

HARLEY DAVIDSON INC
Form 10-Q
August 09, 2012
[Table of Contents](#)

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

FORM 10-Q

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

For the quarterly period ended July 1, 2012

.. **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)

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

Wisconsin
(State of organization)

39-1382325
(I.R.S. Employer Identification No.)

3700 West Juneau Avenue

Milwaukee, Wisconsin
(Address of principal executive offices)

53208
(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 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.

Large accelerated filer

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

Number of shares of the registrant's common stock outstanding at August 2, 2012: 227,900,158 shares

Table of Contents

Harley-Davidson, Inc.

Form 10-Q

For The Quarter Ended July 1, 2012

Part I Financial Information

| | |
|--|----|
| Item 1. <u>Financial Statements</u> | 3 |
| <u>Condensed Consolidated Statements of Operations</u> | 3 |
| <u>Condensed Consolidated Statements of Comprehensive Income</u> | 4 |
| <u>Condensed Consolidated Balance Sheets</u> | 5 |
| <u>Condensed Consolidated Statements of Cash Flows</u> | 6 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 7 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 40 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 61 |
| Item 4. <u>Controls and Procedures</u> | 61 |
| Part II <u>Other Information</u> | 63 |
| Item 1. <u>Legal Proceedings</u> | 63 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 63 |
| Item 6. <u>Exhibits</u> | 64 |
| <u>Signatures</u> | 65 |

Table of Contents**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 | | Six months ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 |
| Revenue: | | | | |
| Motorcycles and related products | \$ 1,569,047 | \$ 1,339,744 | \$ 2,842,416 | \$ 2,402,788 |
| Financial services | 160,613 | 165,853 | 316,935 | 327,739 |
| Total revenue | 1,729,660 | 1,505,597 | 3,159,351 | 2,730,527 |
| Costs and expenses: | | | | |
| Motorcycles and related products cost of goods sold | 1,005,230 | 871,476 | 1,822,089 | 1,582,654 |
| Financial services interest expense | 48,712 | 56,991 | 99,968 | 115,026 |
| Financial services provision for credit losses | (5,259) | (6,790) | 3,754 | (1,184) |
| Selling, administrative and engineering expense | 283,244 | 268,424 | 548,898 | 502,539 |
| Restructuring expense | 6,220 | 13,594 | 17,671 | 36,593 |
| Total costs and expenses | 1,338,147 | 1,203,695 | 2,492,380 | 2,235,628 |
| Operating income | 391,513 | 301,902 | 666,971 | 494,899 |
| Investment income | 2,231 | 1,748 | 4,164 | 3,146 |
| Interest expense | 11,595 | 11,350 | 23,090 | 22,831 |
| Income before provision for income taxes | 382,149 | 292,300 | 648,045 | 475,214 |
| Provision for income taxes | 134,899 | 101,720 | 228,760 | 165,374 |
| Income from continuing operations | 247,250 | 190,580 | 419,285 | 309,840 |
| Income from discontinued operations, net of tax | | | | |
| Net income | \$ 247,250 | \$ 190,580 | \$ 419,285 | \$ 309,840 |
| Earnings per common share from continuing operations: | | | | |
| Basic | \$ 1.08 | \$ 0.81 | \$ 1.83 | \$ 1.32 |
| Diluted | \$ 1.07 | \$ 0.81 | \$ 1.81 | \$ 1.31 |
| Earnings per common share from discontinued operations: | | | | |
| Basic | \$ | \$ | \$ | \$ |
| Diluted | \$ | \$ | \$ | \$ |
| Earnings per common share: | | | | |
| Basic | \$ 1.08 | \$ 0.81 | \$ 1.83 | \$ 1.32 |
| Diluted | \$ 1.07 | \$ 0.81 | \$ 1.81 | \$ 1.31 |
| Cash dividends per common share | \$ 0.155 | \$ 0.125 | \$ 0.310 | \$ 0.225 |

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

Table of Contents

HARLEY-DAVIDSON, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

| | Three months ended | | Six months ended | |
|----------------------|--------------------|------------------|------------------|------------------|
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 |
| Comprehensive income | \$ 245,646 | \$ 207,055 | \$ 426,462 | \$ 345,486 |

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

Table of Contents**HARLEY-DAVIDSON, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

| | (Unaudited) July 1, 2012 | December 31, 2011 | (Unaudited) June 26, 2011 |
|--|--------------------------------|----------------------|---------------------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 1,071,496 | \$ 1,526,950 | \$ 973,478 |
| Marketable securities | 135,848 | 153,380 | 244,555 |
| Accounts receivable, net | 250,268 | 219,039 | 265,663 |
| Finance receivables, net | 1,398,553 | 1,168,603 | 1,144,886 |
| Restricted finance receivables held by variable interest entities, net | 456,285 | 591,864 | 573,208 |
| Inventories | 323,046 | 418,006 | 337,472 |
| Restricted cash held by variable interest entities | 188,564 | 229,655 | 244,060 |
| Other current assets | 245,807 | 234,709 | 217,656 |
| Total current assets | 4,069,867 | 4,542,206 | 4,000,978 |
| Finance receivables, net | 2,569,187 | 1,754,441 | 2,306,165 |
| Restricted finance receivables held by variable interest entities, net | 1,592,544 | 2,271,773 | 1,939,181 |
| Property, plant and equipment, net | 776,793 | 809,459 | 788,943 |
| Goodwill | 28,604 | 29,081 | 31,156 |
| Other long-term assets | 279,789 | 267,204 | 295,556 |
| | \$ 9,316,784 | \$ 9,674,164 | \$ 9,361,979 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 252,239 | \$ 255,713 | \$ 277,395 |
| Accrued liabilities | 535,097 | 564,172 | 590,096 |
| Short-term debt | 845,868 | 838,486 | 694,137 |
| Current portion of long-term debt | 399,962 | 399,916 | |
| Current portion of long-term debt held by variable interest entities | 507,427 | 640,331 | 635,604 |
| Total current liabilities | 2,540,593 | 2,698,618 | 2,197,232 |
| Long-term debt | 2,745,189 | 2,396,871 | 2,893,462 |
| Long-term debt held by variable interest entities | 831,805 | 1,447,015 | 1,217,778 |
| Pension liability | 122,496 | 302,483 | 103,511 |
| Postretirement healthcare liability | 263,295 | 268,582 | 258,881 |
| Other long-term liabilities | 147,019 | 140,339 | 159,719 |
| Commitments and contingencies (Note 16) | | | |
| Total shareholders' equity | 2,666,387 | 2,420,256 | 2,531,396 |
| | \$ 9,316,784 | \$ 9,674,164 | \$ 9,361,979 |

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

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

| | Six months ended | |
|---|------------------|------------------|
| | July 1, 2012 | June 26, 2011 |
| Net cash provided by operating activities of continuing operations (Note 3) | \$ 288,242 | \$ 472,962 |
| Cash flows from investing activities of continuing operations: | | |
| Capital expenditures | (60,078) | (69,267) |
| Origination of finance receivables | (1,583,572) | (1,434,607) |
| Collections on finance receivables | 1,435,790 | 1,416,610 |
| Purchases of marketable securities | (4,993) | (142,653) |
| Sales and redemptions of marketable securities | 23,046 | 39,966 |
| Net cash used by investing activities of continuing operations | (189,807) | (189,951) |
| Cash flows from financing activities of continuing operations: | | |
| Proceeds from issuance of medium-term notes | 397,373 | 447,076 |
| Proceeds from securitization debt | 91,030 | |
| Repayments of securitization debt | (839,401) | (901,851) |
| Net (decrease) increase in credit facilities and unsecured commercial paper | (46,629) | 131,039 |
| Net change in restricted cash | 41,091 | 44,827 |
| Dividends | (71,645) | (53,152) |
| Purchase of common stock for treasury | (172,742) | (5,678) |
| Excess tax benefits from share-based payments | 15,730 | 3,476 |
| Issuance of common stock under employee stock option plans | 35,337 | 4,534 |
| Net cash used by financing activities of continuing operations | (549,856) | (329,729) |
| Effect of exchange rate changes on cash and cash equivalents of continuing operations | (4,033) | (1,702) |
| Net decrease in cash and cash equivalents of continuing operations | (455,454) | (48,420) |
| Cash flows from discontinued operations: | | |
| Cash flows from operating activities of discontinued operations | | (35) |
| Cash flows from investing activities of discontinued operations | | |
| Effect of exchange rate changes on cash and cash equivalents of discontinued operations | | (35) |
| Net decrease in cash and cash equivalents | \$ (455,454) | \$ (48,455) |
| Cash and cash equivalents: | | |
| Cash and cash equivalents beginning of period | \$ 1,526,950 | \$ 1,021,933 |
| Cash and cash equivalents of discontinued operations beginning of period | | |
| Net decrease in cash and cash equivalents | (455,454) | (48,455) |
| Less: Cash and cash equivalents of discontinued operations end of period | | |
| Cash and cash equivalents end of period | \$ 1,071,496 | \$ 973,478 |

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

Table of Contents

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 July 1, 2012 and June 26, 2011, the condensed consolidated statements of operations for the three and six month periods then ended, the condensed consolidated statements of comprehensive income for the three and six month periods then ended and the condensed consolidated statements of cash flows for the six 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, 2011.

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.

During 2008, the Company acquired Italian motorcycle manufacturer MV Agusta (MV). On October 15, 2009, the Company announced its intent to divest MV, and the Company completed the sale on August 6, 2010. MV is presented as a discontinued operation for all periods.

2. New Accounting Standards

Accounting Standards Recently Adopted

In May 2011, the FASB issued ASU No. 2011-4 Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS.) ASU No. 2011-04 clarifies the application of the existing guidance within ASC Topic 820, *Fair Value Measurement*, to ensure consistency between U.S. GAAP and IFRS. ASU No. 2011-04 also requires new disclosures about purchases, sales, issuances, and settlements related to Level 3 measurements and also requires new disclosures around transfers into and out of Level 1 and 2 in the fair value hierarchy. The Company adopted ASU No. 2011-04 on January 1, 2012. The required new disclosures are presented in Note 9.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*. ASU No. 2011-05 amends the guidance within ASC Topic 220, *Comprehensive Income*, to eliminate the option to present the components of other comprehensive income as part of the statement of shareholders' equity. ASU No. 2011-05 requires that all nonowner changes in shareholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company decided to present comprehensive income in two separate but consecutive statements. The Company adopted ASU No. 2011-05 on January 1, 2012. The adoption of ASU No. 2011-05 and the Company's decision to present comprehensive income in two separate but consecutive statements required the presentation of an additional financial statement, condensed consolidated statements of comprehensive income, for all periods presented.

Table of Contents**3. Additional Balance Sheet and Cash Flow Information***Marketable Securities*

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

| | July 1, 2012 | December 31, 2011 | June 26, 2011 |
|---------------------|-----------------|----------------------|------------------|
| Available-for-sale: | | | |
| Corporate bonds | \$ 135,848 | \$ 153,380 | \$ 194,556 |
| U.S. Treasuries | | | 49,999 |
| | \$ 135,848 | \$ 153,380 | \$ 244,555 |

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 half of 2012 and 2011, the Company recognized gross unrealized gains in other comprehensive income of \$0.5 million and \$1.7 million, respectively, or \$0.3 million and \$1.1 million net of taxes, respectively, to adjust amortized cost to fair value. The marketable securities have contractual maturities that generally come due over the next 12 to 48 months.

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):

| | July 1, 2012 | December 31, 2011 | June 26, 2011 |
|--|-----------------|----------------------|------------------|
| Components at the lower of FIFO cost or market | | | |
| Raw materials and work in process | \$ 116,166 | \$ 113,932 | \$ 108,518 |
| Motorcycle finished goods | 120,199 | 226,261 | 147,787 |
| Parts and accessories and general merchandise | 131,040 | 121,340 | 115,202 |
| Inventory at lower of FIFO cost or market | 367,405 | 461,533 | 371,507 |
| Excess of FIFO over LIFO cost | (44,359) | (43,527) | (34,035) |
| | \$ 323,046 | \$ 418,006 | \$ 337,472 |

Table of Contents*Operating Cash Flow*

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

| | Six months ended | |
|---|------------------|------------------|
| | July 1, 2012 | June 26, 2011 |
| Cash flows from operating activities: | | |
| Net income | \$ 419,285 | \$ 309,840 |
| Loss from discontinued operations | | |
| Income from continuing operations | 419,285 | 309,840 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | |
| Depreciation | 85,997 | 89,543 |
| Amortization of deferred loan origination costs | 38,075 | 39,054 |
| Amortization of financing origination fees | 5,021 | 5,833 |
| Provision for employee long-term benefits | 34,263 | 34,456 |
| Contributions to pension and postretirement plans | (213,648) | (205,498) |
| Stock compensation expense | 22,119 | 20,537 |
| Net change in wholesale finance receivables related to sales | (124,919) | 11,909 |
| Provision for credit losses | 3,754 | (1,184) |
| Pension and postretirement healthcare plan curtailment and settlement expense | | 236 |
| Foreign currency adjustments | 8,143 | (2,813) |
| Other, net | 5,567 | 27,226 |
| Changes in current assets and liabilities: | | |
| Accounts receivable, net | (34,977) | 8,301 |
| Finance receivables accrued interest and other | 2,912 | 5,553 |
| Inventories | 89,162 | (530) |
| Accounts payable and accrued liabilities | (12,286) | 133,838 |
| Restructuring reserves | (9,915) | 3,195 |
| Derivative instruments | (1,420) | 1,195 |
| Other | (28,891) | (7,729) |
| Total adjustments | (131,043) | 163,122 |
| Net cash provided by operating activities of continuing operations | \$ 288,242 | \$ 472,962 |

Table of Contents

4. Discontinued Operations

In October 2009, the Company unveiled a new business strategy to drive growth through a focus of efforts and resources on the unique strengths of the Harley-Davidson brand and to enhance productivity and profitability through continuous improvement. The Company's Board of Directors approved and the Company committed to the divestiture of MV as part of this strategy. The Company engaged a third party investment bank to assist with the marketing and sale of MV. During 2009, the Company recorded pre-tax impairment charges of \$115.4 million related to MV and a net tax benefit of \$40 million related to losses estimated in connection with the sale of MV. As of December 31, 2009, the Company estimated the total tax benefit associated with losses related to the sale of MV to be \$66 million of which \$26 million was deemed uncertain and appropriately reserved against.

At each subsequent reporting date in 2010 through the date of sale of MV in August 2010, the fair value less selling costs was re-assessed and additional impairment charges totaling \$111.8 million and additional tax benefits totaling \$18 million were recognized in 2010. As the effort to sell MV progressed into 2010, adverse factors led to decreases in the fair value of MV. During 2010, challenging economic conditions continued to persist, negatively impacting the appetite of prospective buyers and the motorcycle industry as a whole. Information coming directly from the selling process, including discussions with the prospective buyers, indicated a fair value that was less than previously estimated.

On August 6, 2010, the Company concluded its sale of MV to MV Augusta Motor Holding S.r.l., a company controlled by the former owner of MV. Under the agreement relating to the sale, (1) the Company received nominal consideration in return for the transfer of MV and related assets; (2) the parties waived their respective rights under the stock purchase agreement and other documents related to the Company's purchase of MV in 2008, which included a waiver of the former owner's right to contingent earn-out consideration; and (3) the Company contributed 20.0 million Euros to MV as operating capital. The 20.0 million Euros contributed were factored into the Company's estimate of MV's fair value prior to the sale and was recognized in the 2010 impairment charges discussed above. As a result of the impairment charges recorded in 2009 and 2010 prior to the sale, the Company only incurred an immaterial loss on the date of sale, which was included in the loss from discontinued operations, net of tax, during the year ended December 31, 2010.

As of December 31, 2010, the Company's estimated total tax benefit associated with the loss on the sale of MV was \$101.0 million, of which \$43.5 million was deemed uncertain and appropriately reserved against. As a result, the total cumulative net tax benefit recognized as of December 31, 2010 was \$57.5 million. The increase in the estimated tax benefit during 2010 was driven by an increase in the losses related to the sale of MV, not a change in the tax position.

In determining the tax benefit recognized from October 2009 through December 2010, the Company engaged appropriate technical expertise and considered all relevant available information. In accordance with ASC 740, *Income Taxes*, at each balance sheet date during this period, the Company re-evaluated the overall tax benefit, determined that it was at least more likely than not that it would be sustained upon review and calculated the amount of recognized tax benefit based on a cumulative probability basis.

Beginning in 2010, the Company voluntarily elected to participate in a pre-filing agreement process with the Internal Revenue Service (IRS) in order to accelerate their review of the Company's tax position related to MV. The IRS effectively completed its review in late 2011 and executed a Closing Agreement on Final Determination Covering Specific Matters with the Company.

There were no changes to the Company's estimated gross or recognized tax benefit associated with the loss on the sale of MV during the first three quarters of 2011. In the fourth quarter of 2011, given the outcome of the closing agreement, the Company recognized a \$43.5 million tax benefit by reversing the reserve recorded as of September 25, 2011 and recognized an incremental \$7.5 million tax benefit related to the final calculation of the tax basis in the loan to and the stock of MV.

Table of Contents

5. Restructuring Expense

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 (2011 New Castalloy Restructuring Plan). The Company expects the transition of supply from New Castalloy to be complete by mid-2013. The decision to close New Castalloy came as part of the Company's overall long term strategy to develop world-class manufacturing capability throughout the Company by restructuring and consolidating operations for greater competitiveness, efficiency and flexibility. In connection with this decision, the Company will reduce its workforce by approximately 200 employees by mid-2013.

Under the 2011 New Castalloy Restructuring Plan, restructuring expenses consist of employee severance and termination costs, accelerated depreciation and other related costs. The Company expects to incur approximately \$30 million in restructuring charges related to the transition through 2013. Approximately 35% of the \$30 million will be non-cash charges. On a cumulative basis, the Company has incurred \$15.4 million of restructuring expense under the 2011 New Castalloy Restructuring Plan as of July 1, 2012, of which \$6.0 million was incurred during the first six months of 2012.

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 facility in December 2009, and allows for similar flexibility and increased production efficiency. Once the new contract is fully implemented, the production system in Kansas City, like Wisconsin and York, will include the addition of a flexible workforce component.

After taking actions to implement the new ratified labor agreement (2011 Kansas City Restructuring Plan), the Company expects to have about 145 fewer full-time hourly unionized employees in its Kansas City facility than would have been required under the prior contract.

Under the 2011 Kansas City Restructuring Plan, restructuring expenses consist of employee severance and termination costs and other related costs. The Company expects to incur approximately \$14 million in restructuring expenses related to the new contract through 2012, of which approximately 10% are expected to be non-cash. On a cumulative basis, the Company has incurred \$7.8 million of restructuring expense under the 2011 Kansas City Restructuring Plan as of July 1, 2012. During the first six months of 2012, the Company released a portion of its 2011 Kansas City Restructuring Plan reserve related to severance costs as these costs are no longer expected to be incurred.

For the six months ended June 26, 2011, restructuring expense included \$0.2 million of noncash curtailment losses related to the Company's pension plan that covers employees of the Kansas City facility.

Table of Contents

The following table summarizes the Motorcycle segment's 2011 Kansas City Restructuring Plan and 2011 New Castalloy Restructuring Plan reserve activity and balances as recorded in accrued liabilities (in thousands):

| | Kansas City | | | Six months ended July 1, 2012 New Castalloy | | | Consolidated | | |
|------------------------------|---|-------|----------|---|---------|-----------------------------|--------------|-----------|-------|
| | Employee Severance and Termination Costs | | Total | Employee Severance and Termination Costs | | Accelerated Depreciation | Other | Total | Total |
| | | Other | | | | | | | |
| Balance, beginning of period | \$ 4,123 | \$ | \$ 4,123 | \$ 8,428 | \$ | \$ 305 | \$ 8,733 | \$ 12,856 | |
| Restructuring expense | | | | 1,141 | 4,093 | 755 | 5,989 | 5,989 | |
| Utilized cash | | | | (312) | | (722) | (1,034) | (1,034) | |
| Utilized noncash | | | | | (4,093) | | (4,093) | (4,093) | |
| Noncash reserve release | (967) | | (967) | | | | | (967) | |
| Balance, end of period | \$ 3,156 | \$ | \$ 3,156 | \$ 9,257 | \$ | \$ 338 | \$ 9,595 | \$ 12,751 | |

| | Six months ended June 26, 2011 Kansas City | | |
|------------------------|---|-------|----------|
| | Employee Severance and Termination Costs | | Total |
| | | Other | |
| Restructuring expense | 7,177 | 340 | 7,517 |
| Utilized cash | (3,843) | (340) | (4,183) |
| Utilized noncash | (236) | | (236) |
| Balance, end of period | \$ 3,098 | \$ | \$ 3,098 |

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 facility in December 2009 and allow for similar flexibility and increased production efficiency. Once the new contracts are fully implemented, the production system in Wisconsin, like York, will include the addition of a flexible workforce component.

Based on the new ratified labor agreements (2010 Restructuring Plan), the Company expects to have about 250 fewer full-time hourly unionized employees in its Milwaukee-area facilities when the contracts are fully implemented than would have been required under the prior contracts. In Tomahawk, the Company expects to have about 75 fewer full-time hourly unionized employees when the contract is fully implemented than would have been required under the prior contract.

Under the 2010 Restructuring Plan, restructuring expenses consist of employee severance and termination costs and other related costs. The Company expects to incur approximately \$62 million in restructuring expenses related to the new contracts through 2012, of which approximately 42% are expected to be non-cash. On a cumulative basis, the Company has incurred \$60.4 million of restructuring expense under the 2010 Restructuring Plan as of July 1, 2012, of which \$3.5 million was incurred during the first six months of 2012.

Table of Contents

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

| | Six months ended July 1, 2012 Employee Severance and Termination Costs | Six months ended June 26, 2011 Employee Severance and Termination Costs |
|------------------------------|--|---|
| Balance, beginning of period | \$ 20,361 | \$ 8,652 |
| Restructuring expense | 3,457 | 6,296 |
| Utilized cash | (10,053) | (732) |
| Balance, end of period | \$ 13,765 | \$ 14,216 |

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) that are expected to be completed at various dates between 2009 and 2012. The actions were designed to reduce administrative costs, eliminate excess capacity and exit non-core business operations. The Company's significant announced actions include the restructuring and transformation of its York, Pennsylvania production facility including the implementation of a new more flexible unionized labor agreement; consolidation of facilities related to engine and transmission production; outsourcing of certain distribution and transportation activities and exiting the Buell product line.

The 2009 Restructuring Plan includes an estimated reduction of approximately 2,700 to 2,900 hourly production positions and approximately 720 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 consist of employee severance and termination costs, accelerated depreciation on the long-lived assets that will be exited as part of the 2009 Restructuring Plan and other related costs. The Company expects total costs related to the 2009 Restructuring Plan to result in restructuring and impairment expenses of approximately \$384 million to \$404 million from 2009 to 2012, of which approximately 30% are expected to be non-cash. On a cumulative basis, the Company has incurred \$389.8 million of restructuring and impairment expense under the 2009 Restructuring Plan as of July 1, 2012, of which \$9.2 million was incurred during the first six months of 2012.

Table of Contents

The following table summarizes the Company's 2009 Restructuring Plan reserve activity and balances recorded in accrued liabilities (in thousands):

| | Six months ended July 1, 2012 Motorcycles & Related Products | | | |
|------------------------------|---|-----------------------------|----------|-----------|
| | Employee Severance and Termination Costs | Accelerated Depreciation | Other | Total |
| Balance, beginning of period | \$ 10,089 | \$ | \$ | \$ 10,089 |
| Restructuring expense | 331 | | 10,888 | 11,219 |
| Utilized cash | (1,878) | | (10,888) | (12,766) |
| Utilized noncash | | | | |
| Noncash reserve release | (2,027) | | | (2,027) |
| Balance, end of period | \$ 6,515 | \$ | \$ | \$ 6,515 |

| | Six months ended June 26, 2011 Motorcycles & Related Products | | | |
|------------------------------|--|-----------------------------|----------|-----------|
| | Employee Severance and Termination Costs | Accelerated Depreciation | Other | Total |
| Balance, beginning of period | \$ 23,818 | \$ | \$ 2,764 | \$ 26,582 |
| Restructuring expense | 3,504 | | 19,276 | 22,780 |
| Utilized cash | (8,159) | | (20,341) | (28,500) |
| Utilized noncash | | | 253 | 253 |
| Balance, end of period | \$ 19,163 | \$ | \$ 1,952 | \$ 21,115 |

Other restructuring costs under the 2009 Restructuring Plan include items such as the exit costs for terminating supply contracts, lease termination costs and moving costs. During the first six months of 2012, the Company released a portion of its 2009 Restructuring Plan reserve related to employee severance costs as these costs are no longer expected to be incurred.

6. 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.

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.

Table of Contents

Finance receivables, net, including finance receivables held by VIEs, consisted of the following (in thousands):

| | July 1, 2012 | December 31, 2011 | June 26, 2011 |
|-----------------------------|-----------------|----------------------|------------------|
| Retail | \$ 5,225,779 | \$ 5,087,490 | \$ 5,374,055 |
| Wholesale | 905,038 | 824,640 | 733,789 |
| | 6,130,817 | 5,912,130 | 6,107,844 |
| Allowance for credit losses | (114,248) | (125,449) | (144,404) |
| | \$ 6,016,569 | \$ 5,786,681 | \$ 5,963,440 |

At July 1, 2012, December 31, 2011 and June 26, 2011, the Company's Condensed Consolidated Balance Sheet included finance receivables, net of \$2.05 billion, \$2.86 billion and \$2.51 billion, respectively, which were restricted as collateral for the payment of debt held by VIEs and other related obligations as discussed in Note 7. These receivables are included in retail finance receivables in the table above.

A provision for credit losses on finance receivables is charged or credited to earnings in amounts that the Company believes are sufficient to maintain the allowance for credit losses on finance receivables at a level that is adequate to cover losses of principal inherent in the existing portfolio. The allowance for credit losses on finance receivables represents management's estimate of probable losses inherent in the finance receivable portfolio as of the balance sheet date. However, due to the use of projections and assumptions in estimating the losses, the amount of losses actually incurred by the Company could differ from the amounts estimated.

Table of Contents

Changes in the allowance for credit losses on finance receivables by portfolio were as follows (in thousands):

| | Three months ended July 1, 2012 | | |
|------------------------------|---------------------------------|-----------|------------|
| | Retail | Wholesale | Total |
| Balance, beginning of period | \$ 112,857 | \$ 9,646 | \$ 122,503 |
| Provision for credit losses | (3,681) | (1,578) | (5,259) |
| Charge-offs | (17,054) | | (17,054) |
| Recoveries | 14,058 | | 14,058 |
| Balance, end of period | \$ 106,180 | \$ 8,068 | \$ 114,248 |

| | Three months ended June 26, 2011 | | |
|------------------------------|----------------------------------|-----------|------------|
| | Retail | Wholesale | Total |
| Balance, beginning of period | \$ 141,704 | \$ 17,980 | \$ 159,684 |
| Provision for credit losses | (2,596) | (4,194) | (6,790) |
| Charge-offs | (22,903) | (330) | (23,233) |
| Recoveries | 14,743 | | 14,743 |
| Balance, end of period | \$ 130,948 | \$ 13,456 | \$ 144,404 |

| | Six months ended July 1, 2012 | | |
|------------------------------|-------------------------------|-----------|------------|
| | Retail | Wholesale | Total |
| Balance, beginning of period | \$ 116,112 | \$ 9,337 | \$ 125,449 |
| Provision for credit losses | 5,023 | (1,269) | 3,754 |
| Charge-offs | (42,906) | | (42,906) |
| Recoveries | 27,951 | | 27,951 |
| Balance, end of period | \$ 106,180 | \$ 8,068 | \$ 114,248 |

| | Six months ended June 26, 2011 | | |
|------------------------------|--------------------------------|-----------|------------|
| | Retail | Wholesale | Total |
| Balance, beginning of period | \$ 157,791 | \$ 15,798 | \$ 173,589 |
| Provision for credit losses | 843 | (2,027) | (1,184) |
| Charge-offs | (58,094) | (330) | (58,424) |
| Recoveries | 30,408 | 15 | 30,423 |
| Balance, end of period | \$ 130,948 | \$ 13,456 | \$ 144,404 |

Included in the \$106.2 and \$130.9 million retail allowance for credit losses on finance receivables is \$41.9 and \$62.1 million, respectively, related to finance receivables held by VIEs.

Portions of the allowance for credit losses on finance receivables are specified to cover estimated losses on finance receivables specifically identified for impairment. The unspecified portion of the allowance for credit losses on finance receivables covers estimated losses on finance receivables which are collectively reviewed for impairment. Finance receivables are considered impaired when management determines it is probable that the Company will be unable to collect all amounts due according to the terms of the loan agreement.

Table of Contents

The retail portfolio primarily consists of a large number of small balance, homogeneous finance receivables. HDFS performs a periodic and systematic collective evaluation of the adequacy of the retail allowance for credit losses. HDFS utilizes loss forecast models which consider a variety of factors including, but not limited to, historical loss trends, origination or vintage analysis, known and inherent risks in the portfolio, the value of the underlying collateral, recovery rates and current economic conditions including items such as unemployment rates. As retail finance receivables are collectively and not individually reviewed for impairment, this portfolio does not have finance receivables specifically impaired.

The wholesale portfolio is primarily composed of large balance, non-homogeneous loans. The Company's evaluation for the wholesale allowance for credit losses is first based on a loan-by-loan review. A specific allowance for credit losses is established for wholesale finance receivables determined to be individually impaired when management concludes that the borrower will not be able to make full payment of the contractual amounts due based on the original terms of the loan agreement. The impairment is determined based on the cash that the Company expects to receive discounted at the loan's original interest rate or the fair value of the collateral, if the loan is collateral-dependent. Finance receivables in the wholesale portfolio that are not considered impaired on an individual basis are segregated, based on similar risk characteristics, according to the Company's internal risk rating system and collectively evaluated for impairment. The related allowance for credit losses is based on factors such as the specific borrower's financial performance and ability to repay, the Company's past loan loss experience, current economic conditions, and the value of the underlying collateral.

Generally, it is the Company's policy not to change the terms and conditions of finance receivables. However, to minimize the economic loss, the Company may modify certain finance receivables in troubled debt restructurings. Total restructured finance receivables are not significant.

The allowance for credit losses and finance receivables by portfolio, segregated by those amounts that are individually evaluated for impairment and those that are collectively evaluated for impairment was, as follows (in thousands):

| | Retail | July 1, 2012 Wholesale | Total |
|---|--------------|---------------------------|--------------|
| Allowance for credit losses, ending balance: | | | |
| Individually evaluated for impairment | \$ | \$ | \$ |
| Collectively evaluated for impairment | 106,180 | 8,068 | 114,248 |
| Total allowance for credit losses | \$ 106,180 | \$ 8,068 | \$ 114,248 |
| Finance receivables, ending balance: | | | |
| Individually evaluated for impairment | \$ | \$ | \$ |
| Collectively evaluated for impairment | 5,225,779 | 905,038 | 6,130,817 |
| Total finance receivables | \$ 5,225,779 | \$ 905,038 | \$ 6,130,817 |

Table of Contents

| | December 31, 2011 | | |
|---|---------------------|-------------------|---------------------|
| | Retail | Wholesale | Total |
| Allowance for credit losses, ending balance: | | | |
| Individually evaluated for impairment | \$ | \$ | \$ |
| Collectively evaluated for impairment | 116,112 | 9,337 | 125,449 |
| Total allowance for credit losses | \$ 116,112 | \$ 9,337 | \$ 125,449 |
| Finance receivables, ending balance: | | | |
| Individually evaluated for impairment | \$ | \$ | \$ |
| Collectively evaluated for impairment | 5,087,490 | 824,640 | 5,912,130 |
| Total finance receivables | \$ 5,087,490 | \$ 824,640 | \$ 5,912,130 |
| | June 26, 2011 | | |
| | Retail | Wholesale | Total |
| Allowance for credit losses, ending balance: | | | |
| Individually evaluated for impairment | \$ | \$ 3,031 | \$ 3,031 |
| Collectively evaluated for impairment | 130,948 | 10,425 | 141,373 |
| Total allowance for credit losses | \$ 130,948 | \$ 13,456 | \$ 144,404 |
| Finance receivables, ending balance: | | | |
| Individually evaluated for impairment | \$ | \$ 4,676 | \$ 4,676 |
| Collectively evaluated for impairment | 5,374,055 | 729,113 | 6,103,168 |
| Total finance receivables | \$ 5,374,055 | \$ 733,789 | \$ 6,107,844 |

There were no wholesale finance receivables at July 1, 2012 or December 31, 2011 that were individually deemed to be impaired under ASC Topic 310, Receivables. Additional information related to the wholesale finance receivables that were individually deemed to be impaired under ASC Topic 310, Receivables, at June 26, 2011 includes (in thousands):

| | June 26, 2011 | | | | | | |
|---|---------------------|--------------------------|-------------------|-----------------------------|---|-----------------------------|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Three months ended Interest Income Recognized | Average Recorded Investment | Six months ended Interest Income Recognized |
| Wholesale: | | | | | | | |
| No related allowance recorded | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Related allowance recorded | 4,676 | 4,441 | 3,031 | 4,932 | | 5,050 | |
| Total impaired wholesale finance receivables | \$ 4,676 | \$ 4,441 | \$ 3,031 | \$ 4,932 | \$ | \$ 5,050 | \$ |

Retail finance receivables are contractually delinquent if the minimum payment is not received by the specified due date. Retail finance receivables are generally charged-off at 120 days contractually past due. Retail finance receivables accrue interest until either collected or charged-off. Accordingly, as of July 1, 2012, December 31, 2011 and June 26, 2011, all retail finance receivables were accounted for as interest-earning receivables, of which \$14.8 million, \$27.5 million and \$18.7 million, respectively, were 90 days or more past due.

Wholesale finance receivables are delinquent if the minimum payment is not received by the contractual due date. A specific allowance for credit losses is established once management determines that the borrower does not have the ability to repay the loan in full. Interest continues to accrue on past due wholesale finance

Table of Contents

receivables until the date the collection of the finance receivables becomes doubtful, at which time the finance receivable is placed on non-accrual status. The Company will resume accruing interest on these wholesale finance receivables when payments are current according to the terms of the loan agreements and future payments are reasonably assured. While on non-accrual status, all cash received is applied to principal or interest as appropriate. There were no wholesale receivables on non-accrual status at July 1, 2012 or December 31, 2011. The recorded investment of non-accrual status wholesale finance receivables at June 26, 2011 was \$4.7 million. At July 1, 2012, December 31, 2011 and June 26, 2011, \$0.6 million, \$0.9 million, and \$1.2 million of wholesale finance receivables were 90 days or more past due and accruing interest, respectively.

An analysis of the aging of past due finance receivables, which includes non-accrual status finance receivables was as follows (in thousands):

| | July 1, 2012 | | | | | Total Finance Receivables |
|--------------|---------------------|------------------------|---------------------------|-------------------------------------|-------------------|---------------------------------|
| | Current | 31-60 Days Past Due | 61-90 Days Past Due | Greater than 90 Days Past Due | Total Past Due | |
| Retail | \$ 5,101,847 | \$ 84,858 | \$ 24,247 | \$ 14,827 | \$ 123,932 | \$ 5,225,779 |
| Wholesale | 902,891 | 1,125 | 468 | 554 | 2,147 | 905,038 |
| Total | \$ 6,004,738 | \$ 85,983 | \$ 24,715 | \$ 15,381 | \$ 126,079 | \$ 6,130,817 |

| | December 31, 2011 | | | | | Total Finance Receivables |
|--------------|---------------------|------------------------|------------------------|-------------------------------------|-------------------|---------------------------------|
| | Current | 31-60 Days Past Due | 61-90 Days Past Due | Greater than 90 Days Past Due | Total Past Due | |
| Retail | \$ 4,915,711 | \$ 107,373 | \$ 36,937 | \$ 27,469 | \$ 171,779 | \$ 5,087,490 |
| Wholesale | 822,610 | 777 | 344 | 909 | 2,030 | 824,640 |
| Total | \$ 5,738,321 | \$ 108,150 | \$ 37,281 | \$ 28,378 | \$ 173,809 | \$ 5,912,130 |

| | June 26, 2011 | | | | | Total Finance Receivables |
|--------------|---------------------|------------------------|------------------------|-------------------------------------|-------------------|---------------------------------|
| | Current | 31-60 Days Past Due | 61-90 Days Past Due | Greater than 90 Days Past Due | Total Past Due | |
| Retail | \$ 5,205,300 | \$ 115,163 | \$ 34,860 | \$ 18,732 | \$ 168,755 | \$ 5,374,055 |
| Wholesale | 730,476 | 816 | 387 | 2,110 | 3,313 | 733,789 |
| Total | \$ 5,935,776 | \$ 115,979 | \$ 35,247 | \$ 20,842 | \$ 172,068 | \$ 6,107,844 |

A significant part of managing HDFS finance receivable portfolios includes the assessment of credit risk associated with each borrower. As the credit risk varies between the retail and wholesale portfolios, HDFS utilizes different credit risk indicators for each portfolio.

HDFS manages retail credit risk through its credit approval policy and ongoing collection efforts. HDFS uses FICO scores, a standard credit rating measurement, to differentiate the expected default rates of retail credit applicants enabling the Company to better evaluate credit applicants for approval and to tailor pricing according to this assessment. Retail loans with a FICO score of 640 or above at origination are considered prime, and loans with a FICO score below 640 are considered sub-prime. These credit quality indicators are determined at the time of loan origination and are not updated subsequent to the loan origination date.

Table of Contents

The recorded investment of retail finance receivables, by credit quality indicator, was as follows (in thousands):

| | July 1, 2012 | December 31, 2011 | June 26, 2011 |
|--------------|---------------------|---------------------|---------------------|
| Prime | \$ 4,181,527 | \$ 4,097,048 | \$ 4,313,863 |
| Sub-prime | 1,044,252 | 990,442 | 1,060,192 |
| Total | \$ 5,225,779 | \$ 5,087,490 | \$ 5,374,055 |

HDFS credit risk on the wholesale portfolio is different from that of the retail portfolio. Whereas the retail portfolio represents a relatively homogeneous pool of retail finance receivables that exhibit more consistent loss patterns, the wholesale portfolio exposures are less consistent. HDFS utilizes an internal credit risk rating system to manage credit risk exposure consistently across wholesale borrowers and capture credit risk factors for each borrower.

HDFS uses the following internal credit quality indicators, based on the Company's internal risk rating system, listed from highest level of risk to lowest level of risk for the wholesale portfolio: Doubtful, Substandard, Special Mention, Medium Risk and Low Risk. Based upon management's review, the dealers classified in the Doubtful category are the dealers with the greatest likelihood of being charged-off, while the dealers classified as Low Risk are least likely to be charged-off. The internal rating system considers factors such as the specific borrowers' ability to repay and the estimated value of any collateral. Dealer risk rating classifications are reviewed and updated on a quarterly basis.

The recorded investment of wholesale finance receivables, by internal credit quality indicator, was as follows (in thousands):

| | July 1, 2012 | December 31, 2011 | June 26, 2011 |
|-----------------|-------------------|-------------------|-------------------|
| Doubtful | \$ 9,467 | \$ 13,048 | \$ 12,386 |
| Substandard | 5,902 | 5,052 | 21,088 |
| Special Mention | 7,897 | 14,361 | 12,887 |
| Medium Risk | 808 | 3,032 | 12,861 |
| Low Risk | 880,964 | 789,147 | 674,567 |
| Total | \$ 905,038 | \$ 824,640 | \$ 733,789 |

7. Asset-Backed Financing

HDFS participates in asset-backed financing through both term asset-backed securitization transactions and its asset-backed commercial paper conduit facility. In both types of asset-backed financing programs, HDFS transfers U.S. retail motorcycle finance receivables to a consolidated special purpose entity (SPE) while retaining the servicing rights. Each SPE then converts those assets into cash, through the issuance of debt. These SPEs are considered VIEs under U.S. GAAP. HDFS is required to consolidate any VIEs in which it is deemed to be the primary beneficiary through having power over the significant activities of the entity and having an obligation to absorb losses or the right to receive benefits from the VIE which are potentially significant to the VIE.

HDFS is considered to have power over the significant activities of its term asset-backed securitization and asset-backed commercial paper conduit facility VIEs due to its role as servicer. Servicing fees are typically not considered potentially significant variable interests in a VIE. However, HDFS retains a residual interest in the VIEs in the form of a debt security, which gives HDFS the right to receive benefits that could be potentially significant to the VIE. Therefore, the Company is the primary beneficiary and consolidates all of its VIEs within its consolidated financial statements. Servicing fees paid by VIEs to HDFS are eliminated in consolidation and therefore are not recorded on a consolidated basis.

Table of Contents

HDFS is not required, and does not currently intend, to provide any additional financial support to its VIEs. Investors and creditors only have recourse to the assets held by the VIEs.

The Company's VIEs have been aggregated on the balance sheet due to the similarity of the nature of the assets involved as well as the purpose and design of the VIEs.

Term Asset-Backed Securitization VIEs

The Company transfers U.S. retail motorcycle finance receivables to SPEs which in turn issue secured notes to investors, with various maturities and interest rates, secured by future collections of the purchased U.S. retail motorcycle finance receivables. Each term asset-backed securitization SPE is a separate legal entity and the U.S. retail motorcycle finance receivables included in each term asset-backed securitization are only available for payment of that secured debt and other obligations arising from the term asset-backed securitization transaction and are not available to pay other obligations or claims of the Company's creditors until the associated secured debt and other obligations are satisfied. Cash and cash equivalent balances held by the SPEs are used only to support the securitizations. There are no amortization schedules for the secured notes; however, the debt is reduced monthly as available collections on the related U.S. retail motorcycle finance receivables are applied to outstanding principal. The secured notes' contractual lives have various maturities ranging from 2012 to 2018.

During the second quarter of 2012, the Company issued \$89.5 million of secured notes through the sale of notes that had been previously retained as part of certain 2009 and 2011 term asset-backed securitization transactions. These notes were sold at a premium, which will be recognized over the term of the notes. At July 1, 2012, the unaccreted premium associated with these notes was \$1.8 million. There was no additional term-asset backed securitization activity during the six months ended July 1, 2012. There were no term-asset backed securitization transactions during the six months ended June 26, 2011.

The following table presents the assets and liabilities of the consolidated term asset-backed securitization SPEs that were included in the Company's financial statements (in thousands):

| | July 1, 2012 | December 31, 2011 | June 26, 2011 |
|---------------------------------------|---------------------|----------------------|---------------------|
| Assets: | | | |
| Finance receivables | \$ 2,082,375 | \$ 2,916,219 | \$ 2,554,758 |
| Allowance for credit losses | (41,781) | (65,735) | (61,642) |
| Restricted cash | 187,782 | 228,776 | 242,618 |
| Other assets | 4,243 | 6,772 | 7,594 |
| Total assets | \$ 2,232,619 | \$ 3,086,032 | \$ 2,743,328 |
| Liabilities | | | |
| Term asset-backed securitization debt | \$ 1,339,232 | \$ 2,087,346 | \$ 1,853,382 |

Asset-Backed Commercial Paper Conduit Facility VIE

On September 9, 2011, the Company amended and restated its third-party bank sponsored asset-backed commercial paper conduit facility which provides for a total aggregate commitment of \$600.0 million based on, among other things, the amount of eligible U.S. retail motorcycle loans held by the SPE as collateral. The amended agreement has terms similar to the prior agreement and is for the same amount. Under the facility, HDFS may transfer U.S. retail motorcycle finance receivables to a SPE, which in turn may issue debt to third-party bank-sponsored asset-backed commercial paper conduits. The assets of the SPE are restricted as collateral for the payment of the debt or other obligations arising in the transaction and are not available to pay other obligations or claims of the Company's creditors. The terms for this debt provide for interest on the outstanding principal based on prevailing commercial paper rates, or LIBOR plus a specified margin to the extent the advance is not funded by a conduit lender through the issuance of commercial paper. The conduit facility also provides for

Table of Contents

an unused commitment fee based on the unused portion of the total aggregate commitment of \$600.0 million. There is no amortization schedule; however, the debt is reduced monthly as available collections on the related finance receivables are applied to outstanding principal. Upon expiration of the conduit facility, any outstanding principal will continue to be reduced monthly through available collections. Unless earlier terminated or extended by mutual agreement of HDFS and the lenders, the conduit facility has an expiration date of September 7, 2012.

The following table presents the assets of the asset-backed commercial paper conduit facility SPEs that were included in our financial statements (in thousands):

| | July 1, 2012 | December 31, 2011 | June 26, 2011 |
|-----------------------------|-----------------|----------------------|------------------|
| Finance receivables | \$ 8,403 | \$ 13,455 | \$ 19,747 |
| Allowance for credit losses | (168) | (302) | (475) |
| Restricted cash | 782 | 879 | 1,443 |
| Other assets | 158 | 449 | 288 |
| Total assets | \$ 9,175 | \$ 14,481 | \$ 21,003 |

The SPEs had no borrowings outstanding under the conduit facility at July 1, 2012, December 31, 2011 or June 26, 2011, therefore, these assets are restricted as collateral for the payment of fees associated with the unused portion of the total aggregate commitment of \$600.0 million.

8. Fair Value Measurements

Certain assets and liabilities are recorded at fair value in the financial statements; some of these are measured on a recurring basis while others are measured on a non-recurring basis. Assets and liabilities measured on a recurring basis are those that are adjusted to fair value each time a financial statement is prepared. Assets and liabilities measured on a non-recurring basis are those that are adjusted to fair value when a significant event occurs. In determining fair value of assets and liabilities, the Company uses various valuation techniques. The availability of inputs observable in the market varies from instrument to instrument and depends on a variety of factors including the type of instrument, whether the instrument is actively traded, and other characteristics particular to the transaction. For many financial instruments, pricing inputs are readily observable in the market, the valuation methodology used is widely accepted by market participants, and the valuation does not require significant management discretion. For other financial instruments, pricing inputs are less observable in the market and may require management judgment.

The Company assesses the inputs used to measure fair value using a three-tier hierarchy. The hierarchy indicates the extent to which inputs used in measuring fair value are observable in the market. Level 1 inputs include quoted prices for identical instruments and are the most observable. Level 2 inputs include quoted prices for similar assets and observable inputs such as interest rates, foreign currency exchange rates, commodity rates and yield curves. The Company uses the market approach to derive the fair value for its level 2 fair value measurements. Foreign currency exchange contracts are valued using publicly quoted spot and forward prices; commodity contracts are valued using publicly quoted prices, where available, or dealer quotes; interest rate swaps are valued using publicized swap curves; and investments in marketable debt and equity securities are valued using publicly quoted prices.

Level 3 inputs are not observable in the market and include management's judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the following tables.

Table of Contents*Recurring Fair Value Measurements*

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis (in thousands):

| | July 1, 2012 | | | |
|-----------------------|----------------------------------|---|---|--|
| | Balance as of July 1, 2012 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents | \$ 764,147 | \$ 764,147 | \$ | \$ |
| Marketable securities | 135,848 | | 135,848 | |
| Derivatives | 8,879 | | 8,879 | |
| | \$ 908,874 | \$ 764,147 | \$ 144,727 | \$ |
| Liabilities: | | | | |
| Derivatives | \$ 2,042 | \$ | \$ 2,042 | \$ |

| | December 31, 2011 | | | |
|-----------------------|------------------------------------|---|---|--|
| | Balance as of December 31, 2011 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents | \$ 1,302,367 | \$ 1,302,367 | \$ | \$ |
| Marketable securities | 153,380 | | 153,380 | |
| Derivatives | 16,443 | | 16,443 | |
| | \$ 1,472,190 | \$ 1,302,367 | \$ 169,823 | \$ |
| Liabilities: | | | | |
| Derivatives | \$ 5,136 | \$ | \$ 5,136 | \$ |

| | June 26, 2011 | | | |
|-----------------------|--------------------------------------|--|---|--|
| | Balance as of June 26, 2011 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents | \$ 582,808 | \$ 582,808 | \$ | \$ |
| Marketable securities | 244,555 | 49,999 | 194,556 | |
| Derivatives | | | | |
| | \$ 827,363 | \$ 632,807 | \$ 194,556 | \$ |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

Liabilities:

| | | | | | | | |
|-------------|----|--------|----|--|----|--------|----|
| Derivatives | \$ | 14,933 | \$ | | \$ | 14,933 | \$ |
|-------------|----|--------|----|--|----|--------|----|

Table of Contents**9. Fair Value of Financial Instruments**

The Company's financial instruments consist primarily of cash and cash equivalents, marketable securities, trade receivables, finance receivables, net, trade payables, debt, foreign currency contracts and interest rate swaps (derivative instruments are discussed further in Note 10). Under U.S. GAAP, certain of these items are required to be recorded in the financial statements at fair value, while others are required to be recorded at historical cost.

The following table summarizes the fair value and carrying value of the Company's financial instruments (in thousands):

| | July 1, 2012 | | December 31, 2011 | | June 26, 2011 | |
|--|--------------|----------------|-------------------|----------------|---------------|----------------|
| | Fair Value | Carrying Value | Fair Value | Carrying Value | Fair Value | Carrying Value |
| Assets: | | | | | | |
| Cash and cash equivalents | \$ 1,071,496 | \$ 1,071,496 | \$ 1,526,950 | \$ 1,526,950 | \$ 973,478 | \$ 973,478 |
| Marketable securities | \$ 135,848 | \$ 135,848 | \$ 153,380 | \$ 153,380 | \$ 244,555 | \$ 244,555 |
| Accounts receivable, net | \$ 250,268 | \$ 250,268 | \$ 219,039 | \$ 219,039 | \$ 265,663 | \$ 265,663 |
| Derivatives | \$ 8,879 | \$ 8,879 | \$ 16,443 | \$ 16,443 | \$ | \$ |
| Finance receivables, net | \$ 6,099,619 | \$ 6,016,569 | \$ 5,888,040 | \$ 5,786,681 | \$ 6,052,156 | \$ 5,963,440 |
| Restricted cash held by variable interest entities | \$ 188,564 | \$ 188,564 | \$ 229,655 | \$ 229,655 | \$ 244,060 | \$ 244,060 |
| Liabilities: | | | | | | |
| Accounts payable | \$ 252,239 | \$ 252,239 | \$ 255,713 | \$ 255,713 | \$ 277,395 | \$ 277,395 |
| Derivatives | \$ 2,042 | \$ 2,042 | \$ 5,136 | \$ 5,136 | \$ 14,933 | \$ 14,933 |
| Unsecured commercial paper | \$ 845,868 | \$ 845,868 | \$ 874,286 | \$ 874,286 | \$ 735,737 | \$ 735,737 |
| Credit facilities | \$ 143,792 | \$ 143,792 | \$ 159,794 | \$ 159,794 | \$ 201,112 | \$ 201,112 |
| Medium-term notes | \$ 2,967,112 | \$ 2,698,359 | \$ 2,561,458 | \$ 2,298,193 | \$ 2,555,926 | \$ 2,347,750 |
| Senior unsecured notes | \$ 360,791 | \$ 303,000 | \$ 376,513 | \$ 303,000 | \$ 391,051 | \$ 303,000 |
| Term asset-backed securitization debt | \$ 1,345,452 | \$ 1,339,232 | \$ 2,099,060 | \$ 2,087,346 | \$ 1,883,465 | \$ 1,853,382 |

Cash and Cash Equivalents, Restricted Cash, Accounts Receivable, Net and Accounts Payable With the exception of certain money-market investments, these items are recorded in the financial statements at historical cost. The historical cost basis for these amounts is estimated to approximate their respective fair values due to the short maturity of these instruments.

Marketable Securities Marketable securities are recorded in the financial statements at fair value. The fair value of marketable securities is based primarily on quoted market prices of similar financial assets. Changes in fair value are recorded, net of tax, as other comprehensive income and included as a component of shareholders' equity. Fair Value is based on Level 1 or Level 2 inputs.

Finance Receivables, Net Finance receivables, net includes finance receivables held for investment, net and restricted finance receivables held by VIEs, net. Retail and wholesale finance receivables are recorded in the financial statements at historical cost less a provision for credit losses. The fair value of retail finance receivables is generally calculated by discounting future cash flows using an estimated discount rate that reflects current credit, interest rate and prepayment risks associated with similar types of instruments. Fair value is determined based on Level 3 inputs. The historical cost basis of wholesale finance receivables approximates fair value because they either are short-term or have interest rates that adjust with changes in market interest rates.

Derivatives Interest rate swaps, foreign currency exchange contracts and commodity contracts are derivative financial instruments and are carried at fair value on the balance sheet. The fair value of interest rate swaps is determined using pricing models that incorporate quoted prices for similar assets and observable inputs such as interest rates and yield curves. The fair value of foreign currency exchange and commodity contracts are determined using publicly quoted prices. Fair value is calculated using Level 2 inputs.

Table of Contents

Debt Debt is generally recorded in the financial statements at historical cost. The carrying value of debt provided under credit facilities approximates fair value since the interest rates charged under the facilities are tied directly to market rates and fluctuate as market rates change. The carrying value of unsecured commercial paper approximates fair value due to its short maturity. Fair value is calculated using Level 2 inputs.

The fair values of the medium-term notes maturing in December 2012, December 2014, March 2016, March 2017 and June 2018 are estimated based upon rates currently available for debt with similar terms and remaining maturities. Fair value is calculated using Level 2 inputs.

The fair value of the senior unsecured notes is estimated based upon rates currently available for debt with similar terms and remaining maturities. Fair value is calculated using Level 2 inputs.

The fair value of the debt related to term asset-backed securitization transactions is estimated based on pricing currently available for transactions with similar terms and maturities. Fair value is calculated using Level 2 inputs.

10. Derivative Instruments and Hedging Activities

The Company is exposed to certain risks such as foreign currency exchange rate risk, interest rate risk and commodity price risk. To reduce its exposure to such risks, the Company selectively uses derivative financial instruments. All derivative transactions are authorized and executed pursuant to regularly reviewed policies and procedures, which prohibit the use of financial instruments for speculative trading purposes.

All derivative instruments are recognized on the balance sheet at fair value (see Note 9). In accordance with ASC Topic 815, Derivatives and Hedging, the accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. Changes in the fair value of derivatives that are designated as fair value hedges, along with the gain or loss on the hedged item, are recorded in current period earnings. For derivative instruments that are designated as cash flow hedges, the effective portion of gains and losses that result from changes in the fair value of derivative instruments is initially recorded in other comprehensive income (OCI) and subsequently reclassified into earnings when the hedged item affects income. The Company assesses, both at the inception of each hedge and on an on-going basis, whether the derivatives that are used in its hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. Any ineffective portion is immediately recognized in earnings. No component of a hedging derivative instrument's gain or loss is excluded from the assessment of hedge effectiveness. Derivative instruments that do not qualify for hedge accounting are recorded at fair value and any changes in fair value are recorded in current period earnings.

The Company sells its products internationally and in most markets those sales are made in the foreign country's local currency. As a result, the Company's earnings can be affected by fluctuations in the value of the U.S. dollar relative to foreign currency. The Company's most significant foreign currency risk relates to the Euro, the Australian dollar and the Japanese yen. The Company utilizes foreign currency contracts to mitigate the effects of these currencies' fluctuations on earnings. The foreign currency contracts are entered into with banks and allow the Company to exchange a specified amount of foreign currency for U.S. dollars at a future date, based on a fixed exchange rate.

The Company utilizes natural gas contracts and diesel fuel contracts to hedge portions of the cost of those commodities consumed in the Company's motorcycle production and distribution operations.

The Company's foreign currency contracts and commodity contracts generally have maturities of less than one year.

The Company's earnings are affected by changes in interest rates. HDFS utilizes interest rate swaps to reduce the impact of fluctuations in interest rates on its unsecured commercial paper by converting a portion from a floating rate basis to a fixed rate basis. HDFS also entered into derivative contracts to facilitate its first quarter 2008 term asset-backed securitization transaction. These derivatives, which hedged assets held by a VIE, did not qualify for hedge accounting treatment and expired during 2011. The fair value of HDFS's interest rate swaps is determined using pricing models that incorporate quoted prices for similar assets and observable inputs such as interest rates and yield curves.

Table of Contents

The following table summarizes the fair value of the Company's derivative financial instruments (in thousands):

| Derivatives Designated As Hedging | July 1, 2012 | | | December 31, 2011 | | | June 26, 2011 | | |
|---|-------------------|---------------------------------|-------------------------------------|-------------------|---------------------------------|-------------------------------------|-------------------|---------------------------------|-------------------------------------|
| | Notional Value | Asset Fair Value ^(a) | Liability Fair Value ^(b) | Notional Value | Asset Fair Value ^(a) | Liability Fair Value ^(b) | Notional Value | Asset Fair Value ^(a) | Liability Fair Value ^(b) |
| Instruments Under ASC Topic 815 | | | | | | | | | |
| Foreign currency contracts ^(c) | \$ 244,221 | \$ 8,879 | \$ 1,027 | \$ 306,450 | \$ 16,443 | \$ 1,852 | \$ 272,637 | \$ | \$ 9,691 |
| Natural gas contracts ^(c) | 1,066 | | 33 | 3,915 | | 265 | 2,915 | | 86 |
| Interest rate swaps unsecured commercial paper ^(c) | 41,600 | | 982 | 102,100 | | 3,020 | 117,500 | | 5,156 |
| Total | \$ 286,887 | \$ 8,879 | \$ 2,042 | \$ 412,465 | \$ 16,443 | \$ 5,137 | \$ 393,052 | \$ | \$ 14,933 |

| Derivatives Not Designated As Hedging | July 1, 2012 | | | December 31, 2011 | | | June 26, 2011 | | |
|---------------------------------------|----------------|---------------------------------|-------------------------------------|-------------------|---------------------------------|-------------------------------------|----------------|---------------------------------|-------------------------------------|
| | Notional Value | Asset Fair Value ^(a) | Liability Fair Value ^(b) | Notional Value | Asset Fair Value ^(a) | Liability Fair Value ^(b) | Notional Value | Asset Fair Value ^(a) | Liability Fair Value ^(b) |
| Instruments Under ASC Topic 815 | | | | | | | | | |
| Disel fuel contracts | \$ 4,346 | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| | \$ 4,346 | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |

- (a) Included in other current assets
- (b) Included in accrued liabilities
- (c) Derivative designated as a cash flow hedge

The following tables summarize the amount of gains and losses related to derivative financial instruments designated as cash flow hedges (in thousands):

| Cash Flow Hedges | Amount of Gain/(Loss) Recognized in OCI | | | |
|--|--|-------------------|------------------|--------------------|
| | Three months ended | | Six months ended | |
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 |
| Foreign currency contracts | \$ 10,309 | \$ (6,760) | \$ 4,095 | \$ (16,921) |
| Natural gas contracts | (109) | (227) | (424) | (264) |
| Interest rate swaps unsecured commercial paper | (9) | (397) | (24) | (405) |
| Total | \$ 10,191 | \$ (7,384) | \$ 3,647 | \$ (17,590) |

| Cash Flow Hedges | Amount of Gain/(Loss) Reclassified from AOCI into Income | | | | |
|---|---|---------------|------------------|---------------|---|
| | Three months ended | | Six months ended | | Expected to be Reclassified Over the Next Twelve Months |
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 | |
| Foreign currency contracts ^(a) | \$ 9,683 | \$ (14,781) | \$ 12,104 | \$ (20,788) | \$ (5,162) |
| Natural gas contracts ^(a) | (337) | (166) | (656) | (424) | 33 |
| | (968) | (1,336) | (1,935) | (2,686) | (986) |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

Interest rate swaps unsecured commercial
paper^(b)

| | | | | | |
|-------|----------|-------------|----------|-------------|------------|
| Total | \$ 8,378 | \$ (16,283) | \$ 9,513 | \$ (23,898) | \$ (6,115) |
|-------|----------|-------------|----------|-------------|------------|

- (a) Gain/(loss) reclassified from accumulated other comprehensive income (AOCI) to income is included in cost of goods sold.
- (b) Gain/(loss) reclassified from AOCI to income is included in financial services interest expense.

Table of Contents

For the three and six months ended July 1, 2012 and June 26, 2011, the cash flow hedges were highly effective and, as a result, the amount of hedge ineffectiveness was not material. No amounts were excluded from effectiveness testing.

For the three and six months ended July 1, 2012 and June 26, 2011, there were no gains or losses recognized in income related to derivative financial instruments designated as fair value hedges.

For the three and six months ended July 1, 2012 and June 26, 2011, there were no gains or losses recognized in income related to derivative financial instruments not designated as hedging instruments.

The Company is exposed to credit loss risk in the event of non-performance by counterparties to these derivative financial instruments. Although no assurances can be given, the Company does not expect any of the counterparties to these derivative financial instruments to fail to meet its obligations. To manage credit loss risk, the Company selects counterparties based on credit ratings and, on a quarterly basis, evaluates each hedge's net position relative to the counterparty's ability to cover its position.

11. Income Taxes

The Company's 2012 income tax rate for the three and six months ended July 1, 2012 was 35.3% compared to 34.8% for the same periods last year. Prior year was favorably impacted by the Federal research and development credit that expired at the end of 2011.

12. Product Warranty and Safety Recall Campaigns

The Company currently provides a standard two-year limited warranty on all new motorcycles sold worldwide, except for Japan, where the Company currently provides a standard three-year limited warranty on all new motorcycles sold. In addition, the Company started offering a one-year warranty for Parts & Accessories (P&A) in 2012. The warranty coverage for the retail customer generally begins when the product is sold to a retail customer. The Company maintains reserves for future warranty claims using an estimated cost, which is based primarily on historical Company claim information. Additionally, the Company has from time to time initiated certain voluntary safety recall campaigns. The Company reserves for all estimated costs associated with safety recalls in the period that the safety recalls are announced.

Changes in the Company's warranty and safety recall liability were as follows (in thousands):

| | Three months ended | | Six months ended | |
|--|--------------------|------------------|------------------|------------------|
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 |
| Balance, beginning of period | \$ 57,102 | \$ 57,111 | \$ 54,994 | \$ 54,134 |
| Warranties issued during the period | 17,127 | 12,335 | 32,618 | 23,560 |
| Settlements made during the period | (18,549) | (12,570) | (33,086) | (22,866) |
| Recalls and changes to pre-existing warranty liabilities | 12,121 | (1,469) | 13,275 | 579 |
| Balance, end of period | \$ 67,801 | \$ 55,407 | \$ 67,801 | \$ 55,407 |

The liability for safety recall campaigns was \$6.7 million, \$10.7 million and \$2.9 million as of July 1, 2012, December 31, 2011 and June 26, 2011, respectively.

Table of Contents**13. Earnings Per Share**

The following table sets forth the computation for basic and diluted earnings per share from continuing operations (in thousands, except per share amounts):

| | Three months ended | | Six months ended | |
|--|--------------------|------------------|------------------|------------------|
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 |
| Numerator: | | | | |
| Income from continuing operations used in computing basic and diluted earnings per share | \$ 247,250 | \$ 190,580 | \$ 419,285 | \$ 309,840 |
| Denominator: | | | | |
| Denominator for basic earnings per share- weighted-average common shares | 228,838 | 234,336 | 228,914 | 234,086 |
| Effect of dilutive securities employee stock compensation plan | 2,085 | 1,832 | 2,190 | 1,958 |
| Denominator for diluted earnings per share- adjusted weighted-average shares outstanding | 230,923 | 236,168 | 231,104 | 236,044 |
| Earnings per common share from continuing operations: | | | | |
| Basic | \$ 1.08 | \$ 0.81 | \$ 1.83 | \$ 1.32 |
| Diluted | \$ 1.07 | \$ 0.81 | \$ 1.81 | \$ 1.31 |

Outstanding options to purchase 2.1 million and 4.1 million shares of common stock for the three months ended July 1, 2012 and June 26, 2011, respectively, and 2.3 million and 3.7 million shares of common stock for the six months ended July 1, 2012 and June 26, 2011, respectively, were not included in the Company's computation of dilutive securities because the exercise price was greater than the market price and therefore the effect would have been anti-dilutive.

The Company has a share-based compensation plan under which employees may be granted share-based awards including shares of restricted stock and restricted stock units (RSUs). Non-forfeitable dividends are paid on unvested shares of restricted stock and non-forfeitable dividend equivalents are paid on unvested RSUs. As such, shares of restricted stock and RSUs are considered participating securities under the two-class method of calculating earnings per share as described in ASC Topic 260, Earnings per Share. The two-class method of calculating earnings per share did not have a material impact on the Company's earnings per share calculation for the three and six month periods ending July 1, 2012 and June 26, 2011, respectively.

Table of Contents**14. Employee Benefit Plans**

The Company has defined benefit pension plans and postretirement healthcare benefit plans, which cover substantially all employees of the Motorcycles segment. The Company also has unfunded supplemental employee retirement plan agreements (SERPA) with certain employees which were instituted to replace benefits lost under the Tax Revenue Reconciliation Act of 1993. Components of net periodic benefit costs were as follows (in thousands):

| | Three months ended | | Six months ended | |
|--|--------------------|------------------|------------------|------------------|
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 |
| <u>Pension and SERPA Benefits</u> | | | | |
| Service cost | \$ 8,420 | \$ 9,273 | \$ 16,840 | \$ 18,545 |
| Interest cost | 20,816 | 20,147 | 41,632 | 40,294 |
| Expected return on plan assets | (29,277) | (26,653) | (58,555) | (53,307) |
| Amortization of unrecognized: | | | | |
| Prior service cost | 740 | 745 | 1,479 | 1,489 |
| Net loss | 10,969 | 7,554 | 21,937 | 15,109 |
| Curtailment loss | | | | 236 |
| Net periodic benefit cost | \$ 11,668 | \$ 11,066 | \$ 23,333 | \$ 22,366 |
| <u>Postretirement Healthcare Benefits</u> | | | | |
| Service cost | \$ 1,853 | \$ 1,907 | \$ 3,706 | \$ 3,814 |
| Interest cost | 4,578 | 4,911 | 9,155 | 9,822 |
| Expected return on plan assets | (2,356) | (2,346) | (4,712) | (4,692) |
| Amortization of unrecognized: | | | | |
| Prior service credit | (963) | (969) | (1,927) | (1,938) |
| Net loss | 1,855 | 1,798 | 3,711 | 3,596 |
| Net periodic benefit cost | \$ 4,967 | \$ 5,301 | \$ 9,933 | \$ 10,602 |

During the first six months of 2012, the Company voluntarily contributed \$200.0 million in cash to further fund its pension plans. No additional pension contributions are required in 2012. The Company also voluntarily contributed \$200.0 million in cash to further fund its pension plans during the first six months of 2011. The Company expects it will continue to make on-going contributions related to current benefit payments for SERPA and postretirement healthcare plans.

Table of Contents**15. Business Segments**

The Company operates in two business segments: Motorcycles and Financial Services. The Company's reportable segments are strategic business units that offer different products and services. They are managed separately based on the fundamental differences in their operations. Selected segment information is set forth below (in thousands):

| | Three months ended | | Six months ended | |
|---|--------------------|------------------|------------------|------------------|
| | July 1, 2012 | June 26, 2011 | July 1, 2012 | June 26, 2011 |
| Motorcycles net revenue | \$ 1,569,047 | \$ 1,339,744 | \$ 2,842,416 | \$ 2,402,788 |
| Gross profit | 563,817 | 468,268 | 1,020,327 | 820,134 |
| Selling, administrative and engineering expense | 248,038 | 234,827 | 485,033 | 438,632 |
| Restructuring expense | 6,220 | 13,594 | 17,671 | 36,593 |
| Operating income from Motorcycles | 309,559 | 219,847 | 517,623 | 344,909 |
| Financial services income | 160,613 | 165,853 | 316,935 | 327,739 |
| Financial services expense | 78,659 | 83,798 | 167,587 | 177,749 |
| Operating income from Financial Services | 81,954 | 82,055 | 149,348 | 149,990 |
| Operating income | \$ 391,513 | \$ 301,092 | \$ 666,971 | \$ 494,899 |

16. Commitment and Contingencies

The Company is subject to lawsuits and other claims related to environmental, product and other matters. In determining required reserves related to these items, the Company carefully analyzes cases and considers the likelihood of adverse judgments or outcomes, as well as the potential range of possible loss. The required reserves are monitored on an ongoing basis and are updated based on new developments or new information in each matter.

Environmental Protection Agency Notice

In December 2009, the Company received formal, written requests for information from the United States Environmental Protection Agency (EPA) regarding: (i) certificates of conformity for motorcycle emissions and related designations and labels, (ii) aftermarket parts, and (iii) warranty claims on emissions related components. The Company promptly submitted written responses to the EPA's inquiry and engaged in discussions with the EPA. It is possible that a result of the EPA's investigation will be some form of enforcement action by the EPA that will seek a fine or other relief. However, at this time the Company does not know and cannot reasonably estimate the impact of any remedies the EPA might seek.

York Environmental Matters:

The Company is involved with government agencies and groups of potentially responsible parties in various environmental matters, including a matter involving the cleanup of soil and groundwater contamination at its York, Pennsylvania facility. The York facility was formerly used by the U.S. Navy and AMF prior to the purchase of the York facility by the Company from AMF in 1981. Although the Company is not certain as to the full extent of the environmental contamination at the York facility, it has been working with the Pennsylvania Department of Environmental Protection (PADEP) since 1986 in undertaking environmental investigation and remediation activities, including an ongoing site-wide remedial investigation/feasibility study (RI/FS). In January 1995, the Company entered into a settlement agreement (the Agreement) with the Navy. The Agreement calls for the Navy and the Company to contribute amounts into a trust equal to 53% and 47%, respectively, of future costs associated with environmental investigation and remediation activities at the York facility (Response Costs). The trust administers the payment of the Response Costs incurred at the York facility as covered by the Agreement.

Table of Contents

In February 2002, the Company was advised by the EPA that it considers some of the Company's remediation activities at the York facility to be subject to the EPA's corrective action program under the Resource Conservation and Recovery Act (RCRA) and offered the Company the option of addressing corrective action under a RCRA facility lead agreement. In July 2005, the York facility was designated as the first site in Pennsylvania to be addressed under the One Cleanup Program. The program provides a more streamlined and efficient oversight of voluntary remediation by both PADEP and EPA and will be carried out consistent with the Agreement with the Navy. As a result, the RCRA facility lead agreement has been superseded.

The Company estimates that its share of the future Response Costs at the York facility will be approximately \$2.3 million and has established a reserve for this amount which is included in accrued liabilities in the Condensed Consolidated Balance Sheets. As noted above, the RI/FS is still underway and given the uncertainty that exists concerning the nature and scope of additional environmental investigation and remediation that may ultimately be required under the RI/FS or otherwise at the York facility, we are unable to make a reasonable estimate of those additional costs, if any, that may result.

The estimate of the Company's future Response Costs that will be incurred at the York facility is based on reports of independent environmental consultants retained by the Company, the actual costs incurred to date and the estimated costs to complete the necessary investigation and remediation activities. Response Costs related to the remediation of soil are expected to be incurred primarily over a period of several years ending in 2015. Response Costs related to ground water remediation may continue for some time beyond 2015.

Product Liability Matters:

Additionally, the Company is involved in product liability suits related to the operation of its business. The Company accrues for claim exposures that are probable of occurrence and can be reasonably estimated. The Company also maintains insurance coverage for product liability exposures. The Company believes that its accruals and insurance coverage are adequate and that product liability will not have a material adverse effect on the Company's consolidated financial statements.

17. Supplemental Consolidating Data

The supplemental consolidating data for the periods noted is presented for informational purposes. The supplemental consolidating data may be different than segment information presented elsewhere due to the allocation of intercompany eliminations to reporting segments. All supplemental data is presented in thousands.

Table of Contents

| | Three months ended July 1, 2012 | | | Consolidated |
|---|---|---------------------|----------------|-------------------|
| | Motorcycles & Related Products Operations | Services Operations | Eliminations | |
| Revenue: | | | | |
| Motorcycles and related products | \$ 1,572,003 | \$ | \$ (2,956) | \$ 1,569,047 |
| Financial services | | 160,843 | (230) | 160,613 |
| Total revenue | 1,572,003 | 160,843 | (3,186) | 1,729,660 |
| Costs and expenses: | | | | |
| Motorcycles and related products cost of goods sold | 1,005,230 | | | 1,005,230 |
| Financial services interest expense | | 48,712 | | 48,712 |
| Financial services provision for credit losses | | (5,259) | | (5,259) |
| Selling, administrative and engineering expense | 248,268 | 38,162 | (3,186) | 283,244 |
| Restructuring expense | 6,220 | | | 6,220 |
| Total costs and expenses | 1,259,718 | 81,615 | (3,186) | 1,338,147 |
| Operating income | 312,285 | 79,228 | | 391,513 |
| Investment income | 2,231 | | | 2,231 |
| Interest expense | 11,595 | | | 11,595 |
| Income before provision for income taxes | 302,921 | 79,228 | | 382,149 |
| Provision for income taxes | 106,377 | 28,522 | | 134,899 |
| Income from continuing operations | 196,544 | 50,706 | | 247,250 |
| Loss from discontinued operations, net of tax | | | | |
| Net income | \$ 196,544 | \$ 50,706 | \$ | \$ 247,250 |

| | Six months ended July 1, 2012 | | | Consolidated |
|---|---|---------------------|------------------|------------------|
| | Motorcycles & Related Products Operations | Services Operations | Eliminations | |
| Revenue: | | | | |
| Motorcycles and related products | \$ 2,847,786 | \$ | \$ (5,370) | \$ 2,842,416 |
| Financial services | | 316,749 | 186 | 316,935 |
| Total revenue | 2,847,786 | 316,749 | (5,184) | 3,159,351 |
| Costs and expenses: | | | | |
| Motorcycles and related products cost of goods sold | 1,822,089 | | | 1,822,089 |
| Financial services interest expense | | 99,968 | | 99,968 |
| Financial services provision for credit losses | | 3,754 | | 3,754 |
| Selling, administrative and engineering expense | 484,847 | 69,235 | (5,184) | 548,898 |
| Restructuring expense | 17,671 | | | 17,671 |
| Total costs and expenses | 2,324,607 | 172,957 | (5,184) | 2,492,380 |
| Operating income | 523,179 | 143,792 | | 666,971 |
| Investment income | 229,164 | | (225,000) | 4,164 |
| Interest expense | 23,090 | | | 23,090 |
| Income before provision for income taxes | 729,253 | 143,792 | (225,000) | 648,045 |
| Provision for income taxes | 176,995 | 51,765 | | 228,760 |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

| | | | | |
|---|------------|-----------|--------------|------------|
| Income from continuing operations | 552,258 | 92,027 | (225,000) | 419,285 |
| Loss from discontinued operations, net of tax | | | | |
| Net income | \$ 552,258 | \$ 92,027 | \$ (225,000) | \$ 419,285 |

Table of Contents

| | Three months ended June 26, 2011 | | | |
|---|---|---------------------|----------------|-------------------|
| | Motorcycles & Related Products Operations | Services Operations | Eliminations | Consolidated |
| Revenue: | | | | |
| Motorcycles and related products | \$ 1,342,803 | \$ | \$ (3,059) | \$ 1,339,744 |
| Financial services | | 166,518 | (665) | 165,853 |
| Total revenue | 1,342,803 | 166,518 | (3,724) | 1,505,597 |
| Costs and expenses: | | | | |
| Motorcycles and related products cost of goods sold | 871,476 | | | 871,476 |
| Financial services interest expense | | 56,991 | | 56,991 |
| Financial services provision for credit losses | | (6,790) | | (6,790) |
| Selling, administrative and engineering expense | 235,492 | 36,656 | (3,724) | 268,424 |
| Restructuring expense | 13,594 | | | 13,594 |
| Total costs and expenses | 1,120,562 | 86,857 | (3,724) | 1,203,695 |
| Operating income | 222,241 | 79,661 | | 301,902 |
| Investment income | 1,748 | | | 1,748 |
| Interest expense | 11,350 | | | 11,350 |
| Income before provision for income taxes | 212,639 | 79,661 | | 292,300 |
| Provision for income taxes | 73,042 | 28,678 | | 101,720 |
| Income from continuing operations | 139,597 | 50,983 | | 190,580 |
| Loss from discontinued operations, net of tax | | | | |
| Net income | \$ 139,597 | \$ 50,983 | \$ | \$ 190,580 |

| | Six months ended June 26, 2011 | | | |
|---|---|---------------------|----------------|------------------|
| | Motorcycles & Related Products Operations | Services Operations | Eliminations | Consolidated |
| Revenue: | | | | |
| Motorcycles and related products | \$ 2,408,293 | \$ | \$ (5,505) | \$ 2,402,788 |
| Financial services | | 328,270 | (531) | 327,739 |
| Total revenue | 2,408,293 | 328,270 | (6,036) | 2,730,527 |
| Costs and expenses: | | | | |
| Motorcycles and related products cost of goods sold | 1,582,654 | | | 1,582,654 |
| Financial services interest expense | | 115,026 | | 115,026 |
| Financial services provision for credit losses | | (1,184) | | (1,184) |
| Selling, administrative and engineering expense | 439,163 | 69,412 | (6,036) | 502,539 |
| Restructuring expense | 36,593 | | | 36,593 |
| Total costs and expenses | 2,058,410 | 183,254 | (6,036) | 2,235,628 |
| Operating income | 349,883 | 145,016 | | 494,899 |
| Investment income | 128,146 | | (125,000) | 3,146 |
| Interest expense | 22,831 | | | 22,831 |
| Income before provision for income taxes | 455,198 | 145,016 | (125,000) | 475,214 |
| Provision for income taxes | 113,168 | 52,206 | | 165,374 |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

| | | | | |
|---|------------|-----------|--------------|------------|
| Income from continuing operations | 342,030 | 92,810 | (125,000) | 309,840 |
| Loss from discontinued operations, net of tax | | | | |
| Net income | \$ 342,030 | \$ 92,810 | \$ (125,000) | \$ 309,840 |

Table of Contents

| | July 1, 2012 | | | |
|--|---|----------------------------------|---------------------|---------------------|
| | Motorcycles & Related Products Operations | Financial Services Operations | Eliminations | Consolidated |
| ASSETS | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 725,909 | \$ 345,587 | \$ | \$ 1,071,496 |
| Marketable securities | 135,848 | | | 135,848 |
| Accounts receivable, net | 885,797 | | (635,529) | 250,268 |
| Finance receivables, net | | 1,398,553 | | 1,398,553 |
| Restricted finance receivables held by variable interest entities, net | | 456,285 | | 456,285 |
| Inventories | 323,046 | | | 323,046 |
| Restricted cash held by variable interest entities | | 188,564 | | 188,564 |
| Other current assets | 182,464 | 63,343 | | 245,807 |
| Total current assets | 2,253,064 | 2,452,332 | (635,529) | 4,069,867 |
| Finance receivables, net | | 2,569,187 | | 2,569,187 |
| Restricted finance receivables held by variable interest entities, net | | 1,592,544 | | 1,592,544 |
| Property, plant and equipment, net | 747,133 | 29,660 | | 776,793 |
| Goodwill | 28,604 | | | 28,604 |
| Other long-term assets | 335,811 | 17,956 | (73,978) | 279,789 |
| | \$ 3,364,612 | \$ 6,661,679 | \$ (709,507) | \$ 9,316,784 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | |
| Current liabilities: | | | | |
| Accounts payable | \$ 197,891 | \$ 689,877 | \$ (635,529) | \$ 252,239 |
| Accrued liabilities | 466,808 | 71,756 | (3,467) | 535,097 |
| Short-term debt | | 845,868 | | 845,868 |
| Current portion of long-term debt | | 399,962 | | 399,962 |
| Current portion of long-term debt held by variable interest entities | | 507,427 | | 507,427 |
| Total current liabilities | 664,699 | 2,514,890 | (638,996) | 2,540,593 |
| Long-term debt | 303,000 | 2,442,189 | | 2,745,189 |
| Long-term debt held by variable interest entities | | 831,805 | | 831,805 |
| Pension liability | 122,496 | | | 122,496 |
| Postretirement healthcare benefits | 263,295 | | | 263,295 |
| Other long-term liabilities | 131,754 | 15,265 | | 147,019 |
| Commitments and contingencies (Note 17) | | | | |
| Total shareholders' equity | 1,879,368 | 857,530 | (70,511) | 2,666,387 |
| | \$ 3,364,612 | \$ 6,661,679 | \$ (709,507) | \$ 9,316,784 |

Table of Contents

| | December 31, 2011 | | | |
|--|---|---------------------|---------------------|---------------------|
| | Motorcycles & Related Products Operations | Services Operations | Eliminations | Consolidated |
| ASSETS | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 943,330 | \$ 583,620 | \$ | \$ 1,526,950 |
| Marketable securities | 153,380 | | | 153,380 |
| Accounts receivable, net | 393,615 | | (174,576) | 219,039 |
| Finance receivables, net | | 1,168,603 | | 1,168,603 |
| Restricted finance receivables held by variable interest entities, net | | 591,864 | | 591,864 |
| Inventories | 418,006 | | | 418,006 |
| Restricted cash held by variable interest entities | | 229,655 | | 229,655 |
| Other current assets | 167,423 | 67,286 | | 234,709 |
| Total current assets | 2,075,754 | 2,641,028 | (174,576) | 4,542,206 |
| Finance receivables, net | | 1,754,441 | | 1,754,441 |
| Restricted finance receivables held by variable interest entities, net | | 2,271,773 | | 2,271,773 |
| Property, plant and equipment, net | 779,330 | 30,129 | | 809,459 |
| Goodwill | 29,081 | | | 29,081 |
| Other long-term assets | 322,379 | 17,460 | (72,635) | 267,204 |
| | \$ 3,206,544 | \$ 6,714,831 | \$ (247,211) | \$ 9,674,164 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | |
| Current liabilities: | | | | |
| Accounts payable | \$ 220,957 | \$ 209,332 | \$ (174,576) | \$ 255,713 |
| Accrued liabilities | 482,838 | 85,038 | (3,704) | 564,172 |
| Short-term debt | | 838,486 | | 838,486 |
| Current portion of long-term debt | | 399,916 | | 399,916 |
| Current portion of long-term debt held by variable interest entities | | 640,331 | | 640,331 |
| Total current liabilities | 703,795 | 2,173,103 | (178,280) | 2,698,618 |
| Long-term debt | 303,000 | 2,093,871 | | 2,396,871 |
| Long-term debt held by variable interest entities | | 1,447,015 | | 1,447,015 |
| Pension liability | 302,483 | | | 302,483 |
| Postretirement healthcare benefits | 268,582 | | | 268,582 |
| Other long-term liabilities | 126,036 | 14,303 | | 140,339 |
| Commitments and contingencies (Note 17) | | | | |
| Total shareholders' equity | 1,502,648 | 986,539 | (68,931) | 2,420,256 |
| | \$ 3,206,544 | \$ 6,714,831 | \$ (247,211) | \$ 9,674,164 |

Table of Contents

| | June 26, 2011 | | | |
|--|---|---------------------|------------------|------------------|
| | Motorcycles & Related Products Operations | Services Operations | Eliminations | Consolidated |
| ASSETS | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 681,804 | \$ 291,674 | \$ | \$ 973,478 |
| Marketable securities | 244,555 | | | 244,555 |
| Accounts receivable, net | 710,791 | | (445,128) | 265,663 |
| Finance receivables, net | | 1,144,886 | | 1,144,886 |
| Restricted finance receivables held by variable interest entities, net | | 573,208 | | 573,208 |
| Inventories | 337,472 | | | 337,472 |
| Restricted cash held by variable interest entities | | 244,060 | | 244,060 |
| Other current assets | 160,059 | 57,597 | | 217,656 |
| Total current assets | 2,134,681 | 2,311,425 | (445,128) | 4,000,978 |
| Finance receivables, net | | 2,306,165 | | 2,306,165 |
| Restricted finance receivables held by variable interest entities, net | | 1,939,181 | | 1,939,181 |
| Property, plant and equipment, net | 758,828 | 30,115 | | 788,943 |
| Goodwill | 31,156 | | | 31,156 |
| Other long-term assets | 339,666 | 26,711 | (70,821) | 295,556 |
| | \$ 3,264,331 | \$ 6,613,597 | \$ (515,949) | \$ 9,361,979 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | |
| Current liabilities: | | | | |
| Accounts payable | \$ 243,954 | \$ 478,569 | \$ (445,128) | \$ 277,395 |
| Accrued liabilities | 522,533 | 70,880 | (3,317) | 590,096 |
| Short-term debt | | 694,137 | | 694,137 |
| Current portion of long-term debt held by variable interest entities | | 635,604 | | 635,604 |
| Total current liabilities | 766,487 | 1,879,190 | (448,445) | 2,197,232 |
| Long-term debt | 303,000 | 2,590,462 | | 2,893,462 |
| Long-term debt held by variable interest entities | | 1,217,778 | | 1,217,778 |
| Pension liability | 103,511 | | | 103,511 |
| Postretirement healthcare liability | 258,881 | | | 258,881 |
| Other long-term liabilities | 146,286 | 13,433 | | 159,719 |
| Commitments and contingencies (Note 17) | | | | |
| Total shareholders' equity | 1,686,166 | 912,734 | (67,504) | 2,531,396 |
| | \$ 3,264,331 | \$ 6,613,597 | \$ (515,949) | \$ 9,361,979 |

Table of Contents

| | Six months ended July 1, 2012 | | | Consolidated |
|--|---|---------------------|--------------------------------------|------------------|
| | Motorcycles & Related Products Operations | Services Operations | Financial Eliminations & Adjustments | |
| Cash flows from operating activities: | | | | |
| Income from continuing operations | \$ 552,258 | 92,027 | \$ (225,000) | \$ 419,285 |
| Adjustments to reconcile income from continuing operations to cash provided by operating activities: | | | | |
| Depreciation | 82,954 | 3,043 | | 85,997 |
| Amortization of deferred loan origination costs | | 38,075 | | 38,075 |
| Amortization of financing origination fees | 237 | 4,784 | | 5,021 |
| Provision for employee long-term benefits | 33,236 | 1,027 | | 34,263 |
| Contributions to pension and postretirement plans | (213,648) | | | (213,648) |
| Stock compensation expense | 20,539 | 1,580 | | 22,119 |
| Net change in wholesale finance receivables | | | (124,919) | (124,919) |
| Provision for credit losses | | 3,754 | | 3,754 |
| Pension and postretirement healthcare plan curtailment and settlement expense | | | | |
| Foreign currency adjustments | 8,143 | | | 8,143 |
| Other, net | 1,275 | 4,292 | | 5,567 |
| Change in current assets and current liabilities: | | | | |
| Accounts receivable | (295,930) | | 260,953 | (34,977) |
| Finance receivables accrued interest and other | | 2,912 | | 2,912 |
| Inventories | 89,162 | | | 89,162 |
| Accounts payable and accrued liabilities | (22,227) | 270,894 | (260,953) | (12,286) |
| Restructuring reserves | (9,915) | | | (9,915) |
| Derivative instruments | (1,293) | (127) | | (1,420) |
| Other | (25,286) | (3,605) | | (28,891) |
| Total adjustments | (332,753) | 326,629 | (124,919) | (131,043) |
| Net cash provided by operating activities of continuing operations | 219,505 | 418,656 | (349,919) | 288,242 |
| Cash flows from investing activities of continuing operations: | | | | |
| Capital expenditures | (57,504) | (2,574) | | (60,078) |
| Origination of finance receivables | | (3,766,621) | 2,183,049 | (1,583,572) |
| Collections of finance receivables | | 3,493,920 | (2,058,130) | 1,435,790 |
| Sales and redemptions of marketable securities | 18,053 | | | 18,053 |
| Net cash (used by) provided by investing activities of continuing operations | (39,451) | (275,275) | 124,919 | (189,807) |
| Cash flows from financing activities of continuing operations: | | | | |
| Proceeds from issuance of medium-term notes | | 397,373 | | 397,373 |
| Loan to HDFS | (200,000) | 200,000 | | |
| Proceeds from securitization of debt | | 91,030 | | 91,030 |
| Repayments of securitization debt | | (839,401) | | (839,401) |
| Net decrease in credit facilities and unsecured commercial paper | | (46,629) | | (46,629) |
| Net change in restricted cash | | 41,091 | | 41,091 |
| Dividends paid | (71,645) | (225,000) | 225,000 | (71,645) |
| Purchase of common stock for treasury | (172,742) | | | (172,742) |
| Excess tax benefits from share based payments | 15,730 | | | 15,730 |
| Issuance of common stock under employee stock option plans | 35,337 | | | 35,337 |
| Net cash used by financing activities of continuing operations | (393,320) | (381,536) | 225,000 | (549,856) |
| Effect of exchange rate changes on cash and cash equivalents of continuing operations | (4,155) | 122 | | (4,033) |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

| | | | |
|---|--------------|--------------|--------------|
| Net (decrease) increase in cash and cash equivalents of continuing operations | (217,421) | (238,033) | (455,454) |
| Cash flows from discontinued operations: | | | |
| Cash flows from operating activities of discontinued operations | | | |
| Cash flows from investing activities of discontinued operations | | | |
| Effect of exchange rate changes on cash and cash equivalents of discontinued operations | | | |
| Net (decrease) increase in cash and cash equivalents | | | |
| | \$ (217,421) | \$ (238,033) | \$ (455,454) |
| Cash and cash equivalents: | | | |
| Cash and cash equivalents beginning of period | \$ 943,330 | \$ 583,620 | \$ 1,526,950 |
| Cash and cash equivalents of discontinued operations beginning of period | | | |
| Net (decrease) increase in cash and cash equivalents | (217,421) | (238,033) | (455,454) |
| Less: Cash and cash equivalents of discontinued operations end of period | | | |
| Cash and cash equivalents end of period | \$ 725,909 | \$ 345,587 | \$ 1,071,496 |

Table of Contents

| | Six months ended June 26, 2011 | | | |
|--|---|---------------------|--|--------------|
| | Motorcycles & Related Products Operations | Services Operations | Financial Eliminations & Adjustments | Consolidated |
| Cash flows from operating activities: | | | | |
| Net income | \$ 342,030 | \$ 92,810 | \$ (125,000) | \$ 309,840 |
| Loss from discontinued operations | | | | |
| Income from continuing operations | 342,030 | 92,810 | (125,000) | 309,840 |
| Adjustments to reconcile income from continuing operations to cash provided by operating activities: | | | | |
| Depreciation | 86,375 | 3,168 | | 89,543 |
| Amortization of deferred loan origination costs | | 39,054 | | 39,054 |
| Amortization of financing origination fees | 237 | 5,596 | | 5,833 |
| Provision for employee long-term benefits | 33,018 | 1,438 | | 34,456 |
| Contributions to pension and postretirement plans | (205,498) | | | (205,498) |
| Stock compensation expense | 19,176 | 1,361 | | 20,537 |
| Net change in wholesale finance receivables | | | 11,909 | 11,909 |
| Provision for credit losses | | (1,184) | | (1,184) |
| Pension and postretirement healthcare plan curtailment and settlement expense | 236 | | | 236 |
| Foreign currency adjustments | (2,813) | | | (2,813) |
| Other, net | 5,337 | 21,889 | | 27,226 |
| Change in current assets and current liabilities: | | | | |
| Accounts receivable | (44,899) | | 53,200 | 8,301 |
| Finance receivables accrued interest and other | | 5,553 | | 5,553 |
| Inventories | (530) | | | (530) |
| Accounts payable and accrued liabilities | 79,110 | 60,426 | (5,698) | 133,838 |
| Restructuring reserves | 3,195 | | | 3,195 |
| Derivative instruments | 1,188 | 7 | | 1,195 |
| Other | (4,729) | 44,575 | (47,575) | (7,729) |
| Total adjustments | (30,597) | 181,883 | 11,836 | 163,122 |
| Net cash provided by (used by) operating activities of continuing operations | 311,433 | 274,693 | (113,164) | 472,962 |
| Cash flows from investing activities of continuing operations: | | | | |
| Capital expenditures | (65,956) | (3,311) | | (69,267) |
| Origination of finance receivables | | (3,264,370) | 1,829,763 | (1,434,607) |
| Collections of finance receivables | | 3,258,282 | (1,841,672) | 1,416,610 |
| Purchases of marketable securities | (142,653) | | | (142,653) |
| Sales and redemptions of marketable securities | 39,966 | | | 39,966 |
| Net cash (used by) provided by investing activities of continuing operations | (168,643) | (9,399) | (11,909) | (189,951) |
| Cash flows from financing activities of continuing operations: | | | | |
| Proceeds from issuance of medium-term notes | | 447,076 | | 447,076 |
| Loan to HDFS | (200,000) | 200,000 | | |
| Repayments of securitization debt | | (901,851) | | (901,851) |
| Net decrease in credit facilities and unsecured commercial paper | | 131,039 | | 131,039 |
| Net change in restricted cash | | 44,827 | | 44,827 |
| Dividends paid | (53,152) | (125,000) | 125,000 | (53,152) |
| Purchase of common stock for treasury | (5,678) | | | (5,678) |
| Excess tax benefits from share based payments | 3,476 | | | 3,476 |
| Issuance of common stock under employee stock option plans | 4,534 | | | 4,534 |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

| | | | | |
|---|--------------|------------|---------|--------------|
| Net cash (used by) provided by financing activities of continuing operations | (250,820) | (203,909) | 125,000 | (329,729) |
| Effect of exchange rate changes on cash and cash equivalents of continuing operations | (1,922) | 147 | 73 | (1,702) |
| Net (decrease) increase in cash and cash equivalents of continuing operations | (109,952) | 61,532 | | (48,420) |
| Cash flows from discontinued operations: | | | | |
| Cash flows from operating activities of discontinued operations | (35) | | | (35) |
| Cash flows from investing activities of discontinued operations | | | | |
| Effect of exchange rate changes on cash and cash equivalents of discontinued operations | | | | |
| | (35) | | | (35) |
| Net (decrease) increase in cash and cash equivalents | \$ (109,987) | \$ 61,532 | \$ | \$ (48,455) |
| Cash and cash equivalents: | | | | |
| Cash and cash equivalents beginning of period | \$ 791,791 | \$ 230,142 | \$ | \$ 1,021,933 |
| Cash and cash equivalents of discontinued operations beginning of period | | | | |
| Net (decrease) increase in cash and cash equivalents | (109,987) | 61,532 | | (48,455) |
| Less: Cash and cash equivalents of discontinued operations end of period | | | | |
| Cash and cash equivalents end of period | \$ 681,804 | \$ 291,674 | \$ | \$ 973,478 |

Table of Contents

18. Subsequent Event

In July 2012, the Company issued \$675.3 million of secured notes through a term asset-backed securitization transaction.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Harley-Davidson, Inc. is the parent company of the groups of companies doing business as Harley-Davidson Motor Company (HDMC) and Harley-Davidson Financial Services (HDFS). HDMC produces heavyweight cruiser and touring motorcycles. HDMC manufactures five families of motorcycles: Touring, Dyna®, Softail®, Sportster® and V-Rod®. HDFS provides wholesale and retail financing and insurance programs primarily to Harley-Davidson dealers and customers.

The Company operates in two business segments: Motorcycles & Related Products (Motorcycles) and Financial Services (Financial Services). The Company's reportable segments are strategic business units that offer different products and services. They are managed separately based on the fundamental differences in their operations.

The % Change figures included in the Results of Operations section were calculated using unrounded dollar amounts and may differ from calculations using the rounded dollar amounts presented.

Overview

The Company's income from continuing operations was \$247.3 million, or \$1.07 per fully diluted share, for the second quarter of 2012 compared to \$190.6 million, or \$0.81 per fully diluted share, in the second quarter of 2011. The increase in income from continuing operations was driven by strong financial performance in the Motorcycles segment. Operating income from the Motorcycles segment was up \$89.7 million or 40.8 % over last year's second quarter on a 25.0% increase in wholesale shipments of Harley-Davidson motorcycles. Motorcycles segment results also reflect a higher gross margin percentage, lower restructuring costs and higher selling and administrative expenses. Operating income from Financial Services in the second quarter of 2012 was \$82.0 million compared to \$82.1 million in the year-ago quarter.

During the second quarter of 2012, worldwide independent dealer retail sales of new Harley-Davidson motorcycles grew 2.8% compared to 2011, including a 4.0% increase in the U.S. and a 0.5% increase in international markets. Through six months, retail sales grew 9.3%, including increases of 12.0% and 4.5% in the U.S. and international markets, respectively. As expected, retail sales growth rates moderated in the second quarter due to an unusually warm spring in the U.S. that pulled some retail sales forward into the first quarter. The Company continues to remain cautious about its expectations for retail sales globally in an environment of greater economic uncertainty, including in Europe where retail sales have been affected by the challenging Eurozone economy.

(1) Note Regarding Forward-Looking Statements

The Company intends that certain matters discussed in this report are forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements can generally be identified as such by reference to this footnote or because the context of the statement will include words such as the Company believes, anticipates, expects, plans, or estimates or words of similar meaning. Similarly, statements that describe future plans, objectives, outlooks, targets, guidance or goals are also forward-looking statements. Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated as of the date of this report. Certain of such risks and uncertainties are described in close proximity to such statements or elsewhere in this report, including under the caption Cautionary Statements and in Item 1A Risk Factors of the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Shareholders, potential investors, and other readers are urged to consider these factors in evaluating the forward-looking statements and cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included in this report are made only as of the date of the filing of this report (August 9, 2012), and the Company disclaims any obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances.

Table of Contents

Outlook⁽¹⁾

On August 1, 2012, the Company reaffirmed its expectation to ship 245,000 to 250,000 Harley-Davidson motorcycles to dealers and distributors worldwide in 2012. In addition, the Company announced that its full-year shipment estimate includes expected shipments of 51,000 to 56,000 motorcycles in the third quarter of 2012, down 9% to 17% from prior year. The Company expects 2012 third quarter shipments to be down behind lower production as a result of the planned downtime associated with its July enterprise resource planning (ERP) system implementation at its York, Pennsylvania facility (York). The Company also expects that 2012 fourth quarter shipments and production will be down compared to prior year due to the implementation of flexible production capabilities as discussed below and a decrease in production days due to a five-day decrease in the Company's fiscal fourth quarter of 2012 as compared to the fourth quarter of 2011. In addition, fourth quarter production will be down due to the incremental production in 2011 related to approximately 7,000 motorcycles produced and inventoried in the fourth quarter of 2011 in advance of the 2012 ERP implementation which the Company had initially expected to occur in the second quarter of 2012. The Company continues to expect U.S. dealers to sell more units at retail than the Company expects to ship in 2012 resulting in a decrease in U.S. retail inventory during 2012.

As previously disclosed, beginning in early 2013, the Company expects to implement flexible production capabilities at York by adding flexible workers thus enabling the Company to increase capacity in the first half of 2013 to more closely match retail demand. The Company expects to achieve the ability to maximize flexibility in the entire manufacturing system during 2014 when it expects that the same capability will be in place for the Kansas City operations. Consequently the Company expects U.S. retail inventory to be slightly lower on a year over year basis at the end of 2012 and 2013 which will be aligned with the seasonal low point for retail sales.

Also on August 1, 2012, the Company announced that it continues to expect 2012 full-year gross margin to be between 34.75% and 35.75%. The Company expects gross margin will be positively impacted by incremental restructuring savings, increased productivity from continuous improvement opportunities, motorcycle pricing actions and product mix. The Company believes that raw material surcharges and temporary inefficiencies resulting from restructuring activities will be comparable to 2011 levels. The Company expects that currency impacts will be unfavorable for 2012. The Company continues to expect 2012 third and fourth quarter gross margin percentages to be down from first half levels driven by several factors including currency and lower production volumes.

The Company also announced on August 1, 2012 that it continues to expect its full-year 2012 effective tax rate from continuing operations to be approximately 35.5%. This guidance excludes the effect of any potential future nonrecurring adjustments such as changes in tax legislation or audit settlements which are recorded as discrete items in the period in which they are settled.

Finally, on August 1, 2012, the Company confirmed its full-year capital expenditure estimate of \$190 million to \$210 million which includes approximately \$35 million of capital related to restructuring.

Restructuring Activities⁽¹⁾

2011 Restructuring Plan

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. The Company expects the transition of supply from New Castalloy to be complete by mid-2013. The decision to close New Castalloy came as part of the Company's overall long term strategy to develop world-class manufacturing capability throughout the Company by restructuring and consolidating operations for greater competitiveness, efficiency and flexibility. In connection with this decision, the Company will reduce its workforce by approximately 200 employees by mid-2013.

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 facility in December 2009, and allows for similar flexibility and increased production efficiency. Once the new contract is fully implemented, the production system in Kansas City, like Wisconsin and York, will include the addition of a flexible workforce component.

Table of Contents

After taking actions to fully implement the new ratified labor agreement, the Company expects to have about 145 fewer full-time hourly unionized employees in its Kansas City facility than would be required under the prior contract.

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 facility in December 2009 and allow for similar flexibility and increased production efficiency. Once the new contracts are fully implemented, the production system in Wisconsin, like York, will include the addition of a flexible workforce component.

After taking actions to fully implement the new ratified labor agreements, the Company expects to have about 250 fewer full-time hourly unionized employees in its Milwaukee-area facilities when the contracts are fully implemented in 2012 than would be required under the previous contract. In Tomahawk, the Company expects to have about 75 fewer full-time hourly unionized employees when the contract is fully implemented than would be required under the previous contract.

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 that are expected to be completed at various dates between 2009 and 2012. The actions were designed to reduce administrative costs, eliminate excess capacity and exit non-core business operations. The Company's significant announced actions include the restructuring and transformation of its York, Pennsylvania production facility including the implementation of a new more flexible unionized labor agreement; consolidation of facilities related to engine and transmission production; outsourcing of certain distribution and transportation activities and exiting the Buell product line.

The 2009 restructuring plan includes an estimated reduction of approximately 2,700 to 2,900 hourly production positions and approximately 720 non-production, primarily salaried positions within the Motorcycles segment and approximately 100 salaried positions in the Financial Services segment.

Restructuring Costs and Savings

During the first half of 2012, the Company incurred \$17.7 million in restructuring expense related to its combined restructuring plan activities. This is in addition to \$455.8 million in restructuring and impairment expense incurred in prior years since the restructuring activities were initiated in 2009. On August 1, 2012, the Company revised its estimate for restructuring expenses related to its combined restructuring plan activities that it expects to incur from 2009 to 2013 to \$490 million to \$510 million. The Company's previous estimate had been \$500 million to \$510 million. The Company continues to expect approximately 35% of those amounts to be non-cash. The estimated restructuring expense includes estimated restructuring expenses of \$40 million to \$50 million in 2012, which was revised down from the previous estimate of \$50 million to \$60 million. The Company has realized or estimates that it will realize cumulative savings from these restructuring activities, measured against 2008, as follows:

2009 \$91 million (91% operating expense and 9% cost of sales) (actual);

2010 \$172 million (64% operating expense and 36% cost of sales) (actual);

2011 \$217 million (51% operating expense and 49% cost of sales) (actual);

2012 \$275 million to \$295 million (35-45% operating expense and 55-65% cost of sales) (estimated);

2013 \$300 million to \$320 million (30-40% operating expense and 60-70% cost of sales) (estimated); and

Ongoing annually upon completion \$315 million to \$335 million (30-40% operating expense and 60-70% cost of sales) (estimated).

Table of Contents**Results of Operations for the Three Months Ended July 1, 2012****Compared to the Three Months Ended June 26, 2011****Consolidated Results**

| (in thousands, except earnings per share) | Three months ended | | (Decrease) | % |
|--|--------------------|-------------------|------------------|--------------|
| | July 1, 2012 | June 26, 2011 | Increase | Change |
| Operating income from motorcycles & related products | \$ 309,559 | \$ 219,847 | \$ 89,712 | 40.8% |
| Operating income from financial services | 81,954 | 82,055 | (101) | (0.1) |
| Operating income | 391,513 | 301,902 | 89,611 | 29.7 |
| Investment income | 2,231 | 1,748 | 483 | 27.6 |
| Interest expense | 11,595 | 11,350 | 245 | 2.2 |
| Income before income taxes | 382,149 | 292,300 | 89,849 | 30.7 |
| Provision for income taxes | 134,899 | 101,720 | 33,179 | 32.6 |
| Income from continuing operations | 247,250 | 190,580 | 56,670 | 29.7 |
| Loss from discontinued operations, net of income taxes | | | | N/M |
| Net income | \$ 247,250 | \$ 190,580 | \$ 56,670 | 29.7% |
| Diluted earnings per share from continuing operations | \$ 1.08 | \$ 0.81 | \$ 0.27 | 33.3% |
| Diluted earnings per share from discontinued operations | \$ | \$ | \$ | N/M |
| Diluted earnings per share | \$ 1.07 | \$ 0.81 | \$ 0.26 | 32.1% |

Operating income for the Motorcycles segment during the second quarter of 2012 improved by \$89.7 million compared to second quarter 2011. The increase was primarily due to increased motorcycle shipments, higher gross margin and favorable restructuring spending, partially offset by higher selling and administrative expenses. Operating income for the Financial Services segment was strong during the second quarter of 2012, but down slightly compared to the second quarter of 2011 when the Financial Services segment was favorably impacted by a \$15.1 million release in the total (retail and wholesale combined) allowance for credit losses. This compares to a \$11.2 million release in the total allowance for credit losses in the second quarter of 2012. Please refer to the Motorcycles and Related Products Segment and Financial Services Segment discussions following for a more detailed discussion of the factors affecting operating income.

The effective income tax rate for the second quarter of 2012 was 35.3% compared to 34.8% for the second quarter of 2011. The second quarter of 2011 was favorably affected by the Federal research and development credits that expired at the end of 2011.

Table of Contents**Motorcycles & Related Products Segment****Harley-Davidson Motorcycle Worldwide Retail Sales**

Worldwide independent dealer retail sales of Harley-Davidson motorcycles increased 2.8% during the second quarter of 2012 compared to the second quarter of 2011. Retail sales of Harley-Davidson motorcycles increased 4.0% in the United States and 0.5% internationally in the quarter. The following table includes retail unit sales of Harley-Davidson motorcycles:

Harley-Davidson Motorcycle Worldwide Retail Sales^(a)**Heavyweight (651+cc)**

| | Three months ended | | (Decrease) | % |
|--|--------------------|----------|------------|--------|
| | June 30, | June 30, | Increase | Change |
| | 2012 | 2011 | | |
| <u>North America Region</u> | | | | |
| United States | 55,761 | 53,599 | 2,162 | 4.0% |
| Canada | 4,881 | 4,793 | 88 | 1.8 |
| Total North America Region | 60,642 | 58,392 | 2,250 | 3.9 |
| <u>Europe, Middle East and Africa Region (EMEA)</u> | | | | |
| Europe ^(b) | 14,639 | 16,106 | (1,467) | (9.1) |
| Other | 1,797 | 1,458 | 339 | 23.3 |
| Total Europe Region | 16,436 | 17,564 | (1,128) | (6.4) |
| <u>Asia Pacific Region</u> | | | | |
| Japan | 2,898 | 3,128 | (230) | (7.4) |
| Other | 3,509 | 2,696 | 813 | 30.2 |
| Total Asia Pacific Region | 6,407 | 5,824 | 583 | 10.0 |
| <u>Latin America Region</u> | | | | |
| | 2,229 | 1,616 | 613 | 37.9 |
| Total Worldwide Retail Sales | 85,714 | 83,396 | 2,318 | 2.8% |

(a) Data source for retail sales figures shown above is new sales warranty and registration information provided by Harley-Davidson dealers and compiled by the Company. The Company must rely on information that its dealers supply concerning retail sales and this information is subject to revision. Only Harley-Davidson motorcycles are included in the table above.

(b) Europe data includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

Table of Contents**Motorcycle Unit Shipments**

The following table includes wholesale motorcycle unit shipments for the Motorcycles segment:

| | Three months ended | | | | Increase | % Change |
|---|--------------------|---------------|------------------|---------------|---------------|--------------|
| | July 1, 2012 | | June 26, 2011 | | | |
| United States | 56,674 | 67.9% | 42,623 | 63.8% | 14,051 | 33.0% |
| International | 26,828 | 32.1% | 24,192 | 36.2% | 2,636 | 10.9 |
| Harley-Davidson motorcycle units | 83,502 | 100.0% | 66,815 | 100.0% | 16,687 | 25.0% |
| Touring motorcycle units | 32,218 | 38.6% | 25,557 | 38.3% | 6,661 | 26.1% |
| Custom motorcycle units ^(a) | 33,139 | 39.7% | 25,218 | 37.7% | 7,921 | 31.4 |
| Sportster motorcycle units | 18,145 | 21.7% | 16,040 | 24.0% | 2,105 | 13.1 |
| Harley-Davidson motorcycle units | 83,502 | 100.0% | 66,815 | 100.0% | 16,687 | 25.0% |

(a) Custom motorcycle units, as used in this table, include Dyna, Softail, VRSC and CVO models.

The Company shipped 83,502 Harley-Davidson motorcycles worldwide during the second quarter of 2012, which was 25.0% higher than the second quarter of 2011 and in line with Company expectations. During the second quarter of 2012 shipments were higher as the Company depleted its 2012 model-year motorcycle inventory in the U.S. in anticipation of the July 2, 2012 ERP launch at its York, PA facility and the 2013 model year cut-over. International shipments as a percent of the total shipments were down slightly compared to last year given the strong 2012 U.S. first quarter retail sales and tight retail inventory levels in the domestic market. U.S. dealer inventory of new Harley-Davidson motorcycle units was approximately 6,800 higher at the end of the 2012 second quarter than at the end of the year ago period. Despite the increase in retail inventory at the end of the second quarter, the Company continues to expect retail inventory in the U.S. will be below year ago levels for most of the third quarter, due to lower shipments versus prior year as a result of the production lost during the ERP implementation, and due to the later date of the Summer Dealer Meeting which will take place in August 2012 compared to July 2011. The Company announced on August 1, 2012 that it anticipates shipping between 51,000 to 56,000 Harley-Davidson motorcycle units in the third quarter of 2012.⁽¹⁾

Table of Contents**Segment Results**

The following table includes the condensed statements of operations for the Motorcycles segment (in thousands):

| | Three months ended | | Increase (Decrease) | % Change |
|--|--------------------|-------------------|------------------------|--------------|
| | July 1, 2012 | June 26, 2011 | | |
| Revenue: | | | | |
| Motorcycles | \$ 1,223,776 | \$ 1,006,593 | \$ 217,183 | 21.6% |
| Parts & Accessories | 265,574 | 255,378 | 10,196 | 4.0 |
| General Merchandise | 75,137 | 72,910 | 2,227 | 3.1 |
| Other | 4,560 | 4,863 | (303) | (6.2) |
| Total revenue | 1,569,047 | 1,339,744 | 229,303 | 17.1 |
| Cost of goods sold | 1,005,230 | 871,476 | 133,754 | 15.3 |
| Gross profit | 563,817 | 468,268 | 95,549 | 20.4 |
| Selling & administrative expense | 216,726 | 198,782 | 17,944 | 9.0 |
| Engineering expense | 31,312 | 36,045 | (4,733) | (13.1) |
| Restructuring expense | 6,220 | 13,594 | (7,374) | (54.2) |
| Operating expense | 254,258 | 248,421 | 5,837 | 2.3 |
| Operating income from motorcycles | \$ 309,559 | \$ 219,847 | \$ 89,712 | 40.8% |

The following table includes the estimated impact of significant factors affecting the comparability of net revenue, cost of goods sold and gross profit from the second quarter of 2011 to the second quarter of 2012 (in millions):

| | Net Revenue | Cost of Goods Sold | Gross Profit |
|---|----------------|-----------------------|-----------------|
| June 26, 2011 | \$ 1,339.8 | \$ 871.5 | \$ 468.3 |
| Volume | 259.0 | 173.8 | 85.2 |
| Price | 9.6 | | 9.6 |
| Foreign currency exchange rates and hedging | (33.2) | (17.6) | (15.6) |
| Product mix | (6.2) | (7.1) | 0.9 |
| Raw material prices | | (4.7) | 4.7 |
| Manufacturing costs | | (10.7) | 10.7 |
| Total | 229.2 | 133.7 | 95.5 |
| July 1, 2012 | \$ 1,569.0 | \$ 1,005.2 | \$ 563.8 |

Table of Contents

The following factors affected the comparability of net revenue, cost of goods sold and gross profit from 2011 to 2012:

On average, wholesale prices on the Company's 2012 model-year motorcycles are higher than the prior model year resulting in the favorable impact on revenue and gross profit during the period.

Foreign currency exchange rates during the second quarter of 2012 resulted in a negative impact on net revenue and were partially offset by the favorable impact of gains associated with foreign currency hedging (included in cost of goods sold) when compared to the same period last year.

Shipment mix changes negatively impacted net revenue and resulted primarily from product mix changes both between and within the Company's motorcycle families. However, the impact of mix changes on cost of goods sold more than offset the impact to revenue.

Raw material prices were lower in the second quarter of 2012 relative to the second quarter of 2011 primarily due to lower metals and lower fuel prices.

Manufacturing costs benefitted from restructuring savings and higher volumes, partially offset by inflation. Temporary inefficiencies related to restructuring activities were approximately \$9 million in the second quarter of 2012 compared to \$8.0 million in the second quarter of 2011. The Company expects temporary inefficiencies to be approximately \$8 million to \$12 million and \$5 million to \$8 million for the third and fourth quarters of 2012, respectively, for a total of approximately \$32 million for 2012.⁽¹⁾

The net increase in operating expense was due in part to higher selling and administrative expense driven by incremental investments to support the Company's growth initiatives. In addition, warranty and recall expense was higher than in the same period last year. The higher selling and administrative expenses were partially offset by lower restructuring expense related to the Company's previously announced restructuring activities as well as lower engineering expense. For further information regarding the Company's previously announced restructuring activities, refer to Note 5 of Notes to Condensed Consolidated Financial Statements. The Company expects selling and administrative expenses in the third quarter of 2012 to be up moderately compared to the third quarter of 2011.⁽¹⁾ However, in the fourth quarter of 2012 the Company expects selling and administrative expenses to be down compared to the same period last year due to the five fewer calendar days in the fiscal quarter and the \$12 million recall charge incurred in the fourth quarter of 2011.⁽¹⁾

Financial Services Segment**Segment Results**

The following table includes the condensed statements of operations for the Financial Services segment (in thousands):

| | Three months ended | | (Decrease) Increase | % |
|-----------------------------|--------------------|------------------|------------------------|--------|
| | July 1, 2012 | June 26, 2011 | | |
| Interest income | \$ 144,830 | \$ 150,540 | \$ (5,710) | (3.8%) |
| Other income | 15,783 | 15,313 | 470 | 3.1 |
| Financial services revenue | 160,613 | 165,853 | (5,240) | (3.2) |
| Interest expense | 48,712 | 56,991 | (8,279) | (14.5) |
| Provision for credit losses | (5,259) | (6,790) | 1,531 | (22.5) |
| Operating expenses | 35,206 | 33,597 | 1,609 | 4.8 |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

| | | | | |
|--|-----------|-----------|----------|--------|
| Financial services expense | 78,659 | 83,798 | (5,139) | (6.1) |
| Operating income from financial services | \$ 81,954 | \$ 82,055 | \$ (101) | (0.1%) |

Table of Contents

Interest income for the three months ended July 1, 2012 decreased due to lower finance receivables outstanding primarily due to a declining portfolio of retail finance receivables. Interest expense was lower primarily due to a more favorable cost of funds.

The provision for credit losses was unfavorable in the second quarter of 2012 compared to the second quarter of 2011. The provision for credit losses related to retail motorcycle finance receivables increased by \$0.7 million in the second quarter of 2012 compared to the second quarter of 2011. During the second quarter of 2012, there was a \$9.7 million allowance release as compared to a \$15.2 million allowance release in the second quarter of 2011. This was offset by lower finance receivable credit losses in the second quarter of 2012 as compared to the second quarter of 2011. The provision for credit losses related to wholesale motorcycle finance receivables increased by \$2.6 million primarily due to a smaller decline in receivables during the second quarter of 2012 compared to the second quarter of 2011.

The Company continues to believe that 2012 operating income from Financial Services will decrease compared to 2011 due to lower net interest income as the portfolio of retail finance receivables continues to contract as a result of lower U.S. retail sales over the last few years and a modest tightening of margins on prime tier retail lending due to a more competitive lending environment. In addition, while credit performance has continued to improve, the Company expects a smaller benefit from allowance releases during 2012 as compared to 2011.⁽¹⁾ Although the Company expects lower operating income in 2012 compared to 2011, it expects to continue to report positive operating income in 2012.⁽¹⁾

Changes in the allowance for credit losses on finance receivables were as follows (in thousands):

| | Three months ended | |
|-------------------------------------|--------------------|------------------|
| | July 1, 2012 | June 26, 2011 |
| Balance, beginning of period | \$ 122,503 | \$ 159,684 |
| Provision for finance credit losses | (5,259) | (6,790) |
| Charge-offs | (17,054) | (23,233) |
| Recoveries | 14,058 | 14,743 |
| Balance, end of period | \$ 114,248 | \$ 144,404 |

At July 1, 2012, the allowance for credit losses on finance receivables was \$8.1 million for wholesale receivables and \$106.2 million for retail receivables, which includes \$41.9 million related to finance receivables held by VIEs. See Note 7 of Notes to Condensed Consolidated Financial Statements for more information on the Company's VIEs. At June 26, 2011, the allowance for credit losses on finance receivables was \$13.5 million for wholesale receivables and \$130.9 million for retail receivables, which includes \$62.1 million related to receivables held by VIEs.

HDFS' periodic evaluation of the adequacy of the allowance for credit losses on finance receivables is generally based on HDFS' past loan loss experience, known and inherent risks in the portfolio, current economic conditions and the estimated value of any underlying collateral.

Table of Contents**Results of Operations for the Six Months Ended July 1, 2012****Compared to the Six Months Ended June 26, 2011****Consolidated Results**

| (in thousands, except earnings per share) | Six months ended | | Increase (Decrease) | % |
|--|------------------|------------------|------------------------|-------|
| | July 1, 2012 | June 26, 2011 | | |
| Operating income from motorcycles & related products | \$ 517,623 | \$ 344,909 | \$ 172,714 | 50.1% |
| Operating income from financial services | 149,348 | 149,990 | (642) | (0.4) |
| Operating income | 666,971 | 494,899 | 172,072 | 34.8 |
| Investment income | 4,164 | 3,146 | 1,018 | 32.4 |
| Interest expense | 23,090 | 22,831 | 259 | 1.1 |
| Income before income taxes | 648,045 | 475,214 | 172,831 | 36.4 |
| Provision for income taxes | 228,760 | 165,374 | 63,386 | 38.3 |
| Income from continuing operations | 419,285 | 309,840 | 109,445 | 35.3 |
| Loss from discontinued operations, net of income taxes | | | | N/M |
| Net income | \$ 419,285 | \$ 309,840 | \$ 109,445 | 35.3% |
| Diluted earnings per share from continuing operations | \$ 1.83 | \$ 1.31 | \$ 0.52 | 39.7% |
| Diluted loss per share from discontinued operations | \$ | \$ | \$ | N/M |
| Diluted earnings per share | \$ 1.81 | \$ 1.31 | \$ 0.50 | 38.2% |

Operating income for the Motorcycles segment during the first six months of 2012 improved by \$172.7 million compared to the first six months of 2011 primarily due to increased motorcycle shipments gross margin and lower restructuring costs, partially offset by increased selling, general and administrative expenses. Operating income for the Financial Services segment was strong during the first six months of 2012, but down slightly compared to the first six months of 2011 when the Financial Services segment was favorably impacted by a \$27.5 million release in the total (retail and wholesale combined) allowance for credit losses. This compares to a \$14.4 million release in the total allowance for credit losses in the first six months of 2012. Please refer to the Motorcycles and Related Products Segment and Financial Services Segment discussions following for a more detailed discussion of the factors affecting operating income.

The effective income tax rate for the first half of 2012 was 35.3% compared to 34.8% for the first half of 2011. The effective income tax rate for the first half of 2011 was favorably impacted by the Federal research and development credit that expired at the end of 2011.

Motorcycles & Related Products Segment**Harley-Davidson Motorcycle Worldwide Retail Sales**

Worldwide independent dealer retail sales of Harley-Davidson motorcycles increased 9.3% during the first half of 2012 compared to the first half of 2011. Retail sales of Harley-Davidson motorcycles increased 12.0% in the United States and 4.5% internationally in the first half of 2012. On an industry-wide basis, the heavyweight (651+cc) portion of the market was up 7.9% in the United States and down 8.6% in Europe for the six months ended June 30, 2012 when compared to the same periods in 2011. The following table includes retail unit sales of Harley-Davidson motorcycles:

Table of Contents**Harley-Davidson Motorcycle Worldwide Retail Sales^(a)****Heavyweight (651+cc)**

| | Six months ended | | | |
|---|------------------|------------------|------------------------|-------------|
| | June 30, 2012 | June 30, 2011 | (Decrease) Increase | % Change |
| North America Region | | | | |
| United States | 95,523 | 85,290 | 10,233 | 12.0% |
| Canada | 6,948 | 6,830 | 118 | 1.7 |
| Total North America Region | 102,471 | 92,120 | 10,351 | 11.2 |
| Europe, Middle East and Africa Region (EMEA) | | | | |
| Europe ^(b) | 23,521 | 25,273 | (1,752) | (6.9) |
| Other | 3,209 | 2,704 | 505 | 18.7 |
| Total Europe Region | 26,730 | 27,977 | (1,247) | (4.5) |
| Asia Pacific Region | | | | |
| Japan | 4,974 | 4,959 | 15 | 0.3 |
| Other | 6,776 | 5,125 | 1,651 | 32.2 |
| Total Asia Pacific Region | 11,750 | 10,084 | 1,666 | 16.5 |
| Latin America Region | 4,440 | 2,810 | 1,630 | 58.0 |
| Total Worldwide Retail Sales | 145,391 | 132,991 | 12,400 | 9.3% |

(a) Data source for retail sales figures shown above is new sales warranty and registration information provided by Harley-Davidson dealers and compiled by the Company. The Company must rely on information that its dealers supply concerning retail sales and this information is subject to revision. Only Harley-Davidson motorcycles are included in the table above.

(b) Europe data includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

The following table includes industry retail motorcycle registration data:

Heavyweight Motorcycle Registration Data^(a)

| | Six months ended | | | |
|------------------------------|------------------|------------------|----------|-------------|
| | June 30, 2012 | June 30, 2011 | Increase | % Change |
| United States ^(b) | 170,096 | 157,608 | 12,488 | 7.9% |
| | | | | |
| | Six months ended | | | |
| | June 30, 2012 | June 30, 2011 | Decrease | % Change |
| Europe ^(c) | 180,284 | 197,151 | (16,867) | -8.6% |

(a) Heavyweight data includes street legal 651+cc models. Street legal 651+cc models include on-highway, dual purpose models and three-wheeled vehicles.

Table of Contents

- (b) United States industry data is derived from information provided by Motorcycle Industry Council (MIC). This third party data is subject to revision and update.
- (c) Europe data includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom. Industry retail motorcycle registration data includes 651+cc models derived from information provided by Association des Constructeurs Europeens de Motocycles (ACEM), an independent agency. Europe market data is reported on a one-month lag. This third-party data is subject to revision and update.

Motorcycle Unit Shipments

The following table includes wholesale motorcycle unit shipments for the Motorcycles segment:

| | July 1, 2012 | Six months ended | | (Decrease) Increase | % Change | |
|---|-----------------|------------------|------------------|------------------------|---------------|--------------|
| | | July 1, 2012 | June 26, 2011 | | | |
| United States | 97,967 | 66.3% | 77,489 | 64.2% | 20,478 | 26.4% |
| International | 49,798 | 33.7% | 43,153 | 35.8% | 6,645 | 15.4 |
| Harley-Davidson motorcycle units | 147,765 | 100.0% | 120,642 | 100.0% | 27,123 | 22.5% |
| Touring motorcycle units | 59,376 | 40.2% | 48,053 | 39.9% | 11,323 | 23.6% |
| Custom motorcycle units ^(a) | 57,711 | 39.1% | 45,888 | 38.0% | 11,823 | 25.8 |
| Sportster motorcycle units | 30,678 | 20.7% | 26,701 | 22.1% | 3,977 | 14.9 |
| Harley-Davidson motorcycle units | 147,765 | 100.0% | 120,642 | 100.0% | 27,123 | 22.5% |

(a) Custom motorcycle units, as used in this table, include Dyna, Softail, VRSC and CVO models.

The Company shipped 147,765 Harley-Davidson motorcycles worldwide during the first half of 2012, which was 22.5% higher than the first half of 2011. This is in line with Company expectations and resulted in higher U.S. dealer inventory at the end of the first half of 2012 compared to the end of the first half of 2011. During the first half of 2012, shipments were higher as the Company depleted its 2012 model-year motorcycle inventory in the U.S. in anticipation of the July 2, 2012 ERP launch in its York, PA facility and the 2013 model-year cut-over. The year-over-year increase in shipments was also aided by six additional calendar days included in the first half of 2012 compared to the first half of 2011. The calendar adjustment is required every several years to sync up the Company's fiscal calendar with the regular calendar. The fourth fiscal quarter will include five fewer calendar days than last year's fourth fiscal quarter.

Table of Contents**Segment Results**

The following table includes the condensed statements of operations for the Motorcycles segment (in thousands):

| | Six months ended | | Increase (Decrease) | % Change |
|-----------------------------------|------------------|------------------|------------------------|-------------|
| | July 1, 2012 | June 26, 2011 | | |
| Revenue: | | | | |
| Motorcycles | \$ 2,219,678 | \$ 1,840,094 | \$ 379,584 | 20.6% |
| Parts & Accessories | 464,632 | 419,711 | 44,921 | 10.7 |
| General Merchandise | 149,743 | 135,476 | 14,267 | 10.5 |
| Other | 8,363 | 7,507 | 856 | 11.4 |
| Total revenue | 2,842,416 | 2,402,788 | 439,628 | 18.3 |
| Cost of goods sold | 1,822,089 | 1,582,654 | 239,435 | 15.1 |
| Gross profit | 1,020,327 | 820,134 | 200,193 | 24.4 |
| Selling & administrative expense | 423,719 | 372,036 | 51,683 | 13.9 |
| Engineering expense | 61,314 | 66,596 | (5,282) | (7.9) |
| Restructuring expense | 17,671 | 36,593 | (18,922) | (51.7) |
| Operating expense | 502,704 | 475,225 | 27,479 | 5.8 |
| Operating income from motorcycles | \$ 517,623 | \$ 344,909 | \$ 172,714 | 50.1% |

The following table includes the estimated impact of significant factors affecting the comparability of net revenue, cost of goods sold and gross profit from the first half of 2010 to the first half of 2011 (in millions):

| | Net Revenue | Cost of Goods Sold | Gross Profit |
|---|----------------|-----------------------|-----------------|
| June 26, 2011 | \$ 2,402.8 | \$ 1,582.7 | \$ 820.1 |
| Volume | 467.6 | 314.4 | 153.2 |
| Price | 18.1 | | 18.1 |
| Foreign currency exchange rates and hedging | (36.1) | (31.4) | (4.7) |
| Product mix | (10.0) | (10.5) | 0.5 |
| Raw material prices | | (3.1) | 3.1 |
| Manufacturing costs | | (30.0) | 30.0 |
| Total | 439.6 | 239.4 | 200.2 |
| July 1, 2012 | \$ 2,842.4 | \$ 1,822.1 | \$ 1,020.3 |

Table of Contents

The following factors affected the comparability of net revenue, cost of goods sold and gross profit from 2011 to 2012:

On average, wholesale prices on the Company's 2012 model-year motorcycles are higher than the prior model year resulting in the favorable impact on revenue and gross profit during the period.

Foreign currency exchange rates during the first half of 2012 resulted in a negative impact on net revenue and were partially offset by the favorable impact of gains associated with foreign currency hedging (included in cost of goods sold) when compared to the same period last year.

Shipment mix changes negatively impacted net revenue and resulted primarily from product mix changes both between and within the Company's motorcycle families. However, the impact of mix changes on cost of goods sold more than offset the impact to revenue.

Raw material prices were lower in the first half of 2012 relative to the first half of 2011 primarily due to lower metals costs and lower fuel prices.

Manufacturing costs benefitted from restructuring savings, incremental margin on higher volumes and lower year over year temporary inefficiencies related to restructuring, partially offset by inflation. Temporary inefficiencies related to restructuring activities were approximately \$16 million in the first six months of 2012 compared to \$19 million in the same period last year.

The net increase in operating expense was primarily due to higher selling and administrative expense driven by incremental investments to support the Company's growth initiatives and six more fiscal days in the first six months of 2012 compared to the first six months of 2011. In addition, warranty and recall expense was higher than in the same period last year primarily driven by higher motorcycle shipments. The higher selling and administrative expenses were partially offset by lower restructuring expense related to the Company's previously announced restructuring activities as well as lower engineering expense. For further information regarding the Company's previously announced restructuring activities, refer to Note 5 of Notes to Condensed Consolidated Financial Statements.

Financial Services Segment**Segment Results**

The following table includes the condensed statements of operations for the Financial Services segment (in thousands):

| | Six months ended | | (Decrease) | % |
|--|------------------|------------------|-------------|---------|
| | July 1, 2012 | June 26, 2011 | Increase | Change |
| Interest income | \$ 288,809 | \$ 299,965 | \$ (11,156) | (3.7%) |
| Other income | 28,126 | 27,774 | 352 | 1.3 |
| Financial services revenue | 316,935 | 327,739 | (10,804) | (3.3) |
| Interest expense | 99,968 | 115,026 | (15,058) | (13.1) |
| Provision for credit losses | 3,754 | (1,184) | 4,938 | (417.1) |
| Operating expenses | 63,865 | 63,907 | (42) | (0.1) |
| Financial services expense | 167,587 | 177,749 | (10,162) | 5.7 |
| Operating income from financial services | \$ 149,348 | \$ 149,990 | \$ (642) | (0.4%) |

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

Interest income for the six months ended July 1, 2012 decreased due to lower finance receivables outstanding primarily due to a declining portfolio of retail finance receivables. Interest expense was lower primarily due to a more favorable cost of funds.

The provision for credit losses increased in the first six months of 2012. The provision for credit losses related to retail motorcycle finance receivables increased by \$7.4 million in the first six months of 2012 compared to the first six months of 2011. During the first six months of 2012, there was an \$11.8 million allowance release as compared to a \$27.9 million allowance release in the first six months of 2011. This was partially offset by favorable finance receivable credit losses in the first six months of 2012 as compared to the first six months of 2011. The provision for credit losses related to wholesale motorcycle finance receivables increased by \$0.8 million primarily due to an increase in receivables during the first six months of 2012 compared to the first six months of 2011.

Table of Contents

Annualized losses on HDFS retail motorcycle loans were 0.58% during the first six months of 2012 compared to 1.06% in the first six months of 2011. The decrease in credit losses from 2011 was due to a lower frequency of loss. The 30-day delinquency rate for retail motorcycle loans at July 1, 2012 decreased to 2.68% from 3.53% at June 26, 2011.

Changes in the allowance for finance credit losses on finance receivables were as follows (in thousands):

| | Six months ended | |
|-------------------------------------|-------------------|-------------------|
| | July 1, 2012 | June 26, 2011 |
| Balance, beginning of period | \$ 125,449 | \$ 173,589 |
| Provision for finance credit losses | 3,754 | (1,184) |
| Charge-offs | (42,906) | (58,424) |
| Recoveries | 27,951 | 30,423 |
| Balance, end of period | \$ 114,248 | \$ 144,404 |

Other Matters**Contractual Obligations**

The Company has updated its Contractual Obligations table as of July 1, 2012 to reflect the new projected principal and interest payments for the remainder of 2012 and beyond as follows (in thousands):

| | 2012 | 2013 - 2014 | 2015 - 2016 | Thereafter | Total |
|----------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Principal payments on debt | \$ 1,478,792 | \$ 1,401,035 | \$ 934,634 | \$ 1,515,790 | \$ 5,330,251 |
| Interest payments on debt | 108,309 | 326,609 | 191,759 | 98,194 | 724,871 |
| | \$ 1,587,101 | \$ 1,727,644 | \$ 1,126,393 | \$ 1,613,984 | \$ 6,055,122 |

Interest obligations include the impact of interest rate hedges outstanding as of July 1, 2012. Interest for floating rate instruments, as calculated above, assumes rates in effect at July 1, 2012 remain constant.

As of July 1, 2012, there have been no other material changes to the Company's summary of expected payments for significant contractual obligations under the caption "Contractual Obligations" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Commitments and Contingencies

The Company is subject to lawsuits and other claims related to environmental, product and other matters. In determining required reserves related to these items, the Company carefully analyzes cases and considers the likelihood of adverse judgments or outcomes, as well as the potential range of possible loss. The required reserves are monitored on an ongoing basis and are updated based on new developments or new information in each matter.

Table of Contents

Environmental Protection Agency Notice

In December 2009, the Company received formal, written requests for information from the United States Environmental Protection Agency (EPA) regarding: (i) certificates of conformity for motorcycle emissions and related designations and labels, (ii) aftermarket parts, and (iii) warranty claims on emissions related components. The Company promptly submitted written responses to the EPA's inquiry and engaged in discussions with the EPA. It is possible that a result of the EPA's investigation will be some form of enforcement action by the EPA that will seek a fine or other relief. However, at this time the Company does not know and cannot reasonably estimate the impact of any remedies the EPA might seek.

York Environmental Matters:

The Company is involved with government agencies and groups of potentially responsible parties in various environmental matters, including a matter involving the cleanup of soil and groundwater contamination at its York, Pennsylvania facility. The York facility was formerly used by the U.S. Navy and AMF prior to the purchase of the York facility by the Company from AMF in 1981. Although the Company is not certain as to the full extent of the environmental contamination at the York facility, it has been working with the Pennsylvania Department of Environmental Protection (PADEP) since 1986 in undertaking environmental investigation and remediation activities, including an ongoing site-wide remedial investigation/feasibility study (RI/FS). In January 1995, the Company entered into a settlement agreement (the Agreement) with the Navy. The Agreement calls for the Navy and the Company to contribute amounts into a trust equal to 53% and 47%, respectively, of future costs associated with environmental investigation and remediation activities at the York facility (Response Costs). The trust administers the payment of the Response Costs incurred at the York facility as covered by the Agreement.

In February 2002, the Company was advised by the EPA that it considers some of the Company's remediation activities at the York facility to be subject to the EPA's corrective action program under the Resource Conservation and Recovery Act (RCRA) and offered the Company the option of addressing corrective action under a RCRA facility lead agreement. In July 2005, the York facility was designated as the first site in Pennsylvania to be addressed under the One Cleanup Program. The program provides a more streamlined and efficient oversight of voluntary remediation by both PADEP and EPA and will be carried out consistent with the Agreement with the Navy. As a result, the RCRA facility lead agreement has been superseded.

The Company estimates that its share of the future Response Costs at the York facility will be approximately \$2.3 million and has established a reserve for this amount which is included in accrued liabilities in the Condensed Consolidated Balance Sheets⁽¹⁾. As noted above, the RI/FS is still underway and given the uncertainty that exists concerning the nature and scope of additional environmental investigation and remediation that may ultimately be required under the RI/FS or otherwise at the York facility, we are unable to make a reasonable estimate of those additional costs, if any, that may result.

The estimate of the Company's future Response Costs that will be incurred at the York facility is based on reports of independent environmental consultants retained by the Company, the actual costs incurred to date and the estimated costs to complete the necessary investigation and remediation activities. Response Costs related to the remediation of soil are expected to be incurred primarily over a period of several years ending in 2015. Response Costs related to ground water remediation may continue for some time beyond 2015.

Product Liability Matters:

Additionally, the Company is involved in product liability suits related to the operation of its business. The Company accrues for claim exposures that are probable of occurrence and can be reasonably estimated. The Company also maintains insurance coverage for product liability exposures. The Company believes that its accruals and insurance coverage are adequate and that product liability will not have a material adverse effect on the Company's consolidated financial statements.

Table of Contents**Liquidity and Capital Resources as of July 1, 2012⁽¹⁾**

Over the long-term, the Company expects that its business model will continue to generate cash that will allow it to invest in the business, fund future growth opportunities and return value to shareholders. The Company believes the Motorcycles operations will continue to be primarily funded through cash flows generated by operations. The Company's Financial Services operations have been funded with unsecured debt, unsecured commercial paper, an asset-backed commercial paper conduit facility and committed unsecured bank facilities and through the term asset-backed securitization market.

The Company's strategy is to maintain a minimum of twelve months of its projected liquidity needs through a combination of cash and marketable securities and availability under credit facilities. The following table summarizes the Company's cash and marketable securities and availability under credit facilities (in thousands):

| | July 1, 2012 |
|--|---------------------|
| Cash and cash equivalents | \$ 1,071,496 |
| Marketable securities | 135,848 |
| Total cash and cash equivalents and marketable securities | 1,207,344 |
| Global credit facilities ^(a) | 360,340 |
| Asset-backed conduit facility ^(b) | 600,000 |
| Total availability under credit facilities | 960,340 |
| Total | \$ 2,167,684 |

(a) \$675.0 million of the Company's total \$1.35 billion global credit facilities was replaced on April 13, 2012

(b) The conduit facility is set to expire in September 2012.

The Company recognizes that it must continue to monitor and adjust to changes in the lending environment for its Financial Services operations. The Company intends to continue with a diversified funding profile through a combination of short-term and long-term funding vehicles and to pursue a variety of sources to obtain cost-effective funding. The Financial Services operations could be negatively affected by higher costs of funding and increased difficulty of raising, or potential unsuccessful efforts to raise, funding in the short-term and long-term capital markets. These negative consequences could in turn adversely affect the Company's business and results of operations in various ways, including through higher costs of capital, reduced funds available through its Financial Services operations to provide loans to independent dealers and their retail customers, and dilution to existing shareholders through the use of alternative sources of capital.

Cash Flow Activity

The following table summarizes the cash flow activity of continuing operations for the periods indicated (in thousands):

| | Six months ended | |
|---|---------------------|--------------------|
| | July 1, 2012 | July 26, 2011 |
| Net cash provided by operating activities | \$ 288,242 | \$ 472,962 |
| Net cash used by investing activities | (189,807) | (189,951) |
| Net cash used by financing activities | (549,856) | (329,729) |
| Effect of exchange rate changes on cash and cash equivalents | (4,033) | (1,702) |
| Net decrease in cash and cash equivalents of continuing operations | \$ (455,454) | \$ (48,420) |

Operating Activities of Continuing Operations

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

The decrease in cash provided by operating activities for the first six months of 2012 compared to the first six months of 2011 was due to increased HDFS wholesale lending activity driven by an increase in motorcycle shipments in 2012 and changes in working capital primarily due to a decrease in accounts payable. The Company made a voluntary \$200.0 million contribution to the Company's pension plans in the first quarter of 2012 and in the first quarter of 2011. No additional pension contributions are required in 2012. The Company expects it will continue to make on-going contributions related to current benefit payments for SERPA and postretirement healthcare plans.

Table of Contents**Investing Activities of Continuing Operations**

The Company's investing activities consist primarily of capital expenditures, net changes in finance receivables and short-term investment activity. Capital expenditures were \$60.1 million in the first six months of 2012 compared to \$69.3 million in the same period last year. Net cash flows from finance receivables, net for the first six months of 2012 were \$129.8 lower than in the same period last year as a result of an increase in retail motorcycle loan originations during 2012. A net decrease in net cash out-flows related to marketable securities during the first six months of 2011 resulted in higher investing cash flows of approximately \$121 million in 2012.

Financing Activities of Continuing Operations

The Company's financing activities consist primarily of share repurchases, dividend payments and debt activity. Cash outflows from share repurchases were \$172.7 in the first six months of 2012 compared to \$5.7 million for the same period last year. Share repurchases during the first six months of 2012 included 3.6 million shares of common stock related to discretionary share repurchases as well as shares of common stock that employees surrendered to satisfy withholding taxes in connection with the vesting of restricted stock awards. Share repurchases during the second quarter of 2011 were limited to shares of common stock that employees surrendered to satisfy withholding taxes in connection with the vesting of restricted stock awards. As of July 1, 2012, there were 16.7 million shares remaining on a board-approved share repurchase authorization. In addition, as of July 1, 2012, 0.4 million shares remained on a separate board-approved share repurchase authorization that is in place to offset option exercises. In total at July 1, 2012, the Company had authorization to repurchase 17.1 million shares of its common stock.

The Company paid dividends of \$0.31 and \$0.225 per share totaling \$71.6 million and \$53.2 million during the first six months of 2012 and 2011, respectively.

Financing cash flows related to debt activity resulted in net cash outflows of \$397.6 million in the first six months of 2012 compared to \$323.7 million in the first six months of 2011. The Company's total outstanding debt consisted of the following (in thousands):

| | July 1, 2012 | June 26, 2011 |
|--|---------------------|---------------------|
| Global credit facilities | \$ 143,792 | \$ 201,112 |
| Unsecured commercial paper | 845,868 | 735,737 |
| Medium-term notes | 2,698,359 | 2,347,750 |
| Senior unsecured notes | 303,000 | 303,000 |
| | 3,991,019 | 3,587,599 |
| Term asset-backed securitization debt held by VIEs | 1,339,232 | 1,853,382 |
| Total debt | \$ 5,330,251 | \$ 5,440,981 |

To access the debt capital markets, the Company relies on credit rating agencies to assign short-term and long-term credit ratings. Generally, lower credit ratings result in higher borrowing costs and reduced access to debt capital markets. A credit rating agency may change or withdraw the Company's ratings based on its assessment of the Company's current and future ability to meet interest and principal repayment obligations. The Company's short-term debt ratings affect its ability to issue unsecured commercial paper. The Company's short-and long-term debt ratings as of July 1, 2012 were as follows:

Table of Contents

| | Short-Term | Long-Term | Outlook |
|----------------------|------------|-----------|----------|
| Moody's | P2 | Baa1 | Stable |
| Standard & Poor's | A2 | BBB+ | Stable |
| Fitch ^(a) | F2 | BBB+ | Positive |

(a) On July 20, 2012, Fitch upgraded the Company's Long-Term rating to A- and its outlook to Stable. Fitch also reaffirmed the Company's Short-Term rating of F2.

Global Credit Facilities On April 13, 2012, the Company and HDFS entered into a new \$675.0 million five-year credit facility to refinance and replace a \$675.0 million three-year credit facility that was due to mature in April 2013. The new five-year credit facility matures in April 2017. The Company and HDFS also have a \$675.0 million four-year credit facility which matures in April 2015. The new five-year credit facility and the four-year credit facility (together, the Global Credit Facilities) bear interest at various variable interest rates, which may be adjusted upward or downward depending on certain criteria, such as credit ratings. The Global Credit Facilities also require the Company to pay a fee based upon the average daily unused portion of the aggregate commitments under the Global Credit Facilities. The Global Credit Facilities are committed facilities and primarily used to support HDFS' unsecured commercial paper program.

Unsecured Commercial Paper Subject to limitations, HDFS could issue unsecured commercial paper of up to \$1.35 billion as of July 1, 2012 supported by Global Credit Facilities discussed above. Outstanding unsecured commercial paper may not exceed the unused portion of the Global Credit Facilities. Maturities may range up to 365 days from the issuance date. HDFS intends to repay unsecured commercial paper as it matures with additional unsecured commercial paper or through other means, such as borrowing under the Global Credit Facilities, borrowing under its asset-backed commercial paper conduit facility or through the use of operating cash flow.⁽¹⁾

Medium-Term Notes The Company had the following medium-term notes (collectively, the Notes) issued and outstanding at July 1, 2012 (in thousands):

| Principal Amount | Rate | Issue Date | Maturity Date |
|------------------|--------|---------------|---------------|
| \$400,000 | 5.25% | December 2007 | December 2012 |
| \$500,000 | 5.75% | November 2009 | December 2014 |
| \$450,000 | 3.875% | March 2011 | March 2016 |
| \$400,000 | 2.70% | January 2012 | March 2017 |
| \$950,131 | 6.80% | May 2008 | June 2018 |

The Notes provide for semi-annual interest payments and principal due at maturity. Unamortized discounts on the Notes reduced the balance by \$1.8 million and \$2.3 million at July 1, 2012 and June 26, 2011, respectively.

Senior Unsecured Notes In February 2009, the Company issued \$600.0 million of senior unsecured notes in an underwritten offering. The senior unsecured notes provide for semi-annual interest payments and principal due at maturity. The senior unsecured notes mature in February 2014 and have an annual interest rate of 15%. During the fourth quarter of 2010, the Company repurchased \$297.0 million of the \$600.0 million senior unsecured notes at a price of \$380.8 million.

Asset-Backed Commercial Paper Conduit Facility On September 9, 2011, HDFS amended and restated its revolving asset-backed conduit facility which provides for a total aggregate commitment of \$600.0 million. The agreement has similar terms as the prior agreement and is for the same amount. At July 1, 2012, HDFS had no outstanding borrowings under the conduit facility.

Table of Contents

This debt provides for interest on outstanding principal based on prevailing commercial paper rates, or LIBOR plus a specified margin to the extent the advance is not funded by a conduit lender through the issuance of commercial paper. The conduit facility also provides for an unused commitment fee based on the unused portion of the total aggregate commitment of \$600.0 million. There is no amortization schedule; however, the debt is reduced monthly as available collections on the related finance receivable collateral are applied to outstanding principal. Upon expiration of the conduit facility, any outstanding principal will continue to be reduced monthly through available collections. Unless earlier terminated or extended by mutual agreement of HDFS and the lenders, as of July 1, 2012, the conduit facility expires on September 7, 2012. The Company currently intends to renew this conduit facility in the third quarter of 2012.⁽¹⁾

Term Asset-Backed Securitization Debt Held by VIEs During the second quarter of 2012, the Company issued \$89.5 million of secured notes through the sale of notes that had been previously retained as part of certain 2009 and 2011 term asset-backed securitization transactions. These notes were sold at a premium, and at July 1, 2012, the unaccreted premium associated with these notes was \$1.8 million. There was no additional term-asset backed securitization activity during the six months ended July 1, 2012. There were no term-asset backed securitization transactions during the six months ended June 26, 2011. In July 2012, the Company issued \$675.3 million of secured notes through one term asset-backed securitization transaction.

For all of the term asset-backed securitization transactions, HDFS transferred U.S. retail motorcycle finance receivables to separate VIEs, which in turn issued secured notes, with various maturities and interest rates to investors. All of the notes held by the VIEs are secured by future collections of the purchased U.S. retail motorcycle finance receivables. The U.S. retail motorcycle finance receivables included in the term asset-backed securitization transactions are not available to pay other obligations or claims of HDFS' creditors until the associated debt and other obligations are satisfied. Cash and cash equivalent balances held by the VIEs are used only to support the securitizations. There is no amortization schedule for the secured notes; however, the debt is reduced monthly as available collections on the related retail motorcycle finance receivables are applied to outstanding principal. The secured notes' contractual lives have various maturities ranging from 2012 to 2018.

As of July 1, 2012, the assets of the VIEs totaled \$2.23 billion, of which \$2.04 billion of finance receivables and \$187.8 million of cash were restricted as collateral for the payment of \$1.34 billion of obligations under the secured notes. Approximately \$507.4 million of the obligations under the secured notes were classified as current at July 1, 2012, based on the contractual maturities of the restricted finance receivables.

Intercompany Borrowing HDFS has a revolving credit line with the Company whereby HDFS may borrow up to \$210.0 million from the Company at a market interest rate. As of July 1, 2012 and June 26, 2011, HDFS had no outstanding borrowings owed to the Company under this agreement.

During the second quarter of 2012, HDFS and the Company entered into a \$200.0 million Term Loan Agreement which provided for monthly interest payments based on the prevailing commercial paper rates and principal due at maturity in August 2012 or upon earlier demand by the Company. HDFS repaid the \$200.0 million Term Loan Agreement in July 2012. During the second quarter of 2011, HDFS and the Company entered in a \$200.0 million Term Loan Agreement, which was outstanding at June 26, 2011, and matured and was repaid by HDFS during the third quarter of 2011. The Term Loan balances and related interest are eliminated in the Company's consolidated financial statements.

The Company has a support agreement with HDFS whereby, if required, the Company agrees to provide HDFS with financial support to maintain HDFS' fixed-charge coverage at 1.25 and minimum net worth of \$40.0 million. Support may be provided at the Company's option as capital contributions or loans. Accordingly, certain debt covenants may restrict the Company's ability to withdraw funds from HDFS outside the normal course of business. No amount has ever been provided to HDFS under the support agreement.

Table of Contents

Operating and Financial Covenants HDFS and the Company are subject to various operating and financial covenants related to the Global Credit Facilities and various operating covenants under the Notes and the asset-backed commercial paper conduit facility. The more significant covenants are described below.

The covenants limit the Company's and HDFS' ability to:

incur certain additional indebtedness;

assume or incur certain liens;

participate in a merger, consolidation, liquidation or dissolution; and

purchase or hold margin stock.

Under the financial covenants of the Global Credit Facilities, the consolidated debt to equity ratio of HDFS cannot exceed 10.0 to 1.0. In addition, the Company must maintain a minimum interest coverage ratio of at least 2.25 to 1.0 for each fiscal quarter through June 2013 and 2.5 to 1.0 for each fiscal quarter thereafter. No financial covenants are required under the Notes or the asset-backed commercial paper conduit facility.

At July 1, 2012, HDFS and the Company remained in compliance with all of the then existing covenants.

Cash Flows from Discontinued Operations

There were no significant cash flows from discontinued operations during the six months ended July 1, 2012 and June 26, 2011, respectively.

Cautionary Statements

The Company's ability to meet the targets and expectations noted depends upon, among other factors, the Company's ability to:

- (i) execute its business strategy,
- (ii) effectively execute the Company's restructuring plans within expected costs and timing,
- (iii) implement and manage enterprise-wide information technology solutions, including solutions at its manufacturing facilities, and secure data contained in those systems,
- (iv) adjust to fluctuations in foreign currency exchange rates, interest rates and commodity prices,
- (v) anticipate the level of consumer confidence in the economy,
- (vi) manage through inconsistent economic conditions, including changing capital, credit and retail markets,

Edgar Filing: HARLEY DAVIDSON INC - Form 10-Q

- (vii) continue to realize production efficiencies at its production facilities and manage operating costs including materials, labor and overhead,
- (viii) successfully implement with our labor unions the agreements that we have executed with them that we believe will provide flexibility and cost-effectiveness to accomplish restructuring goals and long-term competitiveness,
- (ix) manage risks that arise through expanding international operations and sales,
- (x) manage supply chain issues, including any unexpected interruptions or price increases caused by raw material shortages or natural disasters,
- (xi) manage production capacity and production changes,
- (xii) provide products, services and experiences that are successful in the marketplace,
- (xiii) develop and implement sales and marketing plans that retain existing retail customers and attract new retail customers in an increasingly competitive marketplace,
- (xiv) manage the risks that our independent dealers may have difficulty obtaining capital and managing through changing economic conditions and consumer demand,
- (xv) continue to have access to reliable sources of capital funding and adjust to fluctuations in the cost of capital,
- (xvi) manage the credit quality, the loan servicing and collection activities, and the recovery rates of HDFS loan portfolio,
- (xvii) sell all of its motorcycles and related products and services to its independent dealers,
- (xviii) continue to develop the capabilities of its distributor and dealer network,

Table of Contents

- (xix) manage changes and prepare for requirements in legislative and regulatory environments for its products, services and operations,
- (xx) adjust to healthcare inflation and reform, pension reform and tax changes,
- (xxi) retain and attract talented employees, and
- (xxii) detect any issues with our motorcycles or manufacturing processes to avoid delays in new model launches, recall campaigns, increased warranty costs or litigation.

In addition, the Company could experience delays or disruptions in its operations as a result of work stoppages, strikes, natural causes, terrorism or other factors. Other factors are described in risk factors that the Company has disclosed in documents previously filed with the Securities and Exchange Commission. Many of these risk factors are impacted by the current changing capital, credit and retail markets and the Company's ability to manage through inconsistent economic conditions.

The Company's ability to sell its motorcycles and related products and services and to meet its financial expectations also depends on the ability of the Company's independent dealers to sell its motorcycles and related products and services to retail customers. The Company depends on the capability and financial capacity of its independent dealers and distributors to develop and implement effective retail sales plans to create demand for the motorcycles and related products and services they purchase from the Company.

In addition, the Company's independent dealers and distributors may experience difficulties in operating their businesses and selling Harley-Davidson motorcycles and related products and services as a result of weather, economic conditions or other factors.

Refer to Risk Factors under Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for a discussion of additional risk factors and a more complete discussion of some of the cautionary statements noted above.

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, 2011 for a complete discussion of the Company's market risk. There have been no material changes to the market risk information included in the Company's Annual Report on Form 10-K for the year December 31, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's management evaluated, with the participation of the Company's Chairman, President and Chief Executive Officer and the Senior Vice President and Chief Financial Officer, the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the Chairman, President and Chief Executive Officer and the Senior Vice President and Chief Financial Officer have concluded that the disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time period specified in the Securities and Exchange Commission rules and forms, and to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chairman, President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, as appropriate, to allow timely decisions regarding disclosure.

Table of Contents

Changes in Internal Controls

There was no change in the Company's internal control over financial reporting during the quarter ended July 1, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1 Legal Proceedings**

The information required under this Item 1 of Part II is contained in Item 1 of Part I of the Quarterly report on Form 10-Q in Note 16 of the Notes to Condensed Consolidated Financial Statements, and such information is incorporated herein by reference in this Item 1 of Part II.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

The following table contains detail related to the repurchase of common stock based on the date of trade during the quarter ended July 1, 2012:

| 2012 Fiscal Month | Total Number of Shares Purchased (a) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------------|---|---------------------------------|---|--|
| April 2 to May 6 | 154,453 | \$ 53 | 154,453 | 19,960,974 |
| May 7 to June 3 | 1,239,830 | \$ 49 | 1,239,830 | 18,807,270 |
| June 4 to July 1 | 1,728,125 | \$ 48 | 1,728,125 | 17,195,696 |
| Total | 3,122,408 | \$ 49 | 3,122,408 | |

- (a) Includes discretionary share repurchases and shares of common stock that employees surrendered to satisfy withholding taxes in connection with the vesting of restricted stock awards

The Company has an authorization (originally adopted in December 1997) by its Board of Directors to repurchase shares of its outstanding common stock under which the cumulative number of shares repurchased, at the time of any repurchase, shall not exceed the sum of (1) the number of shares issued in connection with the exercise of stock options occurring on or after January 1, 2004 plus (2) one percent of the issued and outstanding common stock of the Company on January 1 of the current year, adjusted for any stock split. The Company made discretionary share repurchases of 3,086,227 shares during the quarter ended July 1, 2012 under this authorization. As of July 1, 2012, 0.4 million shares remained under this authorization.

In December 2007, the Company's Board of Directors separately authorized the Company to buy back up to 20.0 million shares of its common stock with no dollar limit or expiration date. As of July 1, 2012, 16.7 million shares remained under this authorization.

From time to time, the Company may enter into a Rule 10b5-1 trading plan for the purpose of repurchasing shares under either the 1997 authorization or 2007 authorization.

The Harley-Davidson, Inc. 2009 Incentive Stock Plan and predecessor stock plans permit participants to satisfy all or a portion of the statutory federal, state and local withholding tax obligations arising in connection with plan awards by electing to (a) have the Company withhold shares otherwise issuable under the award, (b) tender back shares received in connection with such award or (c) deliver other previously owned shares, in each case having a value equal to the amount to be withheld. During the second quarter of 2012, the Company acquired 36,181 shares of common stock that employees presented to the Company to satisfy withholding taxes in connection with the vesting of restricted stock awards.

Table of Contents

Item 6 Exhibits

Refer to the Exhibit Index on page 66 of this report.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HARLEY-DAVIDSON, INC.

Date: August 9, 2012

/s/ John A. Olin
John A. Olin
Senior Vice President and
Chief Financial Officer
(Principal financial officer)

Date: August 9, 2012

/s/ Mark R. Kornetzke
Mark R. Kornetzke
Chief Accounting Officer
(Principal accounting officer)

Table of Contents

Harley-Davidson, Inc.

Exhibit Index to Form 10-Q

| Exhibit No. | Description |
|-------------|---|
| 31.1 | Chief Executive Officer Certification pursuant to Rule 13a-14(a) |
| 31.2 | Chief Financial Officer Certification pursuant to Rule 13a-14(a) |
| 32.1 | Written Statement of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. §1350 |
| 101 | Financial statements from the quarterly report on Form 10-Q of Harley-Davidson, Inc. for the quarter ended July 1, 2012, filed on August 9, 2012, formatted in XBRL: (i) the Condensed Consolidated Statements of Income; (ii) the Condensed Consolidated Balance Sheets; (iii) the Condensed Consolidated Statements of Cash Flows; and (iv) the Notes to Condensed Consolidated Financial Statements. |