$60,512	\$—	\$—
Corporate bonds	145,717	145,717	—	—
Asset-backed and mortgage-backed securities	10,970	—	10,970	—
Derivatives	23,598	—	23,598	—
Investments measured at net asset value	187,534			
Liabilities:				
Derivatives	1,970	—	1,970	—

The fair values of the equity securities, government bonds, corporate bonds and asset-backed and mortgage-backed securities are determined using the closing market price reported in the active market in which the fund is traded or the market price for similar assets that are traded in an active market.

Derivatives consist of forward exchange, costless collar and cross-currency swap contracts, the fair values of which are calculated using market observable inputs including both spot and forward prices for the same underlying currencies. The calculation of fair value of the cross-currency swap contracts also utilizes a present value cash flow model that has been adjusted to reflect the credit risk of either the Company or the counterparty.

Investments measured at net asset value primarily consist of investments in fixed income mutual funds, which are measured at fair value using the net asset value per share practical expedient. These investments have not been categorized in the fair value hierarchy. The Company has the ability to liquidate these investments after giving appropriate notice to the issuer.

The primary investment objective for all investments is the preservation of principal and liquidity while earning income.

There are no other financial assets or financial liabilities that are marked to market on a recurring basis. Fair values are transferred between levels of the fair value hierarchy when facts and circumstances indicate that a change in the method of estimating the fair value of a financial asset or financial liability is warranted.

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PARKER-HANNIFIN CORPORATION

FORM 10-Q

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2015
AND COMPARABLE PERIODS ENDED DECEMBER 31, 2014
OVERVIEW

The Company is a leading worldwide diversified manufacturer of motion and control technologies and systems, providing precision engineered solutions for a wide variety of mobile, industrial and aerospace markets.

The Company's order rates provide a near-term perspective of the Company's outlook particularly when viewed in the context of prior and future order rates. The Company publishes its order rates on a quarterly basis. The lead time between the time an order is received and revenue is realized generally ranges from one day to 12 weeks for mobile and industrial orders and from one day to 18 months for aerospace orders. The Company believes the leading economic indicators of these markets that have a strong correlation to the Company's future order rates are as follows:

- Purchasing Managers Index (PMI) on manufacturing activity specific to regions around the world with respect to most mobile and industrial markets;

- Global aircraft miles flown and global revenue passenger miles for commercial aerospace markets and Department of Defense spending for military aerospace markets; and

- Housing starts with respect to the North American residential air conditioning market and certain mobile construction markets.

A PMI above 50 indicates that the manufacturing activity specific to a region of the world in the mobile and industrial markets is expanding. A PMI below 50 indicates the opposite. Recent PMI levels for some regions around the world were as follows:

	December 31, 2015	September 30, 2015	June 30, 2015
United States	48.2	50.2	53.5
Eurozone countries	53.2	52.0	52.5
China	48.2	47.2	49.4
Brazil	45.6	47.0	46.5

Global aircraft miles flown have increased approximately six percent from their comparable fiscal 2015 level and global revenue passenger miles have increased approximately seven percent from their comparable fiscal 2015 level.

The Company anticipates that U.S. Department of Defense spending with regard to appropriations and operations and maintenance for the U.S. Government's fiscal year 2016 will be approximately 10 percent higher than the comparable fiscal 2015 level.

Housing starts in December 2015 were approximately six percent higher than housing starts in December 2014 and were approximately two percent lower than housing starts in June 2015.

The Company remains focused on maintaining its financial strength by adjusting its cost structure to reflect changing demand levels, maintaining a strong balance sheet and managing its cash. The Company has been able to borrow funds at affordable interest rates and had a debt to debt-shareholders' equity ratio of 40.7 percent at December 31, 2015 compared to 40.9 percent at September 30, 2015 and 36.6 percent at June 30, 2015. Net of cash and cash equivalents and marketable securities and other investments, the debt to debt-shareholders' equity ratio was 23.0 percent at December 31, 2015 compared to 24.4 percent at September 30, 2015 and 16.8 percent at June 30, 2015.

The Company believes many opportunities for profitable growth are available. The Company intends to focus primarily on business opportunities in the areas of energy, water, food, environment, defense, life sciences, infrastructure and transportation.

The Company believes it can meet its strategic objectives by:

- Successfully executing its Win Strategy initiatives relating to engaged people, premier customer experience, profitable growth and financial performance;
- Successfully executing its Simplification initiative which is aimed at reducing organizational and process complexity;
- Serving the customer and continuously enhancing its experience with the Company;
- Maintaining its decentralized division and sales company structure;
- Fostering a safety first and entrepreneurial culture;
- Engineering innovative systems and products to provide superior customer value through improved service, efficiency and productivity;
- Delivering products, systems and services that have demonstrable savings to customers and are priced by the value they deliver;
- Acquiring strategic businesses;
- Organizing around targeted regions, technologies and markets;
- Driving efficiency by implementing lean enterprise principles; and
- Creating a culture of empowerment through its values, inclusion and diversity, accountability and teamwork.

Acquisitions will be considered from time to time to the extent there is a strong strategic fit while at the same time, maintaining the Company's strong financial position. In addition, the Company will continue to assess its existing businesses and initiate efforts to divest businesses that are not considered to be a good long-term strategic fit for the Company. Future business divestitures could have a negative effect on the Company's results of operations.

The discussion below is structured to separately discuss the Consolidated Statement of Income, Results by Business Segment, Consolidated Balance Sheet and Consolidated Statement of Cash Flows.

CONSOLIDATED STATEMENT OF INCOME

(dollars in millions)	Three Months Ended December 31,		Six Months Ended December 31,		
	2015	2014	2015	2014	
Net sales	\$2,705.6	\$3,135.0	\$5,574.9	\$6,404.9	
Gross profit	\$565.0	\$733.4	\$1,233.4	\$1,543.5	
Gross profit margin	20.9	% 23.4	% 22.1	% 24.1	%
Selling, general and administrative expenses	\$314.7	\$379.8	\$684.9	\$780.6	
Selling, general and administrative expenses, as a percent of sales	11.6	% 12.1	% 12.3	% 12.2	%
Interest expense	34.3	27.6	70.1	48.6	
Other (income), net					