PARKER HANNIFIN CORP
Form 10-Q
February 08, 2018

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

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2017
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 incorporation or organization) | (IRS Employer 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 ý No ¨
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act (check one):

| | |
|---|---|
| Large accelerated filer ý | Accelerated filer ¨ |
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | Smaller reporting company ¨ |
| | Emerging growth company ¨ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Number of Common Shares outstanding at December 31, 2017: 133,048,544

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 December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Net sales | $3,370,673 | $2,670,804 | $6,735,324 | $5,413,935 |
| Cost of sales | 2,569,070 | 2,044,484 | 5,101,948 | 4,150,490 |
| Selling, general and administrative expenses | 412,462 | 336,578 | 814,134 | 659,547 |
| Interest expense | 53,133 | 33,444 | 106,688 | 67,592 |
| Other (income), net | (24,213) | (64,424) | (21,969) | (76,661) |
| Income before income taxes | 360,221 | 320,722 | 734,523 | 612,967 |
| Income taxes | 303,899 | 79,322 | 392,666 | 161,329 |
| Net income | 56,322 | 241,400 | 341,857 | 451,638 |
| Less: Noncontrolling interest in subsidiaries' earnings | 163 | 95 | 301 | 204 |
| Net income attributable to common shareholders | $56,159 | $241,305 | $341,556 | $451,434 |
| | | | | |
| Earnings per share attributable to common shareholders: | | | | |
| Basic | $0.42 | $1.81 | $2.57 | $3.38 |
| Diluted | $0.41 | $1.78 | $2.51 | $3.33 |
| | | | | |
| Cash dividends per common share | $0.66 | $0.63 | $1.32 | $1.26 |

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(Dollars in thousands)
(Unaudited)

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Net income | $56,322 | $241,400 | $341,857 | $451,638 |
| Less: Noncontrolling interests in subsidiaries' earnings | 163 | 95 | 301 | 204 |
| Net income attributable to common shareholders | 56,159 | 241,305 | 341,556 | 451,434 |
| | | | | |
| Other comprehensive income (loss), net of tax | | | | |
| Foreign currency translation adjustment and other | 28,389 | (261,914) | 101,269 | (253,734) |
| Retirement benefits plan activity | 28,312 | 36,173 | 55,047 | 70,335 |
| Other comprehensive income (loss) | 56,701 | (225,741) | 156,316 | (183,399) |
| Less: Other comprehensive (loss) for noncontrolling interests | (73) | (69) | (160) | (20) |
| Other comprehensive income (loss) attributable to common shareholders | 56,774 | (225,672) | 156,476 | (183,379) |
| Total comprehensive income attributable to common shareholders | $112,933 | $15,633 | $498,032 | $268,055 |

See accompanying notes to consolidated financial statements.

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

| | (Unaudited) December 31, 2017 | June 30, 2017 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $1,024,770 | $884,886 |
| Marketable securities and other investments | 107,976 | 39,318 |
| Trade accounts receivable, net | 1,857,282 | 1,930,751 |
| Non-trade and notes receivable | 313,221 | 254,987 |
| Inventories | 1,780,262 | 1,549,494 |
| Prepaid expenses | 202,848 | 120,282 |
| Total current assets | 5,286,359 | 4,779,718 |
| Plant and equipment | 5,300,983 | 5,186,748 |
| Less: Accumulated depreciation | 3,363,909 | 3,249,456 |
| Plant and equipment, net | 1,937,074 | 1,937,292 |
| Deferred income taxes | 36,668 | 36,057 |
| Investments and other assets | 832,269 | 842,475 |
| Intangible assets, net | 2,174,104 | 2,307,484 |
| Goodwill | 5,698,707 | 5,586,878 |
| Total assets | $15,965,181 | $15,489,904 |
| LIABILITIES | | |
| Current liabilities: | | |
| Notes payable and long-term debt payable within one year | $1,248,212 | $1,008,465 |
| Accounts payable, trade | 1,229,336 | 1,300,496 |
| Accrued payrolls and other compensation | 327,743 | 435,911 |
| Accrued domestic and foreign taxes | 163,405 | 153,137 |
| Other accrued liabilities | 569,007 | 497,851 |
| Total current liabilities | 3,537,703 | 3,395,860 |
| Long-term debt | 4,798,371 | 4,861,895 |
| Pensions and other postretirement benefits | 1,363,466 | 1,406,082 |
| Deferred income taxes | 137,196 | 221,790 |
| Other liabilities | 609,235 | 336,931 |
| Total liabilities | 10,445,971 | 10,222,558 |
| EQUITY | | |
| Shareholders’ equity: | | |
| Serial preferred stock, $.50 par value; authorized 3,000,000 shares; none issued | — | — |
| Common stock, $.50 par value; authorized 600,000,000 shares; issued 181,046,128 shares at December 31 and June 30 | 90,523 | 90,523 |
| Additional capital | 534,003 | 543,879 |
| Retained earnings | 11,095,717 | 10,930,348 |
| Accumulated other comprehensive (loss) | (1,767,728) | (1,924,204) |
| Treasury shares, at cost; 47,997,584 shares at December 31 and 47,854,475 shares at June 30 | (4,439,114) | (4,378,897) |
| Total shareholders’ equity | 5,513,401 | 5,261,649 |
| Noncontrolling interests | 5,809 | 5,697 |
| Total equity | 5,519,210 | 5,267,346 |

| | | |
|---|---|---|
| Total liabilities and equity | $15,965,181 | $15,489,904 |

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

| | Six Months Ended December 31, 2017 | 2016 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $341,857 | $451,638 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation | 120,335 | 92,634 |
| Amortization | 113,881 | 56,451 |
| Share incentive plan compensation | 64,267 | 47,161 |
| Deferred income taxes | (74,101) | 70,976 |
| Foreign currency transaction loss (gain) | 12,620 | (853) |
| (Gain) loss on sale of plant and equipment | (26,529) | 310 |
| (Gain) on sale of businesses | — | (44,930) |
| (Gain) on sale of marketable securities | (1) | (230) |
| Loss on sale and impairment of investments | 33,759 | — |
| Changes in assets and liabilities, net of effect of acquisitions: | | |
| Accounts receivable, net | 49,986 | 160,500 |
| Inventories | (207,334) | (97,440) |
| Prepaid expenses | (81,168) | (31,038) |
| Other assets | (42,147) | (1,625) |
| Accounts payable, trade | (92,267) | (18,258) |
| Accrued payrolls and other compensation | (111,687) | (104,710) |
| Accrued domestic and foreign taxes | 5,796 | 1,003 |
| Other accrued liabilities | 59,003 | (4,705) |
| Pensions and other postretirement benefits | 25,379 | (176,993) |
| Other liabilities | 268,688 | 4,285 |
| Net cash provided by operating activities | 460,337 | 404,176 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Acquisitions (net of cash acquired of $1,760 in 2016) | — | (29,927) |
| Capital expenditures | (144,781) | (71,356) |
| Proceeds from sale of plant and equipment | 59,848 | 4,991 |
| Proceeds from sale of businesses | — | 85,610 |
| Purchases of marketable securities and other investments | (78,309) | (393,909) |
| Maturities of marketable securities and other investments | 12,710 | 506,642 |
| Other | 5,143 | 241 |
| Net cash (used in) provided by investing activities | (145,389) | 102,292 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from exercise of stock options | 2,076 | 1,890 |
| Payments for common shares | (136,436) | (196,000) |
| Proceeds from notes payable, net | 138,900 | 226,499 |
| Proceeds from long-term borrowings | 1,718 | — |
| Payments for long-term borrowings | (12,895) | (4,074) |
| Dividends | (176,187) | (168,990) |
| Net cash (used in) financing activities | (182,824) | (140,675) |
| Effect of exchange rate changes on cash | 7,760 | (66,710) |

| | | |
|---|---|---|
| Net increase in cash and cash equivalents | 139,884 | 299,083 |
| Cash and cash equivalents at beginning of year | 884,886 | 1,221,653 |
| Cash and cash equivalents at end of period | $1,024,770 | $1,520,736 |

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION
BUSINESS SEGMENT INFORMATION
(Dollars in thousands)
(Unaudited)

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

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

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

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Net sales | | | | |
| Diversified Industrial: | | | | |
| North America | $1,565,416 | $1,121,053 | $3,160,107 | $2,288,024 |
| International | 1,255,569 | 1,005,968 | 2,494,343 | 2,020,891 |
| Aerospace Systems | 549,688 | 543,783 | 1,080,874 | 1,105,020 |
| Total net sales | $3,370,673 | $2,670,804 | $6,735,324 | $5,413,935 |
| Segment operating income | | | | |
| Diversified Industrial: | | | | |
| North America | $225,807 | $184,013 | $481,834 | $384,624 |
| International | 164,806 | 127,517 | 356,597 | 264,713 |
| Aerospace Systems | 87,148 | 72,516 | 164,582 | 145,797 |
| Total segment operating income | 477,761 | 384,046 | 1,003,013 | 795,134 |
| Corporate general and administrative expenses | 46,942 | 43,926 | 88,292 | 74,960 |
| Income before interest expense and other expense | 430,819 | 340,120 | 914,721 | 720,174 |
| Interest expense | 53,133 | 33,444 | 106,688 | 67,592 |
| Other expense (income) | 17,465 | (14,046) | 73,510 | 39,615 |
| Income before income taxes | $360,221 | $320,722 | $734,523 | $612,967 |

PARKER-HANNIFIN CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Dollars in thousands, except per share amounts

1. Management representation
In the opinion of the management of the Company, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company's financial position as of December 31, 2017, the results of operations for the three and six months ended December 31, 2017 and 2016 and cash flows for the six months then ended. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's 2017 Annual Report on Form 10-K. Interim period results are not necessarily indicative of the results to be expected for the full fiscal year.
The Company has evaluated subsequent events that have occurred through the date these financial statements were issued. No subsequent events have occurred that required adjustment to these financial statements.

2. New Accounting Pronouncements
In August 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-12, "Targeted Improvements to Accounting for Hedging Activities." ASU 2017-12 provides targeted improvements to Topic 815 accounting for hedging activities by expanding an entity's ability to hedge non-financial and financial risk components and reduce complexity in fair value hedges of interest rate risk. The guidance eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The guidance also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. ASU 2017-12 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early application is permitted in any interim period after issuance of the update. ASU 2017-12 should be applied using a modified retrospective approach for cash flow and net investment hedge relationships that exist on the date of adoption, and prospectively for presentation and disclosure requirements. The Company has not yet determined the effect that ASU 2017-12 will have on its financial statements.
In May 2017, the FASB issued ASU 2017-09, "Scope of Modification Accounting." ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all of the following are met: (1) the fair value of the modified award is the same as fair value of the original award; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) the classification of the award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. ASU 2017-09 is effective for fiscal years, and interim periods within those years, beginning after December 31, 2017. Early adoption is permitted. ASU 2017-09 should be applied prospectively to an award modified on or after the adoption date. During the first quarter of fiscal 2018, the Company adopted ASU 2017-09. The adoption of ASU 2017-09 did not affect the Company's financial statements as there were no modifications of any share-based awards during the first six months of fiscal 2018.
In March 2017, the FASB issued ASU 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." ASU 2017-07 requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. ASU 2017-07 also provides that only the service cost component is eligible for capitalization, when applicable. ASU 2017-07 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued. ASU 2017-07 should be applied retrospectively for the income statement presentation of net periodic

pension cost and net periodic postretirement benefit cost and prospectively, on or after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit cost. The Company has not yet determined the effect that ASU 2017-07 will have on its financial statements.

2. New Accounting Pronouncements, cont'd

In January 2017, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment." ASU 2017-04 eliminates Step 2 from the goodwill impairment test. Under the amendments in this Update, an entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 also eliminates the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. ASU 2017-04 is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted. During the first quarter of fiscal 2018, the Company adopted ASU 2017-04. The adoption of ASU 2017-04 did not affect the Company's financial statements as there were no goodwill impairment tests performed during the first six months of fiscal 2018.

In October 2016, the FASB issued ASU 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory." ASU 2016-16 provides that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in ASU 2016-16 eliminate the exception for an intra-entity transfer of an asset other than inventory. ASU 2016-16 is effective for fiscal years, and interim periods within those years, beginning after December 31, 2017. Early adoption is permitted. The Company currently estimates that the adoption of ASU 2016-16 will eliminate a $57 million income tax deferred charge recorded in the Consolidated Balance Sheet as of December 31, 2017.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides specific guidance on several cash flow classification issues to reduce diversity in practice in how certain transactions are classified within the statement of cash flows. ASU 2016-15 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted. The Company has not yet determined the effect that ASU 2016-15 will have on its financial statements.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments." ASU 2016-13 requires a financial asset (or a group of financial assets) measured at amortized cost to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. ASU 2016-13 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. Early adoption is permitted. The Company has not yet determined the effect that ASU 2016-13 will have on its financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 requires lessees to put most leases on their balance sheet by recognizing a liability to make lease payments and an asset representing their right to use the asset during the lease term. Lessee recognition, measurement, and presentation of expenses and cash flows will not change significantly from existing guidance. Lessor accounting is also largely unchanged from existing guidance. ASU 2016-02 requires qualitative and quantitative disclosures that provide information about the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. The Company has not yet determined the effect that ASU 2016-02 will have on its financial statements.

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

2. New Accounting Pronouncements, cont'd

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration that a company expects to be entitled to in exchange for the goods or services. To achieve this principle, a company must apply five steps including identifying the contract with a customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to the performance obligations, and recognizing revenue when (or as) the company satisfies the performance obligations. Additional quantitative and qualitative disclosure to enhance the understanding about the nature, amount, timing, and uncertainty of revenue and cash flows is also required. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. In April 2016, the FASB issued ASU 2016-10, "Identifying Performance Obligations and Licensing." ASU 2016-10 clarifies the following two aspects of ASU 2014-09: identifying performance obligations and licensing implementation guidance. The effective date of ASU 2016-10 is the same as the effective date of ASU 2014-09. The Company currently anticipates using the modified retrospective method to adopt ASU 2014-09. The Company is still in the process of quantifying the impact of the adoption of ASU 2014-09, but at this time the Company does not expect the adoption to have a material impact on its financial statements.

3. Earnings per share

The following table presents a reconciliation of the numerator and denominator of basic and diluted earnings per share for the three and six months ended December 31, 2017 and 2016.

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Numerator: | | | | |
| Net income attributable to common shareholders | $56,159 | $ 241,305 | $341,556 | $ 451,434 |
| Denominator: | | | | |
| Basic - weighted average common shares | 133,112,568 | 133,320,109 | 133,144,766 | 133,499,744 |
| Increase in weighted average common shares from dilutive effect of equity-based awards | 3,082,351 | 2,492,651 | 2,729,764 | 2,096,963 |
| Diluted - weighted average common shares, assuming exercise of equity-based awards | 136,194,919 | 135,812,760 | 135,874,530 | 135,596,707 |
| Basic earnings per share | $0.42 | $ 1.81 | $2.57 | $ 3.38 |
| Diluted earnings per share | $0.41 | $ 1.78 | $2.51 | $ 3.33 |

For the three months ended December 31, 2017 and 2016, 3,245 and 848,657 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive. For the six months ended December 31, 2017 and 2016, 706,512 and 1,860,081 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive.

4. Share repurchase program

The Company has a program to repurchase its common shares. On October 22, 2014, the Board of Directors of the Company approved an increase in the overall number of shares authorized for repurchase under the program so that, beginning on such date, the aggregate number of shares authorized for repurchase was 35 million. There is no limitation on the number of shares that can be repurchased in a fiscal year. Repurchases may be funded primarily from operating cash flows and commercial paper borrowings and the shares are initially held as treasury shares. During the three-month period ended December 31, 2017, the Company repurchased 270,501 shares at an average price, including commissions, of $184.84 per share. During the six-month period ended December 31, 2017, the Company repurchased 576,538 at an average price, including commissions, of $173.45 per share.

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5. Trade accounts receivable, net

Trade accounts receivable are initially recorded at their net collectible amount and are generally recorded at the time the revenue from the sales transaction is recorded. Receivables are written off to bad debt primarily when, in the judgment of the Company, the receivable is deemed to be uncollectible due to the insolvency of the debtor. Allowance for doubtful accounts was $12,082 and $14,336 at December 31, 2017 and June 30, 2017, respectively.

6. Non-trade and notes receivable

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

| | December 31, 2017 | June 30, 2017 |
|---|---|---|
| Notes receivable | $ 155,166 | $118,351 |
| Accounts receivable, other | 158,055 | 136,636 |
| Total | $ 313,221 | $254,987 |

7. Inventories

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

| | December 31, 2017 | June 30, 2017 |
|---|---|---|
| Finished products | $ 752,213 | $642,788 |
| Work in process | 824,356 | 723,133 |
| Raw materials | 203,693 | 183,573 |
| Total | $ 1,780,262 | $1,549,494 |

8. Business realignment charges

The Company incurred business realignment charges in fiscal 2018 and fiscal 2017. The Company also incurred acquisition integration costs in fiscal 2018 related to the fiscal 2017 acquisition of CLARCOR, Inc.

Business realignment charges and acquisition integration costs presented in the Business Segment Information are as follows:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Diversified Industrial | $24,684 | $6,814 | $37,947 | $17,559 |
| Aerospace Systems | 692 | 1,083 | 1,455 | 1,083 |

Work force reductions in connection with such business realignment charges and acquisition integration costs in the Business Segment Information are as follows:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Diversified Industrial | 723 | 157 | 1,265 | 330 |
| Aerospace Systems | 19 | 37 | 56 | 37 |

8. Business realignment charges, cont'd

The business realignment charges primarily consist of severance costs related to actions taken under the Company's simplification initiative aimed at reducing organizational and process complexity, as well as plant closures, with the majority of the charges incurred in Europe and North America. 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 and acquisition integration costs are presented in the Consolidated Statement of Income as follows:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Cost of sales | $13,657 | $6,606 | $22,772 | $14,626 |
| Selling, general and administrative expenses | 11,719 | 1,291 | 16,630 | 4,016 |

As of December 31, 2017, approximately $12 million in severance payments had been made relating to business realignment charges incurred during fiscal 2018, the remainder of which are expected to be paid by December 31, 2018. Severance payments relating to prior-year business realignment actions are being made as required. Remaining severance payments related to current-year and prior-year business realignment actions of approximately $36 million are primarily reflected within the other accrued liabilities caption in the Consolidated Balance Sheet. Additional charges may be recognized in future periods related to the business realignment actions described above, the timing and amount of which are not known at this time.

9. Equity

Changes in equity for the three months ended December 31, 2017 and 2016 are as follows:

| | Shareholders' Equity | Noncontrolling Interests | Total Equity |
|---|---|---|---|
| Balance at September 30, 2017 | $5,524,940 | $ 5,719 | $5,530,659 |
| Net income | 56,159 | 163 | 56,322 |
| Other comprehensive income (loss) | 56,774 | (73) | 56,701 |
| Dividends paid | (88,082) | — | (88,082) |
| Stock incentive plan activity | 13,610 | — | 13,610 |
| Shares purchased at cost | (50,000) | — | (50,000) |
| Balance at December 31, 2017 | $5,513,401 | $ 5,809 | $5,519,210 |

| | Shareholders' Equity | Noncontrolling Interests | Total Equity |
|---|---|---|---|
| Balance at September 30, 2016 | $4,647,281 | $ 3,308 | $4,650,589 |
| Net income | 241,305 | 95 | 241,400 |
| Other comprehensive (loss) | (225,672) | (69) | (225,741) |
| Dividends paid | (84,176) | (65) | (84,241) |
| Stock incentive plan activity | (1,029) | — | (1,029) |
| Shares purchased at cost | (50,000) | — | (50,000) |
| Balance at December 31, 2016 | $4,527,709 | $ 3,269 | $4,530,978 |

9. Equity, cont'd

Changes in equity for the six months ended December 31, 2017 and 2016 are as follows:

| | Shareholders' Equity | Noncontrolling Interests | Total Equity |
|---|---|---|---|
| Balance at June 30, 2017 | $5,261,649 | $ 5,697 | $5,267,346 |
| Net income | 341,556 | 301 | 341,857 |
| Other comprehensive income (loss) | 156,476 | (160) | 156,316 |
| Dividends paid | (176,187) | — | (176,187) |
| Stock incentive plan activity | 29,907 | — | 29,907 |
| Acquisition activity | — | (29) | (29) |
| Shares purchased at cost | (100,000) | — | (100,000) |
| Balance at December 31, 2017 | $5,513,401 | $ 5,809 | $5,519,210 |

| | Shareholders' Equity | Noncontrolling Interests | Total Equity |
|---|---|---|---|
| Balance at June 30, 2016 | $4,575,255 | $ 3,423 | $4,578,678 |
| Net income | 451,434 | 204 | 451,638 |
| Other comprehensive (loss) | (183,379) | (20) | (183,399) |
| Dividends paid | (168,652) | (338) | (168,990) |
| Stock incentive plan activity | 17,743 | — | 17,743 |
| Shares purchased at cost | (164,692) | — | (164,692) |
| Balance at December 31, 2016 | $4,527,709 | $ 3,269 | $4,530,978 |

Changes in accumulated other comprehensive (loss) in shareholders' equity by component for the six months ended December 31, 2017 and 2016 are as follows:

| | Foreign Currency Translation Adjustment and Other | Retirement Benefit Plans | Total |
|---|---|---|---|
| Balance at June 30, 2017 | $(925,342) | $(998,862) | $(1,924,204) |
| Other comprehensive income before reclassifications | 101,429 | — | 101,429 |
| Amounts reclassified from accumulated other comprehensive (loss) | — | 55,047 | 55,047 |
| Balance at December 31, 2017 | $(823,913) | $(943,815) | $(1,767,728) |

| | Foreign Currency Translation Adjustment and Other | Retirement Benefit Plans | Total |
|---|---|---|---|
| Balance at June 30, 2016 | $(844,121) | $(1,383,644) | $(2,227,765) |
| Other comprehensive (loss) before reclassifications | (253,484) | — | (253,484) |
| Amounts reclassified from accumulated other comprehensive (loss) | (230) | 70,335 | 70,105 |
| Balance at December 31, 2016 | $(1,097,835) | $(1,313,309) | $(2,411,144) |

9. Equity, cont'd

Significant reclassifications out of accumulated other comprehensive (loss) in shareholders' equity for the three and six months ended December 31, 2017 and 2016 are as follows:

| Details about Accumulated Other Comprehensive (Loss) Components | Income (Expense) Reclassified from Accumulated Other Comprehensive (Loss) | | Consolidated Statement of Income Classification |
|---|---|---|---|
| | Three Months Ended December 31, 2017 | Six Months Ended December 31, 2017 | |
| Retirement benefit plans | | | |
| Amortization of prior service cost and initial net obligation | $(1,545) | $(3,683) | See Note 11 |
| Recognized actuarial loss | (35,929) | (74,960) | See Note 11 |
| Total before tax | (37,474) | (78,643) | |
| Tax benefit | 9,162 | 23,596 | Income taxes |
| Net of tax | $(28,312) | $(55,047) | |

| Details about Accumulated Other Comprehensive (Loss) Components | Income (Expense) Reclassified from Accumulated Other Comprehensive (Loss) | | Consolidated Statement of Income Classification |
|---|---|---|---|
| | Three Months Ended December 31, 2016 | Six Months Ended December 31, 2016 | |
| Retirement benefit plans | | | |
| Amortization of prior service cost and initial net obligation | $(1,717) | $(3,467) | See Note 11 |
| Recognized actuarial loss | (54,558) | (106,218) | See Note 11 |
| Total before tax | (56,275) | (109,685) | |
| Tax benefit | 20,102 | 39,350 | Income taxes |
| Net of tax | $(36,173) | $(70,335) | |

10. Goodwill and intangible assets

The changes in the carrying amount of goodwill for the six months ended December 31, 2017 are as follows:

| | Diversified Industrial | Aerospace Systems | Total |
|---|---|---|---|

| | Segment | Segment | |
|---|---|---|---|
| Balance at June 30, 2017 | $5,488,236 | $ 98,642 | $5,586,878 |
| Acquisitions | 40,125 | — | 40,125 |
| Foreign currency translation and other | 71,689 | 15 | 71,704 |
| Balance at December 31, 2017 | $5,600,050 | $ 98,657 | $5,698,707 |

Acquisitions represent adjustments to purchase price allocations during the measurement period subsequent to the applicable acquisition dates. The impact of purchase price allocation adjustments made during the first six months of fiscal 2018 on the Company's results of operations and financial position were immaterial.

10. Goodwill and intangible assets, cont'd

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

| | December 31, 2017 | | June 30, 2017 | |
|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Patents | $267,706 | $ 110,912 | $254,049 | $ 100,860 |
| Trademarks | 558,178 | 217,017 | 553,691 | 200,413 |
| Customer lists and other | 2,538,551 | 862,402 | 2,566,983 | 765,966 |
| Total | $3,364,435 | $ 1,190,331 | $3,374,723 | $ 1,067,239 |

Total intangible amortization expense for the six months ended December 31, 2017 was $110,746. The estimated amortization expense for the five years ending June 30, 2018 through 2022 is $215,424, $205,080, $196,218, $187,406 and $151,240, respectively.

Intangible assets are evaluated for impairment whenever events or circumstances indicate that the undiscounted net cash flows to be generated by their use over their expected useful lives and eventual disposition may be less than their net carrying value. No such events or circumstances occurred during the six months ended December 31, 2017.

11. Retirement benefits

Net pension benefit cost recognized included the following components:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | December 31, | | December 31, | |
| | 2017 | 2016 | 2017 | 2016 |
| Service cost | $18,242 | $23,116 | $41,300 | $47,339 |
| Interest cost | 36,138 | 29,972 | 71,824 | 61,468 |
| Expected return on plan assets | (65,350 ) | (60,180 ) | (128,526) | (117,797 ) |
| Amortization of prior service cost | 1,511 | 1,683 | 3,615 | 3,399 |
| Amortization of net actuarial loss | 35,468 | 54,325 | 74,150 | 105,752 |
| Amortization of initial net obligation | 5 | 5 | 10 | 10 |
| Net pension benefit cost | $26,014 | $48,921 | $62,373 | $100,171 |

During the three months ended December 31, 2017 and 2016, the Company recognized $1,091 and $1,116, respectively, in expense related to other postretirement benefits. During the six months ended December 31, 2017 and 2016, the Company recognized $2,180 and $2,232, respectively, in expense related to other postretirement benefits.

12. Income taxes

On December 22, 2017, the U.S. Tax Cuts and Jobs Act ("the TCJ Act") was enacted into law. The TCJ Act significantly reforms the Internal Revenue Code of 1986, as amended, by among other things, establishing a flat corporate income tax rate of 21 percent and creating a territorial tax system (with a one-time transition tax imposed on previously unremitted foreign earnings and profits).

The reduction in the U.S. corporate tax rate under the TCJ Act required a one-time revaluation of certain tax-related assets and liabilities to reflect their value at the reduced corporate tax rate of 21 percent which resulted in a decrease in income tax expense for the three months ended December 31, 2017 of approximately $62 million. The one-time transition tax on previously unremitted foreign earnings and profits resulted in an increase in income tax expense for the three months ended December 31, 2017 of $287 million. The Company intends to make the election to pay the one-time transition tax over eight years. The amounts recorded for both the revaluation of certain tax-related assets and liabilities and the one-time transition tax on previously unremitted foreign earnings and profits have been recorded as reasonable estimates based on the Company's analysis performed to date and will be revised, as necessary, once the estimates used in the Company's analysis have been finalized.

12. Income taxes, cont'd

The TCJ Act also establishes new tax laws that will affect future tax years, including, but not limited to, the creation of the base erosion anti-abuse tax, a general limitation of U.S. federal income taxes on dividends from foreign subsidiaries, and a new provision designed to tax global intangible low-taxed income. The Company continues to evaluate the future impacts of these provisions and has not recorded any impact of the TCJ Act aside from those previously mentioned.

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 open to assessment of its federal income tax returns by the U.S. Internal Revenue Service for fiscal years after 2011, and its state and local returns for fiscal years after 2011. The Company is also open to assessment for foreign jurisdictions for fiscal years after 2007. Unrecognized tax benefits reflect the difference between positions taken or expected to be taken on income tax returns and the amounts reflected in the financial statements.

As of December 31, 2017, the Company had gross unrecognized tax benefits of $152,705. The total amount of gross unrecognized tax benefits that, if recognized, would affect the effective tax rate was $100,163. If recognized, a significant portion of the gross unrecognized tax benefits would be offset against an asset currently recorded in the Consolidated Balance Sheet. The accrued interest related to the gross unrecognized tax benefits, excluded from the amounts above, is $17,864. It is reasonably possible that within the next 12 months the amount of gross unrecognized tax benefits could be reduced by up to approximately $110,000 as a result of the revaluation of existing uncertain tax positions arising from developments in the examination process or the closure of tax statutes. Any increase in the amount of gross unrecognized tax benefits within the next 12 months is expected to be insignificant.

13. Financial instruments

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

Marketable securities and other investments include deposits, which are recorded at cost, and investments classified as available-for-sale, which are recorded at fair value with unrealized gains and losses recorded in accumulated other comprehensive (loss). Gross unrealized gains and losses were not material as of December 31, 2017 and June 30, 2017. There were no facts or circumstances that indicated the unrealized losses were other than temporary.

The contractual maturities of available-for-sale investments at December 31, 2017 and June 30, 2017 are as follows:

| | December 31, 2017 | | June 30, 2017 | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Less than one year | $1,085 | $1,087 | $690 | $693 |
| One to three years | 7,800 | 7,861 | 7,865 | 7,924 |
| Above three years | 1,798 | 1,805 | 2,108 | 2,113 |

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

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

| | December 31, 2017 | June 30, 2017 |
|---|---|---|
| Carrying value of long-term debt | $ 5,418,171 | $5,383,343 |
| Estimated fair value of long-term debt | 5,712,883 | 5,645,529 |

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

13. Financial instruments, cont'd

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 EUR 700 million aggregate principal amount of Senior Notes due 2025 have been designated as a hedge of the Company’s net investment in certain foreign subsidiaries. The translation of the Senior Notes due 2025 into U.S. dollars is recorded in accumulated other comprehensive (loss) and remains there until the underlying net investment is sold or substantially liquidated.

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

The following summarizes the location and fair value of significant derivative financial instruments reported in the Consolidated Balance Sheet as of December 31, 2017 and June 30, 2017:

| | Balance Sheet Caption | December 31, 2017 | June 30, 2017 |
|---|---|---|---|
| Net investment hedges | | | |
| Cross-currency swap contracts | Other assets | $ — | $15,135 |
| Cross-currency swap contracts | Other liabilities | 516 | — |
| Cash flow hedges | | | |
| Costless collar contracts | Non-trade and notes receivable | 1,142 | 430 |
| Costless collar contracts | Other accrued liabilities | 3,654 | 2,027 |

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

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

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

Gains or losses on derivative financial instruments that were recorded in the Consolidated Statement of Income for the three and six months ended December 31, 2017 and 2016 were not material.

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

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Cross-currency swap contracts | $(2,725) | $8,907 | $(9,298) | $5,019 |
| Foreign denominated debt | (10,893) | 4,934 | (27,727) | 4,261 |

There was no ineffectiveness of the cross-currency swap contracts or foreign denominated debt, nor was any portion of these financial instruments excluded from the effectiveness testing, during the six months ended December 31, 2017 and 2016.

13. Financial instruments, cont'd

A summary of financial assets and liabilities that were measured at fair value on a recurring basis at December 31, 2017 and June 30, 2017 are as follows:

| | Fair Value at December 31, 2017 | Quoted Prices In Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets: | | | | |
| Equity securities | $ 4,574 | $ 4,574 | $ — | $ — |
| Corporate bonds | 6,239 | 6,239 | — | — |
| Asset-backed and mortgage-backed securities | 4,515 | — | 4,515 | — |
| Derivatives | 12,829 | — | 12,829 | — |
| Investments measured at net asset value | 7,422 | | | |
| Liabilities: | | | | |
| Derivatives | 16,094 | — | 16,094 | — |

| | Fair Value at June 30, 2017 | Quoted Prices In Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets: | | | | |
| Equity securities | $ 3,008 | $ 3,008 | $ — | $ — |
| Corporate bonds | 5,968 | 5,968 | — | — |
| Asset-backed and mortgage-backed securities | 4,762 | — | 4,762 | — |
| Derivatives | 16,496 | — | 16,496 | — |
| Investments measured at net asset value | 7,073 | | | |
| Liabilities: | | | | |
| Derivatives | 16,064 | — | 16,064 | — |

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

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

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

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

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

PARKER-HANNIFIN CORPORATION
FORM 10-Q
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2017
AND COMPARABLE PERIODS ENDED DECEMBER 31, 2016
OVERVIEW

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

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

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

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

| | December 31, 2017 | December 31, 2016 | June 30, 2017 |
|---|---|---|---|
| United States | 59.7 | 54.5 | 57.8 |
| Eurozone countries | 60.6 | 54.9 | 57.4 |
| China | 51.5 | 51.9 | 50.4 |
| Brazil | 52.4 | 45.2 | 50.5 |

Global aircraft miles flown increased by approximately six percent and revenue passenger miles increased by approximately eight percent from their comparable fiscal 2017 levels. 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 2018 will be approximately 12 percent higher than the comparable fiscal 2017 level.

Housing starts in December 2017 were approximately six percent lower than housing starts in December 2016 and approximately two percent lower than housing starts in June 2017.

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

- Serving the customer and continuously enhancing its experience with the Company;
- 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 a safety first and entrepreneurial culture;
- Engineering innovative systems and products to provide superior customer value through improved service, efficiency and productivity;
- Delivering products, systems and services that have demonstrable savings to customers and are priced by the value they deliver;
- Acquiring strategic businesses;
- Organizing around targeted regions, technologies and markets;
- Driving efficiency by implementing lean enterprise principles; and
- Creating a culture of empowerment through its values, inclusion and diversity, accountability and teamwork.

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

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

CONSOLIDATED STATEMENT OF INCOME

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| (dollars in millions) | 2017 | 2016 | 2017 | 2016 |
| Net sales | $3,370.7 | $2,670.8 | $6,735.3 | $5,413.9 |
| Gross profit margin | 23.8 % | 23.5 % | 24.3 % | 23.3 % |
| Selling, general and administrative expenses | $412.5 | $336.6 | $814.1 | $659.5 |
| Selling, general and administrative expenses, as a percent of sales | 12.2 % | 12.6 % | 12.1 % | 12.2 % |
| Interest expense | $53.1 | $33.4 | $106.7 | $67.6 |
| Other (income), net | $(24.2 ) | $(64.4 ) | $(22.0 ) | $(76.7 ) |
| Effective tax rate | 84.4 % | 24.7 % | 53.5 % | 26.3 % |
| Net income | $56.3 | $241.4 | $341.9 | $451.6 |
| Net income, as a percent of sales | 1.7 % | 9.0 % | 5.1 % | 8.3 % |

Net sales for the current-year quarter and first six months of fiscal 2018 increased as compared to the prior-year comparable periods primarily due to higher sales in both the Diversified Industrial North American and Diversified Industrial International businesses. The effect of currency rate changes increased net sales by approximately $90 million in the current-year quarter ($82 million of which was attributable to the Diversified Industrial International businesses) and $127 million for the first six months of fiscal 2018 ($112 million of which was attributable to the Diversified Industrial International businesses). Acquisitions made in the last 12 months contributed approximately $356 million and $738 million in sales in the current-year quarter and first six months of fiscal 2018, respectively.

Gross profit margin (calculated as net sales minus cost of sales, divided by net sales) increased in the current-year quarter and the first six months of fiscal 2018 primarily due to higher margins in the Aerospace Systems Segment, partially offset by lower margins in the Diversified Industrial Segment (refer to Results by Business Segment for further discussion). Pension cost included in cost of sales for the current-year quarter and prior-year quarter were

$17.8 million and $33.4 million, respectively, and $44.0 million and $67.3 million for the first six months of fiscal 2018 and 2017, respectively. Cost of sales for the current-year quarter and prior-year quarter also included business realignment charges and acquisition integration costs of $13.7 million and $6.6 million, respectively, and $22.8 million and $14.6 million for the first six months of fiscal 2018 and 2017, respectively.

Selling, general and administrative expenses increased for the current-year quarter and the first six months of fiscal 2018 primarily due to higher amortization expense resulting from recent acquisitions, higher sales expenses, resulting from the increase in sales, and higher incentive compensation. Pension cost included in selling, general and administrative expenses for the current-year quarter and prior-year quarter were $8.6 million and $15.5 million, respectively, and $18.7 million and $32.2 million for the first six months of fiscal 2018 and 2017, respectively. Selling, general and administrative expenses for the current-year quarter and prior-year quarter also included business realignment charges and acquisition integration costs of $11.7 million and $1.3 million, respectively, and $16.6 million and $4.0 million for the first six months of fiscal 2018 and 2017, respectively.
Interest expense for the current-year quarter increased primarily due to higher weighted-average borrowings partially offset by lower weighted-average interest rates. Interest expense for the first six months of fiscal 2018 increased primarily due to higher weighted-average borrowings and higher weighted-average interest rates.
Other (income), net in the current-year quarter and the first six months of fiscal 2018 includes income of $11.5 million and $18.5 million, respectively, related to equity method investments compared to $11.0 million and $19.1 million for the prior-year quarter and first six months of fiscal 2017, respectively. Other (income), net in both the current-year quarter and first six months of fiscal 2018 includes a writedown of an investment of approximately $20.0 million and a gain on the sale of real estate of approximately $28.4 million. Other (income), net for the first six months of fiscal 2018 also includes a loss of $13.8 million on the sale of an investment. Other (income), net includes a gain of approximately $45 million in both the prior-year quarter and first six months of fiscal 2017 related to the sale of a product line.

Effective tax rate for the current-year quarter and the first six months of fiscal 2018 was higher than the comparable prior-year periods primarily due to the impact of one-time adjustments recorded as a result of the U.S. Tax Cuts and Jobs Act ("the TCJ Act"). See Note 12 to the Consolidated Financial Statements for further discussion of the impact of the TCJ Act. Excluding the impact of the TCJ Act one-time adjustments, the effective tax rate for the current-year quarter was lower primarily due to the enactment of a reduced U.S. income tax rate, partially offset by a net decrease in discrete tax benefits, primarily related to stock-based awards. Excluding the impact of the TCJ Act one-time adjustments, the effective tax rate for the first six months of fiscal 2018 was lower primarily due to the enactment of a reduced U.S. income tax rate and a net increase in discrete tax benefits. The Company expects the fiscal 2018 effective tax rate will be approximately 38 percent. The impact on the fiscal 2018 effective tax rate of the TCJ Act one-time adjustments is approximately 13 percent.

RESULTS BY BUSINESS SEGMENT
Diversified Industrial Segment

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| (dollars in millions) | 2017 | 2016 | 2017 | 2016 |
| Net sales | | | | |
| North America | $1,565.4 | $1,121.1 | $3,160.1 | $2,288.0 |
| International | 1,255.6 | 1,006.0 | 2,494.3 | 2,020.9 |
| Operating income | | | | |
| North America | 225.8 | 184.0 | 481.8 | 384.6 |
| International | $164.8 | $127.5 | $356.6 | $264.7 |
| Operating margin | | | | |
| North America | 14.4 % | 16.4 % | 15.2 % | 16.8 % |
| International | 13.1 % | 12.7 % | 14.3 % | 13.1 % |
| Backlog | $2,140.9 | $1,505.6 | $2,140.9 | $1,505.6 |

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

| | Period Ending December 31, 2017 | |
|---|---|---|
| | Three Months | Six Months |
| Diversified Industrial North America – as reported | 39.6% | 38.1 % |
| Acquisitions | 26.3% | 26.4 % |
| Currency | 0.6 % | 0.6 % |
| Diversified Industrial North America – without acquisitions and currency | 12.7% | 11.1 % |
| | | |
| Diversified Industrial International – as reported | 24.8% | 23.4 % |
| Acquisitions | 6.0 % | 6.7 % |
| Currency | 8.1 % | 5.5 % |
| Diversified Industrial International – without acquisitions and currency | 10.7% | 11.2 % |
| | | |
| Total Diversified Industrial Segment – as reported | 32.6% | 31.2 % |
| Acquisitions | 16.7% | 17.1 % |
| Currency | 4.1 % | 2.9 % |
| Total Diversified Industrial Segment – without acquisitions and currency | 11.8% | 11.2 % |

The above presentation reconciles the percentage changes in net sales of the Diversified Industrial Segment 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 (a non-GAAP measure). 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, Diversified Industrial North American sales increased for the current-year quarter and first six months of fiscal 2018 primarily due to higher demand from distributors and end-users in most markets. The markets that experienced the largest increase in end-user demand were the construction equipment, oil and gas, cars and light trucks, heavy-duty truck, farm and agricultural equipment, industrial machinery and engines markets. Excluding the effects of acquisitions and changes in currency exchange rates, Diversified Industrial International sales for the current-year quarter and the first six months of fiscal 2018 increased primarily due to higher volume in all regions. The Asia Pacific region accounted for approximately 52 percent and 54 percent of the sales increase for the current-year quarter and first six months of fiscal 2018, respectively, and Europe accounted for approximately 41 percent of the increase for both the current-year quarter and first six months of fiscal 2018. Within the Asia Pacific region, the largest increase in sales for both the current-year quarter and first six months of fiscal 2018 was experienced from distributors and end-

users in the construction equipment, semiconductor, cars and light trucks, engines, machine tools and general industrial machinery markets. Within Europe, distributors and end-users in the mining, machine tools, construction equipment, heavy-duty truck, farm and agriculture equipment, engines and industrial material handling markets experienced the largest increase in sales during both the current-year quarter and first six months of fiscal 2018.
Operating margins in the Diversified Industrial North American businesses for the current-year quarter and first six months of fiscal 2018 were lower as the impact of the higher sales volume and lower operating expenses resulting from prior-year restructuring activities and the Company's simplification initiative were more than offset by higher amortization expense, the effect of the operations of CLARCOR, Inc. (Clarcor) not being fully integrated and unfavorable raw material prices.
The increase in operating margins in the Diversified Industrial International businesses for the current-year quarter and first six months of fiscal 2018 was primarily due to the higher sales volume and lower operating expenses resulting from prior-year restructuring activities and the Company's simplification initiative, resulting in manufacturing efficiencies, partially offset by higher amortization expense, an unfavorable product mix and unfavorable raw material prices.

The following business realignment expenses and acquisition integration costs are included in Diversified Industrial North American and Diversified Industrial International operating income:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| (dollars in millions) | 2017 | 2016 | 2017 | 2016 |
| Diversified Industrial North America | $11.0 | $2.3 | $20.8 | $6.0 |
| Diversified Industrial International | 13.7 | 4.5 | 17.2 | 11.5 |

The business realignment charges primarily consist of severance costs related to actions taken under the Company's simplification initiative implemented by operating units throughout the world as well as plant closures. The majority of the Diversified Industrial International business realignment charges were incurred in Europe. The Company anticipates that cost savings realized from the work force reduction measures taken in the first six months of fiscal 2018 will not materially impact operating income in fiscal 2018 and will increase operating income in fiscal 2019 by approximately three percent in the Diversified Industrial North American operations and by approximately two percent in the Diversified Industrial International operations. Acquisition integration costs primarily relate to the integration of the fiscal 2017 acquisition of Clarcor and are primarily incurred in the Diversified Industrial North American businesses. The Company expects to continue to take the actions necessary to structure appropriately the operations of the Diversified Industrial Segment. Such actions are expected to result in approximately $69 million of additional business realignment charges and acquisition integration costs in the remainder of fiscal 2018.
Diversified Industrial Segment backlog increased from the prior-year quarter primarily due to the existence of backlog from the Clarcor acquisition as well as orders exceeding shipments in both the Diversified Industrial North American and Diversified Industrial International businesses. Within the Diversified Industrial International businesses, backlog in Europe represented approximately 60 percent of the increase from the prior-year quarter and backlog in the Asia Pacific region represented approximately 40 percent of the increase from the prior-year quarter. Diversified Industrial Segment backlog increased from the June 30, 2017 amount of $2,041.4 million as orders exceeded shipments in the Diversified Industrial International businesses with backlog in Europe representing approximately 40 percent of the increase and backlog in the Asia Pacific region representing approximately 55 percent of the increase. Backlog consists of written firm orders from a customer to deliver products and, in the case of blanket purchase orders, only includes the portion of the order for which a schedule or release date has been agreed to with the customer. The dollar value of backlog is equal to the amount that is expected to be billed to the customer and reported as a sale. The Company anticipates Diversified Industrial North American sales for fiscal 2018 will increase between 22 percent and

26 percent from their fiscal 2017 level and Diversified Industrial International sales for fiscal 2018 will increase between 16 percent and 20 percent from their fiscal 2017 level. The primary driver for the increase in sales in fiscal 2018 is expected to be the sales contribution from fiscal 2017 acquisitions. Diversified Industrial North American operating margins in fiscal 2018 are expected to range from 16.3 percent to 16.7 percent and Diversified Industrial International operating margins in fiscal 2018 are expected to range from 14.0 percent to 14.4 percent.

Aerospace Systems Segment

| (dollars in millions) | Three Months Ended December 31, 2017 | Three Months Ended December 31, 2016 | Six Months Ended December 31, 2017 | Six Months Ended December 31, 2016 |
|---|---|---|---|---|
| Net sales | $549.7 | $543.8 | $1,080.9 | $1,105.0 |
| Operating income | $87.1 | $72.5 | $164.6 | $145.8 |
| Operating margin | 15.9 % | 13.3 % | 15.2 % | 13.2 % |
| Backlog | $1,820.9 | $1,664.9 | $1,820.9 | $1,664.9 |

The increase in net sales in the Aerospace Systems Segment for the current-year quarter was primarily due to higher volume in the commercial and military aftermarket businesses, partially offset by lower volume in the commercial and military original equipment manufacturer (OEM) businesses. The decrease in net sales for the first six months of fiscal 2018 was primarily due to lower volume in the commercial and military OEM businesses, partially offset by higher volume in the commercial and military aftermarket businesses. The higher operating margin for the current-year quarter was primarily due to higher aftermarket profitability, favorable contract settlements, lower operating expenses and lower engineering development costs, partially offset by higher product support costs. The higher operating margin for the first six months of fiscal 2018 was primarily due to favorable aftermarket to OEM product mix, higher aftermarket profitability, lower operating expenses and lower engineering development costs, partially offset by unfavorable contract settlements and higher warranty and product support costs.

The increase in backlog from the prior-year quarter is primarily due to orders exceeding shipments in both the commercial OEM and aftermarket businesses and the military OEM and aftermarket businesses. The increase in backlog from the June 30, 2017 amount of $1,753.0 million is primarily due to orders exceeding shipments in both the commercial OEM and military aftermarket businesses, partially offset by shipments exceeding order rates in the military OEM and commercial aftermarket businesses. Backlog consists of written firm orders from a customer to deliver products and, in the case of blanket purchase orders, only includes the portion of the order for which a schedule or release date has been agreed to with the customer. The dollar value of backlog is equal to the amount that is expected to be billed to the customer and reported as a sale. For fiscal 2018, sales are expected to range from being flat to increasing two percent from the fiscal 2017 level and operating margins are expected to range from 15.5 percent to 15.9 percent. A higher concentration of commercial OEM volume in future product mix and higher than expected new product development costs could result in lower margins.

Corporate general and administrative expenses

Corporate general and administrative expenses were $46.9 million in the current-year quarter compared to $43.9 million in the comparable prior-year quarter and were $88.3 million for the first six months of fiscal 2018, compared to $75.0 million for the first six months of fiscal 2017. As a percent of sales, corporate general and administrative expenses were 1.4 percent in the current-year quarter and 1.6 percent in the prior-year quarter and were 1.3 percent of sales in the first six months of fiscal 2018 and were 1.4 percent in the first six months of fiscal 2017. The primary drivers for the change in corporate general and administrative expenses between the current-year quarter and the first six months of 2018 as compared to the respective prior-year periods were higher expenses associated with the Company's incentive compensation program and lower expenses associated with the Company's deferred compensation program.

Other expense (income) (in the Results By Business Segment) included the following:

| (dollars in millions) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| Expense (income) | 2017 | 2016 | 2017 | 2016 |
| Foreign currency transaction | $9.0 | $(5.9 ) | $12.6 | $(0.9 ) |
| Stock-based compensation | 9.5 | 8.6 | 35.4 | 35.1 |
| Pensions | 4.4 | 19.0 | 12.9 | 40.5 |

| | | | | |
|---|---|---|---|---|
| Divestitures and asset sales and writedowns | (26.0 ) | (44.0 ) | (26.2 ) | (44.6 ) |
| Sale and writedown of investments | 20.0 | — | 33.8 | — |
| Acquisition expenses | 1.6 | 16.1 | 2.6 | 16.1 |
| Other items, net | (1.0 ) | (7.8 ) | 2.4 | (6.6 ) |
| | $17.5 | $(14.0) | $73.5 | $39.6 |

Foreign currency transaction primarily relates to the impact of changes in foreign exchange rates on cash, marketable securities and other investments and intercompany transactions. The lower pension expense is primarily due to a lower level of amortization of past actuarial losses.

CONSOLIDATED BALANCE SHEET

| (dollars in millions) | December 31, 2017 | June 30, 2017 |
|---|---|---|
| Cash | $ 1,132.7 | $ 924.2 |
| Trade accounts receivable, net | 1,857.3 | 1,930.8 |
| Inventories | 1,780.3 | 1,549.5 |
| Shareholders’ equity | 5,513.4 | 5,261.6 |
| Working capital | $ 1,748.7 | $ 1,383.9 |
| Current ratio | 1.49 | 1.41 |

Cash (comprised of cash and cash equivalents and marketable securities and other investments) includes $1,031 million and $874 million held by the Company's foreign subsidiaries at December 31, 2017 and June 30, 2017, respectively. As a result of the TCJ Act, the prior worldwide tax system was replaced by a territorial tax system, which generally allows companies to repatriate future foreign source earnings without incurring additional U.S. Federal taxes. However, other U.S. or foreign taxes may be incurred should cash be remitted between the Company's subsidiaries. The Company has historically considered the earnings in the Company's non-U.S. subsidiaries to be indefinitely reinvested. The Company is currently analyzing this position given the enactment of the TCJ Act.

Trade accounts receivable, net are receivables due from customers for sales of product. Days sales outstanding relating to trade accounts receivable was 51 days at both December 31, 2017 and June 30, 2017. The Company believes that its receivables are collectible and appropriate allowances for doubtful accounts have been recorded.

Inventories as of December 31, 2017 increased $207 million primarily due to an increase in inventories in both the Diversified Industrial and Aerospace Systems Segments as well as the effect of foreign currency translation (which accounted for an increase of $24 million). Approximately 83 percent of the increase in inventories was experienced in the Diversified Industrial Segment and approximately 17 percent of the increase in inventories was experienced in the Aerospace Systems Segment. Days supply of inventory was 78 days at December 31, 2017, 67 days at June 30, 2017 and 72 days at December 31, 2016.

Shareholders’ equity activity during the first six months of fiscal 2018 included a decrease of approximately $100 million as a result of share repurchases and an increase of approximately $100 million as a result of foreign currency translation.

CONSOLIDATED STATEMENT OF CASH FLOWS

| | Six Months Ended December 31, | |
|---|---|---|
| (dollars in millions) | 2017 | 2016 |
| Cash provided by (used in): | | |
| Operating activities | $ 460.3 | $ 404.2 |
| Investing activities | (145.4 ) | 102.3 |
| Financing activities | (182.8 ) | (140.7 ) |
| Effect of exchange rates | 7.8 | (66.7 ) |
| Net increase in cash and cash equivalents | $ 139.9 | $ 299.1 |

Cash flows provided by operating activities for the first six months of fiscal 2018 was higher than the first six months of fiscal 2017 primarily due to an increase in the amount of adjustments to reconcile net income to net cash from operating activities and the absence of a $220 million voluntary cash contribution made to the Company's domestic qualified pension plan made in the first six months of fiscal 2017, partially offset by an increase in cash used for working capital items. The Company continues to focus on managing its inventory and other working capital requirements.

Cash flows used in investing activities includes net maturities (purchases) of marketable securities and other investments of $(66) million and $113 million in the first six months of fiscal 2018 and first six months of fiscal 2017, respectively. Cash flows used in investing activities includes capital expenditures of $145 million in the first six months of fiscal 2018 compared to $71 million in the first six months of fiscal 2017.

Cash flows provided by financing activities for the first six months of fiscal 2018 included $139 million of net commercial paper borrowings versus $226 million of net commercial paper borrowings in the first six months of fiscal 2017. Cash flows provided by financing activities includes repurchase activity under the Company's share repurchase program. The Company repurchased 0.6 million common shares for $100 million in the first six months of fiscal 2018 as compared to the repurchase of 1.3 million common shares for $165 million in the first six months of fiscal 2017.

The Company’s goal is to have no less than an “A” rating on senior debt to ensure availability and reasonable cost of external funds. In periods following significant capital deployment, including for share repurchases or acquisitions, certain of the ratings assigned to the Company's senior debt may be, and at December 31, 2017 was, lower than the stated goal. The Company does not presently believe that its ability to borrow funds in the future at desirable tenors and affordable interest rates will be impacted if certain of its ratings are temporarily below an "A" level at the time of such borrowings. At December 31, 2017, the long-term credit ratings assigned to the Company's senior debt securities by the credit rating agencies engaged by the Company were as follows:

| | |
|---|---|
| Fitch Ratings | A- |
| Moody's Investor Services, Inc. | Baa1 |
| Standard & Poor's | A |

At December 31, 2017, the Company had a line of credit totaling $2,000 million through a multi-currency revolving credit agreement with a group of banks, $1,327 million of which was available. The credit agreement expires in October 2021; however, the Company has the right to request a one-year extension of the expiration date on an annual basis, which request may result in changes to the current terms and conditions of the credit agreement. Advances from the credit agreement can be used for general corporate purposes, including acquisitions, and for the refinancing of existing indebtedness. The credit agreement requires the payment of an annual facility fee, the amount of which may increase in the event the Company’s credit ratings are lowered. Although a lowering of the Company’s credit ratings would likely increase the cost of future debt, it would not limit the Company’s ability to use the credit agreement nor would it accelerate the repayment of any outstanding borrowings.

As of December 31, 2017, the Company was authorized to sell up to $2,000 million of short-term commercial paper notes. As of December 31, 2017, $673 million of commercial paper notes were outstanding and the largest amount of commercial paper notes outstanding during the current-year quarter was $703 million.

The Company’s credit agreements and indentures governing certain debt securities contain various covenants, the violation of which would limit or preclude the use of the credit agreements for future borrowings, or might accelerate the maturity of the related outstanding borrowings covered by the indentures. Based on the Company’s rating level at December 31, 2017, the most restrictive financial covenant provides that the ratio of debt to debt-shareholders' equity cannot exceed .60 to 1.0. At December 31, 2017, the Company's debt to debt-shareholders' equity ratio was .525 to 1.0. The Company is in compliance with all covenants and expects to remain in compliance during the term of the credit agreements and indentures.

FORWARD-LOOKING STATEMENTS

Forward-looking statements contained in this and other written and oral reports are made based on known events and circumstances at the time of release, and as such, are subject in the future to unforeseen uncertainties and risks. All statements regarding future performance, earnings projections, events or developments are forward-looking statements. It is possible that the future performance and earnings projections of the Company, including its individual segments, may differ materially from current expectations, depending on economic conditions within its mobile, industrial and aerospace markets, and the Company's ability to maintain and achieve anticipated benefits associated with announced realignment activities, strategic initiatives to improve operating margins, actions taken to combat the effects of the current economic environment, and growth, innovation and global diversification initiatives. Additionally, the actual impact of the U.S. Tax Cuts and Jobs Act may affect future performance and earnings projections as the amounts reflected in this period are preliminary estimates and exact amounts will not be determined until a later date, and there may be other judicial or regulatory interpretations of the U.S. Tax Cuts and Jobs Act that may also affect these estimates and the actual impact on the Company. A change in the economic conditions in individual markets may have a particularly volatile effect on segment performance.

Among other factors which may affect future performance are:

- changes in business relationships with and purchases by or from major customers, suppliers or distributors, including delays or cancellations in shipments;
- disputes regarding contract terms or significant changes in financial condition, changes in contract cost and revenue estimates for new development programs, and changes in product mix;
- ability to identify acceptable strategic acquisition targets; uncertainties surrounding timing, successful completion or integration of acquisitions and similar transactions, including the integration of Clarcor; ability to successfully divest businesses planned for divestiture and realize the anticipated benefits of such divestitures;
- the determination to undertake business realignment activities and the expected costs thereof and, if undertaken, the ability to complete such activities and realize the anticipated cost savings from such activities;
- ability to implement successfully the capital allocation initiatives, including timing, price and execution of share repurchases;
- availability, limitations or cost increases of raw materials, component products and/or commodities that cannot be recovered in product pricing;
- ability to manage costs related to insurance and employee retirement and health care benefits;
- compliance costs associated with environmental laws and regulations;
- potential labor disruptions;
- threats associated with and efforts to combat terrorism and cyber-security risks;
- uncertainties surrounding the ultimate resolution of outstanding legal proceedings, including the outcome of any appeals;
- competitive market conditions and resulting effects on sales and pricing; and
- global economic factors, including manufacturing activity, air travel trends, currency exchange rates, difficulties entering new markets and general economic conditions such as inflation, deflation, interest rates and credit availability.

The Company makes these statements as of the date of this disclosure, and undertakes no obligation to update them unless otherwise required by law.

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

The Company manages foreign currency transaction and translation risk by utilizing 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. 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.

Derivative financial instruments are recognized on the Consolidated Balance Sheet as either assets or liabilities and are measured at fair value. Further information on the fair value of these contracts is provided in Note 13 to the Consolidated Financial Statements. Gains or losses on derivatives that are not hedges are adjusted to fair value through the Consolidated Statement of Income. Gains or losses on derivatives that are hedges are adjusted to fair value through accumulated other comprehensive (loss) in the Consolidated Balance Sheet until the hedged item is recognized in earnings. The translation of the foreign denominated debt that has been designated as a net investment hedge is recorded in accumulated other comprehensive (loss) and remains there until the underlying net investment is sold or substantially liquidated.

The Company’s debt portfolio contains variable rate debt, inherently exposing the Company to interest rate risk. The Company’s objective is to maintain a 60/40 mix between fixed rate and variable rate debt thereby limiting its exposure to changes in near-term interest rates.

## ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s principal executive officer and principal financial officer, of the effectiveness of the Company’s disclosure controls and procedures as of December 31, 2017. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that, as of December 31, 2017, the Company’s disclosure controls and procedures were effective.

There was no change in the Company’s internal control over financial reporting during the quarter ended December 31, 2017 that materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

PARKER-HANNIFIN CORPORATION
PART II - OTHER INFORMATION

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

(a) Unregistered Sales of Equity Securities. Not applicable.

(b) Use of Proceeds. Not applicable.

(c) Issuer Purchases of Equity Securities.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | (d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---|---|---|---|---|
| October 1, 2017 through October 31, 2017 | 96,400 | $ 179.84 | 96,400 | 16,937,890 |
| November 1, 2017 through November 30, 2017 | 92,200 | $ 183.18 | 92,200 | 16,845,690 |
| December 1, 2017 through December 31, 2017 | 81,901 | $ 192.53 | 81,901 | 16,763,789 |
| Total: | 270,501 | $ 184.82 | 270,501 | 16,763,789 |

(1) On August 16, 1990, the Company publicly announced that its Board of Directors authorized the repurchase by the Company of up to 3 million shares of its common stock. From time to time thereafter, the Board of Directors has adjusted the overall maximum number of shares authorized for repurchase under this program. On October 22, 2014, the Company publicly announced that the Board of Directors increased the overall maximum number of shares authorized for repurchase under this program so that, beginning on such date, the aggregate number of shares authorized for repurchase was 35 million shares. There is no limitation on the amount of shares that can be repurchased in a fiscal year. There is no expiration date for this program.

ITEM 6. Exhibits.

The following documents are furnished as exhibits and are numbered pursuant to Item 601 of Regulation S-K:

| Exhibit No. | Description of Exhibit |
|---|---|
| 12 | Computation of Ratio of Earnings to Fixed Charges as of December 31, 2017.* |
| 31(a) | Certification of the Principal Executive Officer Pursuant to 17 CFR 240.13a-14(a), as Adopted Pursuant to §302 of the Sarbanes-Oxley Act of 2002.* |
| 31(b) | Certification of the Principal Financial Officer Pursuant to 17 CFR 240.13a-14(a), as Adopted Pursuant to §302 of the Sarbanes-Oxley Act of 2002.* |
| 32 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to §906 of the Sarbanes-Oxley Act of 2002. * |
| 101.INS | XBRL Instance Document.* |
| 101.SCH | XBRL Taxonomy Extension Schema Document.* |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.* |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. * |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document.* |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.* |

*Submitted electronically herewith.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statement of Income for the three months ended December 31, 2017 and 2016, (ii) Consolidated Statement of Income for the six months ended December 31, 2017 and 2016, (iii) Consolidated Statement of Comprehensive Income for the three months ended December 31, 2017 and 2016, (iv) Consolidated Statement of Comprehensive Income for the six months ended December 31, 2017 and 2016, (v) Consolidated Balance Sheet at December 31, 2017 and June 30, 2017, (vi) Consolidated Statement of Cash Flows for the six months ended December 31, 2017 and 2016, and (vii) Notes to Consolidated Financial Statements for the six months ended December 31, 2017.

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.

PARKER-HANNIFIN CORPORATION
(Registrant)

/s/ Catherine A. Suever
Catherine A. Suever
Executive Vice President - Finance & Administration and
Chief Financial Officer

Date: February 8, 2018