PARKER HANNIFIN CORP
Form 10-Q
February 08, 2011

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 December 31, 2010

OR

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

For the transition period from to

Commission File number 1-4982

PARKER-HANNIFIN CORPORATION

(Exact name of registrant as specified in its charter)

OHIO	**34-0451060**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
6035 Parkland Blvd., Cleveland, Ohio	**44124-4141**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (216) 896-3000

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

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

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

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

Number of Common Shares outstanding at December 31, 2010: 161,882,021

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PARKER-HANNIFIN CORPORATION

CONSOLIDATED STATEMENT OF INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Net sales	$ 2,866,664	$ 2,354,708	$ 5,695,937	$ 4,591,873
Cost of sales	2,195,728	1,869,481	4,333,602	3,670,426
Gross profit	670,936	485,227	1,362,335	921,447
Selling, general and administrative expenses	345,679	309,840	679,263	611,683
Interest expense	25,631	25,029	50,264	50,752
Other (income) expense, net	(6,624)	8,123	(9,806)	2,748
Income before income taxes	306,250	142,235	642,614	256,264
Income taxes	74,432	37,272	161,766	77,331
Net income	$ 231,818	$ 104,963	$ 480,848	$ 178,933
Less: Noncontrolling interests	1,638	417	3,497	894
Net income attributable to common shareholders	$ 230,180	$ 104,546	$ 477,351	$ 178,039
Earnings per share attributable to common shareholders:				
Basic	$ 1.42	$ .65	$ 2.96	$ 1.11
Diluted	$ 1.39	$ .64	$ 2.90	$ 1.10
Cash dividends per common share	$ .29	$ .25	$ .56	$ .50

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION

CONSOLIDATED BALANCE SHEET

(Dollars in thousands)

	(Unaudited) December 31, 2010	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 808,736	$ 575,526
Accounts receivable, net	1,636,905	1,599,941
Inventories:		
Finished products	562,277	465,477
Work in process	639,321	564,204
Raw materials	159,859	141,974
	1,361,457	1,171,655
Prepaid expenses	106,416	111,545
Deferred income taxes	130,426	130,129
Total current assets	4,043,940	3,588,796
Plant and equipment	4,785,167	4,553,997
Less accumulated depreciation	3,020,609	2,856,116
	1,764,558	1,697,881
Goodwill	2,910,729	2,786,334
Intangible assets, net	1,178,912	1,150,051
Other assets	720,705	687,320
Total assets	$ 10,618,844	$ 9,910,382
LIABILITIES		
Current liabilities:		
Notes payable	$ 101,293	$ 363,272
Accounts payable, trade	960,567	888,743
Accrued payrolls and other compensation	308,362	371,393
Accrued domestic and foreign taxes	148,997	176,349
Other accrued liabilities	421,649	405,134
Total current liabilities	1,940,868	2,204,891
Long-term debt	1,742,464	1,413,634
Pensions and other postretirement benefits	1,328,893	1,500,928
Deferred income taxes	150,069	135,321
Other liabilities	241,957	196,208
Total liabilities	5,404,251	5,450,982
EQUITY		
Shareholders equity:		
Serial preferred stock, $.50 par value; authorized 3,000,000 shares; none issued		
Common stock, $.50 par value; authorized 600,000,000 shares; issued 181,046,128 shares at December 31 and June 30	90,523	90,523
Additional capital	658,042	637,442
Retained earnings	6,449,601	6,086,545
Accumulated other comprehensive (loss)	(881,688)	(1,208,561)

Treasury shares, at cost; 19,164,107 shares at December 31 and 19,790,110 shares at June 30	(1,203,217)	(1,237,984)
Total shareholders' equity	5,113,261	4,367,965
Noncontrolling interests	101,332	91,435
Total equity	5,214,593	4,459,400
Total liabilities and equity	$ 10,618,844	$ 9,910,382

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended December 31, 2010	Six Months Ended December 31, 2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 480,848	$ 178,933
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	116,971	128,919
Amortization	53,322	61,018
Share incentive plan compensation	41,331	37,060
Deferred income taxes	31,121	(39,165)
Foreign currency transaction loss (gain)	9,419	(1,136)
(Gain) loss on sale of plant and equipment	(5,244)	5,582
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	26,609	73,842
Inventories	(129,640)	44,867
Prepaid expenses	9,844	44,928
Other assets	(35,653)	19,454
Accounts payable, trade	40,491	36,522
Accrued payrolls and other compensation	(71,122)	(98,140)
Accrued domestic and foreign taxes	(39,497)	32,263
Other accrued liabilities	(8,056)	26,776
Pensions and other postretirement benefits	(136,394)	50,619
Other liabilities	23,807	3,908
Net cash provided by operating activities	408,157	606,250
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions (less cash acquired of $1 in 2010)	(43,359)	
Capital expenditures	(109,795)	(61,232)
Proceeds from sale of plant and equipment	17,243	5,665
Other	(9,369)	(14,310)
Net cash (used in) investing activities	(145,280)	(69,877)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options	16,306	4,538
(Payments for) common shares	(30,000)	(10,000)
Tax benefit from share incentive plan compensation	18,557	1,489
(Payments for) notes payable, net	(18,908)	(378,174)
Proceeds from long-term borrowings	295,714	1,937
(Payments for) long-term borrowings	(257,133)	(23,696)
Dividends	(90,907)	(80,363)
Net cash (used in) financing activities	(66,371)	(484,269)
Effect of exchange rate changes on cash	36,704	(5,816)
Net increase in cash and cash equivalents	233,210	46,288
Cash and cash equivalents at beginning of year	575,526	187,611
Cash and cash equivalents at end of period	$ 808,736	$ 233,899

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION

BUSINESS SEGMENT INFORMATION

(Dollars in thousands)

(Unaudited)

The Company operates in three reportable business segments: Industrial, Aerospace and Climate & Industrial Controls. The Industrial Segment is the largest and includes a significant portion of international operations.

Industrial - This segment produces a broad range of motion-control and fluid systems and components used in all kinds of manufacturing, packaging, processing, transportation, mobile construction, agricultural and military machinery and equipment. Sales are made directly to major original equipment manufacturers (OEMs) and through a broad distribution network to smaller OEMs and the aftermarket.

Aerospace - This segment designs and manufactures products and provides aftermarket support for commercial, business jet, military and general aviation aircraft, missile and spacecraft markets. The Aerospace Segment provides a full range of systems and components for hydraulic, pneumatic and fuel applications.

Climate & Industrial Controls - This segment manufactures motion-control systems and components for use primarily in the refrigeration and air conditioning and transportation industries.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Net sales				
Industrial:				
North America	$ 1,045,469	$ 847,208	$ 2,110,384	$ 1,630,293
International	1,147,231	932,057	2,240,212	1,782,307
Aerospace	459,630	400,551	896,310	817,407
Climate & Industrial Controls	214,334	174,892	449,031	361,866
Total	$ 2,866,664	$ 2,354,708	$ 5,695,937	$ 4,591,873
Segment operating income:				
Industrial:				
North America	$ 159,429	$ 114,435	$ 348,791	$ 190,606
International	167,776	82,636	351,576	144,459
Aerospace	63,644	41,026	107,420	94,172
Climate & Industrial Controls	9,501	6,144	31,053	16,641
Total segment operating income	400,350	244,241	838,840	445,878
Corporate general and administrative expenses	37,593	31,472	70,947	57,774
Income from operations before interest expense and other	362,757	212,769	767,893	388,104
Interest expense	25,631	25,029	50,264	50,752
Other expense	30,876	45,505	75,015	81,088
Income before income taxes	$ 306,250	$ 142,235	$ 642,614	$ 256,264

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Dollars in thousands, except per share amounts

1. Management representation

In the opinion of the management of the Company, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of December 31, 2010, the results of operations for the three and six months ended December 31, 2010 and 2009 and cash flows for the six months then ended. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s 2010 Annual Report on Form 10-K. Interim period results are not necessarily indicative of the results to be expected for the full fiscal year.

The Company has evaluated subsequent events that have occurred through the date these financial statements were issued. No subsequent events occurred that required either adjustment to or disclosure in these financial statements.

2. Product warranty

In the ordinary course of business, the Company warrants its products against defects in design, materials and workmanship over various time periods. The warranty accrual as of December 31, 2010 and June 30, 2010 is immaterial to the financial position of the Company and the change in the accrual for the current quarter and first six months of fiscal 2011 is immaterial to the Company s results of operations and cash flows.

3. Earnings per share

The following table presents a reconciliation of the numerator and denominator of basic and diluted earnings per share for the three and six months ended December 31, 2010 and 2009.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
<u>Numerator:</u>				
Net income attributable to common shareholders	$ 230,180	$ 104,546	$ 477,351	$ 178,039
<u>Denominator:</u>				
Basic - weighted average common shares	161,701,219	160,767,790	161,486,878	160,698,541
Increase in weighted average from dilutive effect of equity-based awards	4,400,316	1,976,998	3,303,911	1,679,541
Diluted - weighted average common shares, assuming exercise of equity-based awards	166,101,535	162,744,788	164,790,789	162,378,082
Basic earnings per share	$ 1.42	$ .65	$ 2.96	$ 1.11
Diluted earnings per share	$ 1.39	$ .64	$ 2.90	$ 1.10

3. Earnings per share, continued

For the three months ended December 31, 2010 and 2009, 48,390 and 7,905,697 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive. For the six months ended December 31, 2010 and 2009, 2,993,100 and 9,729,440 common shares subject to equity-based awards, respectively, were excluded from the computation of diluted earnings per share because the effect of their exercise would be anti-dilutive.

4. Share repurchase program

The Company has a program to repurchase its common shares. Under the program, the Company is authorized to repurchase an amount of common shares each fiscal year equal to the greater of 7.5 million shares or five percent of the shares outstanding as of the end of the prior fiscal year. Repurchases are funded primarily from operating cash flows and commercial paper borrowings, and the shares are initially held as treasury stock. During the three-month period ended December 31, 2010, the Company repurchased 248,238 shares of its common stock at an average price of $80.57 per share. Fiscal year-to-date, the Company repurchased 409,602 shares at an average price of $73.24 per share.

5. Accounts receivable, net

The Accounts receivable, net caption in the Consolidated Balance Sheet is comprised of the following components:

	December 31, 2010	June 30, 2010
Accounts receivable, trade	$ 1,428,110	$ 1,457,355
Allowance for doubtful accounts	(10,829)	(14,701)
Non-trade accounts receivable	86,330	58,091
Notes receivable	133,294	99,196
Total	$ 1,636,905	$ 1,599,941

Accounts receivable, trade are initially recorded at their net collectible amount and are generally recorded at the time the revenue from the sales transaction is recorded. Receivables are written off to bad debt primarily when in the judgment of the Company the receivable is deemed to be uncollectible due to insolvency of the debtor.

6. Business realignment charges

During the second quarter and first six months of fiscal 2011, the Company recorded charges of $1.7 million and $4.8 million, respectively, for the costs to structure its businesses in light of current and anticipated customer demand. The charges primarily consist of severance costs related to plant closures as well as general work force reductions implemented by various operating units throughout the world. The Company believes the realignment actions will positively impact future results of operations but will have no material effect on liquidity and sources and uses of capital. The Industrial Segment recognized all of the second quarter fiscal 2011 charge and recognized $4.5 million of the total charge for the first six months of fiscal 2011, relating to approximately 40 employees in the second quarter of fiscal 2011 and 210 employees in the first six months of fiscal 2011. The Aerospace Segment recognized $0.3 million of the total charge for the first six months of fiscal 2011 relating to approximately 20 employees. The charge is presented primarily in the Cost of sales caption in the Consolidated Statement of Income for the three and six months ended December 31, 2010. As of December 31, 2010, approximately $3.3 million in severance payments have been made with the remaining payments expected to be made by June 30, 2011.

6. Business realignment charges, continued

During the second quarter and first six months of fiscal 2010, the Company recorded charges of $7.1 million and $26.4 million, respectively, for the costs to structure its businesses in light of current and anticipated customer demand. The charges primarily consisted of severance costs related to plant closures as well as general work force reductions implemented by various operating units throughout the world. The Company believes the realignment actions will positively impact future results of operations but will have no material effect on liquidity and sources and uses of capital. The Industrial Segment recognized $5.6 million and $22.7 million of the total charge for the second quarter and first six months of fiscal 2010, respectively, relating to approximately 195 and 1,015 employees, respectively. The Climate & Industrial Controls Segment recognized $0.9 million and $3.1 million of the total charge for the second quarter and first six months of fiscal 2010, respectively, relating to approximately 237 employees for the first six months of fiscal 2010. The Aerospace Segment recognized $0.6 million of the total charge for the second quarter and first six months of fiscal 2010 relating to approximately 50 employees. The charge is presented primarily in the Cost of sales caption in the Consolidated Statement of Income for the three and six months ended December 31, 2009. All required severance payments have been made.

Additional charges to be recognized in future periods related to the specific actions discussed above are not expected to be material.

7. Equity

Changes in equity for the three months ended December 31, 2010 and December 31, 2009 are as follows (net of taxes amounts relate to Shareholders Equity):

	Shareholders Equity	Noncontrolling Interests	Total Equity
Balance September 30, 2010	$ 4,894,945	$ 97,632	$ 4,992,577
Net income	230,180	1,638	231,818
Other comprehensive income:			
Foreign currency translation (net of taxes of $12,397)	9,301	2,337	11,638
Retirement benefits plan activity (net of taxes of $11,647)	19,844		19,844
Net realized loss (net of taxes of $32)	51		51
Total comprehensive income	259,376	3,975	263,351
Dividends paid	(46,984)	(275)	(47,259)
Stock incentive plan activity	25,924		25,924
Shares purchased at cost	(20,000)		(20,000)
Balance December 31, 2010	$ 5,113,261	$ 101,332	$ 5,214,593

7. Equity, continued

	Shareholders Equity	Noncontrolling Interests	Total Equity
Balance September 30, 2009	$ 4,481,984	$ 87,629	$ 4,569,613
Net income	104,546	417	104,963
Other comprehensive (loss) income:			
Foreign currency translation (net of taxes of $5,199)	(22,935)	(2,281)	(25,216)
Retirement benefits plan activity (net of taxes of $7,613)	13,169		13,169
Net unrealized gain (net of taxes of $275)	442		442
Total comprehensive (loss) income	95,222	(1,864)	93,358
Dividends paid	(40,192)	(6)	(40,198)
Stock incentive plan activity	13,552		13,552
Shares purchased at cost	(5,000)		(5,000)
Retirement benefits plan activity	6,461		6,461
Balance December 31, 2009	$ 4,552,027	$ 85,759	$ 4,637,786

Changes in equity for the six months ended December 31, 2010 and December 31, 2009 are as follows (the net of taxes amounts relate to Shareholders Equity):

	Shareholders Equity	Noncontrolling Interests	Total Equity
Balance June 30, 2010	$ 4,367,965	$ 91,435	$ 4,459,400
Net income	477,351	3,497	480,848
Other comprehensive income:			
Foreign currency translation (net of taxes of $17,487)	288,701	6,675	295,376
Retirement benefits plan activity (net of taxes of $22,289)	38,062		38,062
Net realized loss (net of taxes of $68)	110		110
Total comprehensive income	804,224	10,172	814,396
Dividends paid	(90,632)	(275)	(90,907)
Stock incentive plan activity	61,704		61,704
Shares purchased at cost	(30,000)		(30,000)
Balance December 31, 2010	$ 5,113,261	$ 101,332	$ 5,214,593

7. Equity, continued

	Shareholders Equity	Noncontrolling Interests	Total Equity
Balance June 30, 2009	$ 4,268,199	$ 82,241	$ 4,350,440
Net income	178,039	894	178,933
Other comprehensive (loss) income:			
Foreign currency translation (net of taxes of $4,796)	115,033	2,630	117,663
Retirement benefits plan activity (net of taxes of $12,635)	22,056		22,056
Net unrealized gain (net of taxes of $254)	406		406
Total comprehensive income	315,534	3,524	319,058
Dividends paid	(80,363)	(6)	(80,369)
Stock incentive plan activity	43,127		43,127
Shares purchased at cost	(10,000)		(10,000)
Retirement benefits plan activity	15,530		15,530
Balance December 31, 2009	$ 4,552,027	$ 85,759	$ 4,637,786

8. Goodwill and intangible assets

The changes in the carrying amount of goodwill for the six months ended December 31, 2010 are as follows:

	Industrial Segment	Aerospace Segment	Climate & Industrial Controls Segment	Total
Balance June 30, 2010	$ 2,380,640	$ 98,856	$ 306,838	$ 2,786,334
Acquisitions	3,785		1,291	5,076
Foreign currency translation	114,886	29	4,084	118,999
Goodwill adjustments	296		24	320
Balance December 31, 2010	$ 2,499,607	$ 98,885	$ 312,237	$ 2,910,729

Goodwill adjustments primarily represented final adjustments to the purchase price allocation for acquisitions during the measurement period subsequent to the applicable acquisition dates. The Company s previously reported results of operations and financial position would not be materially different had the goodwill adjustments recorded during the first six months of fiscal 2011 been reflected in the same reporting period that the initial purchase price allocations for those acquisitions were made.

8. Goodwill and intangible assets, continued

Intangible assets are amortized on the straight-line method over their legal or estimated useful lives. The following summarizes the gross carrying value and accumulated amortization for each major category of intangible assets:

	December 31, 2010		June 30, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patents	$ 119,686	$ 54,629	$ 114,935	$ 48,682
Trademarks	307,238	99,620	289,017	83,936
Customer lists and other	1,199,289	293,052	1,125,782	247,065
Total	$ 1,626,213	$ 447,301	$ 1,529,734	$ 379,683

Total intangible amortization expense for the six months ended December 31, 2010 was $52,852. The estimated amortization expense for the five years ending June 30, 2011 through 2015 is $105,366, $96,818, $89,321, $83,767 and $81,057, respectively.

9. Retirement benefits

Net periodic pension cost recognized included the following components:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Service cost	$ 20,020	$ 17,316	$ 41,890	$ 36,383
Interest cost	43,573	44,880	86,845	88,087
Expected return on plan assets	(49,201)	(44,152)	(97,934)	(87,484)
Amortization of prior service cost	3,197	3,351	6,326	6,506
Amortization of net actuarial loss	28,361	17,094	54,159	32,601
Amortization of initial net (asset) obligation	(15)	(14)	(29)	(8)
Net periodic benefit cost	$ 45,935	$ 38,475	$ 91,257	$ 76,085

Postretirement benefit cost recognized included the following components:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Service cost	$ 136	$ 127	$ 275	$ 278
Interest cost	980	1,037	1,962	1,963
Net amortization and deferral and other	(113)	(114)	(228)	(229)
Net periodic benefit cost	$ 1,003	$ 1,050	$ 2,009	$ 2,012

During the first six months of fiscal 2011, the Company made $219 million in cash contributions to its qualified defined benefit plans and expects to contribute approximately $22 million in cash to its qualified defined benefit plans during the last six months of fiscal 2011. Most of the cash contributions are discretionary.

10. Debt

During the first six months of fiscal 2011, the Company issued $300,000 aggregate principal amount of Medium-Term Notes. The notes are due in a balloon payment in September 2022 and carry an annual interest rate of 3.5%. Interest payments are due semiannually. The Company used the net proceeds from the Medium-Term Note issuance to repay outstanding commercial paper borrowings.

11. Income taxes

As of December 31, 2010, the Company had gross unrecognized tax benefits of $76,507. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was $74,605. The accrued interest related to the gross unrecognized tax benefits, excluded from the amounts above, was $9,958.

The Company and its subsidiaries file income tax returns in the United States jurisdiction and various foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities throughout the world. The Company is no longer subject to examinations of its federal income tax returns by the Internal Revenue Service for fiscal years through 2007. All significant state, local and foreign tax returns have been examined for fiscal years through 2001. The Company does not anticipate that, within the next twelve months, the total amount of unrecognized tax benefits will significantly change due to the settlement of examinations and the expiration of statutes of limitation.

12. Financial instruments

The Company s financial instruments consist primarily of Cash and cash equivalents, long-term investments, and Accounts receivable, net as well as obligations under Accounts payable, trade, Notes payable and Long-term debt. Due to their short-term nature, the carrying values for Cash and cash equivalents, Accounts receivable, net, Accounts payable, trade and Notes payable approximate fair value. The carrying value of Long-term debt (excluding leases) was $1,843,385 and $1,758,845 at December 31, 2010 and June 30, 2010, respectively, and was estimated to have a fair value of $1,981,806 and $1,925,397 at December 31, 2010 and June 30, 2010, respectively. The fair value of Long-term debt was estimated using discounted cash flow analyses based on the Company s current incremental borrowing rate for similar types of borrowing arrangements.

The Company manages foreign currency transaction and translation risk by utilizing derivative and non-derivative financial instruments, including forward exchange contracts, costless collar contracts, cross-currency swap contracts and certain foreign denominated debt designated as net investment hedges. The derivative financial instrument contracts are with major investment grade financial institutions and the Company does not anticipate any material non-performance by any of the counterparties. The Company does not hold or issue derivative financial instruments for trading purposes.

The Company s euro bonds and Japanese yen credit facility have been designated as a hedge of the Company s net investment in certain foreign subsidiaries. The translation of the euro bonds and Japanese yen credit facility into U.S. dollars is recorded in accumulated other comprehensive income (loss) and remains there until the underlying net investment is sold or substantially liquidated.

Derivative financial instruments are recognized on the balance sheet as either assets or liabilities and are measured at fair value. Gains or losses on derivatives that are not hedges are adjusted to fair value through the Cost of sales caption in the Consolidated Statement of Income. Gains or losses on derivatives that are hedges are adjusted to fair value through Accumulated other comprehensive income (loss) in the Consolidated Balance Sheet until the hedged item is recognized in earnings.

12. Financial instruments, continued

During the first six months of fiscal 2011, the Company entered into 10-year cross-currency swap contracts with an aggregate notional amount of approximately 235 million and designated the cross-currency swap contracts as a hedge of the Company s net investment in certain foreign subsidiaries whose functional currency is the euro. Also during the first six months of fiscal 2011, the Company entered into forward exchange contracts with an aggregate notional amount of 200 million. The forward exchange contracts were entered into to hedge against foreign currency movements prior to the repayment of the Company s euro bonds that matured in November 2010. The forward exchange contracts were settled in November 2010.

The following summarizes the location and fair value of derivative financial instruments reported in the Consolidated Balance Sheet as of December 31, 2010 and June 30, 2010:

	Balance Sheet Caption	December 31, 2010	June 30, 2010
Net investment hedges			
Cross-currency swap contracts	Other liabilities	$ 18,739	$
Cash flow hedges			
Costless collar contracts	Accounts receivable	1,100	1,624
Costless collar contracts	Other accrued liabilities	4,472	2,334

The cross-currency swap contracts have been designated as hedging instruments. The costless collar contracts have not been designated as hedging instruments and are considered to be economic hedges of forecasted transactions.

Gains (losses) on derivative financial instruments that were recorded in the Consolidated Statement of Income are as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Forward exchange contracts	$ 3,245	$	$ 19,048	$
Costless collar contracts	(1,018)	(499)	(4,554)	(4,034)

Gains (losses) on derivative and non-derivative financial instruments that were recorded in accumulated other comprehensive income (loss) in the Consolidated Balance Sheet are as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Cross-currency swap contracts	$ 3,244	$	$ (11,577)	$
Foreign denominated debt	226	9,397	(36,334)	(8,092)

There was no ineffectiveness of the cross-currency swap contracts or foreign denominated debt, nor were any portion of these financial instruments excluded from the effectiveness testing, during the six months ending December 31, 2010 and 2009.

13. Fair value measurement

The fair value of financial assets and financial liabilities that were measured at fair value on a recurring basis at December 31, 2010 follows:

	Total	Quoted Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale equity securities	$ 3,542	$	$	$ 3,542
Derivatives	1,100		1,100	
Liabilities:				
Deferred compensation plans	119,841		119,841	
Derivatives	23,211		23,211	

The fair value of financial assets and financial liabilities that were measured at fair value on a recurring basis at June 30, 2010 follows:

	Total	Quoted Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale equity securities	$ 3,542	$	$	$ 3,542
Derivatives	1,624		1,624	
Liabilities:				
Deferred compensation plans	112,189		112,189	
Derivatives	2,334		2,334	

Available for sale securities consist of an investment in stock in an electronic and electrical equipment company the fair value of which was estimated using a market and income approach with equal weighting given to each approach. The market approach estimates a fair value by applying price-to-earnings multiples for similar companies that are publicly traded while the income approach estimates a fair value using a discounted cash flow analysis. There were no purchases, sales, issuances or settlements of available for sale securities during the six months ended December 31, 2010.

13. Fair value measurement, continued

The fair value of derivatives is calculated using a present value cash flow model that utilizes market observable inputs, including both spot and forward prices for the same underlying currencies, and have been adjusted to reflect the credit risk of either the Company or the counterparty.

The Company has established nonqualified deferred compensation programs that permit officers, directors and certain management employees to defer a portion of their compensation, on a pre-tax basis, until their termination of employment. Changes in the value of the compensation deferred under these programs are recognized based on the fair value of the participant s investment elections.

PARKER-HANNIFIN CORPORATION

FORM 10-Q

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2010

AND COMPARABLE PERIODS ENDED DECEMBER 31, 2009

OVERVIEW

The Company is a leading worldwide diversified manufacturer of motion and control technologies and systems, providing precision engineered solutions for a wide variety of mobile, industrial and aerospace markets.

The Company s order rates provide a near-term perspective of the Company s outlook particularly when viewed in the context of prior and future order rates. The Company publishes its order rates on a quarterly basis. The lead time between the time an order is received and revenue is realized generally ranges from one day to 12 weeks for mobile and industrial orders and from one day to 18 months for aerospace orders. The Company believes the leading economic indicators of these markets that have a strong correlation to the Company s future order rates are as follows:

- Purchasing Managers Index (PMI) on manufacturing activity specific to regions around the world with respect to most mobile and industrial markets;
- Aircraft miles flown and revenue passenger miles for commercial aerospace markets and Department of Defense spending for military aerospace markets; and
- Housing starts with respect to the North American residential air conditioning market and certain mobile construction markets.

A PMI above 50 indicates that the manufacturing activity specific to a region around the world in the mobile and industrial markets is expanding. A PMI below 50 indicates the opposite. The PMI at the end of December 2010 for the United States, the Eurozone countries and China was 57.0, 57.1 and 54.4, respectively. Since June 30, 2010 and September 30, 2010, the PMI for the United States, the Eurozone countries and China has increased.

Aircraft miles flown and revenue passenger miles have both increased approximately 8 percent from their comparable fiscal 2010 levels. The Company anticipates that U.S. Department of Defense spending with regards to appropriations and operations and maintenance for the U.S. Government s fiscal year 2011 will be about 6 percent higher than the comparable fiscal 2010 level.

Housing starts in December 2010 were approximately 8 percent lower than housing starts in December 2009.

The Company remains focused on maintaining its financial strength by adjusting its cost structure to reflect changing demand levels, maintaining a strong balance sheet and managing its cash. The Company continues to generate substantial cash flows from operations, has controlled capital spending and has proactively managed working capital. The Company has been able to borrow needed funds at affordable interest rates as demonstrated by the issuance of $300 million aggregate principal amount of Medium-Term Notes in September 2010, and currently has a debt to debt-shareholders equity ratio of 26.5 percent.

The Company believes many opportunities for profitable growth are available. The Company intends to focus primarily on business opportunities in the areas of energy, water, agriculture, environment, defense, life sciences, infrastructure and transportation.

The Company believes it can meet its strategic objectives by:

- Serving the customer and empowering its employees;
- Successfully executing its Win Strategy initiatives relating to premier customer service, financial performance and profitable growth;
- Engineering innovative systems and products to provide superior customer value through improved service, efficiency and productivity;
- Delivering products, systems and services that have demonstrable savings to customers and are priced by the value they deliver;
- Acquiring strategic businesses; and
- Organizing the Company around targeted regions, technologies and markets.

During the first six months of fiscal 2011, the Company completed two acquisitions. Acquisitions will continue to be considered from time to time to the extent there is a strong strategic fit, while at the same time, maintaining the Company s strong financial position. The Company will also continue to assess its existing businesses and initiate efforts to divest businesses that are not considered to be a good long-term strategic fit for the Company. Future business divestitures could have a negative effect on the Company s results of operations.

The discussion below is structured to separately discuss the Consolidated Statement of Income, Results by Business Segment, Consolidated Balance Sheet and Consolidated Statement of Cash Flows.

CONSOLIDATED STATEMENT OF INCOME

	Three months ended December 31,		Six months ended December 31,	
(dollars in millions)	2010	2009	2010	2009
Net sales	$ 2,866.6	$ 2,354.7	$ 5,695.9	$ 4,591.9
Gross profit	$ 670.9	$ 485.2	$ 1,362.3	$ 921.4
Gross profit margin	23.4%	20.6%	23.9%	20.1%
Selling, general and administrative expenses	$ 345.7	$ 309.8	$ 679.2	$ 611.7
Selling, general and administrative expenses, as a percent of sales	12.1%	13.2%	11.9%	13.3%
Interest expense	$ 25.6	$ 25.0	$ 50.3	$ 50.8
Other (income) expense, net	$ (6.6)	$ 8.1	$ (9.8)	$ 2.7
Effective tax rate	24.3%	26.2%	25.2%	30.2%
Net income	$ 231.8	$ 105.0	$ 480.8	$ 178.9
Net income, as a percent of sales	8.1%	4.5%	8.4%	3.9%

Net sales for the current-year quarter and first six months of fiscal 2011 increased 21.7 percent and 24.0 percent, respectively, over the comparable prior-year net sales amounts reflecting higher sales in all segments with the largest increase occurring in the Industrial Segment. Acquisitions made in the last 12 months contributed approximately $10 million and $14 million in sales in the current-year quarter and first six months of fiscal 2011, respectively. The effect of currency rate changes decreased net sales by approximately $21 million and $47 million in the current-year quarter and first six months of fiscal 2011, respectively.

Gross profit margin increased for the current-year quarter and first six months of fiscal 2011 primarily due to a combination of the higher sales volume, resulting in manufacturing efficiencies, as well as lower business realignment expenses recorded in the current-year quarter and first six months of fiscal 2011 as compared to the prior-year quarter and first six months.

Selling, general and administrative expenses increased for the current-year quarter and first six months of fiscal 2011 primarily due to the higher sales volume as well as higher incentive compensation.

Interest expense for the current-year quarter was slightly higher than the prior-year quarter primarily due to the debt portfolio in the current-year quarter having a slightly higher average interest rate than the prior-year quarter debt portfolio. Interest expense for the six months of fiscal 2011 was lower than the first six months of fiscal 2010 primarily due to a lower amount of average debt outstanding.

Other (income) expense, net for the current-year quarter and first six months of fiscal 2011 includes a $2.3 million gain from the sale of intellectual property. Other (income) expense, net for the current-year quarter and first six months of fiscal 2011 includes a gain of $4.1 million and $4.6 million, respectively, related to the sale of real estate. Other (income) expense, net for the prior-year quarter and first six months of fiscal 2010 included $7.7 million of asset writedowns, including assets related to a business that was being held for sale. Other (income) expense, net for the first six months of fiscal 2010 also included income of $3.2 million related to the restructuring of the Company s executive life insurance program.

Effective tax rate for the current-year quarter and first six months of fiscal 2011 was lower than the prior-year quarter and first six months of fiscal 2010 due primarily to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Tax Extender Legislation) that was passed by Congress in December 2010. The Tax Extender Legislation restored the U.S. research tax credit and extended certain favorable foreign income tax provisions. The effective tax rate for the current-year quarter reflects a discrete tax benefit of approximately $5 million for the catch up on the U.S. research tax credit for the last six months of calendar 2010. The Company expects the effective tax rate for fiscal 2011 will be approximately 27 percent.

RESULTS BY BUSINESS SEGMENT

Industrial Segment

	Three months ended December 31,		Six months ended December 31,	
(dollars in millions)	2010	2009	2010	2009
Net sales				
North America	$ 1,045.5	$ 847.2	$ 2,110.4	$ 1,630.3
International	1,147.2	932.1	2,240.2	1,782.3
Operating income				
North America	159.4	114.4	348.8	190.6
International	$ 167.8	$ 82.6	$ 351.6	$ 144.5
Operating margin				
North America	15.2%	13.5%	16.5%	11.7%
International	14.6%	8.9%	15.7%	8.1%
Backlog	$ 1,703.2	$ 1,318.2	$ 1,703.2	$ 1,318.2

The Industrial Segment operations experienced the following percentage changes in net sales in the current-year compared to the equivalent prior-year period:

	Period ending December 31	
	Three months	Six months
Industrial North America as reported	23.4%	29.4%
Acquisitions	0.5%	0.2%
Currency	0.5%	0.5%
Industrial North America without acquisitions and currency	22.4%	28.7%

Industrial International	as reported	23.1%	25.7%
Acquisitions		0.1%	0.1%
Currency		(2.6)%	(2.9)%
Industrial International	without acquisitions and currency	25.6%	28.5%
Total Industrial Segment	as reported	23.2%	27.5%
Acquisitions		0.3%	0.2%
Currency		(1.1)%	(1.3)%
Total Industrial Segment	without acquisitions and currency	24.0%	28.6%

The above presentation reconciles the percentage changes in net sales of the Industrial operations reported in accordance with U.S. GAAP to percentage changes in net sales adjusted to remove the effects of acquisitions made within the prior four fiscal quarters as well as the effects of currency exchange rates. The effects of acquisitions and currency exchange rates are removed to allow investors and the Company to meaningfully evaluate the percentage changes in net sales on a comparable basis from period to period.

Excluding the effects of acquisitions and currency exchange rates, the increase in Industrial North American sales for the current-year quarter and first six months of fiscal 2011 reflects higher demand experienced from distributors and end-users in virtually all markets, particularly in the construction equipment, heavy-duty truck, mining, farm and agriculture equipment and machine tool markets. The increase in Industrial International sales for the current-year quarter and first six months of fiscal 2011 is primarily attributed to higher end-user demand experienced across most markets in all regions, with the largest increase in volume being experienced in Europe.

The increase in margins in both the Industrial North American and Industrial International businesses for the current-year quarter and first six months of fiscal 2011 is primarily due to the higher sales volume, resulting in manufacturing efficiencies, and a lower fixed cost structure resulting from past business realignment actions.

Included in Industrial North American operating income are business realignment charges of $1.5 million and $3.6 million in the current-year quarter and prior-year quarter, respectively, and $3.8 million and $8.3 million for the first six months of fiscal 2011 and 2010, respectively. Included in Industrial International operating income are business realignment charges of $0.2 million and $2.0 million in the current-year quarter and prior-year quarter, respectively, and $0.7 million and $14.4 million for the first six months of fiscal 2011 and 2010, respectively. The business realignment expenses consist primarily of severance costs resulting from plant closures as well as general reductions in the work force. The Company does not anticipate that cost savings realized from the workforce reductions taken during the first six months of fiscal 2011 will have a material impact on future operating margins. The Company expects to continue to take the actions necessary to structure appropriately the operations of the Industrial Segment. Such actions may include the necessity to record additional business realignment charges in fiscal 2011, the timing and amount of which has not been finalized.

The increase in backlog from the prior-year quarter and from the June 30, 2010 amount of $1,505.0 million is primarily due to higher order rates in most markets in both the Industrial North American and Industrial International businesses with the Industrial International businesses experiencing a greater portion of the increase from June 30, 2010. The Company anticipates Industrial North American sales for fiscal 2011 will increase between 19.8 percent and 21.8 percent from the fiscal 2010 level and Industrial International sales for fiscal 2011 will increase between 18.6 percent and 20.6 percent from the fiscal 2010 level. The expected higher sales levels for fiscal 2011 are primarily due to higher end-user demand expected in most markets. Industrial North American operating margins in fiscal 2011 are expected to range from 16.2 percent to 16.8 percent and Industrial International operating margins are expected to range from 15.1 percent to 15.7 percent.

Aerospace Segment

(dollars in millions)	Three months ended December 31, 2010	2009	Six months ended December 31, 2010	2009
Net sales	$ 459.6	$ 400.6	$ 896.3	$ 817.4
Operating income	$ 63.6	$ 41.0	$ 107.4	$ 94.2
Operating margin	13.8%	10.2%	12.0%	11.5%
Backlog	$ 1,702.7	$ 1,458.7	$ 1,702.7	$ 1,458.7

The increase in net sales in the current-year quarter and first six months of fiscal 2011 in the Aerospace Segment is primarily due to an increase in both commercial original equipment manufacturer (OEM) and aftermarket volume partially offset by lower military aftermarket volume. Net sales in the current-year quarter also benefited from higher military OEM volume. The higher margins in the current-year quarter and first six months of fiscal 2011 were primarily due to the higher sales volume, particularly in the higher margin commercial aftermarket businesses, partially offset by higher engineering development costs. Margins for the current-year quarter also include the favorable effect of retroactive billings and contract reserve adjustments resulting from the finalization of contract price negotiations related to certain programs.

The increase in backlog from the prior-year quarter and from the June 30, 2010 amount of $1,474.4 million is primarily due to higher order rates in both the commercial OEM and aftermarket businesses as well as the military OEM business. For fiscal 2011, sales are expected to increase between 6.7 percent and 8.7 percent from the fiscal 2010 level primarily due to anticipated higher commercial OEM and aftermarket volume. Operating margins are expected to range from 13.6 percent to 13.9 percent. A higher than expected concentration of commercial OEM volume in future product mix and higher than expected new product development costs could result in lower margins.

Climate & Industrial Controls Segment

(dollars in millions)	Three months ended December 31, 2010	2009	Six months ended December 31, 2010	2009
Net sales	$ 214.3	$ 174.9	$ 449.0	$ 361.9
Operating income	$ 9.5	$ 6.1	$ 31.1	$ 16.6
Operating margin	4.4%	3.5%	6.9%	4.6%
Backlog	$ 174.1	$ 130.5	$ 174.1	$ 130.5

The increase in net sales in the Climate & Industrial Controls Segment in the current-year quarter and first six months of fiscal 2011 is primarily due to higher end-user demand in the heavy-duty truck, automotive and commercial refrigeration markets. Margins in the current-year quarter and first six months of fiscal 2011 were higher primarily due to the higher sales volume and a favorable product mix. Margins in both the current-year quarter and first six months of fiscal 2011 were adversely affected by higher material costs as well as operating inefficiencies, which primarily include overtime and premium freight charges. Included in operating income for the prior-year quarter and first six months of fiscal 2010 were business realignment charges of $0.8 million and $3.1 million, respectively. The Company may take further actions to structure appropriately the operations of the Climate & Industrial Controls Segment. Such actions may include the necessity to record business realignment charges in fiscal 2011.

The increase in backlog from the prior-year quarter and from the June 30, 2010 amount of $161.9 million is primarily due to higher orders in the heavy-duty truck, automotive and commercial refrigeration markets. For fiscal 2011, sales are expected to increase between 14.6 percent and 15.6 percent from the fiscal 2010 level and operating margins are expected to range from 8.3 percent to 8.8 percent.

Corporate general and administrative expenses

Corporate general and administrative expenses were $37.6 million in the current-year quarter compared to $31.5 million in the prior-year quarter and were $70.9 million for the first six months of fiscal 2011 compared to $57.8 million for the first six months of fiscal 2010. As a percent of sales, corporate general and administrative expenses for the current-year quarter remained at the prior-year quarter level of 1.3 percent and decreased to 1.2 percent for the first six months of fiscal 2011 compared to 1.3 percent for the first six months of fiscal 2010. The higher expense for the current-year quarter and first six months of fiscal 2011 is primarily due to higher incentive compensation expenses.

Other expense (in the Business Segment Results) included the following:

(in millions)	Three months ended December 31,		Six months ended December 31,	
Expense (income)	2010	2009	2010	2009
Currency transaction loss	$ 2.3	$ 5.1	$ 2.2	$ 7.9
Stock compensation	8.1	7.4	33.2	30.5
Asset sales and writedowns	(5.2)	7.7	(5.4)	5.5
Pensions	18.8	13.7	37.0	25.0
Other items, net	6.9	11.6	8.0	12.2
	$ 30.9	$ 45.5	$ 75.0	$ 81.1

CONSOLIDATED BALANCE SHEET

(dollars in millions)	December 31, 2010	June 30, 2010
Accounts receivable, net	$ 1,636.9	$ 1,599.9
Inventories	1,361.5	1,171.7
Plant and equipment, net of accumulated depreciation	1,764.6	1,697.9
Goodwill	2,910.7	2,786.3
Intangible assets, net	1,178.9	1,150.1
Notes payable	101.3	363.3
Accounts payable, trade	960.6	888.7
Accrued payrolls and other compensation	308.4	371.4
Accrued domestic and foreign taxes	149.0	176.3
Other liabilities	242.0	196.2
Shareholders equity	5,113.3	4,368.0
Working capital	$ 2,103.1	$ 1,383.9
Current ratio	2.08	1.63

Accounts receivable, net are primarily receivables due from customers for sales of product ($1,417 million at December 31, 2010 and $1,443 million at June 30, 2010). Days sales outstanding relating to trade accounts receivable was 46 days at December 31, 2010 and 48 days at June 30, 2010. The Company believes that its receivables are collectible and appropriate allowances for doubtful accounts have been recorded.

Inventories increased $190 million, primarily in the Industrial Segment, in response to positive order trends. Days supply of inventory increased to 62 days from 58 days at June 30, 2010.

Notes payable decreased due to the $257 million payment of the Euro Bonds in the current-year quarter.

Accounts payable, trade increased from June 30, 2010 primarily due to increased production levels and the timing of payments.

Accrued payrolls and other compensation decreased primarily due to the payment of incentive compensation during fiscal 2011 that had been accrued as of June 30, 2010.

Accrued domestic and foreign taxes decreased primarily due to the payment of estimated income taxes during fiscal 2011 that had been accrued as of June 30, 2010.

Other liabilities increased primarily due to the cross-currency swap contracts the Company entered during the current fiscal year.

Shareholders equity included an increase of $289 million related to foreign currency translation adjustments and primarily affected Accounts receivable, Inventories, Plant and equipment, Goodwill, Intangible assets, Accounts payable, trade and Long-term debt.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Six months ended December 31,	
(in millions)	2010	2009
Cash provided by (used in):		
Operating activities	$ 408.2	$ 606.3
Investing activities	(145.3)	(69.9)
Financing activities	(66.4)	(484.3)
Effect of exchange rates	36.7	(5.8)
Net increase in cash and cash equivalents	233.2	46.3

Cash flows from operating activities decreased from the first six months of fiscal 2010 primarily as a result of a $200 million voluntary contribution made to the Company s qualified defined benefit pension plan. Also, cash flow used for working capital increased primarily due to higher inventory and accounts receivable levels. The Company continues to focus on managing its inventory and other working capital requirements.

Cash flows used in investing activities increased from the prior year as economic uncertainties in the prior year resulted in the Company reducing its acquisition activity and limiting capital expenditures during such year. The Company completed two acquisitions in fiscal 2011. Also, capital expenditures, as a percent of sales, increased to 1.9 percent for the first six months of fiscal 2011 as compared to 1.3 percent in the first six months of fiscal 2010.

Cash flows used in financing activities in fiscal 2011 included the issuance of $300 million aggregate principal amount of Medium-Term Notes and payments of approximately $257 million related to the Euro Bonds which matured in November 2010. In the prior year, the Company used cash to repay its commercial paper borrowings.

The Company's goal is to maintain no less than an "A" rating on senior debt to ensure availability and reasonable cost of external funds. As a means of achieving this objective, the Company has established a financial goal of maintaining a ratio of debt to debt-shareholders equity of no more than 37 percent.

(In millions) Debt to Debt-Shareholders Equity Ratio	December 31, 2010	June 30, 2010
Debt	$ 1,844	$ 1,777
Debt & Shareholders equity	6,957	6,145
Ratio	26.5%	28.9%

The Company has a line of credit totaling $1,500 million through a multi-currency revolving credit agreement with a group of banks, all of which was available as of December 31, 2010. The credit agreement expires in September 2012; however, the Company has the right to request a one-year extension of the expiration date on an annual basis, which request may result in changes to the current terms and conditions of the credit agreement. A portion of the credit agreement supports the Company s commercial paper note program, which is rated A-1 by Standard & Poor s, P-1 by Moody s and F-1 by Fitch Ratings. These ratings are considered investment grade. The revolving credit agreement requires a facility fee of 4.5/100ths of one percent of the commitment per annum at the Company s present rating level. The revolving credit agreement contains provisions that increase the facility fee of the credit agreement in the event the Company s credit ratings are lowered. Although a lowering of the Company s credit ratings would likely increase the cost of future debt, it would not limit the Company s ability to use the credit agreement nor would it accelerate the repayment of any outstanding borrowings.

The Company is currently authorized to sell up to $1,370 million of short-term commercial paper notes. No commercial paper notes were outstanding as of December 31, 2010 and the largest amount of commercial paper notes outstanding during the second quarter of fiscal 2011 was $118 million.

The Company s credit agreements and indentures governing certain debt agreements contain various covenants, the violation of which would limit or preclude the use of the credit agreements for future borrowings, or might accelerate the maturity of the related outstanding borrowings covered by the indentures. At the Company s present rating level, the most restrictive financial covenants provide that the ratio of secured debt to net tangible assets be less than 10 percent. However, the Company currently does not have secured debt in its debt portfolio. The Company is in compliance with all covenants and expects to remain in compliance during the term of the credit agreements and indentures.

The Company s principal sources of liquidity are its cash flows provided from operating activities and borrowings either from or directly supported by its line of credit. The Company s ability to borrow has not been affected by a lack of general credit and the Company does not foresee any impediments to borrow funds at favorable interest rates in the near future. The Company expects that its ability to generate cash from its operations and ability to borrow directly from its line of credit or sources directly supported by its line of credit should be sufficient to support working capital needs, planned growth, benefit plan funding, dividend payments and share repurchases in the near term.

CRITICAL ACCOUNTING POLICIES

Impairment of Goodwill and Long-Lived Assets - Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests whenever events or circumstances indicate that the carrying value of a reporting unit may exceed its fair value. For the Company, a reporting unit is one level below the operating segment level. Determining whether an impairment has occurred requires the valuation of the respective reporting unit, which the Company has consistently estimated using a discounted cash flow model. The Company believes that the use of a discounted cash flow model results in the most accurate calculation of a reporting unit s fair value because the market value for a reporting unit is not readily available. The discounted cash flow analysis requires several assumptions, including future sales growth and operating margin levels, as well as assumptions regarding future industry specific market conditions. Each reporting unit regularly prepares discrete operating forecasts and uses these forecasts as the basis for the assumptions used in the discounted cash flow analyses. The Company has consistently used a discount rate commensurate with its cost of capital, adjusted for inherent business risks and has consistently used a terminal growth factor of 2.5 percent. The Company also reconciles the estimated aggregate fair value of its reporting units as derived from the discounted cash flow analyses to the Company s overall market capitalization.

The Company continually monitors its reporting units for impairment indicators and updates assumptions used in the most recent calculation of the fair value of a reporting unit as appropriate. The Company is unaware of any current market trends that are contrary to the assumptions made in the most recent estimation of the fair value of any of its reporting units. If the expected recovery of the current economic environment is not consistent with the Company s current expectations, it is possible that the estimated fair value of certain reporting units could fall below their carrying value resulting in the necessity to conduct additional goodwill impairment tests. The annual goodwill impairment test for fiscal 2011 is currently in process and is expected to be completed by the end of the third quarter of fiscal 2011.

Long-lived assets held for use, which primarily includes finite lived intangible assets and property, plant and equipment, are evaluated for impairment whenever events or circumstances indicate that the undiscounted net cash flows to be generated by their use over their expected useful lives and eventual disposition are less than their net carrying value. The long-term nature of these assets requires the estimation of their cash inflows and outflows several years into the future and only takes into consideration technological advances known at the time of the impairment test. During the first six months of fiscal 2011, there were no events or circumstances that indicated that the net carrying value of the Company s long-lived assets was not recoverable.

FORWARD-LOOKING STATEMENTS

Forward-looking statements contained in this and other written and oral reports are made based on known events and circumstances at the time of release, and as such, are subject in the future to unforeseen uncertainties and risks. All statements regarding future performance, earnings projections, events or developments are forward-looking statements. It is possible that the future performance and earnings projections of the Company, including its individual segments, may differ materially from current expectations, depending on economic conditions within its mobile, industrial and aerospace markets, and the Company s ability to maintain and achieve anticipated benefits associated with announced realignment activities, strategic initiatives to improve operating margins, actions taken to combat the effects of the current economic environment, and growth, innovation and global diversification initiatives. A change in the economic conditions in individual markets may have a particularly volatile effect on segment performance.

Among other factors which may affect future performance are:

- changes in business relationships with and purchases by or from major customers, suppliers or distributors, including delays or cancellations in shipments, disputes regarding contract terms or significant changes in financial condition, changes in contract cost and revenue estimates for new development programs and changes in product mix,
- uncertainties surrounding timing, successful completion or integration of acquisitions,
- ability to realize anticipated costs savings from business realignment activities,
- threats associated with and efforts to combat terrorism,
- uncertainties surrounding the ultimate resolution of outstanding legal proceedings, including the outcome of any appeals,
- competitive market conditions and resulting effects on sales and pricing,
- increases in raw material costs that cannot be recovered in product pricing,
- the Company s ability to manage costs related to insurance and employee retirement and health care benefits, and

global economic factors, including manufacturing activity, air travel trends, currency exchange rates, difficulties entering new markets and general economic conditions such as inflation, deflation, interest rates and credit availability.

The Company makes these statements as of the date of this disclosure, and undertakes no obligation to update them unless otherwise required by law.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company manages foreign currency transaction and translation risk by utilizing derivative and non-derivative financial instruments, including forward exchange contracts, costless collar contracts and cross-currency swap contracts and certain foreign denominated debt designated as net investment hedges. The derivative financial instrument contracts are with major investment grade financial institutions and the Company does not anticipate any material non-performance by any of the counterparties. The Company does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are recognized on the balance sheet as either assets or liabilities and are measured at fair value. Further information on the fair value of these contracts is provided in Notes 12 and 13 to the Consolidated Financial Statements. Gains or losses on derivatives that are not hedges are adjusted to fair value through the Consolidated Statement of Income. Gains or losses on derivatives that are hedges are adjusted to fair value through accumulated other comprehensive income (loss) in the Consolidated Balance Sheet until the hedged item is recognized in earnings. The translation of the foreign denominated debt that has been designated as a net investment hedge is recorded in accumulated other comprehensive income (loss) and remains there until the underlying net investment is sold or substantially liquidated.

The Company s debt portfolio contains variable rate debt, inherently exposing the Company to interest rate risk. The Company s objective is to maintain a 60/40 mix between fixed rate and variable rate debt thereby limiting its exposure to changes in near-term interest rates.

ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s principal executive officer and principal financial officer, of the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the second quarter of fiscal 2011. Based on this evaluation, the principal executive officer and principal financial officer have concluded that the Company s disclosure controls and procedures are effective.

There has been no change in the Company s internal control over financial reporting during the quarter ended December 31, 2010 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PARKER-HANNIFIN CORPORATION

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings. Parker ITR S.r.l. (Parker ITR), a subsidiary acquired on January 31, 2002, has been the subject of a number of lawsuits and regulatory investigations. The lawsuits and investigations relate to allegations that for a period of up to 21 years, the Parker ITR business unit that manufactures and sells marine hose, typically used in oil transfer, conspired with competitors in unreasonable restraint of trade to artificially raise, fix, maintain or stabilize prices, rig bids and allocate markets and customers for marine oil and gas hose in the United States and in other jurisdictions. Parker ITR and the Company have cooperated with all of the regulatory authorities investigating the activities of the Parker ITR business unit that manufactures and sells marine hose and continue to cooperate with the investigations that remain ongoing. Several of the investigations and all but one of the lawsuits have concluded. The following investigations and lawsuit remain pending or were resolved after September 30, 2010.

Brazilian competition authorities commenced their investigations on November 14, 2007. Parker ITR filed a procedural defense in January 2008. The Brazilian competition authorities have not yet responded to Parker ITR s filing. The Brazilian competition authorities investigation is ongoing and the Company and Parker ITR continue to cooperate. The Brazilian authorities appear to be investigating the period from 1999 through May 2007. Because the Brazilian competition authorities have not yet responded to Parker ITR s initial filing, the potential outcome of this investigation is uncertain and will depend on the resolution of numerous issues not yet addressed at the current preliminary stage of the investigation.

On May 15, 2007, the European Commission issued its initial Request for Information to the Company and Parker ITR. On January 28, 2009, the European Commission announced the results of its investigation of the alleged cartel activities. As part of its decision, the European Commission found that Parker ITR infringed Article 81 of the European Commission treaty from April 1986 to May 2, 2007 and fined Parker ITR 25.61 million euros. The European Commission also determined that the Company was jointly and severally responsible for 8.32 million euros of the total fine which related to the period from January 2002, when the Company acquired Parker ITR, to May 2, 2007, when the cartel activities ceased. Parker ITR and the Company filed an appeal to the Court of First Instance of the European Communities on April 10, 2009, which is pending.

A lawsuit was filed against the Company and Parker ITR on May 25, 2010 under the False Claims Act in the Central District of California: The United States of America ex rel. Douglas Farrow v. Trelleborg, AB et al. The United States declined to intervene against the Company or Parker ITR in the case. Plaintiff generally seeks treble damages, penalties for each false claim and attorneys fees. The court dismissed the complaint with prejudice as to the Company, but it remains pending against Parker ITR.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

(a) ***Unregistered Sales of Equity Securities.*** Not applicable.

(b) ***Use of Proceeds.*** Not applicable.

(c) ***Issuer Purchases of Equity Securities.***

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2010 through October 31, 2010	54,513 (2)	$ 72.26	46,100	9,014,858
November 1, 2010 through November 30, 2010	85,400	$ 79.62	85,400	8,929,458
December 1, 2010 through December 31, 2010	116,738	$ 84.56	116,738	8,812,720
Total:	256,651	$ 80.30	248,238	8,812,720

(1) On August 16, 1990, the Company publicly announced that its Board of Directors authorized the repurchase by the Company of up to 3.0 million shares of its common stock. From time to time, the Board of Directors has adjusted the number of shares authorized for repurchase under this program. On January 28, 2009, the Finance Committee of the Board of Directors of the Company approved an increase in the number of shares authorized for repurchase under this program so that, beginning on such date, the aggregate number of shares authorized for repurchase was equal to 10 million. Subject to this overall limitation, each fiscal year the Company is authorized to repurchase an amount of common shares equal to the greater of 7.5 million shares or five percent of the shares outstanding as of the end of the prior fiscal year. There is no expiration date for this program.

(2) Includes: (i) 4,573 shares surrendered to the Company by an executive officer to satisfy tax withholding obligations on restricted stock issued under the Company s Long Term Incentive Awards; (ii) 3,390 shares surrendered to the Company by certain non-employee directors to satisfy tax withholding obligations on restricted stock issued under the Company s Non-Employee Director s Stock Plan; and (iii) 450 shares forfeited by a non-employee director upon his retirement.

ITEM 6. Exhibits.

The following documents are furnished as exhibits and are numbered pursuant to Item 601 of Regulation S-K:

Exhibit No.	**Description of Exhibit**
10(a)	Parker-Hannifin Corporation Non-Employee Directors Restricted Stock Award Agreement.*
10(b)	Parker-Hannifin Corporation Non-Employee Directors Restricted Stock Award Terms and Conditions.*
10(c)	Summary of the Compensation of the Non-Employee Members of the Board of Directors, effective October 1, 2010.*

10(d)	Parker-Hannifin Corporation 2010 Performance Bonus Plan incorporated by reference to Appendix A to the Company s Definitive Proxy Statement filed with the Commission on September 27, 2010 (Commission File No. 1-4982).
12	Computation of Ratio of Earnings to Fixed Charges as of December 31, 2010.*
31(i)(a)	Certification of the Principal Executive Officer Pursuant to 17 CFR 240.13a-14(a), as Adopted Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
31(i)(b)	Certification of the Principal Financial Officer Pursuant to 17 CFR 240.13a-14(a), as Adopted Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
32	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to §906 of the Sarbanes-Oxley Act of 2002. *
101.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*

* Submitted electronically herewith.
Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statement of Income for the three months ended December 31, 2010 and 2009, (ii) Consolidated Statement of Income for the six months ended December 31, 2010 and 2009, (iii) Consolidated Balance Sheet at December 31, 2010 and June 30, 2010, (iv) Consolidated Statement of Cash Flows for the six months ended December 31, 2010 and 2009 and (v) Notes to Consolidated Financial Statements for the six months ended December 31, 2010.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

SIGNATURE

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

PARKER-HANNIFIN CORPORATION

(Registrant)

/s/ Jon P. Marten
Jon P. Marten

Executive Vice President-Finance and Administration

and Chief Financial Officer

Date: February 8, 2011

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