

Eaton Corp plc
Form 10-Q
April 29, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2015

Commission file number 000-54863

EATON CORPORATION plc

(Exact name of registrant as specified in its charter)

Ireland

98-1059235

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification Number)

Eaton House, 30 Pembroke Road, Dublin 4, Ireland
(Address of principal executive offices)

-
(Zip Code)

+1 (440) 523-5000

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year if changed since last report)

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

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

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

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

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

There were 467.1 million Ordinary Shares outstanding as of March 31, 2015.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

EATON CORPORATION plc
CONSOLIDATED STATEMENTS OF INCOME

(In millions except for per share data)	Three months ended		
	March 31		
	2015	2014	
Net sales	\$5,223	\$5,492	
Cost of products sold	3,593	3,858	
Selling and administrative expense	915	962	
Research and development expense	158	162	
Interest expense - net	57	62	
Other income - net	(5) (5)
Income before income taxes	505	453	
Income tax expense	38	12	
Net income	467	441	
Less net income for noncontrolling interests	(1) (2)
Net income attributable to Eaton ordinary shareholders	\$466	\$439	
Net income per ordinary share			
Diluted	\$0.99	\$0.92	
Basic	1.00	0.92	
Weighted-average number of ordinary shares outstanding			
Diluted	470.0	478.8	
Basic	467.9	475.8	
Cash dividends declared per ordinary share	\$0.55	\$0.49	

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	Three months ended		
	March 31		
	2015	2014	
Net income	\$467	\$441	
Less net income for noncontrolling interests	(1) (2)
Net income attributable to Eaton ordinary shareholders	466	439	
Other comprehensive (loss) income, net of tax			
Currency translation and related hedging instruments	(720) (47)
Pensions and other postretirement benefits	86	50	
Other comprehensive (loss) income attributable to Eaton ordinary shareholders	(634	) 3
Total comprehensive (loss) income attributable to Eaton ordinary shareholders	\$(168	) \$442

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)	March 31, 2015	December 31, 2014
Assets		
Current assets		
Cash	\$663	\$781
Short-term investments	139	245
Accounts receivable - net	3,733	3,667
Inventory	2,424	2,428
Deferred income taxes	576	593
Prepaid expenses and other current assets	405	386
Total current assets	7,940	8,100
Property, plant and equipment - net	3,634	3,750
Other noncurrent assets		
Goodwill	13,548	13,893
Other intangible assets	6,317	6,556
Deferred income taxes	220	228
Other assets	1,037	1,002
Total assets	\$32,696	\$33,529
Liabilities and shareholders' equity		
Current liabilities		
Short-term debt	\$267	\$2
Current portion of long-term debt	1,244	1,008
Accounts payable	1,969	1,940
Accrued compensation	282	420
Other current liabilities	1,904	1,985
Total current liabilities	5,666	5,355
Noncurrent liabilities		
Long-term debt	7,829	8,024
Pension liabilities	1,530	1,812
Other postretirement benefits liabilities	506	513
Deferred income taxes	881	901
Other noncurrent liabilities	1,020	1,085
Total noncurrent liabilities	11,766	12,335
Shareholders' equity		
Eaton shareholders' equity	15,210	15,786
Noncontrolling interests	54	53
Total equity	15,264	15,839
Total liabilities and equity	\$32,696	\$33,529

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	Three months ended	
	March 31	
	2015	2014
Operating activities		
Net income	\$467	\$441
Adjustments to reconcile to net cash provided by operating activities		
Depreciation and amortization	226	249
Deferred income taxes	14	(24)
Pension and other postretirement benefits expense	76	99
Contributions to pension plans	(223)	(272)
Contributions to other postretirement benefits plans	(9)	(12)
Excess tax benefit from equity-based compensation	—	(20)
Changes in working capital	(372)	(370)
Other - net	(102)	(79)
Net cash provided by operating activities	77	12
Investing activities		
Cash paid for acquisitions of businesses, net of cash acquired	(38)	—
Capital expenditures for property, plant and equipment	(105)	(110)
Sales of short-term investments - net	99	431
Proceeds from sale of businesses	—	3
Other - net	(9)	(20)
Net cash (used in) provided by investing activities	(53)	304
Financing activities		
Proceeds from borrowings	266	—
Payments on borrowings	(3)	(257)
Cash dividends paid	(251)	(229)
Exercise of employee stock options	33	23
Repurchase of shares	(170)	—
Excess tax benefit from equity-based compensation	—	20
Other - net	(2)	—
Net cash used in financing activities	(127)	(443)
Effect of currency on cash	(15)	(4)
Total decrease in cash	(118)	(131)
Cash at the beginning of the period	781	915
Cash at the end of the period	\$663	\$784

The accompanying notes are an integral part of these condensed consolidated financial statements.

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EATON CORPORATION plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Amounts are in millions unless indicated otherwise (per share data assume dilution).

Note 1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Eaton Corporation plc (Eaton or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles (US GAAP) for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring accruals) have been made that are necessary for a fair presentation of the condensed consolidated financial statements for the interim periods.

This Form 10-Q should be read in conjunction with the consolidated financial statements and related notes included in Eaton's 2014 Form 10-K. The interim period results are not necessarily indicative of the results to be expected for the full year. Management has evaluated subsequent events through the date this Form 10-Q was filed with the Securities Exchange Commission.

Certain prior year amounts have been reclassified to conform to the current year presentation.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (ASU 2014-09). This accounting standard supersedes all existing US GAAP revenue recognition guidance. Under ASU 2014-09, a company will recognize revenue when it transfers the control of promised goods or services to customers in an amount that reflects the consideration which the company expects to collect in exchange for those goods or services. ASU 2014-09 will require additional disclosures in the notes to the consolidated financial statements and is effective for annual and interim reporting periods beginning after December 15, 2016. In April 2015, the FASB proposed to defer the effective date of the new standard for one year. If the proposal is approved, then early adoption as of the original effective date would be permitted. Eaton is evaluating the impact of ASU 2014-09 and an estimate of the impact to the consolidated financial statements cannot be made at this time.

Note 2. ACQUISITION AND SALE OF BUSINESSES

Acquisition of UK Safety Technology Manufacturer Oxalis Group Ltd.

On January 12, 2015, Eaton acquired Oxalis Group Ltd. (Oxalis). Oxalis is a manufacturer of closed-circuit television camera stations, public address and general alarm systems and other electrical products for the hazardous area, marine and industrial communications markets. Oxalis is reported within the Electrical Systems and Services business segment.

Sale of Aerospace Power Distribution Management Solutions and Integrated Cockpit Solutions

On May 9, 2014, Eaton sold the Aerospace Power Distribution Management Solutions and Integrated Cockpit Solutions businesses to Safran for \$270, which resulted in a pre-tax gain of \$154.

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Note 3. ACQUISITION INTEGRATION CHARGES

Eaton incurs integration charges related to acquired businesses. A summary of these charges follows:

	Three months ended March 31	
	2015	2014
Acquisition integration charges		
Electrical Products	\$6	\$29
Electrical Systems and Services	3	26
Hydraulics	1	4
Total business segments	10	59
Corporate	1	7
Total acquisition integration charges before income taxes	\$11	\$66
Total after income taxes	\$7	\$44
Per ordinary share - diluted	\$0.02	\$0.09

Business segment integration charges during the first three months of 2015 and 2014 were related primarily to the integration of Cooper Industries plc (Cooper) to gain efficiencies in selling, marketing, traditional back-office functions and manufacturing and distribution. These charges were included in Cost of products sold or Selling and administrative expense, as appropriate. In Business Segment Information the charges reduced Operating profit of the related business segment. See Note 13 for additional information about business segments.

Corporate integration charges in 2015 and 2014 were related to the acquisition of Cooper. These charges were included in Selling and administrative expense. In Business Segment Information the charges were included in Other corporate expense - net.

The Cooper integration initiatives are expected to continue throughout 2015.

Note 4. GOODWILL

A summary of goodwill follows:

	Electrical Products	Electrical Systems and Services	Hydraulics	Aerospace	Vehicle	Total
December 31, 2014	\$6,940	\$4,314	\$1,327	\$962	\$350	\$13,893
Additions	—	22	—	—	—	22
Translation adjustments	(206	) (98	) (51	) (6	) (6	) (367
March 31, 2015	\$6,734	\$4,238	\$1,276	\$956	\$344	\$13,548

Note 5. RETIREMENT BENEFITS PLANS

The components of retirement benefits expense follow:

	United States		Non-United States		Other postretirement	
	pension benefit expense		pension benefit expense		benefits expense	
	Three months ended March 31					
	2015	2014	2015	2014	2015	2014
Service cost	\$31	\$29	\$18	\$16	\$2	\$4
Interest cost	39	40	18	22	6	9
Expected return on plan assets	(66	) (61	) (25	) (25	) (1	) (1
Amortization	30	23	10	7	—	2
	34	31	21	20	7	14
Settlement loss	14	34	—	—	—	—
Total expense	\$48	\$65	\$21	\$20	\$7	\$14

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Note 6. LEGAL CONTINGENCIES

Eaton is subject to a broad range of claims, administrative and legal proceedings such as lawsuits that relate to contractual allegations, tax audits, patent infringement, personal injuries, antitrust matters and employment-related matters. Eaton is also subject to asbestos claims from historic products which may have contained asbestos. Historically, significant insurance coverage has been available to cover costs associated with these claims. Although it is not possible to predict with certainty the outcome or cost of these matters, the Company believes they will not have a material adverse effect on the consolidated financial statements.

In 2010, a Brazilian court held that a judgment obtained by a Brazilian company, Raysul, against another Brazilian company, Saturnia, which was sold by Eaton in 2006, could be enforced against Eaton Ltda. and Eaton Holding S.à.r.l. This judgment is based on an alleged violation of an agency agreement between Raysul and Saturnia. At March 31, 2015, the Company has a total accrual of 85 Brazilian Reais related to this matter (\$26 based on current exchange rates), comprised of 60 Brazilian Reais recognized in the fourth quarter of 2010 (\$18 based on current exchange rates) with an additional 25 Brazilian Reais recognized through March 31, 2015 (\$8 based on current exchange rates). In 2010, Eaton filed motions for clarification with the Brazilian court of appeals which were denied on April 6, 2011. Eaton filed appeals on various issues to the Superior Court of Justice in Brasilia. In April 2013, the Superior Court of Justice ruled in favor of Raysul. Additional motions for clarification have been filed with the Superior Court of Justice in Brasilia and were denied. On February 2, 2015, a final appeal was filed with the Superior Court of Justice in Brasilia. The Company expects that any sum it may be required to pay in connection with this matter will not exceed the amount of the recorded liability.

Note 7. INCOME TAXES

The effective income tax rate for the first quarter of 2015 was expense of 8% compared to expense of 3% for the first quarter of 2014. The increase in the effective income tax rate in first quarter of 2015 is primarily due to more income earned in higher tax jurisdictions including the United States.

Note 8. EQUITY

Eaton has an ordinary share repurchase program (2013 Program) that authorizes the repurchase of 40 million ordinary shares. During the first quarter of 2015, 2.4 million ordinary shares were repurchased under the 2013 Program in the open market at a total cost of \$170.

The changes in Shareholders' equity follow:

	Eaton shareholders' equity	Noncontrolling interests	Total equity
Balance at December 31, 2014	\$ 15,786	\$ 53	\$ 15,839
Net income	466	1	467
Other comprehensive loss	(634)	) —	(634)
Cash dividends paid and accrued	(257)	) —	(257)
Issuance of shares under equity-based compensation plans - net	19	—	19
Repurchase of shares	(170)	) —	(170)
Balance at March 31, 2015	\$ 15,210	\$ 54	\$ 15,264

The changes in Accumulated other comprehensive loss follow:

	Currency translation and related hedging instruments	Pensions and other postretirement benefits	Cash flow hedges	Total
Balance at December 31, 2014	\$(1,414)	) \$(1,485)	) \$—	) \$(2,899)
Other comprehensive (loss) income before reclassifications	(720)	) 51	1	) (668)
Amounts reclassified from Accumulated other	—	35	(1)	) 34

comprehensive loss				
Net current-period Other comprehensive (loss) income	(720) 86	—	(634)
Balance at March 31, 2015	\$(2,134) \$(1,399) \$—	\$(3,533)

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The reclassifications out of Accumulated other comprehensive loss follow:

	Three months ended March 31, 2015	Consolidated statements of income classification
Amortization of pensions and other postretirement benefits items		
Actuarial loss and prior service cost	\$(54	)¹
Tax benefit	19	
Total, net of tax	(35)
Gains and (losses) on cash flow hedges		
Currency exchange contracts	2	Cost of products sold
Tax expense	(1)
Total, net of tax	1	
Total reclassifications for the period	\$(34)

¹ These components of Accumulated other comprehensive loss are included in the computation of net periodic benefit cost. See Note 5 for additional information about pension and other post retirement benefits items.

Net Income per Ordinary Share

A summary of the calculation of net income per ordinary share attributable to shareholders follows:

	Three months ended	
(Shares in millions)	March 31 2015	2014
Net income attributable to Eaton ordinary shareholders	\$466	\$439
Weighted-average number of ordinary shares outstanding - diluted	470.0	478.8
Less dilutive effect of equity-based compensation	2.1	3.0
Weighted-average number of ordinary shares outstanding - basic	467.9	475.8
Net income per ordinary share		
Diluted	\$0.99	\$0.92
Basic	1.00	0.92

For the first quarter 2015 and 2014, 0.9 million and 0.1 million stock options, respectively, were excluded from the calculation of diluted net income per ordinary share because the exercise price of the options exceeded the average market price of the ordinary shares during the period and their effect, accordingly, would have been antidilutive.

Note 9. EQUITY-BASED COMPENSATION

In February 2015, the Compensation and Organization Committee of the Board of Directors approved the grant of performance share units (PSUs) to certain employees that vest based on the satisfaction of a three-year service period and the achievement of certain performance metrics. The maximum number of ordinary shares that may be issued under this grant award is 911,050. The fair value of these PSUs is determined based on the closing market price of the Company's ordinary shares at the date of grant. Equity-based compensation expense is recognized over the period an employee is required to provide service based on the number of PSUs for which achievement of the performance objectives is probable.

Note 10. FAIR VALUE MEASUREMENTS

Fair value is measured based on an exit price, representing the amount that would be received to sell an asset or paid to satisfy a liability in an orderly transaction between market participants. Fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, a fair value hierarchy is established, which categorizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs,

other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

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A summary of financial instruments recognized at fair value, and the fair value measurements used, follows:

	Total	Level 1	Level 2	Level 3
March 31, 2015				
Cash	\$663	\$663	\$—	\$—
Short-term investments	139	139	—	—
Net derivative contracts	129	—	129	—
Long-term debt converted to floating interest rates by interest rate swaps - net	(122	) —	(122) —