

PARKER HANNIFIN CORP
Form 10-Q
November 08, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 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)

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

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

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

| | |
|--|--|
| Large accelerated filer <input checked="" type="checkbox"/> | Accelerated filer <input type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

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

Number of Common Shares outstanding at September 30, 2010 161,331,980

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 September 30, | |
|---|---|--------------|
| | 2010 | 2009 |
| Net sales | \$ 2,829,273 | \$ 2,237,165 |
| Cost of sales | 2,137,874 | 1,800,945 |
| Gross profit | 691,399 | 436,220 |
| Selling, general and administrative expenses | 333,584 | 301,843 |
| Interest expense | 24,633 | 25,723 |
| Other (income), net | (3,182) | (5,375) |
| Income before income taxes | 336,364 | 114,029 |
| Income taxes | 87,334 | 40,059 |
| Net income | 249,030 | 73,970 |
| Less: Noncontrolling interest in subsidiaries earnings | 1,859 | 477 |
| Net income attributable to common shareholders | \$ 247,171 | \$ 73,493 |
| Earnings per share attributable to common shareholders: | | |
| Basic | \$ 1.53 | \$.46 |
| Diluted | \$ 1.51 | \$.45 |
| Cash dividends per common share | \$.27 | \$.25 |

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION

CONSOLIDATED BALANCE SHEET

(Dollars in thousands)

| | (Unaudited) September 30, 2010 | June 30, 2010 |
|---|--------------------------------------|------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 923,836 | \$ 575,526 |
| Accounts receivable, net | 1,694,313 | 1,599,941 |
| Inventories: | | |
| Finished products | 509,613 | 465,477 |
| Work in process | 623,866 | 564,204 |
| Raw materials | 161,658 | 141,974 |
| | 1,295,137 | 1,171,655 |
| Prepaid expenses | 104,216 | 111,545 |
| Deferred income taxes | 130,094 | 130,129 |
| Total current assets | 4,147,596 | 3,588,796 |
| Plant and equipment | 4,765,948 | 4,553,997 |
| Less accumulated depreciation | 2,994,965 | 2,856,116 |
| | 1,770,983 | 1,697,881 |
| Goodwill | 2,915,602 | 2,786,334 |
| Intangible assets, net | 1,180,021 | 1,150,051 |
| Other assets | 695,519 | 687,320 |
| Total assets | \$ 10,709,721 | \$ 9,910,382 |
| LIABILITIES | | |
| Current liabilities: | | |
| Notes payable | \$ 391,303 | \$ 363,272 |
| Accounts payable, trade | 953,259 | 888,743 |
| Accrued payrolls and other compensation | 310,462 | 371,393 |
| Accrued domestic and foreign taxes | 195,455 | 176,349 |
| Other accrued liabilities | 431,625 | 405,134 |
| Total current liabilities | 2,282,104 | 2,204,891 |
| Long-term debt | 1,745,812 | 1,413,634 |
| Pensions and other postretirement benefits | 1,327,195 | 1,500,928 |
| Deferred income taxes | 149,701 | 135,321 |
| Other liabilities | 212,332 | 196,208 |
| Total liabilities | 5,717,144 | 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 September 30 and June 30 | 90,523 | 90,523 |

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| | | |
|---|---------------|--------------|
| Additional capital | 664,265 | 637,442 |
| Retained earnings | 6,284,148 | 6,086,545 |
| Accumulated other comprehensive (loss) | (910,884) | (1,208,561) |
| Treasury shares, at cost; 19,714,148 shares at September 30 and 19,790,110 at June 30 | (1,233,107) | (1,237,984) |
| Total shareholders' equity | 4,894,945 | 4,367,965 |
| Noncontrolling interests | 97,632 | 91,435 |
| Total equity | 4,992,577 | 4,459,400 |
| Total liabilities and equity | \$ 10,709,721 | \$ 9,910,382 |

See accompanying notes to consolidated financial statements.

PARKER-HANNIFIN CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

| | Three Months Ended September 30, | |
|---|---|-------------|
| | 2010 | 2009 |
| <u>CASH FLOWS FROM OPERATING ACTIVITIES</u> | | |
| Net income | \$ 249,030 | \$ 73,970 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation | 57,738 | 64,165 |
| Amortization | 27,248 | 28,798 |
| Share incentive plan compensation | 29,242 | 26,436 |
| Deferred income taxes | 31,033 | (16,011) |
| Foreign currency transaction loss (gain) | 7,934 | (4,096) |
| (Gain) on sale of plant and equipment | (209) | (2,194) |
| Changes in assets and liabilities, net of effects from acquisitions: | | |
| Accounts receivable | (20,281) | (2,682) |
| Inventories | (68,538) | 17,863 |
| Prepaid expenses | 10,764 | 42,962 |
| Other assets | (7,243) | 25,690 |
| Accounts payable, trade | 33,863 | 110 |
| Accrued payrolls and other compensation | (68,653) | (82,069) |
| Accrued domestic and foreign taxes | 13,099 | 29,760 |
| Other accrued liabilities | 8,843 | 35,792 |
| Pensions and other postretirement benefits | (169,958) | 25,177 |
| Other liabilities | (11,032) | (3,618) |
| Net cash provided by operating activities | 122,880 | 260,053 |
| <u>CASH FLOWS FROM INVESTING ACTIVITIES</u> | | |
| Acquisitions (less acquired cash of \$1 in 2010) | (8,129) | |
| Capital expenditures | (52,690) | (30,099) |
| Proceeds from sale of plant and equipment | 2,169 | 4,422 |
| Other | (318) | (1,334) |
| Net cash (used in) investing activities | (58,968) | (27,011) |
| <u>CASH FLOWS FROM FINANCING ACTIVITIES</u> | | |
| Proceeds from exercise of stock options | 3,585 | 2,868 |
| (Payments for) common shares | (10,000) | (5,000) |
| Tax benefit from share incentive plan compensation | 3,110 | 886 |
| (Payments of) notes payable, net | (539) | (190,983) |
| Proceeds from long-term borrowings | 294,551 | 679 |
| (Payments of) long-term borrowings | (60) | (6,975) |
| Dividends | (43,648) | (40,171) |
| Net cash provided by (used in) financing activities | 246,999 | (238,696) |
| Effect of exchange rate changes on cash | 37,399 | 7,892 |

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| | | |
|--|------------|------------|
| Net increase in cash and cash equivalents | 348,310 | 2,238 |
| Cash and cash equivalents at beginning of year | 575,526 | 187,611 |
| Cash and cash equivalents at end of period | \$ 923,836 | \$ 189,849 |

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 September 30, | |
|--|---|---------------------|
| | 2010 | 2009 |
| Net sales | | |
| Industrial: | | |
| North America | \$ 1,064,915 | \$ 783,085 |
| International | 1,092,981 | 850,250 |
| Aerospace | 436,680 | 416,856 |
| Climate & Industrial Controls | 234,697 | 186,974 |
| Total | \$ 2,829,273 | \$ 2,237,165 |
| Segment operating income | | |
| Industrial: | | |
| North America | \$ 189,362 | \$ 76,171 |
| International | 183,800 | 61,823 |
| Aerospace | 43,776 | 53,146 |
| Climate & Industrial Controls | 21,552 | 10,497 |
| Total segment operating income | 438,490 | 201,637 |
| Corporate general and administrative expenses | 33,354 | 26,302 |
| Income from operations before interest expense and other | 405,136 | 175,335 |
| Interest expense | 24,633 | 25,723 |
| Other expense | 44,139 | 35,583 |
| Income before income taxes | \$ 336,364 | \$ 114,029 |

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 September 30, 2010, the results of operations for the three months ended September 30, 2010 and 2009 and cash flows for the three 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 defect in design, materials and workmanship over various time periods. The warranty accrual as of September 30, 2010 and June 30, 2010 is immaterial to the financial position of the Company and the change in the accrual for both the current-year quarter and prior-year quarter was 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 months ended September 30, 2010 and 2009.

| | Three Months Ended September 30, | |
|---|-------------------------------------|-------------|
| | 2010 | 2009 |
| <u>Numerator:</u> | | |
| Net income attributable to common shareholders | \$ 247,171 | \$ 73,493 |
| <u>Denominator:</u> | | |
| Basic - weighted average common shares | 161,272,536 | 160,629,291 |
| Increase in weighted average from dilutive effect of stock-based awards | 2,834,684 | 1,411,494 |
| Diluted - weighted average common shares, assuming exercise of stock-based awards | 164,107,220 | 162,040,785 |
| Basic earnings per share | \$ 1.53 | \$.46 |
| Diluted earnings per share | \$ 1.51 | \$.45 |

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dollars in thousands, except per share amounts

3. Earnings per share, continued

At September 30, 2010 and 2009, 4,566,836 and 10,031,236 common shares, respectively, subject to stock-based awards 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. The Company repurchased 161,364 shares of its common stock at an average price of \$61.97 during the three-month period ended September 30, 2010 under this program.

5. Business realignment charges

During the first quarter of fiscal 2011, the Company recorded a \$3.1 million charge for the costs to structure its businesses in light of current and anticipated customer demand. The charge primarily consists 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 \$2.8 million of the total charge primarily for severance costs related to approximately 170 employees and the Aerospace Segment recognized \$0.3 million of the total charge primarily for severance costs related to approximately 20 employees. The charge is presented primarily in the Cost of sales caption in the Consolidated Statement of Income for the three months ended September 30, 2010. As of September 30, 2010, \$1.1 million of severance payments have been made with the majority of the remaining payments expected to be made by December 31, 2010.

During the first quarter of fiscal 2010, the Company recorded a \$19.3 million charge for the costs to structure its businesses in light of current and anticipated customer demand. The charge primarily consists 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 \$17.0 million of the total charge primarily for severance costs related to approximately 820 employees and the Climate & Industrial Controls Segment recognized \$2.3 million of the total charge primarily for severance costs related to approximately 235 employees. The charge is presented primarily in the Cost of sales caption in the Consolidated Statement of Income for the three months ended September 30, 2009. All required severance payments have been made.

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

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dollars in thousands, except per share amounts

6. Equity

Changes in equity for the three months ended September 30, 2010 and September 30, 2009 are as follows:

| | Shareholders Equity | Noncontrolling Interests | Total Equity |
|-----------------------------------|------------------------|-----------------------------|-----------------|
| Balance June 30, 2010 | \$ 4,367,965 | \$ 91,435 | \$ 4,459,400 |
| Net income | 247,171 | 1,859 | 249,030 |
| Other comprehensive income: | | | |
| Foreign currency translation | 279,400 | 4,338 | 283,738 |
| Retirement benefits plan activity | 18,218 | | 18,218 |
| Net realized loss | 59 | | 59 |
| Total comprehensive income | 544,848 | 6,197 | 551,045 |
| Dividends paid | (43,648) | | (43,648) |
| Stock incentive plan activity | 35,780 | | 35,780 |
| Shares purchased at cost | (10,000) | | (10,000) |
| Balance September 30, 2010 | \$ 4,894,945 | \$ 97,632 | \$ 4,992,577 |
| Balance June 30, 2009 | \$ 4,268,199 | \$ 82,241 | \$ 4,350,440 |
| Net income | 73,493 | 477 | 73,970 |
| Other comprehensive income: | | | |
| Foreign currency translation | 137,968 | 4,911 | 142,879 |
| Retirement benefits plan activity | 8,887 | | 8,887 |
| Net unrealized (loss) | (36) | | (36) |
| Total comprehensive income | 220,312 | 5,388 | 225,700 |
| Dividends paid | (40,171) | | (40,171) |
| Stock incentive plan activity | 29,575 | | 29,575 |
| Shares purchased at cost | (5,000) | | (5,000) |
| Retirement benefits plan activity | 9,069 | | 9,069 |
| Balance September 30, 2009 | \$ 4,481,984 | \$ 87,629 | \$ 4,569,613 |

With regard to other comprehensive income for shareholders' equity, foreign currency translation is net of taxes of \$29,884 and \$9,995 for the three months ended September 30, 2010 and September 30, 2009, respectively. Retirement benefits plan activity is net of taxes of \$10,641 and \$5,022 for the three months ended September 30, 2010 and September 30, 2009, respectively. Net realized loss relates to hedging activities and is net of taxes of \$36 for the three months ended September 30, 2010. Net unrealized (loss) relates to marketable equity securities and hedging activities and is net of taxes of \$20 for the three months ended September 30, 2009. In Note 7 of the Company's Quarterly Report on Form 10-Q for the first quarter of fiscal 2010, net income was inadvertently excluded from the reported amount of total comprehensive income. Such amount has been corrected in the table above.

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dollars in thousands, except per share amounts

7. Goodwill and intangible assets

The changes in the carrying amount of goodwill for the three months ended September 30, 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 | | | 1,183 | 1,183 |
| Foreign currency translation | 123,128 | 36 | 4,493 | 127,657 |
| Goodwill adjustments | 428 | | | 428 |
| Balance September 30, 2010 | \$ 2,504,196 | \$ 98,892 | \$ 312,514 | \$ 2,915,602 |

Goodwill adjustments primarily represented final adjustments to the purchase price allocation for acquisitions during the measurement period subsequent to the acquisition date.

Goodwill is tested for impairment on an annual basis, as of December 31, and between annual tests whenever events or circumstances indicate that the carrying value of a reporting unit may not exceed its fair value. No such events or circumstances occurred during the three months ended September 30, 2010.

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:

| | September 30, 2010 | | June 30, 2010 | |
|--------------------------|--------------------------|-----------------------------|--------------------------|-----------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Patents | \$ 120,431 | \$ 52,914 | \$ 114,935 | \$ 48,682 |
| Trademarks | 301,990 | 93,919 | 289,017 | 83,936 |
| Customer lists and other | 1,180,404 | 275,971 | 1,125,782 | 247,065 |
| Total | \$ 1,602,825 | \$ 422,804 | \$ 1,529,734 | \$ 379,683 |

Total intangible amortization expense for the three months ended September 30, 2010 was \$26,663. The estimated amortization expense for the five years ending June 30, 2011 through 2015 is \$104,369, \$95,325, \$87,828, \$82,274 and \$79,564, respectively.

Intangible assets 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 may be less than their net carrying value. No such events or circumstances occurred during the three months ended September 30, 2010.

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dollars in thousands, except per share amounts

8. Retirement benefits

Net periodic pension cost recognized included the following components:

| | Three Months Ended September 30, | |
|--|-------------------------------------|------------------|
| | 2010 | 2009 |
| Service cost | \$ 21,870 | \$ 19,067 |
| Interest cost | 43,271 | 43,207 |
| Expected return on plan assets | (48,733) | (43,332) |
| Amortization of prior service cost | 3,129 | 3,155 |
| Amortization of net actuarial loss | 25,798 | 15,507 |
| Amortization of initial net (asset) obligation | (14) | 6 |
| Net periodic benefit cost | \$ 45,321 | \$ 37,610 |

Postretirement benefit cost recognized included the following components:

| | Three Months Ended September 30, | |
|---|-------------------------------------|---------------|
| | 2010 | 2009 |
| Service cost | \$ 139 | \$ 151 |
| Interest cost | 982 | 926 |
| Net amortization and deferral and other | (114) | (114) |
| Net periodic benefit cost | \$ 1,007 | \$ 963 |

During the first three months of fiscal 2011, the Company made approximately \$200 million in cash contributions to its qualified defined benefit plans and expects to contribute approximately \$50 million in cash to its qualified defined benefit plans during the last nine months of fiscal 2011. The majority of the cash contributions are discretionary.

9. Debt

During the first quarter 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.

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dollars in thousands, except per share amounts

10. Income taxes

As of September 30, 2010, the Company had gross unrecognized tax benefits of \$75,624. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$73,196. The accrued interest related to the gross unrecognized tax benefits, excluded from the amounts above, was \$9,376.

The Company and its subsidiaries file income tax returns in the United States federal jurisdiction and various state and 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 and local and foreign tax returns have been examined for fiscal years through 2001. The Company does not anticipate that the total amount of unrecognized tax benefits will significantly change due to the settlement of examinations and the expiration of statutes of limitations within the next twelve months.

11. 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 \$2,118,788 and \$1,758,845 at September 30, 2010 and June 30, 2010, respectively, and was estimated to have a fair value of \$2,362,849 and \$1,925,397 at September 30, 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 utilizes 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, to manage foreign currency transaction and translation risk. 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.

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dollars in thousands, except per share amounts

11. Financial instruments, continued

In September 2010, 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 in September 2010, 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 mature in November 2010.

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

| | Balance Sheet Caption | September 30, 2010 | June 30, 2010 |
|-------------------------------|---------------------------|-----------------------|------------------|
| Net investment hedges | | | |
| Cross-currency swap contracts | Other liabilities | \$ 23,990 | \$ |
| Cash flow hedges | | | |
| Costless collar contracts | Accounts receivable | 503 | 1,624 |
| Costless collar contracts | Other accrued liabilities | 3,683 | 2,334 |
| Forward exchange contracts | Accounts receivable | 15,803 | |

The cross-currency swap contracts have been designated as hedging instruments. The costless collar contracts and forward exchange 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 September 30, | |
|----------------------------|-------------------------------------|------------|
| | 2010 | 2009 |
| Costless collar contracts | \$ (3,536) | \$ (3,535) |
| Forward exchange contracts | 15,803 | |

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 September 30, | |
|-------------------------------|-------------------------------------|----------|
| | 2010 | 2009 |
| Cross-currency swap contracts | \$ (14,821) | \$ |
| Foreign denominated debt | (36,560) | (17,489) |

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 three months ending September 30, 2010 and 2009.

PARKER-HANNIFIN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dollars in thousands, except per share amounts

12. Fair value measurement

The fair value of financial assets and liabilities that were measured at fair value on a recurring basis at September 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 securities | \$ 3,542 | \$ | \$ | \$ 3,542 |
| Derivatives | 16,306 | | 16,306 | |
| Liabilities: | | | | |
| Deferred compensation plans | 110,364 | | 110,364 | |
| Derivatives | 27,673 | | 27,673 | |

The fair value of financial assets and 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 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 three months ended September 30, 2010.

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 MONTHS ENDED SEPTEMBER 30, 2010

AND COMPARABLE PERIOD ENDED SEPTEMBER 30, 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 for the United States at the end of September 2010 was 54.4, the PMI for the Eurozone countries at the end of September 2010 was 53.7 and the PMI at the end of September 2010 for China was 52.9. Since June 30, 2010, the PMI for the United States and the Eurozone countries have declined and the PMI for China has increased.

Aircraft miles flown have increased approximately six percent and revenue passenger miles have increased approximately four percent from their comparable fiscal 2010 levels. The Company anticipates that Department of Defense spending in fiscal 2011 will be about two percent higher than the comparable fiscal 2010 level.

Housing starts in September 2010 were approximately four percent higher than housing starts in September 2009.

The Company also believes that there is a high negative correlation between interest rates and industrial manufacturing activity. Increases in interest rates typically have a negative impact on industrial production thereby lowering future order rates while decreases in interest rates typically have the opposite effect.

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's Win Strategy initiatives relating to growth and margin improvement as well as the implementation of a number of business realignment initiatives continue to help meet this objective.

The financial condition of the Company remains strong. 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 30.4 percent.

While the uncertainty of the current worldwide economic environment necessitates that the Company continue to concentrate its efforts on maintaining financial strength, the Company believes many opportunities for growth remain available. The Company will evaluate these opportunities as appropriate in the current economic environment. Major opportunities for growth are as follows:

Leveraging the Company's broad product line with customers desiring to consolidate their vendor base and outsource system engineering;

Marketing systems solutions for customer applications;

Expanding the Company's business presence outside of North America;

Introducing new products, including those resulting from the Company's innovation initiatives;

Completing strategic acquisitions in a consolidating motion and control industry; and

Expanding the Company's vast distribution network.

During the first quarter of fiscal 2011, the Company completed one acquisition. 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

| (in millions) | Three Months Ended | |
|--|--------------------|------------|
| | September 30, | |
| | 2010 | 2009 |
| Net sales | \$ 2,829.3 | \$ 2,237.2 |
| Gross profit | \$ 691.4 | \$ 436.2 |
| Gross profit margin | 24.4% | 19.5% |
| Selling, general and administrative expenses | \$ 333.6 | \$ 301.8 |
| Selling general and administrative expenses, as a percent of sales | 11.8% | 13.5% |
| Interest expense | \$ 24.6 | \$ 25.7 |
| Other (income), net | \$ (3.2) | \$ (5.4) |

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| | | |
|-----------------------------------|----------|---------|
| Effective tax rate | 26.0% | 35.1% |
| Net income attributable to common | | |
| shareholders | \$ 247.2 | \$ 73.5 |

Net sales for the first quarter of fiscal 2011 increased 26.5 percent over the prior-year first quarter reflecting higher volume experienced in all Segments, with the largest increase in net sales occurring in the Industrial Segment. Acquisitions made in the last 12 months did not materially impact the sales level in the first quarter of fiscal 2011. The effect of currency rate changes decreased net sales by approximately \$25 million in the first quarter of fiscal 2011.

Gross profit margin increased primarily due to the higher sales volume, resulting in manufacturing efficiencies as well as lower business realignment charges recorded in the current-year quarter.

Selling, general and administrative expenses increased primarily due to the higher sales volume as well as higher incentive compensation, partially offset by benefits realized from past business realignment activities.

Interest expense for the current-year quarter decreased 4.2 percent from the prior-year first quarter primarily due to lower average debt outstanding in the current-year quarter.

Other (income), net in the prior-year quarter 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 was lower than the prior-year quarter primarily due to discrete tax items in the current-year quarter having a more favorable impact on the tax rate than those recorded in the prior-year quarter. Discrete tax items primarily relate to the settlement of tax audits. The Company expects the effective tax rate for fiscal 2011 to be approximately 29 percent.

RESULTS BY BUSINESS SEGMENT

Industrial Segment

| (in millions) | Three months ended September 30, | |
|---|-------------------------------------|------------|
| | 2010 | 2009 |
| Net sales | | |
| North America | \$ 1,064.9 | \$ 783.1 |
| International | 1,093.0 | 850.3 |
| Operating income | | |
| North America | 189.4 | 76.2 |
| International | \$ 183.8 | \$ 61.8 |
| Operating income, as a percent of sales | | |
| North America | 17.8% | 9.7% |
| International | 16.8% | 7.3% |
| Backlog | \$ 1,596.9 | \$ 1,310.7 |

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

| | Three months ended September 30, 2010 |
|--|---|
| Industrial North America as reported | 36.0% |
| Acquisitions | 0.0% |
| Currency | 0.4% |
| Industrial North America without acquisitions and currency | 35.6% |
| Industrial International as reported | 28.5% |

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| | |
|--|--------|
| Acquisitions | 0.0% |
| Currency | (3.2)% |
| Industrial International without acquisitions and currency | 31.7% |
| Total Industrial Segment as reported | 32.1% |
| Acquisitions | 0.0% |
| Currency | (1.5)% |
| Total Industrial Segment without acquisitions and currency | 33.6% |

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 reflects higher demand experienced from distributors and end-users in virtually all markets, particularly in the construction equipment, heavy-duty truck, farm and agriculture equipment, machine tool and semiconductor markets. The increase in Industrial International sales is primarily attributed to higher end-user demand experienced across most markets, with the largest increase in volume occurring in Europe.

The increase in both Industrial North American and Industrial International margins is primarily due to the higher sales volume, benefits realized from past restructuring initiatives, and lower business realignment expenses in the current-year quarter.

Included in Industrial North American operating income are business realignment charges of \$2.3 million and \$4.7 million in the current-year quarter and prior-year quarter, respectively. Included in Industrial International operating income are business realignment charges of \$0.5 million and \$12.3 million in the current-year quarter and prior-year quarter, 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 anticipates realizing cost savings resulting from the severance costs taken in the current-year quarter of approximately \$2.0 million in fiscal 2011 and \$3.0 million in fiscal 2012. The amount of savings that is actually realized may be lower than expected, particularly if the Company needs to hire employees in the future as a result of an increase in end-user demand. 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 have not been finalized at this time.

The increase in backlog from the prior-year quarter is primarily due to higher order rates in both the Industrial North American and Industrial International businesses. The increase in backlog from the June 30, 2010 amount of \$1,505.0 million is primarily due to higher order rates for Industrial International businesses. The Company anticipates Industrial North American sales for fiscal 2011 will increase between 13.4 percent and 16.4 percent from the fiscal 2010 level and Industrial International sales for fiscal 2011 will increase between 13.3 percent and 16.3 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 for fiscal 2011 are expected to range from 16.4 percent to 17.0 percent and Industrial International operating margins are expected to range from 15.2 percent to 16.1 percent.

Aerospace Segment

| (in millions) | Three months ended | |
|---|--------------------|------------|
| | September 30, | |
| | 2010 | 2009 |
| Net sales | \$ 436.7 | \$ 416.9 |
| Operating income | \$ 43.8 | \$ 53.1 |
| Operating income, as a percent of sales | 10.0% | 12.7% |
| Backlog | \$ 1,601.0 | \$ 1,496.4 |

The increase in net sales 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 OEM and aftermarket volume. The decline in margin was primarily due to a higher concentration of commercial OEM volume in the current-year quarter product mix as well as higher engineering development and operating costs.

The increase in backlog from the prior-year quarter and the June 30, 2010 amount of \$1,474.4 million was primarily due to higher order rates in the commercial OEM businesses. For fiscal 2011, sales are expected to increase between 4.1 percent and 6.7 percent from the fiscal 2010 level primarily due to anticipated higher commercial OEM and aftermarket volume. Operating margins are expected to range from 12.0 percent to 12.8 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

| (in millions) | Three months ended | |
|---|--------------------|----------|
| | September 30, | |
| | 2010 | 2009 |
| Net sales | \$ 234.7 | \$ 187.0 |
| Operating income | \$ 21.6 | \$ 10.5 |
| Operating income, as a percent of sales | 9.2% | 5.6% |
| Backlog | \$ 154.7 | \$ 121.5 |

The increase in net sales in the Climate & Industrial Controls Segment is primarily due to higher end-user demand in the residential air conditioning, heavy-duty truck and automotive markets. Margins in the current-year quarter were higher than the prior-year level primarily due to the higher sales volume resulting in manufacturing efficiencies and a favorable product mix. Included in the prior-year quarter operating income were business realignment charges of \$2.3 million. 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 is primarily due to higher order rates in the automotive, heavy-duty truck and residential air conditioning markets. A decline in order rates in the residential air conditioning market resulted in a decline in backlog from the June 30, 2010 amount of \$161.9 million. For fiscal 2011, sales are expected to increase between 12.3 percent and 15.3 percent from the fiscal 2010 level and operating margins are expected to range from 8.8 percent to 9.4 percent.

Corporate and Other

Corporate general and administrative expenses increased to \$33.4 million in the current-year quarter compared to \$26.3 million in the prior-year quarter. As a percent of sales, corporate general and administrative expenses for the current-year quarter and prior-year quarter was 1.2 percent. The higher expense in the current-year quarter is primarily due to higher incentive compensation expenses.

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

| (in millions) | Three months ended | |
|----------------------------------|--------------------|--------------------|
| | September 30, 2010 | September 30, 2009 |
| Expense (income) | | |
| Currency transaction (gain) loss | \$ (0.1) | \$ 2.9 |
| Stock compensation | 25.1 | 23.1 |
| Pensions | 18.2 | 11.2 |
| Other items, net | 0.9 | (1.6) |
| | \$ 44.1 | \$ 35.6 |

The increase in pension expense in the current-year quarter primarily results from a higher amount of actuarial losses, primarily related to the domestic defined benefit plans, being recognized in the current-year quarter as compared to the prior-year quarter.

CONSOLIDATED BALANCE SHEET

| (dollars in millions) | September 30, 2010 | June 30, 2010 |
|--|--------------------|---------------|
| Accounts receivable | \$ 1,694.3 | \$ 1,599.9 |
| Inventories | 1,295.1 | 1,171.7 |
| Plant and equipment, net of accumulated depreciation | 1,771.0 | 1,697.9 |
| Goodwill | 2,915.6 | 2,786.3 |
| Intangible assets, net | 1,180.0 | 1,150.1 |
| Accounts payable, trade | 953.3 | 888.7 |
| Accrued payrolls and other compensation | 310.5 | 371.4 |
| Shareholders' equity | 4,894.9 | 4,368.0 |
| Working capital | \$ 1,865.5 | \$ 1,383.9 |
| Current ratio | 1.82 | 1.63 |

Accounts receivable are primarily receivables due from customers for sales of product (\$1,513 million at September 30, 2010 and \$1,443 million at June 30, 2010). Days sales outstanding relating to trade accounts receivable was 50 days at September 30, 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 \$123 million, primarily in the Industrial Segment, in response to positive order trends. Days supply of inventory increased to 61 days from 58 days at June 30, 2010.

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 during the current-year quarter of incentive compensation amounts that had been accrued as of June 30, 2010.

Shareholders' equity included an increase of \$279 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

| (in millions) | Three months ended | |
|---|--------------------|----------|
| | September 30, | |
| | 2010 | 2009 |
| Cash provided by (used in): | | |
| Operating activities | \$ 122.9 | \$ 260.0 |
| Investing activities | (59.0) | (27.0) |
| Financing activities | 247.0 | (238.7) |
| Effect of exchange rates | 37.4 | 7.9 |
| Net increase in cash and cash equivalents | 348.3 | 2.2 |

Cash flows from operating activities decreased 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 flow used in investing activities increased as economic uncertainties in the prior-year quarter resulted in the Company reducing its acquisition activity and limiting capital expenditures. The Company completed one acquisition and increased capital expenditures in the current-year quarter.

Cash flow used in financing activities in the current-year quarter included net cash proceeds of approximately \$294.5 million from the issuance of Medium-Term Notes that mature in September 2022. The net cash proceeds were used to repay outstanding 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.

| Debt to Debt-Shareholders' Equity Ratio (in millions) | September 30, | June 30, |
|---|---------------|----------|
| | 2010 | 2010 |
| Debt | \$ 2,137 | \$ 1,777 |
| Debt & Shareholders' equity | 7,032 | 6,145 |
| Ratio | 30.4% | 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, of which \$1,482 million was available as of September 30, 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'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 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.

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 three 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, and changes in contract cost and revenue estimates for new development programs,

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 utilizes 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, to manage foreign currency transaction and translation risk. 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 11 and 12 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 first 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 September 30, 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. All of the lawsuits and several of the investigations have concluded. The following investigations remain pending or were resolved after June 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.

An additional related action was brought 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. On September 16, 2010, the court dismissed the complaint as to the Company. The complaint has been dismissed with prejudice.

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 |
|--|---|--|---|---|
| July 1, 2010 through July 31, 2010 | 125,372(2) | \$ 58.15 | 57,100 | 9,165,222 |
| August 1, 2010 through August 31, 2010 | 79,822(3) | \$ 62.91 | 54,500 | 9,110,722 |
| September 1, 2010 through September 30, 2010 | 49,764 | \$ 65.67 | 49,764 | 9,060,958 |
| Total: | 254,958 | \$ 61.11 | 161,364 | 9,060,958 |

- (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 68,272 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.
- (3) Includes 25,322 shares surrendered to the Company by certain executive officers to satisfy tax withholding obligations on restricted stock issued under the Company's Long Term Incentive Awards.

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 Amended and Restated 2005 Performance Bonus Plan.* |
| 10(b) | Parker-Hannifin Corporation Amended and Restated 2003 Stock Incentive Plan.* |
| 10(c) | Parker-Hannifin Corporation Amended and Restated 2009 Omnibus Stock Incentive Plan.* |
| 10(d) | Parker-Hannifin Corporation Target Incentive Plan.* |
| 10(e) | Parker-Hannifin Corporation Target Incentive Plan Subject to Performance Bonus Plan.* |
| 10(f) | Parker-Hannifin Corporation RONA Plan Subject to Performance Bonus Plan.* |
| 10(g) | Parker-Hannifin Corporation Stock Appreciation Rights Award Agreement for executive officers incorporated by reference to Exhibit 10.2 to the Registrant's Report on Form 8-K filed with the Commission on August 17, 2010 (Commission File No. 1-4982). |
| 10(h) | Parker-Hannifin Corporation Stock Appreciation Rights Terms and Conditions for executive officers incorporated by reference to Exhibit 10.1 to the Registrant's Report on Form 8-K filed with the Commission on August 17, 2010 (Commission File No. 1-4982). |
| 10(i) | Terms and Conditions of Restricted Stock Issued as a Payout Under the LTI Plan.* |
| 12 | Computation of Ratio of Earnings to Fixed Charges as of September 30, 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 September 30, 2010 and 2009, (ii) Consolidated Balance Sheet at September 30, 2010 and June 30, 2010, (iii) Consolidated Statement of Cash Flows for the three months ended September 30, 2010 and 2009 and (iv) Notes to Consolidated Financial Statements for the three months ended September 30, 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/ Timothy K. Pistell
Timothy K. Pistell
Executive Vice President - Finance and Administration

and Chief Financial Officer

Date: November 8, 2010

EXHIBIT INDEX

| Exhibit No. | Description of Exhibit |
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