

EATON CORP
Form 10-Q
October 31, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2012
Commission file number 1-1396

EATON CORPORATION

(Exact name of registrant as specified in its charter)

Ohio

34-0196300

(State or other jurisdiction of incorporation or
organization)

(IRS Employer Identification Number)

Eaton Center, Cleveland, Ohio

44114-2584

(Address of principal executive offices)

(Zip Code)

(216) 523-5000

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year if
changed since last report)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller
reporting company)

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

There were 337.9 million Common Shares outstanding as of September 30, 2012.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

EATON CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

| (In millions except for per share data) | Three months ended | | Nine months ended | | |
|--|--------------------|---------|-------------------|----------|---|
| | September 30 | | September 30 | | |
| | 2012 | 2011 | 2012 | 2011 | |
| Net sales | \$3,950 | \$4,123 | \$11,978 | \$12,016 | |
| Cost of products sold | 2,747 | 2,900 | 8,316 | 8,444 | |
| Selling and administrative expense | 687 | 668 | 2,079 | 2,031 | |
| Research and development expense | 102 | 104 | 313 | 316 | |
| Interest expense-net | 42 | 29 | 100 | 92 | |
| Other (income) expense-net | (4 |) (10 |) 7 | (30 |) |
| Income before income taxes | 376 | 432 | 1,163 | 1,163 | |
| Income tax expense | 29 | 65 | 123 | 172 | |
| Net income | 347 | 367 | 1,040 | 991 | |
| Less net income for noncontrolling interests | (2 |) (2 |) (2 |) (3 |) |
| Net income attributable to Eaton common shareholders | \$345 | \$365 | \$1,038 | \$988 | |
| Net income per common share | | | | | |
| Diluted | \$1.02 | \$1.07 | \$3.05 | \$2.86 | |
| Basic | 1.02 | 1.07 | 3.08 | 2.90 | |
| Weighted-average number of common shares outstanding | | | | | |
| Diluted | 339.8 | 341.9 | 339.7 | 344.4 | |
| Basic | 337.6 | 338.1 | 336.7 | 339.7 | |
| Cash dividends declared per common share | \$0.76 | \$0.34 | \$1.52 | \$1.02 | |

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (In millions) | Three months ended | | Nine months ended | |
|---|--------------------|-------|-------------------|-------|
| | September 30 | | September 30 | |
| | 2012 | 2011 | 2012 | 2011 |
| Net income | \$347 | \$367 | \$1,040 | \$991 |
| Less net income for noncontrolling interests | (2 |) (2 |) (2 |) (3 |
| Net income attributable to Eaton common shareholders | 345 | 365 | 1,038 | 988 |
| Other comprehensive income (loss), net of tax | | | | |
| Foreign currency translation and related hedging instruments | 146 | (449 |) 47 | (111 |
| Pensions and other postretirement benefits | 22 | 34 | 93 | 69 |
| Cash flow hedges | 4 | (20 |) 16 | (25 |
| Other comprehensive income (loss) attributable to Eaton common shareholders | 172 | (435 |) 156 | (67 |
| Total comprehensive income (loss) attributable to Eaton common shareholders | \$517 | \$(70 |) \$1,194 | \$921 |

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

Table of ContentsEATON CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

| (In millions) | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Assets | | |
| Current assets | | |
| Cash | \$425 | \$385 |
| Short-term investments | 620 | 699 |
| Accounts receivable-net | 2,645 | 2,444 |
| Inventory | 1,801 | 1,701 |
| Other current assets | 704 | 597 |
| Total current assets | 6,195 | 5,826 |
| Property, plant and equipment-net | 2,794 | 2,602 |
| Other noncurrent assets | | |
| Goodwill | 5,838 | 5,537 |
| Other intangible assets | 2,253 | 2,192 |
| Deferred income taxes | 1,064 | 1,134 |
| Other assets | 656 | 582 |
| Total assets | \$18,800 | \$17,873 |
| Liabilities and shareholders' equity | | |
| Current liabilities | | |
| Short-term debt | \$108 | \$86 |
| Current portion of long-term debt | 307 | 321 |
| Accounts payable | 1,441 | 1,491 |
| Accrued compensation | 385 | 420 |
| Other current liabilities | 1,467 | 1,319 |
| Total current liabilities | 3,708 | 3,637 |
| Noncurrent liabilities | | |
| Long-term debt | 3,690 | 3,366 |
| Pension liabilities | 1,509 | 1,793 |
| Other postretirement benefits liabilities | 645 | 642 |
| Deferred income taxes | 569 | 442 |
| Other noncurrent liabilities | 437 | 501 |
| Total noncurrent liabilities | 6,850 | 6,744 |
| Shareholders' equity | | |
| Eaton shareholders' equity | 8,220 | 7,469 |
| Noncontrolling interests | 22 | 23 |
| Total equity | 8,242 | 7,492 |
| Total liabilities and equity | \$18,800 | \$17,873 |

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

Table of ContentsEATON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In millions) | Nine months ended | |
|---|-------------------|-------|
| | September 30 | |
| | 2012 | 2011 |
| Operating activities | | |
| Net income | \$1,040 | \$991 |
| Adjustments to reconcile to net cash provided by operating activities | | |
| Depreciation and amortization | 419 | 419 |
| Pension expense | 205 | 170 |
| Contributions to pension plans | (383) | (341) |
| Contributions to other postretirement benefits plans | (34) | (150) |
| Changes in working capital | (318) | (290) |
| Other-net | 48 | (110) |
| Net cash provided by operating activities | 977 | 689 |
| Investing activities | | |
| Cash paid for acquisitions of businesses | (554) | (298) |
| Capital expenditures for property, plant and equipment | (357) | (384) |
| Sales of short-term investments-net | 89 | 272 |
| Other-net | (35) | 1 |
| Net cash used in investing activities | (857) | (409) |
| Financing activities | | |
| Borrowings with original maturities of more than three months | | |
| Proceeds | 600 | 352 |
| Payments | (319) | (14) |
| Payments with original maturities of less than three months-net | (2) | (38) |
| Deferred financing costs | (63) | — |
| Cash dividends paid | (384) | (348) |
| Exercise of equity-based awards | 54 | 66 |
| Repurchase of shares | — | (343) |
| Excess tax benefit from equity-based compensation | 18 | — |
| Other-net | — | (4) |
| Net cash used in financing activities | (96) | (329) |
| Effect of foreign exchange rate changes on cash | 16 | (6) |
| Total increase (decrease) in cash | 40 | (55) |
| Cash at the beginning of the period | 385 | 333 |
| Cash at the end of the period | \$425 | \$278 |

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

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EATON CORPORATION

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Amounts are in millions unless indicated otherwise (per share data assume dilution).

Note 1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Eaton Corporation (Eaton or Company) have been prepared in accordance with generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring accruals) have been made that are necessary for a fair presentation of the condensed consolidated financial statements for the interim periods.

This Form 10-Q should be read in conjunction with the consolidated financial statements and related notes included in Eaton's 2011 Form 10-K. The interim period results are not necessarily indicative of the results to be expected for the full year. Management has evaluated subsequent events through the date this Form 10-Q was filed with the SEC. Certain prior year amounts have been reclassified to conform to the current year presentation.

Note 2. ACQUISITIONS OF BUSINESSES

In 2012 and 2011, Eaton acquired businesses and entered into a joint venture in separate transactions. The Consolidated Statements of Income include the results of these businesses from the dates of the transactions or formation. These transactions and the related annual sales prior to acquisition are summarized below:

| Acquired businesses and joint venture | Date of transaction | Business segment | Annual sales |
|--|---------------------|--------------------------|---|
| <p>Rolec Comercial e Industrial S.A. A Chilean manufacturer of integrated power assemblies and low- and medium-voltage switchgear, and a provider of engineering services serving mining and other heavy industrial applications in Chile and Peru.</p> | September 28, 2012 | Electrical Americas | \$85 for the 12 months ended September 30, 2012 |
| <p>Jeil Hydraulics Co., Ltd. A Korean manufacturer of track drive motors, swing drive motors, main control valves and remote control valves for the construction equipment market.</p> | July 6, 2012 | Hydraulics | \$189 for 2011 |
| <p>Polimer Kaucuk Sanayi ve Pazarlama A.S. A Turkish manufacturer of hydraulic and industrial hose for construction, mining, agriculture, oil and gas, manufacturing, food and beverage, and chemicals markets. This business sells its products under the SEL brand name.</p> | June 1, 2012 | Hydraulics | \$335 for 2011 |
| <p>Gycom Electrical Low-Voltage Power Distribution, Control and Automation A Swedish electrical low-voltage power distribution, control and automation components business.</p> | June 1, 2012 | Electrical Rest of World | \$24 for 2011 |
| <p>E.A. Pedersen Company A United States manufacturer of medium voltage switchgear, metal-clad switchgear, power control buildings and relay control panels primarily for the electrical utilities industry.</p> | December 29, 2011 | Electrical Americas | \$37 for 2011 |
| IE Power, Inc. | | | \$5 for 2010 |

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A Canadian provider of high power inverters for a variety of mission-critical applications including solar, wind and battery energy storage.

August 31,
2011

Electrical
Americas

E. Begerow GmbH & Co. KG

A German system provider of advanced liquid filtration solutions. This business develops and produces technologically innovative filter media and filtration systems for food and beverage, chemical, pharmaceutical and industrial applications.

August 15,
2011

Hydraulics \$84 for 2010

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| Acquired businesses and joint venture | Date of transaction | Business segment | Annual sales |
|--|---------------------|--------------------------------|---|
| ACTOM Low Voltage A South African manufacturer and supplier of motor control components, engineered electrical distribution systems and uninterruptible power supply (UPS) systems. | June 30, 2011 | Electrical Rest of World | \$65 for the year ended May 31, 2011 |
| C.I. ESI de Colombia S.A. A Colombian distributor of industrial electrical equipment and engineering services in the Colombian market, focused on oil and gas, mining, and industrial and commercial construction. | June 2, 2011 | Electrical Americas | \$8 for 2010 |
| Internormen Technology Group A Germany-based manufacturer of hydraulic filtration and instrumentation with sales and distribution subsidiaries in China, the United States, India and Brazil. | May 12, 2011 | Hydraulics | \$55 for 2010 |
| Eaton-SAMC (Shanghai) Aircraft Conveyance System Manufacturing Co., Ltd. A 49%-owned joint venture in China focusing on the design, development, manufacturing and support of fuel and hydraulic conveyance systems for the global civil aviation market. | March 8, 2011 | Aerospace | Joint venture |
| Tuthill Coupling Group A United States based manufacturer of pneumatic and hydraulic quick coupling solutions and leak-free connectors used in industrial, construction, mining, defense, energy and power applications. | January 1, 2011 | Hydraulics | \$35 for the year ended November 30, 2010 |

On May 21, 2012, Eaton reached an agreement to acquire Cooper Industries plc (Cooper). Cooper is incorporated in Ireland and is a diversified global manufacturer of electrical components and tools with sales of \$5.4 billion for 2011. At the close of the transaction, Eaton and Cooper will be combined under a newly created company (New Eaton), which is currently called Eaton Corporation Limited and is incorporated in Ireland. The total consideration to be received by Cooper shareholders in the transaction is comprised of both cash and equity and has a value of approximately \$11.8 billion based on the closing share price of Eaton common stock of \$42.40 on May 18, 2012. Based on the terms of the transaction agreement, the purchase consideration entitles the holder of each ordinary share of Cooper to receive from New Eaton \$39.15 and 0.77479 of a New Eaton ordinary share. At the close of the transaction, the former shareholders of Eaton and Cooper are expected to own approximately 73% and 27% of New Eaton, respectively. The transaction was approved by shareholders of both companies on October 26, 2012, and is subject to receipt of certain regulatory approvals and other customary conditions. The transaction is expected to close in the fourth quarter of 2012.

Note 3. ACQUISITION INTEGRATION CHARGES

Eaton incurs charges related to the integration of acquired businesses. A summary of these charges follows:

| Business segment | Three months ended | | Nine months ended | |
|--------------------------|----------------------|------|----------------------|------|
| | September 30 2012 | 2011 | September 30 2012 | 2011 |
| Electrical Americas | \$1 | \$3 | \$4 | \$7 |
| Electrical Rest of World | 1 | — | 5 | 1 |

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| | | | | |
|--|--------|--------|--------|--------|
| Hydraulics | 5 | 1 | 9 | 1 |
| Total business segment integration charges before income taxes | 7 | 4 | 18 | 9 |
| Corporate | 20 | — | 28 | — |
| Total integration charges before income taxes | \$27 | \$4 | \$46 | \$9 |
| After-tax integration charges | \$18 | \$2 | \$30 | \$6 |
| Per common share | \$0.05 | \$0.01 | \$0.09 | \$0.02 |

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Business segment charges for the third quarter of 2012 were related primarily to Internormen Technology Group, Jeil Hydraulics, Polimer Kaucuk Sanayi ve Pazarlama (SEL) and E. Begerow GmbH & Co. KG. Business segment charges for the first nine months of 2012 were related primarily to The Moeller Group, Internormen Technology Group, E. Begerow GmbH & Co. KG and Tuthill Coupling Group. Business segment charges in 2011 were related primarily to CopperLogic, Wright Line Holding and EMC Engineers. These charges were included in Cost of products sold or Selling and administrative expense, as appropriate. In Note 13, Business Segment Information, the charges reduced Operating profit of the related business segment.

Corporate charges in 2012 were related primarily to pre-acquisition transaction costs associated with the planned acquisition of Cooper. These charges were included in Selling and administrative expense and Interest expense-net. In Note 13, Business Segment Information, the charges were included in Interest expense-net and Other corporate expense-net. See Note 2 for additional information about business acquisitions.

Note 4. GOODWILL

A summary of goodwill follows:

| | September 30, 2012 | December 31, 2011 |
|--------------------------|-----------------------|----------------------|
| Electrical Americas | \$2,058 | \$2,043 |
| Electrical Rest of World | 986 | 981 |
| Hydraulics | 1,393 | 1,116 |
| Aerospace | 1,045 | 1,040 |
| Truck | 149 | 150 |
| Automotive | 207 | 207 |
| Total goodwill | \$5,838 | \$5,537 |

The increase in goodwill in 2012 was primarily due to businesses acquired during 2012. For additional information regarding acquired businesses, see Note 2.

Assessing Goodwill for Impairment

Goodwill is tested for impairment annually as of July 1 at the reporting unit level, which is equivalent to Eaton's operating segments. Impairment testing for 2012 was performed from a qualitative perspective by assessing certain trends and factors, including projected market outlook and growth rates, forecasted and actual sales and operating profit margins, discount rates, industry data and other relevant qualitative factors. These trends and factors were compared to and based on the assumptions used in the quantitative assessment performed in 2010. For 2012, the fair value of Eaton's reporting units continues to substantially exceed the respective carrying amount.

Note 5. DEBT

On May 21, 2012, Eaton secured a 364-day bridge facility totaling \$6.75 billion related to financing the cash portion of the acquisition of Cooper. The bridge facility will be available in a single draw on the acquisition closing date. At the Company's discretion, the interest rate on the bridge facility may initially be set at either a LIBOR-based rate plus a margin of 1.25%, with increases in margin every 90 days to a maximum margin of 2.50%, or an Alternate Base Rate (ABR) plus the margin for LIBOR loans at any time minus 1.00%. The ABR is the highest of (a) Prime Rate (as published in the Wall Street Journal), (b) the Federal Funds rate plus 0.50%, and (c) one-month LIBOR plus 1.00%. The bridge facility allows for voluntary prepayment at any time without a premium or penalty. Upon the closing of the Cooper acquisition or shortly thereafter, the bridge facility will be guaranteed by certain subsidiaries of the Company and Cooper. The bridge facility contains customary events of default, the occurrence of which may accelerate the payment of interest and principal amounts outstanding. The bridge facility is subject to certain customary affirmative and negative covenants. At September 30, 2012, capitalized deferred financing fees totaled \$56 and are being amortized in Interest expense-net over the estimated term of the bridge facility.

On June 14, 2012, Eaton refinanced a \$500, three-year revolving credit facility and a \$500, five-year revolving credit facility with a \$750, three-year revolving credit facility and a \$750, five-year revolving credit facility, respectively. These facilities increase long-term revolving credit facilities from \$1.5 billion to \$2.0 billion. The revolving credit

facilities are used to support commercial paper borrowings. The three-year revolving credit facility will expire June 14, 2015, and the five-year revolving credit facility will expire June 14, 2017. There were no borrowings outstanding under Eaton's revolving credit facilities at September 30, 2012.

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On June 28, 2012, Eaton received proceeds totaling \$600 from the private issuance of \$300, 3.47% notes due June 28, 2021 and \$300, 3.68% notes due June 28, 2023 (collectively, the Notes). Interest is payable semi-annually. The Notes contain a change of control provision which requires the Company to make an offer to purchase all or any part of the Notes at a purchase price of 100% of the principal amount plus accrued and unpaid interest. The Notes are subject to certain customary covenants.

These financing activities were initiated to enhance the Company's capital structure prior to completing the acquisition of Cooper. See Note 2 for additional information about business acquisitions.

Note 6. RETIREMENT BENEFITS PLANS

The components of retirement benefits expense follow:

| | Three months ended September 30 | | | | | |
|--------------------------------|---------------------------------|-------------------------|-------------------------|-------------------------|----------------------|------------------|
| | United States | | Non-United States | | Other postretirement | |
| | pension benefit expense | pension benefit expense | pension benefit expense | pension benefit expense | benefits expense | benefits expense |
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Service cost | \$28 | \$23 | \$13 | \$12 | \$5 | \$4 |
| Interest cost | 33 | 33 | 18 | 19 | 10 | 10 |
| Expected return on plan assets | (46) | (41) | (18) | (17) | (2) | — |
| Amortization | 30 | 19 | 3 | 3 | 3 | 3 |
| | 45 | 34 | 16 | 17 | 16 | 17 |
| Curtailment loss | — | — | — | 1 | — | — |
| Settlement loss | 8 | 5 | — | — | — | — |
| Total expense | \$53 | \$39 | \$16 | \$18 | \$16 | \$17 |
| | Nine months ended September 30 | | | | | |
| | United States | | Non-United States | | Other postretirement | |
| | pension benefit expense | pension benefit expense | pension benefit expense | pension benefit expense | benefits expense | benefits expense |
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Service cost | \$86 | \$69 | \$37 | \$37 | \$13 | \$12 |
| Interest cost | 100 | 99 | 56 | 59 | 29 | 30 |
| Expected return on plan assets | (136) | (123) | (56) | (53) | (5) | — |
| Amortization | 88 | 57 | 11 | 9 | 10 | 9 |
| | 138 | 102 | 48 | 52 | 47 | 51 |
| Curtailment loss | — | — | — | 1 | — | — |
| Settlement loss | 17 | 12 | 2 | 3 | — | — |
| Total expense | \$155 | \$114 | \$50 | \$56 | \$47 | \$51 |

Note 7. LEGAL CONTINGENCIES

In December 2010, a Brazilian court held that a judgment obtained by a Brazilian company, Raysul, against another Brazilian company, Saturnia, which was sold by Eaton in 2006, could be enforced against Eaton Ltda. This judgment is based on an alleged violation of an agency agreement between Raysul and Saturnia. At September 30, 2012, the Company has a total accrual of 77 Brazilian Reais related to this matter (\$38 based on current exchange rates), comprised of 60 Brazilian Reais recognized in the fourth quarter of 2010 (\$30 based on current exchange rates) with an additional 17 Brazilian Reais recognized through September 30, 2012 (\$8 based on current exchange rates) due to subsequent accruals for interest and inflation. The Company expects that any sum it may be required to pay in connection with this matter will not exceed the amount of the recorded liability. In 2010, Eaton filed motions for clarification with the Brazilian court of appeals which were denied on April 6, 2011. Eaton Holding and Eaton Ltda. filed appeals on various issues to the Superior Court of Justice in Brasilia. All appeals have been accepted by the Superior Court of Justice and will be heard in due course.

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On October 5, 2006, ZF Meritor LLC and Meritor Transmission Corporation (collectively, Meritor) filed an action against Eaton in the United States District Court for Delaware. The action sought damages, which would be trebled under United States antitrust laws, as well as injunctive relief and costs. The suit alleged that Eaton engaged in anti-competitive conduct against Meritor in the sale of heavy-duty truck transmissions in North America. Following a four week trial on liability only, on October 8, 2009, the jury returned a verdict in favor of Meritor. Eaton firmly believes that it competes fairly and honestly for business in the marketplace, and that at no time did it act in an anti-competitive manner. During an earlier stage in the case, the judge concluded that damage estimates contained in a report filed by Meritor were not based on reliable data and the report was specifically excluded from the case. On November 3, 2009, Eaton filed a motion for judgment as a matter of law and to set aside the verdict. That motion was denied on March 10, 2011. On March 14, 2011, Eaton filed a motion for entry of final judgment of liability, zero damages and no injunctive relief. That motion was denied on June 9, 2011. On August 19, 2011, the Court entered final judgment of liability but awarded zero damages to plaintiffs. The Court also entered an injunction prohibiting Eaton from offering rebates or other incentives based on purchasing targets but stayed the injunction pending appeal. Eaton appealed the liability finding and the injunction to the Third Circuit Court of Appeals. Meritor cross-appealed the finding of zero damages. On September 28, 2012, the Court of Appeals affirmed the District Court's denial of Eaton's motion for judgment as a matter of law, and let stand the jury verdict in favor of Meritor. The Third Circuit also ruled that the plaintiffs' damages report was properly excluded, but reversed the judgment of zero damages and ordered that the District Court must allow plaintiffs a limited opportunity to amend the damages report, which may be re-considered for reliability and admissibility. Injunctive relief also was vacated. An estimate of any potential loss related to this action cannot be made at this time.

Eaton is subject to a broad range of claims, administrative and legal proceedings such as lawsuits that relate to contractual allegations, tax audits, patent infringement, personal injuries (including asbestos claims), antitrust matters and employment-related matters. Although it is not possible to predict with certainty the outcome or cost of these matters, the Company believes they will not have a material adverse effect on the consolidated financial statements.

Note 8. INCOME TAXES

The effective income tax rate for the third quarter of 2012 was 7.7% compared to 15.2% for the third quarter of 2011 and 10.6% for the first nine months of 2012 compared to 14.8% for the first nine months of 2011. The lower effective tax rate in the third quarter of 2012 was primarily attributable to the utilization of deferred tax assets in Asia Pacific jurisdictions, as well as adjustments related to the filing of the 2011 income tax returns in the United States and international tax jurisdictions. The lower effective tax rate in the first nine months of 2012 was attributable to the items noted above, the favorable impact of enhanced investment incentives in Europe, and a reduction in deferred tax liabilities in a European jurisdiction due to the realization of a lower effective tax rate.

At the end of the fourth quarter of 2011, the IRS issued a Notice for Eaton's 2005 and 2006 tax years. The Notice proposes assessments of \$75 in additional taxes plus \$52 in penalties related primarily to transfer pricing adjustments for products manufactured in the Company's facilities in Puerto Rico and the Dominican Republic and sold to affiliated companies located in the U.S., net of agreed credits and deductions. The Company has set its transfer prices for products sold between these affiliates at the same prices that the Company sells such products to third parties. The Notice was issued despite the IRS having previously recognized the validity of the Company's transfer pricing methodology by entering into two successive binding Advance Pricing Agreements (APAs) that approved and, in fact, required the application of the Company's transfer pricing methodology for the ten year period of 2001 through 2010. For the years 2001 through 2004, the IRS had previously accepted the transfer pricing methodology related to these APAs after a comprehensive review conducted in two separate audit cycles. On December 16, 2011, immediately prior to the Notice being issued, the IRS sent a letter stating that it was canceling the APAs.

The Company firmly believes that the proposed assessments are without merit. The Company also believes that it was in full compliance with the terms of the two APAs and that the IRS's unilateral attempt to retroactively cancel these two binding contracts is also without merit and represents a breach of the two contracts. On February 29, 2012, the Company filed a Petition with the U.S. Tax Court in which it asserted that the transfer pricing established in the two APA contracts meets the arms-length standard set by the U.S. income tax law, that the transfer pricing the Company

has used is in full compliance with U.S. income tax laws, and accordingly, that the two APA contracts should be enforced in accordance with their terms. On June 11, 2012, the Company filed a motion for partial summary judgment with the U.S. Tax Court, asking the U.S. Tax Court to rule the APAs are “contracts” and that the IRS has the burden of proof to substantiate cancellation of the APAs. On October 22, 2012, a hearing on the partial summary judgment motion was held at the U.S. Tax Court. The Company believes that the ultimate resolution of this matter will not have a material impact on its consolidated financial statements.

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Note 9. EQUITY

The changes in Shareholders' equity follow:

| | Eaton shareholders' equity | Noncontrolling interests | Total equity |
|--|----------------------------------|-----------------------------|-----------------|
| Balance at December 31, 2011 | \$7,469 | \$23 | \$7,492 |
| Net income | 1,038 | 2 | 1,040 |
| Other comprehensive income | 156 | — | 156 |
| Cash dividends paid and accrued | (512 |) (3 |) (515 |
| Issuance of shares under equity-based compensation plans-net | 69 | — | 69 |
| Balance at September 30, 2012 | \$8,220 | \$22 | \$8,242 |
| Net Income per Common Share | | | |

A summary of the calculation of net income per common share attributable to common shareholders follows:

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|--------|-----------------------------------|--------|
| (Shares in millions) | 2012 | 2011 | 2012 | 2011 |
| Net income attributable to Eaton common shareholders | \$345 | \$365 | \$1,038 | \$988 |
| Weighted-average number of common shares outstanding-diluted | 339.8 | 341.9 | 339.7 | 344.4 |
| Less dilutive effect of stock options and restricted stock awards | 2.2 | 3.8 | 3.0 | 4.7 |
| Weighted-average number of common shares outstanding-basic | 337.6 | 338.1 | 336.7 | 339.7 |
| Net income per common share | | | | |
| Diluted | \$1.02 | \$1.07 | \$3.05 | \$2.86 |
| Basic | 1.02 | 1.07 | 3.08 | 2.90 |

For the third quarter and first nine months of 2012, 4.2 million and 2.5 million stock options, respectively, were excluded from the calculation of diluted net income per common share because the exercise price of the options exceeded the average market price of the common shares during the period and their effect, accordingly, would have been antidilutive. For the third quarter and first nine months of 2011, 2.7 million and 1.1 million stock options, respectively, were excluded from the calculation of diluted net income per common share because the exercise price of the options exceeded the average market price of the common shares during the period and their effect, accordingly, would have been antidilutive.

Note 10. FAIR VALUE MEASUREMENTS

Fair value is measured based on an exit price, representing the amount that would be received to sell an asset or paid to satisfy a liability in an orderly transaction between market participants. Fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, a fair value hierarchy is established, which categorizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

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A summary of financial instruments recognized at fair value, and the fair value measurements used, follows:

| | Total | Quoted prices in active markets for identical assets (Level 1) | Other observable inputs (Level 2) | Unobservable inputs (Level 3) |
|---|-------|--|--|-------------------------------------|
| September 30, 2012 | | | | |
| Cash | \$425 | \$425 | \$— | \$— |
| Short-term investments | 620 | 620 | — | — |
| Net derivative contracts | 93 | — | 93 | — |
| Long-term debt converted to floating interest rates by | 92 | — | 92 | — |
| interest rate swaps - net | | | | |
| December 31, 2011 | | | | |
| Cash | \$385 | \$385 | \$— | \$— |
| Short-term investments | 699 | 699 | — | — |
| Net derivative contracts | 46 | — | 46 | — |
| Long-term debt converted to floating interest rates by | 66 | — | 66 | — |
| interest rate swaps - net | | | | |

Eaton values its financial instruments using an industry standard market approach, in which prices and other relevant information is generated by market transactions involving identical or comparable assets or liabilities. No financial instruments were recognized using unobservable inputs.

Other Fair Value Measurements

Long-term debt and the current portion of long-term debt had a carrying value of \$3,997 and fair value of \$4,576 at September 30, 2012 compared to \$3,687 and \$4,273, respectively, at December 31, 2011. The fair value of debt is determined based on trade information in the financial markets of the Company's public debt and is considered a Level 2 fair value measurement.

Note 11. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

In the normal course of business, Eaton is exposed to certain risks related to fluctuations in interest rates, foreign currency exchange rates and commodity prices. The Company uses various derivative and non-derivative financial instruments, primarily interest rate swaps, foreign currency forward exchange contracts, foreign currency swaps and, to a lesser extent, commodity contracts, to manage risks from these market fluctuations. The instruments used by Eaton are straightforward, non-leveraged instruments. The counterparties to these instruments are financial institutions with strong credit ratings. Eaton maintains control over the size of positions entered into with any one counterparty and regularly monitors the credit rating of these institutions. Such instruments are not purchased and sold for trading purposes.

Derivative financial instruments are accounted for at fair value and recognized as assets or liabilities in the Condensed Consolidated Balance Sheets. Accounting for the gain or loss resulting from the change in the fair value of the derivative financial instrument depends on whether it has been designated, and is effective, as part of a hedging relationship and, if so, as to the nature of the hedging activity. Eaton formally documents all relationships between these derivative financial instruments accounted for as hedges and the hedged item, as well as its risk-management objective and strategy for undertaking the hedge transaction. This process includes linking all derivative financial instruments to a recognized asset or liability, specific firm commitment, forecasted transaction, or net investment in a foreign operation. These financial instruments can be designated as:

- Hedges of the change in the fair value of a recognized fixed-rate asset or liability, or the firm commitment to acquire such an asset or liability (a fair value hedge); for these hedges, the gain or loss from the derivative

financial instrument, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in income during the period of change in fair value.

Hedges of the variable cash flows of a recognized variable-rate asset or liability, or the forecasted acquisition of such an asset or liability (a cash flow hedge); for these hedges, the effective portion of the gain or loss from the derivative financial instrument is recognized in Accumulated other comprehensive income (loss) and reclassified to income in the same period when the gain or loss on the hedged item is included in income.

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Hedges of the foreign currency exposure related to a net investment in a foreign operation (a net investment hedge); for these hedges, the effective portion of the gain or loss from the derivative financial instrument is recognized in Accumulated other comprehensive income (loss) and reclassified to income in the same period when the gain or loss related to the net investment in the foreign operation is included in income.

The gain or loss from a derivative financial instrument designated as a hedge that is effective is classified in the same line of the Consolidated Statements of Income as the offsetting loss or gain on the hedged item. The change in fair value of a derivative financial instrument that is not effective as a hedge is immediately recognized in income.

For derivatives that are not designated as a hedge, any gain or loss is immediately recognized in income. The majority of derivatives used in this manner relate to risks resulting from assets or liabilities denominated in a foreign currency and certain commodity contracts that arise in the normal course of business. Gains and losses associated with commodity hedge contracts are classified in Cost of products sold.

Eaton uses certain of its debt denominated in foreign currency to hedge portions of its net investments in foreign operations against foreign currency exposure (net investment hedges). Debt denominated in foreign currency and designated as non-derivative net investment hedging instruments was \$129 at September 30, 2012 and December 31, 2011.

Derivative Financial Statement Impacts

The fair value of derivative financial instruments recognized in the Condensed Consolidated Balance Sheets follows:

| | Notional amount | Other current assets | Other long-term assets | Other current liabilities | Other long-term liabilities | Type of hedge | Term |
|---------------------------------------|-----------------|----------------------|------------------------|---------------------------|-----------------------------|---------------|-----------------|
| September 30, 2012 | | | | | | | |
| Derivatives designated as hedges | | | | | | | |
| Fixed-to-floating interest rate swaps | \$ 1,290 | \$— | \$92 | \$— | \$— | Fair value | 1 to 21 years |
| Floating-to-fixed interest rate swaps | 300 | — | — | — | 2 | Cash flow | 2 years |
| Foreign currency exchange contracts | 436 | 8 | — | 4 | — | Cash flow | 12 to 36 months |
| Commodity contracts | 27 | — | — | — | — | Cash flow | 12 months |
| Total | | \$8 | \$92 | \$4 | \$2 | | |
| Derivatives not designated as hedges | | | | | | | |
| Foreign currency exchange contracts | \$3,641 | \$14 | | \$16 | | | 12 months |
| Commodity contracts | 22 | 1 | | — | | | 12 months |
| Total | | \$15 | | \$16 | | | |
| December 31, 2011 | | | | | | | |
| Derivatives designated as hedges | | | | | | | |
| Fixed-to-floating interest rate swaps | \$ 940 | \$— | \$68 | \$— | \$2 | Fair value | 1 to 22 years |
| Floating-to-fixed interest rate swaps | 300 | — | — | — | — | Cash flow | 2 years |
| Foreign currency exchange contracts | 308 | 4 | — | 9 | — | Cash flow | 12 to 36 months |
| Commodity contracts | 47 | — | — | 7 | — | Cash flow | 12 months |
| Total | | \$4 | \$68 | \$16 | \$2 | | |
| Derivatives not designated as hedges | | | | | | | |
| Foreign currency exchange contracts | \$2,954 | \$18 | | \$14 | | | 12 months |
| Commodity contracts | 61 | — | | 12 | | | 12 months |
| Total | | \$18 | | \$26 | | | |

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The foreign currency exchange contracts shown in the table above as derivatives not designated as hedges are primarily contracts entered into to manage foreign currency volatility or exposure on intercompany sales and loans. While Eaton does not elect hedge accounting treatment for these derivatives, Eaton targets managing 100% of the intercompany balance sheet exposure to minimize the effect of currency volatility related to the movement of goods and services in the normal course of its operations. This activity represents the great majority of these foreign currency exchange contracts.

Amounts recognized in Accumulated other comprehensive income (loss) follow:

| | Three months ended September 30 | | | |
|--|---|---|---|---|
| | 2012 | | 2011 | |
| | Gain (loss) recognized in Accumulated other comprehensive income (loss) | Gain (loss) reclassified from Accumulated other comprehensive income (loss) | Gain (loss) recognized in Accumulated other comprehensive income (loss) | Gain (loss) reclassified from Accumulated other comprehensive income (loss) |
| Derivatives designated as cash flow hedges | | | | |
| Floating-to-fixed interest rate swaps | \$ (1) | \$ — | \$ — | \$ — |
| Foreign currency exchange contracts | 4 | 2 | (7) | (1) |
| Commodity contracts | 2 | (3) | (12) | 2 |
| Total | \$ 5 | \$ (1) | \$ (19) | \$ 1 |

| | Nine months ended September 30 | | | |
|---|---|---|---|---|
| | 2012 | | 2011 | |
| | Gain (loss) recognized in Accumulated other comprehensive income (loss) | Gain (loss) reclassified from Accumulated other comprehensive income (loss) | Gain (loss) recognized in Accumulated other comprehensive income (loss) | Gain (loss) reclassified from Accumulated other comprehensive income (loss) |
| Derivatives designated as cash flow hedges | | | | |
| Floating-to-fixed interest rate swaps | \$ (3) | \$ (1) | \$ — | \$ — |
| Foreign currency exchange contracts | 10 | 1 | (6) | (1) |
| Commodity contracts | 2 | (7) | (13) | 7 |
| Derivatives designated as net investment hedges | | | | |
| Cross currency swaps | — | — | 1 | — |
| Total | \$ 9 | \$ (7) | \$ (18) | \$ 6 |

Gains and losses reclassified from Accumulated other comprehensive income (loss) to the Consolidated Statements of Income were recognized in Cost of products sold or Interest expense-net, as appropriate.

Amounts recognized in net income follow:

| | Three months ended September 30 | | Nine months ended September 30 | |
|--|---------------------------------|-------|--------------------------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| Derivatives designated as fair value hedges | | | | |
| Fixed-to-floating interest rate swaps | \$ 11 | \$ 23 | \$ 25 | \$ 25 |
| Related long-term debt converted to floating interest rates by interest rate swaps | (11) | (23) | (25) | (25) |
| | \$ — | \$ — | \$ — | \$ — |

Gains and losses described above were recognized in Interest expense-net.

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Note 12. INVENTORY

The components of inventory follow:

| | September 30, 2012 | December 31, 2011 |
|-------------------------------|-----------------------|----------------------|
| Raw materials | \$779 | \$706 |
| Work-in-process | 305 | 272 |
| Finished goods | 872 | 867 |
| Inventory at FIFO | 1,956 | 1,845 |
| Excess of FIFO over LIFO cost | (155 |) (144 |
| Total inventory | \$1,801 | \$1,701 |

Note 13. BUSINESS SEGMENT INFORMATION

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated on a regular basis by the chief operating decision maker, or decision making group, in deciding how to allocate resources to an individual segment and in assessing performance. Eaton's operating segments are Electrical Americas, Electrical Rest of World, Hydraulics, Aerospace, Truck and Automotive. For additional information regarding Eaton's business segments, see Note 14 to the Consolidated Financial Statements contained in the 2011 Form 10-K.

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BUSINESS SEGMENT INFORMATION

| | Three months ended | | Nine months ended | |
|--|--------------------|---------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2012 | 2011 | 2012 | 2011 |
| Net sales | | | | |
| Electrical Americas | \$1,143 | \$1,074 | \$3,363 | \$3,071 |
| Electrical Rest of World | 686 | 755 | 2,020 | 2,285 |
| Hydraulics | 763 | 717 | 2,267 | 2,130 |
| Aerospace | 419 | 420 | 1,285 | 1,218 |
| Truck | 549 | 715 | 1,805 | 1,964 |
| Automotive | 390 | 442 | 1,238 | 1,348 |
| Total net sales | \$3,950 | \$4,123 | \$11,978 | \$12,016 |
| Segment operating profit | | | | |
| Electrical Americas | \$207 | \$156 | \$559 | \$432 |
| Electrical Rest of World | 76 | 62 | 181 | 209 |
| Hydraulics | 93 | 109 | 325 | 335 |
| Aerospace | 49 | 71 | 168 | 166 |
| Truck | 103 | 139 | 339 | 349 |
| Automotive | 41 | 62 | 133 | 167 |
| Total segment operating profit | 569 | 599 | 1,705 | 1,658 |
| Corporate | | | | |
| Amortization of intangible assets | (45 |) (47 |) (129 |) (143 |
| Interest expense-net | (42 |) (29 |) (100 |) (92 |
| Pension and other postretirement benefits expense | (41 |) (35 |) (121 |) (105 |
| Other corporate expense-net | (65 |) (56 |) (192 |) (155 |
| Income before income taxes | 376 | 432 | 1,163 | 1,163 |
| Income tax expense | 29 | 65 | 123 | 172 |
| Net income | 347 | 367 | 1,040 | 991 |
| Less net income for noncontrolling interests | (2 |) (2 |) (2 |) (3 |
| Net income attributable to Eaton common shareholders | \$345 | \$365 | \$1,038 | \$988 |

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2. OPERATIONS.

Amounts are in millions of dollars or shares unless indicated otherwise (per share data assume dilution).

COMPANY OVERVIEW

Eaton Corporation is a diversified power management company with 2011 net sales of \$16.0 billion. The Company is a global technology leader in electrical components and systems for power quality, distribution and control; hydraulics components, systems and services for industrial and mobile equipment; aerospace fuel, hydraulics and pneumatic systems for commercial and military use; and truck and automotive drivetrain and powertrain systems for performance, fuel economy and safety. Eaton has approximately 74,000 employees in over 50 countries, and sells products to customers in more than 150 countries.

Eaton acquired certain businesses that affect comparability on a year over year basis. The Consolidated Statements of Income include the results of these businesses from the dates of the transactions or formation. For a list of business acquisitions and joint ventures impacting the comparative periods, see Note 2 to the Condensed Consolidated Financial Statements.

A summary of Eaton's Net sales, Net income attributable to Eaton common shareholders, and Net income per common share-diluted follows:

| | Three months ended | | Nine months ended | |
|--|--------------------|---------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2012 | 2011 | 2012 | 2011 |
| Net sales | \$3,950 | \$4,123 | \$11,978 | \$12,016 |
| Net income attributable to Eaton common shareholders | 345 | 365 | 1,038 | 988 |
| Net income per common share-diluted | \$1.02 | \$1.07 | \$3.05 | \$2.86 |

RESULTS OF OPERATIONS

The following discussion of Consolidated Financial Results and Business Segment Results of Operations includes certain non-GAAP financial measures. These financial measures include operating earnings, operating earnings per common share, and operating profit before acquisition integration charges for each business segment as well as corporate expense, each of which excludes amounts that differ from the most directly comparable measure calculated in accordance with generally accepted accounting principles (GAAP). A reconciliation of each of these financial measures to the most directly comparable GAAP measure is included in the table below and in the discussion of the operating results of each business segment. Management believes that these financial measures are useful to investors because they exclude transactions of an unusual nature, allowing investors to more easily compare Eaton's financial performance period to period. Management uses this information in monitoring and evaluating the on-going performance of Eaton and each business segment.

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Consolidated Financial Results

| | Three months ended | | Decrease | Nine months ended | | Increase | |
|---|----------------------|---------|----------|----------------------|----------|----------|---|
| | September 30 2012 | 2011 | | September 30 2012 | 2011 | | |
| Net sales | \$3,950 | \$4,123 | (4)% | \$11,978 | \$12,016 | — | % |
| Gross profit | 1,203 | 1,223 | (2)% | 3,662 | 3,572 | 3 | % |
| Percent of net sales | 30.5 | % 29.7 | % | 30.6 | % 29.7 | % | |
| Income before income taxes | 376 | 432 | (13)% | 1,163 | 1,163 | — | % |
| Net income | \$347 | \$367 | (5)% | \$1,040 | \$991 | 5 | % |
| Less net income for noncontrolling interests | (2) | (2) | | (2) | (3) | | |
| Net income attributable to Eaton common shareholders | 345 | 365 | (5)% | 1,038 | 988 | 5 | % |
| Excluding acquisition integration charges (after-tax) | 18 | 2 | | 30 | 6 | | |
| Operating earnings | \$363 | \$367 | (1)% | \$1,068 | \$994 | 7 | % |
| Net income per common share-diluted | \$1.02 | \$1.07 | (5)% | \$3.05 | \$2.86 | 7 | % |
| Excluding per share impact of acquisition integration charges (after-tax) | 0.05 | 0.01 | | 0.09 | 0.02 | | |
| Operating earnings per common share | \$1.07 | \$1.08 | (1)% | \$3.14 | \$2.88 | 9 | % |

Net Sales

Net sales in the third quarter of 2012 decreased 4% compared to the third quarter of 2011. The sales decrease was due to a decrease of 4% from the impact of foreign exchange and a decrease of 2% in core sales, partially offset by an increase of 2% from acquisition of businesses. End markets declined 1% in the third quarter of 2012 compared to the same period in 2011. The decrease in core sales in the third quarter of 2012 was due to lower sales volumes as a result of subdued economic growth in Europe and China, and decelerating industrial activity in the U.S. Net sales in the first nine months of 2012 were flat compared to the first nine months of 2011, with a decrease of 3% from the impact of foreign exchange offset by an increase of 2% in core sales and an increase of 1% from acquisitions of businesses. The increase in core sales in the first nine months of 2012 was due to modest growth of the Company's markets during the first six months of 2012, partially offset by lower sales volumes in the third quarter of 2012 as noted above.

Gross Profit

Gross profit decreased 2% in the third quarter of 2012 compared to the third quarter of 2011. Gross profit margin increased 0.8 percentage points from 29.7% in the third quarter of 2011 to 30.5% in the third quarter of 2012. Gross profit increased 3% in the first nine months of 2012 compared to the first nine months of 2011. Gross profit margin increased 0.9 percentage points from 29.7% for the first nine months of 2011 to 30.6% for the first nine months of 2012. The gross profit margin in both the third quarter and first nine months of 2012 was positively impacted by lower commodity costs, partially offset by the factors impacting net sales as noted above.

Income Taxes

The effective income tax rate for the third quarter of 2012 was 7.7% compared to 15.2% for the third quarter of 2011 and 10.6% for the first nine months of 2012 compared to 14.8% for the first nine months of 2011. The lower effective tax rate in the third quarter of 2012 was primarily attributable to the utilization of deferred tax assets in Asia Pacific jurisdictions, as well as adjustments related to the filing of the 2011 income tax returns in the United States and international tax jurisdictions. The lower effective tax rate in the first nine months of 2012 was attributable to the items noted above, the favorable impact of enhanced investment incentives in Europe, and a reduction in deferred tax liabilities in a European jurisdiction due to the realization of a lower effective tax rate.

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Net Income

Net income attributable to Eaton common shareholders of \$345 in the third quarter of 2012 decreased 5% compared to net income of \$365 in the third quarter of 2011, and Net income per common share of \$1.02 in the third quarter of 2012 decreased 5% from Net income per common share of \$1.07 in the third quarter of 2011. The decrease in the third quarter of 2012 was primarily due to lower sales volumes as noted above and costs incurred pursuant to the acquisition of Cooper, partially offset by lower commodity costs and a lower effective tax rate. Net income attributable to Eaton common shareholders of \$1,038 in the first nine months of 2012 increased 5% compared to net income of \$988 in the first nine months of 2011, and Net income per common share of \$3.05 in the first nine months of 2012 increased 7% over Net income per common share of \$2.86 in the first nine months of 2011. The increase in the first nine months of 2012 was primarily due to strong incremental margins on sales volume growth during the first nine months of 2012, lower commodity costs, and a lower effective tax rate.

Business Segment Results of Operations

The following is a discussion of net sales, operating profit and operating profit margin by business segment that includes a discussion of operating profit and operating profit margin before acquisition integration charges. For additional information related to acquired businesses and acquisition integration charges, see Note 2 and Note 3 to the Condensed Consolidated Financial Statements, respectively.

Electrical Americas

| | Three months ended September 30 | | | Nine months ended September 30 | | | |
|--|------------------------------------|---------|----------|-----------------------------------|---------|----------|--|
| | 2012 | 2011 | Increase | 2012 | 2011 | Increase | |
| Net sales | \$1,143 | \$1,074 | 6 % | \$3,363 | \$3,071 | 10 % | |
| Operating profit | 207 | 156 | 33 % | 559 | 432 | 29 % | |
| Operating margin | 18.1 % | 14.5 % | | 16.6 % | 14.1 % | | |
| Acquisition integration charges | \$1 | \$3 | | \$4 | \$7 | | |
| Before acquisition integration charges | | | | | | | |
| Operating profit | \$208 | \$159 | 31 % | \$563 | \$439 | 28 % | |
| Operating margin | 18.2 % | 14.8 % | | 16.7 % | 14.3 % | | |

Net sales increased 6% in the third quarter of 2012 compared to the third quarter of 2011 due to an increase of 6% in core sales. End markets grew 4% in the third quarter of 2012 compared to the same period in 2011. Net sales increased 10% in the first nine months of 2012 compared to the first nine months of 2011 due to an increase of 10% in core sales and an increase of 1% from the acquisition of businesses, partially offset by a 1% decrease from the impact of foreign exchange. The increase in net sales in both the third quarter and first nine months of 2012 was due to continued growth in markets served by the Electrical Americas segment, with particularly strong growth in residential and non-residential construction markets. Eaton now anticipates its Electrical Americas markets will grow 6% for all of 2012.

Operating profit before acquisition integration charges in the third quarter of 2012 increased 31% from the third quarter of 2011. Operating margin before acquisition integration charges increased 3.4 percentage points from 14.8% in the third quarter of 2011 to 18.2% in the third quarter of 2012. Operating profit before acquisition integration charges in the first nine months of 2012 increased 28% from the first nine months of 2011. Operating margin before acquisition integration charges increased 2.4 percentage points from 14.3% for the first nine months of 2011 to 16.7% for the first nine months of 2012. The increase in operating margin in both the third quarter and first nine months of 2012 was primarily due to benefits from higher sales volumes, lower commodity costs, and commodity hedge contract losses in the third quarter of 2011 that did not repeat in 2012.

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Electrical Rest of World

| | Three months ended | | (Decrease) increase | Nine months ended | | (Decrease) increase |
|--|--------------------|-------|------------------------|-------------------|---------|------------------------|
| | September 30 | | | September 30 | | |
| | 2012 | 2011 | | 2012 | 2011 | |
| Net sales | \$686 | \$755 | (9)% | \$2,020 | \$2,285 | (12)% |
| Operating profit | 76 | 62 | 23 % | 181 | 209 | (13)% |
| Operating margin | 11.1 | % 8.2 | % | 9.0 | % 9.1 | % |
| Acquisition integration charges | \$1 | \$— | | \$5 | \$1 | |
| Before acquisition integration charges | | | | | | |
| Operating profit | \$77 | \$62 | 24 % | \$186 | \$210 | (11)% |
| Operating margin | 11.2 | % 8.2 | % | 9.2 | % 9.2 | % |

Net sales decreased 9% in the third quarter of 2012 compared to the third quarter of 2011 due to a decrease of 6% from the impact of foreign exchange and a decrease of 3% in core sales. End markets declined 6% in the third quarter of 2012 compared to the third quarter of 2011. Net sales decreased 12% in the first nine months of 2012 compared to the first nine months of 2011 due to a decrease in core sales of 7% and a decrease of 6% from the impact of foreign exchange, partially offset by an increase of 1% from the acquisition of a business. The decrease in net sales in both the third quarter and first nine months of 2012 reflects lower sales volumes from the continued weakness in Europe and China. Eaton continues to anticipate its Electrical Rest of World markets will decline 3% for all of 2012.

Operating profit before acquisition integration charges in the third quarter of 2012 increased 24% from the third quarter of 2011. Operating margin before acquisition integration charges increased 3.0 percentage points from 8.2% in the third quarter of 2011 to 11.2% in the third quarter of 2012. The increase in operating margin in the third quarter of 2012 was primarily due to favorable product mix, lower commodity costs, and commodity hedge contract losses in the third quarter of 2011 that did not repeat in 2012. Operating profit before acquisition integration charges in the first nine months of 2012 decreased 11% from the first nine months of 2011. Operating margin before acquisition integration charges was flat, at 9.2% for the first nine months of 2011 and 2012. Operating margin in the first nine months of 2012 was positively impacted by lower commodity costs, as described above, offset by the impact of lower sales volumes from the continued weakness in Europe and China.

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Hydraulics

| | Three months ended | | Increase (decrease) | | Nine months ended | | Increase (decrease) | |
|---------------------------------|--------------------|--------|------------------------|----|-------------------|---------|------------------------|----|
| | September 30 | | | | September 30 | | | |
| | 2012 | 2011 | | | 2012 | 2011 | | |
| Net sales | \$763 | \$717 | 6 | % | \$2,267 | \$2,130 | 6 | % |
| Operating profit | 93 | 109 | (15) |)% | 325 | 335 | (3) |)% |
| Operating margin | 12.2 | % 15.2 | % | | 14.3 | % 15.7 | % | |
| Acquisition integration charges | \$5 | \$1 | | | \$9 | \$1 | | |

Before acquisition integration charges

| | | | | | | | | |
|------------------|------|--------|------|----|-------|--------|-----|----|
| Operating profit | \$98 | \$110 | (11) |)% | \$334 | \$336 | (1) |)% |
| Operating margin | 12.8 | % 15.3 | % | | 14.7 | % 15.8 | % | |

Net sales in the third quarter of 2012 increased 6% compared to the third quarter of 2011 due to an increase of 13% from the acquisition of businesses, partially offset by a decrease of 4% in core sales and a decrease of 3% from the impact of foreign exchange. End markets declined 4% in the third quarter of 2012 compared to the third quarter of 2011. U.S. markets declined 1% and markets outside the U.S. declined 6%. Net sales in the first nine months of 2012 increased 6% compared to the first nine months of 2011 due to an increase of 8% from the acquisition of businesses, partially offset by a 2% decrease from the impact of foreign exchange. Global hydraulics markets in both the third quarter and first nine months of 2012 were negatively impacted by a slowdown in capital expenditures, particularly in the U.S. and China construction equipment industries, as economic uncertainties in both countries has caused some postponement of customer purchases. Eaton now anticipates its Hydraulics markets will decline 2% for all of 2012. Operating profit before acquisition integration charges in the third quarter of 2012 decreased 11% from the third quarter of 2011. Operating margin before acquisition integration charges decreased 2.5 percentage points from 15.3% in the third quarter of 2011 to 12.8% in the third quarter of 2012. Operating profit before acquisition integration charges in the first nine months of 2012 decreased 1% from the first nine months of 2011. Operating margin before acquisition integration charges decreased 1.1 percentage points from 15.8% for the first nine months of 2011 to 14.7% for the first nine months of 2012. The decrease in operating margin in both the third quarter and first nine months of 2012 was primarily due to the factors impacting net sales above.

Aerospace

| | Three months ended | | Increase (decrease) | | Nine months ended | | Increase (decrease) | |
|------------------|--------------------|--------|------------------------|----|-------------------|---------|------------------------|---|
| | September 30 | | | | September 30 | | | |
| | 2012 | 2011 | | | 2012 | 2011 | | |
| Net sales | \$419 | \$420 | — | % | \$1,285 | \$1,218 | 6 | % |
| Operating profit | 49 | 71 | (31) |)% | 168 | 166 | 1 | % |
| Operating margin | 11.7 | % 16.9 | % | | 13.1 | % 13.6 | % | |

Net sales in the third quarter of 2012 were flat compared to the third quarter of 2011, with an increase in core sales of 1% offset by a 1% decrease from the impact of foreign exchange. End markets grew 4% in the third quarter of 2012 compared to the third quarter of 2011. Net sales in the third quarter of 2012 were consistent with the third quarter of 2011 primarily due to continued strength in the commercial OEM market, offset by decreased demand in the military OEM market. Net sales in the first nine months of 2012 increased 6% compared to the first nine months of 2011 due to an increase in core sales of 7%, partially offset by a 1% decrease from the impact of foreign exchange. The increase in net sales in the first nine months of 2012 was primarily due to continued strength in the commercial OEM aerospace market. Eaton continues to anticipate its Aerospace markets will grow 4% for all of 2012.

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Operating profit in the third quarter of 2012 decreased 31% from the third quarter of 2011. Operating margin decreased 5.2 percentage points from 16.9% in the third quarter of 2011 to 11.7% in the third quarter of 2012. The decrease in operating margin in the third quarter of 2012 was primarily due to a shift in product mix to a higher percent of commercial OEM business. Operating profit in the first nine months of 2012 increased 1% from the first nine months of 2011. Operating margin decreased 0.5 percentage points from 13.6% in the first nine months of 2011 to 13.1% in the first nine months of 2012. The decrease in operating margin in the first nine months of 2012 was primarily due to the factors impacting the third quarter of 2012 as noted above, partially offset by higher sales volumes during the first six months of 2012.

Truck

| | Three months ended | | | Nine months ended | | |
|------------------|--------------------|--------|----------|-------------------|---------|----------|
| | September 30 | | Decrease | September 30 | | Decrease |
| | 2012 | 2011 | | 2012 | 2011 | |
| Net sales | \$549 | \$715 | (23)% | \$1,805 | \$1,964 | (8)% |
| Operating profit | 103 | 139 | (26)% | 339 | 349 | (3)% |
| Operating margin | 18.8 % | 19.4 % | | 18.8 % | 17.8 % | |

Net sales decreased 23% in the third quarter of 2012 compared to the third quarter of 2011 due to a decrease in core sales of 16% and a decrease of 7% from the impact of foreign exchange. End markets declined 8% in the third quarter of 2012 compared to the third quarter of 2011, with U.S. markets down 3% and markets outside the U.S. down 11%. The decrease in core sales in the third quarter of 2012 was primarily due to lower sales volumes in the NAFTA Class 8 market related to the uncertain economic outlook in the U.S., as well as lower sales in the Brazil truck and bus markets. Net sales decreased 8% in the first nine months of 2012 compared to the first nine months of 2011 due to a 6% decrease from the impact of foreign exchange and a decrease in core sales of 2%. The decrease in core sales in the first nine months of 2012 was primarily due to the factors impacting the third quarter of 2012 noted above. Eaton now anticipates its Truck markets will decline 4% for all of 2012.

Operating profit in the third quarter of 2012 decreased 26% as compared to the third quarter of 2011. Operating margin decreased 0.6 percentage points from 19.4% in the third quarter of 2011 to 18.8% in the third quarter of 2012. The decrease in operating margin in the third quarter of 2012 was due to the factors impacting net sales as noted above. Operating profit in the first nine months of 2012 decreased 3% from the first nine months of 2011. Operating margin increased 1.0 percentage points from 17.8% in the first nine months of 2011 to 18.8% in the first nine months of 2012. The increase in operating margin in the first nine months of 2012 was due to the benefits from higher U.S. sales volumes during the first six months of the year, partially offset by the factors impacting net sales noted above.

Automotive

| | Three months ended | | | Nine months ended | | |
|------------------|--------------------|--------|----------|-------------------|---------|----------|
| | September 30 | | Decrease | September 30 | | Decrease |
| | 2012 | 2011 | | 2012 | 2011 | |
| Net sales | \$390 | \$442 | (12)% | \$1,238 | \$1,348 | (8)% |
| Operating profit | 41 | 62 | (34)% | 133 | 167 | (20)% |
| Operating margin | 10.5 % | 14.0 % | | 10.7 % | 12.4 % | |

Net sales decreased 12% in the third quarter of 2012 compared to the third quarter of 2011 due to a decrease of 5% from the impact of foreign exchange, a decrease of 4% related to a business divestiture in 2011, and a decrease in core sales of 3%. End markets were flat in the third quarter of 2012 compared to the third quarter of 2011, with a decline of 3% in markets outside the U.S. offset by growth of 8% in U.S. automotive markets. The decrease in core sales in the third quarter of 2012 was primarily due to lower sales volumes from weakness in Europe. Net sales decreased 8% in the first nine months of 2012 compared to the first nine months of 2011 due to a decrease of 5% from the impact of foreign exchange and a decrease of 4% related to a business divestiture in 2011, partially offset by a 1% increase in core sales. Eaton now anticipates its Automotive markets will grow 2% for all of 2012.

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Operating profit in the third quarter of 2012 decreased 34% from the third quarter of 2011. Operating margin decreased 3.5 percentage points from 14.0% in the third quarter of 2011 to 10.5% in the third quarter of 2012. Operating profit in the first nine months of 2012 decreased 20% from the first nine months of 2011. Operating margin decreased 1.7 percentage points from 12.4% in the first nine months of 2011 to 10.7% in the first nine months of 2012. The decrease in operating profit in both the third quarter and first nine months of 2012 was primarily due to the factors impacting net sales as noted above and start-up costs associated with a new facility in China.

Corporate Expense

| | Three months ended | | (Decrease) increase | Nine months ended | | (Decrease) increase | | |
|---|----------------------|-------|------------------------|----------------------|-------|------------------------|-----|----|
| | September 30 2012 | 2011 | | September 30 2012 | 2011 | | | |
| Amortization of intangible assets | \$45 | \$47 | (4 |)% | \$129 | \$143 | (10 |)% |
| Interest expense-net | 42 | 29 | 45 | % | 100 | 92 | 9 | % |
| Pension and other postretirement benefits expense | 41 | 35 | 17 | % | 121 | 105 | 15 | % |
| Other corporate expense-net | 65 | 56 | 16 | % | 192 | 155 | 24 | % |
| Total corporate expense | \$193 | \$167 | 16 | % | \$542 | \$495 | 9 | % |

Total Corporate expense increased 16% in the third quarter of 2012 to \$193 from \$167 in the third quarter of 2011 principally due to a 45% increase in Interest expense-net primarily related to higher debt levels from the issuance of \$300, 3.47% notes due June 28, 2021 and \$300, 3.68% notes due June 28, 2023 and amortization of deferred financing fees over the estimated term of the bridge facility related to the planned acquisition of Cooper, a 16% increase in Other corporate expense-net primarily related to pre-acquisition transaction costs associated with the planned acquisition of Cooper, and a 17% increase in Pension and other postretirement benefits expense primarily related to changes in the discount rate for 2012.

Total Corporate expense increased 9% in the first nine months of 2012 to \$542 from \$495 in the first nine months of 2011 principally due to a 24% increase in Other corporate expense-net primarily related to pre-acquisition transaction costs associated with the planned acquisition of Cooper and higher miscellaneous corporate expense, and a 15% increase in Pension and other postretirement benefits expense primarily related to changes in the discount rate for 2012. These increases in total corporate expense were partially offset by a 10% decrease in Amortization of intangible assets principally due to certain intangible assets being fully amortized in 2011.

For additional information on acquisition integration charges, see Note 3 to the Condensed Consolidated Financial Statements.

LIQUIDITY, CAPITAL RESOURCES AND CHANGES IN FINANCIAL CONDITION

Financial Condition and Liquidity

Eaton's objective is to finance its business through operating cash flow and an appropriate mix of equity and long-term and short-term debt. By diversifying its debt maturity structure, Eaton reduces liquidity risk. The Company maintains access to the commercial paper markets through credit facilities that support commercial paper borrowings. On June 14, 2012, Eaton refinanced a \$500, three-year revolving credit facility and a \$500, five-year revolving credit facility with a \$750, three-year revolving credit facility and a \$750, five-year revolving credit facility, respectively. These facilities increase long-term revolving credit facilities from \$1.5 billion to \$2.0 billion. There were no borrowings outstanding under these revolving credit facilities at September 30, 2012. Over the course of a year, cash, short-term investments and short-term debt may fluctuate in order to manage global liquidity. Eaton believes it has the operating flexibility, cash flow, cash and short-term investment balances, and access to capital markets in excess of the liquidity necessary to meet future operating needs of the business.

On May 21, 2012, Eaton secured a 364-day bridge facility totaling \$6.75 billion related to financing the cash portion of the acquisition of Cooper. The bridge facility will be available in a single draw on the acquisition closing date. At September 30, 2012, capitalized deferred financing fees totaled \$56 and are being amortized in Interest expense-net over the estimated term of the bridge facility.

On June 28, 2012, the Company received proceeds totaling \$600 from the private issuance of \$300, 3.47% notes due June 28, 2021 and \$300, 3.68% notes due June 28, 2023.

These financing activities were initiated to enhance the Company's capital structure prior to completing the acquisition of Cooper. For additional information on the agreement to acquire Cooper and these financing transactions, see Note 2 and Note 5 to the Condensed Consolidated Financial Statements, respectively.

Eaton was in compliance with each of its debt covenants as of September 30, 2012 and for all periods presented.

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Agreement to Acquire Cooper

On May 21, 2012, Eaton reached an agreement to acquire Cooper. Cooper is incorporated in Ireland and is a diversified global manufacturer of electrical components and tools with sales of \$5.4 billion for 2011. At the close of the transaction, Eaton and Cooper will be combined under a newly created company (New Eaton), which is currently called Eaton Corporation Limited and is incorporated in Ireland. The total consideration to be received by Cooper shareholders in the transaction is comprised of both cash and equity and has a value of approximately \$11.8 billion based on the closing share price of Eaton common stock of \$42.40 on May 18, 2012. At the close of the transaction, the former shareholders of Eaton and Cooper are expected to own approximately 73% and 27% of New Eaton, respectively. The transaction was approved by shareholders of both companies on October 26, 2012, and is subject to receipt of certain regulatory approvals and other customary conditions. The transaction is expected to close in the fourth quarter of 2012. For additional information on the agreement to acquire Cooper, see Note 2 to the Condensed Consolidated Financial Statements.

Undistributed Assets of Non-U.S. Subsidiaries

At September 30, 2012, approximately 70% of the Company's consolidated cash and short-term investments resided in non-U.S. locations. These funds are considered permanently reinvested to be used to expand operations either organically or through acquisitions outside the U.S. The largest growth areas that are expected to require capital are in developing foreign markets such as Africa, Brazil, China, India, the Middle East and Southeast Asia. The Company's U.S. operations generate cash flow sufficient to satisfy U.S. operating requirements. The Company does not intend to repatriate any significant amounts of cash to the U.S. in the foreseeable future.

Sources and Uses of Cash Flow

Operating Cash Flow

Net cash provided by operating activities was \$977 in the first nine months of 2012, an increase of \$288 compared to \$689 in the first nine months of 2011. Operating cash flows in 2012 were positively impacted primarily by the absence of contributions of \$100 to other postretirement benefits plans that were made in the first nine months of 2011, higher net income in 2012, and changes in deferred tax and other long-term liabilities. Partially offsetting these sources of cash were increased contributions to the Company's U.S. qualified pension plan.

Investing Cash Flow

Net cash used in investing activities was \$857 in the first nine months of 2012, an increase of \$448 compared to \$409 in the first nine months of 2011. Investing cash flows in 2012 were primarily impacted by decreased sales of short-term investments, from \$272 in the the first nine months of 2011 to \$89 in the first nine months of 2012, related to lower operating and liquidity needs, and an increase in cash paid for acquisitions of businesses from \$298 in the first nine months of 2011 to \$554 in the first nine months of 2012. For additional information on business acquisitions see to Note 2 to the Condensed Consolidated Financial Statements.

Financing Cash Flow

Net cash used in financing activities was \$96 in the first nine months of 2012, a decrease of \$233 compared to \$329 in the first nine months of 2011. The decrease was primarily due to proceeds totaling \$600 from private debt issuances completed by Eaton during the second quarter of 2012 and the absence of share repurchases in the first nine months of 2012 as compared to the first nine months of 2011. Partially offsetting these sources of cash were payments of \$300 related to notes that matured in July 2012 and capitalized deferred financing fees of \$63 primarily related to bridge financing associated with the agreement to acquire Cooper. For additional information on business acquisitions see to Note 2 to the Condensed Consolidated Financial Statements.

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OTHER MATTERS

In December 2010, a Brazilian court held that a judgment obtained by a Brazilian company, Raysul, against another Brazilian company, Saturnia, which was sold by Eaton in 2006, could be enforced against Eaton Ltda. This judgment is based on an alleged violation of an agency agreement between Raysul and Saturnia. At September 30, 2012, the Company has a total accrual of 77 Brazilian Reais related to this matter (\$38 based on current exchange rates), comprised of 60 Brazilian Reais recognized in the fourth quarter of 2010 (\$30 based on current exchange rates) with an additional 17 Brazilian Reais recognized through September 30, 2012 (\$8 based on current exchange rates) due to subsequent accruals for interest and inflation. The Company expects that any sum it may be required to pay in connection with this matter will not exceed the amount of the recorded liability. In 2010, Eaton filed motions for clarification with the Brazilian court of appeals which were denied on April 6, 2011. Eaton Holding and Eaton Ltda. filed appeals on various issues to the Superior Court of Justice in Brasilia. All appeals have been accepted by the Superior Court of Justice and will be heard in due course.

On October 5, 2006, ZF Meritor LLC and Meritor Transmission Corporation (collectively, Meritor) filed an action against Eaton in the United States District Court for Delaware. The action sought damages, which would be trebled under United States antitrust laws, as well as injunctive relief and costs. The suit alleged that Eaton engaged in anti-competitive conduct against Meritor in the sale of heavy-duty truck transmissions in North America. Following a four week trial on liability only, on October 8, 2009, the jury returned a verdict in favor of Meritor. Eaton firmly believes that it competes fairly and honestly for business in the marketplace, and that at no time did it act in an anti-competitive manner. During an earlier stage in the case, the judge concluded that damage estimates contained in a report filed by Meritor were not based on reliable data and the report was specifically excluded from the case. On November 3, 2009, Eaton filed a motion for judgment as a matter of law and to set aside the verdict. That motion was denied on March 10, 2011. On March 14, 2011, Eaton filed a motion for entry of final judgment of liability, zero damages and no injunctive relief. That motion was denied on June 9, 2011. On August 19, 2011, the Court entered final judgment of liability but awarded zero damages to plaintiffs. The Court also entered an injunction prohibiting Eaton from offering rebates or other incentives based on purchasing targets but stayed the injunction pending appeal. Eaton appealed the liability finding and the injunction to the Third Circuit Court of Appeals. Meritor cross-appealed the finding of zero damages. On September 28, 2012, the Court of Appeals affirmed the District Court's denial of Eaton's motion for judgment as a matter of law, and let stand the jury verdict in favor of Meritor. The Third Circuit also ruled that the plaintiffs' damages report was properly excluded, but reversed the judgment of zero damages and ordered that the District Court must allow plaintiffs a limited opportunity to amend the damages report, which may be re-considered for reliability and admissibility. Injunctive relief also was vacated. An estimate of any potential loss related to this action cannot be made at this time.

At the end of the fourth quarter of 2011, the IRS issued a Notice for Eaton's 2005 and 2006 tax years. The Notice proposes assessments of \$75 in additional taxes plus \$52 in penalties related primarily to transfer pricing adjustments for products manufactured in the Company's facilities in Puerto Rico and the Dominican Republic and sold to affiliated companies located in the U.S., net of agreed credits and deductions. The Company has set its transfer prices for products sold between these affiliates at the same prices that the Company sells such products to third parties. The Notice was issued despite the IRS having previously recognized the validity of the Company's transfer pricing methodology by entering into two successive binding Advance Pricing Agreements (APAs) that approved and, in fact, required the application of the Company's transfer pricing methodology for the ten year period of 2001 through 2010. For the years 2001 through 2004, the IRS had previously accepted the transfer pricing methodology related to these APAs after a comprehensive review conducted in two separate audit cycles. On December 16, 2011, immediately prior to the Notice being issued, the IRS sent a letter stating that it was canceling the APAs.

The Company firmly believes that the proposed assessments are without merit. The Company also believes that it was in full compliance with the terms of the two APAs and that the IRS's unilateral attempt to retroactively cancel these two binding contracts is also without merit and represents a breach of the two contracts. On February 29, 2012, the Company filed a Petition with the U.S. Tax Court in which it asserted that the transfer pricing established in the two APA contracts meets the arms-length standard set by the U.S. income tax law, that the transfer pricing the Company has used is in full compliance with U.S. income tax laws, and accordingly, that the two APA contracts should be

enforced in accordance with their terms. On June 11, 2012, the Company filed a motion for partial summary judgment with the U.S. Tax Court, asking the U.S. Tax Court to rule the APAs are “contracts” and that the IRS has the burden of proof to substantiate cancellation of the APAs. On October 22, 2012, a hearing on the partial summary judgment motion was held at the U.S. Tax Court. The Company believes that the ultimate resolution of this matter will not have a material impact on its consolidated financial statements.

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FORWARD-LOOKING STATEMENTS

This Form 10-Q Report contains forward-looking statements concerning the acquisition of Cooper, Eaton's liquidity, performance in 2012 of Eaton's worldwide end markets and other matters. These statements may discuss goals, intentions and expectations as to future trends, plans, events, results of operations or financial condition, or state other information relating to Eaton, based on current beliefs of management as well as assumptions made by, and information currently available to, management. Forward-looking statements generally will be accompanied by words such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "guidance," "intend," "may," "possible," "potential," or other similar words, phrases or expressions. These statements should be used with caution and are subject to various risks and uncertainties, many of which are outside Eaton's control. The following factors could cause actual results to differ materially from those in the forward-looking statements: unanticipated changes in the markets for the company's business segments; unanticipated downturns in business relationships with customers or their purchases from us; the availability of credit to customers and suppliers; competitive pressures on sales and pricing; increases in the cost of material and other production costs, or unexpected costs that cannot be recouped in product pricing; the introduction of competing technologies; unexpected technical or marketing difficulties; unexpected claims, charges, litigation or dispute resolutions or an unfavorable resolution of pending litigation; strikes or other labor unrest; the impact of acquisitions and divestitures; unanticipated delays in closing of, or failure to close, the Cooper acquisition; unanticipated difficulties integrating acquisitions, including, specifically, the Cooper acquisition; new laws and governmental regulations; interest rate changes; tax rate changes or exposure to additional income tax liability; stock and commodity market and currency fluctuations; and unanticipated deterioration of economic and financial conditions in the United States and around the world. Eaton does not assume any obligation to update these forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

There have been no material changes in exposures to market risk since December 31, 2011.

ITEM 4. CONTROLS AND PROCEDURES.

Pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 (the Exchange Act), an evaluation was performed, under the supervision and with the participation of Eaton's management, including Alexander M. Cutler - Chairman, Chief Executive Officer and President; and Richard H. Fearon - Vice Chairman and Chief Financial and Planning Officer, of the effectiveness of the design and operation of Eaton's disclosure controls and procedures. Based on that evaluation, management concluded that Eaton's disclosure controls and procedures were effective as of September 30, 2012.

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Disclosure controls and procedures are designed to ensure that information required to be disclosed in Eaton's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in Eaton's reports filed under the Exchange Act is accumulated and communicated to management, including Eaton's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There were no changes in Eaton's internal control over financial reporting that materially affected, or is reasonably likely to materially affect, Eaton's internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Information regarding the Company's current legal proceedings is presented in Note 7 and Note 8 of the Notes to the Condensed Consolidated Financial Statements.

ITEM 1A. RISK FACTORS.

"Item 1A. Risk Factors" in Eaton's 2011 Form 10-K includes a discussion of the Company's risk factors. The information presented below updates, and should be read in conjunction with, the risk factors and information disclosed in the 2011 Form 10-K. Except as presented below, there have been no material changes from the risk factors described in the 2011 Form 10-K.

Failure to consummate Eaton's acquisition of Cooper (the transaction) could negatively impact the share price and the future business and financial results of Eaton.

If the transaction is not consummated, the ongoing business of Eaton may be adversely affected and, without realizing any of the benefits of having consummated the transaction, Eaton will be subject to a number of risks, including the following:

Eaton will be required to pay specified costs and expenses relating to the proposed transaction;

if the transaction agreement is terminated under specified circumstances, Eaton may be required to pay to Cooper a termination fee equal to \$300 million;

the transaction agreement restricts Eaton and Cooper, without the other party's consent and subject to certain exceptions, from making certain acquisitions and taking other specified actions until the merger and the acquisition occur or the transition agreement terminates. These restrictions may prevent Eaton from pursuing otherwise attractive business opportunities and making other changes to the business that may arise prior to completion of the merger and the acquisition or termination of the transaction agreement.

Eaton also could be subject to litigation related to any failure to consummate the transaction or related to any enforcement proceeding commenced against Eaton to perform its respective obligations under the transaction agreement.

If the transaction is not consummated, these risks may materialize and may adversely affect Eaton's business, operating results and share price.

If the transaction is completed, Eaton may not realize all of the anticipated benefits or those benefits may take longer to realize than expected. Further, Eaton's post-transaction leverage and debt service obligations could adversely affect Eaton's business.

Eaton's ability to realize the anticipated benefits of the transaction will depend, to a large extent, on Eaton's ability to integrate the two businesses. The integration process may disrupt the businesses and, if implemented ineffectively, would preclude realization of the full benefits expected. Failure to meet the challenges involved in integrating the two businesses to realize the anticipated benefits of the transaction could cause an interruption of, or a loss of momentum in, the activities of New Eaton and could adversely affect New Eaton's results of operations. The difficulties of combining the operations of the companies include, among others:

the diversion of management's attention to integration matters;

•

difficulties in achieving anticipated cost savings, synergies, business opportunities and growth prospects from combining the business of Cooper with that of Eaton;
• difficulties in the integration of operations and systems;
• difficulties in the assimilation of employees;

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•difficulties in managing the expanded operations of a significantly larger and more complex company;
•challenges in keeping existing customers and obtaining new customers; and
•challenges in attracting and retaining key personnel.

Many of these factors will be outside of Eaton's control and any one of them could result in increased costs, decreases in the amount of expected revenues and diversion of management's time and energy, which could materially impact the business, financial condition and results of operations of Eaton. Further, Eaton intends to incur new term debt in excess of \$5 billion to pay the cash portion of the transaction purchase price. The degree to which Eaton will be leveraged following the transaction could have important consequences to shareholders.

ITEM 6. EXHIBITS.

Exhibits — See Exhibit Index attached.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

EATON CORPORATION
Registrant

Date: October 31, 2012

By: /s/ Richard H. Fearon
Richard H. Fearon
Vice Chairman and Chief Financial and Planning Officer
(On behalf of the Registrant and as Principal Financial
Officer)

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Eaton Corporation

Third Quarter 2012 Report on Form 10-Q

Exhibit Index

| | |
|---------|--|
| 2 (a) | Transaction Agreement and Amendment No. 1 to the Transaction Agreement - Incorporated by reference to the Eaton Corporation Limited Form S-4, Annex A, filed on June 22, 2012 |
| 2 (b) | Amendment No. 2 to the Transaction Agreement - Incorporated by reference to Exhibit 2.1 of the Form 8-K Report filed on October 19, 2012 |
| 3 (a) | Amended Articles of Incorporation (amended and restated as of April 27, 2011) — Incorporated by reference to the Form 10-Q Report for the three months ended March 31, 2011 |
| 3 (b) | Amended Regulations (amended and restated as of April 27, 2011) — Incorporated by reference to the Form 10-Q Report for the three months ended March 31, 2011 |
| 4 | Pursuant to Regulation S-K Item 601(b)(4), Eaton agrees to furnish to the SEC, upon request, a copy of the instruments defining the rights of holders of its other long-term debt |
| 10 | Material contracts |
| (oo) | 2012 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 16, 2012 |
| (pp) | Senior Unsecured Bridge Credit Agreement - Incorporated by reference to Exhibit 10.1 of the Form 8-K Report filed on May 24, 2012 |
| 12 | Ratio of Earnings to Fixed Charges — Filed in conjunction with this Form 10-Q Report * |
| 31.1 | Certification of Chief Executive Officer (Pursuant to Rule 13a-14(a)) — Filed in conjunction with this Form 10-Q Report * |
| 31.2 | Certification of Chief Financial Officer (Pursuant to Rule 13a-14(a)) — Filed in conjunction with this Form 10-Q Report * |
| 32.1 | Certification of Chief Executive Officer (Pursuant to Rule 13a-14(b) as adopted pursuant to Section 906 of the Sarbanes-Oxley Act) — Filed in conjunction with this Form 10-Q Report * |
| 32.2 | Certification of Chief Financial Officer (Pursuant to Rule 13a-14(b) as adopted pursuant to Section 906 of the Sarbanes-Oxley Act) — Filed in conjunction with this Form 10-Q Report * |
| 101.INS | XBRL Instance Document * |
| 101.SCH | XBRL Taxonomy Extension Schema Document * |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document * |
| 101.DEF | XBRL Taxonomy Extension Label Definition Document * |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document * |

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document *

* Submitted electronically herewith.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Income for the three months ended September 30, 2012 and 2011, (ii) Consolidated Statements of Income for the nine months ended September 30, 2012 and 2011, (iii) Consolidated Statements of Comprehensive Income for the three months ended September 30, 2012 and 2011, (iv) Consolidated Statements of Comprehensive Income for the nine months ended September 30, 2012 and 2011, (v) Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011, (vi) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 and (vii) Notes to Condensed Consolidated Financial Statements for the nine months ended September 30, 2012.

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

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