

PARKER HANNIFIN CORP  
Form 10-Q  
May 07, 2013

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 March 31, 2013  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File number 1-4982

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

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

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

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

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

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

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

Large accelerated filer  Accelerated filer

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

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

Number of Common Shares outstanding at March 31, 2013 149,251,263

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Net sales	\$3,307,041	\$3,393,563	\$9,587,471	\$9,734,276
Cost of sales	2,569,189	2,590,315	7,468,608	7,386,079
Gross profit	737,852	803,248	2,118,863	2,348,197
Selling, general and administrative expenses	379,690	377,479	1,141,912	1,132,635
Interest expense	23,050	22,313	70,775	69,303
Other (income) expense, net	(3,439)	) 2,629	(31,062)	) (5,100)
Income before income taxes	338,551	400,827	937,238	1,151,359
Income taxes	81,959	88,138	259,584	298,169
Net income	256,592	312,689	677,654	853,190
Less: Noncontrolling interest in subsidiaries' earnings	32	615	391	3,332
Net income attributable to common shareholders	\$256,560	\$312,074	\$677,263	\$849,858
Earnings per share attributable to common shareholders:				
Basic	\$1.72	\$2.07	\$4.54	\$5.61
Diluted	\$1.68	\$2.01	\$4.46	\$5.49
Cash dividends per common share	\$0.43	\$0.39	\$1.25	\$1.13
See accompanying notes to consolidated financial statements.				

PARKER-HANNIFIN CORPORATION  
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Net income	\$256,592	\$312,689	\$677,654	\$853,190
Less: Noncontrolling interests in subsidiaries' earnings	32	615	391	3,332
Net income attributable to common shareholders	256,560	312,074	677,263	849,858
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment	(122,964 )	119,941	36,330	(230,326 )
Retirement benefits plan activity	34,263	19,096	102,103	56,392
Realized loss	51	51	153	153
Other comprehensive income (loss)	(88,650 )	139,088	138,586	(173,781 )
Less: Other comprehensive income (loss) for noncontrolling interests	46	(27,101 )	(1,478 )	(25,609 )
Other comprehensive income (loss) attributable to common shareholders	(88,696 )	166,189	140,064	(148,172 )
Total comprehensive income attributable to common shareholders	\$167,864	\$478,263	\$817,327	\$701,686

See accompanying notes to consolidated financial statements.

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

	(Unaudited) March 31, 2013	June 30, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,677,319	\$ 838,317
Accounts receivable, net	2,017,126	1,992,284
Inventories:		
Finished products	559,438	576,291
Work in process	785,168	692,042
Raw materials	128,466	132,399
	1,473,072	1,400,732
Prepaid expenses	136,268	137,429
Deferred income taxes	134,724	129,352
Total current assets	5,438,509	4,498,114
Plant and equipment	5,013,020	4,849,229
Less accumulated depreciation	3,183,305	3,129,261
	1,829,715	1,719,968
Other assets	859,731	931,126
Intangible assets, net	1,313,990	1,095,218
Goodwill	3,229,827	2,925,856
Total assets	\$ 12,671,772	\$ 11,170,282
<b>LIABILITIES</b>		
Current liabilities:		
Notes payable and long-term debt payable within one year	\$ 1,527,696	\$ 225,589
Accounts payable, trade	1,162,125	1,194,684
Accrued payrolls and other compensation	395,113	463,889
Accrued domestic and foreign taxes	120,352	153,809
Other accrued liabilities	443,263	448,042
Total current liabilities	3,648,549	2,486,013
Long-term debt	1,496,026	1,503,946
Pensions and other postretirement benefits	1,693,048	1,909,755
Deferred income taxes	127,159	88,091
Other liabilities	294,582	276,747
Total liabilities	7,259,364	6,264,552
<b>EQUITY</b>		
Shareholders' equity:		
Serial preferred stock, \$.50 par value; authorized 3,000,000 shares; none issued	—	—
Common stock, \$.50 par value; authorized 600,000,000 shares; issued 181,046,128 shares at March 31 and June 30	90,523	90,523
Additional capital	630,245	640,249
Retained earnings	8,229,106	7,787,175
Accumulated other comprehensive (loss)	(1,275,837	) (1,415,900
Treasury shares, at cost; 31,794,865 shares at March 31 and 31,415,530 shares at June 30	(2,264,979	) (2,205,532

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Total shareholders' equity	5,409,058	4,896,515
Noncontrolling interests	3,350	9,215
Total equity	5,412,408	4,905,730
Total liabilities and equity	\$12,671,772	\$11,170,282

See accompanying notes to consolidated financial statements.

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PARKER-HANNIFIN CORPORATION  
CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended	
	March 31,	
	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$677,654	\$853,190
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	159,803	159,505
Amortization	90,771	84,898
Share incentive plan compensation	65,516	64,102
Deferred income taxes	(1,858)	(54,928)
Foreign currency transaction loss	14,381	8,626
Gain on sale of plant and equipment	(2,080)	(2,921)
Gain on sale of businesses	(13,313)	—
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	39,518	(138,796)
Inventories	10,941	(55,329)
Prepaid expenses	580	11,367
Other assets	(27,457)	(26,360)
Accounts payable, trade	(64,202)	3,054
Accrued payrolls and other compensation	(80,636)	(40,216)
Accrued domestic and foreign taxes	(40,725)	(33,478)
Other accrued liabilities	(63,131)	52,368
Pensions and other postretirement benefits	(53,905)	89,078
Other liabilities	6,942	32,301
Net cash provided by operating activities	718,799	1,006,461
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Acquisitions (less cash acquired of \$33,932 in 2013 and \$6,802 in 2012)	(620,647)	(31,004)
Capital expenditures	(214,061)	(154,097)
Proceeds from sale of plant and equipment	24,321	15,560
Proceeds from sale of businesses	72,190	—
Other	(9,375)	(16,381)
Net cash (used in) investing activities	(747,572)	(185,922)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from exercise of stock options	28,928	8,451
Payments for common shares	(207,150)	(333,545)
Tax benefit from share incentive plan compensation	52,897	12,549
Acquisition of noncontrolling interests	(1,072)	(147,441)
Proceeds from notes payable, net	1,512,882	48,102
Proceeds from long-term borrowings	3,767	73,066
Payments for long-term borrowings	(329,970)	(73,405)
Dividends	(187,705)	(178,606)
Net cash provided by (used in) financing activities	872,577	(590,829)
Effect of exchange rate changes on cash	(4,802)	(113,717)
Net increase in cash and cash equivalents	839,002	115,993
Cash and cash equivalents at beginning of year	838,317	657,466

Cash and cash equivalents at end of period	\$1,677,319	\$773,459
See accompanying notes to consolidated financial statements.		

PARKER-HANNIFIN CORPORATION  
BUSINESS SEGMENT INFORMATION

(Dollars in thousands)

(Unaudited)

The Company operates in three reportable business segments: Industrial, Aerospace and Climate & Industrial Controls. The Industrial Segment is the largest and includes a significant portion of international operations.

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

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

Climate & Industrial Controls - This segment manufactures motion-control systems and components for use primarily in the refrigeration and air conditioning and transportation industries.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2012	2013	2012
Net sales				
Industrial:				
North America	\$1,283,649	\$1,315,357	\$3,747,401	\$3,703,526
International	1,241,464	1,286,751	3,587,315	3,794,678
Aerospace	578,026	542,760	1,647,765	1,536,757
Climate & Industrial Controls	203,902	248,695	604,990	699,315
Total	\$3,307,041	\$3,393,563	\$9,587,471	\$9,734,276
Segment operating income				
Industrial:				
North America	\$209,048	\$226,986	\$620,154	\$645,951
International	152,309	195,065	427,514	569,224
Aerospace	80,080	65,925	194,150	204,824
Climate & Industrial Controls	21,324	23,203	51,164	52,818
Total segment operating income	462,761	511,179	1,292,982	1,472,817
Corporate general and administrative expenses	41,410	38,377	126,578	142,529
Income before interest expense and other expense	421,351	472,802	1,166,404	1,330,288
Interest expense	23,050	22,313	70,775	69,303
Other expense	59,750	49,662	158,391	109,626
Income before income taxes	\$338,551	\$400,827	\$937,238	\$1,151,359



PARKER-HANNIFIN CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Dollars in thousands, except per share amounts

1. Management representation

In the opinion of the management of the Company, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of March 31, 2013, the results of operations for the nine months ended March 31, 2013 and 2012 and cash flows for the nine months then ended. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's 2012 Annual Report on Form 10-K and previously filed fiscal 2013 Form 10-Q's. Interim period results are not necessarily indicative of the results to be expected for the full fiscal year.

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

2. New accounting pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued new accounting guidance requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income (AOCI) by component. For items reclassified out of AOCI in their entirety, the disclosure of the income statement line where those items are reflected is also required. Cross-reference to disclosures providing additional information is required for other items not reclassified in their entirety. The guidance does not change the current requirements for reporting net income or other comprehensive income. The guidance, which must be presented prospectively, is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012.

3. Product warranty

In the ordinary course of business, the Company warrants its products against defects in design, materials and workmanship over various time periods. The warranty accrual as of March 31, 2013 and June 30, 2012 is immaterial to the financial position of the Company and the change in the accrual for the current quarter and first nine months of fiscal 2013 is immaterial to the Company's results of operations and cash flows.

## 4. Earnings per share

The following table presents a reconciliation of the numerator and denominator of basic and diluted earnings per share for the three and nine months ended March 31, 2013 and 2012.

	Three Months Ended		Nine Months Ended	
	March 31, 2013	2012	March 31, 2013	2012
Numerator:				
Net income attributable to common shareholders	\$256,560	\$312,074	\$677,263	\$849,858
Denominator:				
Basic - weighted average common shares	149,287,628	151,017,910	149,191,583	151,472,380
Increase in weighted average common shares from dilutive effect of equity-based awards	3,072,984	3,926,336	2,661,939	3,432,169
Diluted - weighted average common shares, assuming exercise of equity-based awards	152,360,612	154,944,246	151,853,522	154,904,549
Basic earnings per share	\$1.72	\$2.07	\$4.54	\$5.61
Diluted earnings per share	\$1.68	\$2.01	\$4.46	\$5.49

For the three months ended March 31, 2013 and 2012, 345,779 and 74,554 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive. For the nine months ended March 31, 2013 and 2012, 1,160,648 and 764,508 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive.

## 5. Share repurchase program

The Company has a program to repurchase its common shares. Under the program, the Company is authorized to repurchase an amount of common shares each fiscal year equal to the greater of 7.5 million shares or five percent of the shares outstanding as of the end of the prior fiscal year. Repurchases are funded primarily from operating cash flows and commercial paper borrowings, and the shares are initially held as treasury stock. During the three-month period ended March 31, 2013, the Company repurchased 529,000 shares at an average price, including commissions, of \$92.90 per share. Fiscal year-to-date, the Company repurchased 2,460,762 shares at an average price, including commissions, of \$83.84 per share.

## 6. Accounts receivable, net

The Accounts receivable, net caption in the Consolidated Balance Sheet is comprised of the following components:

	March 31, 2013	June 30, 2012
Accounts receivable, trade	\$1,816,475	\$1,792,961
Allowance for doubtful accounts	(13,089	) (10,518
Non-trade accounts receivable	101,961	84,872
Notes receivable	111,779	124,969
Total	\$2,017,126	\$1,992,284

Accounts receivable, trade are initially recorded at their net collectible amount and are generally recorded at the time the revenue from the sales transaction is recorded. Receivables are written off to bad debt primarily when, in the judgment of the Company, the receivable is deemed to be uncollectible due to the insolvency of the debtor.



7. Business realignment charges

To structure its businesses in light of current and anticipated customer demand, the Company incurred business realignment charges in fiscal 2013 and fiscal 2012.

Business realignment charges by business segment are as follows:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Industrial	\$ 1,688	\$ 3,133	\$ 6,826	\$ 10,031
Climate & Industrial Controls	263	192	630	340

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

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Industrial	183	152	501	356
Climate & Industrial Controls	1	8	31	12

The charges primarily consist of severance costs related to plant closures as well as general work force reductions implemented by various operating units throughout the world. In addition, \$1,918 of severance costs for 98 people have been recognized in connection with the Company's divestiture of its Turkey refrigeration components business and is reflected in the other expense caption in the Business Segment Information for the first nine months of fiscal 2013. The realignment charges for the three and nine months ended March 31, 2012 also include charges related to enhanced retirement benefits. The Company believes the realignment actions will positively impact future results of operations but will not have a material effect on liquidity and sources and uses of capital.

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

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Cost of sales	\$ 1,474	\$ 3,314	\$ 5,578	\$ 9,966
Selling, general and administrative expenses	477	11	1,878	405
Other (income) expense, net	—	—	1,918	—

As of March 31, 2013, approximately \$6.5 million in severance payments have been made relating to charges incurred during fiscal 2013, with the majority of the remaining payments expected to be made by September 30, 2013. All required severance payments have been made relating to charges incurred in fiscal 2012. Additional charges to be recognized in future periods related to the realignment actions described above are not expected to be material.

## 8. Equity

As of July 1, 2012, the Company adopted the provisions of FASB Accounting Standards Update No. 2011-05, "Presentation of Comprehensive Income." As a result of this adoption, the Company has presented total comprehensive income in a separate Statement of Comprehensive Income.

Changes in equity for the three months ended March 31, 2013 and 2012 are as follows:

	Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance at December 31, 2012	\$5,325,717	\$3,272	\$5,328,989
Net income	256,560	32	256,592
Other comprehensive income (loss)	(88,696	) 46	(88,650
Dividends paid	(64,377	) —	(64,377
Stock incentive plan activity	28,996	—	28,996
Shares purchased at cost	(49,142	) —	(49,142
Balance at March 31, 2013	\$5,409,058	\$3,350	\$5,412,408
	Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance at December 31, 2011	\$5,158,126	\$97,777	\$5,255,903
Net income	312,074	615	312,689
Other comprehensive income (loss)	166,189	(27,101	) 139,088
Dividends paid	(59,015	) (560	) (59,575
Stock incentive plan activity	28,912	—	28,912
Acquisition activity	(8,694	) (61,855	) (70,549
Shares purchased at cost	(20,000	) —	(20,000
Balance at March 31, 2012	\$5,577,592	\$8,876	\$5,586,468

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## 8. Equity, cont'd

Changes in equity for the nine months ended March 31, 2013 and 2012 are as follows:

	Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance at June 30, 2012	\$4,896,515	\$9,215	\$4,905,730
Net income	677,263	391	677,654
Other comprehensive income (loss)	140,064	(1,478)	) 138,586
Dividends paid	(186,978)	) (727)	) (187,705)
Stock incentive plan activity	85,282	—	85,282
Acquisition activity	3,231	(4,051)	) (820)
Shares purchased at cost	(206,319)	) —	(206,319)
Balance at March 31, 2013	\$5,409,058	\$3,350	\$5,412,408
	Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance at June 30, 2011	\$5,383,854	\$104,482	\$5,488,336
Net income	849,858	3,332	853,190
Other comprehensive income (loss)	(148,172)	) (25,609)	) (173,781)
Dividends paid	(171,106)	) (7,500)	) (178,606)
Stock incentive plan activity	68,744	—	68,744
Acquisition activity	(73,614)	) (65,829)	) (139,443)
Shares purchased at cost	(331,972)	) —	(331,972)
Balance at March 31, 2012	\$5,577,592	\$8,876	\$5,586,468

## 9. Goodwill and intangible assets

The changes in the carrying amount of goodwill for the nine months ended March 31, 2013 are as follows:

	Industrial Segment	Aerospace Segment	Climate & Industrial Controls Segment	Total
Balance at June 30, 2012	\$2,518,121	\$98,674	\$309,061	\$2,925,856
Acquisitions	318,674	—	—	318,674
Divestitures	(61	) —	(20,044	) (20,105
Foreign currency translation and other	3,047	(339	) 2,694	5,402
Balance at March 31, 2013	\$2,839,781	\$98,335	\$291,711	\$3,229,827

Acquisitions represent the original goodwill allocation, purchase price adjustments, and final adjustments to the purchase price allocation for the acquisitions during the measurement period subsequent to the applicable acquisition dates. The Company's previously reported results of operations and financial position would not be materially different had the goodwill adjustments recorded during the first nine months of fiscal 2013 been reflected in the same reporting period in which the initial purchase price allocations for those acquisitions were made.

Divestitures represent goodwill associated with businesses divested during the first nine months of fiscal 2013 as more fully discussed in Note 13.

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

	March 31, 2013		June 30, 2012	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patents	\$140,610	\$72,831	\$118,034	\$66,303
Trademarks	386,912	143,223	321,019	129,081
Customer lists and other	1,463,491	460,969	1,247,820	396,271
Total	\$1,991,013	\$677,023	\$1,686,873	\$591,655

Total intangible amortization expense for the nine months ended March 31, 2013 was \$88,431. The estimated amortization expense for the five years ending June 30, 2013 through 2017 is \$117,553, \$119,448, \$114,449, \$109,433, and \$105,646, respectively.

Intangible assets are evaluated for impairment whenever events or circumstances indicate that the undiscounted net cash flows to be generated by their use over their expected useful lives and eventual disposition may be less than their net carrying value. No such events or circumstances occurred during the nine months ended March 31, 2013.



## 10. Retirement benefits

Net pension benefit cost recognized included the following components:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2012	2013	2012
Service cost	\$24,839	\$21,350	\$79,856	\$63,974
Interest cost	43,329	45,981	131,322	138,720
Expected return on plan assets	(52,863	) (50,225	) (158,279	) (150,495
Amortization of prior service cost	3,618	3,505	10,846	10,512
Amortization of net actuarial loss	50,347	26,706	150,495	79,166
Amortization of initial net obligation (asset)	6	(15	) 18	(45
Net pension benefit cost	\$69,276	\$47,302	\$214,258	\$141,832

Net postretirement benefit cost recognized included the following components:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2012	2013	2012
Service cost	\$255	\$183	\$619	\$545
Interest cost	380	838	2,120	2,600
Net amortization and deferral and other	726	92	959	350
Net postretirement benefit cost	\$1,361	\$1,113	\$3,698	\$3,495

## 11. Income taxes

As of March 31, 2013, the Company had gross unrecognized tax benefits of \$109,292. The total amount of gross unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$64,136. If recognized, a significant portion of the gross unrecognized tax benefits would be offset against an asset currently recorded in the Consolidated Balance Sheet. The accrued interest related to the gross unrecognized tax benefits, excluded from the amounts above, was \$2,560.

The Company and its subsidiaries file income tax returns in the United States and in various foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities throughout the world. The Company is no longer subject to examinations of its federal income tax returns by the United States Internal Revenue Service for fiscal years through 2010. All significant state, local and foreign tax returns have been examined for fiscal years through 2003. The Company does not anticipate that the total amount of gross unrecognized tax benefits will significantly change due to the settlement of examinations and the expiration of statute of limitations within the next twelve months.

## 12. Financial instruments and fair value measurement

The Company's financial instruments consist primarily of cash and cash equivalents, long-term investments, and accounts receivable as well as obligations under accounts payable, trade, notes payable and long-term debt. Due to their short-term nature, the carrying values for cash and cash equivalents, accounts receivable, accounts payable, trade and notes payable approximate fair value. The carrying value of long-term debt (excluding capital leases) and estimated fair value of long-term debt (excluding capital leases) are as follows:

	March 31, 2013	June 30, 2012
Carrying value of long-term debt (excluding capital leases)	\$1,498,550	\$1,728,983
Estimated fair value of long-term debt (excluding capital leases)	1,766,208	2,005,887

The fair value of long-term debt was estimated using a discounted cash flow analysis based on the Company's current incremental borrowing rate for similar types of borrowing arrangements.

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

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

Derivative financial instruments are recognized on the Consolidated Balance Sheet as either assets or liabilities and are measured at fair value. Derivatives consist of forward exchange, costless collar and cross-currency swap contracts the fair value of which is calculated using market observable inputs including both spot and forward prices for the same underlying currencies. The fair value of the cross-currency swap contracts is calculated using a present value cash flow model that has been adjusted to reflect the credit risk of either the Company or the counterparty.

The following summarizes the location and fair value of derivative financial instruments reported in the Consolidated Balance Sheet as of March 31, 2013 and June 30, 2012:

	Balance Sheet Caption	March 31, 2013	June 30, 2012
Net investment hedges			
Cross-currency swap contracts	Other liabilities	\$11,813	\$2,008
Cash flow hedges			
Costless collar contracts	Accounts receivable	1,232	2,466
Forward exchange contracts	Accounts receivable	—	1,887
Costless collar contracts	Other accrued liabilities	3,728	552
Forward exchange contracts	Other accrued liabilities	8,272	—

## 12. Financial instruments and fair value measurement, cont'd

The fair values at March 31, 2013 and June 30, 2012 are classified within level 2 of the fair value hierarchy. There are no other financial assets or financial liabilities that are marked to market on a recurring basis. Fair values are transferred between levels of the fair value hierarchy when facts and circumstances indicate that a change in the method of estimating the fair value of a financial asset or financial liability is warranted.

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

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

Gains (losses) on derivative financial instruments that were recorded in the Consolidated Statement of Income are as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2012	2013	2012
Forward exchange contracts	\$(5,724	) \$11,031	\$(10,288	) \$(3,557
Costless collar contracts	(5,047	) (1,252	) (1,875	) 4,598

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2012	2013	2012
Cross-currency swap contracts	\$6,106	\$(6,633	) \$(6,057	) \$10,682
Foreign denominated debt	8,021	(1,268	) 5,165	15,397

There was no ineffectiveness of the cross-currency swap contracts or foreign denominated debt, nor was any portion of these financial instruments excluded from the effectiveness testing, during the nine months ended March 31, 2013 and 2012.

## 13. Acquisitions and divestitures

Acquisitions - During the first nine months of fiscal 2013, the Company completed eight acquisitions whose aggregate sales for their most recent fiscal year prior to acquisition were \$484 million. Total purchase price for the eight acquisitions was approximately \$621 million in cash and \$114 million in assumed debt.

Divestitures - During the first nine months of fiscal 2013, the Company divested the automotive businesses of its Mobile Climate Systems division and its Turkey refrigeration components business. Both of these businesses were part of the Climate & Industrial Controls Segment and had combined revenues of approximately \$158 million for their most recent fiscal year. The Company recorded a net pre-tax gain in the first nine months of fiscal 2013 of approximately \$17 million related to the divestitures. The gain is reflected in the other (income) expense, net caption in the Consolidated Statement of Income.

PARKER-HANNIFIN CORPORATION  
FORM 10-Q

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2013  
AND COMPARABLE PERIODS ENDED MARCH 31, 2012  
OVERVIEW

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

- Purchasing Managers Index (PMI) on manufacturing activity specific to regions around the world with respect to most mobile and industrial markets;
- Global aircraft miles flown and global revenue passenger miles for commercial aerospace markets and Department of Defense spending for military aerospace markets; and
- Housing starts with respect to the North American residential air conditioning market and certain mobile construction markets.

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

	March 31, 2013	December 31, 2012	June 30, 2012
United States	51.3	50.7	49.7
Eurozone countries	46.8	46.1	45.1
China	51.6	51.5	48.2

Global aircraft miles flown have increased approximately two percent from the comparable fiscal 2012 level and global revenue passenger miles have increased approximately three percent from the comparable fiscal 2012 level. The Company anticipates that U.S. Department of Defense spending with regard to appropriations and operations and maintenance for the U.S. Government's fiscal year 2013 will be slightly up from the comparable fiscal 2012 level. Housing starts in March 2013 were approximately 47 percent higher than housing starts in March 2012 and were approximately 9 percent higher than housing starts in December 2012.

The Company remains focused on maintaining its financial strength by adjusting its cost structure to reflect changing demand levels, maintaining a strong balance sheet and managing its cash. The Company has been able to borrow funds at affordable interest rates and had a debt to debt-shareholders' equity ratio of 35.9 percent at March 31, 2013 compared to 27.5 percent at December 31, 2012 and 26.1 percent at June 30, 2012. Net of cash and cash equivalents, the debt to debt-shareholders' equity ratio was 19.9 percent at March 31, 2013 compared to 22.2 percent at December 31, 2012 and 15.4 percent at June 30, 2012.

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

The Company believes it can meet its strategic objectives by:

- Serving the customer;
- Successfully executing its Win Strategy initiatives relating to premier customer service, financial performance and profitable growth;
- Maintaining its decentralized division and sales company structure;
- Fostering an entrepreneurial culture;
- Engineering innovative systems and products to provide superior customer value through improved service, efficiency and productivity;
- Delivering products, systems and services that have demonstrable savings to customers and are priced by the value they deliver;
- Acquiring strategic businesses;
- Organizing around targeted regions, technologies and markets;
- Driving efficiency by implementing lean enterprise principles; and
- Creating a culture of empowerment through its values, inclusion and diversity, accountability and teamwork.

During the first nine months of fiscal 2013, the Company completed eight acquisitions whose aggregate sales for their most recent fiscal year prior to acquisition were \$484 million. Acquisitions will continue to be considered from time to time to the extent there is a strong strategic fit, while at the same time, maintaining the Company's strong financial position. During the first nine months of fiscal 2013, the Company divested the automotive businesses of the Mobile Climate Systems division and the Turkey refrigeration components business. Both of the divested businesses were part of the Climate & Industrial Controls Segment. The Company recognized a net pre-tax gain of \$17 million related to the divestitures. The Company will continue to assess its existing businesses and initiate efforts to divest businesses that are not considered to be a good long-term strategic fit for the Company. Future business divestitures could have a negative effect on the Company's results of operations.

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

#### CONSOLIDATED STATEMENT OF INCOME

(dollars in millions)	Three Months Ended		Nine Months Ended		
	March 31,		March 31,		
	2013	2012	2013	2012	
Net sales	\$3,307.0	\$3,393.6	\$9,587.5	\$9,734.3	
Gross profit	\$737.9	\$803.2	\$2,118.9	\$2,348.2	
Gross profit margin	22.3	% 23.7	% 22.1	% 24.1	%
Selling, general and administrative expenses	\$379.7	\$377.5	\$1,141.9	\$1,132.6	
Selling, general and administrative expenses, as a percent of sales	11.5	% 11.1	% 11.9	% 11.6	%
Interest expense	\$23.1	\$22.3	\$70.8	\$69.3	
Other (income) expense, net	\$(3.4)	) \$2.6	\$(31.1)	) \$(5.1)	)
Effective tax rate	24.2	% 22.0	% 27.7	% 25.9	%
Net income	\$256.6	\$312.7	\$677.7	\$853.2	
Net income, as a percent of sales	7.8	% 9.2	% 7.1	% 8.8	%

Net sales for the current-year quarter and first nine months of fiscal 2013 decreased from the comparable prior-year periods primarily due to lower volume experienced in the Industrial International businesses and the Climate & Industrial Controls Segment offsetting slightly higher volume experienced in the Aerospace Segment. Net sales for the first nine months of fiscal 2013 benefited from slightly higher sales in the North American Industrial businesses. Acquisitions made in the last 12 months contributed approximately \$134 million and \$343 million in sales in the current-year quarter and first nine months of fiscal 2013, respectively. The effect of currency rate changes decreased net sales by approximately \$23 million in the current-year quarter and \$133 million for the first nine months of fiscal 2013.

Gross profit margin declined in the current-year quarter and first nine months of fiscal 2013 primarily due to higher defined benefit costs in all Segments, operating inefficiencies in the Industrial Segment and higher engineering development costs in the Aerospace Segment. Gross profit margin for the first nine months of fiscal 2013 was also adversely impacted by an unfavorable product mix in the Aerospace Segment.

Selling, general and administrative expenses increased slightly for the current-year quarter primarily due to an increase in intangible asset amortization expense and acquisition-related expenses as well as higher net expenses associated with the Company's incentive and deferred compensation programs. Selling, general and administrative expenses for the first nine months of fiscal 2013 were higher primarily due to an increase in intangible asset amortization expense partially offset by lower net expenses associated with the Company's incentive and deferred compensations programs.

Interest expense for the current-year quarter and first nine months of fiscal 2013 increased primarily due to higher weighted-average borrowings and higher interest rates on commercial paper borrowings.

Other (income) expense, net for the first nine months of fiscal 2013 includes a net gain of approximately \$17 million related to the divestiture of the automotive businesses of the Mobile Climate Systems division and the Turkey refrigeration components business.

Effective tax rate for the current-year quarter and first nine months of fiscal 2013 was higher than the comparable prior-year rates primarily due to an unfavorable geographical mix of earnings and the settlement of tax audits in the prior-year periods. The effective tax rate for the first nine months of fiscal 2013 was also adversely impacted by the tax effects of business divestitures. The unfavorable impact of these items was partially offset by the enactment of the American Taxpayer Relief Act on January 2, 2013. The Company expects the effective tax rate for fiscal 2013 will be approximately 28 percent.

## RESULTS BY BUSINESS SEGMENT

### Industrial Segment

(dollars in millions)	Three Months Ended		Nine Months Ended		
	March 31, 2013	2012	March 31, 2013	2012	
Net sales					
North America	\$1,283.6	\$1,315.4	\$3,747.4	\$3,703.5	
International	1,241.5	1,286.8	3,587.3	3,794.7	
Operating income					
North America	209.0	227.0	620.2	646.0	
International	\$152.3	\$195.1	\$427.5	\$569.2	
Operating margin					
North America	16.3	% 17.3	% 16.5	% 17.4	%
International	12.3	% 15.2	% 11.9	% 15.0	%
Backlog	\$1,714.4	\$1,887.8	\$1,714.4	\$1,887.8	

The Industrial Segment operations experienced the following percentage changes in net sales in the current-year period compared to the comparable prior-year period:

	Period ending March 31,			
	Three Months		Nine Months	
Industrial North America – as reported	(2.4	)%	1.2	)%
Acquisitions	5.5	%	4.6	%
Currency	(0.1	)%	—	)%
Industrial North America – without acquisitions and currency	(7.8	)%	(3.4	)%
Industrial International – as reported	(3.5	)%	(5.5	)%
Acquisitions	4.8	%	4.6	%
Currency	(1.7	)%	(3.4	)%
Industrial International – without acquisitions and currency	(6.6	)%	(6.7	)%
Total Industrial Segment – as reported	(3.0	)%	(2.2	)%
Acquisitions	5.1	%	4.6	%
Currency	(0.9	)%	(1.7	)%
Total Industrial Segment – without acquisitions and currency	(7.2	)%	(5.1	)%

The above presentation reconciles the percentage changes in net sales of the Industrial Segment operations reported in accordance with U.S. GAAP to percentage changes in net sales adjusted to remove the effects of acquisitions made within the prior four fiscal quarters as well as the effects of currency exchange rates. The effects of acquisitions and currency exchange rates are removed to allow investors and the Company to meaningfully evaluate the percentage changes in net sales on a comparable basis from period to period.

Excluding the effects of acquisitions and changes in currency exchange rates, the decrease in Industrial North American sales for the current-year quarter and first nine months of fiscal 2013 is primarily the result of lower demand from distributors as well as from end-users in most markets with the largest sales decline occurring in the construction equipment, oil and gas, mining, automotive and machine tool markets. The decrease in Industrial International sales for the current-year quarter and first nine months of fiscal 2013 is primarily attributable to lower volume across most markets in all regions with the largest decrease equally distributed between Europe and the Asia Pacific region.

The decrease in operating margins in the Industrial North American businesses is primarily due to an unfavorable product mix and operating inefficiencies resulting from the decrease in sales volume partially offset by the favorable effect of lower raw material prices. The decrease in operating margins in the Industrial International businesses is primarily due to the lower sales volume, resulting in operating inefficiencies, as well as the impact of integration costs related to current-year acquisitions.

The following business realignment expenses are included in Industrial North America and Industrial International operating income:

(dollars in millions)	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Industrial North America	\$0.7	\$2.0	\$1.1	\$3.0
Industrial International	1.0	1.1	5.7	7.0

The business realignment charges consist primarily of severance costs resulting from plant closures as well as general reductions in work force. The Industrial North America business realignment charges for the prior-year quarter also include expenses associated with enhanced retirement benefits. The Company does not anticipate that cost savings realized from the work force reductions taken during the first nine months of fiscal 2013 will have a material impact on future operating margins. The Company expects to continue to take the actions necessary to structure appropriately the operations of the Industrial Segment. Such actions may include the necessity to record additional business realignment charges in the remainder of fiscal 2013, the timing and amount of which has not been finalized.

The decrease in backlog from the prior-year quarter is primarily due to lower order rates in virtually all of the Industrial North American and Industrial International businesses with the decline in backlog split evenly between Industrial North America and Industrial International. The decrease in backlog from the June 30, 2012 amount of \$1,813.7 million is primarily attributable to lower order rates in the Industrial North American businesses. The Company anticipates Industrial North American sales for fiscal 2013 will range from a decrease of 0.1 percent to an increase of 1.9 percent from the fiscal 2012 level and Industrial International sales for fiscal 2013 will decrease between 4.3 percent and 1.5 percent from the fiscal 2012 level. Industrial North American operating margins in fiscal 2013 are expected to range from 16.8 percent to 17.0 percent and Industrial International operating margins are expected to range from 12.4 percent to 12.8 percent. The lower expected sales and operating margin levels in 2013 are primarily due to anticipated weakness in the Industrial Segment markets for the remainder of fiscal 2013.

Aerospace Segment

(dollars in millions)	Three Months Ended		Nine Months Ended			
	March 31,		March 31,			
	2013	2012	2013	2012		
Net sales	\$578.0	\$542.8	\$1,647.8	\$1,536.8		
Operating income	\$80.1	\$65.9	\$194.2	\$204.8		
Operating margin	13.9	% 12.1	% 11.8	% 13.3		%
Backlog	\$1,944.7	\$1,925.7	\$1,944.7	\$1,925.7		