

EATON CORP  
 Form 10-K  
 February 24, 2012  
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UNITED STATES  
 SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the year ended December 31, 2011

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)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class             | Name of each exchange on which registered |
|---------------------------------|---|
| Common Share (\$0.50 par value) | The New York Stock Exchange               |
|                                 | The Chicago Stock Exchange                |

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

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
 The aggregate market value of Common Stock held by non-affiliates of the registrant as of June 30, 2011 was \$17.5 billion.

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As of January 31, 2012, there were 334.7 million Common Shares outstanding.

Documents Incorporated By Reference

Portions of the Proxy Statement for the 2012 annual shareholders meeting are incorporated by reference into Part III.

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## Part I

## Item 1. Business.

Eaton Corporation (Eaton or Company) 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 73,000 employees in over 50 countries and sells products to customers in more than 150 countries.

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

In 2011, Eaton acquired businesses and entered into a joint venture in separate transactions for combined net cash purchase prices of \$325 million. The Consolidated Statements of Income include the results of these businesses from the dates of the transactions or formation. These transactions are summarized below:

| Acquired businesses and joint venture  | Date of transaction | Business segment         | Annual sales (in millions)           |
|--|---------------------|--------------------------|--------------------------------------|
| <b>E.A. Pedersen Company</b><br>A United States manufacturer of medium voltage switchgear, metal-clad switchgear, power control buildings and relay control panels primarily for the electrical utilities industry.  | December 29, 2011   | Electrical Americas      | \$37 for 2011                        |
| <b>IE Power, Inc.</b><br>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      | \$5 for 2010                         |
| <b>E. Begerow GmbH &amp; Co. KG</b><br>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                        |
| <b>ACTOM Low Voltage</b><br>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 |
| <b>C.I. ESI de Colombia S.A.</b><br>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                         |
| <b>Internormen Technology Group</b><br>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

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On February 20, 2012, Eaton reached an agreement to acquire Polimer Kaucuk Sanayi ve Pazarlama A.S., a Turkish manufacturer of hydraulic and industrial hose. This business sells its products under the SEL brand name and had sales of \$335 for 2011. The acquisition is expected to close early in the second quarter of 2012 and will be included in the Hydraulics segment. The terms of the agreement are subject to customary closing conditions.

Eaton's acquired businesses and joint venture entered into for 2010 and 2009 are presented in Note 2 of the Notes to the Consolidated Financial Statements.

### Business Segment Information

Information by business segment and geographic region regarding principal products, principal markets, methods of distribution, net sales, operating profit and assets is presented in Note 14 of the Notes to the Consolidated Financial Statements on pages 50 through 54. Additional information regarding Eaton's segments and business is presented below.

#### Electrical Americas and Electrical Rest of World

Principal methods of competition in these segments are performance of products and systems, technology, customer service and support, and price. Eaton has a strong competitive position in these segments and, with respect to many products, is considered among the market leaders. In normal economic cycles, sales of these segments are historically lower in the first quarter and higher in the third and fourth quarters of a year. In 2011, one large distributor of electrical products represented 12% of the sales of the Electrical Americas segment.

#### Hydraulics

Principal methods of competition in this segment are product performance, geographic coverage, service and price. Eaton has a strong competitive position in this segment and, with respect to many products, is considered among the market leaders. Sales of this segment are historically higher in the first and second quarters and lower in the third and fourth quarters of the year.

#### Aerospace

Principal methods of competition in this segment are total cost of ownership, product and system performance, quality, design engineering capabilities and timely delivery. Eaton has a strong competitive position in this segment and, with respect to many products and platforms, is considered among the market leaders. In 2011, 11% of this segment's sales were made to one large manufacturer of aircraft.

#### Truck

Principal methods of competition in this segment are product performance, global service, and price. Eaton has a strong competitive position in this segment and, with respect to many products, is considered among the market leaders. In 2011, 66% of this segment's sales were made to five large manufacturers of heavy-, medium-, and light-duty trucks and off-highway vehicles.

#### Automotive

Principal methods of competition in this segment are product performance, global service, and price. Eaton has a strong competitive position in this segment and, with respect to many products, is considered among the market leaders. Sales of this segment historically are slightly lower in the third quarter of the year as a result of the normal seasonal pattern of automotive industry production. In 2011, 58% of this segment's sales were made to six large manufacturers of vehicles and related components.

### Information Concerning Eaton's Business in General

#### Raw Materials

Eaton's major requirements for raw materials include iron, steel, copper, nickel, aluminum, brass, silver, lead, molybdenum, titanium, vanadium, rubber, plastic, electronic components, and insulating materials. Materials are purchased in various forms, such as extrusions, castings, powder metal, metal sheets and strips, forging billets, bar stock and plastic pellets. Raw materials, as well as parts and other components, are purchased from many suppliers and, under normal circumstances, the Company has no difficulty obtaining them. In 2011, prices increased throughout the year for certain raw materials purchased by Eaton. These price increases were managed through a variety of cost reduction projects and customer price increases. Eaton maintained appropriate levels of inventory to prevent basic shortages and did not experience any availability constraints in 2011.



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### Patents and Trademarks

Eaton considers its tradename and trademark to be of significant value to its business as a whole. The Company's products are marketed under a portfolio of patents, trademarks, licenses or other forms of intellectual property that expire at various dates in the future. Eaton develops and acquires new intellectual property on an ongoing basis and considers all of its intellectual property to be valuable. Based on the broad scope of the Company's product lines, management believes that the loss or expiration of any single intellectual property right would not have a material effect on Eaton's consolidated financial statements or its business segments. The Company's policy is to file applications and obtain patents for the great majority of its new products including product modifications and improvements.

### Order Backlog

Since a significant portion of open orders placed with Eaton by original equipment manufacturers of trucks, off-highway vehicles and passenger cars are historically subject to month-to-month releases by customers during each model year, these orders are not considered firm. In measuring backlog orders, only the amount of orders to which customers are firmly committed are included. Using this criterion, total backlog at December 31, 2011 and 2010 was approximately \$3.8 billion and \$3.2 billion, respectively. Backlog should not be relied upon as being indicative of results of operations for future periods.

### Research and Development

Research and development expenses for new products and improvement of existing products in 2011, 2010 and 2009 were \$417 million, \$425 million and \$395 million, respectively. Over the past five years, the Company has invested approximately \$2.0 billion in research and development.

### Environmental Contingencies

Operations of the Company involve the use and disposal of certain substances regulated under environmental protection laws. Eaton continues to modify certain processes on an ongoing, regular basis in order to reduce the impact on the environment, including the reduction or elimination of certain chemicals used in, and wastes generated from, operations. Compliance with federal, state and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, are not expected to have a material adverse effect upon earnings or the competitive position of the Company. Eaton's estimated capital expenditures for environmental control facilities are not expected to be material for 2012 and 2013. Information regarding the Company's liabilities related to environmental matters is presented in Note 7 of the Notes to the Consolidated Financial Statements on page 37.

### Foreign Operations

Financial information related to Eaton's foreign operations is presented in Note 14 of the Notes to the Consolidated Financial Statements on page 54. Information regarding risks that may affect foreign operations is presented in Item 1A of this Form 10-K Report.

### Item 1A. Risk Factors.

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

#### Volatility of end markets that Eaton serves.

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

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

The success of new and improved products and services depends on their initial and continued acceptance by Eaton's customers. The Company's businesses are affected, to varying degrees, by technological change and corresponding



shifts in customer demand, which could result in unpredictable product transitions or shortened life cycles. Eaton may experience difficulties or delays in the research, development, production or marketing of new products and services which may prevent Eaton from recouping or realizing a return on the investments required to bring new products and services to market.

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

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

Eaton's operations depend on production facilities throughout the world, many of which are located outside the United States and are subject to greater risks of disrupted production.

Eaton manages businesses with manufacturing facilities worldwide. In the last five years, the Company's operations outside the United States have increased significantly in relative size in comparison to its total operations. The Company's manufacturing facilities and operations could be disrupted by a natural disaster, labor strike, war, political unrest, terrorist activity or public health concerns. Some of Eaton's non-United States manufacturing facilities also may be more susceptible to economic and political upheaval than United States facilities. Any such disruption could cause delays in shipments of products and the loss of sales and customers, and insurance proceeds may not adequately compensate for losses.

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

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

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

As noted above in Item 1 "Foreign Operations", a significant portion of Eaton's sales are to customers outside the United States, and the Company expects sales in foreign markets to continue to represent a significant portion of its total sales. Foreign sales and operations are subject to changes in local government regulations and policies, including those related to tariffs and trade barriers, investments, property ownership rights, taxation, exchange controls and repatriation of earnings. Changes in the relative values of currencies occur from time to time and could affect Eaton's operating results. While the Company monitors exchange rate exposures and attempts to reduce these exposures through hedging activities, these risks could adversely affect operating results.

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

Eaton is subject to income taxes in the United States and various non-United States jurisdictions. Domestic and international liabilities are subject to the allocation of income among various tax jurisdictions. The Company's effective tax rate could be affected by changes in the mix among earnings in countries with differing statutory tax rates, changes in the valuation allowance of deferred tax assets or changes in tax laws. The amount of income taxes paid is subject to ongoing audits by United States federal, state and local tax authorities and by non-United States tax authorities. If these audits result in assessments different from amounts reserved, future financial results may include unfavorable adjustments to the Company's tax liabilities.

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

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

of which could adversely affect operating results.

Further, Eaton's suppliers of component parts may increase their prices in response to increases in costs of raw materials that they use to manufacture component parts. As a result, the Company may not be able to increase its prices commensurately with its increased costs. Consequently, operating results could be materially and adversely affected.

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Finally, while Eaton carefully monitors the viability of each of its suppliers, the recent global economic downturn has had an adverse impact on Eaton's suppliers' liquidity and solvency. Should one or more material suppliers become insolvent, Eaton could be required to pay increased prices for affected raw materials or components, or experience difficulty in replacing the insolvent supplier, either of which could adversely affect operating results.

Eaton engages in acquisitions and joint ventures, and may encounter unexpected difficulties identifying, pricing or integrating those businesses.

Eaton seeks to grow, in part, through strategic acquisitions and joint ventures, which are intended to complement or expand the Company's businesses, and expects to continue to do so in the future. The success of this strategy will depend on Eaton's ability to identify, price, finance and complete these transactions or arrangements. Success will also depend on the Company's ability to integrate the businesses acquired in these transactions and to develop satisfactory working arrangements with the Company's strategic partners in the joint ventures. Eaton may encounter unexpected difficulties in completing and integrating acquisitions with Eaton's existing operations, and in managing strategic investments. Furthermore, the Company may not realize the degree, or timing, of benefits anticipated when it first entered into a transaction. Any of the foregoing could adversely affect the Company's business and operating results. Eaton may be unable to adequately protect its intellectual property rights, which could affect the Company's ability to compete.

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

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

At any given time, Eaton may be subject to litigation, the disposition of which may have a material adverse effect on the Company's businesses, financial condition or results of operations. Information regarding current legal proceedings is presented in Note 7 of the Notes to the Consolidated Financial Statements on page 36.

Eaton participates in markets that are competitive and Eaton's results could be adversely impacted by competitors' actions.

Eaton's businesses operate in competitive markets. The Company competes against other global manufacturers and service providers on the basis of product performance, quality and price, in addition to other factors. While Eaton's product development and quality initiatives have been competitive strengths in the past, actions by Eaton's competitors could lead to downward pressure on prices and/or a decline in the Company's market share, either of which could adversely affect operating results.

### Item 1B. Unresolved Staff Comments.

None.

### Item 2. Properties.

Eaton's world headquarters is located in Cleveland, Ohio. The Company maintains manufacturing facilities at 219 locations in 34 countries. The Company is a lessee under a number of operating leases for certain real properties and equipment, none of which is material to its operations. Management believes that the existing manufacturing facilities are adequate for operations and that the facilities are maintained in good condition.

Item 3. Legal Proceedings.

Information regarding the Company's current legal proceedings is presented in Note 7 of the Notes to the Consolidated Financial Statements on page 36.

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Item 4. Mine Safety Disclosures.

Not applicable.

Executive Officers of the Registrant

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

Part II

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

The Company's common shares are listed for trading on the New York and Chicago stock exchanges. Information regarding cash dividends paid, and the high and low market price per common share, for each quarter in 2011 and 2010 is presented in "Quarterly Data" on page 68. At December 31, 2011, there were 8,191 holders of record of the Company's common shares. Additionally, 18,220 current and former employees were shareholders through participation in the Eaton Savings Plan (ESP), Eaton Personal Investment Plan (EPIP), and the Eaton Puerto Rico Retirement Savings Plan.

Information regarding equity-based compensation plans required by Regulation S-K Item 201(d) is provided in Item 12 of this Form 10-K Report.

Item 6. Selected Financial Data.

Information regarding selected financial data is presented in the "Ten-Year Consolidated Financial Summary" on page 69.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

"Management's Discussion and Analysis of Financial Condition and Results of Operations" is presented on pages 55 through 67.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Information regarding market risk is presented in "Market Risk Disclosure" on pages 65 through 66.

Item 8. Financial Statements and Supplementary Data.

The report of the independent registered public accounting firm, consolidated financial statements, and notes to consolidated financial statements are presented on pages 15 through 54.

Information regarding selected quarterly financial information for 2011 and 2010 is presented in "Quarterly Data" on page 68.

Item 9. Change in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures - Pursuant to SEC Rule 13a-15, an evaluation was performed under the supervision and with the participation of Eaton's management, including Alexander M. Cutler - Chairman and Chief Executive Officer; President; and Richard H. Fearon - Vice Chairman and Chief Financial and Planning Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, Eaton's management concluded that the Company's disclosure controls and procedures were effective as of December 31, 2011.

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Disclosure controls and procedures are designed to ensure that information required to be disclosed in Company 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 Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Pursuant to Section 404 of the Sarbanes Oxley Act of 2002 and the rules and regulations adopted pursuant thereto, Eaton has included a report of management's assessment of the effectiveness of internal control over financial reporting, which is presented on page 18.

“Report of Independent Registered Public Accounting Firm” relating to internal control over financial reporting as of December 31, 2011 is presented on page 17.

During the fourth quarter of 2011, there was no change in Eaton's internal control over financial reporting that materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

## Item 9B. Other Information.

None.

## Part III

## Item 10. Directors, Executive Officers and Corporate Governance.

Information required with respect to the directors of the Company is set forth under the caption “Election of Directors” in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference. A listing of the Company's executive officers, their ages, positions and offices held over the past five years, as of February 1, 2012, follows:

| Name                | Age | Position (Date elected to position)  |
|---------------------|-----|--|
| Alexander M. Cutler | 60  | Chairman and Chief Executive Officer; President (August 1, 2000 - present)<br>Director (September 22, 1993 - present)  |
| Richard H. Fearon   | 55  | Vice Chairman and Chief Financial and Planning Officer (April 24, 2002 - present)  |
| Craig Arnold        | 51  | Vice Chairman and Chief Operating Officer - Industrial Sector (February 1, 2009 - present)<br>Chief Executive Officer - Fluid Power Group (October 25, 2000 - January 31, 2009)  |
| Thomas S. Gross     | 57  | Vice Chairman and Chief Operating Officer - Electrical Sector (February 1, 2009 - present)<br>President - Power Quality and Control Business (April 1, 2008 - January 31, 2009)<br>Vice President and President - Power Quality Solutions Operations (May 16, 2005 – March 31, 2008) |
| James W. McGill     | 56  | Executive Vice President - Chief Human Resources Officer (January 1, 2010 - present)<br>President - Asia-Pacific Region (April 1, 2008 - December 31, 2009)<br>Vice President - Asia-Pacific (April 1, 2006 - March 31, 2008)  |
| Mark M. McGuire     | 54  | Executive Vice President and General Counsel (December 1, 2005 - present)  |





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| Name            | Age | Position (Date elected to position)  |
|-----------------|-----|--|
| Thomas E. Moran | 47  | Senior Vice President and Secretary (October 1, 2008 - present)<br>Assistant Secretary and Managing Counsel, The Dow Chemical Company (2002 - 2008)  |
| Billie K. Rawot | 60  | Senior Vice President and Controller (March 1, 1991 - present)   |
| David B. Foster | 40  | Senior Vice President - Corporate Development and Treasury (August 1, 2011 - present)<br>Vice President of Finance - Asia Pacific (June 1, 2008 - July 31, 2011)<br>Director of Finance - Automotive Group Engine Air Management Operations (January 1, 2006 - May 31, 2008) |

There are no family relationships among the officers listed, and there are no arrangements or understandings pursuant to which any of them were elected as officers. All officers hold office for one year and until their successors are elected and qualified, unless otherwise specified by the Board of Directors; provided, however, that any officer is subject to removal with or without cause, at any time, by a vote of a majority of the Board of Directors.

Information required with respect to compliance with Section 16(a) of the Exchange Act is set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference.

The Company has adopted a Code of Ethics, which applies to the directors, officers and employees worldwide. This document is available on the Company's website at <http://www.eaton.com>.

There were no changes during the fourth quarter 2011 to the procedures by which security holders may recommend nominees to the Company's Board of Directors.

Information related to the Audit Committee, and members of the Committee that are financial experts, is set forth under the caption "Board Committees - Audit Committee" in the definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference.

#### Item 11. Executive Compensation.

Information required with respect to executive compensation is set forth under the caption "Executive Compensation" in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information required with respect to securities authorized for issuance under equity-based compensation plans is set forth under the caption "Equity Compensation Plans" in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference.

Information required with respect to security ownership of certain beneficial owners, is set forth under the caption "Share Ownership Tables" in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference.

#### Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information required with respect to certain relationships and related transactions is set forth under the caption "Review of Related Person Transactions" in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference.

Information required with respect to director independence is set forth under the caption "Director Independence" in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is incorporated by reference.

#### Item 14. Principal Accounting Fees and Services.

Information required with respect to principal accountant fees and services is set forth under the caption "Audit Committee Report" in the Company's definitive Proxy Statement to be filed on or about March 16, 2012, and is

incorporated by reference.

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Part IV

Item 15. Exhibits, Financial Statement Schedules.

(1) The report of the independent registered public accounting firm, consolidated financial statements and notes to consolidated financial statements are included in Item 8 above:

Report of Independent Registered Public Accounting Firm - Page 15

Consolidated Statements of Income - Years ended December 31, 2011, 2010 and 2009 - Page 19

Consolidated Balance Sheets - December 31, 2011 and 2010 - Page 20

Consolidated Statements of Cash Flows - Years ended December 31, 2011, 2010 and 2009 - Page 21

Consolidated Statements of Shareholders' Equity - Years ended December 31, 2011, 2010 and 2009 - Page 22

Notes to Consolidated Financial Statements - Pages 23 through 54

All other schedules for which provision is made in Regulation S-X of the SEC are not required under the related instructions or are inapplicable and, therefore, have been omitted.

(3) Exhibits

3 Amended Articles of Incorporation (amended and restated as of April 27, 2011) - Incorporated by reference to the (i) Form 10-Q Report for the three months ended March 31, 2011

3 (ii) 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), the Company agrees to furnish to the SEC, upon request, a copy of (a) the instruments defining the rights of holders of its other long-term debt

10 Material contracts

(a) Senior Executive Incentive Compensation Plan (effective January 1, 2008) - Incorporated by reference to the definitive Proxy Statement dated March 14, 2008

(b) Executive Incentive Compensation Plan (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2005

(c) 2005 Non-Employee Director Fee Deferral Plan (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007

(d) Deferred Incentive Compensation Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007

(e) Excess Benefits Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007

(f) Incentive Compensation Deferral Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007

(g) Limited Eaton Service Supplemental Retirement Income Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007

(h) Supplemental Benefits Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007

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- (i) Form of Restricted Share Unit Agreement (2 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (j) Form of Restricted Share Unit Agreement (4 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (k) Form of Restricted Share Agreement (2 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (l) Form of Restricted Share Agreement (4 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (m) Form of Restricted Share Agreement (Non-Employee Directors) - Incorporated by reference to the Form 8-K Report filed February 1, 2010
- (n) Form of Stock Option Agreement for Executives (2008) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (o) Form of Stock Option Agreement for Executives - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2006
- (p) Form of Stock Option Agreement for Non-Employee Directors (2008) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (q) 2002 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 15, 2002
- (r) 2004 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 19, 2004
- (s) 2008 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 14, 2008
- (t) 2009 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 13, 2009
- (u) Plan for the Deferred Payment of Directors' Fees (originally adopted in 1985 and amended effective September 24, 1996, January 28, 1998, January 23, 2002, February 24, 2004, December 8, 2004 and, in certain respects, January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (v) 1996 Non-Employee Director Fee Deferral Plan (amended and restated effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2006
- (w) Form of Change of Control Agreement entered into with officers of Eaton Corporation - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2008
- (x) Form of Indemnification Agreement entered into with officers of Eaton Corporation - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (y) Form of Indemnification Agreement entered into with directors of Eaton Corporation - Incorporated by reference to the Form 8-K Report filed January 26, 2007
- (z) Executive Strategic Incentive Plan (amended and restated January 1, 2008) - Incorporated by reference to the definitive Proxy Statement dated March 14, 2008
- (aa) Executive Strategic Incentive Plan II (effective January 1, 2001) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (bb) Supplemental Executive Strategic Incentive Plan (effective as of June 25, 2008) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2008
- (cc) Deferred Incentive Compensation Plan (amended and restated effective November 1, 2007) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2009

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- (dd) 1998 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 13, 1998
- (ee) Incentive Compensation Deferral Plan (amended and restated October 1, 1997) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2000
- (ff) Trust Agreement - Officers and Employees (dated December 6, 1996) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (gg) Trust Agreement - Non-employee Directors (dated December 6, 1996) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (hh) Group Replacement Insurance Plan (GRIP) (effective June 1, 1992) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 1992
- (ii) 1991 Stock Option Plan - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (jj) Excess Benefits Plan (amended and restated effective January 1, 1989) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (kk) Supplemental Benefits Plan (amended and restated January 1, 1989) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (ll) Eaton Corporation Board of Directors Policy on Incentive Compensation, Stock Options and Other Equity Grants upon the Restatement of Financial Results - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (mm) Amended and Restated Grantor Trust Agreement for Non-Employee Directors' Deferred Fees Plans - effective January 1, 2010 - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2010
- (nn) Amended and Restated Grantor Trust Agreement for Employees' Deferred Compensation Plans - effective January 1, 2010 - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2010
- 12 Ratio of Earnings to Fixed Charges - Filed in conjunction with this Form 10-K Report \*
- 14 Code of Ethics - Incorporated by reference to the definitive Proxy Statement filed on March 14, 2008
- 21 Subsidiaries of Eaton Corporation - Filed in conjunction with this Form 10-K Report \*
- 23 Consent of Independent Registered Public Accounting Firm - Filed in conjunction with this Form 10-K Report \*
- 24 Power of Attorney - Filed in conjunction with this Form 10-K Report \*
- 31.1 Certification of Chief Executive Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 302) - Filed in conjunction with this Form 10-K Report \*
- 31.2 Certification of Chief Financial Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 302) - Filed in conjunction with this Form 10-K Report \*
- 32.1 Certification of Chief Executive Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 906) - Filed in conjunction with this Form 10-K Report \*
- 32.2 Certification of Chief Financial Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 906) - Filed in conjunction with this Form 10-K Report \*
- 101.INSXBRL Instance Document \*
- 101.SCHXBRL Taxonomy Extension Schema Document \*
- 101.CALXBRL Taxonomy Extension Calculation Linkbase Document \*

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- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document \*
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document \*
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document \*

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\*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 years ended December 31, 2011, 2010 and 2009, (ii) Consolidated Balance Sheets at December 31, 2011 and 2010, (iii) Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009, (iv) Notes to Consolidated Financial Statements for the year ended December 31, 2011.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K 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.

(b) Exhibits

Certain exhibits required by this portion of Item 15 are filed as a separate section of this Form 10-K Report.

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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: February 24, 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)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Date: February 24, 2012

Signature Title

\*  
Alexander M. Cutler Chairman and Chief Executive Officer; President; Principal Executive Officer; Director

\*  
Billie K. Rawot Senior Vice President and Controller; Principal Accounting Officer

\*  
Todd M. Bluedorn Director

\*  
Christopher M. Connor Director

\*  
Michael J. Critelli Director

\*  
Charles E. Golden Director

\*  
Arthur E. Johnson Director

\*  
Ned C. Lautenbach Director

\*  
Deborah L. McCoy Director

\*  
Gregory R. Page Director

\*  
Gary L. Tooker Director

\*By /s/ Richard H. Fearon  
Richard H. Fearon, Attorney-in-Fact for the officers and directors signing in the capacities indicated

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Eaton Corporation

We have audited the accompanying consolidated balance sheets of Eaton Corporation as of December 31, 2011 and 2010, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Eaton Corporation at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Eaton Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP  
Cleveland, Ohio  
February 24, 2012



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MANAGEMENT'S REPORT ON FINANCIAL STATEMENTS

We have prepared the accompanying consolidated financial statements and related information of Eaton Corporation included herein for the three years ended December 31, 2011. The primary responsibility for the integrity of the financial information included in this annual report rests with management. The financial information included in this annual report has been prepared in accordance with accounting principles generally accepted in the United States based on our best estimates and judgments and giving due consideration to materiality. The opinion of Ernst & Young LLP, Eaton's independent registered public accounting firm, on those financial statements is included herein.

Eaton has high standards of ethical business practices supported by the Eaton Code of Ethics and corporate policies. Careful attention is given to selecting, training and developing personnel, to ensure that management's objectives of establishing and maintaining adequate internal controls and unbiased, uniform reporting standards are attained. Our policies and procedures provide reasonable assurance that operations are conducted in conformity with applicable laws and with the Company's commitment to a high standard of business conduct.

The Board of Directors pursues its responsibility for the quality of Eaton's financial reporting primarily through its Audit Committee, which is composed of five independent directors. The Audit Committee meets regularly with management, the internal auditors and the independent registered public accounting firm to ensure that they are meeting their responsibilities and to discuss matters concerning accounting, control, audits and financial reporting. The internal auditors and independent registered public accounting firm have full and free access to senior management and the Audit Committee.

/s/ Alexander M. Cutler  
Chairman and Chief Executive  
Officer; President

/s/ Richard H. Fearon  
Vice Chairman and Chief Financial  
and Planning Officer

/s/ Billie K. Rawot  
Senior Vice President  
and Controller

February 24, 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Eaton Corporation

We have audited Eaton Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Eaton Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Eaton Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Eaton Corporation as of December 31, 2011 and 2010, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011 and our report dated February 24, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP  
Cleveland, Ohio  
February 24, 2012

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Eaton Corporation is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act rules 13a-15(f)).

Under the supervision and with the participation of Eaton's management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. In conducting this evaluation, we used the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - Integrated Framework. Based on this evaluation under the framework referred to above, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2011.

The independent registered public accounting firm Ernst & Young LLP has issued an audit report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. This report is included herein.

/s/ Alexander M. Cutler  
Chairman and Chief Executive  
Officer; President

/s/ Richard H. Fearon  
Vice Chairman and Chief Financial  
and Planning Officer

/s/ Billie K. Rawot  
Senior Vice President  
and Controller

February 24, 2012

Table of ContentsEATON CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME

| (In millions except for per share data)              | Year ended December 31 |          |          |
|--|------------------------|----------|----------|
|  | 2011                   | 2010     | 2009     |
| Net sales  | \$16,049               | \$13,715 | \$11,873 |
| Cost of products sold                                | 11,261                 | 9,633    | 8,782    |
| Selling and administrative expense                   | 2,738                  | 2,486    | 2,252    |
| Research and development expense                     | 417                    | 425      | 395      |
| Interest expense-net                                 | 118                    | 136      | 150      |
| Other income-net                                     | (38)                   | (1)      | (9)      |
| Income before income taxes                           | 1,553                  | 1,036    | 303      |
| Income tax expense (benefit)                         | 201                    | 99       | (82)     |
| Net income   | 1,352                  | 937      | 385      |
| Less net income for noncontrolling interests         | (2)                    | (8)      | (2)      |
| Net income attributable to Eaton common shareholders | \$1,350                | \$929    | \$383    |
| Net income per common share                          |                        |          |          |
| Diluted  | \$3.93                 | \$2.73   | \$1.14   |
| Basic  | 3.98                   | 2.76     | 1.16     |
| Weighted-average number of common shares outstanding |                        |          |          |
| Diluted  | 342.8                  | 339.5    | 335.8    |
| Basic  | 338.3                  | 335.5    | 332.7    |
| Cash dividends paid per common share                 | \$1.36                 | \$1.08   | \$1.00   |

The notes on pages 23 to 54 are an integral part of the consolidated financial statements.

Table of ContentsEATON CORPORATION  
CONSOLIDATED BALANCE SHEETS

|   | December 31 |          |
|---|-------------|----------|
| (In millions)   | 2011        | 2010     |
| Assets  |             |          |
| Current assets  |             |          |
| Cash  | \$385       | \$333    |
| Short-term investments  | 699         | 838      |
| Accounts receivable-net   | 2,444       | 2,239    |
| Inventory   | 1,701       | 1,564    |
| Deferred income taxes   | 398         | 303      |
| Prepaid expenses and other current assets                                   | 199         | 229      |
| Total current assets  | 5,826       | 5,506    |
| Property, plant and equipment   |             |          |
| Land and buildings  | 1,525       | 1,494    |
| Machinery and equipment   | 4,669       | 4,485    |
| Gross property, plant and equipment   | 6,194       | 5,979    |
| Accumulated depreciation  | (3,592)     | (3,502)  |
| Net property, plant and equipment   | 2,602       | 2,477    |
| Other noncurrent assets   |             |          |
| Goodwill  | 5,537       | 5,454    |
| Other intangible assets   | 2,192       | 2,272    |
| Deferred income taxes   | 1,134       | 1,001    |
| Other assets  | 582         | 542      |
| Total assets  | \$17,873    | \$17,252 |
| Liabilities and shareholders' equity  |             |          |
| Current liabilities   |             |          |
| Short-term debt   | \$86        | \$72     |
| Current portion of long-term debt   | 321         | 4        |
| Accounts payable  | 1,491       | 1,408    |
| Accrued compensation  | 420         | 465      |
| Other current liabilities   | 1,319       | 1,284    |
| Total current liabilities   | 3,637       | 3,233    |
| Noncurrent liabilities  |             |          |
| Long-term debt  | 3,366       | 3,382    |
| Pension liabilities   | 1,793       | 1,429    |
| Other postretirement benefits liabilities                                   | 642         | 743      |
| Deferred income taxes   | 442         | 487      |
| Other noncurrent liabilities  | 501         | 575      |
| Total noncurrent liabilities  | 6,744       | 6,616    |
| Shareholders' equity  |             |          |
| Common shares (334.4 million outstanding in 2011 and 339.9 million in 2010) | 167         | 170      |
| Capital in excess of par value  | 4,169       | 4,093    |
| Retained earnings   | 5,103       | 4,455    |

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|                                      |          |          |   |
|--------------------------------------|----------|----------|---|
| Accumulated other comprehensive loss | (1,964   | ) (1,348 | ) |
| Deferred compensation plans          | (6       | ) (8     | ) |
| Total Eaton shareholders' equity     | 7,469    | 7,362    |   |
| Noncontrolling interests             | 23       | 41       |   |
| Total equity                         | 7,492    | 7,403    |   |
| Total liabilities and equity         | \$17,873 | \$17,252 |   |

The notes on pages 23 to 54 are an integral part of the consolidated financial statements.

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Table of ContentsEATON CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In millions)  | Year ended December 31 |           |           |
|--|------------------------|-----------|-----------|
|  | 2011                   | 2010      | 2009      |
| Operating activities   |                        |           |           |
| Net income   | \$1,352                | \$937     | \$385     |
| Adjustments to reconcile to net cash provided by operating activities        |                        |           |           |
| Depreciation and amortization  | 556                    | 551       | 573       |
| Deferred income taxes  | (113)                  | ) 26      | (191)     |
| Pension expense  | 227                    | 179       | 270       |
| Contributions to pension plans   | (372)                  | ) (403)   | ) (271)   |
| Contributions to other postretirement benefits plans                         | (223)                  | ) (82)    | ) (87)    |
| Excess tax benefit from equity-based compensation                            | (57)                   | ) —       | (4)       |
| Changes in working capital   |                        |           |           |
| Accounts receivable-net  | (219)                  | ) (305)   | ) 440     |
| Inventory  | (113)                  | ) (219)   | ) 292     |
| Accounts payable   | 92                     | 322       | (73)      |
| Accrued compensation   | (38)                   | ) 203     | (50)      |
| Accrued income and other taxes   | 123                    | (11)      | ) 34      |
| Other current assets   | 11                     | (46)      | ) 48      |
| Other current liabilities  | (30)                   | ) 22      | 58        |
| Other-net  | 52                     | 108       | (16)      |
| Net cash provided by operating activities                                    | 1,248                  | 1,282     | 1,408     |
| Investing activities   |                        |           |           |
| Capital expenditures for property, plant and equipment                       | (568)                  | ) (394)   | ) (195)   |
| Cash paid for acquisitions of businesses                                     | (325)                  | ) (222)   | ) (10)    |
| Sales (purchases) of short-term investments-net                              | 103                    | (392)     | ) (64)    |
| Other-net  | (10)                   | ) (4)     | ) 44      |
| Net cash used in investing activities  | (800)                  | ) (1,012) | ) (225)   |
| Financing activities   |                        |           |           |
| Borrowings with original maturities of more than three months                |                        |           |           |
| Proceeds   | 353                    | 55        | 558       |
| Payments   | (65)                   | ) (65)    | ) (887)   |
| Borrowings (payments) with original maturities of less than three months-net | 12                     | (37)      | ) (424)   |
| (primarily commercial paper)   |                        |           |           |
| Cash dividends paid  | (462)                  | ) (363)   | ) (334)   |
| Exercise of employee stock options   | 71                     | 157       | 27        |
| Repurchase of shares   | (343)                  | ) —       | —         |
| Excess tax benefit from equity-based compensation                            | 57                     | —         | 4         |
| Other-net  | (4)                    | ) (8)     | ) (5)     |
| Net cash used in financing activities  | (381)                  | ) (261)   | ) (1,061) |
| Effect of foreign exchange rate changes on cash                              | (15)                   | ) (16)    | ) 30      |
| Total increase (decrease) in cash  | 52                     | (7)       | ) 152     |
| Cash at the beginning of the period  | 333                    | 340       | 188       |
| Cash at the end of the period  | \$385                  | \$333     | \$340     |

The notes on pages 23 to 54 are an integral part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

| (In millions)  | Common shares |         | Capital in excess of par value | Retained earnings | Accumulated other comprehensive loss | Deferred compensation plans | Total Eaton shareholders' equity | Noncontrolling interests | Total equity |
|--|---------------|---------|--------------------------------|-------------------|--------------------------------------|-----------------------------|----------------------------------|--------------------------|--------------|
|  | Shares        | Dollars |                                |                   |                                      |                             |                                  |                          |              |
| Balance at January 1, 2009   | 330.0         | \$ 165  | \$3,869                        | \$3,844           | \$ (1,538 )                          | \$ (23 )                    | \$ 6,317                         | \$ 48                    | \$6,365      |
| Net income   | —             | —       | —                              | 383               | —                                    | —                           | 383                              | 2                        | 385          |
| Foreign currency translation and related hedging instruments (net of income tax expense of \$45) | —             | —       | —                              | —                 | 349                                  | —                           | 349                              | —                        | 349          |
| Pensions (net of income tax expense of \$42)   | —             | —       | —                              | —                 | 1                                    | —                           | 1                                | —                        | 1            |
| Other postretirement benefits (net of income tax benefit of \$14)                                | —             | —       | —                              | —                 | (56 )                                | —                           | (56 )                            | —                        | (56 )        |
| Cash flow hedges (net of income tax expense of \$19)   | —             | —       | —                              | —                 | 36                                   | —                           | 36                               | —                        | 36           |
| Other comprehensive income   |               |         |                                |                   |                                      |                             | 330                              | —                        | 330          |
| Total comprehensive income   |               |         |                                |                   |                                      |                             | 713                              | 2                        | 715          |
| Cash dividends paid  | —             | —       | —                              | (334 )            | —                                    | —                           | (334 )                           | (5 )                     | (339 )       |
| Issuance of shares under employee benefit plans-net (net of income tax benefit of \$3)           | 2.3           | 1       | 78                             | —                 | —                                    | 2                           | 81                               | —                        | 81           |
| Business divestiture   | —             | —       | —                              | —                 | —                                    | —                           | —                                | (4 )                     | (4 )         |
| Balance at December 31, 2009   | 332.3         | 166     | 3,947                          | 3,893             | (1,208 )                             | (21 )                       | 6,777                            | 41                       | 6,818        |
| Net income   | —             | —       | —                              | 929               | —                                    | —                           | 929                              | 8                        | 937          |
| Foreign currency translation and related hedging instruments                                     | —             | —       | —                              | —                 | (78 )                                | —                           | (78 )                            | —                        | (78 )        |
| Pensions (net of income tax benefit of \$30)   | —             | —       | —                              | —                 | (61 )                                | —                           | (61 )                            | —                        | (61 )        |
| Other postretirement benefits (net of income tax benefit of \$4)                                 | —             | —       | —                              | —                 | (1 )                                 | —                           | (1 )                             | —                        | (1 )         |
| Other comprehensive loss   |               |         |                                |                   |                                      |                             | (140 )                           | —                        | (140 )       |

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|  |        |        |         |         |             |         |          |       |         |
|--|--------|--------|---------|---------|-------------|---------|----------|-------|---------|
| Total comprehensive income   |        |        |         |         |             |         | 789      | 8     | 797     |
| Cash dividends paid  | —      | —      | —       | (363 )  | —           | —       | (363 )   | (8 )  | (371 )  |
| Issuance of shares under employee benefit plans-net (net of income tax expense of \$3)           | 7.6    | 4      | 146     | (4 )    | —           | 13      | 159      | —     | 159     |
| Balance at December 31, 2010   | 339.9  | 170    | 4,093   | 4,455   | (1,348 )    | (8 )    | 7,362    | 41    | 7,403   |
| Net income   | —      | —      | —       | 1,350   | —           | —       | 1,350    | 2     | 1,352   |
| Foreign currency translation and related hedging instruments (net of income tax benefit of \$11) | —      | —      | —       | —       | (241 )      | —       | (241 )   | —     | (241 )  |
| Pensions (net of income tax benefit of \$162)  | —      | —      | —       | —       | (337 )      | —       | (337 )   | —     | (337 )  |
| Other postretirement benefits (net of income tax benefit of \$11)                                | —      | —      | —       | —       | (16 )       | —       | (16 )    | —     | (16 )   |
| Cash flow hedges (net of income tax benefit of \$12)   | —      | —      | —       | —       | (22 )       | —       | (22 )    | —     | (22 )   |
| Other comprehensive loss   |        |        |         |         |             |         | (616 )   | —     | (616 )  |
| Total comprehensive income   |        |        |         |         |             |         | 734      | 2     | 736     |
| Cash dividends paid  | —      | —      | —       | (462 )  | —           | —       | (462 )   | (4 )  | (466 )  |
| Issuance of shares under employee benefit plans-net (net of income tax benefit of \$72)          | 2.8    | 1      | 177     | (2 )    | —           | 2       | 178      | —     | 178     |
| Business divestiture   | —      | —      | —       | —       | —           | —       | —        | (16 ) | (16 )   |
| Repurchase of shares   | (8.3 ) | (4 )   | (101 )  | (238 )  | —           | —       | (343 )   | —     | (343 )  |
| Balance at December 31, 2011   | 334.4  | \$ 167 | \$4,169 | \$5,103 | \$ (1,964 ) | \$ (6 ) | \$ 7,469 | \$ 23 | \$7,492 |

The notes on pages 23 to 54 are an integral part of the consolidated financial statements.

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EATON CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Note 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General Information

Eaton Corporation (Eaton or Company) 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 73,000 employees in over 50 countries, and sells products to customers in more than 150 countries.

Preparation of the consolidated financial statements requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and notes. Actual results could differ from these estimates. Management has evaluated subsequent events through the date the consolidated financial statements were filed with the Securities Exchange Commission.

The consolidated financial statements include accounts of Eaton and all subsidiaries and other controlled entities. Intercompany transactions and balances have been eliminated. The equity method of accounting is used for investments in associate companies where the Company has a 20% to 50% ownership interest. Equity investments are evaluated for impairment whenever events or circumstances indicate the book value of the investment exceeds fair value. An impairment would exist if there is an other-than-temporary decline in value. These associate companies are not material either individually, or in the aggregate, to Eaton's consolidated financial statements. Eaton does not have off-balance sheet arrangements or financings with unconsolidated entities. In the ordinary course of business, the Company leases certain real properties and equipment, as described in Note 7.

Certain prior year amounts have been reclassified to conform to the current year presentation.

Foreign Currency Translation

The functional currency for subsidiaries outside the United States is primarily the local currency. Financial statements for these subsidiaries are translated at year-end exchange rates as to assets and liabilities and weighted-average exchange rates as to revenues and expenses. The resulting translation adjustments are recognized in Accumulated other comprehensive loss.

Revenue Recognition

Sales of products are recognized when a sales agreement is in place, products have been shipped to unaffiliated customers and title has transferred in accordance with shipping terms (FOB shipping point, FOB destination or equivalent International Commercial (INCO) Terms), the selling price is fixed and determinable and collectability is reasonably assured, all significant related acts of performance have been completed, and no other significant uncertainties exist. Shipping and handling costs billed to customers are included in Net sales and the related costs in Cost of products sold. Although the majority of the sales agreements contain standard terms and conditions, there are agreements that contain multiple elements or non-standard terms and conditions. As a result, judgment is required to determine the appropriate accounting, including whether the deliverables specified in these agreements should be treated as separate units of accounting for recognition purposes, and, if so, how the sales price should be allocated among the elements and when to recognize sales for each element. For delivered elements, sales are recognized only when the delivered elements have standalone value, fair values of undelivered elements are known, there are no uncertainties regarding customer acceptance, and there are no customer-negotiated refund or return rights affecting the sales recognized for delivered elements. Sales for service contracts generally are recognized as the services are provided.

Eaton records reductions to revenue for customer and distributor incentives, primarily comprised of rebates, at the time of the initial sale. Rebates are estimated based on sales terms, historical experience, trend analysis and projected market conditions in the various markets served. The rebate programs offered vary across businesses due to the numerous markets Eaton serves, but the most common incentives relate to amounts paid or credited to customers for

achieving defined volume levels or other objectives.

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### Long-Lived Assets

Depreciation and amortization for property, plant and equipment, and intangible assets subject to amortization, are generally computed by the straight-line method and included in Cost of products sold, Selling and administrative expense, and Research and development expense, as appropriate. Cost of buildings are depreciated generally over 40 years and machinery and equipment over 3 to 10 years. At December 31, 2011, the weighted-average amortization period for intangible assets subject to amortization was 18 years for patents and technology and 17 years for customer relationships, primarily as a result of the long life of aircraft platforms. Software is amortized up to a maximum life of 10 years.

Long-lived assets, except goodwill and indefinite life intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Upon indications of impairment, assets and liabilities are grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The asset group would be considered impaired when the estimated future net undiscounted cash flows generated by the asset group are less than its carrying value. Determining asset groups and underlying cash flows requires the use of significant judgment.

### Goodwill and Indefinite Life Intangible Assets

Goodwill and indefinite life intangible assets are evaluated annually for impairment as of July 1 using qualitative analysis, a discounted cash flow model and other valuation techniques. Additionally, goodwill and indefinite life intangible assets are evaluated for impairment whenever events or circumstances indicate there may be a possible permanent loss of value.

Goodwill is tested for impairment at the reporting unit level, which is equivalent to Eaton's operating segments, and based on the net assets for each segment, including goodwill and intangible assets. Goodwill is assigned to each operating segment, as this represents the lowest level that constitutes a business and for which discrete financial information is available and is the level which management regularly reviews the operating results.

### Qualitative Analysis

In September 2011, the Financial Accounting Standards Board issued a revised standard on testing goodwill for impairment. The revised standard allows an entity to first assess the carrying value of goodwill based on qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than the reporting unit's carrying amount. If, based on a qualitative assessment, the fair value of a reporting unit is more likely than not lower than its carrying value, the entity must then test goodwill from a quantitative perspective similar to prior guidance. This standard is effective for 2012, with early adoption permitted. Eaton elected to adopt this standard for its 2011 annual impairment testing.

Impairment testing for 2011 was performed by assessing certain qualitative 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 2011, it is more likely than not that the fair value of Eaton's reporting units continues to substantially exceed the respective carrying amount.

### Quantitative Analysis

In 2010, goodwill was tested based on a discounted cash flow model to estimate the fair value of each operating segment, which considers forecasted cash flows discounted at an estimated weighted-average cost of capital. The Company selected the discounted cash flow methodology as it believes that it is comparable to what would be used by market participants. The forecasted cash flows are based on the Company's long-term operating plan, and a terminal value is used to estimate the operating segment's cash flows beyond the period covered by the operating plan. The weighted-average cost of capital is an estimate of the overall after-tax rate of return required by equity and debt market participants of a business enterprise. These analyses require the exercise of significant judgments, including judgments about appropriate discount rates, perpetual growth rates and the timing of expected future cash flows. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective operating segment. Sensitivity analyses are performed around these assumptions in order to assess the reasonableness of the assumptions and the resulting estimated fair values. For 2010, the fair value of Eaton's reporting units substantially exceeded the respective carrying values.

Indefinite life intangible assets primarily consist of trademarks. The fair value of these assets are determined using a royalty relief methodology similar to that employed when the associated assets were acquired, but using updated estimates of future sales, cash flows and profitability. For 2011 and 2010, the fair value of indefinite lived intangible assets substantially exceeded the respective carrying value.

For additional information about goodwill and other intangible assets, see Note 4.

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### Derivative Financial Instruments and Hedging Activities

Eaton uses derivative financial instruments to manage the exposure to the volatility in raw material costs, foreign currency and interest rates on certain debt instruments. These instruments are marked to fair value. Changes in the fair value of derivative assets or liabilities (i.e., gains or losses) are recognized depending upon the type of hedging relationship and whether an instrument has been designated as a hedge. For those instruments that qualify for hedge accounting, Eaton designates the hedging instrument, based upon the exposure being hedged, as a cash flow hedge, a fair value hedge, or a hedge of a net investment in a foreign operation. Changes in fair value of these instruments that do not qualify for hedge accounting are recognized immediately in net income. See Note 12 for additional information about hedges and derivative financial instruments.

### Warranty Accruals

Product warranty accruals are established at the time the related sale is recognized through a charge to Cost of products sold. Warranty accrual estimates are based primarily on historical warranty claim experience and specific customer contracts. Provisions for warranty accruals are comprised of basic warranties for products sold, as well as accruals for product recalls and other events when they are known and estimable. See Note 7 for additional information about warranty accruals.

### Asset Retirement Obligations

A conditional asset retirement obligation is recognized at fair value when incurred if the fair value of the liability can be reasonably estimated. Uncertainty about the timing or method of settlement of a conditional asset retirement obligation would be considered in the measurement of the liability when sufficient information exists. Eaton believes that for substantially all of its asset retirement obligations, there is an indeterminate settlement date because the range of time over which the Company may settle the obligation is unknown or cannot be estimated. A liability for these obligations will be recognized when sufficient information is available to estimate fair value.

### Income Taxes

Deferred income tax assets and liabilities are determined based on the difference between the financial statement and tax basis of the respective assets and liabilities, using enacted tax rates in effect for the year when the differences are expected to reverse. Deferred income tax assets are recognized for United States and non-United States income tax loss carryforwards and income tax credit carryforwards. Judgment is required in determining and evaluating income tax provisions and valuation allowances for deferred income tax assets. Eaton recognizes the income tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. Eaton evaluates and adjusts these accruals based on changing facts and circumstances. Eaton recognizes interest and penalties related to unrecognized income tax benefits in the provision for income tax expense. The Company has accrued penalties in jurisdictions where they are automatically applied to any deficiency, regardless of the merit of the position. For additional information about income taxes, see Note 8.

### Equity-Based Compensation

Eaton recognizes equity-based compensation expense based on the grant date fair value of the award over the period during which an employee is required to provide service in exchange for the award. The fair value of restricted stock units is based on the closing market price of Eaton common stock on the grant date. Stock options are granted with an exercise price equal to the closing market price of Eaton common shares on the date of grant. The fair value of stock options is determined using a Black-Scholes option-pricing model, which incorporates assumptions regarding the expected volatility, the expected option life, the risk-free interest rate, and the expected dividend yield. See Note 10 for additional information about equity-based compensation.

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## Note 2. ACQUISITIONS OF BUSINESSES

Eaton acquired businesses and entered into joint ventures in separate transactions for combined net cash purchase prices of \$325 in 2011, \$222 in 2010, and \$10 in 2009. The Consolidated Statements of Income include the results of these businesses from the dates of the transactions or formation. These transactions are summarized below:

| Acquired businesses and joint ventures   | Date of transaction | Business segment         | Annual sales                              |
|--|---------------------|--------------------------|---|
| <b>E.A. Pedersen Company</b><br>A United States manufacturer of medium voltage switchgear, metal-clad switchgear, power control buildings and relay control panels primarily for the electrical utilities industry.  | December 29, 2011   | Electrical Americas      | \$37 for 2011                             |
| <b>IE Power, Inc.</b><br>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      | \$5 for 2010                              |
| <b>E. Begerow GmbH &amp; Co. KG</b><br>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                             |
| <b>ACTOM Low Voltage</b><br>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      |
| <b>C.I. ESI de Colombia S.A.</b><br>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                              |
| <b>Internormen Technology Group</b><br>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                             |
| <b>Eaton-SAMC (Shanghai) Aircraft Conveyance System Manufacturing Co., Ltd.</b><br>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                             |
| <b>Tuthill Coupling Group</b><br>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 |
| <b>Chloride Phoenixtec Electronics</b>   |                     |                          |   |



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|  |                  |                                |  |
|--|------------------|--------------------------------|--|
| A China manufacturer of UPS systems. Eaton acquired the remaining shares to increase its ownership from 50% to 100%.   | October 12, 2010 | Electrical<br>Rest of<br>World | \$25 for the year ended September 30, 2010 |
| CopperLogic, Inc.<br>A Canadian manufacturer of electrical and electromechanical systems.  | October 1, 2010  | Electrical<br>Americas         | \$35 for the year ended September 30, 2010 |
| Wright Line Holding, Inc.<br>A United States provider of customized enclosures, rack systems, and air-flow management systems to store, power, and secure mission-critical IT data center electronics. | August 25, 2010  | Electrical<br>Americas         | \$101 for the year ended June 30, 2010     |

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| Acquired businesses and joint ventures   | Date of transaction | Business segment         | Annual sales  |
|--|---------------------|--------------------------|---------------|
| EMC Engineers, Inc.<br>A United States energy engineering and energy services company that delivers energy efficiency solutions for a wide range of governmental, educational, commercial and industrial facilities.   | July 15, 2010       | Electrical Americas      | \$24 for 2009 |
| Micro Innovation Holding AG<br>A Switzerland manufacturer of human machine interfaces, programmable logic controllers and input/output devices. Eaton acquired the remaining shares to increase its ownership from 50% to 100%.  | September 1, 2009   | Electrical Rest of World | \$33 for 2008 |
| SEG Middle East Power Solutions & Switchboard Manufacture LLC<br>A 49%-owned joint venture in Abu Dhabi that manufactures low-voltage switchboards and control panel assemblies for use in the Middle East power generation and industrial markets.<br>On February 20, 2012, Eaton reached an agreement to acquire Polimer Kaucuk Sanayi ve Pazarlama A.S., a Turkish manufacturer of hydraulic and industrial hose. This business sells its products under the SEL brand name and had sales of \$335 for 2011. The acquisition is expected to close early in the second quarter of 2012 and will be included in the Hydraulics segment. The terms of the agreement are subject to customary closing conditions. | July 2, 2009        | Electrical Rest of World | Joint venture |

## Note 3. ACQUISITION INTEGRATION CHARGES

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

| Business segment                              | 2011   | 2010   | 2009   |
|---|--------|--------|--------|
| Electrical Americas                           | \$8    | \$2    | \$4    |
| Electrical Rest of World                      | 2      | 33     | 60     |
| Hydraulics                                    | 4      | 1      | 3      |
| Aerospace                                     | —      | 4      | 12     |
| Automotive                                    | —      | —      | 1      |
|   | 14     | 40     | 80     |
| Corporate                                     | —      | —      | 2      |
| Total integration charges before income taxes | \$14   | \$40   | \$82   |
| After-tax integration charges                 | \$10   | \$27   | \$54   |
| Per common share                              | \$0.03 | \$0.08 | \$0.16 |

Charges in 2011 were related primarily to CopperLogic, Tuthill Coupling Group, Wright Line Holding, EMC Engineers and Internormen Technology Group. Charges in 2010 were related primarily to Moeller and Phoenixtec. Charges in 2009 were related primarily to Moeller, Phoenixtec and Argo-Tech. These charges were included in Cost of products sold or Selling and administrative expense, as appropriate. See Note 2 for additional information about business acquisitions.

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## Note 4. GOODWILL AND OTHER INTANGIBLE ASSETS

A summary of goodwill follows:

|                          | 2011    | 2010    |
|--------------------------|---------|---------|
| Electrical Americas      | \$2,043 | \$2,061 |
| Electrical Rest of World | 981     | 985     |
| Hydraulics               | 1,116   | 1,007   |
| Aerospace                | 1,040   | 1,037   |
| Truck                    | 150     | 151     |
| Automotive               | 207     | 213     |
| Total goodwill           | \$5,537 | \$5,454 |

The increase in goodwill in 2011 was primarily due to businesses acquired during 2011, partially offset by foreign currency translation. For additional information regarding acquired businesses, see Note 2.

A summary of other intangible assets follows:

|   | 2011            |                          | 2010            |                          |
|---|-----------------|--------------------------|-----------------|--------------------------|
|   | Historical cost | Accumulated amortization | Historical cost | Accumulated amortization |
| Intangible assets not subject to amortization<br>(primarily trademarks) | \$451           |                          | \$451           |                          |
| Intangible assets subject to amortization                               |                 |                          |                 |                          |
| Customer relationships  | \$1,173         | \$322                    | \$1,187         | \$274                    |
| Patents and technology  | 849             | 308                      | 835             | 260                      |
| Other   | 481             | 132                      | 441             | 108                      |
| Total other intangible assets   | \$2,503         | \$762                    | \$2,463         | \$642                    |

Expense related to intangible assets subject to amortization in 2011, and for each of the next five years, follows:

|      |       |
|------|-------|
| 2011 | \$158 |
| 2012 | 157   |
| 2013 | 149   |
| 2014 | 143   |
| 2015 | 139   |
| 2016 | 135   |

## Note 5. DEBT

Short-term debt of \$86 at December 31, 2011 included \$75 of short-term commercial paper in the United States which had a weighted-average interest rate of 0.45%, \$10 of other short-term debt in the United States, and \$1 of short-term debt outside the United States. Short-term debt of \$72 at December 31, 2010 included \$50 of short-term commercial paper in the United States which had a weighted-average interest rate of 0.45%, \$15 of other short-term debt in the United States, and \$7 of short-term debt outside the United States. Borrowings outside the United States are generally denominated in local currencies. Operations outside the United States had available short-term lines of credit of \$1,181 from various banks worldwide at December 31, 2011.

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A summary of long-term debt, including the current portion, follows:

|  | 2011    | 2010    |
|--|---------|---------|
| 7.58% notes due 2012   | \$12    | \$12    |
| 5.75% notes due 2012   | 300     | 300     |
| 4.90% notes due 2013 (\$200 converted to floating rate by interest rate swap)      | 300     | 300     |
| 5.95% notes due 2014 (\$100 converted to floating rate by interest rate swap)      | 250     | 250     |
| Floating rate notes due 2014 (\$300 converted to fixed rate by interest rate swap) | 300     | —       |
| 4.65% notes due 2015   | 100     | 100     |
| 5.30% notes due 2017   | 250     | 250     |
| 6.875% to 7.09% notes due 2018   | 36      | 36      |
| 5.60% notes due 2018 (\$215 converted to floating rate by interest rate swap)      | 450     | 450     |
| 4.215% Japanese Yen notes due 2018   | 129     | 123     |
| 6.95% notes due 2019 (\$300 converted to floating rate by interest rate swap)      | 300     | 300     |
| 8.875% debentures due 2019 (\$25 converted to floating rate by interest rate swap) | 38      | 38      |
| 8.10% debentures due 2022  | 100     | 100     |
| 7.625% debentures due 2024 (\$25 converted to floating rate by interest rate swap) | 66      | 66      |
| 6.50% debentures due 2025  | 145     | 145     |
| 7.875% debentures due 2026   | 72      | 72      |
| 7.65% debentures due 2029 (\$50 converted to floating rate by interest rate swap)  | 200     | 200     |
| 5.45% debentures due 2034 (\$25 converted to floating rate by interest rate swap)  | 140     | 140     |
| 5.25% notes due 2035   | 27      | 42      |
| 5.80% notes due 2037   | 240     | 240     |
| Other  | 232     | 222     |
| Total long-term debt   | 3,687   | 3,386   |
| Less current portion of long-term debt   | (321)   | (4)     |
| Long-term debt less current portion  | \$3,366 | \$3,382 |

On June 16, 2011, Eaton issued \$300 floating rate senior unsecured Notes due June 16, 2014 (the Notes). The Notes bear interest annually at a floating rate, reset quarterly, equal to the three-month LIBOR rate for U.S. dollars plus 0.33%. Interest is payable quarterly in arrears. The Notes contain a provision which requires the Company to make an offer to purchase all or any part of the Notes at a purchase price of 101% of the principal amount plus accrued and unpaid interest if certain change of control events occur. The Notes are subject to customary non-financial covenants. Eaton refinanced a \$500, five-year revolving credit facility in June 2011 (the Facility). The Facility will expire June 16, 2016, replacing a \$500 facility that had been set to expire on September 1, 2011. This refinancing maintains long-term revolving credit facilities at a total of \$1,500, of which \$500 expires in 2012, 2013 and 2016, respectively. These facilities support Eaton's commercial paper borrowings. There were no borrowings outstanding under these revolving credit facilities at December 31, 2011 or 2010.

Eaton is in compliance with each of its debt covenants for all periods presented.

Mandatory maturities of long-term debt for each of the next five years follow:

|      |       |
|------|-------|
| 2012 | \$321 |
| 2013 | 310   |
| 2014 | 570   |
| 2015 | 103   |
| 2016 | 1     |

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Interest paid on debt follows:

|      |       |
|------|-------|
| 2011 | \$174 |
| 2010 | 170   |
| 2009 | 180   |

## Note 6. RETIREMENT BENEFITS PLANS

Eaton has defined benefits pension plans and other postretirement benefits plans.

## Obligations and Funded Status

|                           | United States<br>pension liabilities |          | Non-United States<br>pension liabilities |          | Other postretirement<br>liabilities |          |
|---------------------------|--------------------------------------|----------|--|----------|-------------------------------------|----------|
|                           | 2011                                 | 2010     | 2011                                     | 2010     | 2011                                | 2010     |
| Funded status             |                                      |          |  |          |                                     |          |
| Fair value of plan assets | \$1,664                              | \$1,572  | \$989                                    | \$937    | \$156                               | \$—      |
| Benefit obligations       | (2,899 )                             | (2,458 ) | (1,505 )                                 | (1,460 ) | (853 )                              | (826 )   |
| Funded status             | \$(1,235 )                           | \$(886 ) | \$(516 )                                 | \$(523 ) | \$(697 )                            | \$(826 ) |

## Amounts recognized in the Consolidated

| Balance Sheets          |            |          |          |          |          |          |
|-------------------------|------------|----------|----------|----------|----------|----------|
| Non-current assets      | \$—        | \$—      | \$78     | \$52     | \$—      | \$—      |
| Current liabilities     | (12 )      | (9 )     | (24 )    | (23 )    | (55 )    | (83 )    |
| Non-current liabilities | (1,223 )   | (877 )   | (570 )   | (552 )   | (642 )   | (743 )   |
| Total                   | \$(1,235 ) | \$(886 ) | \$(516 ) | \$(523 ) | \$(697 ) | \$(826 ) |

Amounts recognized in Accumulated other  
comprehensive loss (pretax)

|                             |         |         |       |       |       |       |
|-----------------------------|---------|---------|-------|-------|-------|-------|
| Net actuarial loss          | \$1,601 | \$1,142 | \$348 | \$311 | \$257 | \$232 |
| Prior service cost (credit) | 1       | —       | 10    | 8     | (9 )  | (11 ) |
| Total                       | \$1,602 | \$1,142 | \$358 | \$319 | \$248 | \$221 |

## Change in Benefit Obligations

|                              | United States<br>pension liabilities |         | Non-United States<br>pension liabilities |         | Other postretirement<br>liabilities |        |
|------------------------------|--------------------------------------|---------|--|---------|-------------------------------------|--------|
|                              | 2011                                 | 2010    | 2011                                     | 2010    | 2011                                | 2010   |
| Balance at January 1         | \$2,458                              | \$2,244 | \$1,460                                  | \$1,366 | \$826                               | \$830  |
| Service cost                 | 93                                   | 80      | 48                                       | 39      | 15                                  | 16     |
| Interest cost                | 132                                  | 131     | 78                                       | 69      | 41                                  | 46     |
| Actuarial loss               | 346                                  | 133     | 26                                       | 94      | 41                                  | 15     |
| Gross benefits paid          | (131 )                               | (122 )  | (82 )                                    | (76 )   | (101 )                              | (107 ) |
| Foreign currency translation | —                                    | —       | (23 )                                    | (53 )   | (1 )                                | 1      |
| Other                        | 1                                    | (8 )    | (2 )                                     | 21      | 32                                  | 25     |
| Balance at December 31       | \$2,899                              | \$2,458 | \$1,505                                  | \$1,460 | \$853                               | \$826  |

|                                |         |         |         |         |
|--------------------------------|---------|---------|---------|---------|
| Accumulated benefit obligation | \$2,762 | \$2,366 | \$1,364 | \$1,330 |
|--------------------------------|---------|---------|---------|---------|

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## Change in Plan Assets

|                              | United States<br>pension liabilities |         | Non-United States<br>pension liabilities |       | Other postretirement<br>liabilities |        |
|------------------------------|--------------------------------------|---------|--|-------|-------------------------------------|--------|
|                              | 2011                                 | 2010    | 2011                                     | 2010  | 2011                                | 2010   |
| Balance at January 1         | \$1,572                              | \$1,210 | \$937                                    | \$832 | \$—                                 | \$—    |
| Actual return on plan assets | (41 )                                | 182     | 39                                       | 96    | 2                                   | —      |
| Employer contributions       | 264                                  | 313     | 108                                      | 90    | 223                                 | 82     |
| Gross benefits paid          | (131 )                               | (122 )  | (82 )                                    | (76 ) | (101 )                              | (107 ) |
| Foreign currency translation | —                                    | —       | (6 )                                     | (21 ) | —                                   | —      |
| Other                        | —                                    | (11 )   | (7 )                                     | 16    | 32                                  | 25     |
| Balance at December 31       | \$1,664                              | \$1,572 | \$989                                    | \$937 | \$156                               | \$—    |

The components of pension plans with an accumulated benefit obligation in excess of plan assets at December 31 follow:

|                                | United States<br>pension liabilities |         | Non-United States<br>pension liabilities |         |
|--------------------------------|--------------------------------------|---------|--|---------|
|                                | 2011                                 | 2010    | 2011                                     | 2010    |
| Projected benefit obligation   | \$2,899                              | \$2,458 | \$990                                    | \$1,114 |
| Accumulated benefit obligation | 2,762                                | 2,366   | 925                                      | 1,026   |
| Fair value of plan assets      | 1,664                                | 1,572   | 446                                      | 554     |

Changes in pension and other postretirement benefit liabilities recognized in Accumulated other comprehensive loss follow:

|  | United States<br>pension liabilities |         | Non-United States<br>pension liabilities |       | Other postretirement<br>liabilities |       |
|--|--------------------------------------|---------|--|-------|-------------------------------------|-------|
|  | 2011                                 | 2010    | 2011                                     | 2010  | 2011                                | 2010  |
| Balance at January 1                             | \$1,142                              | \$1,107 | \$319                                    | \$263 | \$221                               | \$216 |
| Prior service cost arising during the year       | 1                                    | 1       | 4  | 1     | —                                   | —     |
| Net loss arising during the year                 | 551                                  | 107     | 58                                       | 60    | 39                                  | 15    |
| Foreign currency translation                     | —                                    | —       | (5 )                                     | (5 )  | —                                   | —     |
| Less amounts included in expense during the year | (92 )                                | (69 )   | (18 )                                    | (8 )  | (12 )                               | (10 ) |
| Other  | —                                    | (4 )    | —  | 8     | —                                   | —     |
| Net change for the year                          | 460                                  | 35      | 39                                       | 56    | 27                                  | 5     |
| Balance at December 31                           | \$1,602                              | \$1,142 | \$358                                    | \$319 | \$248                               | \$221 |

## Benefits Expense

|                                | United States<br>pension benefit expense |        |        | Non-United States<br>pension benefit expense |       |       | Other postretirement<br>benefits expense |      |      |
|--------------------------------|--|--------|--------|--|-------|-------|--|------|------|
|                                | 2011                                     | 2010   | 2009   | 2011   | 2010  | 2009  | 2011                                     | 2010 | 2009 |
| Service cost                   | \$93                                     | \$80   | \$76   | \$48   | \$39  | \$34  | \$15                                     | \$16 | \$15 |
| Interest cost                  | 132                                      | 131    | 133    | 78   | 69    | 70    | 41                                       | 46   | 49   |
| Expected return on plan assets | (164 )                                   | (156 ) | (131 ) | (70 )  | (62 ) | (58 ) | —  | —    | —    |
| Amortization                   | 75                                       | 53     | 34     | 13   | 8     | 4     | 12                                       | 10   | 1    |
|                                | 136                                      | 108    | 112    | 69   | 54    | 50    | 68                                       | 72   | 65   |
| Curtailment loss               | —  | 1      | 17     | 1  | —     | 5     | —  | —    | 1    |
| Settlement loss                | 17                                       | 16     | 83     | 4  | —     | 3     | —  | —    | —    |
| Total expense                  | \$153                                    | \$125  | \$212  | \$74   | \$54  | \$58  | \$68                                     | \$72 | \$66 |

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In 2009, due to limitations imposed by the Pension Protection Act on pension lump-sum distributions, Eaton's United States Qualified Pension Plan (the Plan) became restricted from making 100% lump-sum payments. As a result, the Plan experienced a significant increase in lump-sum payments in 2009 prior to the limitation going into effect. Pension settlement expense was \$86 for 2009, of which \$83 was attributable to the United States pension plans. A portion of the increase in lump-sum payments was also attributable to the workforce reduction in 2009. Additionally, Eaton incurred curtailment expense related to pension plans as a result of the workforce reduction in 2009. The curtailment expense included recognition of the change in the projected benefit obligation, as well as recognition of a portion of the unrecognized prior service cost. Curtailment expense was \$22 for 2009. These charges were primarily included in Cost of products sold or Selling and administrative expense, as appropriate. In Business Segment Information, the charges were included in Pension and other postretirement benefits expense. See Note 14 for additional information regarding business segments.

The estimated pretax net amounts that will be recognized from Accumulated other comprehensive loss into net periodic benefit cost in 2012 follow:

|                             | United States<br>pension liabilities | Non-United States<br>pension liabilities | Other postretirement<br>liabilities |
|-----------------------------|--------------------------------------|--|-------------------------------------|
| Actuarial loss              | \$145                                | \$15                                     | \$15                                |
| Prior service cost (credit) | —                                    | 1  | (2)                                 |
| Total                       | \$145                                | \$16                                     | \$13                                |

Retirement Benefits Plans Assumptions  
Pension Plans

|  | United States<br>pension plans |        |        | Non-United States<br>pension plans |        |        |
|--|--------------------------------|--------|--------|------------------------------------|--------|--------|
|  | 2011                           | 2010   | 2009   | 2011                               | 2010   | 2009   |
| Assumptions used to determine benefit obligation at year-end |                                |        |        |                                    |        |        |
| Discount rate  | 4.70 %                         | 5.50 % | 6.00 % | 5.12 %                             | 5.40 % | 5.59 % |
| Rate of compensation increase                                | 3.15 %                         | 3.61 % | 3.62 % | 3.62 %                             | 3.63 % | 3.58 % |
| Assumptions used to determine expense                        |                                |        |        |                                    |        |        |
| Discount rate  | 5.50 %                         | 6.00 % | 6.30 % | 5.40 %                             | 5.59 % | 6.26 % |
| Expected long-term return on plan assets                     | 8.50 %                         | 8.95 % | 8.94 % | 7.17 %                             | 7.20 % | 7.06 % |
| Rate of compensation increase                                | 3.61 %                         | 3.62 % | 3.64 % | 3.63 %                             | 3.58 % | 3.56 % |

The expected long-term rate of return on pension assets was determined for each country and reflects long-term historical data taking into account each plan's target asset allocation. The discount rate was determined using appropriate bond data for each country.

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## Other Postretirement Benefits Plans

Substantially all of the obligation for other postretirement benefits plans relates to United States plans. Assumptions used to determine other postretirement benefits obligations and expense follow:

|   | Other postretirement benefits plans |             |        |   |
|---|-------------------------------------|-------------|--------|---|
|   | 2011                                | 2010        | 2009   |   |
| Assumptions used to determine benefit obligation at year-end  |                                     |             |        |   |
| Discount rate   | 4.60 %                              | 5.20 %      | 5.70 % | % |
| Health care cost trend rate assumed for next year   | 7.60 %                              | 8.10 %      | 8.30 % | % |
| Ultimate health care cost trend rate  | 4.50 %                              | 4.50 %      | 4.75 % | % |
| Year ultimate health care cost trend rate is achieved   | 2020                                | 2020        | 2017   |   |
| Assumptions used to determine expense   |                                     |             |        |   |
| Discount rate   | 5.20 %                              | 5.70 %      | 6.30 % | % |
| Initial health care cost trend rate   | 8.10 %                              | 8.30 %      | 8.25 % | % |
| Ultimate health care cost trend rate  | 4.50 %                              | 4.75 %      | 4.75 % | % |
| Year ultimate health care cost trend rate is achieved   | 2020                                | 2017        | 2017   |   |
| Assumed health care cost trend rates may have a significant effect on the amounts reported for the health care plans. A 1-percentage point change in the assumed health care cost trend rates would have the following effects: |                                     |             |        |   |
|   | 1% increase                         | 1% decrease |        |   |
| Effect on total service and interest cost   | \$1                                 | \$(1        | )      |   |
| Effect on other postretirement liabilities  | 18                                  | (16         | )      |   |

## Employer Contributions to Retirement Benefits Plans

Contributions to pension plans that Eaton expects to make in 2012, and made in 2011, 2010 and 2009, follow:

|                         | 2012  | 2011  | 2010  | 2009  |
|-------------------------|-------|-------|-------|-------|
| United States plans     | \$316 | \$264 | \$313 | \$192 |
| Non-United States plans | 96    | 108   | 90    | 79    |
| Total contributions     | \$412 | \$372 | \$403 | \$271 |

During 2011, Eaton contributed \$154 into a Voluntary Employee Benefit Association (VEBA) trust for the pre-funding of postretirement Medicare Part D prescription drug benefits for the Company's eligible United States employees and retirees.

The following table provides the estimated pension and other postretirement benefit payments for each of the next five years, and the five years thereafter in the aggregate. For other postretirement benefits liabilities, the expected subsidy receipts relate to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, which would reduce the gross payments listed below.

|             | Estimated United States pension payments | Estimated non-United States pension payments | Estimated other postretirement benefit payments |                                    |
|-------------|--|--|---|------------------------------------|
|             |  |  | Gross   | Medicare prescription drug subsidy |
| 2012        | \$143                                    | \$86   | \$91  | \$(7                               |
| 2013        | 148                                      | 74   | 92  | (7                                 |
| 2014        | 329                                      | 75   | 85  | (7                                 |
| 2015        | 205                                      | 77   | 81  | (7                                 |
| 2016        | 215                                      | 80   | 78  | (6                                 |
| 2017 - 2021 | 1,206                                    | 431  | 325   | (12                                |



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Pension lump-sum payments in 2012 and 2013 are restricted to 50% due to limitations imposed by the Pension Protection Act.

## Pension Plan Assets

Investment policies and strategies are developed on a country specific basis. The United States plan, representing 63% of worldwide pension assets, and the United Kingdom plans representing 29% of worldwide pension assets, are invested primarily for growth, as they are open plans with active participants and ongoing accruals. In general, the plans have their primary allocation to diversified, global equities, primarily through index funds in the form of common collective trusts. The United States plan's target allocation is 35% United States equities, 35% non-United States equities, 5% real estate (primarily equity of real estate investment trusts) and 25% debt securities and other, including cash equivalents. The United Kingdom plans' target asset allocations are 63% equities and the remainder in debt securities. The equity risk for the plans is managed through broad geographic diversification and diversification across industries and levels of market capitalization. The majority of debt allocations for these plans are longer duration government (including inflation protected securities) and corporate debt. The United States pension plan is authorized to use derivatives to achieve more economically desired market exposures and to use futures, swaps and options to gain or hedge exposures.

## Other Postretirement Benefits Plan Assets

The VEBA trust which holds other postretirement benefits plan assets has investment guidelines that include allocations to global equities and fixed income investments. The trust's target investment allocation is 50% diversified global equities and 50% fixed income securities. The fixed income securities are primarily comprised of intermediate term, high quality, dollar denominated, fixed income instruments. The equity allocation is invested in a diversified global equity index fund in the form of a collective trust.

## Fair Value Measurements

Financial instruments included in pension and other postretirement benefits plan assets are categorized into a fair value hierarchy of three levels, based on the degree of subjectivity inherent in the valuation methodology as follows:

Level 1 - Quoted prices (unadjusted) for identical assets in active markets.

Level 2 Quoted prices for similar assets in active markets, and inputs that are observable for the asset, either directly - or indirectly, for substantially the full term of the financial instrument.

Level 3 - Unobservable prices or inputs.

## Pension Plans

A summary of the fair value of pension plan assets at December 31, 2011 and 2010, follows:

|  | Total   | Quoted prices<br>in active<br>markets for<br>identical assets<br>(Level 1) | Other<br>observable<br>inputs<br>(Level 2) | Unobservable<br>inputs<br>(Level 3) |
|--|---------|--|--|-------------------------------------|
| 2011   |         |  |  |                                     |
| Common collective trusts                     |         |  |  |                                     |
| Non-United States equity and global equities | \$925   | \$—  | \$925                                      | \$—                                 |
| United States equity                         | 642     | —  | 642  | —                                   |
| Fixed income                                 | 263     | —  | 263  | —                                   |
| Long duration funds                          | 107     | —  | 107  | —                                   |
| Fixed income securities                      | 296     | —  | 296  | —                                   |
| United States treasuries                     | 120     | 120  | —  | —                                   |
| Real estate                                  | 82      | 82   | —  | —                                   |
| Equity securities                            | 79      | 79   | —  | —                                   |
| Cash equivalents                             | 67      | 9  | 58   | —                                   |
| Registered investment companies              | 35      | 35   | —  | —                                   |
| Other  | 37      | 2  | —  | 35                                  |
| Total pension plan assets                    | \$2,653 | \$327  | \$2,291                                    | \$35                                |



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|  | Total   | Quoted prices<br>in active<br>markets for<br>identical assets<br>(Level 1) | Other<br>observable<br>inputs<br>(Level 2) | Unobservable<br>inputs<br>(Level 3) |
|--|---------|--|--|-------------------------------------|
| 2010   |         |  |  |                                     |
| Common collective trusts                     |         |  |  |                                     |
| Non-United States equity and global equities | \$965   | \$—  | \$965                                      | \$—                                 |
| United States equity                         | 577     | —  | 577  | —                                   |
| Fixed income                                 | 241     | —  | 241  | —                                   |
| Long duration funds                          | 91      | —  | 91   | —                                   |
| Fixed income securities                      | 230     | —  | 230  | —                                   |
| United States treasuries                     | 101     | 101  | —  | —                                   |
| Real estate                                  | 81      | 81   | —  | —                                   |
| Equity securities                            | 78      | 78   | —  | —                                   |
| Cash equivalents                             | 77      | 10   | 67   | —                                   |
| Registered investment companies              | 32      | 32   | —  | —                                   |
| Other  | 36      | 2  | —  | 34                                  |
| Total pension plan assets                    | \$2,509 | \$304  | \$2,171                                    | \$34                                |

## Other Postretirement Benefits Plans

A summary of the fair value of other postretirement benefits plan assets at December 31, 2011, follows:

|   | Total | Quoted prices<br>in active<br>markets for<br>identical assets<br>(Level 1) | Other<br>observable<br>inputs<br>(Level 2) | Unobservable<br>inputs<br>(Level 3) |
|---|-------|--|--|-------------------------------------|
| 2011  |       |  |  |                                     |
| Common collective trusts                        |       |  |  |                                     |
| Global equities                                 | \$52  | \$—  | \$52                                       | \$—                                 |
| Fixed income securities                         | 50    | —  | 50   | —                                   |
| Cash equivalents                                | 54    | 54   | —  | —                                   |
| Total other postretirement benefits plan assets | \$156 | \$54   | \$102                                      | \$—                                 |

There were no other postretirement benefits plan assets at December 31, 2010.

## Valuation Methodologies

Following is a description of the valuation methodologies used for pension and other postretirement benefits plan assets measured at fair value. There have been no changes in the methodologies used at December 31, 2011 and 2010.

Common collective trusts - Valued at the net unit value of units held by the trust at year end. The unit value is determined by the total value of fund assets divided by the total number of units of the fund owned. The equity investments in collective trusts are predominantly in index funds for which the underlying securities are actively traded in public markets based upon readily measurable prices.

Fixed income securities - These securities consist of publicly traded United States and non-United States fixed interest obligations (principally corporate and government bonds and debentures). The fair value of corporate and government debt securities is determined through third-party pricing models that consider various assumptions, including time value, yield curves, credit ratings and current market prices. The Company verifies the results of trustees or custodians and evaluates the pricing classification of these securities by performing analyses using other third-party sources.

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United States treasuries - Valued at the closing price of each security.

Real estate and equity securities - These securities consist of direct investments in the stock of publicly traded companies. Such investments are valued based on the closing price reported in an active market on which the individual securities are traded. As such, the direct investments are classified as Level 1.

Cash equivalents - Primarily certificates of deposit, commercial paper and repurchase agreements.

Registered investment companies - Valued at the closing price of the exchange traded fund's shares.

Other - Primarily insurance contracts for international plans and also futures contracts and over-the-counter options. These investments are valued based on the closing prices of future contracts or indices as available on the Bloomberg or similar service, and private equity investments.

For additional information regarding fair value measurements, see Note 11.

#### Defined Contribution Plans

The Company has various defined contribution benefit plans, primarily consisting of the Eaton Savings Plan in the United States. The total contributions related to these plans are charged to expense and were as follows:

|      |      |
|------|------|
| 2011 | \$65 |
| 2010 | 33   |
| 2009 | 25   |

#### Note 7. COMMITMENTS AND CONTINGENCIES

##### 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 December 31, 2011, the Company has a total accrual of 70 Brazilian Reais related to this matter (\$37 based on current exchange rates), comprised of 60 Brazilian Reais recognized in the fourth quarter of 2010 (\$32 based on current exchange rates) with an additional 10 Brazilian Reais recognized in 2011 (\$5 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. On September 27, 2011, the Superior Court of Justice accepted two of the appeals and on November 21, 2011, Eaton's remaining appeal was accepted. These appeals 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 has appealed the liability finding and the injunction to the Third Circuit Court of Appeals. Meritor has cross-appealed the finding of zero damages. Accordingly, 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 effect on the consolidated financial statements.

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## Environmental Contingencies

Eaton has established policies to ensure that its operations are conducted in keeping with good corporate citizenship and with a positive commitment to the protection of the natural and workplace environments. The Company's manufacturing facilities are required to be certified to ISO 14001, an international standard for environmental management systems. The Company routinely reviews EHS performance at each of its facilities and continuously strives to improve pollution prevention.

Eaton is involved in remedial response and voluntary environmental remediation at a number of sites, including certain of its currently-owned or formerly-owned plants. The Company has also been named a potentially responsible party under the federal Superfund law at a number of disposal sites. The Company became involved in these sites through the Company's voluntary decision, in connection with business acquisitions, or as a result of government action. At the end of 2011, the Company was involved with a total of 79 sites world-wide, including the Superfund sites mentioned above, with none of these sites being individually significant to the Company.

Remediation activities, generally involving soil and/or groundwater contamination, include pre-cleanup activities such as fact finding and investigation, risk assessment, feasibility study, design and action planning, performance (where actions may range from monitoring, to removal of contaminants, to installation of longer-term remediation systems), and operation and maintenance of a remediation system. The extent of expected remediation activities and costs varies by site. A number of factors affect the cost of environmental remediation, including the number of parties involved at a particular site, the determination of the extent of contamination, the length of time the remediation may require, the complexity of environmental regulations, and the continuing advancement of remediation technology. Taking these factors into account, Eaton has estimated the costs of remediation, which will be paid over a period of years. The Company accrues an amount on an undiscounted basis, consistent with the estimates of these costs when it is probable that a liability has been incurred. Actual results may differ from these estimates. At December 31, 2011 and 2010, the Company had an accrual totaling \$62 and \$71, respectively, for these costs.

Based upon Eaton's analysis and subject to the difficulty in estimating these future costs, the Company expects that any sum it may be required to pay in connection with environmental matters is not reasonably possible to exceed the recorded liability by an amount that would have a material effect on its financial position, results of operations or cash flows.

## Warranty Accruals

A summary of the current and long-term warranty accruals follows:

|                        | 2011   | 2010   | 2009   |
|------------------------|--------|--------|--------|
| Balance at January 1   | \$ 153 | \$ 147 | \$ 165 |
| Provision              | 98     | 99     | 77     |
| Settled                | (94    | ) (91  | ) (98  |
| Other                  | 1      | (2     | ) 3    |
| Balance at December 31 | \$ 158 | \$ 153 | \$ 147 |

## Lease Commitments

Eaton leases certain real properties and equipment. A summary of minimum rental commitments at December 31, 2011 under noncancelable operating leases, which expire at various dates and in most cases contain renewal options, for each of the next five years and thereafter in the aggregate, follow:

|                                       |        |
|---------------------------------------|--------|
| 2012                                  | \$ 146 |
| 2013                                  | 122    |
| 2014                                  | 88     |
| 2015                                  | 64     |
| 2016                                  | 51     |
| Thereafter                            | 79     |
| Total noncancelable lease commitments | \$ 550 |

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A summary of rental expense follows:

|      |       |
|------|-------|
| 2011 | \$194 |
| 2010 | 172   |
| 2009 | 177   |

## Note 8. INCOME TAXES

Income before income taxes and income tax expense are summarized below based on the geographic location of the operation to which such earnings and income taxes are attributable. Certain foreign operations are branches of Eaton and are subject to United States as well as foreign income tax regulations. As a result, income before tax by location and the components of income tax expense by taxing jurisdiction are not directly related. For purposes of this note, non-United States operations include Puerto Rico.

|                                    | Income (loss) before income taxes |         |         |
|------------------------------------|-----------------------------------|---------|---------|
|                                    | 2011                              | 2010    | 2009    |
| United States                      | \$375                             | \$114   | \$(298) |
| Non-United States                  | 1,178                             | 922     | 601     |
| Total income before income taxes   | \$1,553                           | \$1,036 | \$303   |
|                                    | Income tax expense (benefit)      |         |         |
|                                    | 2011                              | 2010    | 2009    |
| Current                            |                                   |         |         |
| United States                      |                                   |         |         |
| Federal                            | \$85                              | \$(2)   | \$40    |
| State and local                    | 2                                 | 1       | 5       |
| Non-United States                  | 186                               | 107     | 69      |
| Total current income tax expense   | 273                               | 106     | 114     |
| Deferred                           |                                   |         |         |
| United States                      |                                   |         |         |
| Federal                            | (2)                               | 95      | (174)   |
| State and local                    | 8                                 | (15)    | (4)     |
| Non-United States                  | (78)                              | (87)    | (18)    |
| Total deferred income tax benefit  | (72)                              | (7)     | (196)   |
| Total income tax expense (benefit) | \$201                             | \$99    | \$(82)  |

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Reconciliations of income taxes from the United States federal statutory rate of 35% to the consolidated effective income tax rate follow:

|   | 2011   |    | 2010   |    | 2009   |    |
|---|--------|----|--------|----|--------|----|
| Income taxes at the United States federal statutory rate  | 35.0   | %  | 35.0   | %  | 35.0   | %  |
| United States operations  |        |    |        |    |        |    |
| State and local income taxes  | 0.2    | %  | (0.1)  | )% | 0.4    | %  |
| Deductible dividends  | (0.5)  | )% | (0.6)  | )% | (2.1)  | )% |
| Deductible interest   | (0.5)  | )% | (0.8)  | )% | (2.3)  | )% |
| Credit for research activities  | (1.0)  | )% | (1.4)  | )% | (3.9)  | )% |
| Impact of Health Care Reform and Education Reconciliation Act and pre-funding on taxation associated with Medicare Part D | (0.9)  | )% | 2.2    | %  | 0.0    | %  |
| Other-net   | 0.5    | %  | 1.4    | %  | 5.0    | %  |
| Non-United States operations  |        |    |        |    |        |    |
| Foreign tax credit  | (2.3)  | )% | (6.4)  | )% | (2.5)  | )% |
| Non-United States operations (earnings taxed at other than the United States tax rate)                                    | (15.5) | )% | (13.9) | )% | (52.6) | )% |
| Worldwide operations  |        |    |        |    |        |    |
| Adjustments to tax liabilities  | (0.8)  | )% | (1.2)  | )% | (11.9) | )% |
| Adjustments to valuation allowances   | (1.3)  | )% | (4.7)  | )% | 7.7    | %  |
| Effective income tax expense (benefit) rate   | 12.9   | %  | 9.5    | %  | (27.2) | )% |

During 2011, income tax expense of \$201 was recognized (an effective tax rate of 12.9%) compared to \$99 for 2010 (an effective tax rate of 9.5%). The higher effective tax rate in 2011 was primarily attributable to greater levels of income in high tax jurisdictions, particularly in the United States and Brazil, due to continued improvement in market conditions. Earnings taxed at other than the United States tax rate includes the impact of tax holidays in certain jurisdictions.

With limited exceptions, no provision has been made for income taxes on undistributed earnings of non-United States subsidiaries of \$6.4 billion at December 31, 2011, since it is the Company's intention to indefinitely reinvest undistributed earnings of its foreign subsidiaries. It is not practicable to estimate the additional income taxes and applicable foreign withholding taxes that would be payable on the remittance of such undistributed earnings.

The Company's largest growth areas that require capital are in developing foreign markets, such as India, Brazil, the Middle East, Africa, Southeast Asia and China. The cash that is permanently reinvested is typically used to expand operations either organically or through acquisitions in such developing markets as well as other mature foreign markets where the Company targets increased market share. The Company's United States operations normally generate cash flow sufficient to satisfy United States operating requirements. Dividends paid during 2011 from foreign affiliates to the United States parent were not significant.

Worldwide income tax payments follow:

|      |       |
|------|-------|
| 2011 | \$191 |
| 2010 | 141   |
| 2009 | 124   |



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## Deferred Income Tax Assets and Liabilities

Components of current and long-term deferred income taxes follow:

|   | 2011           |                                  | 2010           |                                  |
|---|----------------|----------------------------------|----------------|----------------------------------|
|   | Current assets | Long-term assets and liabilities | Current assets | Long-term assets and liabilities |
| Accruals and other adjustments  |                |                                  |                |                                  |
| Employee benefits   | \$ 114         | \$ 778                           | \$ 94          | \$ 681                           |
| Depreciation and amortization   | (2             | ) (498                           | ) (1           | ) (567                           |
| Other accruals and adjustments  | 293            | 77                               | 224            | 90                               |
| Other items   | —              | (4                               | ) —            | (6                               |
| United States federal income tax loss carryforwards                               | —              | 7                                | —              | 5                                |
| United States federal income tax credit carryforwards                             | —              | 251                              | —              | 253                              |
| United States state and local tax loss carryforwards and tax credit carryforwards | —              | 65                               | —              | 74                               |
| Non-United States tax loss carryforwards  | —              | 417                              | —              | 360                              |
| Non-United States income tax credit carryforwards                                 | —              | 95                               | —              | 72                               |
| Valuation allowance for income tax loss and income tax credit carryforwards       | —              | (441                             | ) —            | (421                             |
| Other valuation allowances  | (7             | ) (55                            | ) (14          | ) (27                            |
| Total deferred income taxes   | \$ 398         | \$ 692                           | \$ 303         | \$ 514                           |

At the end of 2011, United States federal income tax loss carryforwards and income tax credit carryforwards were available to reduce future federal income tax liabilities. These carryforwards and their expiration dates are summarized below:

|  | 2012 through 2016 | 2017 through 2021 | 2022 through 2026 | 2027 through 2031 | Not subject to expiration | Valuation allowance |
|--|-------------------|-------------------|-------------------|-------------------|---------------------------|---------------------|
| United States federal income tax loss carryforwards                                | \$ 3              | \$ —              | \$ 14             | \$ 3              | \$ —                      | \$ —                |
| United States federal deferred income tax assets for income tax loss carryforwards | 1                 | —                 | 5                 | 1                 | —                         | (6                  |
| United States federal income tax credit carryforwards                              | —                 | 93                | 20                | 86                | 52                        | (17                 |

United States state and local tax loss carryforwards and tax credit carryforwards with a future tax benefit are also available at the end of 2011. These carryforwards and their expiration dates are summarized below:

|   | 2012 through 2016 | 2017 through 2021 | 2022 through 2026 | 2027 through 2031 | Not subject to expiration | Valuation allowance |
|---|-------------------|-------------------|-------------------|-------------------|---------------------------|---------------------|
| United States state and local income tax loss carryforwards - net of federal tax effect   | \$ 6              | \$ 4              | \$ 11             | \$ 8              | \$ —                      | \$(8                |
| United States state and local income tax credit carryforwards - net of federal tax effect | 11                | 9                 | 5                 | 5                 | 6                         | (15                 |

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At December 31, 2011, certain non-United States subsidiaries had tax loss carryforwards and income tax credit carryforwards that are available to offset future taxable income. These carryforwards and their expiration dates are summarized below:

|   | 2012<br>through<br>2016 | 2017<br>through<br>2021 | 2022<br>through<br>2026 | 2027<br>through<br>2031 | Not<br>subject to<br>expiration | Valuation<br>allowance |
|---|-------------------------|-------------------------|-------------------------|-------------------------|---------------------------------|------------------------|
| Non-United States income tax loss carryforwards                                   | \$188                   | \$140                   | \$10                    | \$48                    | \$1,143                         | \$—                    |
| Non-United States deferred income tax<br>assets for income tax loss carryforwards | 49                      | 36                      | 3                       | 13                      | 316                             | (367 )                 |
| Non-United States income tax credit carryforwards                                 | 46                      | 33                      | —                       | 9                       | 7                               | (8 )                   |

**Recoverability of Deferred Income Tax Assets**

Eaton is subject to the income tax laws in the jurisdictions in which it operates. In order to determine its income tax provision for financial statement purposes, Eaton must make significant estimates and judgments about its business operations in these jurisdictions. These estimates and judgments are also used in determining the deferred income tax assets and liabilities that have been recognized for differences between the financial statement and income tax basis of assets and liabilities, and income tax loss carryforwards and income tax credit carryforwards.

Management evaluates the realizability of deferred income tax assets for each of the jurisdictions in which it operates. If the Company experiences cumulative pretax income in a particular jurisdiction in the three-year period including the current and prior two years, management normally concludes that the deferred income tax assets will more likely than not be realizable and no valuation allowance is recognized, unless known or planned operating developments would lead management to conclude otherwise. However, if the Company experiences cumulative pretax losses in a particular jurisdiction in the three-year period including the current and prior two years, management then considers a series of factors in the determination of whether the deferred income tax assets can be realized. These factors include historical operating results, known or planned operating developments, the period of time over which certain temporary differences will reverse, consideration of the utilization of certain deferred income tax liabilities, tax law carryback capability in the particular country, prudent and feasible tax planning strategies, and estimates of future earnings and taxable income using the same assumptions as the Company's goodwill and other impairment testing. After evaluation of these factors, if the deferred income tax assets are expected to be realized within the tax carryforward period allowed for that specific country, management would conclude that no valuation allowance would be required. To the extent that the deferred income tax assets exceed the amount that is expected to be realized within the tax carryforward period for a particular jurisdiction, management would establish a valuation allowance.

As of December 31, 2011, United States federal deferred income tax assets were \$1.6 billion. The largest component of the deferred income tax assets is due to timing differences between revenue and expense recognition for income tax versus financial statement purposes. In addition, the Company possesses certain income tax credit carryforwards that comprise the remainder of the balance. Over the 20 year carryforward period available for net operating losses and general business credits, taxable income of approximately \$4.6 billion would need to be realized to utilize all deferred income tax assets. As of December 31, 2011, management believes that, with a couple of very limited exceptions totaling \$23, it is more likely than not that the entire United States federal deferred income tax assets will be realized. Applying the above methodology, valuation allowances have been established for certain United States federal, state and local income, as well as certain non-United States, deferred income tax assets to the extent they are not expected to be realized within the particular tax carryforward period.

**Unrecognized Income Tax Benefits**

Eaton's historical policy has been to enter into tax planning strategies only if it is more likely than not that the benefit would be sustained upon audit. For example, the Company does not enter into any of the Internal Revenue Service (IRS) Listed Transactions as set forth in Treasury Regulation 1.6011-4.

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A summary of gross unrecognized income tax benefits follows:

|   | 2011  | 2010  | 2009  |
|---|-------|-------|-------|
| Balance at January 1  | \$224 | \$197 | \$139 |
| Increases and decreases as a result of positions taken during prior years |       |       |       |
| Transfers to valuation allowances   | —     | (2    | ) (1  |
| Other increases   | 3     | 7     | 37    |
| Other decreases, including foreign currency translation                   | (14   | ) (31 | ) (4  |
| Balances related to acquired businesses                                   | 2     | 34    | 5     |
| Increases as a result of positions taken during the current year          | 31    | 23    | 28    |
| Decreases relating to settlements with tax authorities                    | (2    | ) —   | (4    |
| Decreases as a result of a lapse of the applicable statute of limitations | (8    | ) (4  | ) (3  |
| Balance at December 31  | \$236 | \$224 | \$197 |

If all unrecognized tax benefits were recognized, the net impact on the provision for income tax expense would be \$184.

As of December 31, 2011 and 2010, Eaton had accrued approximately \$29 and \$36, respectively, for the payment of worldwide interest and penalties. Eaton recognizes interest and penalties related to unrecognized income tax benefits in the provision for income tax expense. The Company has accrued penalties in jurisdictions where they are automatically applied to any deficiency, regardless of the merit of the position.

The resolution of the majority of Eaton's unrecognized income tax benefits is dependent upon uncontrollable factors such as law changes; the prospect of retroactive regulations; new case law; the willingness of the income tax authority to settle the issue, including the timing thereof; and other factors. Therefore, for the majority of unrecognized income tax benefits, it is not reasonably possible to estimate the increase or decrease in the next 12 months. For each of the unrecognized income tax benefits where it is possible to estimate the increase or decrease in the balance within the next 12 months, the Company does not anticipate any significant change.

Eaton or its subsidiaries file income tax returns in the United States and foreign jurisdictions. The IRS has completed their examination of the Company's United States income tax returns for 2005 and 2006 and has issued a Statutory Notice of Deficiency (Notice) as discussed below. The statute of limitations on these tax years remains open to the extent of the tax assessment until the matter is resolved. Although the formal examination has not begun, the Company recently agreed to extend the statute of limitations for the IRS to examine its United States income tax returns for 2007, 2008 and 2009 until December 31, 2013. Eaton is also under examination for the income tax filings in various state and foreign jurisdictions. With only a few exceptions, the Company is no longer subject to state and local income tax examinations for years before 2008, or foreign examinations for years before 2006.

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. The Company intends to file a Petition with the U.S. Tax Court in which it will assert 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. 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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During 2010, Eaton received a significant tax assessment in Brazil for the tax years 2005 through 2008 that relates to the amortization of certain goodwill generated from the acquisition of third party businesses and corporate reorganizations. In this jurisdiction, the Company had previously filed and received a favorable tax ruling on the key aspects of the transaction not specifically covered by the plain meaning of the local tax statutes. The ruling request fully disclosed all steps of the transaction. The tax assessment is pending review at the second of three administrative appeals levels. The first administrative appeal level made a 50% reduction in assessed penalties. The Company disagrees with the assessment and intends to litigate the matter if it is not resolved at the administrative appeals levels. Multiple outside advisors have stated that Brazilian tax authorities are raising the issue for most clients with similar facts and that the matter is expected to require at least 10 years to resolve. At this time, management believes that final resolution of the assessment will not have a material impact on the consolidated financial statements.

**Note 9. EATON SHAREHOLDERS' EQUITY**

There are 500 million common shares authorized (\$0.50 par value per share), 334.4 million of which were issued and outstanding at the end of 2011. At December 31, 2011, there were 8,191 holders of record of common shares. Additionally, 18,220 current and former employees were shareholders through participation in the Eaton Savings Plan (ESP), Eaton Personal Investment Plan (EPIP), and the Eaton Puerto Rico Retirement Savings Plan.

Eaton has a common share repurchase program (2007 Program) that authorizes the repurchase of 10 million common shares. In 2011, 8.3 million common shares were repurchased under the 2007 Program in the open market at a total cost of \$343. On September 28, 2011, Eaton's Board of Directors approved a common share repurchase program (2011 Program) that replaced the 2007 Program and authorizes the purchase of up to 20 million shares, not to exceed an aggregate purchase price of \$1.25 billion. The common shares are expected to be repurchased over time, depending on market conditions, the market price of common shares, capital levels and other considerations. In 2011, no common shares were repurchased under the 2011 Program. No common shares were repurchased in the open market in 2010 or 2009.

Eaton has deferral plans that permit certain employees and directors to defer a portion of their compensation. A trust contains \$6 and \$9 of common shares and marketable securities, as valued at December 31, 2011 and 2010, respectively, to fund a portion of these liabilities. The marketable securities were included in Other assets and the common shares were included in Shareholders' equity at historical cost.

**Accumulated Other Comprehensive Loss**

The components of Accumulated other comprehensive loss as reported in the Consolidated Balance Sheets follow:

|   | 2011            |          | 2010            |          |
|---|-----------------|----------|-----------------|----------|
| Foreign currency translation and related hedging instruments (net of income tax benefit of \$43 in 2011 and \$32 in 2010) | \$(502          | )        | \$(261          | )        |
| Pensions (net of income tax benefit of \$651 in 2011 and \$489 in 2010)   | (1,309          | )        | (972            | )        |
| Other postretirement benefits (net of income tax benefit of \$110 in 2011 and \$99 in 2010)                               | (138            | )        | (122            | )        |
| Cash flow hedges (net of income tax benefit of \$8 in 2011 and income tax expense of \$4 in 2010)                         | (15             | )        | 7               |          |
| <b>Total accumulated other comprehensive loss</b>   | <b>\$(1,964</b> | <b>)</b> | <b>\$(1,348</b> | <b>)</b> |

**Net Income per Common Share**

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

| (Shares in millions)  | 2011    | 2010  | 2009  |
|---|---------|-------|-------|
| Net income attributable to Eaton common shareholders              | \$1,350 | \$929 | \$383 |
| Weighted-average number of common shares outstanding-diluted      | 342.8   | 339.5 | 335.8 |
| Less dilutive effect of stock options and restricted stock awards | 4.5     | 4.0   | 3.1   |
| Weighted-average number of common shares outstanding-basic        | 338.3   | 335.5 | 332.7 |

|                             |        |        |        |
|-----------------------------|--------|--------|--------|
| Net income per common share |        |        |        |
| Diluted                     | \$3.93 | \$2.73 | \$1.14 |
| Basic                       | 3.98   | 2.76   | 1.16   |

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In 2011, 2010 and 2009, 1.5 million, 6.9 million and 16.3 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. EQUITY-BASED COMPENSATION

## Restricted Stock Units

Restricted stock units and awards (RSUs) have been issued to certain employees at fair market value at the date of grant. These awards entitle the holder to receive one common share for each RSU upon vesting, generally over three or four years. A summary of the RSU activity for 2011 follows:

| (Restricted stock units in millions) | Number of restricted stock units | Weighted-average fair value per award |
|--------------------------------------|----------------------------------|---------------------------------------|
| Non-vested at January 1              | 5.2                              | \$26.48                               |
| Granted                              | 1.1                              | 53.53                                 |
| Vested                               | (1.3                             | ) 25.92                               |
| Forfeited                            | (0.2                             | ) 30.83                               |
| Non-vested at December 31            | 4.8                              | \$33.02                               |

Information related to RSUs follows:

|                            | 2011 | 2010 | 2009 |
|----------------------------|------|------|------|
| Pretax expense for RSUs    | \$50 | \$39 | \$25 |
| After-tax expense for RSUs | 32   | 25   | 17   |

As of December 31, 2011, total compensation expense not yet recognized related to non-vested RSUs was \$90, and the weighted-average period in which the expense is expected to be recognized is 2.9 years. Excess tax benefit for restricted stock units and other equity-based compensation totaled \$24 for 2011.

## Stock Options

Under various plans, stock options have been granted to certain employees and directors to purchase common shares at prices equal to fair market value on the date of grant. Substantially all of these options vest ratably during the three-year period following the date of grant and expire 10 years from the date of grant. Compensation expense is recognized for stock options based on the fair value of the options at the date of grant and amortized on a straight-line basis over the period the employee or director is required to provide service.

The Company uses a Black-Scholes option pricing model to estimate the fair value of stock options. The principal assumptions utilized in valuing stock options include the expected stock price volatility (based on the most recent historical period equal to the expected life of the option); the expected option life (an estimate based on historical experience); the expected dividend yield; and the risk-free interest rate (an estimate based on the yield of United States Treasury zero coupon with a maturity equal to the expected life of the option). A summary of the assumptions used in determining the fair value of stock options follows:

|  | 2011         | 2010         | 2009         |
|--|--------------|--------------|--------------|
| Expected volatility                                  | 33           | % 31         | % 30         |
| Expected option life in years                        | 5.5          | 5.5          | 5.5          |
| Expected dividend yield                              | 2.0          | % 2.0        | % 2.0        |
| Risk-free interest rate                              | 2.2% to 1.4% | 2.4% to 1.3% | 2.2% to 1.7% |
| Weighted-average fair value of stock options granted | \$14.56      | \$8.98       | \$5.14       |

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A summary of stock option activity follows:

| (Options in millions)                           | Weighted-average price per option | Options | Weighted-average remaining contractual life in years | Aggregate intrinsic value |
|---|-----------------------------------|---------|--|---------------------------|
| Outstanding at January 1, 2011                  | \$34.62                           | 14.9    |  |                           |
| Granted   | 53.45                             | 0.8     |  |                           |
| Exercised                                       | 28.79                             | (2.5 )  |  |                           |
| Forfeited and canceled                          | 36.85                             | (0.1 )  |  |                           |
| Outstanding at December 31, 2011                | \$36.84                           | 13.1    | 4.3  | \$96                      |
| Exercisable at December 31, 2011                | \$35.84                           | 12.2    | 4.0  | \$94                      |
| Reserved for future grants at December 31, 2011 |                                   | 7.5     |  |                           |

The aggregate intrinsic value in the table above represents the total excess of the \$43.53 closing price of Eaton common shares on the last trading day of 2011 over the exercise price of the stock option, multiplied by the related number of options outstanding and exercisable. The aggregate intrinsic value is not recognized for financial accounting purposes and the value changes based on the daily changes in the fair market value of the Company's common shares.

Information related to stock options follows:

|  | 2011 | 2010 | 2009 |
|--|------|------|------|
| Pretax expense for stock options   | \$5  | \$11 | \$28 |
| After-tax expense for stock options  | 4    | 8    | 19   |
| Proceeds from stock options exercised  | 71   | 157  | 27   |
| Income tax benefit related to stock options exercised  |      |      |      |
| Tax benefit classified in operating activities in the Consolidated Statements of Cash Flows        | 13   | —    | 2    |
| Excess tax benefit classified in financing activities in the Consolidated Statements of Cash Flows | 33   | —    | 4    |
| Intrinsic value of stock options exercised   | 62   | 98   | 19   |
| Total fair value of stock options vesting  | \$5  | \$11 | \$22 |

Stock options exercised, in millions of options 2.541 6.096 1.688

As of December 31, 2011, total compensation expense not yet recognized related to non-vested stock options was \$9, and the weighted-average period in which the expense is expected to be recognized is 2.2 years.

#### Note 11. 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<br>in active<br>markets for<br>identical assets<br>(Level 1) | Other<br>observable<br>inputs<br>(Level 2) | Unobservable<br>inputs<br>(Level 3) |
|--|--------|--|--|-------------------------------------|
| 2011   |        |  |  |                                     |
| Cash   | \$ 385 | \$ 385   | \$—  | \$—                                 |
| Short-term investments   | 699    | 699  | —  | —                                   |
| Net derivative contracts   | 46     | —  | 46   | —                                   |
| Long-term debt converted to floating interest rates<br>by<br>interest rate swaps - net | 66     | —  | 66   | —                                   |
| 2010   |        |  |  |                                     |
| Cash   | \$ 333 | \$ 333   | \$—  | \$—                                 |
| Short-term investments   | 838    | 838  | —  | —                                   |
| Net derivative contracts   | 69     | —  | 69   | —                                   |
| Long-term debt converted to floating interest rates<br>by<br>interest rate swaps - net | 42     | —  | 42   | —                                   |

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 \$3,687 and fair value of \$4,273 at December 31, 2011 compared to \$3,386 and \$3,787, respectively, at December 31, 2010.

**Short-Term Investments**

Eaton invests excess cash generated from operations in short-term marketable investments. For those investments classified as “available-for-sale”, Eaton marks these investments to fair value with the offset recognized in Accumulated other comprehensive loss. A summary of the carrying value of short-term investments follows:

|   | 2011   | 2010   |
|---|--------|--------|
| Time deposits, certificate of deposits and demand deposits with banks | \$ 466 | \$ 592 |
| Money market investments  | 228    | 246    |
| Other   | 5      | —      |
| Total short-term investments  | \$ 699 | \$ 838 |

**Note 12. 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.

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Derivative financial instruments are accounted for at fair value and recognized as assets or liabilities in the 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 derivative financial instruments accounted for as designated hedges and the hedged item, as well as its risk-management objective and strategy for undertaking the hedge transaction. This process includes linking 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 loss and reclassified to income in the same period when the gain or loss on the hedged item is included in income.

- 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 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. During 2011, Eaton incurred losses of \$18 associated with commodity hedge contracts. Gains and losses associated with commodity hedge contracts are reported 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 and \$123 at December 31, 2011 and 2010, respectively. For additional information about debt, see Note 5.

**Interest Rate Risk**

Eaton has entered into fixed-to-floating interest rate swaps and floating-to-fixed interest rate swaps to manage interest rate risk of certain long-term debt. These interest rate swaps are accounted for as fair value hedges and cash flow hedges, respectively, of certain long-term debt. The maturity of the swap corresponds with the maturity of the debt instrument as noted in the table of long-term debt in Note 5.

A summary of interest rate swaps outstanding at December 31, 2011, follows:

**Fixed-to-Floating Interest Rate Swaps**

| Notional amount | Fixed interest rate received | Floating interest rate paid | Basis for contracted floating interest rate paid |
|-----------------|------------------------------|-----------------------------|--|
| \$200           | 4.90%                        | 2.81%                       | 6 month LIBOR + 2.15%                            |
| 100             | 5.95%                        | 3.12%                       | 6 month LIBOR + 2.60%                            |
| 215             | 5.60%                        | 3.00%                       | 6 month LIBOR + 2.34%                            |
| 300             | 6.95%                        | 5.63%                       | 3 month LIBOR + 5.08%                            |
| 25              | 8.875%                       | 4.61%                       | 6 month LIBOR + 3.84%                            |
| 25              | 7.625%                       | 3.03%                       | 6 month LIBOR + 2.48%                            |
| 50              | 7.65%                        | 3.23%                       | 6 month LIBOR + 2.57%                            |
| 25              | 5.45%                        | 0.87%                       | 6 month LIBOR + 0.28%                            |



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## Floating-to-Fixed Interest Rate Swaps

|                 |                                 |                          |  |
|-----------------|---------------------------------|--------------------------|--|
| Notional amount | Floating interest rate received | Fixed interest rate paid | Basis for contracted floating interest rate received |
| \$300           | 0.56%                           | 0.76%                    | 3 month LIBOR  |

## Derivative Financial Statement Impacts

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

|                                       | Notional amount | Other current assets | Other long-term assets | Other current liabilities | Type of hedge  | Term            |
|---------------------------------------|-----------------|----------------------|------------------------|---------------------------|----------------|-----------------|
| 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                   | \$18                      |                |                 |
| Derivatives not designated as hedges  |                 |                      |                        |                           |                |                 |
| Foreign currency exchange contracts   | \$2,954         | \$18                 |                        | \$14                      |                | 12 months       |
| Commodity contracts                   | 57              | —                    |                        | 12                        |                | 12 months       |
| Total                                 |                 | \$18                 |                        | \$26                      |                |                 |
| December 31, 2010                     |                 |                      |                        |                           |                |                 |
| Derivatives designated as hedges      |                 |                      |                        |                           |                |                 |
| Fixed-to-floating interest rate swaps | \$540           | \$—                  | \$42                   | \$—                       | Fair value     | 2 to 23 years   |
| Foreign currency exchange contracts   | 227             | 4                    | —                      | 5                         | Cash flow      | 12 to 36 months |
| Commodity contracts                   | 39              | 8                    | —                      | —                         | Cash flow      | 12 months       |
| Cross currency swaps                  | 75              | 2                    | —                      | —                         | Net investment | 12 months       |
| Total                                 |                 | \$14                 | \$42                   | \$5                       |                |                 |
| Derivatives not designated as hedges  |                 |                      |                        |                           |                |                 |
| Foreign currency exchange contracts   | \$2,777         | \$20                 |                        | \$19                      |                | 12 months       |
| Commodity contracts                   | 102             | 17                   |                        | —                         |                | 12 months       |
| Total                                 |                 | \$37                 |                        | \$19                      |                |                 |

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.



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Amounts recognized in Accumulated other comprehensive loss follow:

|   | 2011  |  | 2010  |  |
|---|---|--|---|--|
|   | Gain (loss)<br>recognized in<br>Accumulated<br>other<br>comprehensive<br>loss | Gain (loss)<br>reclassified<br>from<br>Accumulated<br>other<br>comprehensive<br>loss | Gain (loss)<br>recognized in<br>Accumulated<br>other<br>comprehensive<br>loss | Gain (loss)<br>reclassified<br>from<br>Accumulated<br>other<br>comprehensive<br>loss |
| Derivatives designated as cash flow hedges      |   |  |   |  |
| Foreign currency exchange contracts             | \$(10 )   | \$(6 )   | \$(2 )  | \$1  |
| Commodity contracts                             | (12 )   | 6  | 8   | 5  |
| Derivatives designated as net investment hedges |   |  |   |  |
| Cross currency swaps                            | 1   | —  | (8 )  | —  |
| Total   | \$(21 )   | \$—  | \$(2 )  | \$6  |

Gains and losses reclassified from Accumulated other comprehensive loss to the Consolidated Statements of Income were recognized in Cost of products sold.

Amounts recognized in net income follow:

|  | 2011  | 2010  |
|--|-------|-------|
| Derivatives designated as fair value hedges  |       |       |
| Fixed-to-floating interest rate swaps  | \$24  | \$33  |
| Related long-term debt converted to floating interest rates by interest rate swaps | (24 ) | (33 ) |
|  | \$—   | \$—   |

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

Cash received from the early termination of interest rate swaps totaled \$0, \$22 and \$15 for the years ended December 31, 2011, 2010 and 2009, respectively.

### Note 13. ACCOUNTS RECEIVABLE AND INVENTORY

#### Accounts Receivable

Eaton performs ongoing credit evaluation of its customers and maintains sufficient allowances for potential credit losses. The Company evaluates the collectability of its accounts receivable based on the length of time the receivable is past due and any anticipated future write-off based on historic experience. Accounts receivable balances are written off against an allowance for doubtful accounts after a final determination of uncollectability has been made. Accounts receivable are net of an allowance for doubtful accounts of \$48 and \$51 at December 31, 2011 and 2010, respectively.

#### Inventory

Inventory is carried at lower of cost or market. Inventory in the United States is generally accounted for using the last-in, first-out (LIFO) method. Remaining United States and non-United States inventory is accounted for using the first-in, first-out (FIFO) method. Cost components include raw materials, purchased components, direct labor, indirect labor, utilities, depreciation, inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, and costs of the distribution network.

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The components of inventory follow:

|                               | 2011    | 2010    |
|-------------------------------|---------|---------|
| Raw materials                 | \$706   | \$651   |
| Work-in-process               | 272     | 229     |
| Finished goods                | 867     | 800     |
| Inventory at FIFO             | 1,845   | 1,680   |
| Excess of FIFO over LIFO cost | (144    | ) (116  |
| Total inventory               | \$1,701 | \$1,564 |

Inventory at FIFO accounted for using the LIFO method was 42% and 40% at the end of 2011 and 2010, respectively.

#### Note 14. BUSINESS SEGMENT AND GEOGRAPHIC REGION 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 segments are as follows:

##### Electrical Americas and Electrical Rest of World

The Electrical segments are global leaders in electrical components and systems for power quality, distribution and control. Products include circuit breakers, switchgear, UPS systems, power distribution units, panelboards, loadcenters, motor controls, meters, sensors, relays and inverters. The principal markets for the Electrical Americas and Electrical Rest of World segments are industrial, institutional, governmental, utility, commercial, residential and information technology. These products are used wherever there is a demand for electrical power in commercial buildings, data centers, residences, apartment and office buildings, hospitals, factories and utilities. The segments share several common global customers, but a large number of customers are located regionally and sales are made directly to original equipment manufacturers and indirectly through distributors, resellers and manufacturers representatives.

##### Hydraulics

The Hydraulics segment is a global leader in hydraulics components, systems and services for industrial and mobile equipment. Eaton offers a wide range of power products including pumps, motors and hydraulic power units; a broad range of controls and sensing products including valves, cylinders and electronic controls; a full range of fluid conveyance products including industrial and hydraulic hose, fittings, and assemblies, thermoplastic hose and tubing, couplings, connectors, and assembly equipment; filtration systems solutions; heavy-duty drum and disc brakes; and golf grips. The principal markets for the Hydraulics segment include oil and gas, renewable energy, marine, agriculture, construction, mining, forestry, utility, material handling, truck and bus, machine tools, molding, primary metals and power generation. Key manufacturing customers in these markets and other customers are located globally, and these products are sold and serviced through a variety of channels.

##### Aerospace

The Aerospace segment is a leading global supplier of aerospace fuel, hydraulics and pneumatic systems for commercial and military use. Products include hydraulic power generation systems for aerospace applications including pumps, motors, hydraulic power units, hose and fittings, electro-hydraulic pumps and power and load management systems; controls and sensing products including valves, cylinders, electronic controls, electromechanical actuators, sensors, displays and panels, aircraft flap and slat systems and nose wheel steering systems; fluid conveyance products, including hose, thermoplastic tubing, fittings, adapters, couplings, sealing and ducting; and fuel systems including fuel pumps, sensors, valves, adapters and regulators. The principal markets for the Aerospace segment are manufacturers of commercial and military aircraft and related after-market customers. These manufacturers and other customers operate globally, and these products are sold and serviced through a variety of channels.

##### Truck

The Truck segment is a leader in the design, manufacture and marketing of a complete line of drivetrain and powertrain systems and components for performance, fuel economy and safety for commercial vehicles. Products include transmissions, clutches and hybrid power systems. The principal markets for the Truck segment are original

equipment manufacturers and after-market customers of heavy-, medium-, and light-duty trucks and passenger cars. These manufacturers and other customers are located globally, and most sales of these products are made directly to these customers.

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Automotive

The Automotive segment is a leading supplier of automotive drivetrain and powertrain systems for performance, fuel economy and safety including critical components that reduce emissions and fuel consumption and improve stability, performance, fuel economy and safety of cars, light trucks and commercial vehicles. Products include superchargers, engine valves and valve actuation systems, cylinder heads, locking and limited slip differentials, transmission and engine controls, fuel vapor components, compressor control clutches for mobile refrigeration, fluid connectors and hoses for air conditioning and power steering, underhood plastic components, fluid conveyance products including, hose, thermoplastic tubing, fittings, adapters, couplings and sealing products for the global automotive industry. The principal markets for the Automotive segment are original equipment manufacturers and aftermarket customers of light-duty trucks, SUVs, CUVs, and passenger cars. These manufacturers and other customers are located globally, and most sales of these products are made directly to these customers.

Other Information

No single customer represented greater than 10% of net sales in 2011, 2010 or 2009, respectively.

The accounting policies of the business segments are generally the same as the policies described in Note 1, except that inventory and related cost of products sold of the segments are accounted for using the FIFO method and operating profit only reflects the service cost component related to pensions and other postretirement benefits.

Intersegment sales and transfers are accounted for at the same prices as if the sales and transfers were made to third parties. These intersegment sales are eliminated in consolidation.

For purposes of business segment performance measurement, the Company does not allocate items that are of a non-operating nature, or corporate organizational and functional expenses of a governance nature. Corporate expenses consist of corporate office expenses including compensation, benefits, occupancy, depreciation, and other administrative costs. Identifiable assets of the business segments exclude goodwill, other intangible assets, and general corporate assets, which principally consist of cash, short-term investments, deferred income taxes, certain accounts receivable, certain property, plant and equipment, and certain other assets.

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## Business Segment Information

|  | 2011     | 2010     | 2009     |
|--|----------|----------|----------|
| Net sales  |          |          |          |
| Electrical Americas  | \$4,192  | \$3,675  | \$3,410  |
| Electrical Rest of World   | 2,984    | 2,748    | 2,483    |
| Hydraulics   | 2,835    | 2,212    | 1,692    |
| Aerospace  | 1,648    | 1,536    | 1,602    |
| Truck  | 2,644    | 1,997    | 1,457    |
| Automotive   | 1,746    | 1,547    | 1,229    |
| Total net sales  | \$16,049 | \$13,715 | \$11,873 |
| Segment operating profit   |          |          |          |
| Electrical Americas  | \$605    | \$529    | \$518    |
| Electrical Rest of World   | 278      | 264      | 107      |
| Hydraulics   | 438      | 279      | 51       |
| Aerospace  | 244      | 220      | 245      |
| Truck  | 486      | 245      | 39       |
| Automotive   | 209      | 163      | (10)     |
| Total segment operating profit   | 2,260    | 1,700    | 950      |
| Corporate  |          |          |          |
| Amortization of intangible assets  | (190)    | (181)    | (170)    |
| Interest expense-net   | (118)    | (136)    | (150)    |
| Pension and other postretirement benefits expense  | (142)    | (120)    | (212)    |
| Other corporate expense-net  | (257)    | (227)    | (115)    |
| Income before income taxes   | 1,553    | 1,036    | 303      |
| Income tax expense (benefit)   | 201      | 99       | (82)     |
| Net income   | 1,352    | 937      | 385      |
| Less net income for noncontrolling interests   | (2)      | (8)      | (2)      |
| Net income attributable to Eaton common shareholders   | \$1,350  | \$929    | \$383    |
| Business segment operating profit was reduced by acquisition integration charges as follows: |          |          |          |
|  | 2011     | 2010     | 2009     |
| Electrical Americas  | \$8      | \$2      | \$4      |
| Electrical Rest of World   | 2        | 33       | 60       |
| Hydraulics   | 4        | 1        | 3        |
| Aerospace  | —        | 4        | 12       |
| Automotive   | —        | —        | 1        |
| Total  | \$14     | \$40     | \$80     |

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## Business Segment Information

|  | 2011     | 2010     | 2009     |
|--|----------|----------|----------|
| Identifiable assets                                    |          |          |          |
| Electrical Americas                                    | \$1,364  | \$1,272  | \$1,050  |
| Electrical Rest of World                               | 1,531    | 1,630    | 1,625    |
| Hydraulics   | 1,265    | 1,080    | 939      |
| Aerospace  | 754      | 726      | 729      |
| Truck  | 920      | 866      | 797      |
| Automotive   | 863      | 904      | 866      |
| Total identifiable assets                              | 6,697    | 6,478    | 6,006    |
| Goodwill   | 5,537    | 5,454    | 5,435    |
| Other intangible assets                                | 2,192    | 2,272    | 2,441    |
| Corporate  | 3,447    | 3,048    | 2,400    |
| Total assets   | \$17,873 | \$17,252 | \$16,282 |
| Capital expenditures for property, plant and equipment |          |          |          |
| Electrical Americas                                    | \$65     | \$59     | \$30     |
| Electrical Rest of World                               | 52       | 49       | 39       |
| Hydraulics   | 70       | 45       | 21       |
| Aerospace  | 21       | 21       | 16       |
| Truck  | 80       | 59       | 30       |
| Automotive   | 92       | 61       | 24       |
| Total  | 380      | 294      | 160      |
| Corporate  | 188      | 100      | 35       |
| Total expenditures for property, plant and equipment   | \$568    | \$394    | \$195    |
| Depreciation of property, plant and equipment          |          |          |          |
| Electrical Americas                                    | \$53     | \$55     | \$56     |
| Electrical Rest of World                               | 58       | 56       | 61       |
| Hydraulics   | 54       | 52       | 57       |
| Aerospace  | 26       | 25       | 26       |
| Truck  | 74       | 76       | 83       |
| Automotive   | 73       | 77       | 85       |
| Total  | 338      | 341      | 368      |
| Corporate  | 29       | 28       | 30       |
| Total depreciation of property, plant and equipment    | \$367    | \$369    | \$398    |

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## Geographic Region Information

Net sales are measured based on the geographic destination of sales. Long-lived assets consist of property, plant and equipment-net.

|                   | 2011     | 2010     | 2009     |
|-------------------|----------|----------|----------|
| Net sales         |          |          |          |
| United States     | \$7,165  | \$6,166  | \$5,574  |
| Canada            | 815      | 666      | 562      |
| Latin America     | 1,952    | 1,629    | 1,159    |
| Europe            | 4,092    | 3,532    | 3,157    |
| Asia Pacific      | 2,025    | 1,722    | 1,421    |
| Total             | \$16,049 | \$13,715 | \$11,873 |
| Long-lived assets |          |          |          |
| United States     | \$1,227  | \$1,102  | \$1,024  |
| Canada            | 27       | 25       | 23       |
| Latin America     | 247      | 275      | 272      |
| Europe            | 649      | 664      | 748      |
| Asia Pacific      | 452      | 411      | 378      |
| Total             | \$2,602  | \$2,477  | \$2,445  |

Eaton is a net exporter of products from its United States operations. In 2011, 2010 and 2009, Eaton's net exports were \$961, \$840 and \$710, respectively.

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

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

## COMPANY OVERVIEW

Eaton Corporation (Eaton or Company) 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 73,000 employees in over 50 countries, and sells products to customers in more than 150 countries.

Eaton's operating segments are Electrical Americas, Electrical Rest of World, Hydraulics, Aerospace, Truck and Automotive. These segments are components of the Company with separate financial information that is evaluated on a regular basis by the chief operating decision maker in determining how to allocate resources. For additional information regarding Eaton's business segments, see Note 14 to the Consolidated Financial Statements.

During 2009, Eaton experienced significant challenges due to the global recession and instability in the financial and capital markets, which had a significant impact on the demand for Eaton's products. In response to these events, and to remain competitive in the marketplace, substantial changes were made to the Company's cost structure, including a 17% full-time workforce reduction in 2009, as well as other cost-containment actions. In 2010, the Company experienced a return to growth in end markets, higher demand for products and overall improved operating results due to better economic conditions and the cost-containment actions initiated in 2009.

During 2011, the Company experienced even greater demand for its products due to continued improvements in economic conditions, with growth in all segments. This growth was partially dampened by the slowing Eurozone economy and restrictions on credit availability in China, primarily during the latter part of 2011.

For 2012, the Company expects modest growth of 5% with United States markets slightly stronger than markets outside of the United States. See 2012 Forward-Looking Perspective for Eaton's forward-looking guidance in Management's Discussion and Analysis.

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. For a complete list of business acquisitions and joint ventures, see Note 2 to the 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:

|  | 2011     | 2010     | 2009     |
|--|----------|----------|----------|
| Net sales  | \$16,049 | \$13,715 | \$11,873 |
| Net income attributable to Eaton common shareholders | 1,350    | 929      | 383      |
| Net income per common share-diluted                  | \$3.93   | \$2.73   | \$1.14   |

## 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, 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

|   | 2011     | Change<br>from 2010 | 2010       | Change<br>from 2009 | 2009       |   |
|---|----------|---------------------|------------|---------------------|------------|---|
| Net sales   | \$16,049 | 17                  | % \$13,715 | 16                  | % \$11,873 |   |
| Gross profit  | 4,788    | 17                  | % 4,082    | 32                  | % 3,091    |   |
| Percent of net sales  | 29.8     | %                   | 29.8       | %                   | 26.0       |   |
| Income before income taxes  | 1,553    | 50                  | % 1,036    | 242                 | % 303      |   |
| Net income  | \$1,352  | 44                  | % \$937    | 143                 | % \$385    |   |
| Less net income for noncontrolling interests                              | (2       | )                   | (8         | )                   | (2         | ) |
| Net income attributable to Eaton common shareholders                      | 1,350    | 45                  | % 929      | 143                 | % 383      |   |
| Excluding acquisition integration charges (after-tax)                     | 10       |                     | 27         |                     | 54         |   |
| Operating earnings  | \$1,360  | 42                  | % \$956    | 119                 | % \$437    |   |
| Net income per common share-diluted                                       | \$3.93   | 44                  | % \$2.73   | 141                 | % \$1.14   |   |
| Excluding per share impact of acquisition integration charges (after-tax) | 0.03     |                     | 0.08       |                     | 0.16       |   |
| Operating earnings per common share                                       | \$3.96   | 41                  | % \$2.81   | 117                 | % \$1.30   |   |

## Net Sales

Net sales in 2011 increased by 17% compared to 2010 due to 13% from higher core sales, an increase of 2% from the impact of foreign exchange, and an increase of 2% from acquisitions of businesses. Core sales growth was driven by increased demand in end markets in 2011 compared to 2010. Economic volatility in Europe and restrictions on credit availability in China caused some dampening of overall growth in the second half of 2011. Net sales in 2010 increased by 16% compared to 2009 due to 14% higher core sales, an increase of 1% from the impact of foreign exchange, and an increase of 1% from acquisitions of businesses. Core sales were primarily impacted by the rebound in end markets.

## Gross Profit

Gross profit increased by 17% in 2011 compared to 2010, and profit margin remained consistent compared to 2010 at 29.8% of Net sales. Gross profit increased by 32% in 2010 compared to 2009, improving to 29.8% of Net sales, up 3.8 percentage points from 2009. The increase in both periods was primarily due to higher sales, manufacturing efficiencies resulting from higher sales volumes, and the benefits of substantial changes in the Company's cost structure implemented in 2009 and 2010, partially offset by higher raw material and commodity costs. The Company's cost structure reflects savings associated with workforce reductions taken in 2009. Additionally, contributing to higher gross profit in 2010 is the absence of charges for severance and pension and other postretirement benefits expense incurred in 2009.

## Income Taxes

The effective income tax expense rate for 2011 was 12.9% compared to 9.5% for 2010 and an income tax benefit rate of 27.2% for 2009. The higher effective tax rate for 2011 and 2010 was primarily attributable to greater levels of income in high tax jurisdictions, particularly in the United States and Brazil, due to continued improvement in market conditions. The increased tax rate in 2010 compared to 2009 was further impacted by a one-time, non-cash charge of \$22 to reflect the impact of the Health Care Reform and Education Reconciliation Act on taxation associated with Medicare Part D, and adjustments of \$22 related to an income tax audit of transfer pricing for the period 2005 to 2009, partially offset by the successful resolution of international tax audit issues, the recognition of state and local income tax benefits involving tax loss carryforwards and the recognition of additional international deferred tax assets. The income tax benefit rate for 2009 was favorably impacted by tax benefits of \$104 from United States federal income tax losses. Eaton also recognized income tax benefits of \$13 in 2009, which represented adjustments to certain worldwide tax liabilities and valuation allowances and benefits related to the settlement of international income tax audits. For additional information on income taxes, see Note 8 to the Consolidated Financial Statements.





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## Net Income

Net income attributable to Eaton common shareholders of \$1,350 in 2011 increased 45% compared to Net income attributable to Eaton common shareholders of \$929 in 2010, and Net income per common share of \$3.93 in 2011 increased 44% over Net income per common share of \$2.73 in 2010. The increase was primarily due to higher sales and the factors noted above that affected gross profit. Net income attributable to Eaton common shareholders of \$929 in 2010 increased 143% compared to Net income attributable to Eaton common shareholders of \$383 in 2009 and Net income per common share of \$2.73 in 2010 increased 141% over Net income per common share of \$1.14 in 2009. The increases were primarily due to higher sales in 2010 and the factors that affected gross profit, partially offset by higher income tax expense in 2010 as discussed above. Net income attributable to Eaton common shareholders in 2010 was unfavorably impacted by a \$36 pretax charge related to a legal judgment in Brazil. See Other Matters for additional information related to this legal judgment.

## Business Segment Results of Operations

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

## Electrical Americas

|  | 2011    | Change<br>from 2010 | 2010    | Change<br>from 2009 | 2009    |
|--|---------|---------------------|---------|---------------------|---------|
| Net sales                              | \$4,192 | 14 %                | \$3,675 | 8 %                 | \$3,410 |
| Operating profit                       | 605     | 14 %                | 529     | 2 %                 | 518     |
| Operating margin                       | 14.4 %  |                     | 14.4 %  |                     | 15.2 %  |
| Acquisition integration charges        | \$8     |                     | \$2     |                     | \$4     |
| Before acquisition integration charges |         |                     |         |                     |         |
| Operating profit                       | \$613   | 15 %                | \$531   | 2 %                 | \$522   |
| Operating margin                       | 14.6 %  |                     | 14.4 %  |                     | 15.3 %  |

Net sales increased 14% in 2011 compared to 2010 due to an increase of 11% in core sales, an increase of 2% from the acquisition of businesses, and an increase of 1% from the favorable impact of foreign exchange. The increase in net sales in 2011 was due to strong growth in industrial controls and nonresidential electrical markets. Net sales increased 8% in 2010 compared to 2009 due to an increase in core sales of 5%, an increase of 1% from the favorable impact of foreign exchange, and an increase of 2% from the acquisitions of businesses. Contributing to stronger sales in 2010 was growth in the power quality and industrial control businesses, rebounding from the depressed end market levels of 2009, as well as sales related to government stimulus programs. This increase in sales was partially offset by a decline in non-residential electrical end markets.

Operating profit before acquisition integration charges in 2011 increased 15% from 2010. The increase was largely due to higher net sales as noted above, partially offset by higher raw materials and commodity costs, including losses associated with commodity hedge contracts due to significant declines in metal prices late in September. Operating profit before acquisition integration charges in 2010 increased 2% from 2009 largely due to the increase in sales during 2010, net savings resulting from workforce reductions taken in 2009, and manufacturing efficiencies resulting from higher sales volumes. These increases were partially offset by the cessation of temporary cost-savings measures introduced in 2009, higher raw material costs, and increased support costs as operations returned to normal operating levels compared to the depressed levels in 2009.

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## Electrical Rest of World

|                                 | 2011    | Change<br>from 2010 | 2010      | Change<br>from 2009 | 2009      |   |
|---------------------------------|---------|---------------------|-----------|---------------------|-----------|---|
| Net sales                       | \$2,984 | 9                   | % \$2,748 | 11                  | % \$2,483 |   |
| Operating profit                | 278     | 5                   | % 264     | 147                 | % 107     |   |
| Operating margin                | 9.3     | %                   | 9.6       | %                   | 4.3       | % |
| Acquisition integration charges | \$2     |                     | \$33      |                     | \$60      |   |

## Before acquisition integration charges

|                  |       |    |          |    |         |   |
|------------------|-------|----|----------|----|---------|---|
| Operating profit | \$280 | (6 | )% \$297 | 78 | % \$167 |   |
| Operating margin | 9.4   | %  | 10.8     | %  | 6.7     | % |

Net sales increased 9% in 2011 compared to 2010 due to an increase of 6% from the favorable impact of foreign exchange, an increase of 2% from the acquisition of businesses, and an increase in core sales of 1%. Sales growth in 2011 compared to 2010 was negatively impacted by economic volatility in Europe and restrictions on credit availability in China. Net sales increased 11% in 2010 compared to 2009 due to an increase in core sales of 11% and an increase of 1% from the acquisition of certain businesses, partially offset by a 1% reduction from foreign exchange. The growth in core sales in 2010 was due to the rebound in European and Asian end markets from the depressed levels of 2009.

Operating profit before acquisition integration charges in 2011 decreased 6% from 2010. The decrease in operating profit was primarily due to a decline in the residential solar market, higher raw material and commodity costs, and losses associated with commodity hedge contracts due to significant declines in metal prices late in September.

Operating profit before acquisition integration charges in 2010 increased 78% from 2009 largely due to the increase in sales during 2010, net savings resulting from workforce reductions taken in 2009, and manufacturing efficiencies resulting from higher sales volumes. These increases were partially offset by the cessation of temporary cost-savings measures introduced in 2009, and increased support costs as operations returned to normal operating levels compared to the depressed levels in 2009.

## Hydraulics

|                                 | 2011    | Change<br>from 2010 | 2010      | Change<br>from 2009 | 2009      |   |
|---------------------------------|---------|---------------------|-----------|---------------------|-----------|---|
| Net sales                       | \$2,835 | 28                  | % \$2,212 | 31                  | % \$1,692 |   |
| Operating profit                | 438     | 57                  | % 279     | 447                 | % 51      |   |
| Operating margin                | 15.4    | %                   | 12.6      | %                   | 3.0       | % |
| Acquisition integration charges | \$4     |                     | \$1       |                     | \$3       |   |

## Before acquisition integration charges

|                  |       |    |         |     |        |   |
|------------------|-------|----|---------|-----|--------|---|
| Operating profit | \$442 | 58 | % \$280 | 419 | % \$54 |   |
| Operating margin | 15.6  | %  | 12.7    | %   | 3.2    | % |

Net sales in 2011 increased 28% compared to 2010 due to higher core sales of 20%, an increase of 5% from the acquisition of businesses, and an increase of 3% from the favorable impact of foreign exchange. The increase in core sales was driven by global hydraulics markets, which grew particularly rapidly in the United States, and the positive impact of pricing actions implemented during the latter part of 2011 in response to increased raw material and commodity costs. Net sales in 2010 increased 31% compared to 2009 due to higher core sales of 30% and an increase of 1% from the favorable impact of foreign exchange. The increase in core sales was driven by global hydraulics markets, which rebounded from the depressed market conditions of 2009.



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Operating profit before acquisition integration charges in 2011 increased 58% from 2010, due to the same factors noted above that impacted Net sales. Operating profit before acquisition integration charges in 2010 increased 419% from 2009, primarily due to the increase in sales in 2010, net savings resulting from the workforce reductions taken in 2009, and manufacturing efficiencies resulting from higher sales volumes. These increases were partially offset by the cessation of temporary cost-savings measures introduced in 2009, higher raw material costs, and increased support costs as operations returned to normal operating levels compared to the depressed levels in 2009.

## Aerospace

|                                 | 2011    | Change<br>from 2010 | 2010    | Change<br>from 2009 | 2009    |
|---------------------------------|---------|---------------------|---------|---------------------|---------|
| Net sales                       | \$1,648 | 7 %                 | \$1,536 | (4 %)               | \$1,602 |
| Operating profit                | 244     | 11 %                | 220     | (10 %)              | 245     |
| Operating margin                | 14.8 %  |                     | 14.3 %  |                     | 15.3 %  |
| Acquisition integration charges | \$—     |                     | \$4     |                     | \$12    |

## Before acquisition integration charges

|                  |        |     |        |        |        |
|------------------|--------|-----|--------|--------|--------|
| Operating profit | \$244  | 9 % | \$224  | (13 %) | \$257  |
| Operating margin | 14.8 % |     | 14.6 % |        | 16.0 % |

Net sales in 2011 increased 7% compared to 2010 due to higher core sales of 6% and an increase of 1% from the favorable impact of foreign exchange. Growth in 2011 was primarily driven by higher customer demand in commercial OEM markets and commercial aftermarkets. Net sales in 2010 declined 4% compared to 2009, driven primarily by slow conditions in the commercial aftermarket, reduced production of commercial transports in the U.S., and a small decline in defense aerospace markets.

Operating profit before acquisition integration charges in 2011 increased 9% from 2010. The increase was primarily due to higher sales volumes and growth in the commercial markets noted above, partially offset by increased expenses stemming from changes in scope, program delays, and execution of new customer programs during the first half of 2011. Operating profit before acquisition integration charges in 2010 decreased 13% from 2009, primarily due to the decline in sales in 2010. The decline also reflected the cessation of temporary cost-savings measures introduced in 2009 and increased support costs.

## Truck

|                  | 2011    | Change<br>from 2010 | 2010    | Change<br>from 2009 | 2009    |
|------------------|---------|---------------------|---------|---------------------|---------|
| Net sales        | \$2,644 | 32 %                | \$1,997 | 37 %                | \$1,457 |
| Operating profit | 486     | 98 %                | 245     | 528 %               | 39      |
| Operating margin | 18.4 %  |                     | 12.3 %  |                     | 2.7 %   |

Net sales increased 32% in 2011 compared to 2010 due to an increase in core sales of 29% and an increase of 3% from the favorable impact of foreign exchange. The increase in core sales reflects the continuing rebound in global end markets and in particular strong growth in the NAFTA Class 8 truck market. Net sales increased 37% in 2010 compared to 2009 due to an increase in core sales of 32% and an increase of 5% from the favorable impact of foreign exchange. The increase in core sales reflects the sharp rebound in global end markets, led by a recovery in NAFTA heavy-duty truck markets and strong markets in Brazil truck and agriculture vehicle production.

Operating profit in 2011 increased 98% compared to 2010 primarily due to higher sales volumes in 2011 and the resulting manufacturing efficiencies. Operating profit in 2010 increased 528% from 2009 primarily due to the increase in sales in 2010, net savings resulting from the workforce reductions taken in 2009, and manufacturing efficiencies resulting from higher sales volumes. These increases were partially offset by the cessation of temporary cost-savings measures introduced in 2009, higher raw material costs, and increased support costs as operations returned to normal operating levels compared to the depressed levels in 2009.



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## Automotive

|                  | 2011    | Change<br>from 2010 | 2010    | Change<br>from 2009 | 2009    |
|------------------|---------|---------------------|---------|---------------------|---------|
| Net sales        | \$1,746 | 13 %                | \$1,547 | 26 %                | \$1,229 |
| Operating profit | 209     | 28 %                | 163     | NM                  | (10 )   |
| Operating margin | 12.0 %  |                     | 10.5 %  |                     | NM      |

Net sales increased 13% in 2011 compared to 2010 due to an increase in core sales of 12% and an increase of 2% from the favorable impact of foreign exchange, offset by a 1% decrease related to a business divestiture. The increase in core sales in 2011 is due to the continued rebound in global automotive markets. Net sales increased 26% in 2010 from 2009, reflecting a rebound in global automotive markets from the recessionary conditions of 2009.

Operating profit in 2011 increased 28% from 2010 primarily due to higher sales volumes. Operating profit in 2010 increased from 2009 primarily due to the increase in sales in 2010, net savings resulting from workforce reductions taken in 2009, and manufacturing efficiencies resulting from higher sales volumes. These increases were partially offset by the cessation of temporary cost-savings measures introduced in 2009 and increased support costs as operations returned to normal operating levels compared to the depressed levels in 2009.

## Corporate Expense

|   | 2011  | Change<br>from 2010 | 2010  | Change<br>from 2009 | 2009  |
|---|-------|---------------------|-------|---------------------|-------|
| Amortization of intangible assets                 | \$190 | 5 %                 | \$181 | 6 %                 | \$170 |
| Interest expense-net                              | 118   | (13 )%              | 136   | (9 )%               | 150   |
| Pension and other postretirement benefits expense | 142   | 18 %                | 120   | (43 )%              | 212   |
| Other corporate expense-net                       | 257   | 13 %                | 227   | 97 %                | 115   |
| Total corporate expense                           | \$707 | 6 %                 | \$664 | 3 %                 | \$647 |

Total Corporate expense increased 6% in 2011 to \$707 from \$664 in 2010 due to an 18% increase in Pension and other postretirement benefits expense primarily related to changes in the discount rate and asset return assumptions, a 13% increase in Other corporate expense-net due to the adjustment to the LIFO reserve and higher general corporate expense as Eaton continues to add resources to support its growth, and a 5% increase in Amortization of intangible assets resulting from acquisitions of businesses. Total Corporate expense increased 3% in 2010 to \$664 from \$647 in 2009 due primarily to a 97% increase in Other corporate expense-net as Eaton returned to normal operating levels in 2010 from the depressed levels of 2009, a pretax charge of \$36 related to a legal judgment in Brazil and higher expense associated with LIFO inventory. These items were partially offset by a 43% decrease in Pension and other postretirement benefits expense due to the absence of pension settlement and curtailment expense in 2010 that were incurred in 2009 as a result of limitations imposed by the Pension Protection Act on pension lump-sum distributions and the 2009 workforce reduction.

## 2012 FORWARD-LOOKING PERSPECTIVE

As of late February, Eaton estimates its end markets for all of 2012 will grow 5%, with markets in all six segments registering growth. The Company anticipates that it will outgrow its end markets in 2012 by approximately \$320 in Net sales. The incremental revenues in 2012 from recent acquisitions of businesses, net of a divestiture in 2011, are expected to total \$315. Overall, Eaton anticipates its revenues in 2012 will grow by 6% compared to 2011.

End markets for the Electrical Americas segment are expected to grow 5% in 2012.

End markets for the Electrical Rest of World segment are expected to grow 1% in 2012, with Asia Pacific growth of 3% and a 1% decline in Europe.

Global hydraulics markets are anticipated to grow 4% in 2012, with United States markets up 6% and non-United States markets up 2%.

End markets for the Aerospace segment are expected to grow 5% in 2012.



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End markets for the Truck segment are expected to grow 9% in 2012, with United States markets up 16% and non-United States markets up 4%.

End markets for the Automotive segment are expected to grow 5% in 2012, with United States automotive production up 7% and non-United States production up 4%.

## 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 \$1,500 of credit facilities, of which \$500 expires each year in 2012, 2013 and 2016, respectively. These facilities support Eaton's commercial paper borrowings. There were no borrowings outstanding under these revolving credit facilities at December 31, 2011. Eaton's non-United States operations also had available short-term lines of credit of approximately \$1,181 at December 31, 2011. 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.

During 2011, Eaton issued \$300 floating rate senior unsecured Notes due June 16, 2014. The Company also refinanced a \$500, five-year revolving credit facility which maintains long-term revolving credit facilities at a total of \$1,500. For additional information on these financing transactions, see Note 5 to the Consolidated Financial Statements.

Eaton's credit facilities and indentures governing certain long-term debt contain various covenants, the violation of which would limit or preclude the use of the credit facilities for future borrowings, or might accelerate the maturity of the related outstanding borrowings covered by the indentures. At Eaton's present credit rating level, the most restrictive financial covenant provides that the ratio of secured debt (or lease payments due under a sale and leaseback transaction) to adjusted consolidated net worth (or consolidated net tangible assets, in each case as defined in the relevant credit agreement or indenture) may not exceed 10%. In each case, the ratio was substantially below the required threshold. In addition, Eaton is in compliance with each of its debt covenants for all periods presented.

## Undistributed Assets of Non-U.S. Subsidiaries

At December 31, 2011, approximately 59% 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 \$1,248 in 2011, a decrease of \$34 compared to \$1,282 in 2010.

Operating cash flows in 2011 were primarily impacted by higher net income in 2011, which was more than offset by increased contributions to defined benefits plans, particularly contributions of \$154 to other postretirement benefits plans that were not contributed in 2010, and higher working capital requirements compared to 2010. For additional information on postretirement benefits plans, see Note 6 to the Consolidated Financial Statements.

Net cash provided by operating activities was \$1,282 in 2010, a decrease of \$126 compared to \$1,408 in 2009.

Operating cash flows in 2010 reflected higher net income of \$937 compared to \$385 in 2009. Higher net income in 2010 primarily resulted from increased sales due to the global economic recovery during the year and the positive effect of recent changes in the Company's cost structure. Cash provided by operating activities in 2010 was lowered by increased contributions to pension plans of \$403 compared to \$271 in 2009. Net working capital funding was neutral in 2010 compared to a source of funds of \$749 in 2009.





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## Investing Cash Flow

Net cash used in investing activities was \$800 in 2011, a decrease of \$212 compared to \$1,012 in 2010. The decrease in 2011 was principally due to cash proceeds of \$103 from the sale of short-term investments compared to purchases of \$392 in 2010, partially offset by an increase in capital expenditures to \$568 in 2011 from \$394 in 2010, both of which are related to higher liquidity requirements as the Company returns to growth from the depressed levels of 2009. Investing cash flow usage included \$325 related to the acquisitions of businesses, the largest of which were Internormen Technology Group, E. Begerow GmbH & Co. KG, and ACTOM Low Voltage. Higher capital expenditures were due to the Company's increased investments in property, plant and equipment to facilitate growth. Eaton expects \$600 in capital expenditures in 2012.

Net cash used in investing activities was \$1,012 in 2010, an increase of \$787 compared to \$225 in 2009. Investing cash flows in 2010 included \$394 in capital expenditures for property, plant and equipment, an increase of \$199 from the depressed level of spending of \$195 in 2009. Investing cash flows include \$222 related to the acquisitions of businesses primarily including CopperLogic, Wright Line Holding, Inc., and EMC Engineers. Acquisition expenditures in 2009 were \$10.

For additional information on business acquisitions see to Note 2 to the Consolidated Financial Statements.

## Financing Cash Flow

Net cash used in financing activities was \$381 in 2011, an increase of \$120 compared to a use of cash of \$261 in 2010. The increase was primarily due to share repurchases of \$343 in 2011 and an increase of \$99 in cash dividends paid in 2011 to Eaton common shareholders, partially offset by proceeds received from a \$300 debt issuance completed by Eaton during 2011. Higher cash dividends paid was due to an increase in the quarterly cash dividend paid per common share from \$1.08 to \$1.36 per share, which was announced during the first quarter of 2011.

Net cash used in financing activities was \$261 in 2010, a decrease of \$800 compared to \$1,061 in 2009. The decrease was primarily due to the use of cash in 2009 to markedly reduce long-term debt, with over \$887 of debt paid off during the year.

## Net-Debt-to-Capital Ratio

The net-debt-to-capital ratio was 26.5% at December 31, 2011 compared to 23.7% at December 31, 2010. The increase reflected the combined effect during 2011 of the \$315 increase in total debt, the \$87 decrease in cash and short-term investments, and the \$107 increase in Eaton shareholders' equity.

## Credit Ratings

A summary of Eaton's credit rating follows:

| Credit Rating Agency (long- /short-term rating) | Rating | Outlook        |
|---|--------|----------------|
| Standard & Poor's                               | A-/A-2 | Stable outlook |
| Moody's   | A3/P-2 | Stable outlook |
| Fitch   | A-/F2  | Stable outlook |

## Defined Benefits Plans

## Pension Plans

During 2011, the fair value of plan assets in the Company's employee pension plans increased \$144 to \$2,653 at December 31, 2011. The increase in plan assets was primarily due to contributions in excess of benefit payments and plan related expenses. At December 31, 2011, the net unfunded position of \$1,751 in pension liabilities consisted of \$1,086 in the U.S. Qualified Pension Plan, \$618 in plans that have no minimum funding requirements, and \$125 in all other plans that require minimum funding, partially offset by \$78 in plans that are overfunded.

Funding requirements are a major consideration in making contributions to Eaton's pension plans. With respect to the Company's pension plans worldwide, the Company intends to contribute annually not less than the minimum required by applicable law and regulations. In 2011, \$372 was contributed to the pension plans. The Company contributed \$304 to the U.S. Qualified Pension Plan in early 2012 and anticipates making an additional \$108 of contributions to certain pension plans during 2012. The funded status of the Company's pension plans at the end of 2012, and future contributions, will depend primarily on the actual return on assets during the year and the discount rate used to calculate certain benefits at the end of the year. Depending on these factors, and the resulting funded status of the pension plans, the level of future contributions could be materially higher or lower than in 2011.



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### Other Postretirement Benefits Plans

During 2011, Eaton contributed \$154 into a Voluntary Employee Benefit Association (VEBA) trust for the pre-funding of postretirement Medicare Part D prescription drug benefits for the Company's eligible United States employees and retirees.

### Off-Balance Sheet Arrangements

Eaton does not have off-balance sheet arrangements or financings with unconsolidated entities or other persons. In the ordinary course of business, the Company leases certain real properties and equipment, as described in Note 7 to the Consolidated Financial Statements.

## CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) in the United States requires management to make certain estimates and assumptions that may involve the exercise of significant judgment. For any estimate or assumption used, there may be other reasonable estimates or assumptions that may have been used. However, based on facts and circumstances inherent in developing estimates and assumptions, management believes it is unlikely that applying other such estimates and assumptions would have caused materially different amounts to have been reported. Actual results may differ from these estimates.

### Revenue Recognition

Sales of products are recognized when a sales agreement is in place, products have been shipped to unaffiliated customers and title has transferred in accordance with shipping terms (FOB shipping point, FOB destination or equivalent International Commercial (INCO) Terms), the selling price is fixed and determinable and collectability is reasonably assured, all significant related acts of performance have been completed, and no other significant uncertainties exist. Shipping and handling costs billed to customers are included in Net sales and the related costs in Cost of products sold. Although the majority of the sales agreements contain standard terms and conditions, there are also agreements that contain multiple elements or non-standard terms and conditions. As a result, judgment is required to determine the appropriate accounting, including whether the deliverables specified in these agreements should be treated as separate units of accounting for sales recognition purposes, and, if so, how the sales price should be allocated among the elements and when to recognize sales for each element. For delivered elements, sales are recognized only when the delivered elements have standalone value, fair values of undelivered elements are known, there are no uncertainties regarding customer acceptance and there are no customer-negotiated refund or return rights affecting the sales recognized for delivered elements. Sales for service contracts are generally recognized as the services are provided.

Eaton records reductions to revenue for customer and distributor incentives, primarily comprised of rebates, at the time of the initial sale. Rebates are estimated based on sales terms, historical experience, trend analysis and projected market conditions in the various markets served. The rebate programs offered vary across businesses due to the numerous markets Eaton serves, but the most common incentives relate to amounts paid or credited to customers for achieving defined volume levels or other objectives.

### Impairment of Goodwill and Other Long-Lived Assets

Goodwill and indefinite life intangible assets are evaluated annually for impairment as of July 1 using qualitative analysis, a discounted cash flow model and other valuation techniques. Additionally, goodwill and indefinite life intangible assets are evaluated for impairment whenever events or circumstances indicate there may be a possible permanent loss of value. Goodwill is tested for impairment at the reporting unit level, which is equivalent to Eaton's operating segments, and based on the net assets for each segment, including goodwill and intangible assets. Goodwill is assigned to each operating segment, as this represents the lowest level that constitutes a business and for which discrete financial information is available and is the level which management regularly reviews the operating results.

### Qualitative Analysis

In September 2011, the Financial Accounting Standards Board issued a revised standard on testing goodwill for impairment. The revised standard allows an entity to first assess the carrying value of goodwill based on qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than the reporting unit's carrying amount. If, based on a qualitative assessment, the fair value of a reporting unit is more likely than not

lower than its carrying value, the entity must then test goodwill from a quantitative perspective similar to prior guidance. This standard is effective for 2012, with early adoption permitted. Eaton elected to adopt this standard for its 2011 annual impairment testing.

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Impairment testing for 2011 was performed by assessing certain qualitative 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 2011, it is more likely than not that the fair value of Eaton's reporting units continues to substantially exceed the respective carrying amount.

### Quantitative Analysis

In 2010, goodwill was tested based on a discounted cash flow model to estimate the fair value of each operating segment, which considers forecasted cash flows discounted at an estimated weighted-average cost of capital. The Company selected the discounted cash flow methodology as it believes that it is comparable to what would be used by market participants. The forecasted cash flows are based on the Company's long-term operating plan, and a terminal value is used to estimate the operating segment's cash flows beyond the period covered by the operating plan. The weighted-average cost of capital is an estimate of the overall after-tax rate of return required by equity and debt market participants of a business enterprise. These analyses require the exercise of significant judgments, including judgments about appropriate discount rates, perpetual growth rates and the timing of expected future cash flows. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective operating segment. Sensitivity analyses are performed around these assumptions in order to assess the reasonableness of the assumptions and the resulting estimated fair values. For 2010, the fair value of Eaton's reporting units substantially exceeded the respective carrying values.

Indefinite life intangible assets primarily consist of trademarks. The fair value of these assets are determined using a royalty relief methodology similar to that employed when the associated assets were acquired, but using updated estimates of future sales, cash flows and profitability. For 2011, the fair value of indefinite lived intangible assets substantially exceeded the respective carrying value.

For additional information about goodwill and other intangible assets, see Note 4 to the Consolidated Financial Statements.

Long-lived assets, goodwill and indefinite life intangible assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Events or circumstances that may result in an impairment review include operations reporting losses, a significant adverse change in the use of an asset, the planned disposal or sale of the asset, a significant adverse change in the business climate or legal factors related to the asset, or a significant decrease in the estimated fair value of an asset. Upon indications of impairment, assets and liabilities are grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The asset group would be considered impaired when the estimated future net undiscounted cash flows generated by the asset group are less than its carrying value. In instances where the carrying amount of the asset group exceeded the undiscounted cash flows, the fair value of the asset group would be determined and an impairment loss would be recognized based on the amount by which the carrying value of the asset group exceeds its fair value. Determining asset groups and underlying cash flows requires the use of significant judgment.

### Recoverability of Deferred Income Tax Assets

Eaton is subject to the income tax laws in the jurisdictions in which it operates. In order to determine the income tax provision for financial statement purposes, Eaton must make significant estimates and judgments about its business operations in these jurisdictions. These estimates and judgments are also used in determining the deferred income tax assets and liabilities that have been recognized for differences between the financial statement and income tax basis of assets and liabilities, and income tax loss carryforwards and income tax credit carryforwards.

Management evaluates the realizability of deferred income tax assets for each jurisdiction in which it operates. If the Company experiences cumulative pretax income in a particular jurisdiction in a three-year period including the current and prior two years, management normally concludes that the deferred income tax assets will more likely than not be realizable and no valuation allowance is recognized, unless known or planned operating developments would lead management to conclude otherwise. However, if the Company experiences cumulative pretax losses in a particular jurisdiction in a three-year period including the current and prior two years, management then considers a series of factors in the determination of whether the deferred income tax assets can be realized. These factors include historical operating results, known or planned operating developments, the period of time over which certain temporary

differences will reverse, consideration of the utilization of certain deferred income tax liabilities, tax law carryback capability in a particular country, prudent and feasible tax planning strategies, and estimates of future earnings and taxable income using the same assumptions as the Company's goodwill and other impairment testing. After evaluation of these factors, if the deferred income tax assets are expected to be realized within the tax carryforward period allowed for that specific country, management would conclude that no valuation allowance would be required. To the extent that the deferred income tax assets exceed the amount that is expected to be realized within the tax carryforward period for a particular jurisdiction, management would establish a valuation allowance. For additional information about income taxes, see Note 8 to the Consolidated Financial Statements.

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### Pension and Other Postretirement Benefits Plans

The measurement of liabilities related to pension plans and other postretirement benefits plans is based on assumptions related to future events including interest rates, return on plan assets, rate of compensation increases, and health care cost trend rates. Actual plan asset performance will either reduce or increase losses included in accumulated other comprehensive loss, which ultimately affects net income.

The discount rate for United States plans was determined by discounting the expected future benefit payments using a theoretical zero-coupon spot yield curve derived from a universe of high-quality bonds as of the measurement date and solving for the single rate that generated the same benefit obligation. Only bonds rated Aa3 or better by Moody's Investor Services were included. Callable bonds and certain other bonds with uncertain pricing were eliminated. Finally, a subset of bonds was selected by grouping the universe of bonds by duration and retaining 50% of the bonds that had the highest yields.

The discount rates for non-United States plans are determined by region and are based on high quality long-term corporate and government bonds. Consideration has been given to the duration of the liabilities in each plan for selecting the bonds to be used in determining the discount rate.

Key assumptions used to calculate pension and other postretirement benefits expense are adjusted at each year-end. A 1-percentage point change in the assumed rate of return on pension plan assets is estimated to have approximately a \$32 effect on pension expense. Likewise, a 1-percentage point change in the discount rate is estimated to have approximately a \$53 effect on pension expense. A 1-percentage point change in the assumed rate of return on other postretirement benefits assets is estimated to have approximately a \$1 effect on other postretirement benefits expense. A 1-percentage point change in the discount rate is estimated to have approximately a \$4 effect on expense for other postretirement benefits plans. Additional information related to changes in key assumptions used to recognize expense for other postretirement benefits plans is found in Note 6 to the Consolidated Financial Statements.

### Environmental Contingencies

As a result of past operations, Eaton is involved in remedial response and voluntary environmental remediation at a number of sites, including certain of its currently-owned or formerly-owned plants. The Company has also been named a potentially responsible party under the federal Superfund law at a number of disposal sites.

A number of factors affect the cost of environmental remediation, including the number of parties involved at a particular site, the determination of the extent of contamination, the length of time the remediation may require, the complexity of environmental regulations, and the continuing advancement of remediation technology. Taking these factors into account, Eaton has estimated the costs of remediation, which will be incurred over a period of years. The Company accrues an amount on an undiscounted basis, consistent with the estimates of these costs, when it is probable that a liability has been incurred. At December 31, 2011 and 2010, \$62 and \$71 was accrued for these costs. Based upon Eaton's analysis and subject to the difficulty in estimating these future costs, the Company expects that any sum it may be required to pay in connection with environmental matters is not reasonably possible to exceed the recorded liability by an amount that would have a material effect on its financial position, results of operations or cash flows.

### MARKET RISK DISCLOSURE

On a regular basis, Eaton monitors third-party depository institutions that hold its cash and short-term investments, primarily for safety of principal and secondarily for maximizing yield on those funds. The Company diversifies its cash and short-term investments among counterparties to minimize exposure to any one of these entities. Eaton also monitors the creditworthiness of its customers and suppliers to mitigate any adverse impact.

Eaton uses derivative instruments to manage exposure to volatility in raw material costs, foreign currency and interest rates on certain debt instruments. Derivative financial instruments used by the Company are straightforward and non-leveraged; 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. See Note 12 to the Consolidated Financial Statements for additional information about hedges and derivative financial instruments.



Eaton's ability to access the commercial paper market, and the related cost of these borrowings, is based on the strength of its credit rating and overall market conditions. The Company has not experienced any material limitations in its ability to access these sources of liquidity. At December 31, 2011, Eaton had \$1,500 of long-term revolving credit facilities with banks in support of its commercial paper program. It has no direct borrowings outstanding under these credit facilities. Eaton's non-United States operations also had available short-term lines of credit of approximately \$1,181 at December 31, 2011.

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Interest rate risk can be measured by calculating the short-term earnings impact that would result from adverse changes in interest rates. This exposure results from short-term debt, which includes commercial paper at a floating interest rate, long-term debt that has been swapped to floating rates, and money market investments that have not been swapped to fixed rates. Based upon the balances of investments and floating rate debt at year end 2011, a 100 basis point increase in short-term interest rates would have increased the Company's net, pretax interest expense by \$3.2. Eaton also measures interest rate risk by estimating the net amount by which the fair value of the Company's financial liabilities would change as a result of movements in interest rates. Based on Eaton's best estimate for a hypothetical, 100 basis point decrease in interest rates at December 31, 2011, the market value of the Company's debt and interest rate swap portfolio, in aggregate, would increase by \$211.

Foreign currency risk is the risk of economic losses due to adverse changes in foreign currency exchange rates. The Company mitigates foreign currency risk by funding some investments in foreign markets through local currency financings. Such non-United States dollar debt was \$154 at December 31, 2011. To augment Eaton's non-United States dollar debt portfolio, the Company also enters into forward foreign exchange contracts and foreign currency swaps from time to time to mitigate the risk of economic loss in its foreign investments. At December 31, 2011, the aggregate balance of such contracts was \$341. Eaton also monitors exposure to transactions denominated in currencies other than the functional currency of each country in which the Company operates, and regularly enters into forward contracts to mitigate that exposure. In the aggregate, Eaton's portfolio of forward contracts related to such transactions was not material to its Consolidated Financial Statements.

**CONTRACTUAL OBLIGATIONS**

A summary of contractual obligations as of December 31, 2011 follows:

|  | 2012    | 2013<br>to<br>2014 | 2015<br>to<br>2016 | After<br>2016 | Total   |
|--|---------|--------------------|--------------------|---------------|---------|
| Long-term debt <sup>(1)</sup>  | \$321   | \$880              | \$104              | \$2,197       | \$3,502 |
| Interest expense related to long-term debt   | 185     | 313                | 276                | 970           | 1,744   |
| Reduction of interest expense from interest rate swap agreements related to long-term debt | (36 )   | (54 )              | (33 )              | (77 )         | (200 )  |
| Operating leases   | 146     | 210                | 115                | 79            | 550     |
| Purchase obligations   | 624     | 75                 | 62                 | 108           | 869     |
| Other long-term obligations  | 420     | 24                 | 24                 | 32            | 500     |
| Total  | \$1,660 | \$1,448            | \$548              | \$3,309       | \$6,965 |

<sup>(1)</sup> Long-term debt excludes deferred gains and losses on derivatives related to debt, adjustments to fair market value, and premiums and discounts on long-term debentures.

Interest expense related to long-term debt is based on the fixed interest rate, or other applicable interest rate, related to the debt instrument. The reduction of interest expense due to interest rate swap agreements related to long-term debt is based on the difference in the fixed interest rate the Company receives from the swap, compared to the floating interest rate the Company pays on the swap. Purchase obligations are entered into with various vendors in the normal course of business. These amounts include commitments for purchases of raw materials, outstanding non-cancelable purchase orders, releases under blanket purchase orders and commitments under ongoing service arrangements. Other long-term obligations principally include anticipated contributions of \$412 to pension plans in 2012 and \$81 of deferred compensation earned under various plans for which the participants have elected to receive disbursement at a later date.

The table above does not include future expected pension benefit payments or expected other postretirement benefits payments. Information related to the amounts of these future payments is described in Note 6 to the Consolidated Financial Statements. The table above also excludes the liability for unrecognized income tax benefits, since the Company cannot predict with reasonable certainty the timing of cash settlements with the respective taxing authorities. At December 31, 2011, the gross liability for unrecognized income tax benefits totaled \$236 and interest

and penalties were \$29.

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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 December 31, 2011, the Company has a total accrual of 70 Brazilian Reais related to this matter (\$37 based on current exchange rates), comprised of 60 Brazilian Reais recognized in the fourth quarter of 2010 (\$32 based on current exchange rates) with an additional 10 Brazilian Reais recognized in 2011 (\$5 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. On September 27, 2011, the Superior Court of Justice accepted two of the appeals and on November 21, 2011, Eaton's remaining appeal was accepted. These appeals 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 has appealed the liability finding and the injunction to the Third Circuit Court of Appeals. Meritor has cross-appealed the finding of zero damages. Accordingly, an estimate of any potential loss related to this action cannot be made at this time.

**FORWARD-LOOKING STATEMENTS**

This Annual Report to Shareholders contains forward-looking statements concerning Eaton's full year 2012 sales, the performance in 2012 of its worldwide end markets, and Eaton's 2012 growth in relation to end markets, among 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," "predict," "project" 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; strikes or other labor unrest; the impact of acquisitions and divestitures; unanticipated difficulties integrating acquisitions; new laws and governmental regulations; interest rate changes; tax rate changes or exposure to additional income tax liability; stock 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.



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## QUARTERLY DATA (unaudited)

| (In millions except per share data)                           | Quarter ended in 2011 |          |         |         | Quarter ended in 2010 |          |         |         |
|---|-----------------------|----------|---------|---------|-----------------------|----------|---------|---------|
|   | Dec. 31               | Sept. 30 | June 30 | Mar. 31 | Dec. 31               | Sept. 30 | June 30 | Mar. 31 |
| Net sales   | \$4,033               | \$4,123  | \$4,090 | \$3,803 | \$3,663               | \$3,571  | \$3,378 | \$3,103 |
| Gross profit  | 1,216                 | 1,223    | 1,228   | 1,121   | 1,098                 | 1,091    | 991     | 902     |
| Percent of net sales  | 30.2                  | % 29.7   | % 30.0  | % 29.5  | % 30.0                | % 30.6   | % 29.3  | % 29.1  |
| Income before income taxes                                    | 390                   | 432      | 396     | 335     | 293                   | 305      | 251     | 187     |
| Net income  | \$361                 | \$367    | \$338   | \$286   | \$283                 | \$269    | \$229   | \$156   |
| Adjustment for net loss (income) for noncontrolling interests | 1                     | (2 )     | (2 )    | 1       | (3 )                  | (1 )     | (3 )    | (1 )    |
| Net income attributable to Eaton common shareholders          | \$362                 | \$365    | \$336   | \$287   | \$280                 | \$268    | \$226   | \$155   |
| Net income per common share                                   |                       |          |         |         |                       |          |         |         |
| Diluted   | \$1.07                | \$1.07   | \$0.97  | \$0.83  | \$0.82                | \$0.78   | \$0.66  | \$0.46  |
| Basic   | \$1.08                | \$1.07   | \$0.99  | \$0.84  | \$0.83                | \$0.80   | \$0.67  | \$0.46  |
| Cash dividends paid per common share                          | \$0.34                | \$0.34   | \$0.34  | \$0.34  | \$0.29                | \$0.29   | \$0.25  | \$0.25  |
| Market price per common share                                 |                       |          |         |         |                       |          |         |         |
| High  | \$47.44               | \$53.23  | \$56.42 | \$56.49 | \$51.35               | \$42.17  | \$40.89 | \$38.47 |
| Low   | \$33.09               | \$33.97  | \$45.79 | \$48.57 | \$40.49               | \$31.48  | \$32.66 | \$30.42 |

Earnings per share for the four quarters in a year may not equal full year earnings per share.

Significant non-recurring adjustments included in Income before income taxes are as follows:

| Acquisition integration charges | Quarter ended in 2011 |          |         |         | Quarter ended in 2010 |          |         |         |
|---------------------------------|-----------------------|----------|---------|---------|-----------------------|----------|---------|---------|
|                                 | Dec. 31               | Sept. 30 | June 30 | Mar. 31 | Dec. 31               | Sept. 30 | June 30 | Mar. 31 |
|                                 | \$5                   | \$4      | \$2     | \$3     | \$15                  | \$7      | \$9     | \$9     |

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## TEN-YEAR CONSOLIDATED FINANCIAL SUMMARY (unaudited)

(In millions  
except for per  
share data)Continuing  
operations

|  | 2011     | 2010     | 2009     | 2008     | 2007     | 2006     | 2005     | 2004    | 2003    | 2002    |
|--|----------|----------|----------|----------|----------|----------|----------|---------|---------|---------|
| Net sales  | \$16,049 | \$13,715 | \$11,873 | \$15,376 | \$13,033 | \$12,232 | \$10,874 | \$9,547 | \$7,796 | \$6,983 |
| Income before<br>income taxes                                    | 1,553    | 1,036    | 303      | 1,140    | 1,055    | 979      | 969      | 756     | 475     | 378     |
| Income after<br>income taxes                                     | \$1,352  | \$937    | \$385    | \$1,067  | \$973    | \$907    | \$788    | \$633   | \$368   | \$272   |
| Income from<br>discontinued<br>operations                        | —        | —        | —        | 3        | 35       | 53       | 22       | 22      | 30      | 23      |
| Net income   | 1,352    | 937      | 385      | 1,070    | 1,008    | 960      | 810      | 655     | 398     | 295     |
| Less net income<br>for noncontrolling<br>interests               | (2)      | (8)      | (2)      | (12)     | (14)     | (10)     | (5)      | (7)     | (12)    | (14)    |
| Net income<br>attributable to<br>Eaton<br>common<br>shareholders | \$1,350  | \$929    | \$383    | \$1,058  | \$994    | \$950    | \$805    | \$648   | \$386   | \$281   |

Net income per  
common share -  
diluted

|                            |        |        |        |        |        |        |        |        |        |        |
|----------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Continuing<br>operations   | \$3.93 | \$2.73 | \$1.14 | \$3.25 | \$3.19 | \$2.94 | \$2.54 | \$2.00 | \$1.18 | \$0.90 |
| Discontinued<br>operations | —      | —      | —      | 0.01   | 0.12   | 0.17   | 0.08   | 0.07   | 0.10   | 0.08   |
| Total                      | \$3.93 | \$2.73 | \$1.14 | \$3.26 | \$3.31 | \$3.11 | \$2.62 | \$2.07 | \$1.28 | \$0.98 |

Net income per  
common share -  
basic

|                            |        |        |        |        |        |        |        |        |        |        |
|----------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Continuing<br>operations   | \$3.98 | \$2.76 | \$1.16 | \$3.29 | \$3.26 | \$2.99 | \$2.61 | \$2.05 | \$1.20 | \$0.91 |
| Discontinued<br>operations | —      | —      | —      | 0.01   | 0.12   | 0.17   | 0.07   | 0.07   | 0.11   | 0.09   |
| Total                      | \$3.98 | \$2.76 | \$1.16 | \$3.30 | \$3.38 | \$3.16 | \$2.68 | \$2.12 | \$1.31 | \$1.00 |

Weighted-average  
number of  
common  
shares  
outstanding

|         |       |       |       |       |       |       |       |       |       |       |
|---------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Diluted | 342.8 | 339.5 | 335.8 | 324.6 | 300.6 | 305.8 | 308.0 | 314.2 | 301.0 | 286.8 |
| Basic   | 338.3 | 335.5 | 332.7 | 320.4 | 294.6 | 300.4 | 300.4 | 306.2 | 295.8 | 282.4 |

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|  |          |          |          |          |          |          |          |         |         |         |
|--|----------|----------|----------|----------|----------|----------|----------|---------|---------|---------|
| Cash dividends<br>paid per common<br>share           | \$1.36   | \$1.08   | \$1.00   | \$1.00   | \$0.86   | \$0.74   | \$0.62   | \$0.54  | \$0.46  | \$0.44  |
| Total assets   | \$17,873 | \$17,252 | \$16,282 | \$16,655 | \$13,430 | \$11,417 | \$10,218 | \$9,075 | \$8,223 | \$7,138 |
| Long-term debt                                       | 3,366    | 3,382    | 3,349    | 3,190    | 2,432    | 1,774    | 1,830    | 1,734   | 1,651   | 1,887   |
| Total debt   | 3,773    | 3,458    | 3,467    | 4,271    | 3,417    | 2,586    | 2,464    | 1,773   | 1,953   | 2,088   |
| Eaton<br>shareholders'<br>equity                     | 7,469    | 7,362    | 6,777    | 6,317    | 5,172    | 4,106    | 3,778    | 3,606   | 3,117   | 2,302   |
| Eaton<br>shareholders'<br>equity per<br>common share | \$22.34  | \$21.66  | \$20.39  | \$19.14  | \$17.71  | \$14.04  | \$12.72  | \$11.76 | \$10.19 | \$8.15  |
| Common shares<br>outstanding                         | 334.4    | 339.9    | 332.3    | 330.0    | 292.0    | 292.6    | 297.0    | 306.6   | 306.0   | 282.4   |



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Eaton Corporation

2011 Annual Report on Form 10-K

Exhibit Index

- 3 (i) 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 (ii) 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 (a) 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
  - (a) Senior Executive Incentive Compensation Plan (effective January 1, 2008) - Incorporated by reference to the definitive Proxy Statement dated March 14, 2008
  - (b) Executive Incentive Compensation Plan (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2005
  - (c) 2005 Non-Employee Director Fee Deferral Plan (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (d) Deferred Incentive Compensation Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (e) Excess Benefits Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (f) Incentive Compensation Deferral Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (g) Limited Eaton Service Supplemental Retirement Income Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (h) Supplemental Benefits Plan II (2008 restatement) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (i) Form of Restricted Share Unit Agreement (2 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (j) Form of Restricted Share Unit Agreement (4 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (k) Form of Restricted Share Agreement (2 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
  - (l) Form of Restricted Share Agreement (4 year vesting) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007

- (m) Form of Restricted Share Agreement (Non-Employee Directors) - Incorporated by reference to the Form 8-K Report filed February 1, 2010
- (n) Form of Stock Option Agreement for Executives (2008) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (o) Form of Stock Option Agreement for Executives - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2006
- (p) Form of Stock Option Agreement for Non-Employee Directors (2008) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (q) 2002 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 15, 2002

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- (r) 2004 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 19, 2004
- (s) 2008 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 14, 2008
- (t) 2009 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 13, 2009
- (u) Plan for the Deferred Payment of Directors' Fees (originally adopted in 1985 and amended effective September 24, 1996, January 28, 1998, January 23, 2002, February 24, 2004, December 8, 2004 and, in certain respects, January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (v) 1996 Non-Employee Director Fee Deferral Plan (amended and restated effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2006
- (w) Form of Change of Control Agreement entered into with officers of Eaton Corporation - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2008
- (x) Form of Indemnification Agreement entered into with officers of Eaton Corporation - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (y) Form of Indemnification Agreement entered into with directors of Eaton Corporation - Incorporated by reference to the Form 8-K Report filed January 26, 2007
- (z) Executive Strategic Incentive Plan (amended and restated January 1, 2008) - Incorporated by reference to the definitive Proxy Statement dated March 14, 2008
- (aa) Executive Strategic Incentive Plan II (effective January 1, 2001) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (bb) Supplemental Executive Strategic Incentive Plan (effective as of June 25, 2008) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2008
- (cc) Deferred Incentive Compensation Plan (amended and restated effective November 1, 2007) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2009
- (dd) 1998 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 13, 1998
- (ee) Incentive Compensation Deferral Plan (amended and restated October 1, 1997) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2000
- (ff) Trust Agreement - Officers and Employees (dated December 6, 1996) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (gg) Trust Agreement - Non-employee Directors (dated December 6, 1996) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (hh) Group Replacement Insurance Plan (GRIP) (effective June 1, 1992) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 1992

- (ii) 1991 Stock Option Plan - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (jj) Excess Benefits Plan (amended and restated effective January 1, 1989) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (kk) Supplemental Benefits Plan (amended and restated January 1, 1989) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002
- (ll) Eaton Corporation Board of Directors Policy on Incentive Compensation, Stock Options and Other Equity Grants upon the Restatement of Financial Results - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2007
- (mm) Amended and Restated Grantor Trust Agreement for Non-Employee Directors' Deferred Fees Plans - effective January 1, 2010 - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2010

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|         |  |
|---------|--|
| (nn)    | Amended and Restated Grantor Trust Agreement for Employees' Deferred Compensation Plans - effective January 1, 2010 - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2010 |
| 12      | Ratio of Earnings to Fixed Charges - Filed in conjunction with this Form 10-K Report *   |
| 14      | Code of Ethics - Incorporated by reference to the definitive Proxy Statement filed on March 14, 2008   |
| 21      | Subsidiaries of Eaton Corporation - Filed in conjunction with this Form 10-K Report *  |
| 23      | Consent of Independent Registered Public Accounting Firm - Filed in conjunction with this Form 10-K Report *   |
| 24      | Power of Attorney - Filed in conjunction with this Form 10-K Report *  |
| 31.1    | Certification of Chief Executive Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 302) - Filed in conjunction with this Form 10-K Report *   |
| 31.2    | Certification of Chief Financial Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 302) - Filed in conjunction with this Form 10-K Report *   |
| 32.1    | Certification of Chief Executive Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 906) - Filed in conjunction with this Form 10-K Report *   |
| 32.2    | Certification of Chief Financial Officer (Pursuant to the Sarbanes-Oxley Act of 2002, Section 906) - Filed in conjunction with this Form 10-K 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 Definition Linkbase Document *   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document *  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document *   |

\* Submitted electronically herewith.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Income for the years ended December 31, 2011, 2010 and 2009, (ii) Consolidated Balance Sheets at December 31, 2011 and 2010, (iii) Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009, (iv) Notes to Consolidated Financial Statements for the year ended December 31, 2011.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K 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.