

REGAL BELOIT CORP
Form 10-Q
August 08, 2017

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 July 1, 2017 or
..TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-07283

REGAL BELOIT CORPORATION
(Exact name of registrant as specified in its charter)

Wisconsin 39-0875718
(State of other jurisdiction of (IRS Employer
incorporation) Identification No.)
200 State Street, Beloit, Wisconsin 53511
(Address of principal executive office)
(608) 364-8800
Registrant's telephone number, including area code

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 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller Reporting Company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Edgar Filing: REGAL BELOIT CORP - Form 10-Q

As of August 4, 2017 there were 44,596,861 shares of the registrant's common stock, \$.01 par value per share, outstanding.

REGAL BELOIT CORPORATION
INDEX

	Page
<u>PART I — FINANCIAL INFORMATION</u>	
Item 1 — <u>Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Statements of Income</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Condensed Consolidated Balance Sheets</u>	<u>6</u>
<u>Condensed Consolidated Statements of Equity</u>	<u>7</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>8</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>9</u>
Item 2 — <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
Item 3 — <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>37</u>
Item 4 — <u>Controls and Procedures</u>	<u>39</u>
 <u>PART II — OTHER INFORMATION</u>	
Item 1 — <u>Legal Proceedings</u>	<u>39</u>
Item 1A — <u>Risk Factors</u>	<u>39</u>
Item 2 — <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>40</u>
Item 6 — <u>Exhibits</u>	<u>41</u>
<u>Signature</u>	<u>42</u>

CAUTIONARY STATEMENT

Certain statements made in this Quarterly Report on Form 10-Q are “forward-looking statements” intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on management’s expectations, beliefs, current assumptions, and projections. When used in this Quarterly Report on Form 10-Q, words such as “may,” “will,” “expect,” “intend,” “estimate,” “forecast,” “anticipate,” “believe,” “should,” “project” or “plan” or the negative thereof or similar words are intended to identify forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties, assumptions and other factors, some of which are beyond our control, which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. Those factors include, but are not limited to:

- uncertainties regarding our ability to execute our restructuring plans within expected costs and timing;
- increases in our overall debt levels as a result of the acquisition of the Power Transmission Solutions business of Emerson Electric Co. ("PTS") or otherwise and our ability to repay principal and interest on our outstanding debt;
- actions taken by our competitors and our ability to effectively compete in the increasingly competitive global electric motor, drives and controls, power generation and mechanical motion control industries;
- our ability to develop new products based on technological innovation and marketplace acceptance of new and existing products;
- fluctuations in commodity prices and raw material costs;
- our dependence on significant customers;
- issues and costs arising from the integration of acquired companies and businesses including PTS and the timing and impact of purchase accounting adjustments;
- prolonged declines in oil and gas up stream capital spending;
- economic changes in global markets where we do business, such as reduced demand for the products we sell, currency exchange rates, inflation rates, interest rates, recession, government policies, including policy changes affecting taxation, trade, immigration and the like, and other external factors that we cannot control;
- product liability and other litigation, or claims by end users, government agencies or others that our products or our customers’ applications failed to perform as anticipated, particularly in high volume applications or where such failures are alleged to be the cause of property or casualty claims;
- unanticipated liabilities of acquired businesses;
- unanticipated costs or expenses we may incur related to product warranty issues;
- our dependence on key suppliers and the potential effects of supply disruptions;
- infringement of our intellectual property by third parties, challenges to our intellectual property and claims of infringement by us of third party technologies;
- effects on earnings of any significant impairment of goodwill or intangible assets;
- cyclical downturns affecting the global market for capital goods;
- and
- other risks and uncertainties including but not limited to those described in “Risk Factors” in our Annual Report on Form 10-K and from time to time in our reports filed with US Securities and Exchange Commission.

Shareholders, potential investors, and other readers are urged to consider these factors in evaluating the forward-looking statements and cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included in this Quarterly Report on Form 10-Q are made only as of the date of this report, and we undertake no obligation to update these statements to reflect subsequent events or circumstances. Additional information regarding these and other risks and factors is included in Part I - Item 1A - Risk Factors in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2017.

PART I—FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

REGAL BELOIT CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Amounts in Millions, Except Per Share Data)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net Sales	\$869.2	\$838.6	\$1,682.7	\$1,656.8
Cost of Sales	646.2	615.7	1,244.1	1,216.5
Gross Profit	223.0	222.9	438.6	440.3
Operating Expenses	140.0	131.5	280.8	279.6
Income From Operations	83.0	91.4	157.8	160.7
Interest Expense	14.7	14.8	29.1	29.8
Interest Income	1.0	1.2	2.0	2.3
Income Before Taxes	69.3	77.8	130.7	133.2
Provision For Income Taxes	15.0	19.4	28.8	32.1
Net Income	54.3	58.4	101.9	101.1
Less: Net Income Attributable to Noncontrolling Interests	1.3	1.8	2.6	2.9
Net Income Attributable to Regal Beloit Corporation	\$53.0	\$56.6	\$99.3	\$98.2
Earnings Per Share Attributable to Regal Beloit Corporation:				
Basic	\$1.19	\$1.27	\$2.22	\$2.20
Assuming Dilution	\$1.18	\$1.26	\$2.20	\$2.19
Cash Dividends Declared Per Share	\$0.26	\$0.24	\$0.50	\$0.47
Weighted Average Number of Shares Outstanding:				
Basic	44.7	44.7	44.8	44.7
Assuming Dilution	45.1	45.0	45.1	45.0

See accompanying Notes to Condensed Consolidated Financial Statements

REGAL BELOIT CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)
 (Dollars in Millions)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net Income	\$54.3	\$58.4	\$101.9	\$101.1
Other Comprehensive Income (Loss) Net of Tax:				
Foreign Currency Translation Adjustments	39.1	(32.5)	68.5	(6.8)
Hedging Activities:				
Increase (Decrease) in Fair Value of Hedging Activities, Net of Tax Effects of \$ 6.1 Million and \$(6.7) Million for the Three Months ended July 1, 2017 and July 2, 2016 and \$18.0 Million and \$(5.4) Million for the Six Months ended July 1, 2017 and July 2, 2016 Respectively	10.0	(11.1)	29.4	(8.8)
Reclassification of Losses included in Net Income, Net of Tax Effects of \$1.8 Million and \$4.7 Million for the Three Months ended July 1, 2017 and July 2, 2016 and \$6.2 Million and \$9.7 Million for the Six Months ended July 1, 2017 and July 2, 2016 Respectively	2.7	7.6	10.0	15.7
Pension and Post Retirement Plans:				
Reclassification Adjustments for Pension and Post Retirement Benefits included in Net Income, Net of Tax Effects of \$0.2 Million and \$0.4 Million for the Three Months Ended July 1, 2017 and July 2, 2016 and \$0.4 Million and \$0.6 Million for the Six Months Ended July 1, 2017 and July 2, 2016, Respectively	0.4	0.6	0.8	1.3
Other Comprehensive Income (Loss)	52.2	(35.4)	108.7	1.4
Comprehensive Income	106.5	23.0	210.6	102.5
Less: Comprehensive Income Attributable to Noncontrolling Interests	1.8	0.9	3.6	2.4
Comprehensive Income Attributable to Regal Beloit Corporation	\$104.7	\$22.1	\$207.0	\$100.1
See accompanying Notes to Condensed Consolidated Financial Statements				

REGAL BELOIT CORPORATION
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)
 (Dollars in Millions, Except Per Share Data)

	July 1, 2017	December 31, 2016
ASSETS		
Current Assets:		
Cash and Cash Equivalents	\$243.7	\$ 284.5
Trade Receivables, Less Allowances of \$10.4 Million in 2017 and \$11.5 Million in 2016	544.5	462.2
Inventories	698.2	660.8
Prepaid Expenses and Other Current Assets	156.7	124.5
Total Current Assets	1,643.1	1,532.0
Net Property, Plant and Equipment	637.3	627.5
Goodwill	1,469.0	1,453.2
Intangible Assets, Net of Amortization	692.3	711.7
Deferred Income Tax Benefits	27.5	22.4
Other Noncurrent Assets	13.8	11.7
Total Assets	\$4,483.0	\$ 4,358.5
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts Payable	\$406.5	\$ 334.2
Dividends Payable	11.6	10.7
Current Hedging Obligations	14.5	49.0
Accrued Compensation and Employee Benefits	75.7	70.1
Other Accrued Expenses	123.8	137.0
Current Maturities of Long-Term Debt	100.7	100.6
Total Current Liabilities	732.8	701.6
Long-Term Debt	1,199.5	1,310.9
Deferred Income Taxes	142.4	97.7
Noncurrent Hedging Obligations	1.1	17.6
Pension and Other Post Retirement Benefits	107.4	106.5
Other Noncurrent Liabilities	51.0	46.0
Commitments and Contingencies (see Note 12)		
Equity:		
Regal Beloit Corporation Shareholders' Equity:		
Common Stock, \$.01 par value, 100.0 Million Shares Authorized, 44.6 Million and 44.8 Million Shares Issued and Outstanding in 2017 and 2016, Respectively	0.4	0.4
Additional Paid-In Capital	890.8	904.5
Retained Earnings	1,525.0	1,452.0
Accumulated Other Comprehensive Loss	(210.4)	(318.1)
Total Regal Beloit Corporation Shareholders' Equity	2,205.8	2,038.8
Noncontrolling Interests	43.0	39.4
Total Equity	2,248.8	2,078.2
Total Liabilities and Equity	\$4,483.0	\$ 4,358.5

See accompanying Notes to Condensed Consolidated Financial Statements.

REGAL BELOIT CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
(Unaudited)
(Dollars in Millions, Except Per Share Data)

	Common Stock \$.01 Par Value	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Non- controlling Interests	Total Equity
Balance as of January 2, 2016	\$ 0.4	\$ 900.8	\$ 1,291.1	\$ (255.0)	\$ 45.5	\$ 1,982.8
Net Income	—	—	98.2	—	2.9	101.1
Other Comprehensive Income (Loss)	—	—	—	1.9	(0.5)	1.4
Dividends Declared (\$0.47 Per Share)	—	—	(20.9)	—	—	(20.9)
Stock Options Exercised, Including Income Tax Benefit and Share Cancellations	—	(1.7)	—	—	—	(1.7)
Dividends Declared to Noncontrolling Interests	—	—	—	—	(0.3)	(0.3)
Share-based Compensation	—	7.1	—	—	—	7.1
Purchase of Subsidiary Shares from Noncontrolling Interest	—	(7.2)	—	(2.7)	(9.7)	\$(19.6)
Balance as of July 2, 2016	\$ 0.4	\$ 899.0	\$ 1,368.4	\$ (255.8)	\$ 37.9	\$ 2,049.9

	Common Stock \$.01 Par Value	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Non- controlling Interests	Total Equity
Balance as of December 31, 2016	\$ 0.4	\$ 904.5	\$ 1,452.0	\$ (318.1)	\$ 39.4	\$ 2,078.2
Net Income	—	—	99.3	—	2.6	101.9
Other Comprehensive Income	—	—	—	107.7	1.0	108.7
Dividends Declared (\$0.50 Per Share)	—	—	(22.3)	—	—	(22.3)
Stock Options Exercised	—	(3.1)	—	—	—	(3.1)
Stock Repurchase	—	(17.7)	(4.0)	—	—	(21.7)
Share-based Compensation	—	7.1	—	—	—	7.1
Balance as of July 1, 2017	\$ 0.4	\$ 890.8	\$ 1,525.0	\$ (210.4)	\$ 43.0	\$ 2,248.8

See accompanying Notes to Condensed Consolidated Financial Statements.

REGAL BELOIT CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)
 (Dollars in Millions)

	Six Months Ended	
	July 1, 2017	July 2, 2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$101.9	\$101.1
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities (Net of Acquisitions and Divestitures):		
Depreciation and Amortization	68.8	79.0
(Gain) Loss on Sale or Disposition of Assets, Net	(0.3)	1.0
Share-Based Compensation Expense	7.1	7.1
Exit of Business	3.9	—
Gain on Sale of Businesses	(0.1)	(11.6)
Change in Operating Assets and Liabilities, Net of Acquisitions and Divestitures	(32.4)	(0.5)
Net Cash Provided By Operating Activities	148.9	176.1
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to Property, Plant and Equipment	(33.7)	(31.7)
Sales of Investment Securities	0.5	30.3
Purchases of Investment Securities	(0.5)	(25.8)
Proceeds from Sale of Businesses	0.5	25.0
Proceeds from Sale of Assets	1.3	0.1
Net Cash Used In Investing Activities	(31.9)	(2.1)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings Under Revolving Credit Facility	492.2	360.0
Repayments Under Revolving Credit Facility	(494.3)	(338.0)
Proceeds from Short-Term Borrowings	15.1	20.8
Repayments of Short-Term Borrowings	(15.0)	(27.5)
Proceeds from Long-Term Borrowings	0.3	—
Repayments of Long-Term Borrowings	(112.1)	(125.2)
Dividends Paid to Shareholders	(21.4)	(20.5)
Shares Surrendered for Taxes	(3.4)	(1.9)
Proceeds from the Exercise of Stock Options	0.4	0.5
Payments of Contingent Consideration	(5.3)	—
Repurchase of Common Stock	(21.0)	—
Distributions to Noncontrolling Interests	—	(0.3)
Purchase of Subsidiary Shares from Noncontrolling Interest	—	(19.6)
Net Cash Used In Financing Activities	(164.5)	(151.7)
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	6.7	(3.7)
Net Increase (Decrease) in Cash and Cash Equivalents	(40.8)	18.6
Cash and Cash Equivalents at Beginning of Period	284.5	252.9
Cash and Cash Equivalents at End of Period	\$243.7	\$271.5
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash Paid For:		
Interest	\$26.8	\$27.3
Income taxes	\$30.6	\$40.5

See accompanying Notes to Condensed Consolidated Financial Statements.

8

REGAL BELOIT CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
July 1, 2017
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying (a) condensed consolidated balance sheet of Regal Beloit Corporation (the "Company") as of December 31, 2016, which has been derived from audited consolidated financial statements, and (b) unaudited interim condensed consolidated financial statements as of July 1, 2017 and for the three and six months ended July 1, 2017 and July 2, 2016, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP"), have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading.

It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's 2016 Annual Report on Form 10-K filed on March 1, 2017.

In the opinion of management, all adjustments considered necessary for a fair presentation of financial results have been made. Except as otherwise discussed, such adjustments consist of only those of a normal recurring nature. Operating results for the three and six months ended July 1, 2017 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 30, 2017.

The condensed consolidated financial statements have been prepared in accordance with GAAP, which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the periods reported. Actual results could differ from those estimates. The Company uses estimates in accounting for, among other items, allowance for doubtful accounts; excess and obsolete inventory; share-based compensation; acquisitions; product warranty obligations; pension and post retirement assets and liabilities; derivative fair values; goodwill and other asset impairments; health care reserves; retirement benefits; rebates and incentives; litigation claims and contingencies, including environmental matters; and income taxes. The Company accounts for changes to estimates and assumptions when warranted by factually based experience.

The Company operates on a 52/53 week fiscal year ending on the Saturday closest to December 31.

New Accounting Standards

In May 2017, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2017-09, Stock Compensation - Scope of Modification Accounting. The ASU amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Accounting Standards Codification ("ASC") 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The ASU is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted and prospective application is required. The Company plans to adopt this pronouncement for fiscal years beginning December 31, 2017 and will consider the impact that this standard may have on future share based award changes, should they occur.

In February 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The ASU amends current guidance to require employers that present a measure of operating income in their statement of income to include only the service cost component of net periodic pension cost and net periodic postretirement benefit cost in operating expenses (together with other employee compensation costs). The other components of net benefit cost, including amortization of prior service cost/credit, and settlement and curtailment effects, are to be included in nonoperating expenses.

Employers that do not present a measure of operating income are required to include the service cost component in the same line item as other employee compensation costs. The ASU also stipulates that only the service cost component of net benefit cost is eligible for capitalization. The changes, which respond to input from financial statement users, are intended to classify costs according to their natures, and better align the effect of defined benefit plans on operating income with International Financial Reporting Standards. The ASU is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The ASU will impact the components of income before taxes but will not impact the amount of income before taxes.

In February 2016, the FASB issued ASU 2016-02, Leases. The core principle of ASU 2016-02 is that an entity should recognize on its balance sheet assets and liabilities arising from a lease. In accordance with that principle, ASU 2016-02 requires that a lessee

recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying leased asset for the lease term. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on the lease classification as a finance or operating lease. This new accounting guidance is effective for fiscal years beginning after December 15, 2018 under a modified retrospective approach and early adoption is permitted. The Company has identified a six step process to successfully implement the new Lease standard: Form a task force to become experts and take the lead on understanding and implementing the new Lease standard; Update lease inventories; Decide on transition method; Review legal agreements and debt covenants; Consider IT needs; Discuss with stakeholders. The Company is currently evaluating the impact the adoption of ASU 2016-02 will have on its consolidated financial statements and has commenced the first step of identifying a task force to take the lead in implementing the new Lease standard.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, a comprehensive new revenue recognition standard that supersedes current revenue recognition requirements. This update requires the Company to recognize revenue at amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services at the time of transfer. ASU No. 2014-09 (and related updates) will become effective for the Company at the beginning of its 2018 fiscal year. The standard allows the option of using either a full retrospective or a modified retrospective approach for the adoption of the standard. The Company has identified a four step process to successfully implement the new revenue standard - data gathering, assessment, solution development, and solution implementation. The Company has completed Step one, data gathering, and is currently finishing the assessment phase. The Company is in the process of evaluating and quantifying the materiality of the standard's impact on its consolidated financial statements. The Company plans to adopt this accounting standard update using the modified retrospective method, with the cumulative effect of initially applying this update recognized in the first reporting period of 2018. The Company is in the process of drafting an updated accounting policy, evaluating new disclosure requirements and identifying and implementing appropriate changes to its business processes, systems and controls to support recognition and disclosure under the new guidance.

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation: Improvements to Employee Share-Based Payment Accounting. The new guidance includes multiple provisions intended to simplify various aspects of the accounting for share-based payments. The provisions include:

- a. recording all tax effects associated with stock-based compensation through the income statement, as opposed to recording certain amounts in other paid-in capital, which eliminates the requirement to calculate a "windfall pool";
- b. allowing entities to withhold shares to satisfy the employer's statutory tax withholding requirement up to the highest marginal tax rate applicable to employees rather than the employer's minimum statutory rate, without requiring liability classification for the award;
- c. modifying the requirement to estimate the number of awards that will ultimately vest by providing an accounting policy election to either estimate the number of forfeitures or recognize forfeitures as they occur;
- d. changing certain presentation requirements in the statement of cash flows, including removing the requirement to present excess tax benefits as an inflow from financing activities and an outflow from operating activities, and requiring the cash paid to taxing authorities arising from withheld shares to be classified as a financing activity; and
- e. the assumed proceeds from applying the treasury stock method when computing earnings per share is amended to exclude the amount of excess tax benefits that previously would have been recognized in additional paid-in capital.

The Company adopted the provisions of ASU 2016-09 on January 1, 2017. As a result of adopting the standard, the Changes in Operating Assets and Liabilities, Net of Acquisitions and Divestitures line in the Cash Flows From Operating Activities section on the Condensed Consolidated Statements of Cash Flows and the Shares Surrendered for Taxes line in the Cash Flows from Financing Activities section were both adjusted by \$1.9 million for 2016. The presentation on the Condensed Consolidated Statements of Cash Flows for shares surrendered by employees to meet the minimum statutory withholding requirement and excess tax benefits were applied retrospectively. In addition, the Excess Tax Expense from Share-Based Compensation lines in the Cash Flows from Operating Activities section and

the Cash Flows from Financing Activities section were removed. The Company removed the excess tax benefits from the calculation of dilutive shares on a prospective basis. In addition, the Company began recording all tax effects associated with stock-based compensation through the income statement on a prospective basis. The Company did not have any awards classified as liability awards due to the statutory tax withholding requirements as of January 1, 2017. The Company made an accounting policy election to continue to estimate forfeitures as it had previously.

2. OTHER FINANCIAL INFORMATION

Inventories

The approximate percentage distribution between major classes of inventories was as follows:

	July 1, December 31,	
	2017	2016
Raw Material and Work in Process	48%	45%
Finished Goods and Purchased Parts	52%	55%

Inventories are stated at cost, which is not in excess of market. Cost for approximately 50% of the Company's inventory at July 1, 2017, and 55% at December 31, 2016 was determined using the LIFO method.

Property, Plant and Equipment

Property, plant, and equipment by major classification was as follows (dollars in millions):

	Useful Life in Years	July 1, 2017	December 31, 2016
Land and Improvements		\$79.6	\$ 76.7
Buildings and Improvements	3 - 50	292.2	280.4
Machinery and Equipment	3 - 15	970.8	929.9
Property, Plant and Equipment		1,342.6	1,287.0
Less: Accumulated Depreciation		(705.3)	(659.5)
Net Property, Plant and Equipment		\$637.3	\$ 627.5
Other			

As part of the purchase agreement of the 2008 acquisition of the Wuxi Hwada Motor Co., the Company agreed that if certain relocation compensation was received for the relocation of the business, the Company would pay a portion of that compensation to the seller as part of a deferred contingent purchase price. During the six months ended July 1, 2017, a final deferred contingent purchase price payment of \$5.3 million was made under this agreement.

3. ACQUISITIONS AND DIVESTITURES

There were no acquisition related expenses for the six months ended July 1, 2017 and July 2, 2016.

2016 Acquisitions

Elco Purchase

On January 18, 2016, the Company purchased the remaining shares owned by the joint venture partner in its Elco Group B.V. ("Elco") joint venture increasing the Company's ownership from 55.0% to 100.0% for \$19.6 million. The purchase price of Elco is reflected as a component of equity.

2016 Divestitures

Mastergear Worldwide

On June 1, 2016, the Company sold its Mastergear Worldwide ("Mastergear") business to Rotork PLC for a purchase price of \$25.1 million, subject to customary finalization. Mastergear was included in the Company's Power Transmission Solutions segment. Gains related to the sale of \$0.1 million and \$11.6 million were recorded as a reduction to Operating Expenses in the Condensed Consolidated Statements of Income during fiscal 2017 and 2016, respectively.

Venezuelan Subsidiary

On July 7, 2016, the Company sold the assets of its Venezuelan subsidiary, which had been included in the Company's Commercial and Industrial Systems segment, to a private company for \$3.0 million. Of this amount, \$1.0 million was received on the transaction

closing date and \$2.0 million is to be received in 24 monthly installments. The Company may receive additional amounts in the future related to certain accounts receivable of this business. The gains will be recognized as the cash is received. The Company wrote down its investment and ceased operations of this subsidiary in 2015.

4. ACCUMULATED OTHER COMPREHENSIVE LOSS

Foreign currency translation adjustments, hedging activities and pension and post retirement benefit adjustments are included in Equity in Accumulated Other Comprehensive Loss ("AOCI").

The changes in AOCI by component for the three and six months ended July 1, 2017 and July 2, 2016 were as follows (in millions):

	Three Months Ended			Total
	July 1, 2017			
	Hedging Activities	Pension and Post Retirement Benefit Adjustments	Foreign Currency Translation Adjustments	
Beginning Balance	\$(14.4)	\$ (35.8)	\$ (211.9)	\$(262.1)
Other Comprehensive Income (Loss) before Reclassifications	16.1	(0.1)	38.7	54.7
Tax Impact	(6.1)	—	—	(6.1)
Amounts Reclassified from Accumulated Other Comprehensive Loss	4.5	0.6	—	5.1
Tax Impact	(1.8)	(0.2)	—	(2.0)
Net Current Period Other Comprehensive Income	12.7	0.3	38.7	51.7
Ending Balance	\$(1.7)	\$ (35.5)	\$ (173.2)	\$(210.4)

	Three Months Ended			Total
	July 2, 2016			
	Hedging Activities	Pension and Post Retirement Benefit Adjustments	Foreign Currency Translation Adjustments	
Beginning Balance	\$(37.1)	\$ (34.7)	\$ (149.5)	\$(221.3)
Other Comprehensive Income (Loss) before Reclassifications	(17.8)	0.5	(32.1)	(49.4)
Tax Impact	6.7	—	—	6.7
Amounts Reclassified from Accumulated Other Comprehensive Loss	12.3	1.0	—	13.3
Tax Impact	(4.7)	(0.4)	—	(5.1)
Net Current Period Other Comprehensive Income (Loss)	(3.5)	1.1	(32.1)	(34.5)
Ending Balance	\$(40.6)	\$ (33.6)	\$ (181.6)	\$(255.8)

	Six Months Ended July 1, 2017			
	Hedging Activities	Pension and Post Retirement Benefit Adjustments	Foreign Currency Translation Adjustments	Total
Beginning Balance	\$(41.1)	\$ (36.0)	\$ (241.0)	\$(318.1)
Other Comprehensive Income (Loss) before Reclassifications	47.4	(0.3)	67.8	114.9
Tax Impact	(18.0)	—	—	(18.0)
Amounts Reclassified from Accumulated Other Comprehensive Loss	16.2	1.2	—	17.4
Tax Impact	(6.2)	(0.4)	—	(6.6)
Net Current Period Other Comprehensive Income	39.4	0.5	67.8	107.7
Ending Balance	\$(1.7)	\$ (35.5)	\$ (173.2)	\$(210.4)

	Six Months Ended July 2, 2016			
	Hedging Activities	Pension and Post Retirement Benefit Adjustments	Foreign Currency Translation Adjustments	Total
Beginning Balance	\$(47.5)	\$ (35.4)	\$ (172.1)	\$(255.0)
Other Comprehensive Income (Loss) before Reclassifications	(14.2)	0.5	(6.8)	(20.5)
Tax Impact	5.4	—	—	5.4
Amounts Reclassified from Accumulated Other Comprehensive Loss	25.4	1.9	—	27.3
Tax Impact	(9.7)	(0.6)	—	(10.3)
Net Current Period Other Comprehensive Income (Loss)	6.9	1.8	(6.8)	1.9
Purchase of Subsidiary Shares from Noncontrolling Interest	—	—	(2.7)	(2.7)
Ending Balance	\$(40.6)	\$ (33.6)	\$ (181.6)	\$(255.8)

The Condensed Consolidated Statements of Income line items affected by the hedging activities reclassified from accumulated other comprehensive loss in the tables above are disclosed in Note 13 of Notes to Condensed Consolidated Financial Statements.

The reclassification amounts for pension and post retirement benefit adjustments in the tables above are part of net periodic benefit costs recorded in Operating Expenses (see also Note 8 of Notes to Condensed Consolidated Financial Statements).

5. GOODWILL AND INTANGIBLE ASSETS

Goodwill

As required, the Company performs an annual impairment test of goodwill as of the end of the October fiscal month or more frequently if events or circumstances change that would more likely than not reduce the fair value of its reporting units below their carrying value.

The following information presents changes to goodwill during the six months ended July 1, 2017 (in millions):

	Total	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions
Balance as of December 31, 2016	\$1,453.2	\$ 540.6	\$ 341.8	\$ 570.8
Translation Adjustments	15.8	6.6	1.2	8.0
Balance as of July 1, 2017	\$1,469.0	\$ 547.2	\$ 343.0	\$ 578.8
Cumulative Goodwill Impairment Charges	\$275.7	\$ 244.8	\$ 7.7	\$ 23.2

Intangible Assets

Intangible assets consisted of the following (in millions):

	Weighted Average Amortization Period (Years)	July 1, 2017		December 31, 2016	
		Gross Value	Accumulated Amortization	Gross Value	Accumulated Amortization
Amortizable Intangible Assets:					
Customer Relationships	15	\$714.0	\$ 226.1	\$703.6	\$ 201.6
Technology	11	191.1	116.5	189.7	109.5
Trademarks	12	32.4	24.7	31.8	23.3
Patent and Engineering Drawings	5	16.6	16.6	16.6	16.6
Non-Compete Agreements	5	8.4	8.2	8.3	8.1
		962.5	392.1	950.0	359.1
Non-Amortizable Trade Names		121.9	—	120.8	—
		\$1,084.4	\$ 392.1	\$1,070.8	\$ 359.1

Amortization expense recorded for the three and six months ended July 1, 2017 was \$13.9 million and \$28.0 million, respectively. Amortization expense recorded for the three and six months ended July 2, 2016 was \$15.8 million and \$31.4 million, respectively. Amortization expense for 2017 is estimated to be \$55.3 million.

Estimated expected future annual amortization for intangible assets is as follows (in millions):

Year	Estimated Amortization
2018	\$ 53.3
2019	52.9
2020	49.8
2021	42.1
2022	40.4

6. BUSINESS SEGMENTS

The Commercial and Industrial Systems segment produces medium and large electric motors, power generation products, high-performance drives and controls, and starters. Applications include general commercial and industrial equipment, commercial HVAC, power generation, and oil and gas.

The Climate Solutions segment produces small motors, controls and air moving solutions. Applications include residential and

light commercial HVAC, commercial refrigeration and water heaters.

The Power Transmission Solutions segment produces power transmission gearing, hydraulic pump drives, large open gearing and specialty mechanical products. Applications include material handling, industrial equipment, energy and off-road equipment.

The Company evaluates performance based on the segment's income from operations. Corporate costs have been allocated to each segment based on the net sales of each segment. The reported external net sales of each segment are from external customers.

The following sets forth certain financial information attributable to the Company's operating segments as of and for the three and six months ended July 1, 2017 and July 2, 2016 (in millions):

	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions	Eliminations	Total
As of and for Three Months Ended July 1, 2017					
External Sales	\$ 407.4	\$ 270.5	\$ 191.3	\$ —	\$ 869.2
Intersegment Sales	19.9	6.0	2.2	(28.1)	—
Total Sales	427.3	276.5	193.5	(28.1)	869.2
Gross Profit	91.9	68.3	62.8	—	223.0
Operating Expenses	71.3	28.1	40.6	—	140.0
Income from Operations	20.6	40.2	22.2	—	83.0
Depreciation and Amortization	14.8	5.6	14.0	—	34.4
Capital Expenditures	11.1	2.3	3.3	—	16.7
As of and for Three Months Ended July 2, 2016					
External Sales	\$ 394.7	\$ 254.5	189.4	\$ —	\$ 838.6
Intersegment Sales	11.4	7.0	1.1	(19.5)	—
Total Sales	406.1	261.5	190.5	(19.5)	838.6
Gross Profit	96.2	64.7	62.0	—	222.9
Operating Expenses	71.1	28.6	31.8	—	131.5
Income from Operations	25.1	36.1	30.2	—	91.4
Depreciation and Amortization	19.2	6.5	13.2	—	38.9
Capital Expenditures	9.6	3.6	3.6	—	16.8

	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions	Eliminations	Total
As of and for Six Months Ended July 1, 2017					
External Sales	\$ 788.6	\$ 518.2	\$ 375.9	\$ —	\$1,682.7
Intersegment Sales	35.8	14.2	2.9	(52.9)	—
Total Sales	824.4	532.4	378.8	(52.9)	1,682.7
Gross Profit	187.5	129.0	122.1	—	438.6
Operating Expenses	141.1	57.6	82.1	—	280.8
Income from Operations	46.4	71.4	40.0	—	157.8
Depreciation and Amortization	30.0	11.1	27.7	—	68.8
Capital Expenditures	21.7	6.6	5.4	—	33.7
As of and for Six Months Ended July 2, 2016					
External Sales	\$ 772.3	\$ 494.3	390.2	\$ —	\$1,656.8
Intersegment Sales	22.7	12.2	2.0	(36.9)	—
Total Sales	795.0	506.5	392.2	(36.9)	1,656.8
Gross Profit	189.8	120.9	129.6	—	440.3
Operating Expenses	143.0	60.2	76.4	—	279.6
Income from Operations	46.8	60.7	53.2	—	160.7
Depreciation and Amortization	38.9	12.7	27.4	—	79.0
Capital Expenditures	16.9	7.5	7.3	—	31.7

The following table presents identifiable assets information attributable to the Company's operating segments as of July 1, 2017 and December 31, 2016 (in millions):

	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions	Total
Identifiable Assets as of July 1, 2017	\$ 1,926.2	\$ 946.1	\$ 1,610.7	\$4,483.0
Identifiable Assets as of December 31, 2016	\$ 1,872.7	\$ 881.8	\$ 1,604.0	\$4,358.5

7. DEBT AND BANK CREDIT FACILITIES

The Company's indebtedness as of July 1, 2017 and December 31, 2016 was as follows (in millions):

	July 1, 2017	December 31, 2016
Term Facility	\$686.1	\$ 798.1
Senior Notes	600.0	600.0
Multicurrency Revolving Facility	15.9	18.0
Other	5.3	5.1
Less: Debt Issuance costs	(7.1)	(9.7)
	1,300.2	1,411.5
Less: Current Maturities	100.7	100.6
Non-Current Portion	\$1,199.5	\$ 1,310.9

The Credit Agreement

In connection with the Company's acquisition of the Power Transmission Solutions business of Emerson Electric Co. (the "PTS Acquisition"), on January 30, 2015, the Company entered into a Credit Agreement (the "Credit Agreement") with JPMorgan Chase Bank, N.A., as Administrative Agent and the lenders named therein, providing for a (i) 5-year unsecured term loan facility in the principal amount of \$1.25 billion (the "Term Facility") and (ii) a 5-year unsecured multicurrency revolving facility in the principal amount of \$500.0 million (the "Multicurrency Revolving Facility"), including a \$100.0 million letter of credit sub facility, available for general corporate purposes. Borrowings under the Credit Agreement bear interest at floating rates based upon indices determined by the currency of the borrowing, plus an applicable margin determined by reference to the Company's consolidated funded debt to consolidated EBITDA ratio or at an alternative base rate.

The Term Facility was drawn in full on January 30, 2015 in connection with the closing of the PTS Acquisition. The loan under the Term Facility requires quarterly amortization at a rate starting at 5.0% per annum, increasing to 7.5% per annum after two years and further increasing to 10.0% per annum for the last two years of the Term Facility, unless previously prepaid. The weighted average interest rate on the Term Facility was 2.5% and 2.4% for the three and six months ended July 1, 2017 and 1.9% for the three and six months ended July 2, 2016. The Credit Agreement requires the Company prepay the loans under the Term Facility with 100% of the net cash proceeds received from specified asset sales and borrowed money indebtedness, subject to certain exceptions.

At July 1, 2017, the Company had borrowings under the Multicurrency Revolving Facility in the amount of \$15.9 million, \$32.3 million of standby letters of credit issued under the facility, and \$451.8 million of available borrowing capacity. The average daily balance in borrowings under the Multicurrency Revolving Facility was \$114.8 million and \$109.2 million, and the weighted average interest rate on the Multicurrency Revolving Facility was 2.5% and 2.4% for the three and six months ended July 1, 2017, respectively. The average daily balance in borrowings under the Multicurrency Revolving Facility was \$29.8 million and \$52.7 million and the weighted average interest rate on the Multicurrency Revolving Facility was 1.9% for the three and six months ended July 2, 2016. The Company pays a non-use fee on the aggregate unused amount of the Multicurrency Revolving Facility at a rate determined by reference to its consolidated funded debt to consolidated EBITDA ratio.

Senior Notes

At July 1, 2017, the Company had \$600.0 million of senior notes (the "Notes") outstanding. The Notes consist of (i) \$500.0 million in senior notes (the "2011 Notes") in a private placement which were issued in seven tranches with maturities from seven to twelve years and carry fixed interest rates and (ii) \$100.0 million in senior notes (the "2007 Notes") issued in 2007 with a floating interest rate based on a margin over the London Inter-Bank Offered Rate ("LIBOR"). The 2011 Notes are included in Long-Term Debt and the 2007 Notes are included in Current Maturities of Long-Term Debt on the Condensed Consolidated Balance Sheets.

Details on the Notes at July 1, 2017 were (in millions):

	Principal	Interest Rate	Maturity
Floating Rate Series 2007A	\$ 100.0	Floating (1)	August 23, 2017
Fixed Rate Series 2011A	100.0	4.1%	July 14, 2018
Fixed Rate Series 2011A	230.0	4.8 to 5.0%	July 14, 2021
Fixed Rate Series 2011A	170.0	4.9 to 5.1%	July 14, 2023
	\$ 600.0		

(1) Interest rates vary as LIBOR varies. At July 1, 2017, the interest

rate was
1.9%. At
December
31, 2016,
the interest
rate was
1.6%

The Company has interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk (see also Note 13 of Notes to the Condensed Consolidated Financial Statements).

Financial Covenants

The Credit Agreement and the Notes require the Company to meet specified financial ratios and to satisfy certain financial condition tests. The Company was in compliance with all financial covenants contained in the Notes and the Credit Agreement as of July 1, 2017.

Other Notes Payable

At July 1, 2017, other notes payable of approximately \$5.3 million were outstanding with a weighted average interest rate of 5.1%. At December 31, 2016, other notes payable of approximately \$5.1 million were outstanding with a weighted average rate of 5.6%.

Based on rates for instruments with comparable maturities and credit quality, which are classified as Level 2 inputs (see also Note 14 of Notes to the Condensed Consolidated Financial Statements), the approximate fair value of the Company's total debt was \$1,325.3 million and \$1,433.4 million as of July 1, 2017 and December 31, 2016, respectively.

8. POST RETIREMENT PLANS

The Company's net periodic benefit cost was comprised of the following components (in millions):

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Service Cost	\$1.8	\$2.0	\$3.6	\$4.1
Interest Cost	2.4	2.7	4.8	5.1
Expected Return on Plan Assets	(2.8)	(2.9)	(5.6)	(5.9)
Amortization of Prior Service Cost and Net Actuarial Loss	0.6	1.0	1.2	1.9
Net Periodic Benefit Cost	\$2.0	\$2.8	\$4.0	\$5.2

The estimated net actuarial loss and prior service cost for post retirement plans that will be amortized from AOCI into net periodic benefit cost during the 2017 fiscal year is \$2.2 million and \$0.2 million, respectively.

For the three months ended July 1, 2017 and July 2, 2016, the Company contributed \$1.4 million and \$1.1 million, respectively, to post retirement plans. For the six months ended July 1, 2017 and July 2, 2016, the Company contributed \$2.2 million and \$2.2 million, respectively, to post retirement plans. The Company expects to make total contributions of \$4.4 million in 2017. The Company contributed a total of \$10.4 million in fiscal 2016. The assumptions used in the valuation of the Company's post retirement plans and in the target investment allocation have remained the same as those disclosed in the Company's 2016 Annual Report on Form 10-K filed on March 1, 2017.

9. SHAREHOLDERS' EQUITY

Repurchase of Common Stock

The Company acquired and retired 276,804 shares of its common stock in the quarter ended July 1, 2017, at an average cost of \$78.42 per share for a total cost of \$21.7 million. The repurchases were under the 3.0 million share repurchase program approved by the Company's Board of Directors in November, 2013. There are approximately 2.0 million shares of the Company's common stock available for repurchase under this program.

Share-Based Compensation

The majority of the Company's annual share-based incentive awards are made in the fiscal second quarter.

The Company recognized approximately \$4.1 million and \$3.8 million in share-based compensation expense for the three months ended July 1, 2017 and July 2, 2016, respectively. Share-based compensation expense was \$7.1 million for the six months ended July 1, 2017 and July 2, 2016. The total income tax benefit recognized in the Consolidated Statements of Income for share-based compensation expense was \$1.6 million and \$1.4 million for the three months ended July 1, 2017 and July 2, 2016, respectively. The total income tax benefit recognized in the Consolidated

Statements of Income for share-based compensation expense was \$2.7 million for the six months ended July 1, 2017 and July 2, 2016. The Company recognizes compensation expense on grants of share-based compensation awards on a straight-line basis over the vesting period of each award. As of July 1, 2017, total unrecognized compensation cost related to share-based compensation awards was approximately \$31.3 million, net of estimated forfeitures, which the Company expects to recognize over a weighted average period of approximately 2.4 years.

Approximately 0.9 million shares were available for future grant under the 2013 Equity Incentive Plan at July 1, 2017.

Options and Stock Appreciation Rights

The Company uses stock settled stock appreciation rights (“SARs”) as a form of share-based incentive awards. SARs are the right to receive stock in an amount equal to the appreciation in value of a share of stock over the base price per share that generally vest over 5 years and expire 10 years from the grant date. All grants are made at prices equal to the fair market value of the stock on the grant date. For the six months ended July 1, 2017 and July 2, 2016, expired and canceled shares were immaterial.

The table below presents share-based compensation activity for the six months ended July 1, 2017 and July 2, 2016 (in millions):

	July 1, 2017	July 2, 2016
Total intrinsic value of share-based incentive awards exercised	\$ 3.1	\$0.3
Cash received from stock option exercises	0.4	0.5
Income tax benefit (expense) from the exercise of stock options	0.7	(0.1)
Total fair value of share-based incentive awards vested	4.3	4.8

The assumptions used in the Company's Black-Scholes valuation related to grants for options and SARs were as follows:

	2017	2016
Per share weighted average fair value of grants	\$23.31	\$15.22
Risk-free interest rate	2.1 %	1.4 %
Expected life (years)	7.0	7.0
Expected volatility	28.6 %	29.6 %
Expected dividend yield	1.3 %	1.7 %

The average risk-free interest rate is based on US Treasury security rates in effect as of the grant date. The expected dividend yield is based on the projected annual dividend as a percentage of the estimated market value of the Company's common stock as of the grant date. The Company estimated the expected volatility using a weighted average of daily historical volatility of the Company's stock price over the expected term of the award. The Company estimated the expected term using historical data adjusted for the estimated exercise dates of unexercised awards. Following is a summary of share-based incentive plan grant activity (options and SARs) for the six months ended July 1, 2017.

Number of Shares Under Options and SARs	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in millions)
Exercisable at December 31, 2016	1,610,499	\$ 63.16		
Granted	194,142	80.70		
Exercised	(134,991)	52.67		
Forfeited	(1,180)	54.61		
Expired	(9,485)	64.21		
Outstanding at July 1, 2017	1,658,985	\$ 66.07	6.1	\$ 25.4
Exercisable at July 1, 2017	989,761	\$ 63.93	4.3	\$ 17.4

Compensation expense recognized related to options and SARs was \$2.2 million for the six months ended July 1, 2017.

As of July 1, 2017, there was \$12.0 million of unrecognized compensation cost related to non-vested options and SARs that is expected to be recognized as a charge to earnings over a weighted average period of 3.6 years.

The amount of options expected to vest is materially consistent with those outstanding and not yet exercisable.

Restricted Stock Awards and Restricted Stock Units

Restricted stock awards ("RSA") and restricted stock units ("RSU") consist of shares or the rights to shares of the Company's stock. The awards are restricted such that they are subject to substantial risk of forfeiture and to restrictions on their sale or other

transfer. As defined in the individual grant agreements, acceleration of vesting may occur under a change in control, or death, disability or normal retirement of the grantee.

Following is a summary of RSA award activity for the six months ended July 1, 2017:

	Shares	Weighted Average Fair Value at Grant Date	Weighted Average Remaining Contractual Term (years)
Unvested RSAs at December 31, 2016	19,593	\$ 57.43	0.4
Granted	13,941	80.70	
Vested	(19,593)	57.43	
Unvested RSAs at July 1, 2017	13,941	\$ 80.70	0.9

RSAs vest on the first anniversary of the grant date, provided the holder of the shares is continuously employed by or in the service of the Company until the vesting date. Compensation expense recognized related to the RSAs was \$0.6 million for the six months ended July 1, 2017.

As of July 1, 2017, there was \$1.0 million of unrecognized compensation cost related to non-vested RSAs that is expected to be recognized as a charge to earnings over a weighted average period of 0.9 years.

Following is a summary of RSU award activity for the six months ended July 1, 2017:

	Shares	Weighted Average Fair Value at Grant Date	Weighted Average Remaining Contractual Term (years)
Unvested RSUs at December 31, 2016	277,863	\$ 69.23	1.7
Granted	75,614	80.46	
Vested	(28,625)	75.15	
Forfeited	(1,614)	67.90	
Unvested RSUs at July 1, 2017	273,218	\$ 70.64	2.1

RSUs vest on the third anniversary of the grant date, provided the holder of the RSUs is continuously employed by the Company until the vesting date. Compensation expense recognized related to the RSUs was \$3.3 million for the six months ended July 1, 2017.

As of July 1, 2017, there was \$11.4 million of unrecognized compensation cost related to non-vested RSUs that is expected to be recognized as a charge to earnings over a weighted average period of 2.1 years.

Performance Share Units

Performance share unit ("PSU") awards consist of shares or the rights to shares of the Company's stock which are awarded to employees of the Company. These shares are payable upon the determination that the Company achieved

certain established performance targets and can range from 0% to 200% of the targeted payout based on the actual results. PSUs have a performance period of 3 years. As set forth in the individual award agreements, acceleration of vesting may occur under a change in control, death or disability. There are no voting rights associated with PSUs until vesting occurs and a share of stock is issued. Some of the PSU awards are valued using a Monte Carlo simulation method as of the grant date while others are valued using the closing market price as of the grant date depending on the performance criteria for the award.

The assumptions used in the Company's Monte Carlo simulation related to grants for performance share units were as follows:

	July 1, July 2,	
	2017	2016
Risk-free interest rate	1.6 %	0.9 %
Expected life (years)	3.0	3.0
Expected volatility	24.0%	23.0%
Expected dividend yield	1.3 %	1.7 %

Following is a summary of PSU award activity for the six months ended July 1, 2017:

Shares	Weighted Average Fair Value at Grant Date	Weighted Average Remaining Contractual Term (years)
Unvested PSUs at December 31, 2016		
133,340	\$ 65.28	2.0
Granted		
48,403	90.80	
Vested		
(110)	83.74	
Forfeited		
(21,705)	83.21	
Unvested PSUs at July 1, 2017		
156,928	\$ 70.31	2.4

Compensation expense for awards granted is recognized based on the Monte Carlo simulation value or the expected payout ratio depending upon the performance criterion for the award, net of estimated forfeitures. Compensation expense recognized related to PSUs was \$1.0 million for the six months ended July 1, 2017. Total unrecognized compensation expense for all PSUs granted as of July 1, 2017 is estimated to be \$6.9 million recognized as a charge to earnings over a weighted average period of 2.4 years.

10. INCOME TAXES

The effective tax rate for the three months ended July 1, 2017 was 21.6% versus 24.9% for the three months ended July 2, 2016. The effective tax rate for the six months ended July 1, 2017 was 22.0% versus 24.1% for the six months ended July 2, 2016. The change in the effective tax rate for the three months and six months ended July 1, 2017 was primarily driven by the mix of earnings and the 2016 gain derived from the sale of the Mastergear business. The lower effective rate as compared to the 35.0% statutory Federal income tax rate is driven by lower foreign tax rates. As of July 1, 2017 and December 31, 2016, the Company had approximately \$10.2 million and \$10.0 million, respectively, of unrecognized tax benefits, all of which would impact the effective income tax rate if recognized. Potential interest and penalties related to unrecognized tax benefits are recorded in income tax expense. With few exceptions, the Company is no longer subject to US Federal and state/local income tax examinations by tax authorities for years prior to 2012, and the Company is no longer subject to non-US income tax examinations by tax authorities for years prior to 2010.

11. EARNINGS PER SHARE

Diluted earnings per share is computed based upon earnings applicable to common shares divided by the weighted-average number of common shares outstanding during the period adjusted for the effect of other dilutive securities. Options for common shares where the exercise price was above the market price have been excluded from the calculation of effect of dilutive securities shown below; the amount of the anti-dilutive shares were 0.4 million and 1.3 million for the three months ended July 1, 2017 and July 2, 2016, respectively, and 0.4 million and 1.2 million for the six months ended July 1, 2017 and July 2, 2016, respectively. The following table reconciles the basic and diluted shares used in earnings per share calculations for the three and six months ended July 1, 2017 and July 2, 2016 (in

millions):

	Three Months Ended		Six Months Ended	
	July 2, 2017	July 2, 2016	July 2, 2017	July 2, 2016
Denominator for Basic Earnings Per Share	44.7	44.7	44.8	44.7
Effect of Dilutive Securities	0.4	0.3	0.3	0.3
Denominator for Diluted Earnings Per Share	45.1	45.0	45.1	45.0

21

12. CONTINGENCIES

One of the Company's subsidiaries that it acquired in 2007 is subject to numerous claims filed in various jurisdictions relating to certain sub-fractional motors that were primarily manufactured through 2004 and that were included as components of residential and commercial ventilation units manufactured and sold in high volumes by a third party. These ventilation units are subject to regulation by government agencies such as the US Consumer Product Safety Commission ("CPSC"). The claims generally allege that the ventilation units were the cause of fires. The Company has recorded an estimated liability for incurred claims. Based on the current facts, the Company cannot assure that these claims, individually or in the aggregate, will not have a material adverse effect on its subsidiary's financial condition. The Company's subsidiary cannot reasonably predict the outcome of these claims, the nature or extent of any CPSC or other remedial actions, if any, that the Company's subsidiary may need to undertake with respect to motors that remain in the field, or the costs that may be incurred, some of which could be significant.

The Company is, from time to time, party to litigation and other legal or regulatory proceedings that arise in the normal course of its business operations and the outcomes of which are subject to significant uncertainty, including product warranty and liability claims, contract disputes and environmental, asbestos, intellectual property, employment and other litigation matters. The Company's products are used in a variety of industrial, commercial and residential applications that subject the Company to claims that the use of its products is alleged to have resulted in injury or other damage. Many of these matters will only be resolved when one or more future events occur or fail to occur. Management conducts regular reviews, including updates from legal counsel, to assess the need for accounting recognition or disclosure of these contingencies, and such assessment inherently involves an exercise in judgment. The Company accrues for exposures in amounts that it believes are adequate, and the Company does not believe that the outcome of any such lawsuit individually or collectively will have a material effect on the Company's financial position, its results of operations or its cash flows.

The Company recognizes the cost associated with its standard warranty on its products at the time of sale. The amount recognized is based on historical experience. The following is a reconciliation of the changes in accrued warranty costs for the three and six months ended July 1, 2017 and July 2, 2016 (in millions):

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Beginning Balance	\$ 18.2	\$ 17.5	\$20.3	\$19.1
Less: Payments	(4.5)	(4.6)	(12.8)	(9.7)
Provisions	4.4	6.3	10.5	9.8
Translation Adjustments	—	—	0.1	—
Ending Balance	\$ 18.1	\$ 19.2	\$18.1	\$19.2

These liabilities are included in Other Accrued Expenses and Other Noncurrent Liabilities on the Consolidated Balance Sheet.

13. DERIVATIVE INSTRUMENTS

The Company is exposed to certain risks relating to its ongoing business operations. The primary risks managed using derivative instruments are commodity price risk, currency exchange risk, and interest rate risk. Forward contracts on certain commodities are entered into to manage the price risk associated with forecasted purchases of materials used in the Company's manufacturing process. Forward contracts on certain currencies are entered into to manage forecasted cash flows in certain foreign currencies. Interest rate swaps are entered into to manage interest rate risk associated with the Company's floating rate borrowings.

The Company is exposed to credit losses in the event of non-performance by the counterparties to various financial agreements, including its commodity hedging transactions, foreign currency exchange contracts and interest rate swap agreements. Exposure to counterparty credit risk is managed by limiting counterparties to major international banks and financial institutions meeting established credit guidelines and continually monitoring their compliance with the credit guidelines. The Company does not obtain collateral or other security to support financial instruments subject to

credit risk. The Company does not anticipate non-performance by its counterparties, but cannot provide assurances.

22

The Company recognizes all derivative instruments as either assets or liabilities at fair value in the statement of financial position. The Company designates commodity forward contracts as cash flow hedges of forecasted purchases of commodities, currency forward contracts as cash flow hedges of forecasted foreign currency cash flows and interest rate swaps as cash flow hedges of forecasted LIBOR-based interest payments. There were no significant collateral deposits on derivative financial instruments as of July 1, 2017.

Cash flow hedges

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of AOCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or changes in market value of derivatives not designated as hedges are recognized in current earnings. At July 1, 2017, the Company had \$(2.1) million, net of tax, of derivative losses on closed hedge instruments in AOCI that will be realized in earnings when the hedged items impact earnings. At December 31, 2016, the Company had \$(7.5) million, net of tax, of derivative losses on closed hedge instruments in AOCI that was subsequently realized in earnings when the hedged items impacted earnings.

As of July 1, 2017, the Company had the following currency forward contracts outstanding (with maturities extending through October 2019) to hedge forecasted foreign currency cash flows (in millions):

	Notional Amount (in US Dollars)
Chinese Renminbi	\$ 324.2
Mexican Peso	229.8
Euro	59.8
Indian Rupee	40.7
Canadian Dollar	37.1
Australian Dollar	13.7
Thai Baht	6.2
British Pound	7.8

As of July 1, 2017, the Company had the following commodity forward contracts outstanding (with maturities extending through December 2018) to hedge forecasted purchases of commodities (notional amounts expressed in terms of the dollar value of the hedged item (in millions):

	Notional Amount
Copper	\$ 62.9
Aluminum	5.3

As of July 1, 2017, the total notional amount of the Company's receive-variable/pay-fixed interest rate swap was \$100.0 million (with maturity in August 2017).

Fair values of derivative instruments as of July 1, 2017 and December 31, 2016 were (in millions):

	July 1, 2017			
	Prepaid		Current	Noncurrent
	Expenses	Other	Hedging	Hedging
	and	Noncurrent	Obligations	Obligations
	Other	Assets		
	Current			
	Assets			
Designated as hedging instruments:				
Interest rate swap contracts	\$—	\$ —	\$ 1.1	\$ —
Currency contracts	6.9	5.1	12.8	1.1
Commodity contracts	5.1	0.2	0.2	—
Not designated as hedging instruments:				
Currency contracts	3.2	—	0.4	—
Commodity contracts	0.1	—	—	—
Total Derivatives	\$15.3	\$ 5.3	\$ 14.5	\$ 1.1

	December 31, 2016			
	Prepaid		Current	Noncurrent
	Expenses	Other	Hedging	Hedging
	and	Noncurrent	Obligations	Obligations
	Other	Assets		
	Current			
	Assets			
Designated as hedging instruments:				
Interest rate swap contracts	\$—	\$ —	\$ 3.3	\$ —
Currency contracts	1.3	0.4	39.7	17.6
Commodity contracts	4.7	—	—	—
Not designated as hedging instruments:				
Currency contracts	1.5	—	6.0	—
Commodity contracts	2.6	—	—	—
Total Derivatives	\$10.1	\$ 0.4	\$ 49.0	\$ 17.6

The effect of derivative instruments on the Condensed Consolidated Statements of Income and Comprehensive Income (pre-tax) was as follows (in millions):

Derivatives Designated as Cash Flow Hedging Instruments

	Three Months Ended				July 2, 2016			
	July 1, 2017							
	Commodity	Interest	Total	Commodity	Interest	Total		
	Forwards	Rate Swaps		Forwards	Rate Swaps			
Gain (Loss) recognized in Other Comprehensive Income (Loss)	\$2.2	\$ 13.9	\$ —	\$16.1	\$0.7	\$(18.2)	\$(0.3)	\$(17.8)
Amounts reclassified from Other Comprehensive Income (Loss):								
Gain recognized in Net Sales	—	0.3	—	0.3	—	—	—	—
Gain (Loss) recognized in Cost of Sales	3.8	(7.5)	—	(3.7)	(4.3)	(6.7)	—	(11.0)
Loss recognized in Interest Expense	—	—	(1.1)	(1.1)	—	—	(1.3)	(1.3)
	Six Months Ended				July 2, 2016			
	July 1, 2017							
	Commodity	Interest	Total	Commodity	Interest	Total		
	Forwards	Rate Swaps		Forwards	Rate Swaps			
Gain (Loss) recognized in Other Comprehensive Income (Loss)	\$4.5	\$ 42.9	\$ —	\$47.4	\$2.1	\$(15.6)	\$(0.7)	\$(14.2)
Amounts reclassified from Other Comprehensive Income (Loss):								
Gain recognized in Net Sales	—	0.4	—	0.4	—	—	—	—
Gain (Loss) recognized in Cost of Sales	4.7	(19.1)	—	(14.4)	(9.7)	(13.2)	—	(22.9)
Loss recognized in Interest Expense	—	—	(2.2)	(2.2)	—	—	(2.5)	(2.5)

The ineffective portion of hedging instruments recognized during the three and six months ended July 1, 2017 and July 2, 2016, respectively, was immaterial.

Derivatives Not Designated as Cash Flow Hedging Instruments (in millions):

	Three Months Ended			
	July 1, 2017		July 2, 2016	
	Commodity	Currency	Commodity	Currency
	Forwards	Forwards	Forwards	Forwards
Gain (Loss) recognized in Cost of Sales	\$(1.4)	\$ —	—\$ 0.1	\$ —
Gain (Loss) recognized in Operating Expenses	—	3.3	—	(1.6)
	Six Months Ended			
	July 1, 2017		July 2, 2016	
	Commodity	Currency	Commodity	Currency
	Forwards	Forwards	Forwards	Forwards
Gain recognized in Cost of Sales	\$0.2	\$ —	—\$ 0.2	\$ —
Gain (Loss) recognized in Operating Expenses	—	7.7	—	(0.7)

The net AOCI hedging component balance of \$(1.7) million loss at July 1, 2017 includes \$0.4 million of net current deferred gains expected to be realized in the next twelve months.

The Company's commodity and currency derivative contracts are subject to master netting agreements with the respective counterparties which allow the Company to net settle transactions with a single net amount payable by one party to another party. The Company has elected to present the derivative assets and derivative liabilities on the Condensed Consolidated Balance Sheets on a gross basis for the periods ended July 1, 2017 and December 31, 2016.

The following table presents the derivative assets and derivative liabilities presented on a net basis under enforceable master netting agreements (in millions):

	July 1, 2017		
	Gross		
	Amounts	Derivative	Derivative
	as	Contract	Contracts
	Presented	Amounts	as
	in the	Subject to	Presented
	Condensed	Right of	on a Net
	Consolidated	Offset	Basis
	Balance		
	Sheet		
Prepaid Expenses and Other Current Assets:			
Derivative Currency Contracts	\$10.1	\$ (5.6)	\$ 4.5
Derivative Commodity Contracts	5.2	(0.2)	5.0
Other Noncurrent Assets:			
Derivative Currency Contracts	5.1	(0.9)	4.2
Derivative Commodity Contracts	0.2	—	0.2
Current Hedging Obligations:			
Derivative Currency Contracts	13.2	(5.6)	7.6
Derivative Commodity Contracts	0.2	(0.2)	—
Noncurrent Hedging Obligations:			
Derivative Currency Contracts	1.1	(0.9)	0.2
	December 31, 2016		
	Gross		
	Amounts	Derivative	Derivative
	as	Contract	Contracts
	Presented	Amounts	as
	in the	Subject to	Presented
	Condensed	Right of	on a Net
	Consolidated	Offset	Basis
	Balance		
	Sheet		

14. FAIR VALUE

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The inputs used to measure fair value are classified into the following hierarchy:

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities
- Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or
Unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or
Inputs other than quoted prices that are observable for the asset or liability
- Level 3 Unobservable inputs for the asset or liability

The Company uses the best available information in measuring fair value. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The fair values of cash equivalents and short-term deposits approximate their carrying values as of July 1, 2017 and December 31, 2016, due to the short period of time to maturity and are classified using Level 1 inputs. The fair values of trade receivables and accounts payable approximate the carrying values due to the short period of time to maturity. See Note 7 of Notes to Condensed Consolidated Financial Statements for disclosure of the approximate fair value of the Company's debt at July 1, 2017 and December 31, 2016.

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of July 1, 2017 and December 31, 2016 (in millions):

	July 1, 2017	December 31, 2016	Classification
Assets:			
Prepaid Expenses and Other Current Assets:			
Derivative Currency Contracts	\$ 10.1	\$ 2.8	Level 2
Derivative Commodity Contracts	5.2	7.3	Level 2
Other Noncurrent Assets:			
Assets Held in Rabbi Trust	5.5	5.4	Level 1
Derivative Currency Contracts	5.1	0.4	Level 2
Derivative Commodity Contracts	0.2	—	Level 2
Liabilities:			
Current Hedging Obligations:			
Interest Rate Swap	1.1	3.3	Level 2
Derivative Currency Contracts	13.2	45.7	Level 2
Derivative Commodity Contracts	0.2	—	Level 2
Noncurrent Hedging Obligations:			
Derivative Currency Contracts	1.1	17.6	Level 2

Level 1 fair value measurements for assets held in a Rabbi Trust are unadjusted quoted prices.

Level 2 fair value measurements for derivative assets and liabilities are measured using quoted prices in active markets for similar assets and liabilities. Interest rate swaps are valued based on the discounted cash flows for the LIBOR forward yield curve for a swap with similar contractual terms. Foreign currency forwards are valued based on exchange rates quoted by domestic and foreign banks for similar instruments. Commodity forwards are valued based on observable market transactions of forward commodity prices.

During the six months ended July 1, 2017, there were no transfers between classification Levels 1, 2 or 3.

15. RESTRUCTURING AND RELATED COSTS

The Company incurred restructuring and restructuring related costs on projects beginning in 2014. Restructuring costs include employee termination and plant relocation costs. Restructuring-related costs include costs directly associated with actions resulting from our Simplification initiatives, such as asset write-downs or accelerated depreciation due to shortened useful lives in connection with site closures, discretionary employment benefit costs and other facility rationalization costs. Restructuring costs for employee termination expenses are generally required to be accrued over the employees remaining service period while restructuring costs for plant relocation costs and restructuring-related costs are generally required to be expensed as incurred.

The following is a reconciliation of provisions and payments for the restructuring projects for the three and six months ended July 1, 2017 and July 2, 2016 (in millions):

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Beginning Balance	\$1.0	\$ 1.0	\$0.6	\$ 1.3
Provision	7.7	1.7	10.9	3.1
Less: Payments	7.4	1.3	10.2	3.0
Ending Balance	\$1.3	\$ 1.4	\$1.3	\$ 1.4

The following is a reconciliation of restructuring and restructuring-related costs for the restructuring projects for the three and six months ended July 1, 2017 and July 2, 2016, respectively (in millions):

	Three Months Ended					
	July 1, 2017			July 2, 2016		
Restructuring Costs:	Cost of Sales	Operating Expenses	Total	Cost of Sales	Operating Expenses	Total
Employee Termination Expenses	\$1.2	\$ 0.7	\$ 1.9	\$0.2	\$ 0.1	\$ 0.3
Facility Related Costs	1.6	0.1	1.7	0.4	0.4	0.8
Other Expenses	3.9	—	3.9	0.6	—	0.6
Total Restructuring Costs	\$6.7	\$ 0.8	\$ 7.5	\$1.2	\$ 0.5	\$ 1.7
Restructuring Related Costs:						
Other Employment Benefit Expenses	\$0.2	—	\$0.2	\$—	\$ —	\$—
Total Restructuring Related Costs	\$0.2	—	\$0.2	\$—	\$ —	\$—
Total Restructuring and Restructuring Related Costs	\$6.9	\$ 0.8	\$ 7.7	\$1.2	\$ 0.5	\$ 1.7
	Six Months Ended					
	July 1, 2017			July 2, 2016		
Restructuring Costs:	Cost of Sales	Operating Expenses	Total	Cost of Sales	Operating Expenses	Total
Employee Termination Expenses	\$2.4	\$ 1.3	\$3.7	\$0.4	\$ 0.1	\$ 0.5
Facility Related Costs	2.3	0.3	2.6	0.5	0.4	0.9
Other Expenses	3.9	—	3.9	0.6	—	0.6
Total Restructuring Costs	\$8.6	\$ 1.6	\$10.2	\$1.5	\$ 0.5	\$ 2.0
Restructuring Related Costs:						
Other Employment Benefit Expenses	\$0.7	—	\$0.7	\$0.5	\$ 0.6	\$ 1.1
Total Restructuring Related Costs	\$0.7	—	\$0.7	\$0.5	\$ 0.6	\$ 1.1

Total Restructuring and Restructuring Related Costs \$9.3\$ 1.6 \$10.9 \$2.0\$ 1.1 \$3.1

The following table shows the allocation of Restructuring Costs by segment for the three and six months ended July 1, 2017 and July 2, 2016. (in millions):

	Total	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions
Restructuring Costs - Three Months Ended July 1, 2017	\$ 7.7	\$ 6.9	\$ 0.6	\$ 0.2
Restructuring Costs - Three Months Ended July 2, 2016	\$ 1.7	\$ 0.7	\$ 0.5	\$ 0.5

	Total	Commercial and Industrial Systems	Climate Solutions	Power Transmission Solutions
Restructuring Costs - Six Months Ended July 1, 2017	\$ 10.9	\$ 8.6	\$ 1.7	\$ 0.6
Restructuring Costs - Six Months Ended July 2, 2016	\$ 3.1	\$ 0.8	\$ 1.8	\$ 0.5

The Company's current restructuring activities are expected to continue into 2018. The Company expects to record aggregate future charges of approximately \$8.7 million which includes \$1.8 million of employee termination expenses and \$6.9 million of facility related and other costs.

16. SUBSEQUENT EVENT

The Company has evaluated subsequent events from July 1, 2017 through the date of this report. The Company is not aware of any subsequent events that would require recognition or disclosure.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless the context requires otherwise, references in this Item 2 to "we," "us," "our" or the "Company" refer collectively to Regal Beloit Corporation and its subsidiaries.

Overview

Regal Beloit Corporation (NYSE: RBC), based in Beloit, Wisconsin (USA), is a leading manufacturer of electric motors, electrical motion controls, power generation and power transmission products serving markets throughout the world.

Operating Segments

Our company is comprised of three operating segments: Commercial and Industrial Systems, Climate Solutions and Power Transmission Solutions.

A description of the three operating segments is as follows:

- Commercial and Industrial Systems produces medium and large motors, commercial and industrial equipment, generator and custom drives and systems. These products serve markets including commercial Heating, Ventilation, and Air Conditioning ("HVAC"), pool and spa, standby and critical power and oil and gas systems.
- Climate Solutions produces small motors, controls and air moving solutions serving markets including residential and light commercial HVAC, water heaters and commercial refrigeration.
-

Power Transmission Solutions manufactures, sells and services belt and chain drives, helical and worm gearing, mounted and unmounted bearings, couplings, modular plastic belts, conveying chains and components, hydraulic pump drives, large open gearing and specialty mechanical products serving markets including beverage, bulk handling, metals, special machinery, energy, aerospace and general industrial.

Components of Profit and Loss

Net Sales. We sell our products to a variety of manufacturers, distributors and end users. Our customers consist of a large cross-section of businesses, ranging from Fortune 100 companies to small businesses. A number of our products are sold to Original Equipment Manufacturers ("OEM's"), who incorporate our products, such as electric motors, into products they manufacture, and many of our products are built to the requirements of our customers. The majority of our sales derive from direct sales, but a significant portion derives from sales made by manufacturer's representatives, who are paid exclusively on commission. Our product sales are made via purchase order, long-term contract, and, in some instances, one-time purchases. Many of our products have broad customer bases, with the levels of concentration of revenues varying from division to division.

Our level of net sales for any given period is dependent upon a number of factors, including (i) the demand for our products; (ii) the strength of the economy generally and the end markets in which we compete; (iii) our customers' perceptions of our product quality at any given time; (iv) our ability to timely meet customer demands; (v) the selling price of our products; and (vi) the weather. As a result, our total revenue has tended to experience quarterly variations and our total revenue for any particular quarter may not be indicative of future results.

We use the term "organic sales" to refer to sales from existing operations excluding (i) sales from acquired businesses recorded prior to the first anniversary of the acquisition less the amount of sales attributable to any divested businesses ("acquisition sales"), and (ii) the impact of foreign currency translation. The impact of foreign currency translation is determined by translating the respective period's sales (excluding acquisition sales) using the same currency exchange rates that were in effect during the prior year periods. We use the term "organic sales growth" to refer to the increase in our sales between periods that is attributable to organic sales. We use the term "acquisition growth" to refer to the increase in our sales between periods that is attributable to acquisition sales.

Gross Profit. Our gross profit is impacted by our levels of net sales and cost of sales. Our cost of sales consists of costs for, among other things (i) raw materials, including copper, steel and aluminum; (ii) components such as castings, bars, tools, bearings and electronics; (iii) wages and related personnel expenses for fabrication, assembly and logistics personnel; (iv) manufacturing facilities, including depreciation on our manufacturing facilities and equipment, taxes, insurance and utilities; and (v) shipping. The majority of our cost of sales consists of raw materials and components. The price we pay for commodities and components can be subject to commodity price fluctuations. We attempt to mitigate this through fixed-price agreements with suppliers and our hedging strategies. We are currently reducing the number of our suppliers we use in order to leverage the better prices and terms that can be obtained with higher volume orders. A large amount of our suppliers are in North America. As we expand production and our geographic footprint, we expect it may be advantageous to increase our use of foreign suppliers. When we experience commodity price increases, we have tended to announce price increases to our customers who purchase via purchase order, with such increases generally taking effect a period of time after the public announcements. For those sales we make under long-term contracts, we tend to include material price formulas that specify quarterly or semi-annual price adjustments based on a variety of factors, including commodity prices.

Outside of general economic cyclicality, our different business units experience different levels of variation in gross margin from quarter to quarter based on factors specific to each division. For example, a portion of our Climate Solutions segment manufactures products that are used in air conditioning applications. As a result, our sales for that business tend to be lower in the first and fourth quarters and higher in the second and third quarters. In contrast, our Commercial and Industrial Systems segment and our Power Transmission Solutions segment have a broad customer base and a variety of applications, thereby helping to mitigate large quarter-to-quarter fluctuations outside of general economic conditions.

Operating Expenses. Our operating expenses consist primarily of (i) general and administrative expenses; (ii) sales and marketing expenses; (iii) general engineering and research and development expenses; and (iv) handling costs

incurred in conjunction with distribution activities. Personnel related costs are our largest operating expense.

Our general and administrative expenses consist primarily of costs for (i) salaries, benefits and other personnel expenses related to our executive, finance, human resource, information technology, legal and operations functions; (ii) occupancy expenses; (iii) technology related costs; (iv) depreciation and amortization; and (v) corporate-related travel. The majority of our general and administrative costs are for salaries and related personnel expenses. These costs can vary by division given the location of our different manufacturing operations.

Our sales and marketing expenses consist primarily of costs for (i) salaries, benefits and other personnel expenses related to our sales and marketing function; (ii) internal and external sales commissions and bonuses; (iii) travel, lodging and other out-of-pocket expenses associated with our selling efforts; and (iv) other related overhead.

Our general engineering and research and development expenses consist primarily of costs for (i) salaries, benefits and other personnel expenses; (ii) the design and development of new energy efficiency products and enhancements; (iii) quality assurance and testing; and (iv) other related overhead. Our research and development efforts tend to be targeted toward developing new products that would allow us to maintain or gain additional market share, whether in new or existing applications. While these costs make up an insignificant portion of our operating expenses in the Power Transmission Solutions segment, they are more substantial in our Commercial and Industrial Systems and Climate Solutions segments. In particular, a large driver of our research and development efforts in these two segments is energy efficiency, which generally means using less electrical power to produce more mechanical power.

Operating Profit. Our operating profit consists of the segment gross profit less the segment operating expenses. In addition, there are shared operating costs that cover corporate, engineering and IT expenses that are consistently allocated to the operating segments and are included in the segment operating expenses. Operating profit is a key metric used to measure year over year improvement of the segments.

Restructuring and Related Costs. Beginning in 2014, we announced the closure of several of our manufacturing and warehouse facilities and consolidation into existing facilities to simplify manufacturing operations in our Commercial and Industrial Systems, Climate Solutions and Power Transmission Solutions segments. As a result of these closures, we incurred restructuring and restructuring-related costs. Restructuring costs includes employee termination and plant relocation costs. Restructuring-related costs includes costs directly associated with actions resulting from our simplification initiatives, such as asset write-downs or accelerated depreciation due to shortened useful lives in connection with site closures, discretionary employment benefit costs and other facility rationalization costs. Restructuring costs for employee termination expenses are generally required to be accrued over the employees remaining service period while restructuring costs for plant relocation costs and restructuring-related costs are generally required to be expensed as incurred.

Outlook

Our order trends remain positive, and we continue to expect low single digit organic sales growth for the full year.

Results of Operations

Three Months Ended July 1, 2017 Compared to July 2, 2016

Net sales increased \$30.6 million or 3.6% for the second quarter 2017 compared to the second quarter 2016. The increase consisted of an organic sales increase of 4.8%, a negative foreign currency translation impact of 0.7% and a negative impact from the sale of the Mastergear Worldwide (“Mastergear”) business of 0.5%. Gross profit of \$223.0 million for the second quarter 2017 was relatively unchanged as compared to the second quarter 2016. Gross profit as a percentage of sales for the second quarter 2017 decreased 90 basis points as compared to the second quarter 2016 primarily driven by restructuring charges, commodity inflation and challenges of increasing our production after recent plant consolidations which were partially offset by the sales volume increase. Operating expenses for the second quarter 2017 increased \$8.5 million or 6.5% as compared to the same period in the prior year. The prior year included a gain on the sale of Mastergear totaling \$11.6 million.

Commercial and Industrial Systems Segment net sales for the second quarter 2017 were \$407.4 million, an increase of \$12.7 million or 3.2% as compared to the second quarter 2016. The increase consisted of an organic sales increase of 4.3%, driven by growth in Asia and improved oil and gas end markets and a negative foreign currency translation impact of 1.1%. Gross profit decreased \$4.3 million as compared to the prior year. The decrease was mainly driven by an increase in restructuring costs due to the exit of a noncore business, commodity inflation and challenges of increasing our production after recent plant consolidations that was partially offset by the increase in sales volume. Operating expenses for the second quarter 2017 were flat at \$71.3 million as compared to the same period in the prior year. Operating expenses as a percentage of net sales decreased 50 basis points as compared to second quarter 2016 due to leveraging of costs on the increased sales base and lower depreciation and amortization expenses which was partially offset by the increase in restructuring charges.

Climate Solutions Segment net sales were \$270.5 million, an increase of 6.3% compared to second quarter 2016 net sales of \$254.5 million. The increase consisted of an organic sales increase of 6.5%, driven by growth in North American residential HVAC and partially offset by weakness in commercial refrigeration. Foreign currency had a negative 0.2% impact on the net sales for the second quarter 2017. Gross profit increased \$3.6 million or 5.6% compared to the prior year primarily due to the increase in sales volume. Operating expenses for the second quarter 2017 were \$28.1 million which was an 80 basis points decrease as a percentage of net sales as compared to the prior year primarily due to leveraging of costs on the increased sales volume.

Power Transmission Solutions segment net sales for the first quarter 2017 were \$191.3 million or a 1.0% increase compared to second quarter 2016 net sales of \$189.4 million. The increase consisted of an organic sales growth increase of 3.5%, a negative impact from the Mastergear divestiture of 2.0% and a negative foreign currency translation impact of 0.5%. The increase in organic

sales was primarily driven by improved oil and gas and renewable energy end market demand. Gross profit for the first quarter 2017 increased \$0.8 million or 1.3% primarily due to the increase in sales volume. Operating expenses for the second quarter 2017 increased \$8.8 million as compared to the second quarter 2016. Operating expenses in the prior year were reduced by the gain on the sale of the Mastergear business of \$11.6 million.

Six Months Ended July 1, 2017 Compared to July 2, 2016

Net sales increased \$25.9 million or 1.6% for the six months ended July 1, 2017 compared to the six months ended July 2, 2016. The increase consisted of an organic sales growth increase of 2.8%, a negative impact from sales of the divested Mastergear business of 0.5% and a negative foreign currency translation impact of 0.6%. Gross profit for the six months ended July 1, 2017 decreased \$1.7 million or 0.4% compared to the six months ended July 2, 2016 primarily due to increased restructuring charges and partially offset by the increase in sales volume. Operating expenses for the six months ended July 1, 2017 increased \$1.2 million or 0.4% compared to the same period in the prior year due the \$11.6 million gain on the sale of the Mastergear business recorded in the prior year which is partially offset by the leveraging of costs on the increased sales volume and lower depreciation and amortization expenses.

Commercial and Industrial Systems segment net sales increased \$16.3 million or 2.1% for the six months ended July 1, 2017 compared to the six months ended July 2, 2016. The increase consisted of an organic sales increase of 3.0% and a negative foreign currency translation impact of 0.9%. Organic sales increase was primarily driven by growth in Asia and improved oil and gas end markets. Gross profit for six months ended 2017 decreased \$2.3 million or 1.2% primarily due to the impact of increased restructuring charges resulting from the exit of a non-core business that was offset by increased sales volume. Operating expenses for the six months ended July 1, 2017 decreased \$1.9 million or 1.3% compared to the six months ended July 2, 2016 due to leveraging of costs on the increased sales base and lower depreciation and amortization expenses.

Climate Solutions segment net sales increased \$23.9 million or 4.8% for the six months ended July 1, 2017 compared to the six months ended July 2, 2016. The increase consisted of an organic sales increase of 5.1% and a negative foreign currency translation impact of 0.3%. The organic sales increase was primarily driven by growth in North American residential HVAC partially offset by weakness in commercial refrigeration. Gross profit increased \$8.1 million or 6.7% primarily due to higher volumes. Operating expenses for the six months ended July 1, 2017 decreased \$2.6 million or 4.3% as compared to the six months ended July 2, 2016.

Power Transmission Solutions segment net sales decreased \$14.3 million or 3.7% for the six months ended July 1, 2017 compared to the six months ended July 2, 2016. The decrease consisted of a negative impact from sales of the divested Mastergear business of 2.3%, an organic sales decline of 0.8% and a negative foreign currency translation impact of 0.5%. Improved oil and gas and renewable energy end market demand sales partially offset the organic sales decline. Gross profit for the six months ended July 1, 2017 compared to the six months ended July 2, 2016 decreased \$7.5 million or 5.8% primarily due to the lower sales volume. Operating expenses for the six months ended July 1, 2017 increased \$5.7 million or 7.5% as compared to the six months ended July 2, 2016 as the prior year included the \$11.6 million gain on the sale of the Mastergear business.

	Three Months Ended		Six Months Ended		
	July 1,	July 2,	July 1,	July 2,	
	2017	2016	2017	2016	
(Dollars in Millions)					
Net Sales:					
Commercial and Industrial Systems	\$407.4	\$394.7	\$788.6	\$772.3	
Climate Solutions	270.5	254.5	518.2	494.3	
Power Transmission Solutions	191.3	189.4	375.9	390.2	
Consolidated	\$869.2	\$838.6	\$1,682.7	\$1,656.8	
Gross Profit as a Percent of Net Sales:					
Commercial and Industrial Systems	22.6	% 24.4	% 23.8	% 24.6	%
Climate Solutions	25.3	% 25.4	% 24.9	% 24.5	%
Power Transmission Solutions	32.8	% 32.7	% 32.5	% 33.2	%
Consolidated	25.7	% 26.6	% 26.1	% 26.6	%
Operating Expenses as a Percent of Net Sales:					
Commercial and Industrial Systems	17.5	% 18.0	% 17.9	% 18.5	%
Climate Solutions	10.4	% 11.2	% 11.1	% 12.2	%
Power Transmission Solutions	21.2	% 16.8	% 21.8	% 19.6	%
Consolidated	16.1	% 15.7	% 16.7	% 16.9	%
Income from Operations as a Percent of Net Sales:					
Commercial and Industrial Systems	5.1	% 6.4	% 5.9	% 6.1	%
Climate Solutions	14.9	% 14.2	% 13.8	% 12.3	%
Power Transmission Solutions	11.6	% 16.0	% 10.6	% 13.6	%
Consolidated	9.5	% 10.9	% 9.4	% 9.7	%
Income from Operations	\$83.0	\$91.4	\$157.8	\$160.7	
Interest Expense	14.7	14.8	29.1	29.8	
Interest Income	1.0	1.2	2.0	2.3	
Income before Taxes	69.3	77.8	130.7	133.2	
Provision for Income Taxes	15.0	19.4	28.8	32.1	
Net Income	54.3	58.4	101.9	101.1	
Less: Net Income Attributable to Noncontrolling Interests	1.3	1.8	2.6	2.9	
Net Income Attributable to Regal Beloit Corporation	\$53.0	\$56.6	\$99.3	\$98.2	

The effective tax rate for the three months ended July 1, 2017 was 21.6% versus 24.9% for the three months ended July 2, 2016. The effective tax rate for the six months ended July 1, 2017 was 22.0% versus 24.1% for the six months ended July 2, 2016. The change in the effective tax rate for the three months and six months ended July 1, 2017 was primarily driven by the mix of earnings and the 2016 gain derived from the sale of the Mastergear business. The lower effective rate as compared to the 35.0% statutory Federal income tax rate is driven by lower foreign tax rates.

Liquidity and Capital Resources

General

Our principal source of liquidity is cash flow provided by operating activities. In addition to operating income, other significant factors affecting our cash flow include working capital levels, capital expenditures, dividends, share

repurchases, acquisitions, availability of debt financing, and the ability to attract long-term capital at acceptable terms.

34

Cash flow provided by operating activities was \$148.9 million for the six months ended July 1, 2017, a \$27.2 million decrease from the six months ended July 2, 2016. The decrease was primarily the result of the higher investment in net working capital for the six months ended July 1, 2017 as compared to the six months ended July 2, 2016.

Cash flow used in investing activities was \$31.9 million for the six months ended July 1, 2017 versus \$2.1 million for the six months ended July 2, 2016. The change was driven by the \$25.0 million received for the sale of our Mastergear business in the six months ended July 2, 2016.

Cash flow used in financing activities was \$164.5 million for the six months ended July 1, 2017, compared to \$151.7 million provided by financing activities for the six months ended July 2, 2016. Net repayments of \$113.8 million were made during the six months ended July 1, 2017, compared to net repayments of \$109.9 million made during the six months ended July 2, 2016. We paid \$21.4 million in dividends to shareholders in the six months ended July 1, 2017, compared to \$20.5 million for the six months ended July 2, 2016. Cash used for share repurchases was \$21.0 million for the six months ended July 1, 2017. Cash used to purchase additional interest in joint ventures was \$19.6 million for the six months ended July 2, 2016.

Our working capital was \$910.3 million at July 1, 2017, compared to \$830.4 million at December 31, 2016. At July 1, 2017 and December 31, 2016, our current ratio (which is the ratio of our current assets to current liabilities) was 2.2:1. Our working capital increased primarily due to an increase in Trade Receivables of \$82.3 million at July 1, 2017 as compared to December 31, 2016. We will pay our \$100.0 million 2007 Note due in August using existing cash as well as cash generated from operations.

The following table presents selected financial information and statistics as of July 1, 2017 and January 2, 2016 (in millions):

	July 1, 2017	December 31, 2016
Cash and Cash Equivalents	\$243.7	\$ 284.5
Trade Receivables, Net	544.5	462.2
Inventories	698.2	660.8
Working Capital	910.3	830.4
Current Ratio	2.2:1	2.2:1

At July 1, 2017, our cash and cash equivalents totaled \$243.7 million. At July 1, 2017, \$239.9 million of our cash was held by foreign subsidiaries and could be used in our domestic operations if necessary. The repatriation of cash from certain foreign subsidiaries could have adverse net tax consequences on us should we be required to pay and record US income taxes and foreign withholding taxes on such funds. We periodically evaluate our cash held outside the US and may pursue opportunities to repatriate certain foreign cash amounts to the extent that we do not incur unfavorable net tax consequences. During the six months ended July 1, 2017, we have repatriated \$101.4 million of foreign cash.

Substantially all of our expenses are paid in cash, often with payment term provisions that include early payment discounts and time elements. We believe that our ability to generate positive cash flow coupled with our available revolving credit balance will be sufficient to fund our operations for the foreseeable future. We focus on optimizing our investment in working capital through improved and enforced payment terms, maintaining an optimal level of inventory and operational efficiencies. Additionally, we believe that our capital expenditures for maintenance of equipment and facilities will be consistent with prior levels and not present a funding challenge.

We will, from time to time, maintain excess cash balances which may be used to (i) fund operations, (ii) repay outstanding debt, (iii) fund acquisitions, (iv) pay dividends, (v) make investments in new product development programs, (vi) repurchase our common stock, or (vii) fund other corporate objectives.