

REGAL BELOIT CORP  
Form 10-Q  
November 10, 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 October 1, 2016  
or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Commission file number 001-07283

REGAL BELOIT CORPORATION  
(Exact name of registrant as specified in its charter)

Wisconsin 39-0875718  
(State of other jurisdiction of (IRS Employer  
incorporation) Identification No.)  
200 State Street, Beloit, Wisconsin 53511  
(Address of principal executive office)  
(608) 364-8800  
Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

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

Large Accelerated Filer  Accelerated Filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

As of November 7, 2016 there were 44,761,519 shares of the registrant's common stock, \$.01 par value per share, outstanding.



REGAL BELOIT CORPORATION  
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## CAUTIONARY STATEMENT

Certain statements made in this Quarterly Report on Form 10-Q are “forward-looking statements” intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on management’s expectations, beliefs, current assumptions, and projections. When used in this Quarterly Report on Form 10-Q, words such as “may,” “will,” “expect,” “intend,” “estimate,” “anticipate,” “believe,” “should,” or “plan” or the negative thereof or similar words are intended to identify forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties, assumptions and other factors, some of which are beyond our control, which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. Those factors include, but are not limited to:

- uncertainties regarding our ability to execute our restructuring plans within expected costs and timing;
- increases in our overall debt levels as a result of the acquisition of the Power Transmission Solutions business of Emerson Electric Co. ("PTS"), or otherwise and our ability to repay principal and interest on our outstanding debt;
- actions taken by our competitors and our ability to effectively compete in the increasingly competitive global electric motor, drives and controls, power generation and mechanical motion control industries;
- our ability to develop new products based on technological innovation and marketplace acceptance of new and existing products;
- fluctuations in commodity prices and raw material costs;
- our dependence on significant customers;
- issues and costs arising from the integration of acquired companies and businesses including PTS, and the timing and impact of purchase accounting adjustments;
- prolonged declines in oil and gas up stream capital spending;
- unanticipated costs or expenses we may incur related to product warranty issues;
- our dependence on key suppliers and the potential effects of supply disruptions;
- infringement of our intellectual property by third parties, challenges to our intellectual property and claims of infringement by us of third party technologies;
- product liability and other litigation, or the failure of our products to perform as anticipated, particularly in high volume applications;
- economic changes in global markets where we do business, such as reduced demand for the products we sell, currency exchange rates, inflation rates, interest rates, recession, foreign government policies and other external factors that we cannot control;
- unanticipated liabilities of acquired businesses, including PTS;
- effects on earnings of any significant impairment of goodwill or intangible assets;
- cyclical downturns affecting the global market for capital goods;
- difficulties associated with managing foreign operations; and
- other risks and uncertainties including but not limited to those described in “Risk Factors” in this Quarterly Report on Form 10-Q and from time to time in our reports filed with US Securities and Exchange Commission.

Shareholders, potential investors, and other readers are urged to consider these factors in evaluating the forward-looking statements and cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included in this Quarterly Report on Form 10-Q are made only as of the date of this report, and we undertake no obligation to update these statements to reflect subsequent events or circumstances. Additional information regarding these and other risks and factors is included in Part I - Item 1A - Risk Factors in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2016.



## PART I—FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## REGAL BELOIT CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Amounts in Millions, Except Per Share Data)

	Three Months Ended		Nine Months Ended	
	October 3, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Net Sales	\$809.6	\$ 882.3	\$2,466.4	\$ 2,736.2
Cost of Sales	577.9	641.2	1,794.4	2,022.8
Gross Profit	231.7	241.1	672.0	713.4
Operating Expenses	141.9	141.0	421.5	446.5
Income From Operations	89.8	100.1	250.5	266.9
Interest Expense	14.4	15.1	44.2	45.1
Interest Income	1.1	1.0	3.4	3.1
Income Before Taxes	76.5	86.0	209.7	224.9
Provision For Income Taxes	15.4	21.7	47.5	57.8
Net Income	61.1	64.3	162.2	167.1
Less: Net Income Attributable to Noncontrolling Interests	1.5	0.9	4.4	4.5
Net Income Attributable to Regal Beloit Corporation	\$59.6	\$ 63.4	\$157.8	\$ 162.6
Earnings Per Share Attributable to Regal Beloit Corporation:				
Basic	\$1.33	\$ 1.42	\$3.53	\$ 3.63
Assuming Dilution	\$1.32	\$ 1.41	\$3.51	\$ 3.61
Cash Dividends Declared Per Share	\$0.24	\$ 0.23	\$0.71	\$ 0.68
Weighted Average Number of Shares Outstanding:				
Basic	44.8	44.8	44.7	44.8
Assuming Dilution	45.0	45.1	45.0	45.1

See accompanying Notes to Condensed Consolidated Financial Statements.

REGAL BELOIT CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (Unaudited)  
 (Dollars in Millions)

	Three Months Ended October 1, 2016		Nine Months Ended October 3, 2016	
	2016	2015	2016	2015
Net Income	\$61.1	\$ 64.3	\$162.2	\$ 167.1
Other comprehensive income (loss) net of tax:				
Foreign currency translation adjustments	(2.4 )	(36.8 )	(9.2 )	(67.3 )
Hedging Activities:				
Decrease in fair value of hedging activities, net of tax effects of \$(3.8) million and \$(14.5) million for the three months ended October 1, 2016 and October 3, 2015 and \$(9.2) million and \$(21.9) million for the nine months ended October 1, 2016 and October 3, 2015 respectively	(6.3 )	(23.6 )	(15.1 )	(35.7 )
Reclassification of losses included in net income, net of tax effects of \$4.6 million and \$4.1 million for the three months ended October 1, 2016 and October 3, 2015 and \$14.3 million and \$10.6 million for the nine months ended October 1, 2016 and October 3, 2015 respectively	7.7	6.9	23.4	17.4
Pension and Post Retirement Plans:				
Reclassification adjustments for pension and post retirement benefits included in net income, net of tax effects of \$0.3 million and \$0.3 million for the three months ended October 1, 2016 and October 3, 2015 and \$0.9 million and \$1.8 million for the nine months ended October 1, 2016 and October 3, 2015, respectively	0.5	0.7	1.8	1.2
Other comprehensive income (loss)	(0.5 )	(52.8 )	0.9	(84.4 )
Comprehensive income	60.6	11.5	163.1	82.7
Less: Comprehensive income (loss) attributable to noncontrolling interests	1.6	(0.1 )	4.0	2.3
Comprehensive income attributable to Regal Beloit Corporation	\$59.0	\$ 11.6	\$159.1	\$ 80.4

See accompanying Notes to Condensed Consolidated Financial Statements.

REGAL BELOIT CORPORATION  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)  
 (Dollars in Millions, Except Per Share Data)

	October 1, 2016	January 2, 2016
<b>ASSETS</b>		
Current Assets:		
Cash and Cash Equivalents	\$281.6	\$252.9
Trade Receivables, less allowances of \$12.2 million in 2016 and \$11.3 million in fiscal 2015	501.0	462.0
Inventories	685.6	775.0
Prepaid Expenses and Other Current Assets	129.7	145.3
Total Current Assets	1,597.9	1,635.2
Net Property, Plant and Equipment	645.0	678.5
Goodwill	1,466.0	1,465.6
Intangible Assets, net of Amortization	734.1	777.8
Deferred Income Tax Benefits	20.6	18.6
Other Noncurrent Assets	13.5	16.0
Total Assets	\$4,477.1	\$4,591.7
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Accounts Payable	\$343.6	\$336.2
Dividends Payable	10.7	10.3
Hedging Obligations	38.3	44.7
Accrued Compensation and Employee Benefits	76.1	80.6
Other Accrued Expenses	130.4	134.7
Current Maturities of Long-Term Debt	100.8	6.3
Total Current Liabilities	699.9	612.8
Long-Term Debt	1,409.7	1,715.6
Deferred Income Taxes	102.1	100.9
Hedging Obligations	16.8	27.6
Pension and Other Post Retirement Benefits	100.9	105.9
Other Noncurrent Liabilities	45.4	46.1
Commitments and Contingencies (see Note 12)		
Equity:		
Regal Beloit Corporation Shareholders' Equity:		
Common Stock, \$.01 par value, 100.0 million shares authorized, 44.8 million and 44.7 million shares issued and outstanding in 2016 and fiscal 2015, respectively	0.4	0.4
Additional Paid-In Capital	901.6	900.8
Retained Earnings	1,417.2	1,291.1
Accumulated Other Comprehensive Loss	(256.4	) (255.0 )
Total Regal Beloit Corporation Shareholders' Equity	2,062.8	1,937.3
Noncontrolling Interests	39.5	45.5
Total Equity	2,102.3	1,982.8
Total Liabilities and Equity	\$4,477.1	\$4,591.7
See accompanying Notes to Condensed Consolidated Financial Statements.		





REGAL BELOIT CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY  
(Unaudited)  
(Dollars in Millions, Except Per Share Data)

	Common Stock \$.01 Par Value	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interests	Total Equity
Balance as of January 3, 2015	\$ 0.4	\$ 896.1	\$ 1,188.9	\$ (151.0 )	\$ 44.9	\$ 1,979.3
Net Income	—	—	162.6	—	4.5	167.1
Other Comprehensive Loss	—	—	—	(82.2 )	(2.2 )	(84.4 )
Dividends Declared (\$0.68 per share)	—	—	(30.4 )	—	—	(30.4 )
Stock Options Exercised, including income tax benefit and share cancellations	—	2.0	—	—	—	2.0
Stock Repurchase	—	(11.6 )	(0.4 )	—	—	(12.0 )
Dividends Declared to Non-controlling Interests	—	—	—	—	(0.3 )	(0.3 )
Share-based Compensation	—	10.6	—	—	—	10.6
Purchase of Subsidiary Shares from Noncontrolling Interest	—	—	—	—	(1.4 )	\$(1.4 )
Balance as of October 3, 2015	\$ 0.4	\$ 897.1	\$ 1,320.7	\$ (233.2 )	\$ 45.5	\$ 2,030.5

	Common Stock \$.01 Par Value	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interests	Total Equity
Balance as of January 2, 2016	\$ 0.4	\$ 900.8	\$ 1,291.1	\$ (255.0 )	\$ 45.5	\$ 1,982.8
Net Income	—	—	157.8	—	4.4	162.2
Other Comprehensive Income (Loss)	—	—	—	1.3	(0.4 )	0.9
Dividends Declared (\$0.71 per share)	—	—	(31.7 )	—	—	(31.7 )
Stock Options Exercised, including income tax benefit and share cancellations	—	(2.1 )	—	—	—	(2.1 )
Dividends Declared to Non-controlling Interests	—	—	—	—	(0.3 )	(0.3 )
Share-based Compensation	—	10.1	—	—	—	10.1
Purchase of Subsidiary Shares from Noncontrolling Interest	—	(7.2 )	—	(2.7 )	(9.7 )	(19.6 )
Balance as of October 1, 2016	\$ 0.4	\$ 901.6	\$ 1,417.2	\$ (256.4 )	\$ 39.5	\$ 2,102.3

See accompanying Notes to Condensed Consolidated Financial Statements.

REGAL BELOIT CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)  
 (Dollars in Millions)

	Nine Months Ended	
	October 3, 2016	October 3, 2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 162.2	\$ 167.1
Adjustments to reconcile net income to net cash provided by operating activities (net of acquisitions):		
Depreciation and amortization	116.6	120.1
Excess tax expense (benefit) from share-based compensation	0.2	(1.3 )
Loss on sale or disposition of assets, net	0.9	1.8
Share-based compensation expense	10.1	10.6
Loss on Venezuela currency devaluation	—	1.5
Gain on sale of business	(11.6 )	—
Change in operating assets and liabilities	50.0	(32.6 )
Net cash provided by operating activities	328.4	267.2
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to property, plant and equipment	(46.1 )	(65.4 )
Proceeds from sale of assets	1.6	7.8
Sales of investment securities	43.2	30.3
Purchases of investment securities	(53.7 )	(36.0 )
Business acquisitions, net of cash acquired	—	(1,400.7 )
Proceeds from sale of business	25.5	—
Net cash used in investing activities	(29.5 )	(1,464.0 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from revolving credit facility	447.0	400.0
Repayments of the revolving credit facility	(437.0 )	(401.0 )
Proceeds from short-term borrowings	20.9	112.1
Repayments of short-term borrowings	(27.7 )	(108.6 )
Proceeds from long-term borrowings	—	1,250.0
Repayments of long-term borrowings	(218.1 )	(72.2 )
Dividends paid to shareholders	(31.3 )	(29.9 )
Proceeds from the exercise of stock options	0.5	3.8
Excess tax (expense) benefit from share-based compensation	(0.2 )	1.3
Repurchase of common stock	—	(12.0 )
Distributions to noncontrolling interests	(0.3 )	(0.3 )
Purchase of subsidiary shares from noncontrolling interest	(19.6 )	(1.4 )
Financing fees paid	—	(17.8 )
Net cash provided by (used in) financing activities	(265.8 )	1,124.0
<b>EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>	<b>(4.4 )</b>	<b>(6.7 )</b>
Net increase (decrease) in cash and cash equivalents	28.7	(79.5 )
Cash and cash equivalents at beginning of period	252.9	334.1
Cash and cash equivalents at end of period	\$ 281.6	\$ 254.6
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid for:		

Interest	\$46.7	\$ 47.2
Income taxes	\$54.6	\$ 57.5

See accompanying Notes to Condensed Consolidated Financial Statements.

REGAL BELOIT CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

October 1, 2016

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying (a) condensed consolidated balance sheet of Regal Beloit Corporation (the "Company") as of January 2, 2016, which has been derived from audited consolidated financial statements, and (b) unaudited interim condensed consolidated financial statements as of October 1, 2016 and for the three and nine months ended October 1, 2016 and October 3, 2015, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP"), have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading.

It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's 2015 Annual Report on Form 10-K filed on March 2, 2016.

In the opinion of management, all adjustments considered necessary for a fair presentation of financial results have been made. Except as otherwise discussed, such adjustments consist of only those of a normal recurring nature.

Operating results for the three and nine months ended October 1, 2016 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 31, 2016.

The condensed consolidated financial statements have been prepared in accordance with GAAP, which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the periods reported. Actual results could differ from those estimates. The Company uses estimates in accounting for, among other items, allowance for doubtful accounts; excess and obsolete inventory; share-based compensation; acquisitions; product warranty obligations; pension and post retirement assets and liabilities; derivative fair values; goodwill and other asset impairments; health care reserves; retirement benefits; rebates and incentives; litigation claims and contingencies, including environmental matters; and income taxes. The Company accounts for changes to estimates and assumptions when warranted by factually based experience.

The Company operates on a 52/53 week fiscal year ending on the Saturday closest to December 31.

Change in Accounting Principles

As of the beginning of its fiscal year 2016, the Company changed its inventory valuation method for the US inventory of the recently acquired Power Transmission Solutions ("PTS") business to the last-in, first-out ("LIFO") method from the first-in, first-out ("FIFO") method. This change affected approximately 9% of the Company's inventory. The Company believed this change in accounting principle is preferable under the circumstances because LIFO would better match current costs with current revenues since the cost of raw materials has been volatile in recent years, resulting in greater consistency in inventory costing across the organization since LIFO is the method used for the majority of the Company's other US inventory, and better aligns with how management assesses the performance of the business. Because this change in accounting principle was immaterial in all annual or interim prior periods, it was not applied retrospectively. The change did not have a material impact on the condensed consolidated financial statements for the three and nine months ended October 1, 2016.

Also, as of the beginning of its fiscal year 2016, the Company changed its method of calculating LIFO inventories, which represented approximately 51% of the Company's inventory. The Company reduced the number of LIFO inventory pools to three to align with the Company's reportable segments. Previously, the Company had 10 LIFO inventory pools, some of which crossed reportable segments. The Company believed this change in accounting principle is preferable under the circumstances because fewer pools will simplify the LIFO calculations, combine inventory items with similarities within a reportable segment, and better align with how management assesses the performance of the businesses. The Company determined that it had the data needed to apply this change in

accounting principle prospectively as of the beginning of its fiscal year 2014, but that full retrospective application is impracticable because the data is not available to determine the cumulative effect of the change. Because the effect of applying the change prospectively as of the beginning of fiscal 2014 is immaterial in any annual or interim period in fiscal years 2014 or 2015, the Company applied this change in accounting principle prospectively from the first day of fiscal year 2016.

**New Accounting Standards**

In October 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No.2016-16, which removes the prohibition in Accounting Standards Codification ("ASC") 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. Under the ASU, the selling (transferring)

entity is required to recognize a current tax expense or benefit upon transfer of the asset. Similarly, the purchasing (receiving) entity is required to recognize a deferred tax asset or deferred tax liability, as well as the related deferred tax benefit or expense, upon receipt of the asset. For public business entities, the ASU is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted for all entities as of the beginning of a fiscal year for which neither the annual or interim (if applicable) financial statements have been issued. The Company is currently assessing the impact that this standard will have on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force), The new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. For public business entities, the standard is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, provided that all of the amendments are adopted in the same period. The guidance requires application using a retrospective transition method. The Company is currently assessing the impact that this standard will have on its consolidated financial statements.

In March 2016 the FASB issued Accounting ASU No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU includes multiple provisions intended to simplify various aspects of the accounting for share-based payments. Implementation and administration may present challenges for companies with significant share-based payment activities and there are various transition methods. The Company is required to adopt the new requirements in the first quarter of fiscal 2017. The Company is currently evaluating the impact of the new requirements on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The core principle of ASU 2016-02 is that an entity should recognize on its balance sheet assets and liabilities arising from a lease. In accordance with that principle, ASU 2016-02 requires that a lessee recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying leased asset for the lease term. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on the lease classification as a finance or operating lease. This new accounting guidance is effective for public companies for fiscal years beginning after December 15, 2018 under a modified retrospective approach and early adoption is permitted. The Company has identified a six step process to successfully implement the new Lease standard - Form a task force to become experts and take the lead on understanding and implementing the new Lease standard; Update lease inventories; Decide on transition method; Review legal agreements and debt covenants; Consider IT needs; Discuss with stakeholders. The Company is currently evaluating the impact the adoption of ASU 2016-02 will have on its consolidated financial statements and has commenced the first step of identifying a task force to take the lead in implementing the new Lease standard.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU is based on the principle that an entity should recognize revenue to depict the transfer of 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 ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract.

ASU No. 2014-09 (and related updates) will become effective for the Company at the beginning of its 2018 fiscal year. Entities have the option of using either a full retrospective or a modified retrospective approach for the adoption of the standard. The Company has identified a four step process to successfully implement the new Revenue standard

- Complete accounting analysis; Identify system, process and control changes; Implement system, process and control changes; Test controls. The Company is currently in the process of completing the accounting analysis and assessing the impact that this standard will have on its consolidated financial statements.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606) - Narrow-Scope Improvements and Practical Expedients, which clarifies the guidance in Topic 606 on assessing collectibility, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. The amendments in ASU No. 2016-12 do not change the core principles of the guidance in Topic 606.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing, which clarifies the identification of performance obligations and the licensing implementation guidance in Topic 606. The amendments in ASU No. 2016-10 do not change the core principles of the guidance in Topic 606.



In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606) - Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which amends the principal-versus-agent implementation guidance in ASU No. 2014-09 (Topic 606). ASU No. 2016-08 clarifies the principal-versus-agent guidance in Topic 606 and requires an entity to determine whether the nature of its promise to provide goods or services to a customer is performed in a principal or agent capacity and to recognize revenue in a gross or net manner based on its principal/agent designation.

## 2. OTHER FINANCIAL INFORMATION

### Inventories

The approximate percentage distribution between major classes of inventories was as follows:

	October 1, January 2, 2016 2016	
Raw Material and Work in Process	47%	45%
Finished Goods and Purchased Parts	53%	55%

Inventories are stated at cost, which is not in excess of market. Cost for approximately 51% of the Company's inventory at October 1, 2016, and 42% at January 2, 2016 was determined using the LIFO method.

### Property, Plant and Equipment

Property, plant, and equipment by major classification was as follows (dollars in millions):

	Useful Life in Years	October 1, January 2, 2016 2016	
Land and Improvements		\$ 78.6	\$ 80.7
Buildings and Improvements	3 - 50	277.7	276.9
Machinery and Equipment	3 - 15	934.2	926.7
Property, Plant and Equipment		1,290.5	1,284.3
Less: Accumulated Depreciation		(645.5 )	(605.8 )
Net Property, Plant and Equipment		\$ 645.0	\$ 678.5

## 3. ACQUISITIONS AND DIVESTITURES

The results of operations for acquired businesses are included in the Condensed Consolidated Financial Statements from the dates of acquisition. There were no acquisition-related expenses for the three months ended October 1, 2016 or October 3, 2015. There were no acquisition-related expenses for the nine months ended October 1, 2016.

Acquisition-related expenses for the nine months ended October 3, 2015 were \$9.2 million. Acquisition-related expenses are recorded in operating expenses as incurred.

### 2016 Acquisitions

#### Elco Purchase

On January 18, 2016, the Company purchased the remaining shares owned by the joint venture partner in its Elco Group B.V. ("Elco") joint venture, increasing the Company's ownership from 55.0% to 100.0%, for a purchase price of \$19.6 million. The Company consolidated the results of Elco into the Company's consolidated financial statements in the Climate Solutions segment.

### 2016 Divestitures

#### Mastergear Worldwide

On June 1, 2016, the Company sold its Mastergear Worldwide ("Mastergear") business to Rotork PLC for a purchase price of \$25.5 million, subject to customary finalization. Mastergear was included in the Company's Power Transmission Solutions segment. A gain related to the sale of \$11.6 million was recorded as a reduction to operating expenses in the Condensed Consolidated Statements of Income during the nine months ended October 1, 2016.

#### Venezuelan Subsidiary



On July 7, 2016, the Company sold the assets of its Venezuelan subsidiary, which had been included in the Company's Commercial and Industrial Systems segment, to a private company for \$3.0 million. Of this amount, \$1.0 million was received on the transaction closing date and \$2.0 million will be received in 24 monthly installments. The Company may receive additional amounts in the future related to certain accounts receivable of this business. These gains will be recognized as the cash is received. The Company wrote down its investment and ceased operations of this subsidiary in 2015.

## 2015 Acquisitions

### PTS

On January 30, 2015, the Company acquired PTS for \$1,408.9 million in cash through a combination of stock and asset purchases. PTS is a global leader in highly engineered power transmission products and solutions. The business manufactures, sells and services bearings, couplings, gearing, drive components and conveyor systems. PTS is included in the Power Transmission Solutions segment. The Company acquired PTS because management believes it diversifies the Company's end market exposure, provides complementary products, expands and balances the Company's product portfolio, and enhances its margin profile.

The acquisition of PTS was accounted for as a purchase in accordance with FASB ASC Topic 805, Business Combinations. Assets acquired and liabilities assumed were recorded at their fair values as of the acquisition date. The fair values of identifiable intangible assets, which were primarily customer relationships, trade names and technology, were based on valuations using the income approach. The excess of the purchase price over the estimated fair values of tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. The goodwill is attributable to expected synergies and expected growth opportunities. Approximately 65% of goodwill will be deductible for United States income tax purposes.

The purchase price allocation for PTS was as follows (in millions):

	As of January 30, 2015
Current assets	\$22.5
Trade receivables	67.2
Inventories	108.8
Property, plant and equipment	184.4
Intangible assets	648.2
Goodwill	564.3
Total assets acquired	1,595.4
Accounts payable	57.2
Current liabilities assumed	32.3
Long-term liabilities assumed	97.0
Net assets acquired	\$1,408.9

The valuation of the net assets acquired of \$1,408.9 million was classified as Level 3 in the valuation hierarchy (see also Note 14 of the Notes to the Condensed Consolidated Financial Statements for the definition of Level 3 inputs).

The Company valued property, plant and equipment using both a market approach and a cost approach depending on the asset. Intangible assets were valued using the present value of projected future cash flows and significant assumptions included royalty rates, discount rates, customer attrition and obsolescence factors.

The components of Intangible Assets included as part of the PTS acquisition was as follows (in millions):

	Weighted Average Amortization Period (Years)	Gross Value
Amortizable intangible assets		
Customer Relationships	17.0	\$ 462.8
Technology	14.5	63.5
Intangible assets subject to amortization	16.7	526.3
Non-amortizable intangible assets		
Trade Names	-	121.9
Intangible assets		\$ 648.2

Net sales from PTS were \$117.7 million and \$380.5 million for the three and nine months ended October 1, 2016, respectively. Net sales from PTS were \$128.9 million and \$384.7 million for the three and nine months ended October 3, 2015, respectively. Operating income from PTS was \$4.6 million and \$24.6 million for the three and nine months ended October 1, 2016, respectively. Operating income from PTS was \$10.7 million and \$7.7 million for the three and nine months ended October 3, 2015, respectively. Purchase accounting inventory adjustments and transaction costs of \$29.8 million reduced PTS operating income for the nine months ended October 3, 2015.

#### Pro Forma Consolidated Results for PTS Acquisition

The following supplemental pro forma financial information presents the financial results for the nine months ended October 3, 2015, as if the acquisition of PTS had occurred at the beginning of fiscal year 2015. The pro forma financial information includes, where applicable, adjustments for: (i) the estimated amortization of acquired intangible assets, (ii) estimated additional interest expense on acquisition related borrowings, and (iii) the income tax effect on the pro forma adjustments using an estimated effective tax rate. The pro forma financial information excludes, where applicable, adjustments for: (i) the estimated impact of inventory purchase accounting adjustments, (ii) the estimated closing costs on the acquisition and (iii) any estimated cost synergies or other effects of the integration of the acquisition. The pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have been achieved had the acquisition been completed as of the date indicated or the results that may be obtained in the future (in millions, except per share amounts):

	Nine Months Ended October 3, 2015
Pro forma net sales	\$ 2,784.8
Pro forma net income attributable to the Company	164.3
Basic earnings per share as reported	\$ 3.63
Pro forma basic earnings per share	3.67
Diluted earnings per share as reported	\$ 3.61
Pro forma diluted earnings per share	3.65

#### 4. ACCUMULATED OTHER COMPREHENSIVE LOSS

Foreign currency translation adjustments, hedging activities and pension and post retirement benefit adjustments are included in Equity in Accumulated Other Comprehensive Loss ("AOCI").

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The changes in AOCI by component for the three and nine months ended October 1, 2016 and October 3, 2015 were as follows (in millions):

	Three Months Ended October 1, 2016			
	Hedging Activities	Pension and Post Retirement Benefit Adjustments	Foreign Currency Translation Adjustments	Total
Beginning balance	\$(40.6)	\$ (33.6 )	\$ (181.6 )	\$(255.8)
Other comprehensive income (loss) before reclassifications	(10.1 )	0.1	(2.6 )	(12.6 )
Tax impact	3.8	—	—	3.8
Amounts reclassified from accumulated other comprehensive loss	12.3	0.8	—	13.1
Tax impact	(4.6 )	(0.3 )	—	(4.9 )
Net current period other comprehensive income (loss)	1.4	0.6	(2.6 )	(0.6 )
Ending balance	\$(39.2)	\$ (33.0 )	\$ (184.2 )	\$(256.4)

	Three Months Ended October 3, 2015			
	Hedging Activities	Pension Benefit Adjustments	Foreign Currency Translation Adjustments	Total
Beginning balance	\$(32.6)	\$ (39.0 )	\$ (109.8 )	\$(181.4)
Other comprehensive income (loss) before reclassifications	(38.1 )	—	(35.8 )	(73.9 )
Tax impact	14.5	—	—	14.5
Amounts reclassified from accumulated other comprehensive income (loss)	11.0	1.0	—	12.0
Tax impact	(4.1 )	(0.3 )	—	(4.4 )
Net current period other comprehensive income (loss)	(16.7 )	0.7	(35.8 )	(51.8 )
Ending balance	\$(49.3)	\$ (38.3 )	\$ (145.6 )	\$(233.2)

	Nine Months Ended October 1, 2016			
	Hedging Activities	Pension and Post Retirement Benefit Adjustments	Foreign Currency Translation Adjustments	Total
Beginning balance	\$(47.5)	\$ (35.4 )	\$ (172.1 )	\$(255.0)
Other comprehensive income (loss) before reclassifications	(24.3 )	0.6	(9.4 )	(33.1 )
Tax impact	9.2	—	—	9.2
Amounts reclassified from accumulated other comprehensive loss	37.7	2.7	—	40.4
Tax impact	(14.3 )	(0.9 )	—	(15.2 )
Net current period other comprehensive income (loss)	8.3	2.4	(9.4 )	1.3
Purchase of subsidiary shares from noncontrolling interest	—	—	(2.7 )	(2.7 )
Ending balance	\$(39.2)	\$ (33.0 )	\$ (184.2 )	\$(256.4)

	Nine Months Ended October 3, 2015			
	Hedging Activities	Pension Benefit Adjustments	Foreign Currency Translation Adjustments	Total
Beginning balance	\$(31.0)	\$ (39.5 )	\$ (80.5 )	\$(151.0)
Other comprehensive income (loss) before reclassifications	(57.6 )	—	(65.1 )	(122.7 )
Tax impact	21.9	—	—	21.9
Amounts reclassified from accumulated other comprehensive income (loss)	28.0	3.0	—	31.0
Tax impact	(10.6 )	(1.8 )	—	(12.4 )
Net current period other comprehensive income (loss)	(18.3 )	1.2	(65.1 )	(82.2 )
Ending balance	\$(49.3)	\$ (38.3 )	\$ (145.6 )	\$(233.2)

The Condensed Consolidated Statements of Income line items affected by the hedging activities reclassified from accumulated other comprehensive loss in the tables above are disclosed in Note 13 of Notes to Condensed Consolidated Financial Statements.

The reclassification amounts for pension and post retirement benefit adjustments in the tables above are part of net periodic benefit costs recorded in Operating Expenses (see also Note 8 of Notes to Condensed Consolidated Financial Statements).

## 5. GOODWILL AND INTANGIBLE ASSETS

### Goodwill

As required, the Company performs an annual impairment test of goodwill as of the end of the October fiscal month or more frequently if events or circumstances change that would more likely than not reduce the fair value of its reporting units below their carrying value. Continued declines in oil and gas, distribution and agricultural end-markets resulted in the Company performing an interim goodwill impairment test for one of its goodwill reporting units during the third quarter of 2016. The results of the interim goodwill impairment test indicated there was no goodwill impairment in the third quarter of 2016.



The following information presents changes to goodwill during the nine months ended October 1, 2016 (in millions):

	Total	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions
Balance as of January 2, 2016	\$1,465.6	\$ 547.7	\$ 342.8	\$ 575.1
Acquisition and valuation adjustments	(0.3 )	—	—	(0.3 )
Translation adjustments	0.7	(2.1 )	(0.5 )	3.3
Balance as of October 1, 2016	\$1,466.0	\$ 545.6	\$ 342.3	\$ 578.1
Cumulative goodwill impairment charges	\$275.7	\$ 244.8	\$ 7.7	\$ 23.2

Intangible Assets

Intangible assets consisted of the following (in millions):

	Weighted Average Amortization Period (Years)	October 1, 2016		January 2, 2016	
		Gross Value	Accumulated Amortization	Gross Value	Accumulated Amortization
Amortizable intangible assets:					
Customer relationships	15	\$712.4	\$ 194.0	\$709.0	\$ 161.4
Technology	11	191.1	106.4	191.1	92.9
Trademarks	12	32.4	23.4	32.1	21.8
Patent and engineering drawings	5	16.6	16.6	16.6	16.6
Non-compete agreements	5	8.4	8.1	8.5	8.1
		960.9	348.5	957.3	300.8
Non-amortizable trade names		121.7	—	121.3	—
		\$1,082.6	\$ 348.5	\$1,078.6	\$ 300.8

Estimated expected future annual amortization for intangible assets is as follows (in millions):

Year	Estimated Amortization
2017	\$ 55.3
2018	53.3
2019	52.9
2020	49.8
2021	42.1

Amortization expense recorded for the three and nine months ended October 1, 2016 was \$15.6 million and \$47.0 million, respectively. Amortization expense recorded for the three and nine months ended October 3, 2015 was \$16.7 million and \$47.7 million, respectively. Amortization expense for 2016 is estimated to be \$61.9 million.



## 6. BUSINESS SEGMENTS

The following sets forth certain financial information attributable to the Company's reporting segments as of and for the three and nine months ended October 1, 2016 and October 3, 2015 (in millions):

	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions	Eliminations	Total
As of and for Three Months Ended October 1, 2016					
External sales	\$ 389.4	\$ 250.5	\$ 169.7	\$ —	\$ 809.6
Intersegment sales	10.8	5.7	1.1	(17.6 )	—
Total sales	400.2	256.2	170.8	(17.6 )	809.6
Gross profit	105.4	71.4	54.9	—	231.7
Operating expenses	69.2	29.2	43.5	—	141.9
Income from operations	36.2	42.2	11.4	—	89.8
Depreciation and amortization	17.7	4.9	15.0	—	37.6
Capital expenditures	9.6	2.6	2.2	—	14.4
Identifiable assets	1,920.2	924.4	1,632.5	—	4,477.1
As of and for Three Months Ended October 3, 2015					
External sales	\$ 426.8	\$ 264.4	191.1	\$ —	\$ 882.3
Intersegment sales	14.4	6.0	0.8	(21.2 )	—
Total sales	441.2	270.4	191.9	(21.2 )	882.3
Gross profit	110.3	70.8	60.0	—	241.1
Operating expenses	71.6	30.1	39.3	—	141.0
Income from operations	38.8	40.7	20.6	—	100.1
Depreciation and amortization	19.6	7.1	15.3	—	42.0
Capital expenditures	10.4	4.6	5.7	—	20.7
Identifiable assets	2,380.2	888.2	1,610.0	—	4,878.4

	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions	Eliminations	Total
As of and for Nine Months Ended October 1, 2016					
External sales	\$ 1,161.7	\$ 744.8	\$ 559.9	\$ —	\$2,466.4
Intersegment sales	33.5	17.9	3.1	(54.5 )	—
Total sales	1,195.2	762.7	563.0	(54.5 )	2,466.4
Gross profit	295.2	192.3	184.5	—	672.0
Operating expenses	212.2	89.4	119.9	—	421.5
Income from operations	83.0	102.9	64.6	—	250.5
Depreciation and amortization	56.6	17.6	42.4	—	116.6
Capital expenditures	26.5	10.1	9.5	—	46.1
Identifiable assets	1,920.2	924.4	1,632.5	—	4,477.1
As of and for Nine Months Ended October 3, 2015					
External sales	\$ 1,324.2	\$ 830.9	581.1	\$ —	\$2,736.2
Intersegment sales	60.7	18.9	3.1	(82.7 )	—
Total sales	1,384.9	849.8	584.2	(82.7 )	2,736.2
Gross profit	336.8	207.5	169.1	—	713.4
Operating expenses	223.2	89.7	133.6	—	446.5
Income from operations	113.6	117.8	35.5	—	266.9
Depreciation and amortization	58.4	21.7	40.0	—	120.1
Capital expenditures	38.5	13.3	13.6	—	65.4
Identifiable assets	2,380.2	888.2	1,610.0	—	4,878.4

The Commercial and Industrial Systems segment produces medium and large electric motors, power generation products, high-performance drives and controls, and starters. Applications include general commercial and industrial equipment, commercial HVAC, power generation, and oil and gas.

The Climate Solutions segment produces small motors, controls and air moving solutions. Applications include residential and light commercial HVAC, commercial refrigeration and water heaters.

The Power Transmission Solutions segment produces power transmission gearing, hydraulic pump drives, large open gearing and specialty mechanical products. Applications include material handling, industrial equipment, energy and off-road equipment.

The Company evaluates performance based on each segment's income from operations. Corporate costs have been allocated to each segment based on the net sales of each segment. The reported external net sales of each segment are from external customers.

## 7. DEBT AND BANK CREDIT FACILITIES

The Company's indebtedness as of October 1, 2016 and January 2, 2016 was as follows (in millions):

	October 1, January 2,	
	2016	2016
Term facility	\$903.1	\$1,118.1
Senior notes	600.0	600.0
Multicurrency revolving facility	13.0	3.0
Other	5.6	15.5
Less: Debt issuance costs	(11.2 )	(14.7 )
	1,510.5	1,721.9
Less: Current maturities	100.8	6.3
Non-current portion	\$1,409.7	\$1,715.6

## The Credit Agreement

In connection with the PTS Acquisition, on January 30, 2015, the Company entered into a new Credit Agreement (the "Credit Agreement") with JPMorgan Chase Bank, N.A., as Administrative Agent, and the lenders named therein, providing for (i) a 5-year unsecured term loan facility in the principal amount of \$1.25 billion (the "Term Facility") and (ii) a 5-year unsecured multicurrency revolving facility in the principal amount of \$500.0 million (the "Multicurrency Revolving Facility") available for general corporate purposes.

The Term Facility was drawn in full on January 30, 2015 in connection with the closing of the PTS Acquisition. The loans under the Term Facility require quarterly amortization at a rate starting at 5.0% per annum, increasing to 7.5% per annum after two years and further increasing to 10.0% per annum for the last two years of the Term Facility. At October 1, 2016 the Company had borrowings under the Multicurrency Revolving Facility in the amount of \$13.0 million, \$32.3 million of standby letters of credit issued under the facility, and \$454.7 million of available borrowing capacity.

Borrowings under the Credit Agreement bear interest at floating rates based upon indices determined by the currency of the borrowing, plus an applicable margin determined by reference to the Company's consolidated funded debt to consolidated EBITDA ratio or at an alternative base rate. The weighted average interest rate on the Multicurrency Revolving Facility was 1.9% for the three and nine months ended October 1, 2016 and October 3, 2015. The weighted average interest rate on the Term Facility was 2.0% for the three and nine months ended October 1, 2016 and October 3, 2015. The Company pays a non-use fee on the aggregate unused amount of the Multicurrency Revolving Facility at a rate determined by reference to its consolidated funded debt to consolidated EBITDA ratio.

The Credit Agreement requires the Company to prepay the loans under the Term Facility with 100% of the net cash proceeds received from specified asset sales and borrowed money indebtedness, subject to certain exceptions.

## Senior Notes

At October 1, 2016, the Company had \$600.0 million of unsecured senior notes (the "Notes") outstanding. The Notes consist of (i) \$500.0 million in senior notes (the "2011 Notes") as issued in a private placement consisting of seven tranches with maturities from seven to twelve years that carry fixed interest rates and (ii) \$100.0 million in senior notes (the "2007 Notes") issued in 2007 with a floating interest rate based on a margin over the London Inter-Bank Offered Rate ("LIBOR"). The 2011 Notes are included in Long-Term Debt and the 2007 Notes are included in Current Maturities of Long-Term Debt on the Condensed Consolidated Balance Sheets.

Details on the Notes at October 1, 2016 were (in millions):

	Principal	Interest Rate	Maturity
Floating Rate Series 2007A	100.0	Floating (1)	August 23, 2017
Fixed Rate Series 2011A	100.0	4.1%	July 14, 2018
Fixed Rate Series 2011A	230.0	4.8 to 5.0%	July 14, 2021
Fixed Rate Series 2011A	170.0	4.9 to 5.1%	July 14, 2023
	\$ 600.0		



(1)  
 Interest rates vary as LIBOR varies.  
 At October 1, 2016, the interest rate was 1.5%.  
 At January 2, 2016, the interest rate was 1.1%.

The Company has interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk (see also Note 13 of Notes to the Condensed Consolidated Financial Statements).

Financial Covenants

The Credit Agreement and the Notes require the Company to meet specified financial ratios and to satisfy certain financial condition tests.

Other Notes Payable

At October 1, 2016, other notes payable of approximately \$5.6 million were outstanding with a weighted average interest rate of 5.4%. At January 2, 2016, other notes payable of approximately \$15.5 million were outstanding with a weighted average rate of 2.5%.

Based on rates for instruments with comparable maturities and credit quality, which are classified as Level 2 inputs (see also Note 14 of Notes to the Condensed Consolidated Financial Statements), the approximate fair value of the Company's total debt was \$1,559.3 million and \$1,758.2 million as of October 1, 2016 and January 2, 2016, respectively.

8. POST RETIREMENT PLANS

The Company's net periodic benefit cost was comprised of the following components (in millions):

	Three Months Ended		Nine Months Ended	
	October 2016	October 2015	October 2016	October 2015
Service cost	\$2.0	\$ 2.7	\$6.1	\$ 7.4
Interest cost	2.6	2.9	7.7	8.3
Expected return on plan assets	(3.0 )	(2.8 )	(8.9 )	(8.0 )

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Amortization of prior service cost and net actuarial loss	0.8	1.0	2.7	3.0
Net periodic benefit cost	\$2.4	\$ 3.8	\$7.6	\$ 10.7

The estimated net actuarial loss and prior service cost for post retirement plans that will be amortized from AOCI into net periodic benefit cost during the 2016 fiscal year is \$3.1 million and \$0.2 million, respectively.

For the three months ended October 1, 2016 and October 3, 2015, the Company contributed \$6.8 million and \$0.8 million, respectively, to post retirement plans. For the nine months ended October 1, 2016 and October 3, 2015, the Company contributed \$9.0 million and \$2.3 million, respectively, to post retirement plans. The Company expects to make total contributions of \$9.3 million in 2016. The Company contributed a total of \$4.7 million in fiscal 2015. The assumptions used in the valuation of the Company's post retirement plans and in the target investment allocation have remained the same as those disclosed in the Company's 2015 Annual Report on Form 10-K filed on March 2, 2016. Beginning in 2016, the Company changed the method used to estimate the service and interest cost components of the net periodic pension and other post retirement benefit costs. The new method uses the spot yield curve approach to estimate the service and interest costs by applying the specific spot rates along the yield curve used to determine the benefit obligations to relevant projected cash outflows. The change will not affect the measurement of the total benefit obligations as the change in service and interest costs is offset in the actuarial gains and losses recorded in other comprehensive income. The methodology of selecting a discount rate that matches each plan's cash flows to that of a theoretical bond portfolio yield curve will continue to be used to value the benefit obligation at the end of each year. The Company changed to the new method to provide a more precise measure of interest and service costs by improving the correlation between the projected benefit cash flows and the discrete spot yield curve rates. The Company has accounted for this change as a change in estimate prospectively and it is expected to result in a \$2.9 million reduction in expense for fiscal 2016 as compared to the previous method.

## 9. SHAREHOLDERS' EQUITY

### Common Stock

The Board of Directors has approved a repurchase program of up to 3.0 million common shares of Company stock. Management is authorized to effect purchases from time to time in the open market or through privately negotiated transactions. There were no purchases under this program during the nine months ended October 1, 2016. There are approximately 2.3 million shares of our common stock available for repurchase under this program.

### Share-Based Compensation

The majority of the Company's annual share-based incentive awards are made in the fiscal second quarter.

The Company recognized \$3.0 million and \$3.5 million in share-based compensation expense for the three months ended October 1, 2016 and October 3, 2015, respectively. Share-based compensation expense was \$10.1 million and \$10.6 million for the nine months ended October 1, 2016 and October 3, 2015, respectively. The Company recognizes compensation expense on grants of share-based compensation awards on a straight-line basis over the vesting period of each award. The total excess income tax (expense) benefit recognized relating to share-based compensation was \$0.2 million for the nine months ended October 1, 2016 and \$1.3 million for the nine months ended October 3, 2015. As of October 1, 2016, total unrecognized compensation cost related to share-based compensation awards was approximately \$27.9 million, net of estimated forfeitures, which the Company expects to recognize over a weighted average period of approximately 2.2 years.

Approximately 1.4 million shares were available for future grant under the 2013 Equity Incentive Plan at October 1, 2016.

### Options and Stock Appreciation Rights

The Company uses several forms of share-based incentive awards, including non-qualified stock options, incentive stock options, and stock settled stock appreciation rights ("SARs"). Options and SARs generally vest over 5 years and expire 10 years from the grant date. All grants are made at prices equal to the fair market value of the stock on the grant date. For the nine months ended October 1, 2016 and October 3, 2015, expired and canceled shares were immaterial.

The table below presents share-based compensation activity for the nine months ended October 1, 2016 and October 3, 2015 (in millions):

	October 1, 2016	October 3, 2015
Total intrinsic value of share-based incentive awards exercised	\$ 1.1	\$ 4.0
Cash received from stock option exercises	0.5	2.5
Income tax (expense) benefit from the exercise of stock options	(0.2 )	1.5
Total fair value of share-based incentive awards vested	4.9	4.8

The assumptions used in the Company's Black-Scholes valuation related to grants for options and SARs were as follows:

	2016	2015
Per share weighted average fair value of grants	\$ 15.22	\$ 27.16
Risk-free interest rate	1.4 %	1.9 %
Expected life (years)	7.0	7.0
Expected volatility	29.6 %	35.6 %
Expected dividend yield	1.7 %	1.2 %

The average risk-free interest rate is based on US Treasury security rates in effect as of the grant date. The expected dividend yield is based on the projected annual dividend as a percentage of the estimated market value of the Company's common stock as of the grant date. The Company estimated the expected volatility using a weighted average of daily historical volatility of the Company's stock price over the expected term of the award. The Company estimated the expected term using historical data adjusted for the estimated exercise dates of unexercised awards.



Following is a summary of share-based incentive plan activity (options and SARs) for the nine months ended October 1, 2016.

Number of Shares Under Options and SARs	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in millions)
Outstanding at January 2, 2016	1,548,266	\$ 63.09		
Granted	293,400	57.43		
Exercised	(77,020 )	46.67		
Forfeited	(28,177 )	73.24		
Expired	(47,630 )	68.63		
Outstanding at October 1, 2016	1,688,839	\$ 62.53	5.8	\$ 5.6
Exercisable at October 1, 2016	1,021,614	\$ 59.89	4.1	\$ 5.1

Compensation expense recognized related to options and SARs was \$3.4 million for the nine months ended October 1, 2016.

As of October 1, 2016, there was \$11.1 million of unrecognized compensation cost related to non-vested options and SARs that is expected to be recognized as a charge to earnings over a weighted average period of 3.4 years.

The amount of options expected to vest is materially consistent with those outstanding and not yet exercisable.

#### Restricted Stock Awards and Restricted Stock Units

Restricted stock awards ("RSA") and restricted stock units ("RSU") consist of shares or the rights to shares of the Company's stock. The awards are restricted such that they are subject to substantial risk of forfeiture and to restrictions on their sale or other transfer. As defined in the individual grant agreements, acceleration of vesting may occur under a change in control, or death, disability or normal retirement of the grantee.

Following is a summary of RSA activity for the nine months ended October 1, 2016:

	Shares	Weighted Average Fair Value at Grant Date	Weighted Average Remaining Contractual Term (years)
Unvested RSAs at January 2, 2016	14,400	\$ 78.15	0.4
Granted	19,593	57.43	
Vested	(14,400 )	78.15	
Unvested RSAs October 1, 2016	19,593	\$ 57.43	0.6

RSAs vest on the first anniversary of the grant date, provided the holder of the shares is continuously employed by or in the service of the Company until the vesting date. Compensation expense recognized related to the RSAs was \$0.8 million for the nine months ended October 1, 2016.

As of October 1, 2016, there was \$0.7 million of unrecognized compensation cost related to non-vested RSAs that is expected to be recognized as a charge to earnings over a weighted average period of 0.6 years.

Following is a summary of RSU activity for the nine months ended October 1, 2016:

Shares	Weighted Average Fair Value at Grant Date	Weighted Average Remaining Contractual Term (years)
Unvested RSUs at January 2, 2016	268,655 \$ 72.91	1.8
Granted	105,228 57.43	
Vested	(80,730) 65.20	
Forfeited	(11,290) 74.92	
Unvested RSUs at October 1, 2016	279,863 \$ 69.22	1.9

RSUs vest on the third anniversary of the grant date, provided the holder of the RSUs is continuously employed by the Company until the vesting date. Compensation expense recognized related to the RSUs was \$4.2 million for the nine months ended October 1, 2016.

As of October 1, 2016, there was \$10.7 million of unrecognized compensation cost related to non-vested RSUs that is expected to be recognized as a charge to earnings over a weighted average period of 1.9 years.

#### Performance Share Units

Performance share unit ("PSU") awards consist of shares or the rights to shares of the Company's stock which are awarded to employees of the Company. These shares are payable upon the determination that the Company achieved certain established performance targets and can range from 0% to 200% of the targeted payout based on the actual results. PSUs have a performance period of 3 years. As set forth in the individual grant agreements, acceleration of vesting may occur under a change in control, death or disability. There are no voting rights with these instruments until vesting occurs and a share of stock is issued. Some of the PSU awards are valued using a Monte Carlo simulation method as of the grant date while others are valued using the closing market price as of the grant date depending on the performance criteria for the award.

The assumptions used in the Company's Monte Carlo simulation related to grants for performance share units were as follows:

	October 1, 2016	October 3, 2015
Risk-free interest rate	0.9 %	1.0 %
Expected life (years)	3.0	3.0
Expected volatility	23.0 %	25.0 %
Expected dividend yield	1.7 %	1.2 %

Following is a summary of PSU activity for the nine months ended October 1, 2016:

Shares	Weighted Average Remaining Contractual Term (years)
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	Weighted Average Fair Value at Grant Date		
Unvested PSUs at January 2, 2016		87,895	\$ 75.81 1.9
Granted for the Unvested PSUs October 1, 2016		83,605	51.84
		(3,710)	59.98
		84,690	\$ 65.26 2.2

Compensation expense for awards granted are recognized based on the targeted payout of 100.0%, net of estimated forfeitures. Compensation expense recognized related to PSUs was \$1.7 million for the nine months ended October 1, 2016. Total unrecognized compensation expense for all PSUs granted as of October 1, 2016 is estimated to be \$5.4 million recognized as a charge to earnings over a weighted average period of 2.2 years.

## 10. INCOME TAXES

The effective tax rate for the three months ended October 1, 2016 was 20.2% versus 25.2% for the three months ended October 3, 2015. The effective tax rate for the nine months ended October 1, 2016 was 22.7% versus 25.7% for the nine months ended October 3, 2015. The change in the effective tax rate for the three months ended October 1, 2016 was primarily driven by the mix of earnings and the favorable adjustments related to the finalization of the 2015 US federal income tax return. For the nine months ended October 1, 2016, the change in the effective tax rate was driven by the mix of earnings and the favorable adjustments related to the finalization of the 2015 US federal income tax return, partially offset by the gain derived from the sale of the Mastergear business. The lower effective rate as compared to the 35.0% statutory federal income tax rate is driven by lower foreign tax rates.

As of October 1, 2016 and January 2, 2016, the Company had approximately \$8.4 million and \$8.3 million, respectively, of unrecognized tax benefits, all of which would impact the effective income tax rate if recognized.

Potential interest and penalties related to unrecognized tax benefits are recorded in income tax expense.

With few exceptions, the Company is no longer subject to US federal and state/local income tax examinations by tax authorities for years prior to 2011, and the Company is no longer subject to non-US income tax examinations by tax authorities for years prior to 2009.

## 11. EARNINGS PER SHARE

Diluted earnings per share is computed based upon earnings applicable to common shares divided by the weighted-average number of common shares outstanding during the period adjusted for the effect of other dilutive securities. Options for common shares where the exercise price was above the market price have been excluded from the calculation of effect of dilutive securities shown below; the amount of the anti-dilutive shares were 1.4 million and 0.8 million for the three months ended October 1, 2016 and October 3, 2015, respectively, and 1.3 million and 0.3 million for the nine months ended October 1, 2016 and October 3, 2015, respectively. The following table reconciles the basic and diluted shares used in earnings per share calculations for the three and nine months ended October 1, 2016 and October 3, 2015 (in millions):

	Three Months Ended October 1, 2016		Nine Months Ended October 3, 2015	
Denominator for basic earnings per share	44.8	44.8	44.7	44.8
Effect of dilutive securities	0.2	0.3	0.3	0.3
Denominator for diluted earnings per share	45.0	45.1	45.0	45.1

## 12. CONTINGENCIES

One of the Company's subsidiaries that it acquired in 2007 is subject to numerous claims filed in various jurisdictions relating to certain sub-fractional motors that were primarily manufactured through 2004 and that were included as components of residential and commercial ventilation units marketed by a third party. These claims generally allege that the ventilation units were the cause of fires. Based on the current facts, the Company does not believe these claims, individually or in the aggregate, will have a material effect on its interim condensed consolidated financial statements as a whole.

The Company is, from time to time, party to litigation that arises in the normal course of its business operations, including product warranty and liability claims, contract disputes and environmental, asbestos, employment and other litigation matters. The Company's products are used in a variety of industrial, commercial and residential applications that subject the Company to claims that the use of its products is alleged to have resulted in injury or other damage. The Company accrues for exposures in amounts that it believes are adequate, and the Company does not believe that the outcome of any such lawsuit individually or collectively will have a material effect on the Company's financial position, its results of operations or its cash flows.

The Company recognizes the cost associated with its standard warranty on its products at the time of sale. The amount recognized is based on historical experience. The following is a reconciliation of the changes in accrued warranty costs for the three and nine months ended October 1, 2016 and October 3, 2015 (in millions):

	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Beginning balance	\$ 19.2	\$ 20.6	\$ 19.1	\$ 19.3
Less: Payments	(5.9 )	(4.5 )	(15.6 )	(13.6 )
Provisions	7.2	5.1	17.0	14.7
Acquisition	—	—	—	0.8
Ending balance	\$ 20.5	\$ 21.2	\$ 20.5	\$ 21.2

### 13. DERIVATIVE INSTRUMENTS

The Company is exposed to certain risks relating to its ongoing business operations. The primary risks managed by using derivative instruments are commodity price, currency exchange and interest rate risk. Forward contracts on certain commodities are entered into to manage the price risk associated with forecasted purchases of materials used in the Company's manufacturing process. Forward contracts on certain currencies are entered into to manage forecasted cash flows in certain foreign currencies. Interest rate swaps are entered into to manage interest rate risk associated with the Company's floating rate borrowings.

The Company recognizes all derivative instruments as either assets or liabilities at fair value in the Condensed Consolidated Balance Sheets. The Company designates commodity forward contracts as cash flow hedges of forecasted purchases of commodities, currency forward contracts as cash flow hedges of forecasted foreign currency cash flows and interest rate swaps as cash flow hedges of forecasted LIBOR-based interest payments. There were no significant collateral deposits on derivative financial instruments as of October 1, 2016.

#### Cash flow hedges

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive loss and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or changes in market value of derivatives not designated as hedges are recognized in current earnings. All derivative instruments used by the Company impact operating cash flows.

At October 1, 2016, the Company had \$(7.6) million, net of tax, of derivative losses on closed hedge instruments in AOCI that will be recognized in earnings when the hedged items impact earnings. At January 2, 2016, the Company had \$(7.4) million, net of tax, of derivative losses on closed hedge instruments in AOCI that was realized in earnings when the hedged items impacted earnings.

As of October 1, 2016, the Company had the following currency forward contracts outstanding (with maturities extending through July 2019) to hedge forecasted foreign currency cash flows (in millions):

	Notional Amount (in US Dollars)
Chinese Renminbi	\$ 282.0
Mexican Peso	248.1
Euro	58.2
Indian Rupee	33.5
Canadian Dollar	32.9
Australian Dollar	9.1
Japanese Yen	3.2
Thai Baht	4.1

Great Britain Pound 2.6

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As of October 1, 2016, the Company had the following commodity forward contracts outstanding (with maturities extending through December 2017) to hedge forecasted purchases of commodities (notional amounts expressed in terms of the dollar value of the hedged item (in millions):

	Notional
	Amount
Copper	\$ 31.9
Aluminum	2.0

As of October 1, 2016, the total notional amount of the Company's receive-variable/pay-fixed interest rate swap was \$100.0 million (with maturity in August 2017).

Fair values of derivative instruments as of October 1, 2016 and January 2, 2016 were (in millions):

	October 1, 2016			
	Prepaid			
	Expenses	Other	Hedging	Hedging
	and	Noncurrent	Obligations	Obligations
	Other	Assets	(current)	(noncurrent)
	Current			
	Assets			
Designated as hedging instruments:				
Interest rate swap contracts	\$—	\$ —	\$ 4.6	\$ —
Currency contracts	1.2	0.5	32.3	16.7
Commodity contracts	1.3	—	0.5	—
Not designated as hedging instruments:				
Currency contracts	0.7	—	0.1	—
Commodity contracts	0.9	0.1	0.8	0.1
Total Derivatives	\$4.1	\$ 0.6	\$ 38.3	\$ 16.8

	January 2, 2016			
	Prepaid			
	Expenses	Other	Hedging	Hedging
	and	Noncurrent	Obligations	Obligations
	Other	Assets	(current)	(noncurrent)
	Current			
	Assets			
Designated as hedging instruments:				
Interest rate swap contracts	\$—	\$ —	\$ —	\$ 7.8
Currency contracts	0.7	0.4	29.9	19.5
Commodity contracts	0.1	—	8.7	—
Not designated as hedging instruments:				
Currency contracts	0.5	0.6	0.9	0.3
Commodity contracts	5.1	—	5.2	—
Total Derivatives	\$6.4	\$ 1.0	\$ 44.7	\$ 27.6

The effect of derivative instruments on the Condensed Consolidated Statements of Income and Comprehensive Income (pre-tax) was as follows:

Derivatives Designated as Cash Flow Hedging Instruments (in millions):

	Three Months Ended October 1, 2016				October 3, 2015			
	Commodity Forwards	Currency Forwards	Interest Rate Swaps	Total	Commodity Forwards	Currency Forwards	Interest Rate Swaps	Total
Gain (Loss) recognized in Other Comprehensive Income (Loss)	\$(0.5)	\$(9.9 )	\$ 0.3	\$(10.1)	\$(10.1)	\$(27.3 )	\$(0.7 )	\$(38.1)
Amounts reclassified from Other Comprehensive Income (Loss):								
Gain recognized in Net Sales	—	0.1	—	0.1	—	0.1	—	0.1
Loss recognized in Cost of Sales	(2.4 )	(8.8 )	—	(11.2 )	(3.9 )	(5.9 )	—	(9.8 )
Loss recognized in Interest Expense	—	—	(1.2 )	(1.2 )	—	—	(1.3 )	(1.3 )
	Nine Months Ended October 1, 2016				October 3, 2015			
	Commodity Forwards	Currency Forwards	Interest Rate Swaps	Total	Commodity Forwards	Currency Forwards	Interest Rate Swaps	Total
Gain (Loss) recognized in Other Comprehensive Income (Loss)	\$1.6	\$(25.5 )	\$(0.4 )	\$(24.3)	\$(17.6)	\$(38.4 )	\$(1.6 )	\$(57.6)
Amounts reclassified from Other Comprehensive Income (Loss):								
Gain recognized in Net Sales	—	0.1	—	0.1	—	0.2	—	0.2
Loss recognized in Cost of Sales	(12.1)	(22.0 )	—	(34.1 )	(13.6 )	(10.7 )	—	(24.3 )
Loss recognized in Interest Expense	—	—	(3.7 )	(3.7 )	—	—	(3.9 )	(3.9 )



Derivatives Not Designated as Cash Flow Hedging Instruments (in millions):

	Three Months Ended			
	October 1, 2016		October 3, 2015	
	Commodity Forwards	Currency Forwards	Commodity Forwards	Currency Forwards
Loss recognized in Cost of Sales	\$—	\$—	—\$(0.1 )	\$ —
Loss recognized in Operating Expenses	—	—	—	(4.0 )
	Nine Months Ended			
	October 1, 2016		October 3, 2015	
	Commodity Forwards	Currency Forwards	Commodity Forwards	Currency Forwards
Gain (Loss) recognized in Cost of Sales	\$0.2	\$ —	—\$(0.1 )	\$ —
Loss recognized in Operating Expenses	—	(0.7 )	—	(4.5 )

The ineffective portion of hedging instruments recognized during the three and nine months ended October 1, 2016 and October 3, 2015 was immaterial.

The net AOCI hedging component balance of \$(39.2) million loss at October 1, 2016 includes \$(21.2) million of net current deferred losses expected to be realized in the next twelve months.

The Company's commodity and currency derivative contracts are subject to master netting agreements with the respective counterparties which allow the Company to net settle transactions with a single net amount payable by one party to another party. The Company has elected to present the derivative assets and derivative liabilities on the Condensed Consolidated Balance Sheets on a gross basis for the periods ended October 1, 2016 and January 2, 2016.

The following table presents the derivative assets and derivative liabilities presented on a net basis under enforceable master netting agreements (in millions):

	October 1, 2016		
	Gross		
	Amounts		
	as Presented in the Condensed Consolidated Balance Sheet	Derivative Contract Amounts Subject to Right of Offset	Derivative Contracts as Presented on a Net Basis
Prepaid Expenses and Other Current Assets:			
Derivative Currency Contracts	\$1.9	\$ (0.9 )	\$ 1.0
Derivative Commodity Contracts	2.2	(1.3 )	0.9
Other Noncurrent Assets:			
Derivative Currency Contracts	0.5	(0.2 )	0.3
Derivative Commodity Contracts	0.1	(0.1 )	—
Hedging Obligations (Current):			
Derivative Currency Contracts	32.4	(0.9 )	31.5
Derivative Commodity Contracts	1.3	(1.3 )	—
Hedging Obligations:			
Derivative Currency Contracts	16.7	(0.2 )	16.5
Derivative Commodity Contracts	0.1	(0.1 )	—
	January 2, 2016		
	Gross		
	Amounts		
	as Presented in the Condensed Consolidated Balance Sheet	Derivative Contract Amounts Subject to Right of Offset	Derivative Contracts as Presented on a Net Basis
Prepaid Expenses and Other Current Assets:			
Derivative Currency Contracts	\$1.2	\$ (1.2 )	\$ —
Derivative Commodity Contracts	5.2	(5.2 )	—
Other Noncurrent Assets:			
Derivative Currency Contracts	1.0	(1.0 )	—
Hedging Obligations (Current):			
Derivative Currency Contracts	30.8	(1.2 )	29.6
Derivative Commodity Contracts	13.9	(5.2 )	8.7
Hedging Obligations:			
Derivative Currency Contracts	19.8	(1.0 )	18.8



## 14. FAIR VALUE

The Company uses a three-tier hierarchy to assess the inputs used to measure the fair value of financial assets and liabilities.

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities

Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or

Unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or

Inputs other than quoted prices that are observable for the asset or liability

Level 3 Unobservable inputs for the asset or liability

The Company uses the best available information in measuring fair value. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The fair values of cash equivalents and term deposits approximate their carrying values as of October 1, 2016 and January 2, 2016, due to the short period of time to maturity and are classified using Level 1 inputs. The fair values of trade receivables and accounts payable approximate the carrying values due to the short period of time to maturity.

See Note 7 of Notes to Condensed Consolidated Financial Statements for disclosure of the approximate fair value of the Company's debt at October 1, 2016 and January 2, 2016.

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of October 1, 2016 and January 2, 2016 (in millions):

	October 1, 2016	January 2, 2016	Classification
Assets:			
Prepaid Expenses and Other Current Assets:			
Derivative Currency Contracts	\$ 1.9	\$ 1.2	Level 2
Derivative Commodity Contracts	2.2	5.2	Level 2
Other Noncurrent Assets:			
Assets Held in Rabbi Trust	5.4	5.2	Level 1
Derivative Currency Contracts	0.5	1.0	Level 2
Derivative Commodity Contracts	0.1	—	Level 2
Liabilities:			
Hedging Obligations (current):			
Interest Rate Swap	4.6	—	Level 2
Derivative Currency Contracts	32.4	30.8	Level 2
Derivative Commodity Contracts	1.3	13.9	Level 2
Hedging Obligations:			
Interest Rate Swap	—	7.8	Level 2
Derivative Currency Contracts	16.7	19.8	Level 2
Derivative Commodity Contracts	0.1	—	Level 2

The Company's derivative contracts are valued at fair value using the market or income approaches. The Company measures the fair value of foreign currency exchange contracts using Level 2 inputs based on observable spot and forward rates in active markets. The Company measures the fair value of commodity contracts using Level 2 inputs through observable market transactions in active markets provided by financial institutions. The Company measures the fair value of investments using Level 1 inputs based on quoted market prices for identical instruments in active markets. The Company measures the fair value of interest rate swaps using Level 2 inputs in an income approach for valuation based on expected interest rate yield curves over the remaining duration of the interest rate swaps. During the nine months ended October 1, 2016, there were no transfers between classification Levels 1, 2 or 3.



### 15. RESTRUCTURING AND RELATED COSTS

Beginning in 2014, the Company announced the closure of several of its manufacturing and warehouse facilities and consolidation into existing facilities to simplify manufacturing operations in its Commercial and Industrial Systems, Climate Solutions and Power Transmission Solutions segments. As a result of these closures, the Company incurred restructuring and restructuring-related costs. Restructuring costs includes employee termination and plant relocation costs. Restructuring-related costs includes costs directly associated with actions resulting from our simplification initiatives, such as asset write-downs or accelerated depreciation due to shortened useful lives in connection with site closures, discretionary employment benefit costs and other facility rationalization costs. Restructuring costs for employee termination expenses are generally required to be accrued over the employees remaining service period while restructuring costs for plant relocation costs and restructuring-related costs are generally required to be expensed as incurred.

The following is a reconciliation of provisions and payments for the restructuring projects for the three and nine months ended October 1, 2016 and October 3, 2015, respectively (in millions):

	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Beginning balance	\$ 1.4	\$ 3.2	\$ 1.3	\$ 6.1
Provision	1.1	1.2	4.2	4.6
Less: Payments	1.3	2.3	4.3	8.6
Ending Balance	\$ 1.2	\$ 2.1	\$ 1.2	\$ 2.1

The following is a reconciliation of restructuring and restructuring-related costs for the restructuring projects for the three and nine months ended October 1, 2016 and October 3, 2015, respectively (in millions):

	Three Months Ended			October 3, 2015		
	October 1, 2016	October 1, 2016	Total	October 3, 2015	October 3, 2015	Total
Restructuring Costs:	Cost of Sales	Operating Expenses		Cost of Sales	Operating Expenses	
Employee termination expenses	\$—	\$ (0.1)	\$(0.1)	\$—	\$—	—\$—
Facility related costs	(0.1)	1.1	1.0	0.2	—	0.2
Other expenses	0.2	—	0.2	1.0	—	1.0
Total restructuring costs	\$0.1	\$ 1.0	\$ 1.1	\$ 1.2	\$—	—\$ 1.2

	Nine Months Ended					
	October 1, 2016			October 3, 2015		
Restructuring Costs:	Cost of Sales	Operating Expenses	Total	Cost of Sales	Operating Expenses	Total
Employee termination expenses	\$0.4	\$—	\$0.4	\$0.1	\$—	\$0.1
Facility related costs	0.4	1.5	1.9	0.6	0.1	0.7
Other expenses	0.8	—	0.8	2.8	1.0	3.8
Total restructuring costs	\$1.6	\$ 1.5	\$ 3.1	\$3.5	\$ 1.1	\$ 4.6
Restructuring-related Costs:						
Other employment benefit expenses	\$0.5	\$ 0.6	\$ 1.1	\$—	\$—	\$—
Total restructuring-related costs	\$0.5	\$ 0.6	\$ 1.1	\$—	\$—	\$—
Total restructuring and restructuring-related costs	\$2.1	\$ 2.1	\$ 4.2	\$3.5	\$ 1.1	\$ 4.6



The Company's current restructuring activities are expected to conclude by the end of the first quarter of fiscal 2017. The Company expects to record aggregate future charges relating to previously announced restructuring activities of approximately \$4.9 million which includes \$1.7 million of employee termination expenses and \$3.2 million of facility related and other costs.

#### 16. SUBSEQUENT EVENT

The Company has evaluated subsequent events from October 1, 2016 through the date these financial statements were issued. The Company is not aware of any subsequent events that would require recognition or disclosure.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless the context requires otherwise, references in this Item 2 to “we,” “us,” “our” or the “Company” refer collectively to Regal Beloit Corporation and its subsidiaries.

### Overview

Regal Beloit Corporation (NYSE: RBC), based in Beloit, Wisconsin (USA), is a leading manufacturer of electric motors, electrical motion controls, power generation and power transmission products serving markets throughout the world.

### Reportable Segments

Our company is comprised of three reportable segments: Commercial and Industrial Systems, Climate Solutions and Power Transmission Solutions. A description of the three reportable segments is as follows:

The Commercial and Industrial Systems segment produces medium and large electric motors, power generation products, high-performance drives and controls, and starters. Applications include general commercial and industrial equipment, commercial HVAC, power generation, and oil and gas.

The Climate Solutions segment produces small motors, controls and air moving solutions. Applications include residential and light commercial HVAC, commercial refrigeration and water heaters.

The Power Transmission Solutions segment produces power transmission gearing, hydraulic pump drives, large open gearing and specialty mechanical products. Applications include material handling, industrial equipment, energy and off-road equipment.

### Components of Profit and Loss

**Net Sales.** We sell our products to a variety of manufacturers, distributors and end users. Our customers consist of a large cross-section of businesses, ranging from Fortune 100 companies to small businesses. A number of our products are sold to original equipment manufacturers (“OEMs”) who incorporate our products, such as electric motors, into products they manufacture, and many of our products are built to the requirements of our customers. The majority of our sales derive from direct sales, but a significant portion derives from sales made by manufacturer’s representatives, who are paid exclusively on commission. Our product sales are made via purchase order, long-term contract, and, in some instances, one-time purchases. Many of our products have broad customer bases, with the levels of concentration of revenues varying from segment to segment.

Our level of net sales for any given period is dependent upon a number of factors, including (i) the demand for our products; (ii) the strength of the economy generally and the end markets in which we compete; (iii) our customers’ perceptions of our product quality at any given time; (iv) our ability to timely meet customer demands; (v) the selling price of our products; and (vi) the weather. As a result, our total revenue has tended to experience quarterly variations and our total revenue for any particular quarter may not be indicative of future results.



We use the term “organic sales” to refer to sales from existing operations excluding (i) sales from acquired businesses recorded prior to the first anniversary of the acquisition less the amount of sales attributable to any divested businesses (“acquisition sales”), and (ii) the impact of foreign currency translation. The impact of foreign currency translation is determined by translating the respective period’s sales (excluding acquisition sales) using the same currency exchange rates that were in effect during the prior year periods. We use the term “organic sales growth” to refer to the increase in our sales between periods that is attributable to organic sales.

Gross Profit. Our gross profit is impacted by our levels of net sales and cost of sales. Our cost of sales consists of costs for, among other things (i) raw materials, including copper, steel and aluminum; (ii) components such as castings, bars, tools, bearings and

electronics; (iii) wages and related personnel expenses for fabrication, assembly and logistics personnel; (iv) manufacturing facilities, including depreciation on our manufacturing facilities and equipment, taxes, insurance and utilities; and (v) shipping and handling.

**Operating Expenses.** Our operating expenses consist primarily of (i) general and administrative expenses; (ii) sales and marketing expenses; and (iii) general engineering and research and development expenses. Personnel related costs are our largest operating expense.

**Operating Profit.** Our operating profit consists of the segment gross profit less the segment operating expenses. In addition, there are shared operating expenses that cover corporate, engineering and IT expenses that are consistently allocated to the operating segments and are included in the segment operating expenses. Operating profit is a key metric used to measure year over year improvement of the segments.

**Restructuring and Related Costs.** Beginning in 2014, as part of our Simplification initiative, we announced the closure of several of our manufacturing and warehouse facilities and their consolidation into existing facilities to simplify manufacturing operations in our Commercial and Industrial Systems, Climate Solutions and Power Transmission Solutions segments. As a result of these closures, we incurred restructuring and restructuring-related costs.

Restructuring costs includes employee termination and plant relocation costs. Restructuring-related costs includes costs directly associated with actions resulting from our Simplification initiative, such as asset write-downs or accelerated depreciation due to shortened useful lives in connection with site closures, discretionary employment benefit costs and other facility rationalization costs. Restructuring costs for employee termination expenses are generally required to be accrued over the employees remaining service period while restructuring costs for plant relocation costs and restructuring-related costs are generally required to be expensed as incurred.

#### Outlook

Our outlook for the remainder of 2016 assumes a continuation of weak global demand from many of our industrial end markets relative to the prior year. These market conditions are expected to negatively impact our sales volume. We expect the lower sales volume will negatively impact income from operations, partially offset by benefits from the Simplification initiative and cost controls.

#### Results of Operations

##### Three Months Ended October 1, 2016 Compared to October 3, 2015

Net sales decreased \$72.7 million or 8.2% for the third quarter 2016 compared to the third quarter 2015. The decrease consisted of an organic sales decline of 7.1%, a negative foreign currency translation impact of 0.6% and a negative impact from the sale of the Mastergear Worldwide ("Mastergear") business of 0.5%. Gross profit decreased \$9.4 million or 3.9% as compared to the prior year. The decrease was largely driven by lower sales volume partially offset by the benefits of the Simplification and cost control initiatives which helped to improve gross profit as a percentage of sales by 130 basis points in 2016 as compared to 2015. In addition, the prior year gross profit benefited from \$4.9 million in duty refunds related to the Generalized System of Preferences ("GSP"), a tariff system, which expired in July 2013 and was retroactively renewed in July 2015; this benefit did not reoccur in 2016. Operating expenses for the third quarter 2016 increased by \$0.9 million primarily due to the timing of certain expenses relative to the same period last year and an increase of \$1.0 million of restructuring expenses. These increases were partially offset by lower variable expenses such as salaries, commissions, and travel as a result of lower sales volumes and continued cost controls. Commercial and Industrial Systems segment net sales decreased \$37.4 million or 8.8% for the third quarter 2016 compared to the third quarter 2015. The decrease consisted of an organic sales decline of 7.9% and a negative foreign currency translation impact of 0.9%. The majority of the decrease was from the impact of weak demand in the North American and China industrial markets, depressed oil and gas and power generation activity, and the impact of contractual two-way material price formulas. Gross profit decreased \$4.9 million or 4.4%. The decline was mainly driven by lower sales volume which was partially offset by the benefits of the Simplification and cost control initiatives. Gross profit as a percentage of sales for 2016 increased 130 basis points as compared to 2015. In addition, the prior year gross profit benefited from \$0.9 million in duty refunds related to the GSP tariff refund, described

above. Operating expenses for the third quarter 2016 were down \$2.4 million or 3.4% due to lower variable expenses such as salaries, commissions, and travel as a result of lower sales volumes and continued cost controls.

Climate Solutions segment net sales decreased \$13.9 million or 5.3% for the third quarter 2016 compared to the third quarter 2015. The decrease consisted of an organic sales decline of 4.9% and a negative foreign currency translation impact of 0.4%. Net sales were unfavorably impacted by a continued decline in Middle East HVAC demand, the impact of contractual two-way material price formulas, and weak demand in the commercial refrigeration and the general industries markets, partially offset from strong sales in the North American residential HVAC market. Gross profit for 2016 increased \$0.6 million as the sales volume decline was offset by the benefits of the Simplification and cost control initiatives in the factories. Gross profit as a percentage of sales

improved 170 basis points as compared to 2015. In addition, the prior year gross profit benefited from \$3.8 million in duty refunds related to the GSP tariff rebate, described above. Operating expenses for the third quarter 2016 decreased \$0.9 million or 3.0% compared to the same period in the prior year due to lower variable expenses such as salaries, commissions, and travel as a result of lower sales volumes and continued cost controls.

Power Transmission Solutions segment net sales decreased \$21.4 million or 11.2% for the third quarter 2016 compared to the third quarter 2015. The decrease consisted of an organic sales decline of 8.5%, divestiture of the Mastergear business of 2.5% and a negative foreign currency translation impact of 0.1%. Organic sales declines were primarily driven by lower demand from the industrial distribution channel, and weak oil and gas, metals and agricultural end markets. Gross profit for the third quarter 2016 decreased \$5.1 million or 8.5%. The decrease was primarily due to lower sales volume that was partially offset by Simplification and cost control initiatives in the factories. Gross profit as a percentage of sales improved 100 basis points as compared to 2015. In addition, the prior year gross profit benefited from \$0.2 million in duty refunds related to the GSP tariff rebate, described above. Operating expenses increased \$4.2 million or 10.7% in 2016 largely due to a \$1.0 million increase in restructuring costs relative to the same period last year and prior period adjustments to align accounting practices between the newly acquired PTS business and the legacy Regal business, partially offset by lower variable expenses such as salaries and travel as a result of lower sales volumes and continued cost controls.

#### Nine Months Ended October 1, 2016 Compared to October 3, 2015

Net sales decreased \$269.8 million or 9.9% for the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015 and included \$29.1 million from the recently acquired businesses, net of dispositions. The decrease consisted of an organic sales decline of 10.0% and a negative foreign currency translation impact of 1.0%, partially offset by a favorable impact from acquisition sales of 1.0%. Gross profit for the nine months ended October 1, 2016 decreased \$41.4 million or 5.8% compared to the nine months ended October 3, 2015 primarily due to the impact of lower sales volume that was partially offset by the benefits from the Simplification and cost control initiatives in the factories. The prior year included non-recurring expenses related to the recognition of the inventory step up in cost of goods sold of \$20.6 million due to purchase accounting adjustments associated with the acquired PTS business. In addition, the prior year gross profit benefited from \$4.9 million in duty refunds related to the GSP tariff system, which expired in July 2013 and was retroactively renewed in July 2015; this benefit did not reoccur in 2016. Gross profit as a percent of sales increased 110 basis points as compared to the prior year with 70 basis points being attributed to the 2015 PTS purchase accounting inventory step up. Operating expenses for the nine months ended October 1, 2016 decreased \$25.0 million or 5.6% compared to the same period in the prior year primarily due to \$9.2 million of acquisition fees incurred in 2015, the \$11.6 million gain on the sale of the Mastergear business in 2016 and reductions in salary, commission, and travel expenses. In addition, current year operating expenses included one month of incremental operating expenses associated with the acquired PTS business.

Commercial and Industrial Systems segment net sales decreased \$162.5 million or 12.3% for the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015. The decrease consisted of an organic sales decline of 10.8% and a negative foreign currency translation impact of 1.4%. Organic sales declines were primarily driven by decreased volume in the oil and gas end markets, weaker demand in North American and Asian industrial markets and the effect of contractual two-way material price formulas. Gross profit decreased \$41.6 million or 12.4% primarily due to the impact of lower demand in the oil and gas end markets was partially offset by benefits from the Simplification and cost control initiatives. Gross profit as a percentage of sales remained flat compared to the prior year. In addition, the prior year gross profit benefited from \$0.9 million in duty refunds related to the GSP tariff rebate, described above. Operating expenses for the nine months ended October 1, 2016 decreased \$11.0 million or 4.9% compared to the nine months ended October 3, 2015 due to a reduction in lower salaries, commissions, and travel expenses associated with lower sales volumes and cost controls.

Climate Solutions segment net sales decreased \$86.1 million or 10.4% for the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015. The decrease consisted of an organic sales decline of 9.7% and a negative foreign currency translation impact of 0.7%. Organic sales declines were primarily driven by a downturn in the Middle East HVAC market and the effect of contractual two-way material price formulas that was partially offset

by stronger demand in the third quarter for North American residential HVAC products. Gross profit decreased \$15.2 million or 7.3% primarily due to lower volume that was partially offset by benefits from the Simplification and cost control initiatives in the factories which contributed to gross profit as a percentage of sales increasing by 80 basis points. In addition, the prior year gross profit benefited from \$3.8 million in duty refunds related to the GSP tariff rebate, described above. Operating expenses for the nine months ended October 1, 2016 decreased \$0.3 million as compared to the nine months ended October 3, 2015.

Power Transmission Solutions segment net sales decreased \$21.2 million or 3.6% for the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015. The decrease consisted of an organic sales decline of 8.5% and a negative foreign currency translation impact of 0.2%. The favorable impact of \$29.1 million from the recently acquired businesses, net of dispositions drove a 5.0% increase. Organic sales declines were primarily driven by lower demand from the industrial distribution channel, and weak oil and gas, metals and agricultural end markets. Gross profit for the nine months ended October 1, 2016

compared to the nine months ended October 3, 2015 increased \$15.4 million or 9.1% primarily due to the inventory step up in cost of goods sold of \$20.6 million related to the acquired PTS business included in the prior year. Gross profit as a percent of sales increased 390 basis points as compared to the prior year with 350 basis points being attributed to the inventory step up discussed above. In addition, the prior year gross profit benefited from \$0.2 million in duty refunds related to the GSP tariff rebate, described above. Operating expenses for the nine months ended October 1, 2016 decreased \$13.7 million or 10.3% due primarily to the \$9.2 million of acquisition fees incurred in 2015 and the \$11.6 million gain on the sale of the Mastergear business in 2016 as compared to the nine months ended October 3, 2015. In addition, current year operating expenses included one month of incremental operating expenses associated with the acquired PTS business.

	Three Months Ended		Nine Months Ended		
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015	
(Dollars in Millions)					
Net Sales:					
Commercial and Industrial Systems	\$389.4	\$426.8	\$1,161.7	\$1,324.2	
Climate Solutions	250.5	264.4	744.8	830.9	
Power Transmission Solutions	169.7	191.1	559.9	581.1	
Consolidated	\$809.6	\$882.3	\$2,466.4	\$2,736.2	
Gross Profit as a Percent of Net Sales:					
Commercial and Industrial Systems	27.1	% 25.8	% 25.4	% 25.4	%
Climate Solutions	28.5	% 26.8	% 25.8	% 25.0	%
Power Transmission Solutions	32.4	% 31.4	% 33.0	% 29.1	%
Consolidated	28.6	% 27.3	% 27.2	% 26.1	%
Operating Expenses as a Percent of Net Sales:					
Commercial and Industrial Systems	17.8	% 16.8	% 18.3	% 16.9	%
Climate Solutions	11.7	% 11.4	% 12.0	% 10.8	%
Power Transmission Solutions	25.6	% 20.6	% 21.4	% 23.0	%
Consolidated	17.5	% 16.0	% 17.1	% 16.3	%
Income from Operations as a Percent of Net Sales:					
Commercial and Industrial Systems	9.3	% 9.1	% 7.1	% 8.6	%
Climate Solutions	16.8	% 15.4	% 13.8	% 14.2	%
Power Transmission Solutions	6.7	% 10.8	% 11.5	% 6.1	%
Consolidated	11.1	% 11.4	% 10.2	% 9.8	%
Income from Operations	\$89.8	\$100.1	\$250.5	\$266.9	
Interest Expense	14.4	15.1	44.2	45.1	
Interest Income	1.1	1.0	3.4	3.1	
Income before Taxes	76.5	86.0	209.7	224.9	
Provision for Income Taxes	15.4	21.7	47.5	57.8	
Net Income	61.1	64.3	162.2	167.1	
Less: Net Income Attributable to Noncontrolling Interests	1.5	0.9	4.4	4.5	
Net Income Attributable to Regal Beloit Corporation	\$59.6	\$63.4	\$157.8	\$162.6	

The effective tax rate for the three months ended October 1, 2016 was 20.2% versus 25.2% for the three months ended October 3, 2015. The effective tax rate for the nine months ended October 1, 2016 was 22.7% versus 25.7% for the nine months ended October 3, 2015. The change in the effective tax rate for the three months ended October 1, 2016 was primarily driven by the mix of earnings and the favorable adjustments related to the finalization of the 2015 US federal income tax return. For the nine months ended October 1, 2016, the change in the effective tax rate was driven by the mix of earnings and the favorable adjustments related to the finalization of the 2015 US federal income tax return, partially offset by the gain derived from the sale of the Mastergear business. The lower effective rate as compared to the 35.0% statutory federal income tax rate is driven by lower foreign tax rates.





## Liquidity and Capital Resources

### General

Our principal source of liquidity is cash flow provided by operating activities. In addition to operating income, other significant factors affecting our cash flow include working capital levels, capital expenditures, dividends, share repurchases, acquisitions, availability of debt financing, and the ability to attract long-term capital at acceptable terms.

Cash flow provided by operating activities was \$328.4 million for the nine months ended October 1, 2016, a \$61.2 million increase from the nine months ended October 3, 2015. The increase was primarily the result of the lower investment in net working capital driven by the planned reduction in inventory for the nine months ended October 1, 2016 as compared to the nine months ended October 3, 2015.

Cash flow used in investing activities was \$29.5 million for the nine months ended October 1, 2016 versus \$1,464.0 million for the nine months ended October 3, 2015. The change was driven by the purchase of PTS for \$1,400.7 million, net of cash acquired, in the nine months ended October 3, 2015 versus \$25.5 million received for the sale of our Mastergear business in the nine months ended October 1, 2016. The proceeds from the sale of Mastergear were used to reduce debt obligations.

Cash flow used in financing activities was \$265.8 million for the nine months ended October 1, 2016, compared to \$1,124.0 million provided by financing activities for the nine months ended October 3, 2015. A \$1,250.0 term loan was taken out to finance the acquisition of PTS during the nine months ended October 3, 2015 and net repayments of \$214.9 million were made during the nine months ended October 1, 2016. We paid \$31.3 million in dividends to shareholders in the nine months ended October 1, 2016, compared to \$29.9 million for the nine months ended October 3, 2015.

Our working capital was \$898.0 million at October 1, 2016, compared to \$1,022.4 million at January 2, 2016. At October 1, 2016 and January 2, 2016, our current ratio (which is the ratio of our current assets to current liabilities) was 2.3:1 and 2.7:1, respectively. Our working capital decreased primarily due to a decrease in Inventories of \$89.4 million and \$100.0 million of private placement debt moving from a long-term classification to a current classification at October 1, 2016 as compared to January 2, 2016. The cash generated by our trade working capital accounts was used to supplement our debt reduction in 2016.

The following table presents selected financial information and statistics as of October 1, 2016 and January 2, 2016 (dollars in millions):

	October 1, 2016	January 2, 2016
Cash and Cash Equivalents	\$ 281.6	\$ 252.9
Trade Receivables, Net	501.0	462.0
Inventories	685.6	775.0
Working Capital	898.0	1,022.4
Current Ratio	2.3:1	2.7:1

At October 1, 2016, our cash and cash equivalents totaled \$281.6 million. At October 1, 2016, \$272.1 million of our cash was held by foreign subsidiaries, and although we do not intend to, this cash could be used in our domestic operations if necessary, but would be subject to repatriation taxes. There are no current trends, demands or uncertainties that we believe are reasonably likely to require repatriation or to have a material impact on our ability to fund US operations.

Predominately all of our expenses are paid in cash, often with payment term provisions that include early payment discounts and time elements. We believe that our ability to generate positive cash flow coupled with our available revolving credit balance will be sufficient to fund our operations for the foreseeable future. We focus on optimizing our investment in working capital through improved and enforced payment terms, maintaining an optimal level of inventory and operational efficiencies. Additionally, we believe that our capital expenditures for maintenance of equipment and facilities will be consistent with prior levels and not present a funding challenge.

We will, from time to time, maintain excess cash balances which may be used to (i) fund operations, (ii) repay outstanding debt, (iii) fund acquisitions, (iv) pay dividends, (v) make investments in new product development programs, (vi) repurchase our common stock, or (vii) fund other corporate objectives.

### Credit Agreement

In connection with the PTS Acquisition, on January 30, 2015, we entered into a new Credit Agreement (the “Credit Agreement”) with JPMorgan Chase Bank, N.A., as Administrative Agent and the lenders named therein, providing for (i) a 5-year unsecured term loan facility in the principal amount of \$1.25 billion (the “Term Facility”) and (ii) a 5-year unsecured multicurrency revolving facility in the principal amount of \$500.0 million (the “Multicurrency Revolving Facility”) available for general corporate purposes.

The Term Facility was drawn in full on January 30, 2015 in connection with the closing of the PTS Acquisition. The loans under the Term Facility require quarterly amortization at a rate starting at 5.0% per annum, increasing to 7.5% per annum after two years and further increasing to 10.0% per annum for the last two years of the Term Facility. At October 1, 2016 we had borrowings under the Multicurrency Revolving Facility in the amount of \$13.0 million, \$32.3 million of standby letters of credit issued under the facility, and \$454.7 million of available borrowing capacity.

Borrowings under the Credit Agreement bear interest at floating rates based upon indices determined by the currency of the borrowing, plus an applicable margin determined by reference to our consolidated funded debt to consolidated EBITDA ratio or at an alternative base rate. The weighted average interest rate on the Multicurrency Revolving Facility was 1.9 % for the three and nine months ended October 1, 2016 and October 3, 2015. The weighted average interest rate on the Term Facility was 2.0% for the three and nine months ended October 1, 2016 and October 3, 2015. We pay a non-use fee on the aggregate unused amount of the Multicurrency Revolving Facility at a rate determined by reference to its consolidated funded debt to consolidated EBITDA ratio.

The Credit Agreement requires that we prepay the loans under the Term Facility with 100% of the net cash proceeds received from specified asset sales and borrowed money indebtedness, subject to certain exceptions.

### Senior Notes

At October 1, 2016, we had \$600.0 million of unsecured senior notes (the “Notes”) outstanding. The Notes consist of (i) \$500.0 million in senior notes (the “2011 Notes”) in a private placement which were issued in seven tranches with maturities from seven to twelve years and carry fixed interest rates and (ii) \$100.0 million in senior notes (the “2007 Notes”) issued in 2007 with a floating interest rate based on a margin over the London Inter-Bank Offered Rate (“LIBOR”). The 2011 Notes are included in Long-Term Debt and the 2007 Notes are included in Current Maturities of Long-Term Debt on the Condensed Consolidated Balance Sheets.

Details on the Notes at October 1, 2016 were (in millions):

	Principal	Interest Rate	Maturity
Floating Rate Series 2007A	100.0	Floating <sup>(1)</sup>	August 23, 2017
Fixed Rate Series 2011A	100.0	4.1%	July 14, 2018
Fixed Rate Series 2011A	230.0	4.8 to 5.0%	July 14, 2021
Fixed Rate Series 2011A	170.0	4.9 to 5.1%	July 14, 2023
	\$ 600.0		

(1)

Interest rates vary as LIBOR varies. At October 1, 2016, the interest rate was 1.5%.

At  
January  
2, 2016,  
the  
interest  
rate was  
1.1%.

We have interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk (see also Note 13 of Notes to the Condensed Consolidated Financial Statements).

#### Compliance with Financial Covenants

The Credit Agreement and the Notes require us to meet specified financial ratios and to satisfy certain financial condition tests. We were in compliance with all financial covenants contained in the Notes and the Credit Agreement as of October 1, 2016.

#### Other Notes Payable

At October 1, 2016, other notes payable of approximately \$5.6 million were outstanding with a weighted average interest rate of 5.4%. At January 2, 2016, other notes payable of approximately \$15.5 million were outstanding with a weighted average rate of 2.5%.

Based on rates for instruments with comparable maturities and credit quality, which are classified as Level 2 inputs (see also Note 14 of Notes to the Condensed Consolidated Financial Statements), the approximate fair value of our total debt was \$1,559.3 million and \$1,758.2 million as of October 1, 2016 and January 2, 2016, respectively.

### Critical Accounting Policies

Our disclosures of critical accounting policies, which are contained in our Annual Report on Form 10-K for the year ended January 2, 2016, have not materially changed since that report was filed.

### Goodwill

We evaluate the carrying amount of our goodwill annually at the end of our October fiscal month end or more frequently if events or circumstances indicate that an asset might be impaired. When applying the accounting guidance, we use estimates to determine when it might be necessary to take an impairment charge. Factors that could trigger an impairment review include significant underperformance relative to historical or forecasted operating results, a significant decrease in the market value of an asset or significant negative industry or economic trends. Testing for impairment is performed on a reporting unit basis. Impairment occurs when the carrying value of goodwill exceeds the implied fair value of a reporting unit.

We use a weighting of the market approach and the income approach (discounted cash flow method) in testing goodwill for impairment. In the market approach, we apply performance multiples from comparable public companies, adjusted for relative risk, profitability, and growth considerations, to our reporting units to estimate fair value. The key assumptions used in the discounted cash flow method used to estimate fair value include discount rates, revenue and operating income projections and terminal value rates because such assumptions are the most sensitive and susceptible to change as they require significant management judgment. Discount rates are determined by using a weighted average cost of capital (“WACC”). The WACC considers market and industry data as well as company-specific risk factors for each reporting unit in determining the appropriate discount rate to be used. The discount rate utilized for each reporting unit is indicative of the return an investor would expect to receive for investing in such a business. Terminal value rate determination follows common methodology of capturing the present value of perpetual cash flow estimates beyond the last projected period assuming a constant WACC and long-term growth rates.

Throughout 2016 and more pronounced during the third quarter, our PTS reporting unit, which is a combination of the acquired PTS business from Emerson Electric and our legacy PTS business, was impacted by declines in the oil and gas, distribution, and agricultural end-markets. As a result, we performed an interim impairment test during our 2016 fiscal third quarter. The PTS reporting unit has goodwill of \$564.1 million as of October 1, 2016. Our interim impairment test indicated the reporting unit’s implied fair value exceeded its book value by 2.5%.

Some of the key considerations used in our impairment testing included:

- Market pricing of guideline publicly traded companies
- Guideline publicly traded company financial projections
- Cost of capital, including the risk-free interest rate
- Recent historical and projected performance of the subject reporting unit

There is inherent uncertainty included in the assumptions used in goodwill impairment testing. A change to any of the assumptions could lead to a future impairment.



**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk relating to our operations due to changes in interest rates, foreign currency exchange rates and commodity prices of purchased raw materials. We manage the exposure to these risks through a combination of normal operating and financing activities and derivative financial instruments such as interest rate swaps, commodity cash flow hedges and foreign currency forward exchange contracts. All hedging transactions are authorized and executed pursuant to clearly defined policies and procedures, which strictly prohibit the use of financial instruments for speculative purposes.

All qualified hedges are recorded on the balance sheet at fair value and are accounted for as cash flow hedges, with changes in fair value recorded in Accumulated Other Comprehensive Loss ("AOCI") in each accounting period. The ineffective portion of the change in fair value, if any, is recorded in earnings in the period of change.

**Interest Rate Risk**

We are exposed to interest rate risk on certain of our short-term and long-term debt obligations used to finance our operations and acquisitions. At October 1, 2016, excluding the impact of the interest rate swap, we had \$505.3 million of fixed rate debt and \$1,016.4 million of variable rate debt. As a result, interest rate changes in variable rate debt impact future earnings and cash flow assuming other factors are constant. We have LIBOR-based floating rate borrowings, which expose us to variability in interest payments due to changes in interest rates. A hypothetical 10% change in the weighted average borrowing rate on outstanding variable rate debt at October 1, 2016 would result in a \$1.1 million change in after-tax annualized earnings.

We entered into a pay fixed/receive LIBOR-based floating interest rate swap to manage fluctuations in cash flows resulting from exposure to interest rate risk on forecasted variable rate interest payments. This interest rate swap has been designated as a cash flow hedge against forecasted LIBOR-based interest payments. Details regarding this instrument, as of October 1, 2016, are as follows (in millions):

Instrument	Notional Amount	Maturity	Rate		Fair Value Loss
			Paid	Received	
Swap	\$ 100.0	August 23, 2017	5.4%	LIBOR (3 month)	\$ (4.6 )

As of October 1, 2016, an interest rate swap liability of \$(4.6) million was included in Hedging Obligations (current). As of January 2, 2016, an interest rate swap liability of \$(7.8) million was included in Hedging Obligations (noncurrent). The unrealized loss on the effective portion of the contract, net of tax, of \$(2.8) million and \$(4.9) million as of October 1, 2016 and January 2, 2016, respectively, was recorded in AOCI.

**Foreign Currency Risk**

We are also exposed to foreign currency risks that arise from normal business operations. These risks include the translation of local currency balances of foreign subsidiaries, intercompany loans with foreign subsidiaries and transactions denominated in foreign currencies. Our objective is to minimize our exposure to these risks through a combination of normal operating activities and the utilization of foreign currency exchange contracts. We do not hedge our exposure to the translation of reported results of foreign subsidiaries from local currency to US dollars.

**Derivatives**

As of October 1, 2016, derivative currency assets (liabilities) of \$1.9 million, \$0.5 million, \$(32.4) million and \$(16.7) million, are recorded in Prepaid Expenses and Other Current Assets, Other Noncurrent Assets, Hedging Obligations (current), and Hedging Obligations (noncurrent), respectively. As of January 2, 2016, derivative currency assets (liabilities) of \$1.2 million, \$1.0 million, \$(30.8) million and \$(19.8) million, are recorded in Prepaid Expenses and Other Current Assets, Other Noncurrent Assets, Hedging Obligations (current), and Hedging Obligations (noncurrent), respectively. The unrealized losses on the contracts of \$(29.3) million net of tax, and \$(29.8) million net of tax, as of October 1, 2016 and January 2, 2016 respectively, were recorded in AOCI. At October 1, 2016, we had \$(6.6) million, net of tax, of derivative currency losses on closed hedge instruments in AOCI that will be realized in earnings when the hedged items impact earnings. At January 2, 2016, we had \$(3.8) million of derivative currency losses on closed hedge instruments in AOCI that will be realized in earnings when the hedged items impacted earnings.





The following table quantifies the outstanding foreign exchange contracts intended to hedge non-US dollar denominated cash flows and the corresponding impact on the value of these instruments assuming a hypothetical 10% appreciation/depreciation of their counter currency on October 1, 2016 (in millions):

Currency	Notional Amount	Fair Value	Gain (Loss) From	
			10% Appreciation of Counter Currency	10% Depreciation of Counter Currency
Chinese Renminbi	\$ 282.0	\$(2.9)	\$ 28.2	\$ (28.2)
Mexican Peso	248.1	(44.7)	24.8	(24.8)
Euro	58.2	—	5.8	(5.8)
Indian Rupee	33.5	1.3	3.4	(3.4)
Canadian Dollar	32.9	0.1	3.3	(3.3)
Australian Dollar	9.1	(0.4)	0.9	(0.9)
Japanese Yen	3.2	—	0.3	(0.3)
Thai Baht	4.1	(0.1)	0.4	(0.4)
Great Britain Pound	2.6	—	0.3	(0.3)

Gains and losses indicated in the sensitivity analysis would be offset by gains and losses on the underlying forecasted non-US dollar denominated cash flows.

#### Commodity Price Risk

We periodically enter into commodity hedging transactions to reduce the impact of changing prices for certain commodities such as copper and aluminum based upon forecasted purchases of such commodities. The majority of these transactions are designated as cash flow hedges and the contract terms of commodity hedge instruments generally mirror those of the hedged item, providing a high degree of risk reduction and correlation.

#### Derivatives

As of October 2, 2016, derivative commodity assets (liabilities) of \$2.2 million, \$0.1 million, \$(1.3) million and \$(0.1) million were recorded in Prepaid Expenses and Other Current Assets, Other Noncurrent Assets, Other Accrued Expenses, Hedging Obligations (current), and Hedging Obligations (noncurrent), respectively. As of January 2, 2016, derivative commodity assets (liabilities) of \$5.2 million, \$(13.9) million are recorded in Prepaid Expenses and Other Current Assets and Hedging Obligations (current), respectively. The unrealized gains (losses) on the effective portion of the contracts of \$0.5 million net of tax and \$(5.4) million net of tax, as of October 1, 2016 and January 2, 2016, respectively, were recorded in AOCI. At October 1, 2016, we had \$(1.0) million, net of tax, of derivative commodity losses on closed hedge instruments in AOCI that will be realized in earnings when the hedged items impact earnings. At January 2, 2016, there was \$(3.6) million, net of tax, of derivative commodity losses on closed hedge instruments in AOCI that were realized into earnings when the hedged items impacted earnings.

The following table quantifies the outstanding commodity contracts intended to hedge raw material commodity prices and the corresponding impact on the value of these instruments assuming a hypothetical 10% appreciation/depreciation of their prices on October 1, 2016 (in millions):

Commodity	Notional Amount	Fair Value	Gain (Loss) From	
			10% Appreciation of Commodity Prices	10% Depreciation of Commodity Prices
Copper	\$ 31.9	\$ 0.8	\$ 3.2	\$ (3.2)
Aluminum	2.0	0.1	0.2	(0.2)

Gains and losses indicated in the sensitivity analysis would be offset by the actual prices of the commodities. The net AOCI balance of \$(39.2) million loss at October 1, 2016 includes \$(21.2) million of net current deferred losses expected to be realized in the next twelve months.



#### Counterparty Risk

We are exposed to credit losses in the event of non-performance by the counterparties to various financial agreements, including our interest rate swap agreement, foreign currency exchange contracts and commodity hedging transactions. We manage exposure to counterparty credit risk by limiting our counterparties to major international banks and financial institutions meeting established credit guidelines and continually monitoring their compliance with the credit guidelines. We do not obtain collateral or other security to support financial instruments subject to credit risk. We do not anticipate non-performance by our counterparties, but cannot provide assurances.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective to ensure that (a) 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 rules and forms of the Securities and Exchange Commission, and (b) information required to be disclosed by us in the reports the Company files or submits under the Exchange Act is accumulated and communicated to our management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

##### Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

#### PART II—OTHER INFORMATION

##### ITEM 1. LEGAL PROCEEDINGS

There have been no material changes in the legal matters described in Part I, Item 3 of the Company's Annual Report on Form 10-K for the year ended January 2, 2016, which is incorporated here by reference.

##### ITEM 1A. RISK FACTORS

Our business and financial results are subject to numerous risks and uncertainties. The risk and uncertainties have not changed materially from those reported in Item 1A in the Company's Annual Report on Form 10-K for the year ended January 2, 2016, which is incorporated here by reference.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table contains detail related to the repurchase of our common stock based on the date of trade during the quarter ended October 1, 2016.

2016 Fiscal Month	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as a Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May be Purchased Under the Plans or Programs
July 3 to Aug 6	707	\$ 59.60	—	2,320,000
Aug 7 to Sep 3	4,975	62.22	—	2,320,000
Sep 4 to Oct 1	—	—	—	2,320,000
	5,682		—	

Under our equity incentive plans, participants may pay the exercise price or satisfy all or a portion of the federal, state and local withholding tax obligations arising in connection with plan awards by electing to (a) have the Company withhold shares of common stock otherwise issuable under the award, (b) tender back shares received in connection with such award or (c) deliver other previously owned shares of common stock, in each case having a value equal to the exercise price or the amount to be withheld. During the quarter ended October 1, 2016, the Company acquired 5,682 shares in connection with transactions pursuant to equity incentive plans.

The Board of Directors has approved a repurchase program for up to 3.0 million shares of our common stock, which repurchase authority has no expiration date. Management is authorized to effect purchases from time to time in the open market or through privately negotiated transactions. From time to time, we may enter into a Rule10b5-1 trading plan for the purpose of repurchasing shares under this authorization. There are approximately 2.3 million shares of our common stock available for repurchase under this program.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description
12	Computation of Ratio of Earnings to Fixed Charges.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.
101	The following materials from Regal Beloit Corporation's Quarterly Report on Form 10-Q for the quarter ended October 1, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Income, (ii) the Condensed Consolidated Statements of Comprehensive Income, (iii) the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Equity, (v) the Condensed Consolidated Statements of Cash Flows, and (vi) Notes to Condensed Consolidated Financial Statements.

SIGNATURE

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.

REGAL BELOIT CORPORATION  
(Registrant)

/s/ Charles A. Hinrichs  
Charles A. Hinrichs  
Vice President  
Chief Financial Officer  
(Principal Financial Officer)

/s/ Robert J. Rehard  
Robert J. Rehard  
Vice President  
Corporate Controller  
(Principal Accounting Officer)

Date: November 10, 2016

INDEX TO EXHIBITS

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