

Eaton Corp plc
Form 10-K
February 22, 2017
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the year ended December 31, 2016

Commission file number 000-54863

EATON CORPORATION plc

(Exact name of registrant as specified in its charter)

Ireland

98-1059235

(State or other jurisdiction of incorporation or organization) (IRS Employer Identification Number)

Eaton House, 30 Pembroke Road, Dublin 4, Ireland

D04 Y0C2

(Address of principal executive offices)

(Zip code)

+353 1637

2900

(Registrant's

telephone

number,

including

area code)

Securities

registered

pursuant to

Section 12(b) of

the Act:

Title of	Name of
each	each
class	exchange
	on which
	registered

Ordinary	The New
Shares	York
(\$0.01	Stock
par	Exchange
value)	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

Act. Yes ☐ No ☐

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

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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 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 ☐
(Do not check if a smaller reporting company)

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

The aggregate market value of Ordinary Shares held by non-affiliates of the registrant as of June 30, 2016 was \$27.2 billion.

As of January 31, 2017, there were 449.7 million Ordinary Shares outstanding.

Documents Incorporated By Reference

Portions of the Proxy Statement for the 2017 annual shareholders meeting are incorporated by reference into Part III.

Table of Contents

TABLE OF CONTENTS

<u>Part I</u>	<u>2</u>
<u>Item 1. Business</u>	<u>2</u>
<u>Item 1A. Risk Factors</u>	<u>3</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>5</u>
<u>Item 2. Properties</u>	<u>5</u>
<u>Item 3. Legal Proceedings</u>	<u>5</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>5</u>
<u>Part II</u>	<u>6</u>
<u>Item 5. Market for the Registrant's Ordinary Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>6</u>
<u>Item 6. Selected Financial Data</u>	<u>6</u>
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>6</u>
<u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>7</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>7</u>
<u>Item 9. Change in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>7</u>
<u>Item 9A. Controls and Procedures</u>	<u>7</u>
<u>Item 9B. Other Information</u>	<u>7</u>
<u>Part III</u>	<u>8</u>
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>8</u>
<u>Item 11. Executive Compensation</u>	<u>9</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>9</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>9</u>
<u>Item 14. Principal Accounting Fees and Services</u>	<u>9</u>
<u>Part IV</u>	<u>9</u>
<u>Item 15. Exhibits, Financial Statement Schedules</u>	<u>9</u>
Item 16. Form 10-K Summary	<u>10</u>
<u>SIGNATURES</u>	<u>11</u>
<u>Exhibit Index</u>	
EX-12	
EX-21	
EX-23	
EX-24	
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 LABELS LINKBASE DOCUMENT	
EX-101 PRESENTATION LINKBASE DOCUMENT	
EX-101 DEFINITION LINKBASE DOCUMENT	

Table of Contents

Part I

Item 1. Business.

Eaton Corporation plc (Eaton or the Company) is a power management company with 2016 net sales of \$19.7 billion. The Company provides energy-efficient solutions that help its customers effectively manage electrical, hydraulic and mechanical power more efficiently, safely and sustainably. Eaton has approximately 95,000 employees in over 60 countries and sells products to customers in more than 175 countries.

Eaton electronically files or furnishes reports pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (Exchange Act) to the United States Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and proxy and information statements, as well as any amendments to those reports. As soon as reasonably practicable, these reports are available free of charge through the Company's Internet website at <http://www.eaton.com>. These filings are also accessible on the SEC's Internet website at <http://www.sec.gov>.

Business Segment Information

Information by business segment and geographic region regarding principal products, principal markets, methods of distribution, net sales, operating profit and assets is presented in Note 15 of the Notes to the Consolidated Financial Statements. Additional information regarding Eaton's segments and business is presented below.

Electrical Products and Electrical Systems and Services

Principal methods of competition in these segments are performance of products and systems, technology, customer service and support, and price. Eaton has a strong competitive position in these segments and, with respect to many products, is considered among the market leaders. In normal economic cycles, sales of these segments are historically lower in the first quarter and higher in the third and fourth quarters of a year. In 2016, 16% of these segments' sales were made to seven large distributors of electrical products and electrical systems and services.

Hydraulics

Principal methods of competition in this segment are product performance, geographic coverage, service, and price. Eaton has a strong competitive position in this segment and, with respect to many products, is considered among the market leaders. Sales of this segment are historically higher in the first and second quarters and lower in the third and fourth quarters of the year. In 2016, 11% of this segment's sales were made to three large original equipment manufacturers or distributors of agricultural, construction, and industrial equipment and parts.

Aerospace

Principal methods of competition in this segment are total cost of ownership, product and system performance, quality, design engineering capabilities, and timely delivery. Eaton has a strong competitive position in this segment and, with respect to many products and platforms, is considered among the market leaders. In 2016, 29% of this segment's sales were made to three large original equipment manufacturers of aircraft.

Vehicle

Principal methods of competition in this segment are product performance, technology, global service, and price. Eaton has a strong competitive position in this segment and, with respect to many products, is considered among the market leaders. In 2016, 68% of this segment's sales were made to nine large original equipment manufacturers of vehicles and related components.

Information Concerning Eaton's Business in General

Raw Materials

Eaton's major requirements for raw materials include iron, steel, copper, nickel, aluminum, brass, tin, silver, lead, molybdenum, titanium, vanadium, rubber, plastic, electronic components, insulating materials and fluids. Materials are purchased in various forms, such as extrusions, castings, powder metal, metal sheets and strips, forging billets, bar stock, and plastic pellets. Raw materials, as well as parts and other components, are purchased from many suppliers. Under normal circumstances, the Company has no difficulty obtaining its raw materials. In 2016, Eaton maintained appropriate levels of inventory to prevent shortages and did not experience any availability constraints.

Table of Contents

Patents and Trademarks

Eaton considers its intellectual property, including without limitation patents, trade names, domain names, trademarks, confidential information, and trade secrets to be of significant value to its business as a whole. The Company's products are manufactured, marketed and sold under a portfolio of patents, trademarks, licenses, and other forms of intellectual property, some of which expire or are allowed to lapse at various dates in the future. Eaton develops and acquires new intellectual property on an ongoing basis and considers all of its intellectual property to be valuable. Based on the broad scope of the Company's product lines, management believes that the loss or expiration of any single intellectual property right would not have a material effect on Eaton's consolidated financial statements or its business segments. The Company's policy is to file applications and obtain patents for the majority of its novel and innovative new products including product modifications and improvements.

Order Backlog

A significant portion of open orders placed with Eaton are by original equipment manufacturers or distributors. These open orders are not considered firm as they have been historically subject to month-to-month releases by customers. In measuring backlog orders, only the amount of orders to which customers are firmly committed are included. Using this criterion, total backlog at December 31, 2016 and 2015 was approximately \$4.0 billion and \$4.1 billion, respectively. Backlog should not be relied upon as being indicative of results of operations for future periods.

Research and Development

Research and development expenses for new products and improvement of existing products in 2016, 2015 and 2014 were \$589 million, \$625 million, and \$647 million, respectively. Over the past five years, the Company has invested approximately \$2.9 billion in research and development.

Environmental Contingencies

Operations of the Company involve the use and disposal of certain substances regulated under environmental protection laws. Eaton continues to modify processes on an ongoing, regular basis in order to reduce the impact on the environment, including the reduction or elimination of certain chemicals used in, and wastes generated from, operations. Compliance with laws that have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, are not expected to have a material adverse effect upon earnings or the competitive position of the Company. Eaton's estimated capital expenditures for environmental control facilities are not expected to be material for 2017 and 2018. Information regarding the Company's liabilities related to environmental matters is presented in Note 8 of the Notes to the Consolidated Financial Statements.

Item 1A. Risk Factors.

Among the risks that could materially adversely affect Eaton's businesses, financial condition or results of operations are the following:

Volatility of end markets that Eaton serves.

Eaton's segment revenues, operating results, and profitability have varied in the past and may vary from quarter to quarter in the future. Profitability can be negatively impacted by volatility in the end markets that Eaton serves. The Company has undertaken measures to reduce the impact of this volatility through diversification of the markets it serves and expansion of the geographic regions in which it operates. Future downturns in any of the markets could adversely affect revenues, operating results, and profitability.

Eaton's operating results depend in part on continued successful research, development, and marketing of new and/or improved products and services, and there can be no assurance that Eaton will continue to successfully introduce new products and services.

The success of new and improved products and services depends on their initial and continued acceptance by Eaton's customers. The Company's businesses are affected, to varying degrees, by technological change and corresponding shifts in customer demand, which could result in unpredictable product transitions or shortened life cycles. Eaton may experience difficulties or delays in the research, development, production, or marketing of new products and services which may prevent Eaton from recouping or realizing a return on the investments required to bring new products and services to market.

Table of Contents

Eaton's ability to attract, develop and retain executives and other qualified employees is crucial to the Company's results of operations and future growth.

Eaton depends on the continued services and performance of key executives, senior management, and skilled personnel, particularly professionals with experience in its industry and business. Eaton cannot be certain that any of these individuals will continue his or her employment with the Company. A lengthy period of time is required to hire and develop replacement personnel when skilled personnel depart. An inability to hire, develop, and retain a sufficient number of qualified employees could materially hinder the business by, for example, delaying Eaton's ability to bring new products to market or impairing the success of the Company's operations.

Eaton's operations depend on production facilities throughout the world, which subjects them to varying degrees of risk of disrupted production.

Eaton manages businesses with manufacturing facilities worldwide. The Company's manufacturing facilities and operations could be disrupted by a natural disaster, labor strike, war, political unrest, terrorist activity, economic upheaval, or public health concerns. Some of these conditions are more likely in certain geographic regions in which Eaton operates. Any such disruption could cause delays in shipments of products and the loss of sales and customers, and insurance proceeds may not adequately compensate for losses.

If Eaton is unable to protect its information technology infrastructure against service interruptions, data corruption, cyber-based attacks or network security breaches, operations could be disrupted or data confidentiality lost.

Eaton relies on information technology networks and systems, including the Internet, to process, transmit and store electronic information, and to manage or support a variety of business processes and activities, including procurement, manufacturing, distribution, invoicing and collection. These technology networks and systems may be susceptible to damage, disruptions or shutdowns due to failures during the process of upgrading or replacing software, databases or components; power outages; hardware failures; or computer viruses. In addition, security breaches could result in unauthorized disclosure of confidential information. If these information technology systems suffer severe damage, disruption, or shutdown, and business continuity plans do not effectively resolve the issues in a timely manner, there could be a negative impact on operating results or the Company may suffer financial or reputational damage.

Eaton's global operations subject it to economic risk as Eaton's results of operations may be adversely affected by changes in government regulations and policies and currency fluctuations.

Operating globally subjects Eaton to changes in government regulations and policies in a large number of jurisdictions around the world, including those related to tariffs and trade barriers, investments, property ownership rights, taxation, exchange controls, and repatriation of earnings. Changes in the relative values of currencies occur from time to time and could affect Eaton's operating results. While the Company monitors exchange rate exposures and attempts to reduce these exposures through hedging activities, these risks could adversely affect operating results.

Eaton may be subject to risks relating to changes in its tax rates or exposure to additional income tax liabilities.

Eaton is subject to income taxes in many jurisdictions around the world. Income tax liabilities are subject to the allocation of income among various tax jurisdictions. The Company's effective tax rate could be affected by changes in the mix among earnings in countries with differing statutory tax rates, changes in the valuation allowance of deferred tax assets, or changes in tax laws. With the Administration change in the United States, tax reform is anticipated. It is uncertain what, if any, impact this reform may have to Eaton since proposals have not been reduced to legislative language at this time. The amount of income taxes paid is subject to ongoing audits by tax authorities in the countries in which Eaton operates. If these audits result in assessments different from amounts reserved, future financial results may include unfavorable adjustments to the Company's tax liabilities.

Eaton uses a variety of raw materials and components in its businesses, and significant shortages, price increases, or supplier insolvencies could increase operating costs and adversely impact the competitive positions of Eaton's products.

Eaton's major requirements for raw materials are described above in Item 1 "Raw Materials". Significant shortages could affect the prices Eaton's businesses are charged and the competitive position of their products and services, all of which could adversely affect operating results.

Further, Eaton's suppliers of component parts may increase their prices in response to increases in costs of raw materials that they use to manufacture component parts. The Company may not be able to increase its prices

commensurately with its increased costs, adversely affecting operating results.

4

Table of Contents

Eaton may be unable to adequately protect its intellectual property rights, which could affect the Company's ability to compete.

Protecting Eaton's intellectual property rights is critical to its ability to compete and succeed. The Company owns a large number of patents and patent applications worldwide, as well as trademark and copyright registrations that are necessary, and contribute significantly, to the preservation of Eaton's competitive position in various markets. Although management believes that the loss or expiration of any single intellectual property right would not have a material effect on the results of operations or financial position of Eaton or its business segments, there can be no assurance that any one, or more, of these patents and other intellectual property will not be challenged, invalidated, or circumvented by third parties. Eaton enters into confidentiality and invention assignment agreements with the Company's employees, and into non-disclosure agreements with suppliers and appropriate customers, so as to limit access to and disclosure of proprietary information. These measures may not suffice to deter misappropriation or independent third party development of similar technologies.

Eaton is subject to litigation and environmental regulations that could adversely impact Eaton's businesses.

At any given time, Eaton may be subject to litigation, the disposition of which may have a material adverse effect on the Company's businesses, financial condition or results of operations. Information regarding current legal proceedings is presented in Note 8 and Note 9 of the Notes to the Consolidated Financial Statements.

Legislative and regulatory action could materially adversely affect Eaton.

Legislative and regulatory action may be taken in the U.S. which, if ultimately enacted, could override tax treaties upon which Eaton relies or broaden the circumstances under which the Company would be considered a U.S. resident, each of which could materially and adversely affect its effective tax rate. Eaton cannot predict the outcome of any specific legislative or regulatory proposals. However, if proposals were enacted that had the effect of disregarding the incorporation in Ireland or limiting Eaton's ability as an Irish company to take advantage of tax treaties with the U.S., the Company could be subject to increased taxation and/or potentially significant expense.

Additionally, existing free trade laws and regulations, such as the North American Free Trade Agreement, provide certain beneficial duties and tariffs for qualifying imports and exports, subject to compliance with the applicable classification and other requirements. Changes in laws or policies governing the terms of foreign trade, and in particular increased trade restrictions, tariffs or taxes on imports from countries where we manufacture products could have an impact on our business and financial results.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Eaton's principal executive offices are located at Eaton House, 30 Pembroke Road, Dublin 4, Ireland D04 Y0C2. The Company maintains manufacturing facilities at 330 locations in 42 countries. The Company is a lessee under a number of operating leases for certain real properties and equipment, none of which is material to its operations. Management believes that the existing manufacturing facilities are adequate for its operations and that the facilities are maintained in good condition.

Item 3. Legal Proceedings.

Information regarding the Company's current legal proceedings is presented in Note 8 and Note 9 of the Notes to the Consolidated Financial Statements.

Item 4. Mine Safety Disclosures.

Not applicable.

Executive Officers of the Registrant

Information regarding executive officers of the Company is presented in Item 10 of this Form 10-K Report.

Table of Contents

Part II

Item 5. Market for the Registrant's Ordinary Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The Company's ordinary shares are listed for trading on the New York Stock Exchange. At December 31, 2016, there were 17,627 holders of record of the Company's ordinary shares. Additionally, 21,235 current and former employees were shareholders through participation in the Eaton Savings Plan (ESP), Eaton Personal Investment Plan (EPIP), and the Eaton Puerto Rico Retirement Savings Plan.

Information regarding cash dividends paid, and the high and low market price per ordinary share, for each quarter in 2016 and 2015 is presented in "Quarterly Data" of this Form 10-K. Information regarding equity-based compensation plans required by Regulation S-K Item 201(d) is provided in Item 12 of this Form 10-K Report.

Irish Taxes Applicable to Dividends

In certain circumstances, Eaton will be required to deduct Irish dividend withholding tax (currently at the rate of 20%) from dividends paid to its shareholders. In the majority of cases, however, shareholders resident in the U.S. will not be subject to Irish withholding tax, and shareholders resident in a number of other countries will not be subject to Irish withholding tax provided that they complete certain Irish tax forms. Effective January 1, 2018, shareholders that reside in the US who hold their shares outside of a Depository Trust Company will be subject to Irish withholding tax on dividends unless they complete certain Irish tax forms.

Irish income tax may also arise with respect to dividends paid on Eaton shares. Dividends paid in respect of Eaton shares will generally not be subject to Irish income tax where the beneficial owner of these shares is exempt from dividend withholding tax, unless the beneficial owner of the dividend has some connection with Ireland other than his or her shareholding in Eaton.

Eaton shareholders who receive their dividends subject to Irish dividend withholding tax will generally have no further liability to Irish income tax on the dividends unless the beneficial owner of the dividend has some connection with Ireland other than his or her shareholding in Eaton.

Issuer's Purchases of Equity Securities

During the fourth quarter of 2016, 2.6 million ordinary shares were repurchased in the open market at a total cost of \$163 million. These shares were repurchased under the program approved by the Board on February 24, 2016. A summary of the shares repurchased in the fourth quarter of 2016 follows:

Month	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs (in millions)
October	—	\$ —	—	\$ 2,015
November	2,635,546	\$ 61.63	2,635,546	\$ 1,853
December	—	\$ —	—	\$ 1,853
Total	2,635,546	\$ —	2,635,546	