HARLEY DAVIDSON INC
Form 10-Q
May 08, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

Q QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 30, 2014
£ 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 1-9183

Harley-Davidson, Inc.
(Exact name of registrant as specified in its charter)

Wisconsin	39-1382325
(State of organization)	(I.R.S. Employer Identification No.)
3700 West Juneau Avenue Milwaukee, Wisconsin	53208
(Address of principal executive offices)	(Zip code)

Registrants telephone number: (414) 342-4680
None
(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 requirements for the past 90 days. Yes Q 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 Q 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.

Large accelerated filer	Q	Accelerated filer	£
Non-accelerated filer	£	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 Q
Number of shares of the registrant’s common stock outstanding at May 1, 2014: 218,365,592 shares

Harley-Davidson, Inc.

Form 10-Q

For The Quarter Ended March 30, 2014

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements

HARLEY-DAVIDSON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three months ended	
	March 30, 2014	March 31, 2013
Revenue:		
Motorcycles and Related Products	$1,571,688	$1,414,248
Financial Services	154,360	156,965
Total revenue	1,726,048	1,571,213
Costs and expenses:		
Motorcycles and Related Products cost of goods sold	979,557	894,806
Financial Services interest expense	38,857	40,554
Financial Services provision for credit losses	20,331	13,110
Selling, administrative and engineering expense	276,421	271,499
Restructuring expense	—	2,938
Total costs and expenses	1,315,166	1,222,907
Operating income	410,882	348,306
Investment income	1,659	1,615
Interest expense	3,677	11,391
Income before provision for income taxes	408,864	338,530
Provision for income taxes	142,947	114,401
Net income	$265,917	$224,129
Earnings per common share:		
Basic	$1.21	$1.00
Diluted	$1.21	$0.99
Cash dividends per common share	$0.275	$0.210

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

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HARLEY-DAVIDSON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three months ended	
	March 30, 2014	March 31, 2013
Net Income	$265,917	$224,129
Other comprehensive income, net of tax		
Foreign currency translation adjustments	2,948	(10,570)
Derivative financial instruments	(227)	10,601
Marketable securities	(42)	(244)
Pension and postretirement benefit plans	6,068	10,239
Total other comprehensive income, net of tax	8,747	10,026
Comprehensive income	$274,664	$234,155

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

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HARLEY-DAVIDSON, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	(Unaudited) March 30, 2014	December 31, 2013	(Unaudited) March 31, 2013
ASSETS			
Current assets:			
Cash and cash equivalents	$935,820	$1,066,612	$1,018,759
Marketable securities	92,940	99,009	135,246
Accounts receivable, net	324,979	261,065	259,673
Finance receivables, net	2,223,199	1,773,686	2,074,036
Inventories	449,044	424,507	416,050
Restricted cash	117,883	144,807	197,025
Deferred income taxes	89,070	103,625	107,828
Other current assets	127,536	115,492	124,362
Total current assets	4,360,471	3,988,803	4,332,979
Finance receivables, net	4,214,496	4,225,877	3,959,903
Property, plant and equipment, net	823,061	842,477	790,245
Prepaid pension costs	250,575	244,871	—
Goodwill	30,427	30,452	28,861
Deferred income taxes	3,023	3,339	156,319
Other long-term assets	47,738	69,221	66,814
	$9,729,791	$9,405,040	$9,335,121
LIABILITIES AND SHAREHOLDERS’ EQUITY			
Current liabilities:			
Accounts payable	$454,366	$239,794	$360,018
Accrued liabilities	566,755	427,335	464,317
Short-term debt	974,153	666,317	687,705
Current portion of long-term debt	848,840	1,176,140	715,143
Total current liabilities	2,844,114	2,509,586	2,227,183
Long-term debt	3,271,648	3,416,713	3,892,469
Pension liability	37,261	36,371	152,132
Postretirement healthcare liability	212,887	216,165	274,597
Deferred income taxes	35,973	49,499	—
Other long-term liabilities	168,073	167,220	131,692
Commitments and contingencies (Note 16)			
Shareholders’ equity:			
Preferred stock, none issued	—	—	—
Common stock	3,435	3,432	3,423
Additional paid-in-capital	1,198,655	1,175,052	1,105,044
Retained earnings	8,058,119	7,852,729	7,483,248
Accumulated other comprehensive loss	(323,929)	(332,676)	(597,652)
Treasury stock, at cost	(5,776,445)	(5,689,051)	(5,337,015)
Total shareholders' equity	3,159,835	3,009,486	2,657,048
	$9,729,791	$9,405,040	$9,335,121

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HARLEY-DAVIDSON, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (continued)
(In thousands)

	(Unaudited) March 30, 2014	December 31, 2013	(Unaudited) March 31, 2013
Balances held by consolidated variable interest entities (Note 6)			
Current finance receivables, net	$274,797	$352,899	$432,079
Other assets	$3,387	$4,149	$5,229
Non-current finance receivables, net	$922,060	$1,184,441	$1,402,541
Restricted cash	$105,536	$133,053	$185,657
Current portion of long-term debt	$309,250	$334,630	$375,835
Long-term debt	$787,383	$922,002	$892,737

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

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HARLEY-DAVIDSON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three months ended March 30, 2014		March 31, 2013	
Net cash provided by (used by) operating activities (Note 3)	$203,586		$(108,489	)
Cash flows from investing activities:				
Capital expenditures	(25,881	)	(22,261	)
Origination of finance receivables	(757,965	)	(622,373	)
Collections on finance receivables	707,431		665,520	
Sales and redemptions of marketable securities	6,001		—	
Other	51		6,656	
Net cash (used by) provided by investing activities	(70,363	)	27,542	
Cash flows from financing activities:				
Repayments of senior unsecured notes	(303,000	)	—	
Repayments of securitization debt	(159,938	)	(178,923	)
Net increase in credit facilities and unsecured commercial paper	307,803		392,564	
Borrowings of asset-backed commercial paper	13,746		—	
Repayments of asset-backed commercial paper	(16,981	)	(17,063	)
Net change in restricted cash	26,924		(9,017	)
Dividends paid	(60,527	)	(47,308	)
Purchase of common stock for treasury	(87,690	)	(126,411	)
Excess tax benefits from share-based payments	4,763		14,468	
Issuance of common stock under employee stock option plans	8,894		13,887	
Net cash (used by) provided by financing activities	(266,006	)	42,197	
Effect of exchange rate changes on cash and cash equivalents	1,991		(10,629	)
Net decrease in cash and cash equivalents	$(130,792	)	$(49,379	)
Cash and cash equivalents:				
Cash and cash equivalents—beginning of period	$1,066,612		$1,068,138	
Net decrease in cash and cash equivalents	(130,792	)	(49,379	)
Cash and cash equivalents—end of period	$935,820		$1,018,759	

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

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HARLEY-DAVIDSON, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Use of Estimates

The condensed consolidated financial statements include the accounts of Harley-Davidson, Inc. and its wholly-owned subsidiaries (the Company), including the accounts of the group of companies doing business as Harley-Davidson Motor Company (HDMC) and Harley-Davidson Financial Services (HDFS). In addition, certain variable interest entities (VIEs) related to secured financing are consolidated as the Company is the primary beneficiary. All intercompany accounts and material intercompany transactions are eliminated.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the condensed consolidated balance sheets as of March 30, 2014 and March 31, 2013, the condensed consolidated statements of operations for the three month periods then ended, the condensed consolidated statements of comprehensive income for the three month periods then ended and the condensed consolidated statements of cash flows for the three month periods then ended.

Certain information and footnote disclosures normally included in complete financial statements have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and U.S. generally accepted accounting principles (U.S. GAAP) for interim financial reporting. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

The Company operates in two business segments: Motorcycles & Related Products (Motorcycles) and Financial Services (Financial Services).

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

2. New Accounting Standards

Accounting Standards Recently Adopted

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11 Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (ASU No. 2013-11). ASU No. 2013-11 amends the guidance within Accounting Standards Codification (ASC) Topic 740, "Income Taxes", to require entities to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The Company adopted ASU No. 2013-11 on January 1, 2014. There were no material presentation changes resulting from the adoption of ASU No. 2013-11.

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3. Additional Balance Sheet and Cash Flow Information

Marketable Securities

The Company’s marketable securities consisted of the following (in thousands):

	March 30, 2014	December 31, 2013	March 31, 2013
Available-for-sale: Corporate bonds	$92,940	$99,009	$135,246
Trading securities: Mutual funds	33,182	30,172	22,473
	$126,122	$129,181	$157,719

The Company’s available-for-sale securities are carried at fair value with any unrealized gains or losses reported in other comprehensive income. During the first three months of 2014 and 2013, the Company recognized gross unrealized losses of approximately $67,000 and $388,000, respectively, or $42,000 and $244,000 net of taxes, respectively, to adjust amortized cost to fair value. The marketable securities have contractual maturities that generally come due over the next 2 to 26 months.

The Company's trading securities relate to investments held by the Company to fund certain deferred compensation obligations. The trading securities are carried at fair value with gains and losses recorded in net income and investments are included in other long-term assets on the consolidated balance sheets.

Inventories

Inventories are valued at the lower of cost or market. Substantially all inventories located in the United States are valued using the last-in, first-out (LIFO) method. Other inventories are valued at the lower of cost or market using the first-in, first-out (FIFO) method. Inventories consist of the following (in thousands):

	March 30, 2014	December 31, 2013	March 31, 2013
Components at the lower of FIFO cost or market			
Raw materials and work in process	$141,381	$140,302	$121,481
Motorcycle finished goods	222,649	205,416	203,275
Parts and accessories and general merchandise	133,740	127,515	137,184
Inventory at lower of FIFO cost or market	497,770	473,233	461,940
Excess of FIFO over LIFO cost	(48,726)	(48,726)	(45,890)
	$449,044	$424,507	$416,050

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Operating Cash Flow

The reconciliation of net income to net cash provided by operating activities is as follows (in thousands):

	Three months ended	
	March 30, 2014	March 31, 2013
Cash flows from operating activities:		
Net income	$265,917	$224,129
Adjustments to reconcile net income to net cash provided by (used by) operating activities:		
Depreciation	43,398	42,850
Amortization of deferred loan origination costs	22,101	19,753
Amortization of financing origination fees	2,085	2,204
Provision for employee long-term benefits	8,425	16,684
Contributions to pension and postretirement plans	(6,879)	(182,047)
Stock compensation expense	9,239	11,096
Net change in wholesale finance receivables related to sales	(439,422)	(336,927)
Provision for credit losses	20,331	13,110
Deferred income taxes	(474)	6,665
Foreign currency adjustments	(4,172)	9,846
Other, net	3,055	(8,470)
Changes in current assets and liabilities:		
Accounts receivable, net	(61,217)	(36,165)
Finance receivables—accrued interest and other	793	1,246
Inventories	(20,317)	(28,613)
Accounts payable and accrued liabilities	356,430	79,861
Restructuring reserves	—	(12,388)
Derivative instruments	1,222	(342)
Other	3,071	69,019
Total adjustments	(62,331)	(332,618)
Net cash provided by (used by) operating activities	$203,586	$(108,489)

4. Restructuring Expense

In 2013, the Company completed the activities related to its 2009, 2010, and 2011 Restructuring Plans.

2011 Restructuring Plans

In December 2011, the Company made a decision to cease operations at New Castalloy, its Australian subsidiary and producer of cast motorcycle wheels and wheel hubs, and source those components through other existing suppliers by the end of 2013 (2011 New Castalloy Restructuring Plan). Under this plan, the Company successfully transitioned a significant amount of wheel production to other existing suppliers. However, during the second quarter of 2013, the Company made a decision to retain limited operations at New Castalloy focused on the production of certain complex, high-finish wheels in a cost-effective and competitive manner. At that time, the Company also entered into a new agreement with the unionized labor force at New Castalloy.

In connection with the modified 2011 New Castalloy Restructuring Plan, the New Castalloy workforce was reduced by approximately 100 employees, leaving approximately 100 remaining employees to support the ongoing operations. The original plan would have resulted in a workforce reduction of approximately 200 employees.

Under the modified 2011 New Castalloy Restructuring Plan, restructuring expenses consisted of employee severance and termination costs, accelerated depreciation and other related costs. On a cumulative basis, the Company incurred $22.1 million of restructuring expense under the modified 2011 New Castalloy Restructuring Plan, of which approximately 35% was non-

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cash. This includes a benefit related to restructuring reserves released in the second quarter of 2013 in connection with the decision to retain a limited operation at the New Castalloy facility, as described above.

In February 2011, the Company’s unionized employees at its facility in Kansas City, Missouri ratified a new seven-year labor agreement. The new agreement took effect on August 1, 2011. The new contract is similar to the labor agreements ratified at the Company’s Wisconsin facilities in September 2010 and its York, Pennsylvania production facility in December 2009, and allows for similar flexibility, increased production efficiency and the addition of a flexible workforce component.

The actions to implement the new ratified labor agreement (2011 Kansas City Restructuring Plan) resulted in approximately 145 fewer full-time hourly unionized employees in its Kansas City facility than would have been required under the previous contract.

Under the 2011 Kansas City Restructuring Plan, restructuring expenses consisted of employee severance and termination costs and other related costs. On a cumulative basis, the Company incurred $6.0 million of restructuring expense under the 2011 Kansas City Restructuring Plan, of which approximately 10% was non-cash.

The following table summarizes the Motorcycles segment’s 2011 Kansas City Restructuring Plan and modified 2011 New Castalloy Restructuring Plan reserve activity and balances as recorded in accrued liabilities as of March 31, 2013 (in thousands):

	Three months ended March 31, 2013							
	Kansas City			New Castalloy				Consolidated
	Employee Severance and Termination Costs	Other	Total	Employee Severance and Termination Costs	Accelerated Depreciation	Other	Total	Total
Balance, beginning of period	$2,259	$—	$2,259	$9,306	$ —	$145	$9,451	$ 11,710
Restructuring expense	—	—	—	474	2,092	444	3,010	3,010
Utilized—cash	—	—	—	(1,416)	—	(456)	(1,872)	(1,872)
Utilized—non-cash	(790)	—	(790)	—	(2,092)	—	(2,092)	(2,882)
Balance, end of period	$1,469	$—	$1,469	$8,364	$ —	$133	$8,497	$ 9,966

2010 Restructuring Plan

In September 2010, the Company’s unionized employees in Wisconsin ratified three separate new seven-year labor agreements which took effect in April 2012 when the prior contracts expired. The new contracts are similar to the labor agreement ratified at the Company's York, Pennsylvania production facility in December 2009 and allow for similar flexibility and increased production efficiency and the addition of a flexible workforce component.

The actions to implement the new ratified labor agreements (2010 Restructuring Plan) resulted in approximately 250 fewer full-time hourly unionized employees in its Milwaukee-area facilities than would have been required under the previous contracts and approximately 75 fewer full-time hourly unionized employees in its Tomahawk, Wisconsin facility than would have been required under the previous contract.

Under the 2010 Restructuring Plan, restructuring expenses consisted of employee severance and termination costs and other related costs. On a cumulative basis, the Company incurred $59.2 million of restructuring expense under the 2010 Restructuring Plan, of which approximately 45% was non-cash.

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The following table summarizes the Motorcycles segment's 2010 Restructuring Plan reserve activity and balances as recorded in accrued liabilities as of March 31, 2013 (in thousands):

	Three months ended March 31, 2013 Employee Severance and Termination Costs
Balance, beginning of period	$10,156
Restructuring expense	—
Utilized—cash	(9,607)
Balance, end of period	$549

2009 Restructuring Plan

During 2009, in response to the U.S. economic recession and worldwide slowdown in consumer demand, the Company committed to a volume reduction and a combination of restructuring actions (2009 Restructuring Plan) expected to be completed at various dates between 2009 and 2013. The actions were designed to reduce administrative costs, eliminate excess capacity and exit non-core business operations. The Company's announced actions include the restructuring and transformation of its York, Pennsylvania production facility including the implementation of a new more flexible unionized labor agreement which allows for the addition of a flexible workforce component; consolidation of facilities related to engine and transmission production; outsourcing of certain distribution and transportation activities and exiting the Buell product line. In addition, the Company implemented projects under this plan involving the outsourcing of select information technology activities and the consolidation of an administrative office in Michigan into its corporate headquarters in Milwaukee, Wisconsin.

The 2009 Restructuring Plan resulted in a reduction of approximately 2,900 hourly production positions and approximately 800 non-production, primarily salaried positions within the Motorcycles segment and approximately 100 salaried positions in the Financial Services segment.

Under the 2009 Restructuring Plan, restructuring expenses consisted of employee severance and termination costs, accelerated depreciation on the long-lived assets that were exited as part of the 2009 Restructuring Plan and other related costs. On a cumulative basis, the Company incurred $393.8 million of restructuring and impairment expense under the 2009 Restructuring Plan, of which approximately 30% was non-cash.

The following table summarizes the Company's 2009 Restructuring Plan reserve activity and balances recorded in accrued liabilities as of March 31, 2013 (in thousands):

	Three months ended March 31, 2013			
	Motorcycles & Related Products			
	Employee Severance and Termination Costs	Accelerated Depreciation	Other	Total
Balance, beginning of period	$5,196	$—	$161	$5,357
Restructuring expense	—	—	638	638
Utilized—cash	(808)	—	(623)	(1,431)
Non-cash reserve release	(710)	—	—	(710)
Balance, end of period	$3,678	$—	$176	$3,854

Other restructuring costs include items such as the exit costs for terminating supply contracts, lease termination costs and moving costs.

5. Finance Receivables

HDFS provides retail financial services to customers of the Company's independent dealers in the United States and Canada. The origination of retail loans is a separate and distinct transaction between HDFS and the retail customer, unrelated to the Company's sale of product to its dealers. Retail finance receivables consist of secured promissory notes and installment loans. HDFS holds either titles or liens on titles to vehicles financed by promissory notes and installment loans.

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HDFS offers wholesale financing to the Company's independent dealers. Wholesale loans to dealers are generally secured by financed inventory or property and are originated in the U.S. and Canada.

Finance receivables, net, consisted of the following (in thousands):

	March 30, 2014	December 31, 2013	March 31, 2013
Retail	$		