POLARIS INDUSTRIES INC/MN
Form 10-Q
July 25, 2014
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## UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark
one)
x
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014
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 1-11411

POLARIS INDUSTRIES INC.
(Exact name of registrant as specified in its charter)

| Minnesota <br> (State or other jurisdiction of <br> incorporation or organization) | $41-1790959$ <br> (I.R.S. Employer <br> 2100 Highway 55, Medina MN |
| :--- | :--- |
| Identification No.) |  |
| (Address of principal executive <br> offices) | 55340 |
|  | (763) 542-0500 <br> (Registrant's telephone number, including area <br> code) |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x 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 filerx
Non-accelerated filer * (Do not check if a smaller reporting company)

Accelerated filer
Smaller reporting company

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes " No x
APPLICABLE ONLY TO CORPORATE ISSUERS:
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
As of July 22, 2014, 65,960,413 shares of Common Stock, \$. 01 par value, of the registrant were outstanding.

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## Part I FINANCIAL INFORMATION

Item 1 - FINANCIAL STATEMENTS
POLARIS INDUSTRIES INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
June 30, 2014
December 31, 2013
(Unaudited)
Assets
Current assets:
Cash and cash equivalents \$119,040 \$92,248

Trade receivables, net
Inventories, net
Prepaid expenses and other
Income taxes receivable
Deferred tax assets
Total current assets
135,411 186,213

Property and equipment, net
559,876 417,948

Investment in finance affiliate
60,002
63,716
24,890 12,217

Investment in other affiliates
94,228
93,356
993,447 865,698

Deferred tax assets
Goodwill and other intangible assets, net
Other long-term assets
Total assets
532,425 $\quad 455,167$

Liabilities and Shareholders' Equity
Current liabilities:
Current portion of capital lease obligations $\quad \$ 3,119 \quad \$ 3,281$
Accounts payable
Accrued expenses:
Compensation
289,423 238,044

Warranties
Sales promotions and incentives
67,597
69,217
$\begin{array}{lll}\text { Investment in other affiliates } & 18,622 & 15,956\end{array}$
21,803 18,616
238,118 229,708
47,037 31,126
\$1,919,049 \$1,685,488

Dealer holdback
64,782 143,504

Other
Income taxes payable
44,811
52,818

Total current liabilities
Long-term income taxes payable
Capital lease obligations
129,161 123,089

Long-term debt
102,890 100,600

Deferred tax liabilities
Other long-term liabilities
86,656 77,480
4,530 9,254
725,372 748,070

Total liabilities
Deferred compensation
13,377 14,292

27,506 3,842

Shareholders' equity:
Preferred stock $\$ 0.01$ par value, 20,000 shares authorized, no shares issued and outstanding
Common stock $\$ 0.01$ par value, 160,000 shares authorized, 65,960 and
65,623 shares issued and outstanding, respectively
Additional paid-in capital
337,000 280,500
22,982 25,028
86,301 69,730
\$ 1,212,538 \$1,141,462
\$12,091 \$8,421
$\$ 660$
410,499 360,616

| Retained earnings | 265,667 | 155,572 |
| :--- | :--- | :--- |
| Accumulated other comprehensive income, net | 17,594 | 18,761 |
| Total shareholders' equity | 694,420 | 535,605 |
| Total liabilities and shareholders' equity | $\$ 1,919,049$ | $\$ 1,685,488$ |
| The accompanying footnotes are an integral part of these consolidated statements. |  |  |

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POLARIS INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

|  | Three months ended June 30, |  | Six months ended June 30, |  |
| :--- | :--- | :--- | :--- | :--- |
|  | 2014 | 2013 | 2014 | 2013 |
| Sales | $\$ 1,013,959$ | $\$ 844,800$ | $\$ 1,902,305$ | $\$ 1,590,709$ |
| Cost of sales | 709,045 | 592,462 | $1,338,974$ | $1,121,723$ |
| Gross profit | 304,914 | 252,338 | 563,331 | 468,986 |
| Operating expenses: |  |  |  |  |
| Selling and marketing | 74,178 | 62,238 | 139,748 | 116,731 |
| Research and development | 36,984 | 34,604 | 72,497 | 66,054 |
| General and administrative | 52,942 | 41,444 | 94,234 | 80,254 |
| Total operating expenses | 164,104 | 138,286 | 306,479 | 263,039 |
| Income from financial services | 14,625 | 11,502 | 25,265 | 21,576 |
| Operating income | 155,435 | 125,554 | 282,117 | 227,523 |
| Non-operating expense (income): |  |  |  |  |
| Interest expense | 3,039 | 1,371 | 5,851 | 2,844 |
| Equity in loss of other affiliates | 967 | 586 | 1,863 | 998 |
| Other (income), net | $(1,883$ | 1,230 | $)(3,988$ | $)(3,698$ |
| Income before income taxes | 153,312 | 124,827 | 278,391 | 227,379 |
| Provision for income taxes | 56,407 | 44,823 | 100,585 | 71,911 |
| Net income | $\$ 96,905$ | $\$ 80,004$ | $\$ 177,806$ | $\$ 155,468$ |
| Basic net income per share | $\$ 1.47$ | $\$ 1.16$ | $\$ 2.70$ | $\$ 2.26$ |
| Diluted net income per share | $\$ 1.42$ | $\$ 1.13$ | $\$ 2.61$ | $\$ 2.20$ |
| Weighted average shares outstanding: | 66,060 | 68,867 |  |  |
| Basic | 68,088 | 70,755 | 65,946 | 68,830 |
| Diluted |  |  |  |  |

The accompanying footnotes are an integral part of these consolidated statements.
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POLARIS INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)


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## POLARIS INDUSTRIES INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

Operating Activities:
Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Depreciation and amortization
Six months ended June 30, 20142013

Noncash compensation
39,279
Noncash income from financial services
Noncash loss from other affiliates
Deferred income taxes
Tax effect of share-based compensation exercises
Changes in operating assets and liabilities:
Trade receivables
Inventories
Accounts payable
Accrued expenses
Income taxes payable/receivable
Prepaid expenses and others, net
Net cash provided by operating activities
Investing Activities:
Purchase of property and equipment
Investment in finance affiliate, net
Investment in other affiliates
Acquisition of businesses, net of cash acquired
Net cash used for investing activities
Financing Activities:
Borrowings under debt arrangements
Repayments under debt arrangements and capital lease obligations
Repurchase and retirement of common shares
Cash dividends to shareholders
Proceeds from stock issuances under employee plans
Tax effect of proceeds from share-based compensation exercises
Net cash provided by (used for) financing activities
Impact of currency exchange rates on cash balances
Net increase (decrease) in cash and cash equivalents
Cash and cash equivalents at beginning of period
Cash and cash equivalents at end of period
(101,607 ) (93,720 )
6,124 4,026
$(4,158)(6,063)$
(17,199 ) (134,817 )
(116,840 ) (230,574 )
$\left.\begin{array}{lll}1,452,444 & 1,432 \\ (1,397,210 & ) & (1,873\end{array}\right)$

Noncash Activity:
Property and equipment obtained through capital leases
\$24,908 \$—
The accompanying footnotes are an integral part of these consolidated statements.

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## POLARIS INDUSTRIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Significant Accounting Policies
Basis of presentation. The accompanying unaudited consolidated financial statements of Polaris Industries Inc. ("Polaris" or the "Company") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements and, therefore, do not include all information and disclosures of results of operations, financial position and changes in cash flow in conformity with accounting principles generally accepted in the United States for complete financial statements. Accordingly, such statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2013 previously filed with the Securities and Exchange Commission. In the opinion of management, such statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. Due to the seasonality of snowmobiles; Off-Road Vehicles (ORV), which include all-terrain vehicles (ATV) and side-by-side vehicles; motorcycles; Small Vehicles (SV); and Parts, Garments and Accessories (PG\&A) businesses, and to certain changes in production and shipping cycles, results of such periods are not necessarily indicative of the results to be expected for the complete year.
Fair value measurements. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Assets and liabilities measured at fair value are classified using the following hierarchy, which is based upon the transparency of inputs to the valuation as of the measurement date: Level 1 - Quoted prices in active markets for identical assets or liabilities.
Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.
In making fair value measurements, observable market data must be used when available. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement. The Company utilizes the market approach to measure fair value for its non-qualified deferred compensation assets and liabilities, and the income approach for foreign currency contracts and commodity contracts. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities, and for the income approach the Company uses significant other observable inputs to value its derivative instruments used to hedge foreign currency and commodity transactions.
Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):
Fair Value Measurements as of June 30, 2014
Asset (Liability)
Non-qualified deferred compensation assets
Total assets at fair value
Foreign exchange contracts, net
Non-qualified deferred compensation liabilities
Total liabilities at fair value
Asset (Liability)
Commodity contracts, net
Non-qualified deferred compensation assets
Total assets at fair value
Foreign exchange contracts, net
Non-qualified deferred compensation liabilities
Total liabilities at fair value

| Total | Level 1 | Level 2 | Level 3 |
| :--- | :--- | :--- | :--- |
| $\$ 41,166$ | $\$ 41,166$ | - | - |
| $\$ 41,166$ | $\$ 41,166$ | - | - |
| $\$(1,608$ | $)$ | - | $\$(1,608$ |
| $(41,166$ | $)$ | $\$(41,166$ | - |
| $\$(42,774$ | $)$ | $\$(41,166$ | $)$ |
| Fair Value | Measurements as of December 31, 2013 |  |  |
| Total | Level 1 | Level 2 | Level 3 |
| $\$ 30$ | - | $\$ 30$ | - |
| 24,711 | $\$ 24,711$ | - | - |
| $\$ 24,741$ | $\$ 24,711$ | $\$ 30$ | - |
| $\$(9$ | $)$ | - | $\$(9$ |
| $(24,711$ | $)$ | $\$(24,711$ | $)$ |
| $\$(24,720$ | $)$ | $\$(24,711$ | $)$ |

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Inventories. Inventory costs include material, labor and manufacturing overhead costs, including depreciation expense associated with the manufacture and distribution of the Company's products. Inventories are stated at the lower of cost (first-in, first-out method) or market. The major components of inventories are as follows (in thousands):

| June 30, 2014 | December 31, 2013 |
| :--- | :--- |
| $\$ 113,841$ | $\$ 107,496$ |
| 150,241 | 125,765 |
| 322,153 | 206,290 |
| $(26,359$ | $)$ |
| $\$ 559,876$ | $\$ 417,603$ |

Raw materials and purchased components
Service parts, garments and accessories
Finished goods
Less: reserves
Inventories

June 30, 2014
\$113,841
322,153
(26,359
\$559,876

Product warranties. Polaris provides a limited warranty for its ORVs for a period of six months, for a period of one year for its snowmobiles and motorcycles and a two year period for SVs. Polaris provides longer warranties in certain geographical markets as determined by local regulations and market conditions and may also provide longer warranties related to certain promotional programs. Polaris' standard warranties require the Company or its dealers to repair or replace defective products during such warranty periods at no cost to the consumer. The warranty reserve is established at the time of sale to the dealer or distributor based on management's best estimate using historical rates and trends. Adjustments to the warranty reserve are made from time to time as actual claims become known in order to properly estimate the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. Factors that could have an impact on the warranty accrual in any given period include the following: improved manufacturing quality, shifts in product mix, changes in warranty coverage periods, snowfall and its impact on snowmobile usage, product recalls and any significant changes in sales volume. The activity in the warranty reserve during the periods presented was as follows (in thousands):

| Three months ended June 30, |  | Six months ended June 30, |  |  |
| :--- | :--- | :--- | :--- | :--- |
| 2014 | 2013 | 2014 | 2013 |  |
| $\$ 47,224$ | $\$ 40,941$ | $\$ 52,818$ | $\$ 47,723$ |  |
| 110 | 1,602 | 110 | 1,602 |  |
| 12,270 | 13,154 | 23,297 | 21,990 |  |
| $(14,793$ | $)$ | $(12,980$ | $)$ | $(31,414$ |$)(28,598 \quad$ )

Balance at beginning of period
Additions to warranty reserve through acquisitions
Additions charged to expense
Warranty claims paid (14,793 ) (12,980 ) (31,414) (28,598
Balance at end of period $\quad \$ 44,811 \quad \$ 42,717 \quad \$ 44,811 \quad \$ 42,717$
New Accounting Pronouncements. In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue from the transfer of goods or services to customers in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. Polaris is required to adopt the new pronouncement on January 1, 2017 using one of two retrospective application methods. The Company is evaluating the application method and the impact of this new standard on our financial statements.
There are no other new accounting pronouncements that are expected to have a significant impact on Polaris' consolidated financial statements.

Note 2. Share-Based Compensation
The amount of compensation cost for share-based awards to be recognized during a period is based on the portion of the awards that are ultimately expected to vest. The Company estimates stock option forfeitures at the time of grant and revises those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company analyzes historical data to estimate pre-vesting forfeitures and records share compensation expense for those awards expected to vest.
Total share-based compensation expenses were as follows (in thousands):

|  | Three months ended June |  | Six months ended June 30, |  |
| :--- | :--- | :--- | :--- | :--- |
|  | 30 |  | 2014 | 2013 |
| Option plan | 2014 | 2013 | 2014 |  |
|  | $\$ 6,375$ | $\$ 5,853$ | $\$ 11,953$ | $\$ 10,977$ |

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| Other share-based awards | 6,688 | 7,973 | 11,099 | 18,105 |
| :--- | :--- | :--- | :--- | :--- |
| Total share-based compensation before tax | 13,063 | 13,826 | 23,052 | 29,082 |
| Tax benefit | 4,885 | 5,168 | 8,614 | 10,866 |
| Total share-based compensation expense included in net | $\$ 8,178$ | $\$ 8,658$ | $\$ 14,438$ | $\$ 18,216$ |

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In addition to the above share-based compensation expenses, Polaris sponsors a qualified non-leveraged employee stock ownership plan (ESOP). Shares allocated to eligible participants' accounts vest at various percentage rates based on years of service and require no cash payments from the recipient.
At June 30, 2014, there was $\$ 85,029,000$ of total unrecognized share-based compensation expense related to unvested share-based equity awards. Unrecognized share-based compensation expense is expected to be recognized over a weighted-average period of 1.64 years. Included in unrecognized share-based compensation is approximately $\$ 47,461,000$ related to stock options and $\$ 37,568,000$ for restricted stock.

Note 3. Financing Agreements
Debt and capital lease obligations and the average related interest rates were as follows (in thousands):

|  | Average interest rate at June 30, 2014 | Maturity | $\begin{aligned} & \text { June 30, } \\ & 2014 \end{aligned}$ | December $31,2013$ |
| :---: | :---: | :---: | :---: | :---: |
| Revolving loan facility | 1.03\% | January 2018 | \$137,000 | \$80,500 |
| Senior notes-fixed rate | 3.81\% | May 2018 | 25,000 | 25,000 |
| Senior notes-fixed rate | 4.60\% | May 2021 | 75,000 | 75,000 |
| Senior notes-fixed rate | 3.13\% | December 2020 | 100,000 | 100,000 |
| Capital lease obligations | 4.87\% | Various through 2029 | 30,625 | 7,123 |
| Total debt and capital lease obligations |  |  | \$367,625 | \$287,623 |
| Less: current maturities |  |  | 3,119 | 3,281 |
| Total long-term debt and capital lease obligations |  |  | \$364,506 | \$284,342 |

In August 2011, Polaris entered into a $\$ 350,000,000$ unsecured revolving loan facility. In January 2013, Polaris amended the loan facility to provide more beneficial covenant and interest rate terms and extend the expiration date from August 2016 to January 2018. Interest is charged at rates based on LIBOR or "prime."
In December 2010, the Company entered into a Master Note Purchase Agreement to issue $\$ 25,000,000$ of unsecured senior notes due May 2018 and $\$ 75,000,000$ of unsecured senior notes due May 2021 (collectively, the "Senior Notes"). The Senior Notes were issued in May 2011. In December 2013, the Company entered into a First Supplement to Master Note Purchase Agreement, under which the Company issued $\$ 100,000,000$ of unsecured senior notes due December 2020.
The unsecured revolving loan facility and the Master Note Purchase Agreement contain covenants that require Polaris to maintain certain financial ratios, including minimum interest coverage and maximum leverage ratios. Polaris was in compliance with all such covenants as of June 30, 2014.
A property lease agreement for a manufacturing facility which Polaris began occupying in Opole, Poland commenced in February 2014. The Poland property lease is accounted for as a capital lease.

Note 4. Goodwill and Other Intangible Assets
Goodwill and other intangible assets, net, consisted of \$130,323,000 of goodwill and \$107,795,000 of intangible assets, net of accumulated amortization, as of June 30, 2014.
Additions to goodwill and other intangible assets in the first six months of 2014 relate to the acquisition of Kolpin Outdoors, Inc. ("Kolpin") on April 1, 2014. Kolpin is a leading aftermarket brand delivering purpose-built and universal-fit ORV accessories and lifestyle products. The aggregate Kolpin purchase price was allocated on a preliminary basis to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.
The changes in the carrying amount of goodwill for the six months ended June 30, 2014 were as follows (in thousands):

Six months ended June
30, 2014
Goodwill, beginning of period
\$126,697
Goodwill acquired during the period ..... 4,345
Currency translation effect on foreign goodwill balances ..... (719Goodwill, end of period\$130,323

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For other intangible assets, the changes in the net carrying amount for the six months ended June 30, 2014 were as follows (in thousands):

Other intangible assets, beginning of period
Intangible assets acquired during the period Amortization expense
Foreign currency translation effect on balances
Other intangible assets, end of period
The components of other intangible assets were as follows (in thousands):
Total estimated
life (years)

Six months ended June 30, 2014

| Gross | Accumulated |  |
| :--- | :--- | :--- |
| Amount | Amortization |  |
| $\$ 116,279$ | $\$(13,268$ | $)$ |
| 11,100 | - | $(5,708$ |
| - | $)$ | 76 |
| $(684$ | $\$(18,900$ | $)$ |
| $\$ 126,695$ |  |  |

Non-amortizable—indefinite lived:
Brand names
Amortized:
Non-compete agreements 5
June 30, 2014
December 31, 2013

Dealer/customer related
7

| June 30,2014 | 2013 |
| :--- | :--- |
|  |  |
| $\$ 45,260$ | $\$ 41,188$ |
|  |  |
| 540 | 540 |
| 65,728 | 59,244 |
| 15,167 | 15,307 |
| 81,435 | 75,091 |
| $(18,900$ | $)$ |
| 62,535 | 61,823 |
| $\$ 107,795$ | $\$ 103,011$ |

Developed technology 5-7
Total amortizable
Less: Accumulated amortization
Net amortized other intangible assets
Total other intangible assets, net
Amortization expense for intangible assets for the three months ended June 30, 2014 and 2013 was $\$ 2,963,000$ and $\$ 2,574,000$, respectively. Estimated amortization expense for the remainder of 2014 through 2019 is as follows: 2014 (remainder), $\$ 6,000,000 ; 2015, \$ 11,800,000 ; 2016, \$ 11,800,000 ; 2017, \$ 11,500,000 ; 2018, \$ 9,800,000 ; 2019$, $\$ 8,500,000$; and after 2019, $\$ 3,100,000$. The preceding expected amortization expense is an estimate and actual amounts could differ due to additional intangible asset acquisitions, changes in foreign currency rates or impairment of intangible assets.

Note 5. Shareholders' Equity
During the six months ended June 30, 2014, Polaris paid \$3,945,000 to repurchase and retire approximately 30,000 shares of its common stock. As of June 30, 2014, the Board of Directors has authorized the Company to repurchase up to an additional $1,574,000$ shares of Polaris stock. The repurchase of any or all such shares authorized for repurchase will be governed by applicable SEC rules and dependent on management's assessment of market conditions. Polaris paid a regular cash dividend of $\$ 0.48$ per share on June 16,2014 to holders of record at the close of business on June 2, 2014. On July 23, 2014, the Polaris Board of Directors declared a regular cash dividend of $\$ 0.48$ per share payable on September 15, 2014 to holders of record of such shares at the close of business on September 2, 2014. Cash dividends declared per common share for the three and six months ended June 30, 2014 and 2013, were as follows:

|  | Three months ended June 30, |  | Six months ended June 30, |  |
| :--- | :--- | :--- | :--- | :--- |
|  | 2014 | 2013 | 2014 | 2013 |
| Cash dividends declared and paid per common | $\$ 0.48$ | $\$ 0.42$ | $\$ 0.96$ | $\$ 0.84$ |
| share |  |  |  |  |

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Net income per share
Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during each period, including shares earned under The Deferred Compensation Plan for Directors ("Director Plan"), the ESOP and deferred stock units under the 2007 Omnibus Incentive Plan ("Omnibus Plan"). Diluted earnings per share is computed under the treasury stock method and is calculated to compute the dilutive effect of outstanding stock options issued under the 1995 Stock Option Plan and the 2003 Non-Employee Director Stock Option Plan (collectively, the "Option Plans") and certain shares issued under the Omnibus Plan. A reconciliation of these amounts is as follows (in thousands):

Three months ended June 30, Six months ended June 30,
201420132014
$\begin{array}{llll}\text { Weighted average number of common shares outstanding } 65,769 & 68,536 & 65,663 & 68,445\end{array}$
Director Plan and deferred stock units 209
ESOP 82
Common shares outstanding-basic
Dilutive effect of Option Plans and Omnibus Plan
Common and potential common shares outstanding-diluted

| 82 | 98 | 78 | 98 |
| :--- | :--- | :--- | :--- |
| 66,060 | 68,867 | 65,946 | 68,830 |
| 2,028 | 1,888 | 2,077 | 1,929 |
| 68,088 | 70,755 | 68,023 | 70,759 |

During the three and six months ended June 30, 2014, the number of options that could potentially dilute earnings per share on a fully diluted basis that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive were 665,000 and 513,000, respectively, compared to $1,018,000$ and 799,000 for the same periods in 2013.
Accumulated other comprehensive income
Changes in the accumulated other comprehensive income balance is as follows (in thousands):

Balance as of December 31, 2013
Reclassification to the income statement Change in fair value
Balance as of June 30, 2014
,2014 \$18,430 The in comprehensive income into the income statement for cash flow derivatives designated as hedging instruments for the three and six months ended June 30, 2014 and 2013 (in thousands):

Location of (Gain) Three months ended June 30, Six months ended June 30,
Derivatives in Cash
Flow Hedging Relationships
Loss
Reclassified from
Accumulated OCI
into Income
Foreign currency contracts Other (income), net $\$(1,687 \quad$ ) $\$(891 \quad \$(2,097 \quad \$(1,111)$
Foreign currency contracts $\quad$ Cost of sales (42 ) 537 753
Total
$\left.\left.\begin{array}{lll}\begin{array}{ll}\text { Foreign } \\ \text { Currency }\end{array} & \text { Cash Flow } & \text { Accumulated Other } \\ \text { Items } & \text { Hedging Derivatives } \\ \text { Comprehensive } \\ \text { Income } \\ - & \$ 18,582 & (2,037\end{array}\right) \$ \begin{array}{l}(2,037 \\ (152\end{array}\right)$

The net amount of the existing gains or losses at June 30, 2014 that is expected to be reclassified into the income statement within the next 12 months is expected to not be material. See Note 9 for further information regarding Polaris' derivative activities.

## Note 6. Financial Services Arrangements

Polaris Acceptance, a joint venture between Polaris and GE Commercial Distribution Finance Corporation (GECDF), an indirect subsidiary of General Electric Capital Corporation, which is supported by a partnership agreement between their respective wholly owned subsidiaries, finances substantially all of Polaris' United States sales whereby Polaris
receives payment within a few days of shipment of the product. Polaris' subsidiary has a 50 percent equity interest in Polaris Acceptance. Polaris Acceptance sells a majority of its receivable portfolio to a securitization facility (the "Securitization Facility") arranged by General Electric Capital Corporation. The sale of receivables from Polaris Acceptance to the Securitization Facility is accounted for in Polaris Acceptance's financial statements as a "true-sale" under ASC Topic 860. Polaris' allocable share of the income of Polaris Acceptance has been included as a component of income from financial services in the accompanying consolidated statements of income. The partnership agreement is effective through February 2017.
Polaris' total investment in Polaris Acceptance of $\$ 67,597,000$ at June 30, 2014 is accounted for under the equity method, and is recorded in investment in finance affiliate in the accompanying consolidated balance sheets. At June 30,2014 , the outstanding amount of net receivables financed for dealers under this arrangement was $\$ 879,588,000$, which included $\$ 246,647,000$ in the Polaris Acceptance portfolio and $\$ 632,941,000$ of receivables within the Securitization Facility ("Securitized Receivables").

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Polaris has agreed to repurchase products repossessed by Polaris Acceptance up to an annual maximum of 15 percent of the aggregate average month-end outstanding Polaris Acceptance receivables and Securitized Receivables during the prior calendar year. For calendar year 2014, the potential 15 percent aggregate repurchase obligation is approximately $\$ 120,815,000$. Polaris' financial exposure under this arrangement is limited to the difference between the amounts unpaid by the dealer with respect to the repossessed product plus costs of repossession and the amount received on the resale of the repossessed product. No material losses have been incurred under this agreement during the periods presented.
Polaris has agreements with Capital One, Sheffield Financial and Synchrony Bank, formerly GE Money Bank, under which these financial institutions provide financing to end consumers of Polaris products. Polaris' income generated from these agreements has been included as a component of income from financial services in the accompanying consolidated statements of income.
Polaris also administers and provides extended service contracts to consumers and certain insurance contracts to dealers and consumers through various third-party suppliers. Polaris does not retain any warranty, insurance or financial risk under any of these arrangements. Polaris' service fee income generated from these arrangements has been included as a component of income from financial services in the accompanying consolidated statements of income.

## Note 7. Investment in Other Affiliates

Investment in other affiliates in the consolidated balance sheets represents the Company's investment in nonmarketable securities of strategic companies. Investment in other affiliates as of June 30, 2014 and December 31, 2013 is comprised of investments in Brammo, Inc. ("Brammo") and Eicher-Polaris Private Limited (EPPL) with the following balances (in thousands):

Investment in Brammo
Investment in EPPL
Total investment in other affiliates

| June 30, 2014 | December 31, 2013 |
| :--- | :--- |
| $\$ 9,500$ | $\$ 9,500$ |
| 9,122 | 6,456 |
| $\$ 18,622$ | $\$ 15,956$ |

Brammo is a privately held designer and developer of electric vehicles. The investment in Brammo is accounted for under the cost method. Brammo is in the early stages of designing and developing electric vehicles. As such, a risk exists that Brammo may not be able to secure sufficient financing to reach viability through cash flow from operations.
EPPL is a joint venture established in 2012 with Eicher Motors Limited (Eicher). Polaris and Eicher each control 50 percent of the joint venture, which is intended to design, develop and manufacture a full range of new vehicles for India and other emerging markets. The investment in EPPL is accounted for under the equity method, with Polaris' proportionate share of income or loss recorded within the consolidated financial statements on a one month lag due to financial information not being available timely. The overall investment is expected to be approximately $\$ 50,000,000$, shared equally with Eicher over a three year period. Through June 30, 2014, Polaris has invested $\$ 13,591,000$ in the joint venture. Polaris' share of EPPL loss for the three and six months ended June 30, 2014 was $\$ 967,000$ and $\$ 1,863,000$, respectively, compared to $\$ 586,000$ and $\$ 998,000$ for the same respective periods in 2013 . The loss is included in equity in loss of other affiliates on the consolidated statements of income.
Polaris will impair or write off an investment and recognize a loss when events or circumstances indicate there is impairment in the investment that is other-than-temporary. No impairments were recognized on currently held investments in the three or six months ended June 30, 2014.

## Note 8. Commitments and Contingencies

Polaris is subject to product liability claims in the normal course of business. In late 2012, Polaris purchased excess insurance coverage for catastrophic product liability claims for incidents occurring after the policy date. Polaris self-insures product liability claims before the policy date and up to the purchased catastrophic insurance coverage after the policy date. The estimated costs resulting from any losses are charged to operating expenses when it is probable a loss has been incurred and the amount of the loss is reasonably determinable. The Company utilizes historical trends and actuarial analysis tools, along with an analysis of current claims, to assist in determining the

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appropriate loss reserve levels. At June 30, 2014, the Company had an accrual of $\$ 25,952,000$ for the probable payment of pending claims related to continuing operations product liability litigation associated with Polaris products. This accrual is included as a component of other accrued expenses in the accompanying consolidated balance sheets.

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Polaris is a defendant in lawsuits and subject to other claims arising in the normal course of business. In the opinion of management, it is unlikely that any legal proceedings pending against or involving Polaris will have a material adverse effect on Polaris' financial position or results of operations.
As a component of certain past acquisition agreements, Polaris has committed to make additional payments to certain sellers contingent upon either the passage of time or certain financial performance criteria. Polaris initially records the fair value of each commitment as of the respective opening balance sheet, and each reporting period the fair value is evaluated, using level 3 inputs, with the change in value reflected in the consolidated statements of income. As of June 30, 2014 and December 31, 2013, the fair value of contingent purchase price commitments was $\$ 18,460,000$ and $\$ 18,249,000$, respectively, recorded in other long-term liabilities in the consolidated balance sheets.

Note 9. Derivative Instruments and Hedging Activities
The Company is exposed to certain risks relating to its ongoing business operations. From time to time, the primary risks managed by using derivative instruments are foreign currency risk, interest rate risk and commodity price fluctuations. Derivative contracts on various currencies are entered into in order to manage foreign currency exposures associated with certain product sourcing activities and intercompany cash flows. Interest rate swaps are entered into in order to manage interest rate risk associated with the Company's variable-rate borrowings. Commodity hedging contracts are entered into in order to manage fluctuating market prices of certain purchased commodities and raw materials that are integrated into the Company's end products.
The Company's foreign currency management objective is to mitigate the potential impact of currency fluctuations on the value of its U.S. dollar cash flows and to reduce the variability of certain cash flows at the subsidiary level. The Company actively manages certain forecasted foreign currency exposures and uses a centralized currency management operation to take advantage of potential opportunities to naturally offset foreign currency exposures against each other. The decision of whether and when to execute derivative instruments, along with the duration of the instrument, can vary from period to period depending on market conditions, the relative costs of the instruments and capacity to hedge. The duration is linked to the timing of the underlying exposure, with the connection between the two being regularly monitored. Polaris does not use any financial contracts for trading purposes.
At June 30, 2014, Polaris had the following open foreign currency contracts (in thousands):

Foreign Currency
Australian Dollar
Canadian Dollar
Japanese Yen
Mexican Peso
Total

Notional Amounts
(in US Dollars)
$\$ 6,303 \quad \$(156)$
$149,554 \quad(1,711)$
11,770 (177
15,665 436
$\$ 183,292 \quad \$(1,608)$

These contracts, with maturities through March 31, 2015, met the criteria for cash flow hedges and the unrealized gains or losses, after tax, are recorded as a component of accumulated other comprehensive income in shareholders' equity.
Polaris enters into derivative contracts to hedge a portion of the exposure related to diesel fuel and aluminum. These diesel fuel and aluminum derivative contracts have not met the criteria for hedge accounting. The impact to cost of sales in the consolidated statements of income for diesel fuel and aluminum derivative contracts during the three and six months ended June 30, 2014 and 2013. There were no outstanding contracts at June 30, 2014.

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The table below summarizes the carrying values of derivative instruments as of June 30, 2014 and December 31, 2013 (in thousands):

Derivatives designated as hedging instruments
Foreign exchange contracts(1)
Total derivatives designated as hedging instruments

Derivatives designated as hedging instruments
Foreign exchange contracts(1)
Total derivatives designated as hedging instruments Commodity contracts(1)
Total derivatives not designated as hedging instruments
Total derivatives
Carrying Values of Derivative Instruments as of June 30, 2014

| Fair Value- | Fair Value- <br> (Liabilities) | Derivative Net <br> Carrying Value |
| :--- | :--- | :--- |

$\$ 474 \quad \$(2,082) \$(1,608 \quad)$
\$474 $\quad \$(2,082) \$(1,608)$

Carrying Values of Derivative Instruments as of December 31, 2013

| Fair Value- | Fair Value- <br> (Liabilities) | Derivative Net <br> Carrying Value |
| :--- | :--- | :--- |

(1) Assets are included in prepaid expenses and other and liabilities are included in other accrued expenses on the accompanying consolidated balance sheets.
For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income and reclassified into the income statement in the same period or periods during which the hedged transaction affects the income statement. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in the current income statement.
The table below provides data about the amount of gains and losses, net of tax, related to derivative instruments designated as cash flow hedges included in accumulated other comprehensive income for the three and six ended June 30, 2014 and 2013 (in thousands):

Gains and (Losses) From Derivatives in
Cash Flow Hedging Relationships
Foreign currency contracts

Three months ended June 30,
$\left.\begin{array}{llll}2014 & 2013 & 2014 & 2013 \\ \$(1,581 & ) & \$ 1,913 & \$(1,015\end{array}\right) \$ 3,020$

See Note 5 for information about the amount of gains and losses, net of tax, reclassified from accumulated other comprehensive income into the income statement for derivative instruments designated as hedging instruments. The ineffective portion of foreign currency contracts was not material for the three and six month periods ended June 30, 2014.

## Item 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Overview

The following discussion pertains to the results of operations and financial position of Polaris Industries Inc., a Minnesota corporation, for the three and six month periods ended June 30, 2014 compared to the three and six month periods ended June 30, 2013. The terms "Polaris," the "Company," "we," "us," and "our" as used herein refer to the business a operations of Polaris Industries Inc., its subsidiaries and its predecessors, which began doing business in the early 1950s. Due to the seasonality of snowmobiles; Off-Road Vehicles (ORV), which includes all-terrain vehicles (ATV) and side-by-side vehicles; motorcycles; Small Vehicles (SV); and Parts, Garments and Accessories (PG\&A) businesses, and to certain changes in production and shipping cycles, results of such periods are not necessarily indicative of the results to be expected for the complete year.

We reported net income of $\$ 96.9$ million, or $\$ 1.42$ per diluted share, an earnings per diluted share increase of 26 percent compared to 2013 second quarter net income of $\$ 80.0$ million, or $\$ 1.13$ per diluted share. Sales totaled $\$ 1,014.0$ million, an increase of 20 percent from last year's second quarter sales of $\$ 844.8$ million. The sales increase was driven primarily by increased sales of ORVs, motorcycles and PG\&A, improved pricing and beneficial mix. Our unit retail sales to consumers in

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North America grew 15 percent in the first quarter of 2014, with the increased demand primarily in ORVs and motorcycles. Our sales to customers outside of North America grew 26 percent driven by higher sales in ORVs, motorcycles and small vehicles. Our gross profit of $\$ 304.9$ million increased 21 percent from $\$ 252.3$ million in the comparable prior year period. The increase in gross profit resulted primarily from higher volume, increased selling prices and continued product cost reduction efforts. Our liquidity remained healthy with $\$ 119.0$ million in cash on hand and over \$200 million of availability on our revolving loan facility at June 30, 2014.

## Results of Operations

Unless otherwise noted, all "quarter" comparisons are from the second quarter 2013 to the second quarter 2014 and all "year-to-date" comparisons are from the six month period ended June 30, 2013 to the six month period ended June 30, 2014.

Sales:
Quarter sales were $\$ 1,014.0$ million, a 20 percent increase from $\$ 844.8$ million in quarter sales the prior year. Year-to-date sales were $\$ 1,902.3$ million, a 20 percent increase from $\$ 1,590.7$ million of sales in the comparable prior year period. The following table is an analysis of the percentage change in total Company sales:
$\left.\begin{array}{llll}\text { Volume } & 16 & \% & 15 \\ \text { Product mix and price } & 5 & 6 & \% \\ \text { Currency } & (1 & ) & (1\end{array}\right)$

Quarter and year-to-date volume increased as we shipped more ORVs, motorcycles and related PG\&A items to dealers given increased consumer retail demand for our products in North America. Product mix and price contributed to the growth primarily due to the positive benefit of a greater number of higher priced ORVs and motorcycles sold to dealers relative to our other businesses. The U.S. dollar to Canadian dollar exchange rate negatively impacted our quarter and year-to-date sales when compared to the prior year period exchange rate.
Our sales by product line were as follows:
Three months ended June 30,

| (\$ in millions) | 2014 | Percent of Total Sales |  | $2013$ | Percent of Total Sales | Percent Change 2014 vs. 2013 |  | 2014 | Percent of Total Sales |  |  | Percent of Total Sales |  | Percent <br> Change <br> 2014 vs. <br> 2013 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Off-Road <br> Vehicles | \$701.5 | 69 | \% | \$619.2 | 73 \% | 13 | \% | \$ 1,304.3 | 69 | \% | \$ 1,160.5 | 73 | \% | 12 | \% |
| Snowmobiles | 6.2 | 1 | \% | 8.5 | 1 \% | (27 | )\% | 21.7 | 1 | \% | 23. | 1 | \% | (6 | ) |
| Motorcycles | 103.1 | 10 | \% | 49.9 | 6 \% | 107 | \% | 182.0 | 10 | \% | 101.7 | 6 | \% | 79 | \% |
| Small <br> Vehicles | 43.5 | 4 | \% | 33.7 | 4 \% | 29 | \% | 82.0 | 4 | \% | 44.8 | 3 | \% | 83 | \% |
| PG\&A | 159.7 | 16 | \% | 133.5 | 16 \% | 20 | \% | 312.3 | 16 | \% | 260.5 | 17 | \% | 20 | \% |
| Total Sales | \$ 1,014.0 | 100 | \% | \$844.8 | 100 \% | 20 | \% | \$ 1,902.3 | 100 | \% | \$ 1,590.7 | 100 | \% | 20 | \% |

ORVs: The quarter and year-to-date sales increase reflects continued market share gains in both ATV and side-by-side vehicles. Our North American ORV quarter unit retail sales to consumers increased low-double digits percent, with side-by-side vehicles unit retail increasing low-teens percent, ATV unit retail increasing mid-single digits percent and the Sportsman $A C E^{\text {TM }}$ category continuing to gain retail momentum. North American dealer unit inventories increased low-teens percent from a year ago, primarily reflecting new ORV product categories added during the 2014 model
year. Quarter sales outside of North America increased 19 percent, primarily due to market share gains. The quarter average per unit sales price increased two percent primarily as a result of the increased sales of higher priced side-by-side vehicle models.
Snowmobiles: Historically, the first half of the year is a slow period for shipments to dealers due to the seasonality of the business. Quarter and year-to-date sales declined slightly due to the timing of shipments of model year 2015 snowmobiles, which begins in earnest in the 2014 third quarter.

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For the snowmobile season ended March 31, 2014 compared to season ended March 31, 2013, the North American industry retail sales were up just over ten percent percent due to favorable snowfall levels in most of the North American snowmobile riding areas. Our North American retail sales were up mid-single digits percent for the full season, but were lower than the industry primarily due to a slow start for our pre-season orders from consumers last spring.
Motorcycles: The quarter and year-to-date increase in sales is due to shipments of the new model year 2014 Indian motorcycles. North American industry, greater than 1400cc heavyweight cruisers and touring motorcycles, quarter retail sales were flat. Polaris North American quarter unit retail sales increased approximately 50 percent. Victory North American retail sales in the 2014 second quarter were down mid-single digits percent largely due to a product recall in May. Increased shipments of Indian motorcycles is the primary driver of (1) North American Polaris dealer inventory increasing approximately 20 percent, (2) quarter sales to customers outside of North America increasing nearly 100 percent and (3) the quarter average per unit sales price increasing nine percent.
Small Vehicles: The quarter increase in sales primarily reflects continued market share gains in Aixam Mega vehicles. The year-to-date sales increase is due to these gains along with the inclusion of Aixam Mega in our consolidated financial statements since it was acquired in April 2013. Also, both GEM and Goupil experienced an increase in quarter and year-to-date sales.
PG\&A: The overall quarter and year-to-date sales increase was driven primarily by double digit increases in ORV and motorcycle product lines resulting from product innovation and increased integration of accessories. In April 2014, we acquired Kolpin Outdoors, Inc. ("Kolpin"), a leading aftermarket brand delivering purpose-built and universal-fit ORV accessories and lifestyle products, which also benefited quarter sales. Quarter sales to customers outside North America increased ten percent primarily due to an increase in sales of small vehicle parts.
Sales by geographic region were as follows:
Three months ended June 30, Six months ended June 30,

| (\$ in millions) | 2014 | Percent of Total Sales | 2013 | Percent of Total Sales | Percent <br> Change <br> 2014 vs. <br> 2013 | 2014 | Percent of Total Sales | 2013 | Percent of Total Sales | Percent Change 2014 vs. 2013 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| United States | \$736.7 | 73 \% | \$599.6 | 71 \% | 23 \% | \$ 1,376.4 | 72 \% | \$ 1,143.6 | 72 \% | 20 \% |
| Canada | 106.8 | 10 \% | 109.7 | 13 \% | (3)\% | 190.3 | 10 \% | 197.2 | 12 \% | (3 )\% |
| Other foreign countries | 170.5 | 17 \% | 135.5 | 16 \% | 26 \% | 335.6 | 18 \% | 249.9 | 16 \% | 34 \% |
| Total sales | \$ 1,014.0 | 100 \% | \$844.8 | 100 \% | 20 \% | \$ 1,902.3 | 100 \% | \$ 1,590.7 | 100 \% | 20 \% |

United States: Quarter and year-to-date sales in the United States increased due to higher shipments of ORVs, motorcycles and PG\&A, improved pricing and more beneficial product mix.
Canada: Quarter and year-to-date sales decreased slightly due to pricing increases being more than offset by an unfavorable seven and eight percent currency rate movement impact on quarter and year-to-date sales, respectively. Other foreign countries: Quarter and year-to-date sales in other foreign countries, primarily in Europe, increased primarily due to increased sales of ORVs, particularly side-by-side vehicles, motorcycles, small vehicles and PG\&A related sales in both the EMEA (Europe, Middle East, and Africa) and APLA (Asia Pacific and Latin America) regions. Currency rate movements had a favorable two and one percent impact on quarter and year-to-date sales, respectively.

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Cost of Sales:

Three months ended June 30, Percent of Percent ©thange
(\$ in millions) 2014 Total 2013 Cost of Sales

Total 2014 vs. 2014 Cost of Sale3

Six months ended June 30,
Percent of Percent Change

Total 2013 Total 2014 vs. Cost of Sales Cost of Sole3

Purchased $\begin{array}{lllllllllllllllll}\text { materials and } & \$ 619.3 & 87 & \% & \$ 518.6 & 88 & \% & 19 & \% & \$ 1,168.3 & 87 & \% & \$ 983.3 & 88 & \% & 19 & \%\end{array}$ services

| Labor and <br> benefits | 56.8 | 8 | $\%$ | 48.2 | 8 | $\%$ | 18 | $\%$ | 106.2 | 8 | $\%$ | 89.5 | 8 | $\%$ | 19 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Depreciation

| and | 20.6 | 3 | $\%$ | 12.5 | 2 | $\%$ | 65 | $\%$ | 41.2 | 3 | $\%$ | 26.9 | 2 | $\%$ | 53 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

amortization
$\begin{array}{lllllllllllllllll}\text { Warranty costs } 12.3 & 2 & \% & 13.2 & 2 & \% & (7 & ) & \% & 23.3 & 2 & \% & 22.0 & 2 & \% & 6 & \%\end{array}$
$\begin{array}{lllllllllllllllll}\text { Total cost of } & \$ 709.0 & 100 & \% & \$ 592.5 & 100 & \% & 20 & \% & \$ 1,339.0 & 100 & \% & \$ 1,121.7 & 100 & \% & 19 & \%\end{array}$ sales
Percentage of sales
$69.9 \%$
$70.1 \quad \% \quad-20$ basis $\quad 70.4 \quad \% \quad 70.5 \quad \% \quad-10$ basis
points
points
The increase in quarter and year-to-date cost of sales dollars resulted primarily from the effect of increases in volume on purchased materials and labor and benefits.
Gross Profit:
Three months ended June 30,

Quarter and year-to-date gross profit, as a percentage of sales, increased due to lower product costs and higher pricing partially offset by the negative impact from currency rate movements. Likewise, quarter and year-to-date gross profit in absolute dollars increased for similar reasons in addition to the impact from increased sales volume.
Operating Expenses:


Operating expenses in absolute dollars for the quarter and year-to-date periods increased due to higher selling and marketing expenses primarily related to the re-launch of Indian motorcycles and higher product liability provisioning. The increase in operating expenses was lower than the increase in sales primarily due to a decrease in long-term incentive compensation expense, which resulted from a decrease in unvested stock awards in which the expense is tied to changes in the Company's stock price.
Income from Financial Services:

|  | Three months ended June 30, |  | Six months ended June 30, |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| (\$ in millions) | 2014 | 2013 | Change |  | 2014 | 2013 | Change |  |
| Income from financial services | $\$ 14.6$ | $\$ 11.5$ | 27 | $\%$ | $\$ 25.3$ | $\$ 21.6$ | 17 | $\%$ |


| Percentage of sales | 1.4 | $\%$ | 1.4 | $\%$ | No change | 1.3 | $\%$ | 1.4 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |$\% \%$| -10 basis |
| :--- |

The increase in quarter and year-to-date income from financial services is primarily due to higher income from dealer inventory financing through Polaris Acceptance. Further discussion can be found in the "Liquidity and Capital Resources" section below.

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Remainder of the Income Statement:
Three months ended June 30,

| (\$ in millions except per share data) | 2014 |  | 2013 |  | $\begin{aligned} & \text { Change } \\ & 2014 \text { vs. } 2013 \end{aligned}$ |  | 2014 |  | 2013 |  | $\begin{aligned} & \text { Change } \\ & 2014 \text { vs. } 2013 \end{aligned}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Interest expense | \$3.0 |  | \$1.4 |  | 122 | \% | \$5.9 |  | \$2.8 |  | 106 | \% |
| Equity in loss of other affiliates | \$ 1.0 |  | \$0.6 |  | 65 | \% | \$1.9 |  | \$1.0 |  | 87 | \% |
| Other (income), net | \$(1.9 | ) | \$(1.2 | ) | 53 | \% | \$(4.0 | ) | \$(3.7 | ) | 8 | \% |
| Income before taxes | \$153.3 |  | \$124.8 |  | 23 | \% | \$278.4 |  | \$227.4 |  | 22 | \% |
| Provision for income taxes | \$56.4 |  | \$44.8 |  | 26 | \% | \$ 100.6 |  | \$71.9 |  | 40 | \% |
| Percentage of income before taxes | 36.8 | \% | 35.9 | \% | +90 basis points |  | 36.1 | \% | 31.6 | \% | +450 basis points |  |
| Net income | \$96.9 |  | \$80.0 |  | 21 | \% | \$177.8 |  | \$155.5 |  | 14 | \% |
| Diluted net income per share | \$1.42 |  | \$ 1.13 |  | 26 | \% | \$2.61 |  | \$2.20 |  | 19 | \% |
| Weighted average diluted shares outstanding | 68.1 |  | 70.8 |  | (4 | )\% | 68.0 |  | 70.8 |  | (4 | )\% |

Interest expense: The quarter and year-to-date increase is primarily due to increased debt levels through borrowings on our existing revolving credit facility and the additional borrowing of $\$ 100.0$ million through our amended Master Note Purchase Agreement in December 2013.
Equity in loss of other affiliates: Increased quarter and year-to-date losses at Eicher-Polaris Private Limited (EPPL) were the result of an increase in the joint venture's pre-production activities. We record our proportionate 50 percent share of EPPL gains and losses.
Other (income), net: The quarter and year-to-date change primarily relates to foreign currency exchange rate movements and the resulting effects on foreign currency transactions and balance sheet positions related to our foreign subsidiaries from period to period.
Provision for income taxes: The quarter and year-to-date income tax rate is negatively impacted by the United States research and development income tax credit not yet being extended to 2014, and as a result no benefit has been recorded year-to-date. Additionally, the year-to-date income tax rate increased as a result of $\$ 8.2$ million of tax benefits which favorably impacted the 2013 year-to-date income tax rate. The 2013 year-to-date tax benefits were from the United States extending the research and development income tax credit retroactively to 2012 and favorable outcomes of income tax audits during the period.
Weighted average shares outstanding: In November 2013, Polaris entered into and executed a Share Repurchase Agreement with Fuji Heavy Industries Ltd. pursuant to which Polaris purchased 3.96 million shares of Polaris stock held by Fuji. This buyback more than offset the issuance of shares under employee compensation plans and resulted in a decrease to the quarter and year-to-date weighted average diluted shares outstanding. As a result of this buyback, the quarter and year-to-date percentage increases in diluted net income per share exceeded the percentage increases in net income.
Cash Dividends:
We paid a regular cash dividend of $\$ 0.48$ per share on June 16,2014 to holders of record at the close of business on June 2, 2014. On July 23, 2014, the Polaris Board of Directors declared a regular cash dividend of $\$ 0.48$ per share payable on September 15, 2014 to holders of record of such shares at the close of business on September 2, 2014.

## Liquidity and Capital Resources

Our primary source of funds has been cash provided by operating and financing activities. Our primary uses of funds have been for acquisitions, repurchase and retirement of common stock, capital investment, new product development and cash dividends to shareholders.

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The following table summarizes the cash flows from operating, investing and financing activities:
(\$ in millions)
Six months ended June 30,
Total cash provided by (used for):
Operating activities
Investing activities
Financing activities
Impact of currency exchange rates on cash balances
Increase (decrease) in cash and cash equivalents
$\left.\begin{array}{lll}2014 & 2013 & \text { Change } \\ & & \\ \$ 130.9 & \$ 103.5 & \$ 27.4 \\ (116.8 & ) & (230.6\end{array}\right) 113.8$

Operating activities: The increase in net cash provided by operating activities is primarily the result of higher net income.
Investing activities: The primary use of cash was for the purchase of property and equipment and the acquisition of Kolpin. We made large capital expenditures related to continued capacity and capability expansion at our manufacturing facilities and the acquisition of an additional headquarters building. We expect that capital expenditures for the full year 2014 will be between $\$ 200$ million and $\$ 250$ million.
Financing activities: Cash provided by (used for) financing activities changed primarily due to net borrowings under debt arrangements and capital lease obligations of $\$ 55.2$ million compared to payments of $\$ 0.4$ million in the 2013 comparable period, and common stock repurchases of $\$ 3.9$ million compared to $\$ 31.9$ million in the 2013 comparable period. Additionally, we paid cash dividends of $\$ 63.4$ million and $\$ 57.5$ million in the six months ended June 30 , 2014 and 2013, respectively, and proceeds from the issuance of stock under employee plans were $\$ 13.0$ million and $\$ 10.2$ million for the six months ended June 30, 2014 and 2013, respectively.
The seasonality of production and shipments cause working capital requirements to fluctuate during the year. We are party to a $\$ 350$ million variable interest rate bank lending agreement and a Master Note Purchase Agreement, as amended and supplemented, under which we have unsecured borrowings. We enter into leasing arrangements to finance the use of certain property and equipment.
Debt and capital lease obligations and the average related interest rates at June 30, 2014 were as follows (in thousands):
(\$ in millions)

Revolving loan facility
Senior notes-fixed rate
Senior notes-fixed rate
Senior notes-fixed rate
Capital lease obligations
Total debt and capital lease obligations
Less: current maturities
Long-term debt and capital lease obligations

| Average interest <br> rate at June 30, | Maturity | June 30, 2014 |
| :--- | :--- | :--- |
| 2014 |  |  |$\quad$ January 2018 $\quad \$ 137.0$

Our debt to total capital ratio was 35 percent and 12 percent at June 30, 2014 and 2013, respectively.
Additionally, at June 30, 2014 we had letters of credit outstanding of $\$ 24.9$ million primarily related to purchase obligations for raw materials.
Our Board of Directors has authorized the cumulative repurchase of up to 75.0 million shares of our common stock. Of that total, approximately 73.4 million shares have been repurchased cumulatively from 1996 through June 30, 2014. We repurchased a nominal number of shares of our common stock for $\$ 3.9$ million during the first six months of 2014, which had a nominal impact on earnings per share. We have authorization from our Board of Directors to repurchase up to an additional 1.6 million shares of our common stock as of June 30, 2014. The repurchase of any or all such shares authorized remaining for repurchase will be governed by applicable SEC rules.
Polaris Acceptance, a joint venture between Polaris and GE Commercial Distribution Finance Corporation (GECDF), an indirect subsidiary of General Electric Capital Corporation, which is supported by a partnership agreement between
their respective wholly owned subsidiaries, finances substantially all of Polaris' United States sales whereby Polaris receives payment within a few days of shipment of the product. Polaris Acceptance sells a majority of its receivable portfolio (the "Securitized Receivables") to a securitization facility ("Securitization Facility") arranged by General Electric Capital

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Corporation, a GECDF affiliate. Polaris Acceptance is not responsible for any continuing servicing costs or obligations with respect to the Securitized Receivables. At June 30, 2014, the outstanding amount of net receivables financed for dealers under this arrangement, including Securitized Receivables, was $\$ 879.6$ million, a 23 percent increase from $\$ 712.8$ million at June 30, 2013.
We account for our investment in Polaris Acceptance under the equity method. Polaris Acceptance is funded through equal equity cash investments from the partners and a loan from an affiliate of GECDF. We do not guarantee the outstanding indebtedness of Polaris Acceptance. The partnership agreement provides that all income and losses of Polaris Acceptance are shared 50 percent by our wholly owned subsidiary and 50 percent by GECDF's subsidiary. Our total investment in Polaris Acceptance at June 30, 2014, was $\$ 67.6$ million. Our exposure to losses of Polaris Acceptance is limited to our equity in Polaris Acceptance. Credit losses in the Polaris Acceptance portfolio have been modest, averaging less than one percent of the portfolio.
We have agreed to repurchase products repossessed by Polaris Acceptance up to an annual maximum of 15 percent of the aggregate average month-end outstanding Polaris Acceptance receivables and Securitized Receivables during the prior calendar year. For calendar year 2014, the potential 15 percent aggregate repurchase obligation is approximately $\$ 120.8$ million. Our financial exposure under this arrangement is limited to the difference between the amount paid to the finance company for repurchases and the amount received on the resale of the repossessed product. No material losses have been incurred under this agreement
See Note 6 in the Notes to Consolidated Financial Statements for further discussion of Polaris Acceptance. We have agreements with Capital One, Sheffield Financial and Synchrony Bank, formerly GE Money Bank, under which these financial institutions provide financing to end consumers of our products. The agreements expire in October 2015, February 2016 and April 2016, respectively. The income generated from these agreements has been included as a component of income from financial services in the accompanying consolidated statements of income. We believe that existing cash balances and cash flow to be generated from operating activities and available borrowing capacity under the line of credit arrangement will be sufficient to fund operations, new product development, cash dividends, share repurchases and capital requirements for the foreseeable future. At this time, management is not aware of any factors that would have a material adverse impact on cash flow.

## Inflation and Foreign Exchange Rates

The changing relationships of the U.S. dollar to the Japanese yen, the Mexican peso, the Canadian dollar, the Australian dollar, the Euro and other foreign currencies have had a material impact from time to time. We actively manage our exposure to fluctuating foreign currency exchange rates by entering into foreign exchange hedging contracts.
Japanese Yen: During 2013, purchases totaling approximately four percent of our cost of sales were from yen-denominated suppliers. Fluctuations in the yen to U.S. dollar exchange rate primarily impact cost of sales. Mexican Peso: With increased production at our Monterrey, Mexico facility, our costs in the Mexican peso have continued to increase. Fluctuations in the peso to U.S. dollar exchange rate primarily impact cost of sales. Canadian Dollar: We operate in Canada through a wholly owned subsidiary. The relationship of the U.S. dollar in relation to the Canadian dollar impacts both sales and net income.
Other currencies: We operate in various countries, principally in Europe and Australia, through wholly owned subsidiaries and also sell to certain distributors in other countries. We also purchase components from certain suppliers directly for our U.S. operations in transactions denominated in Euros and other foreign currencies. The relationship of the U.S. dollar in relation to these other currencies impacts each of sales, cost of sales and net income.

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At June 30, 2014, we had the following open foreign currency hedging contracts for the remainder of 2014 and early 2015, and expect the following net currency impact on gross profit, after consideration of the existing foreign currency hedging contracts, when compared to the respective prior year periods:

Foreign currency hedging contracts

| Foreign Currency | Currency Position | Notional amounts (in thousands of US Dollars) | Average exchange rate of open contracts | Second quarter 2014 | Estimated remainder of 2014 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Australian Dollar (AUD) | Long | \$6,303 | \$0.91 to 1 AUD | Negative | Negative |
| Canadian Dollar (CAD) | Long | 149,554 | \$0.92 to 1 CAD | Negative | Negative |
| Euro | Long | - | - | Neutral | Neutral |
| Japanese Yen | Short | 11,770 | 99 Yen to \$1 | Positive | Positive |
| Mexican Peso | Short | 15,665 | 13.43 Peso to \$1 | Slightly positive | Slightly positive |
| Norwegian Krone | Long | - | - | Neutral | Neutral |
| Swedish Krona | Long | - | - | Neutral | Slightly negative |

The assets and liabilities in all our foreign entities are translated at the foreign exchange rate in effect at the balance sheet date. Translation gains and losses are reflected as a component of accumulated other comprehensive income, net in the shareholders' equity section of the accompanying consolidated balance sheets. Revenues and expenses in all of our foreign entities are translated at the average foreign exchange rate in effect for each month of the quarter. Certain assets and liabilities related to intercompany positions reported on our consolidated balance sheet that are denominated in a currency other than the entity's functional currency are translated at the foreign exchange rates at the balance sheet date and the associated gains and losses are included in net income.
We are subject to market risk from fluctuating market prices of certain purchased commodities and raw materials including steel, aluminum, petroleum-based resins, certain rare earth metals and diesel fuel. In addition, we are a purchaser of components and parts containing various commodities, including steel, aluminum, rubber and others, which are integrated into the Company's end products. While such materials are typically available from numerous suppliers, commodity raw materials are subject to price fluctuations. We generally buy these commodities and components based upon market prices that are established with the vendor as part of the purchase process and from time to time will enter into derivative contracts to hedge a portion of the exposure to commodity risk. At June 30, 2014, we had no outstanding commodity derivative contracts. Based on our current outlook for commodity prices, the total impact of commodities is expected to have a neutral impact on our gross margins for the remainder of 2014 when compared to the same periods in the prior year.
We are a party to a credit agreement with various lenders consisting of a $\$ 350$ million revolving loan facility. Interest accrues on the revolving loan at variable rates based on LIBOR or "prime" plus the applicable add-on percentage as defined in the agreement. At June 30, 2014, our outstanding balance on the revolving loan was $\$ 137.0$ million. Assuming no additional borrowings or payments on the debt, a one-percent fluctuation in interest rates would have a $\$ 0.7$ million impact to interest expense for the remainder of 2014.

Critical Accounting Policies
See our most recent Annual Report on Form 10-K for the year ended December 31, 2013 for a discussion of our critical accounting policies.

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Note Regarding Forward Looking Statements
Certain matters discussed in this report are "forward-looking statements" intended to qualify for the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These "forward-looking statements," including but not limited to the impact of foreign exchange rate movements on sales and net income, and commodity price changes on gross margins, can generally be identified as such because the context of the statement will include words such as the Company or management "believes," "anticipates," "expects," "estimates" or words of similar import. Similarly, statements that describe the Company's future plans, objectives or goals are also forward-looking. Forward-looking statements may also be made from time to time in oral presentations, including telephone, conferences and/or webcasts open to the public. Shareholders, potential investors and others are cautioned that all forward-looking statements involve risks and uncertainties that could cause results in future periods to differ materially from those anticipated by some of the statements made in this report, including the risks and uncertainties described under the heading titled "Item 1A-Risk Factors" appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. In addition to the factors discussed above, among the other factors that could cause actual results to differ materially are the following: product offerings, promotional activities and pricing strategies by competitors; acquisition integration costs; future conduct of litigation processes; warranty expenses; foreign currency exchange rate fluctuations; commodity and transportation costs; environmental and product safety regulatory activity; effects of weather; uninsured product liability claims; uncertainty in the retail and wholesale credit markets and relationships with Capital One, Sheffield Financial and Synchrony Bank; changes in tax policy; and overall economic conditions, including inflation and consumer confidence and spending. The Company does not undertake any duty to any person to provide updates to its forward-looking statements.

## Item 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for a complete discussion on the Company's market risk. There have been no material changes in market risk from those disclosed in the Company's Form 10-K for the year ended December 31, 2013.

## Item 4 - CONTROLS AND PROCEDURES <br> Evaluation of Disclosure 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 Chief Executive Officer and its Vice President - Finance and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15) as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is (1) recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (2) accumulated and communicated to the Company's management, including its Chief Executive Officer and Vice President - Finance and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.
Changes in Internal Controls
There have been no changes in the Company's internal controls over financial reporting during the period covered by this quarterly report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## Part II OTHER INFORMATION

Item 1 - LEGAL PROCEEDINGS
We are involved in a number of legal proceedings incidental to our business, none of which is expected to have a material effect on the financial results of our business.

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## Item 1A - RISK FACTORS

There have been no material changes or additions to our risk factors discussed in our fiscal 2013 Annual Report filed on Form 10-K. Please consider the factors discussed in "Part I, Item 1A. Risk Factors" in such report, which could materially affect the Company's business, financial condition, or future results.

Item 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

|  |  |  | Total <br> Number of | Maximum <br> Number of |
| :--- | :--- | :--- | :--- | :--- |
| Period | Total | Average | Shares | Shares |

(1) The Board of Directors has authorized the cumulative repurchase of up to an aggregate of 75.0 million shares of the Company's common stock (the "Program"). Of that total, 73.4 million shares have been repurchased cumulatively from 1996 through June 30, 2014. The Program does not have an expiration date.

Item 4 - MINE SAFETY DISCLOSURES
Not applicable.
Item 6 - EXHIBITS
A list of exhibits to this Form 10-Q is set forth on the Exhibit Index and is incorporated herein by reference.
Exhibit Index

Exhibit
Number
3.a 2011, incorporated by reference to Exhibit 3.a to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011.
31.a Certification of Chief Executive Officer required by Exchange Act Rule 13a-14(a).
31.b Certification of Chief Financial Officer required by Exchange Act Rule 13a-14(a).

Certification furnished pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Certification furnished pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The following financial information from Polaris Industries Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2014, filed with the SEC on July 25, 2014, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets at June 30, 2014 and December 31, 2013, (ii) the Consolidated Statements of Income for the three and six month periods ended June 30, 2014 and 2013, (iii) the Consolidated Statements of Comprehensive Income for the three and six month periods ended June 30, 2014 and 2013, (iv) the Consolidated Statements of Cash Flows for the six month periods ended June 30, 2014 and 2013, and (v) Notes to Consolidated Financial Statements.

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## SIGNATURES

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.

Date: July 25, 2014

Date: July 25, 2014

POLARIS INDUSTRIES INC.<br>(Registrant)<br>/s/ SCOTT W. WINE<br>Scott W. Wine<br>Chairman and Chief Executive Officer (Principal Executive Officer)<br>/s/ MICHAEL W. MALONE<br>Michael W. Malone<br>Vice President - Finance and Chief Financial Officer<br>(Principal Financial and Chief Accounting Officer)

