HARLEY DAVIDSON INC
Form 10-Q
August 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 1, 2018
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-9183

Harley-Davidson, Inc.
(Exact name of registrant as specified in its charter)

Wisconsin	39-1382325
(State of organization)	(I.R.S. Employer Identification No.)
3700 West Juneau Avenue Milwaukee, Wisconsin	53208
(Address of principal executive offices)	(Zip code)

Registrants telephone number: (414) 342-4680
None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer”, “smaller reporting company,” and emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the exchange act. ¨
Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Exchange Act. Yes ¨ No x
Number of shares of the registrant’s common stock outstanding at August 3, 2018: 166,554,483 shares

Harley-Davidson, Inc.

Form 10-Q

For The Quarter Ended July 1, 2018

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements
HARLEY-DAVIDSON, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)
(Unaudited)

	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Revenue:				
Motorcycles and Related Products	$1,525,121	$1,577,135	$2,889,068	$2,905,846
Financial Services	188,102	188,034	366,276	361,255
Total revenue	1,713,223	1,765,169	3,255,344	3,267,101
Costs and expenses:				
Motorcycles and Related Products cost of goods sold	993,036	1,004,173	1,883,210	1,858,061
Financial Services interest expense	51,943	44,408	100,393	87,697
Financial Services provision for credit losses	18,880	26,217	48,932	69,806
Selling, administrative and engineering expense	313,047	291,084	603,233	563,068
Restructuring expense	12,370	—	59,212	—
Total costs and expenses	1,389,276	1,365,882	2,694,980	2,578,632
Operating income	323,947	399,287	560,364	688,469
Other income (expense), net	645	2,295	865	4,591
Investment income	2,533	577	3,736	1,456
Interest expense	7,728	7,726	15,418	15,399
Income before provision for income taxes	319,397	394,433	549,547	679,117
Provision for income taxes	77,059	135,566	132,446	233,881
Net income	$242,338	$258,867	$417,101	$445,236
Earnings per common share:				
Basic	$1.45	$1.48	$2.49	$2.54
Diluted	$1.45	$1.48	$2.48	$2.53
Cash dividends per common share	$0.370	$0.365	$0.740	$0.730

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

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HARLEY-DAVIDSON, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Net income	$242,338	$258,867	$417,101	$445,236
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(26,482)	9,637	(19,567)	25,194
Derivative financial instruments	23,920	(10,412)	24,685	(19,464)
Marketable securities	—	1,204	—	1,194
Pension and postretirement benefit plans	12,402	7,256	98,167	14,512
Total other comprehensive income, net of tax	9,840	7,685	103,285	21,436
Comprehensive income	$252,178	$266,552	$520,386	$466,672

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

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HARLEY-DAVIDSON, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	(Unaudited) July 1, 2018	December 31, 2017	(Unaudited) June 25, 2017
ASSETS			
Current assets:			
Cash and cash equivalents	$978,749	$687,521	$988,476
Accounts receivable, net	335,594	329,986	330,933
Finance receivables, net	2,252,956	2,105,662	2,338,533
Inventories	465,373	538,202	372,012
Restricted cash	44,386	47,518	63,225
Other current assets	166,362	175,853	151,423
Total current assets	4,243,420	3,884,742	4,244,602
Finance receivables, net	5,060,246	4,859,424	4,994,002
Property, plant and equipment, net	904,113	967,781	946,326
Prepaid pension costs	131,497	19,816	—
Goodwill	55,451	55,947	54,630
Deferred income taxes	67,505	109,073	170,358
Other long-term assets	83,790	75,889	77,853
	$10,546,022	$9,972,672	$10,487,771
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	$287,214	$227,597	$327,346
Accrued liabilities	572,440	529,822	533,412
Short-term debt	1,327,307	1,273,482	928,445
Current portion of long-term debt, net	945,463	1,127,269	1,565,558
Total current liabilities	3,132,424	3,158,170	3,354,761
Long-term debt, net	4,868,346	4,587,258	4,678,350
Pension liability	55,819	54,606	51,797
Postretirement healthcare liability	113,464	118,753	166,023
Other long-term liabilities	214,443	209,608	190,673
Commitments and contingencies (Note 15)			
Shareholders' equity:			
Preferred stock, none issued	—	—	—
Common stock	1,818	1,813	1,813
Additional paid-in-capital	1,442,580	1,422,808	1,404,428
Retained earnings	1,906,015	1,607,570	1,654,457
Accumulated other comprehensive loss	(396,764)	(500,049)	(543,945)
Treasury stock, at cost	(792,123)	(687,865)	(470,586)
Total shareholders' equity	2,161,526	1,844,277	2,046,167
	$10,546,022	$9,972,672	$10,487,771

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HARLEY-DAVIDSON, INC.
CONSOLIDATED BALANCE SHEETS (continued)
(In thousands)

	(Unaudited) July 1, 2018	December 31, 2017	(Unaudited) June 25, 2017
Balances held by consolidated variable interest entities (Note 11)			
Current finance receivables, net	$ 139,405	$ 194,813	$ 217,348
Other assets	$ 1,280	$ 2,148	$ 2,170
Non-current finance receivables, net	$ 392,901	$ 521,940	$ 653,683
Restricted cash - current and non-current	$ 39,757	$ 48,706	$ 62,973
Current portion of long-term debt, net	$ 155,631	$ 209,247	$ 241,754
Long-term debt, net	$ 313,799	$ 422,834	$ 559,379

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

HARLEY-DAVIDSON, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six months ended	
	July 1, 2018	June 25, 2017
Net cash provided by operating activities (Note 7)	$735,859	$627,068
Cash flows from investing activities:		
Capital expenditures	(69,293)	(69,816)
Origination of finance receivables	(1,999,786)	(1,977,839)
Collections on finance receivables	1,712,884	1,647,799
Other	(11,758)	7,031
Net cash used by investing activities	(367,953)	(392,825)
Cash flows from financing activities:		
Proceeds from issuance of medium-term notes	1,144,018	893,668
Repayments of medium-term notes	(877,488)	(400,000)
Repayments of securitization debt	(183,453)	(275,659)
Borrowings of asset-backed commercial paper	120,903	341,625
Repayments of asset-backed commercial paper	(100,660)	(77,732)
Net increase (decrease) in credit facilities and unsecured commercial paper	56,280	(128,787)
Dividends paid	(124,680)	(128,452)
Purchase of common stock for treasury	(111,227)	(243,055)
Issuance of common stock under employee stock option plans	1,965	7,432
Net cash used by financing activities	(74,342)	(10,960)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(10,091)	12,457
Net increase in cash, cash equivalents and restricted cash	$283,473	$235,740
Cash, cash equivalents and restricted cash:		
Cash, cash equivalents and restricted cash—beginning of period	$746,210	$827,131
Net increase in cash, cash equivalents and restricted cash	283,473	235,740
Cash, cash equivalents and restricted cash—end of period	$1,029,683	$1,062,871
Reconciliation of cash, cash equivalents and restricted cash to the Consolidated Balance Sheet:		
Cash and cash equivalents	$978,749	$988,476
Restricted cash	44,386	63,225
Restricted cash included in other long-term assets	6,548	11,170
Total cash, cash equivalents and restricted cash shown in the Statement of Cash Flows	$1,029,683	$1,062,871

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

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HARLEY-DAVIDSON, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Use of Estimates

The consolidated financial statements include the accounts of Harley-Davidson, Inc. and its wholly-owned subsidiaries (the Company), including the accounts of the groups of companies doing business as Harley-Davidson Motor Company (HDMC) and Harley-Davidson Financial Services (HDFS). In addition, certain variable interest entities (VIEs) related to secured financing are consolidated as the Company is the primary beneficiary. All intercompany accounts and material intercompany transactions are eliminated.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the consolidated balance sheets as of July 1, 2018 and June 25, 2017, the consolidated statements of income for the three and six month periods then ended, the consolidated statements of comprehensive income for the three and six month periods then ended and the consolidated statements of cash flows for the six month periods then ended.

Certain information and footnote disclosures normally included in complete financial statements have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and U.S. generally accepted accounting principles (U.S. GAAP) for interim financial reporting. These consolidated financial statements should be read in conjunction with the audited financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

The Company operates in two reportable segments: Motorcycles & Related Products (Motorcycles) and Financial Services.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

2. New Accounting Standards

Accounting Standards Recently Adopted

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09 Revenue from Contracts with Customers (ASU 2014-09). ASU 2014-09 is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The Company adopted ASU 2014-09 on January 1, 2018. The Company applied the standard to all contracts using the modified retrospective method. As such, the Company recognized the cumulative effect of the adoption as an adjustment to the opening balance of retained earnings. The comparative information has not been restated.

The majority of the Company’s Motorcycles and Related Products revenue will continue to be recognized when products are shipped to customers. For a limited number of vehicle sales where revenue was previously deferred due to a guaranteed resale value the Company will now recognize revenue when those vehicles are shipped in accordance with ASU 2014-09. The Company recorded a net increase to the opening balance of retained earnings of $6.0 million, net of income taxes, as of January 1, 2018 as a result of adopting ASU 2014-09. The Company also adjusted other assets and accrued liabilities associated with these vehicle sales in connection with its adoption of ASU 2014-09.

The majority of the Financial Services segment’s revenues relate to loan and servicing activities which are outside the scope of this guidance. Financial Services revenues that fall under the scope of ASU 2014-09 continue to be recognized at the point of sale, or over the estimated life of the contract, as appropriate.

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The following tables illustrate the impact of adoption of ASU 2014-09 on the consolidated statements of income and the consolidated balance sheet (in thousands):

Consolidated Statements of Income

	Three months ended July 1, 2018			Six months ended July 1, 2018		
	As Reported	Without Adoption of ASC 606	Effect of Change	As Reported	Without Adoption of ASC 606	Effect of Change
Revenue:						
Motorcycles and Related Products	$1,525,121	$1,500,384	$24,737	$2,889,068	$2,868,368	$20,700
Costs and expenses:						
Motorcycles and Related Products cost of goods sold	$993,036	$974,385	$18,651	$1,883,210	$1,864,623	$18,587
Operating income	$323,947	$317,861	$6,086	$560,364	$558,251	$2,113
Income before provision for income taxes	$319,397	$313,311	$6,086	$549,547	$547,434	$2,113
Provision for income taxes	$77,059	$75,584	$1,475	$132,446	$131,934	$512
Net income	$242,338	$237,727	$4,611	$417,101	$415,500	$1,601

Consolidated Balance Sheet

	July 1, 2018		
	As Reported	Without Adoption of ASC 606	Effect of Change
ASSETS			
Other current assets	$166,362	$201,405	$(35,043)
Deferred income taxes	$67,505	$69,353	$(1,848)
LIABILITIES AND SHAREHOLDERS' EQUITY			
Accrued liabilities	$572,440	$616,956	$(44,516)
Retained earnings	$1,906,015	$1,898,390	$7,625

In March 2017, the FASB issued ASU No. 2017-07 Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (ASU 2017-07). ASU 2017-07 amends ASC 715, Compensation - Retirement Benefits by requiring employers to present the service cost component of net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Other components of the net periodic benefit cost will be presented separately from the line item that includes the service cost and outside of any subtotal of operating income. The guidance also limits the components that are eligible for capitalization in assets. The Company adopted ASU 2017-07 retrospectively on January 1, 2018. As a result, the non-service cost components of net periodic benefit cost have been presented in Other income (expense), net and the prior period has been recast to reflect the new presentation. The Company elected the practical expedient allowing the use of previously disclosed benefit components as the basis for the retrospective application. Net periodic benefit credit (cost) previously recorded in Motorcycles and Related Products cost of goods sold and Selling, administrative and engineering expense of $2.7 million and $(0.4) million, respectively, for the three months ended June 25, 2017, and $5.3 million and $(0.7) million, respectively, for the six months ended June 25, 2017, has been reclassified to Other income (expense), net.

In November 2016, the FASB issued ASU No. 2016-18 Statement of Cash Flows (Topic 230): Restricted Cash (ASU 2016-18). ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. As such, restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company adopted ASU 2016-18 on January 1, 2018 on a retrospective basis. As a result, the change in restricted cash has been excluded from financing activities and included in the change in cash, cash equivalents and restricted cash and the prior period has been recast to reflect the new presentation.

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In January 2016, the FASB issued ASU No. 2016-01 Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01). ASU 2016-01 enhances the existing financial instruments reporting model by modifying fair value measurement tools, simplifying impairment assessments for certain equity instruments and modifying overall presentation and disclosure requirements. The ASU was subsequently amended by ASU No. 2018-03 and ASU No. 2018-04. The Company adopted ASU 2016-01 on January 1, 2018 on a prospective basis. The adoption of ASU 2016-01 did not have a material impact on its financial statements.

In August 2016, the FASB issued ASU No. 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (ASU 2016-15). ASU 2016-15 addresses eight specific cash flow items with the objective of reducing diversity in practice regarding how certain cash receipts and cash payments are presented in the statement of cash flows. The Company adopted ASU 2016-15 on January 1, 2018 on a retrospective basis. The adoption of ASU 2016-15 did not have a material impact on its financial statements.

In October 2016, the FASB issued ASU No. 2016-16 Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory (ASU 2016-16). ASU 2016-16 states that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The Company adopted ASU 2016-16 on January 1, 2018 using a modified retrospective approach. The adoption of ASU 2016-16 did not have a material impact on its financial statements.

Accounting Standards Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02 Leases (Topic 842) (ASU 2016-02). ASU 2016-02 amends the existing lease accounting model by requiring a lessee to recognize the rights and obligations resulting from certain leases as assets and liabilities on the balance sheet. ASU 2016-02 also requires a company to disclose key information about their leasing arrangements. The Company is required to adopt ASU 2016-02 for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 using a modified retrospective approach. Early adoption is permitted. The Company is currently in the process of gathering and analyzing information necessary to quantify the impact of adopting ASU 2016-02 and evaluating the transition practical expedients it will apply upon adoption. The Company anticipates the adoption of ASU 2016-02 will result in an increase in assets and liabilities recognized on the balance sheet related to its lease arrangements.

In July 2016, the FASB issued ASU No. 2016-13 Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13). ASU 2016-13 changes how to recognize expected credit losses on financial assets. The standard requires a more timely recognition of credit losses on loans and other financial assets and also provides additional transparency about credit risk. The current credit loss standard generally requires that a loss actually be incurred before it is recognized, while the new standard will require recognition of full lifetime expected losses upon initial recognition of the financial instrument. The Company is required to adopt ASU 2016-13 for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2019 on a modified retrospective basis. Early adoption is permitted for fiscal years beginning after December 15, 2018. An entity should apply the standard by recording a cumulative effect adjustment to retained earnings upon adoption. Adoption of this standard will impact how the Company recognizes credit losses on its financial instruments. The Company is currently evaluating the impact of adoption of ASU 2016-13 but anticipates the adoption of ASU 2016-13 will result in an increase in the annual provision for credit losses and the related allowance for credit losses.

In January 2017, the FASB issued ASU No. 2017-04 Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (ASU 2017-04). ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating the requirement to calculate the implied fair value of goodwill. Rather, the goodwill impairment is calculated by comparing the fair value of a reporting unit to its carrying value, and an impairment loss is recognized for the amount by which the carrying amount exceeds the fair value, limited to the total goodwill allocated to the reporting unit. All reporting units apply the same impairment test under the new standard. The Company is required to adopt ASU 2017-04 for its annual and any interim goodwill impairment tests in fiscal years beginning after December 15, 2019 on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017.

In August 2017, the FASB issued ASU No. 2017-12 Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities (ASU 2017-12). ASU 2017-12 amends ASC 815, Derivatives and Hedging to improve the financial reporting of hedging relationships and to simplify the application of the hedge accounting guidance. The ASU makes various updates to the hedge accounting model, including changing the recognition and presentation of changes in the fair value of the hedging instrument and amending disclosure requirements, among other things. The Company is required to adopt ASU 2017-12 for fiscal years beginning after December 15, 2018, and for interim periods within those fiscal years. Early adoption is permitted in any interim period after issuance of the ASU. For cash flow and net investment hedges existing at the date of adoption, the Company must apply a cumulative-effect adjustment as of the beginning of the fiscal year in which the standard

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is adopted. The amendments related to presentation and disclosure are required prospectively. The Company is currently evaluating the impact of adoption of ASU 2017-12.

In February 2018, the FASB issued ASU No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (ASU 2018-02). Under existing U.S. GAAP, the effects of changes in tax rates and laws on deferred tax balances are recorded as a component of income tax expense in the period in which the law was enacted. When deferred tax balances related to items originally recorded in accumulated other comprehensive income are adjusted, certain tax effects become stranded in accumulated other comprehensive income. The amendments in ASU 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the 2017 Tax Cuts and Jobs Act. The amendments in this ASU also require certain disclosures about stranded tax effects. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption in any period is permitted. The Company’s provisional adjustments recorded in 2017 to account for the impact of the 2017 Tax Cuts and Jobs Act resulted in stranded tax effects. The Company is currently evaluating the impact of adopting ASU 2018-02.

3. Revenue

The Company recognizes revenue when it satisfies a performance obligation by transferring control of a good or service to a customer. Revenue is measured based on the consideration that the Company expects to be entitled to in exchange for the goods or services transferred. Taxes that are collected from a customer concurrent with revenue-producing activities are excluded from revenue.

The following table includes revenue disaggregated by major source (in thousands):

	Three months ended July 1, 2018	Six months ended July 1, 2018
Motorcycles and Related Products:		
Motorcycles	$1,201,453	$2,323,126
Parts & Accessories	231,014	400,089
General Merchandise	68,653	125,254
Licensing	10,407	18,765
Other	13,594	21,834
Revenue from Motorcycles and Related Products	1,525,121	2,889,068
Financial Services:		
Interest income	158,639	312,680
Securitization and servicing fee income	304	656
Other income	29,159	52,940
Revenue from Financial Services	188,102	366,276
Total revenue	$1,713,223	$3,255,344

The following is a description of principal activities from which the Company generates its revenue, by reportable segment.

Motorcycles and Related Products

Motorcycles, Parts and Accessories, and General Merchandise - Sales of motorcycles, parts and accessories, and general merchandise are recorded when control is transferred to wholesale customers (independent dealers). This generally takes place upon shipment of the products. The sale of products to independent dealers outside the U.S. and

Canada is generally on open account with terms that generally approximate 30-120 days and the resulting receivables are included in accounts receivable in the consolidated balance sheets. The sale of products in the U.S. and Canada is financed by the purchasing dealers through HDFS and the related receivables are included in finance receivables in the consolidated balance sheets.

The Company offers sales incentive programs to dealers and retail customers designed to promote the sale of motorcycles, parts and accessories, and general merchandise. The Company estimates its variable consideration related to motorcycles and related products sold under its sales incentive programs using the expected value method. Further, the Company accounts for consideration payable to a customer as part of its sales incentives as a reduction of revenue, which is accrued at the later of the date the related sale is recorded or the date the incentive program is both approved and communicated.

The Company offers to its dealers the right to return eligible parts and accessories and general merchandise. When the Company offers a right to return, it estimates returns based on an analysis of historical trends and records revenue on the initial sale only in the amount that it expects to be entitled. The remaining consideration is deferred in a refund liability account. The refund liability is remeasured for changes in the estimate at each reporting date with a corresponding adjustment to revenue.

Variable consideration related to sales incentives and rights to return is adjusted at the earliest of when the amount of consideration the Company expects to receive changes or the consideration becomes fixed. Adjustments for variable consideration related to previously recognized sales decreased revenue by an immaterial amount during the three and six months ended July 1, 2018.

Shipping and handling costs associated with freight after control of a product has transferred to a customer are accounted for as fulfillment costs. The Company accrues for the shipping and handling in the same period that the related revenue is recognized.

The Company offers standard, limited warranties on its motorcycles and parts and accessories. These warranties provide assurance that the product will function as expected and are not separate performance obligations. The Company accounts for estimated warranty costs as a liability when control of the product transfers to the customer.

Licensing - The Company licenses the name “Harley-Davidson” and other trademarks owned by the Company and collects royalties from its customers (licensees). The trademark licenses are considered symbolic intellectual property, which grant the customer a right to access the Company’s intellectual property. The Company satisfies its performance obligation over the license period, as the Company fulfills its promise to grant the customer rights to use and benefit from the intellectual property as well as maintain the intellectual property.

Payment is typically due within thirty days of the end of each quarter, for the royalties earned in that quarter. Revenue, in the form of sales-based royalties, is recognized when the customers’ subsequent sales occur. The Company applies the practical expedient in ASC 606-10-55-18 to recognize licensing revenues in the amount that the Company has the right to invoice because the royalties due each period correspond directly with the value of the Company’s performance to date. Revenue will be recognized over the remaining contract terms which range up to 6 years.

Other Revenue - Other Revenue consists primarily of revenue from Harley Ownership Group (H.O.G.) membership sales, motorcycle rental commissions, dealer software sales, museum admissions and events, and other miscellaneous products and services.

Financial Services

Interest income - Interest income on finance receivables is recorded as earned and is based on the average outstanding daily balance for wholesale and retail receivables. Accrued and uncollected interest is classified with finance receivables. Certain loan origination costs related to finance receivables, including payments made to dealers for certain retail loans, are deferred and recorded within finance receivables, and amortized over the estimated life of the contract.

Securitization and servicing fee income - Securitization and servicing fee income consists of revenue from servicing and ancillary fees associated with HDFS' off-balance sheet asset-backed securitization transaction. Refer to Note 11 of the Notes to Consolidated Financial Statements for further discussion regarding asset-backed financing.

Other income - Other income consists primarily of insurance and licensing revenues. HDFS works with certain unaffiliated insurance companies to offer motorcycle insurance and protection products through most Harley-Davidson dealers in the U.S. and Canada. HDFS also works with third-party financial institutions that issue credit cards, or offer other financial products bearing the Harley-Davidson brand in the U.S and internationally. For many of these contracts, the Company grants temporary rights to use the licensed trademarks owned by the Company and collects royalties from its customers in connection with sales of their products. The trademark licenses are considered symbolic intellectual property, which grant the customer a right to access the intellectual property. The Company satisfies its performance obligation over the license period, as it fulfills its promise to grant the customer rights to use and benefit from the intellectual property as well as maintain the intellectual property. Royalty and profit sharing amounts are received either quarterly or per annum, based upon the contract. Revenue, in the form of sales-based royalties, is recognized when the customers' subsequent sales occur. Revenue will be recognized over

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the remaining contract terms which range up to 6 years. The Company is the primary obligor for certain other insurance related contracts and, as a result, revenue is recognized over the life of the contract as the Company fulfills its performance obligation.

Contract Liabilities

Deferred revenue relates to payments received at contract inception in advance of the Company's performance under the contract and generally relates to the sale of H.O.G. memberships and extended service plan contracts. Deferred revenue is recognized as revenue as the Company performs under the contract. On January 1, 2018, $23.4 million of deferred revenue was included in Accrued liabilities and Other long-term liabilities in the consolidated balance sheet. $5.1 million and $9.1 million of this was recognized as revenue in the three and six months ended July 1, 2018, respectively. At July 1, 2018, the unearned revenue balance was $30.8 million. The Company expects to recognize approximately $10.8 million of the remaining unearned revenue in 2018, $9.8 million in 2019 and $10.2 million thereafter.

4. Restructuring Expenses

In January 2018, the Company initiated a plan to further improve its manufacturing operations and cost structure by commencing a multi-year manufacturing optimization plan which includes the consolidation of its motorcycle assembly plant in Kansas City, Missouri, into its plant in York, Pennsylvania, and the closure of its wheel operations in Adelaide, Australia. As the U.S. operations are consolidated, the Company expects approximately 800 jobs will be eliminated with the closure of Kansas City operations and approximately 450 jobs will be added in York by 2019. Approximately 90 jobs will be eliminated in Adelaide.

The Company expects to incur restructuring and other consolidation costs of $170 million to $200 million in the Motorcycles segment related to this plan through 2019, of which approximately 70% will be cash charges. This includes $135 million to $155 million of restructuring expense and $35 million to $45 million of costs related to temporary inefficiencies. The Company expects restructuring expenses to include the cost of employee termination benefits, accelerated depreciation and other project implementation costs of $50 million to $60 million, $45 million to $50 million and $40 million to $45 million, respectively. Restructuring expense is recorded as a separate line item in the consolidated statement of income and the accrued restructuring liability is recorded in accrued liabilities in the consolidated balance sheet. The Company expects the plan to be completed by mid-2019. Changes in the accrued restructuring liability (in thousands) were as follows:

	Three months ended July 1, 2018			
	Employee Termination Benefits	Accelerated Depreciation	Other	Total
Balance, beginning of period	$38,287	$ —	$ 63	$38,350
Restructuring (benefit) expense	(1,186)	9,746	3,810	12,370
Utilized - cash	(133)	—	(3,793)	(3,926)
Utilized - non cash	—	(9,746)	—	(9,746)
Foreign currency changes	(210)	—	(3)	(213)
Balance, end of period	$36,758	$ —	$ 77	$36,835

	Six months ended July 1, 2018			
	Employee Termination Benefits	Accelerated Depreciation	Other	Total
Balance, beginning of period	$—	$ —	$ —	$—
Restructuring expense	39,605	15,359	4,248	59,212
Utilized - cash	(2,433)	—	(4,167)	(6,600)
Utilized - non cash	—	(15,359)	—	(15,359)

Foreign currency changes	(414)	—	(4)	(418)
Balance, end of period	$36,758	$ —	$ 77	$36,835

During the three months ended July 1, 2018, the Company adjusted its termination benefit liability to reflect updated assumptions resulting in a reversal of approximately $1.7 million of previously recognized restructuring expense.

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During the three and six month periods ended July 1, 2018, the Company incurred $2.4 million and $3.1 million, respectively, of incremental cost of goods sold due to temporary inefficiencies resulting from implementing the manufacturing optimization plan.

5. Income Taxes

The Company’s 2018 effective income tax rate for the six months ended July 1, 2018 was 24.1% compared to 34.4% for the six months ended June 25, 2017. The Company's effective income tax rate was lower in 2018 due primarily to the impact of the 2017 Tax Cuts and Jobs Act (2017 Tax Act) that was enacted in December of 2017. The 2017 Tax Act included broad and complex changes to the U.S. tax code including a reduction of the corporate income tax rate from 35% to 21%, the move toward a territorial tax system and the elimination of the domestic manufacturing deduction. During the three months ended December 31, 2017, the Company recorded a $53.1 million tax expense to recognize the initial effects of the 2017 Tax Act relating primarily to the remeasurement of deferred tax assets. The Company has deemed its income tax estimates related to the 2017 Tax Act to be provisional under SEC Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (SAB 118). The Company believes future guidance, interpretations and pronouncements will add clarity to the numerous aspects of the 2017 Tax Act that may impact the Company which may result in revisions to the Company’s provisional estimates. There were no material changes to these provisional estimates during the six month period ended July 1, 2018.

6. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Numerator:				
Net income used in computing basic and diluted earnings per share	$242,338	$258,867	$417,101	$445,236
Denominator:				
Denominator for basic earnings per share - weighted-average common shares	166,589	174,409	167,364	175,178
Effect of dilutive securities - employee stock compensation plan	615	915	825	992
Denominator for diluted earnings per share - adjusted weighted-average shares outstanding	167,204	175,324	168,189	176,170
Earnings per common share:				
Basic	$1.45	$1.48	$2.49	$2.54
Diluted	$1.45	$1.48	$2.48	$2.53

Outstanding options to purchase 1.5 million and 0.6 million shares of common stock for the three months ended July 1, 2018 and June 25, 2017, respectively, and 1.3 million and 0.7 million shares of common stock for the six months ended July 1, 2018 and June 25, 2017, respectively, were not included in the Company’s computation of dilutive securities because the exercise price was greater than the market price, and therefore, the effect would have been anti-dilutive.

The Company has a share-based compensation plan under which employees may be granted share-based awards including restricted stock units (RSUs). Non-forfeitable dividend equivalents are paid on unvested RSUs. As such, RSUs are considered participating securities under the two-class method of calculating earnings per share as described in ASC Topic 260, “Earnings per Share.” The two-class method of calculating earnings per share did not have a material impact on the Company’s earnings per share calculation for the three and six month periods ended July 1, 2018 and June 25, 2017.

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7. Additional Balance Sheet and Cash Flow Information
Marketable Securities
The Company’s marketable securities consisted of the following (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
Mutual funds	$49,537	$ 48,006	$44,156
Total marketable securities	$49,537	$ 48,006	$44,156

The mutual fund investments are held by the Company to fund certain deferred compensation obligations. These investments are carried at fair value with gains and losses recorded in net income and are included in other long-term assets on the consolidated balance sheets.
Inventories
Substantially all inventories located in the United States are valued using the last-in, first-out (LIFO) method. Other inventories are valued at the lower of cost or net realizable value using the first-in, first-out (FIFO) method.
Inventories consisted of the following (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
Raw materials and work in process	$154,921	$ 161,664	$117,199
Motorcycle finished goods	222,711	289,530	186,244
Parts and accessories and general merchandise	140,096	139,363	116,836
Inventory at lower of FIFO cost or net realizable value	517,728	590,557	420,279
Excess of FIFO over LIFO cost	(52,355)	(52,355)	(48,267)
Total inventories, net	$465,373	$ 538,202	$372,012

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Operating Cash Flow

The reconciliation of net income to net cash provided by operating activities is as follows (in thousands):

	Six months ended July 1, 2018		June 25, 2017	
Cash flows from operating activities:				
Net income	$ 417,101		$ 445,236	
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of intangibles	130,061		107,578	
Amortization of deferred loan origination costs	39,396		40,771	
Amortization of financing origination fees	4,133		4,079	
Provision for long-term employee benefits	18,954		14,950	
Employee benefit plan contributions and payments	(6,422	)	(37,307	)
Stock compensation expense	19,081		17,497	
Net change in wholesale finance receivables related to sales	(171,195	)	(271,927	)
Provision for credit losses	48,932		69,806	
Deferred income taxes	1,515		178	
Other, net	20,894		(4,163	)
Changes in current assets and liabilities:				
Accounts receivable, net	(14,882	)	(28,239	)
Finance receivables - accrued interest and other	4,228		2,067	
Inventories	63,957		138,942	
Accounts payable and accrued liabilities	161,101		133,120	
Derivative instruments	(136	)	3,114	
Other	(859	)	(8,634	)

Total adjustments	318,758	181,832
Net cash provided by operating activities	$ 735,859	$ 627,068

8. Finance Receivables

The Company provides retail financial services to customers of the Company's independent dealers in the United States and Canada. The origination of retail loans is a separate and distinct transaction between the Company and the retail customer, unrelated to the Company's sale of product to its dealers. Retail finance receivables consist of secured promissory notes and secured installment sales contracts. The Company holds either titles or liens on titles to vehicles financed by promissory notes and installment sales contracts.

The Company offers wholesale financing to the Company's independent dealers. Wholesale loans to dealers are generally secured by financed inventory or property and are originated in the U.S. and Canada.

Finance receivables, net, consisted of the following (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
Retail	$6,373,926	$6,140,600	$6,267,211
Wholesale	1,133,206	1,016,957	1,258,852
Total finance receivables	7,507,132	7,157,557	7,526,063
Allowance for credit losses	(193,930)	(192,471)	(193,528)
Finance receivables, net	$7,313,202	$6,965,086	$7,332,535

A provision for credit losses on finance receivables is charged or credited to earnings in amounts that the Company believes are sufficient to maintain the allowance for credit losses at a level that is adequate to cover losses of principal inherent in the existing portfolio. The allowance for credit losses represents management's estimate of probable losses inherent in the

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finance receivable portfolio as of the balance sheet date. However, due to the use of projections and assumptions in estimating the losses, the amount of losses actually incurred by the Company could differ from the amounts estimated.
Changes in the allowance for credit losses on finance receivables by portfolio were as follows (in thousands):

	Three months ended July 1, 2018		
	Retail	Wholesale	Total
Balance, beginning of period	$182,150	$ 8,200	$190,350
Provision for credit losses	20,652	(1,772)	18,880
Charge-offs	(28,947)	—	(28,947)
Recoveries	13,647	—	13,647
Balance, end of period	$187,502	$ 6,428	$193,930

	Three months ended June 25, 2017		
	Retail	Wholesale	Total
Balance, beginning of period	$176,068	$ 7,962	$184,030
Provision for credit losses	26,550	(333)	26,217
Charge-offs	(30,374)	—	(30,374)
Recoveries	13,655	—	13,655
Balance, end of period	$185,899	$ 7,629	$193,528

	Six months ended July 1, 2018		
	Retail	Wholesale	Total
Balance, beginning of period	$186,254	$ 6,217	$192,471
Provision for credit losses	48,721	211	48,932
Charge-offs	(74,028)	—	(74,028)
Recoveries	26,555	—	26,555
Balance, end of period	$187,502	$ 6,428	$193,930

	Six months ended June 25, 2017		
	Retail	Wholesale	Total
Balance, beginning of period	$166,810	$ 6,533	$173,343
Provision for credit losses	68,710	1,096	69,806
Charge-offs	(76,298)	—	(76,298)
Recoveries	26,677	—	26,677
Balance, end of period	$185,899	$ 7,629	$193,528

Finance receivables are considered impaired when management determines it is probable that the Company will be unable to collect all amounts due according to the terms of the loan agreement. Portions of the allowance for credit losses are established to cover estimated losses on finance receivables specifically identified for impairment. The unspecified portion of the allowance for credit losses covers estimated losses on finance receivables which are collectively reviewed for impairment.
The retail portfolio primarily consists of a large number of small balance, homogeneous finance receivables. The Company performs a periodic and systematic collective evaluation of the adequacy of the retail allowance for credit losses. The Company utilizes loss forecast models which consider a variety of factors including, but not limited to, historical loss trends, origination or vintage analysis, known and inherent risks in the portfolio, the value of the underlying collateral, recovery rates, and current economic conditions including items such as unemployment rates. Retail finance receivables are not evaluated individually for impairment prior to charge-off and, therefore, are not reported as impaired loans.

The wholesale portfolio is primarily composed of large balance, non-homogeneous loans. The Company’s evaluation for the wholesale allowance for credit losses is first based on a loan-by-loan review. A specific allowance for credit losses is established for wholesale finance receivables determined to be individually impaired when management concludes that the borrower will not be able to make full payment of the contractual amounts due based on the original terms of the loan

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agreement. The impairment is determined based on the cash that the Company expects to receive discounted at the loan's original interest rate or the fair value of the collateral, if the loan is collateral-dependent. Finance receivables in the wholesale portfolio that are not considered impaired on an individual basis are segregated, based on similar risk characteristics, according to the Company's internal risk rating system and collectively evaluated for impairment. The related allowance for credit losses is based on factors such as the specific borrower's financial performance and ability to repay, the Company's past loan loss experience, current economic conditions, and the value of the underlying collateral.

Generally, it is the Company's policy not to change the terms and conditions of finance receivables. However, to minimize the economic loss, the Company may modify certain finance receivables in troubled debt restructurings. Total restructured finance receivables are not significant.

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The allowance for credit losses and finance receivables by portfolio, segregated by those amounts that are individually evaluated for impairment and those that are collectively evaluated for impairment, was as follows (in thousands):

	July 1, 2018		
	Retail	Wholesale	Total
Allowance for credit losses, ending balance:			
Individually evaluated for impairment	$—	$184	$184
Collectively evaluated for impairment	187,502	6,244	193,746
Total allowance for credit losses	$187,502	$6,428	$193,930
Finance receivables, ending balance:			
Individually evaluated for impairment	$—	$220	$220
Collectively evaluated for impairment	6,373,926	1,132,986	7,506,912
Total finance receivables	$6,373,926	$1,133,206	$7,507,132

	December 31, 2017		
	Retail	Wholesale	Total
Allowance for credit losses, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	186,254	6,217	192,471
Total allowance for credit losses	$186,254	$6,217	$192,471
Finance receivables, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	6,140,600	1,016,957	7,157,557
Total finance receivables	$6,140,600	$1,016,957	$7,157,557

	June 25, 2017		
	Retail	Wholesale	Total
Allowance for credit losses, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	185,899	7,629	193,528
Total allowance for credit losses	$185,899	$7,629	$193,528
Finance receivables, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	6,267,211	1,258,852	7,526,063
Total finance receivables	$6,267,211	$1,258,852	$7,526,063

Additional information related to the wholesale finance receivables that are individually deemed to be impaired under ASC Topic 310, "Receivables," includes (in thousands):

	As of July 1, 2018			Three months ended July 1, 2018		Six months ended July 1, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Wholesale:							
No related allowance recorded	$—	$ —	$ —	$ —	$ —	$ —	$ —
Related allowance recorded	251	220	184	251	—	251	—
	$251	$ 220	$ 184	$ 251	$ —	$ 251	$ —

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Retail finance receivables are contractually delinquent if the minimum payment is not received by the specified due date. Retail finance receivables are generally charged-off when the receivable is 120 days or more delinquent, the related asset is repossessed or the receivable is otherwise deemed uncollectible. All retail finance receivables accrue interest until either collected or charged-off. Accordingly, as of July 1, 2018, December 31, 2017 and June 25, 2017, all retail finance receivables were accounted for as interest-earning receivables, of which $22.4 million, $40.0 million and $25.1 million, respectively, were 90 days or more past due.

Wholesale finance receivables are delinquent if the minimum payment is not received by the contractual due date. Wholesale finance receivables are written down once management determines that the specific borrower does not have the ability to repay the loan in full. Interest continues to accrue on past due finance receivables until the date the finance receivable becomes uncollectible and the finance receivable is placed on non-accrual status. The Company will resume accruing interest on these accounts when payments are current according to the terms of the loans and future payments are reasonably assured. While on non-accrual status, all cash received is applied to principal or interest as appropriate. The recorded investment of non-accrual status wholesale finance receivables at July 1, 2018 was $0.2 million. There were no wholesale receivables on non-accrual status at December 31, 2017 or June 25, 2017. At July 1, 2018, December 31, 2017 and June 25, 2017, $0.1 million, $0.1 million, and $1.1 million of wholesale finance receivables were 90 days or more past due and accruing interest, respectively.

An analysis of the aging of past due finance receivables was as follows (in thousands):

	July 1, 2018					
	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Finance Receivables
Retail	$6,198,906	$116,828	$35,763	$22,429	$175,020	$6,373,926
Wholesale	1,132,472	516	134	84	734	1,133,206
Total	$7,331,378	$117,344	$35,897	$22,513	$175,754	$7,507,132

	December 31, 2017					
	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Finance Receivables
Retail	$5,913,473	$139,629	$47,539	$39,959	$227,127	$6,140,600
Wholesale	1,016,000	595	245	117	957	1,016,957
Total	$6,929,473	$140,224	$47,784	$40,076	$228,084	$7,157,557

	June 25, 2017					
	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Finance Receivables
Retail	$6,086,592	$118,616	$36,914	$25,089	$180,619	$6,267,211
Wholesale	1,257,301	281	142	1,128	1,551	1,258,852
Total	$7,343,893	$118,897	$37,056	$26,217	$182,170	$7,526,063

A significant part of managing the Company's finance receivable portfolios includes the assessment of credit risk associated with each borrower. As the credit risk varies between the retail and wholesale portfolios, the Company utilizes different credit risk indicators for each portfolio.

The Company manages retail credit risk through its credit approval policy and ongoing collection efforts. The Company uses FICO scores, a standard credit rating measurement, to differentiate the expected default rates of retail credit applicants, enabling the Company to better evaluate credit applicants for approval and to tailor pricing according to this assessment. Retail loans with a FICO score of 640 or above at origination are considered prime, and loans with a FICO score below 640 are considered sub-prime. These credit quality indicators are determined at the time of loan origination and are not updated subsequent to the loan origination date.

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The recorded investment in retail finance receivables, by credit quality indicator, was as follows (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
Prime	$5,193,641	$ 4,966,193	$5,034,187
Sub-prime	1,180,285	1,174,407	1,233,024
Total	$6,373,926	$ 6,140,600	$6,267,211

The Company's credit risk on the wholesale portfolio is different from that of the retail portfolio. Whereas the retail portfolio represents a relatively homogeneous pool of retail finance receivables that exhibit more consistent loss patterns, the wholesale portfolio exposures are less consistent. The Company utilizes an internal credit risk rating system to manage credit risk exposure consistently across wholesale borrowers and individually evaluates credit risk factors for each borrower. The Company uses the following internal credit quality indicators, based on an internal risk rating system, listed from highest level of risk to lowest level of risk for the wholesale portfolio: Doubtful, Substandard, Special Mention, Medium Risk and Low Risk. Based upon management’s review, the dealers classified in the Doubtful category are the dealers with the greatest likelihood of being charged-off, while the dealers classified as Low Risk are least likely to be charged-off. The internal rating system considers factors such as the specific borrower's ability to repay and the estimated value of any collateral. Dealer risk rating classifications are reviewed and updated on a quarterly basis.

The recorded investment in wholesale finance receivables, by internal credit quality indicator, was as follows (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
Doubtful	$251	$ 688	$5,203
Substandard	803	3,837	10,458
Special Mention	2,154	26,866	4,953
Medium Risk	37,045	9,917	8,115
Low Risk	1,092,953	975,649	1,230,123
Total	$1,133,206	$ 1,016,957	$1,258,852

9. Derivative Instruments and Hedging Activities

The Company is exposed to certain risks such as foreign currency exchange rate risk, interest rate risk and commodity price risk. To reduce its exposure to such risks, the Company selectively uses derivative financial instruments. All derivative transactions are authorized and executed pursuant to regularly reviewed policies and procedures, which prohibit the use of financial instruments for speculative trading purposes.

All derivative instruments are recognized on the balance sheet at fair value. In accordance with ASC Topic 815, “Derivatives and Hedging,” the accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. Changes in the fair value of derivatives that are designated as fair value hedges, along with the gain or loss on the hedged item, are recorded in current period earnings. For derivative instruments that are designated as cash flow hedges, the effective portion of gains and losses that result from changes in the fair value of derivative instruments is initially recorded in other comprehensive income (OCI) and subsequently reclassified into earnings when the hedged item affects income. The Company assesses, both at the inception of each hedge and on an on-going basis, whether the derivatives that are used in its hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. Any ineffective portion is immediately recognized in earnings. No component of a hedging derivative instrument’s gain or loss is excluded from the assessment of hedge effectiveness. Derivative instruments that do not qualify for hedge accounting are recorded at fair value, and any changes in fair value are recorded in current period earnings.

The Company sells its products internationally, and in most markets those sales are made in the foreign country’s local currency. As a result, the Company’s earnings can be affected by fluctuations in the value of the U.S. dollar relative to foreign currency. The Company utilizes foreign currency exchange contracts to mitigate the effects of the Euro, the Australian dollar, the Japanese yen, the Brazilian real, the Canadian dollar and the Mexican peso. The foreign currency exchange contracts are entered into with banks and allow the Company to exchange a specified amount of foreign currency for U.S. dollars at a future date, based on a fixed exchange rate.

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The Company utilizes commodity contracts to hedge portions of the cost of certain commodities consumed in the Company's motorcycle production and distribution operations.

The Company's foreign currency exchange contracts and commodity contracts generally have maturities of less than one year.

The Company has periodically utilized treasury rate lock contracts to fix the interest rate on a portion of the principal related to the issuance of long-term debt. All such treasury rate lock contracts have since settled and the gain or loss at settlement was recorded in accumulated other comprehensive loss which is being reclassified into earnings over the life of the debt.

The Company has also periodically utilized interest rate swaps to reduce the impact of fluctuations in interest rates. The Company utilized an interest rate swap designated as a cash flow hedge of one of its medium-term note issuances to convert it from a floating rate basis to a fixed rate basis.

The following tables summarize the fair value of the Company's derivative financial instruments (in thousands):

	July 1, 2018			December 31, 2017			June 25, 2017		
Derivatives Designated As Hedging Instruments Under ASC Topic 815	Notional Value	Asset Fair Value[a]	Liability Fair Value[b]	Notional Value	Asset Fair Value[a]	Liability Fair Value[b]	Notional Value	Asset Fair Value[a]	Liability Fair Value[b]
Foreign currency contracts[c]	$591,901	$13,238	$ —	$675,724	$1,388	$21,239	$544,601	$ 409	$4,622
Commodity contracts[c]	803	4	—	915	—	69	1,102	—	75
Interest rate swap - medium-term notes[c]	450,000	—	597	—	—	—	—	—	—
Total	$1,042,704	$13,242	$ 597	$676,639	$1,388	$21,308	$545,703	$ 409	$4,697

	July 1, 2018			December 31, 2017			June 25, 2017		
Derivatives Not Designated As Hedging Instruments Under ASC Topic 815	Notional Value	Asset Fair Value[a]	Liability Fair Value[b]	Notional Value	Asset Fair Value[a]	Liability Fair Value[b]	Notional Value	Asset Fair Value[a]	Liability Fair Value[b]
Commodity contracts	$4,421	$204	$ 28	$4,532	$381	$—	$4,336	$ 49	$168
Total	$4,421	$204	$ 28	$4,532	$381	$—	$4,336	$ 49	$168

(a) Included in other current assets
(b) Included in accrued liabilities
(c) Derivative designated as a cash flow hedge

The following tables summarize the amount of gains and losses related to derivative financial instruments designated as cash flow hedges (in thousands):

	Amount of Gain/(Loss) Recognized in OCI, before tax			
	Three months ended		Six months ended	
Cash Flow Hedges	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Foreign currency contracts	$32,635	$(11,851)	$26,745	$(23,648)
Commodity contracts	4	(80)	(12)	(186)
Treasury rate locks	41	(719)	41	(719)
Interest rate swap - medium-term notes	(886)	—	(886)	—
Total	$31,794	$(12,650)	$25,888	$(24,553)

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Cash Flow Hedges	Amount of Gain/(Loss) Reclassified from AOCL into Income				Expected to be Reclassified
	Three months ended		Six months ended		
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017	Over the Next Twelve Months
Foreign currency contracts[a]	$956	$3,957	$(5,753)	$6,473	$ 15,895
Commodity contracts[a]	(12)	17	(85)	65	16
Treasury rate locks[b]	(125)	(99)	(251)	(189)	(492)
Interest rate swap - medium-term notes[b]	(289)	—	(289)	—	(939)
Total	$530	$3,875	$(6,378)	$6,349	$ 14,480

(a) Gain/(loss) reclassified from accumulated other comprehensive loss (AOCL) to income is included in cost of goods sold

(b) Gain/(loss) reclassified from AOCL to income is included in interest expense

For the three and six months ended July 1, 2018 and June 25, 2017, the cash flow hedges were highly effective and, as a result, the amount of hedge ineffectiveness was not material. No amounts were excluded from effectiveness testing.

The following table summarizes the amount of gains and losses related to derivative financial instruments not designated as hedging instruments (in thousands):

Derivatives Not Designated As Hedges	Amount of Gain/(Loss) Recognized in Income on Derivative			
	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Commodity contracts[a]	$195	$(193)	$201	$(173)
Total	$195	$(193)	$201	$(173)

(a) Gain/(loss) recognized in income is included in cost of goods sold

The Company is exposed to credit loss risk in the event of non-performance by counterparties to these derivative financial instruments. Although no assurances can be given, the Company does not expect any of the counterparties to these derivative financial instruments to fail to meet its obligations. To manage credit loss risk, the Company evaluates counterparties based on credit ratings and, on a quarterly basis, evaluates each hedge's net position relative to the counterparty's ability to cover its position.

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10. Debt

Debt with a contractual term of one year or less is generally classified as short-term debt and consisted of the following (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
Unsecured commercial paper	$1,327,307	$ 1,273,482	$928,445
Total short-term debt	$1,327,307	$ 1,273,482	$928,445

Debt with a contractual term greater than one year is generally classified as long-term debt and consisted of the following (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
Secured debt (Note 11)			
Asset-backed Canadian commercial paper conduit facility	$166,638	$ 174,779	$138,739
Asset-backed U.S. commercial paper conduit facilities	300,000	279,457	279,833
Asset-backed securitization debt	169,632	353,085	522,095
Less: unamortized discount and debt issuance costs	(202)	(461)	(795)
Total secured debt	636,068	806,860	939,872
Unsecured notes (at par value)			
1.55% Medium-term notes due in 2017, issued November 2014	—	—	400,000
6.80% Medium-term notes due in 2018, issued May 2008	—	877,488	877,488
2.25% Medium-term notes due in 2019, issued January 2016	600,000	600,000	600,000
Floating-rate Medium-term notes due in 2019, issued March 2017[a]	150,000	150,000	150,000
2.40% Medium-term notes due in 2019, issued September 2014	600,000	600,000	600,000
2.15% Medium-term notes due in 2020, issued February 2015	600,000	600,000	600,000
Floating-rate Medium-term notes due in 2020, issued May 2018[b]	450,000	—	—
2.40% Medium-term notes due in 2020, issued March 2017	350,000	350,000	350,000
2.85% Medium-term notes due in 2021, issued January 2016	600,000	600,000	600,000
3.55% Medium-term notes due in 2021, issued May 2018	350,000	—	—
2.55% Medium-term notes due in 2022, issued June 2017	400,000	400,000	400,000
3.35% Medium-term notes due in 2023, issued February 2018	350,000	—	—
3.50% Senior unsecured notes due in 2025, issued July 2015	450,000	450,000	450,000
4.625% Senior unsecured notes due in 2045, issued July 2015	300,000	300,000	300,000
Less: unamortized discount and debt issuance costs	(22,259)	(19,821)	(23,452)
Gross long-term debt	5,813,809	5,714,527	6,243,908
Less: current portion of long-term debt, net of unamortized discount and debt issuance costs	(945,463)	(1,127,269)	(1,565,558)
Total long-term debt	$4,868,346	$4,587,258	$4,678,350

(a) Floating interest rate based on LIBOR plus 35 bps.

(b) Floating interest rate based on LIBOR plus 50 bps. The Company utilized an interest rate swap designated as a cash flow hedge to convert this from a floating rate basis to a fixed rate basis. Refer to Note 9 of the Notes to the Consolidated Financial Statements for further details.

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11. Asset-Backed Financing

The Company participates in asset-backed financing both through asset-backed securitization transactions and through asset-backed commercial paper conduit facilities. In the Company's asset-backed financing programs, the Company transfers retail motorcycle finance receivables to special purpose entities (SPEs), which are considered VIEs under U.S. GAAP. Each SPE then converts those assets into cash, through the issuance of debt. The Company retains servicing rights for all of the retail motorcycle finance receivables transferred to SPEs as part of an asset-backed financing. The accounting treatment for asset-backed financings depends on the terms of the related transaction and the Company’s continuing involvement with the VIE.

In transactions where the Company has power over the significant activities of the VIE and has an obligation to absorb losses or the right to receive benefits from the VIE that are potentially significant to the VIE, the Company is the primary beneficiary of the VIE and consolidates the VIE within its consolidated financial statements. On a consolidated basis, the asset-backed financing is treated as a secured borrowing in this type of transaction and is referred to as an on-balance sheet asset-backed financing.

In transactions where the Company is not the primary beneficiary of the VIE, the Company must determine whether it can achieve a sale for accounting purposes under ASC Topic 860, "Transfers and Servicing." To achieve a sale for accounting purposes, the assets being transferred must be legally isolated, not be constrained by restrictions from further transfer, and be deemed to be beyond the Company’s control. If the Company does not meet all of these criteria for sale accounting, then the transaction is accounted for as a secured borrowing and is referred to as an on-balance sheet asset-backed financing.

If the Company meets all three of the sale criteria above, the transaction is recorded as a sale for accounting purposes and is referred to as an off-balance sheet asset-backed financing. Upon sale, the retail motorcycle finance receivables are removed from the Company’s balance sheet and a gain or loss is recognized for the difference between the cash proceeds received, the assets derecognized, and the liabilities recognized as part of the transaction. The gain or loss on sale is included in Financial Services revenue in the Consolidated Statement of Income.

The Company is not required, and does not currently intend, to provide any additional financial support to the on or off-balance sheet VIEs associated with these transactions. Investors and creditors in these transactions only have recourse to the assets held by the VIEs.

The following tables show the assets and liabilities related to the on-balance sheet asset-backed financings included in the financial statements (in thousands):

	July 1, 2018					
	Finance receivables	Allowance for credit losses	Restricted cash	Other assets	Total assets	Asset-backed debt
On-balance sheet assets and liabilities						
Consolidated VIEs						
Asset-backed securitizations	$229,201	$(6,943)	$21,912	$465	$244,635	$169,430
Asset-backed U.S. commercial paper conduit facilities	319,758	(9,710)	17,845	815	328,708	300,000
Unconsolidated VIEs						
Asset-backed Canadian commercial paper conduit facility	192,979	(3,405)	11,176	274	201,024	166,638
Total on-balance sheet assets and liabilities	$741,938	$(20,058)	$50,933	$1,554	$774,367	$636,068

	December 31, 2017					
	Finance receivables	Allowance for credit losses	Restricted cash	Other assets	Total assets	Asset-backed debt
On-balance sheet assets and liabilities						
Consolidated VIEs						
Asset-backed securitizations	$439,301	$(13,686)	$34,919	$1,260	$461,794	$352,624
Asset-backed U.S. commercial paper conduit facilities	300,530	(9,392)	13,787	888	305,813	279,457
Unconsolidated VIEs						
Asset-backed Canadian commercial paper conduit facility	203,691	(3,746)	9,983	470	210,398	174,779
Total on-balance sheet assets and liabilities	$943,522	$(26,824)	$58,689	$2,618	$978,005	$806,860

	June 25, 2017					
	Finance receivables	Allowance for credit losses	Restricted cash	Other assets	Total assets	Asset-backed debt
On-balance sheet assets and liabilities						
Consolidated VIEs						
Asset-backed securitizations	$599,754	$(18,291)	$47,980	$1,360	$630,803	$521,300
Asset-backed U.S. commercial paper conduit facilities	298,700	(9,132)	14,993	810	305,371	279,833
Unconsolidated VIEs						
Asset-backed Canadian commercial paper conduit facility	152,248	(2,911)	11,422	203	160,962	138,739
Total on-balance sheet assets and liabilities	$1,050,702	$(30,334)	$74,395	$2,373	$1,097,136	$939,872

On-Balance Sheet Asset-Backed Securitization VIEs

The Company transfers U.S. retail motorcycle finance receivables to SPEs which in turn issue secured notes to investors, with various maturities and interest rates, secured by future collections of the purchased U.S. retail motorcycle finance receivables. Each on-balance sheet asset-backed securitization SPE is a separate legal entity, and the U.S. retail motorcycle finance receivables included in the asset-backed securitizations are only available for payment of the secured debt and other obligations arising from the asset-backed securitization transaction and are not available to pay other obligations or claims of the Company's creditors until the associated secured debt and other obligations are satisfied. Restricted cash balances held by the SPEs are used only to support the securitizations. There are no amortization schedules for the secured notes; however, the debt is reduced monthly as available collections on the related U.S. retail motorcycle finance receivables are applied to outstanding principal. The secured notes' contractual lives have various maturities ranging from 2020 to 2022.

The Company is the primary beneficiary of its on-balance sheet asset-backed securitization VIEs because it retains servicing rights and a residual interest in the VIEs in the form of a debt security. As the servicer, the Company is the variable

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interest holder with the power to direct the activities of the VIE that most significantly impact the VIE’s economic performance. As a residual interest holder, the Company has the obligation to absorb losses and the right to receive benefits which could potentially be significant to the VIE.

There were no on-balance sheet asset-backed securitization transactions during the first half of 2018 or 2017.

On-Balance Sheet Asset-Backed U.S. Commercial Paper Conduit Facilities VIE

In December 2017, the Company renewed its existing $300.0 million and $600.0 million revolving facility agreements with a third-party bank-sponsored asset-backed U.S. commercial paper conduit. Availability under the revolving facilities (together, the U.S. Conduit Facilities) is based on, among other things, the amount of eligible U.S. retail motorcycle receivables held by the relevant SPE as collateral.

Under the U.S. Conduit Facilities, the Company may transfer U.S. retail motorcycle finance receivables to an SPE, which in turn may issue debt to the third-party bank-sponsored asset-backed commercial paper conduit. The assets of the SPE are restricted as collateral for the payment of the debt or other obligations arising in the transaction and are not available to pay other obligations or claims of the Company’s creditors. The terms for this debt provide for interest on the outstanding principal based on prevailing commercial paper rates or LIBOR to the extent the advance is not funded by a conduit lender through the issuance of commercial paper plus, in each case, a program fee based on outstanding principal. The U.S. Conduit Facilities also provide for an unused commitment fee based on the unused portion of the total aggregate commitment of $900.0 million. There is no amortization schedule; however, the debt will be reduced monthly as available collections on the related finance receivables are applied to outstanding principal. Upon expiration of the U.S. Conduit Facilities, any outstanding principal will continue to be reduced monthly through available collections. The expected remaining term of the related receivables held by the SPE is approximately 5 years. Unless earlier terminated or extended by mutual agreement of the Company and the lenders, as of July 1, 2018, the U.S. Conduit Facilities have an expiration date of December 12, 2018.

The Company is the primary beneficiary of its U.S. Conduit Facilities VIE because it retains servicing rights and a residual interest in the VIE in the form of a debt security. As the servicer, the Company is the variable interest holder with the power to direct the activities of the VIE that most significantly impact the VIE’s economic performance. As a residual interest holder, the Company has the obligation to absorb losses and the right to receive benefits which could potentially be significant to the VIE.

The following table includes quarterly transfers of U.S. retail motorcycle finance receivables to the U.S. Conduit and the respective proceeds (in thousands):

	2018		2017	
	Transfers	Proceeds	Transfers	Proceeds
First quarter	$32,900	$29,300	$333,400	$300,000
Second quarter	59,100	53,300	28,200	24,000
	$92,000	$82,600	$361,600	$324,000

On-Balance Sheet Asset-Backed Canadian Commercial Paper Conduit Facility

In June 2018, the Company renewed its facility agreement (Canadian Conduit) with a Canadian bank-sponsored asset-backed commercial paper conduit. Under the agreement, the Canadian Conduit is contractually committed, at the Company's option, to purchase eligible Canadian retail motorcycle finance receivables for proceeds up to C$220.0 million. The transferred assets are restricted as collateral for the payment of the debt. The terms for this debt provide for interest on the outstanding principal based on prevailing market interest rates plus a specified margin. The Canadian Conduit also provides for a program fee and an unused commitment fee based on the unused portion of the total aggregate commitment of C$220.0 million. There is no amortization schedule; however, the debt is reduced monthly as available collections on the related finance receivables are applied to outstanding principal. Upon expiration of the Canadian Conduit, any outstanding principal will continue to be reduced monthly through available collections. The expected remaining term of the related receivables is approximately 5 years. Unless earlier terminated or extended by mutual agreement between the Company and the lenders, as of July 1, 2018, the Canadian Conduit has an expiration date of June 28, 2019.

The Company is not the primary beneficiary of the Canadian bank-sponsored, multi-seller conduit VIE; therefore, the Company does not consolidate the VIE. However, the Company treats the conduit facility as a secured borrowing as it maintains effective control over the assets transferred to the VIE and, therefore, does not meet the requirements for sale accounting.

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As the Company participates in and does not consolidate the Canadian bank-sponsored, multi-seller conduit VIE, the maximum exposure to loss associated with this VIE, which would only be incurred in the unlikely event that all the finance receivables and underlying collateral have no residual value, was $34.4 million at July 1, 2018. The maximum exposure is not an indication of the Company's expected loss exposure.

The following table includes quarterly transfers of Canadian retail motorcycle finance receivables to the Canadian Conduit and the respective proceeds (in thousands):

	2018		2017	
	Transfers	Proceeds	Transfers	Proceeds
First quarter	$7,600	$6,200	$6,300	$5,500
Second quarter	38,900	32,200	14,200	12,400
	$46,500	$38,400	$20,500	$17,900

Off-Balance Sheet Asset-Backed Securitization VIE

There were no off-balance sheet asset-backed securitization transactions during the first half of 2018 or 2017. During the second quarter of 2016, the Company sold retail motorcycle finance receivables with a principal balance of $301.8 million into a securitization VIE that was not consolidated. Similar to an on-balance sheet asset-backed securitization, the Company transferred U.S. retail motorcycle finance receivables to an SPE which in turn issued secured notes to investors, with various maturities and interest rates, secured by future collections of the purchased U.S. retail motorcycle finance receivables. The off-balance sheet asset-backed securitization SPE is a separate legal entity, and the U.S. retail motorcycle finance receivables included in the asset-backed securitization are only available for payment of the secured debt and other obligations arising from the asset-backed securitization transaction and are not available to pay other obligations or claims of the Company’s creditors. In an on-balance sheet asset-backed securitization, the Company retains a financial interest in the VIE in the form of a debt security. As part of this off-balance sheet securitization, the Company did not retain any financial interest in the VIE beyond servicing rights and ordinary representations and warranties and related covenants.

The Company is not the primary beneficiary of the off-balance sheet asset-backed securitization VIE because it only retained servicing rights and does not have the obligation to absorb losses or the right to receive benefits from the VIE which could potentially be significant to the VIE. Accordingly, this transaction met the accounting sale requirements under ASC Topic 860 and was recorded as a sale for accounting purposes. Upon the sale, the retail motorcycle finance receivables were removed from the Company’s balance sheet and a gain was recognized for the difference between the cash proceeds received, the assets derecognized and the liabilities recognized as part of the transaction. The gain on sale was included in Financial Services revenue in the Consolidated Statement of Income.

At July 1, 2018, the assets of this off-balance sheet asset-backed securitization VIE were $109.6 million and represented the current unpaid principal balance of the retail motorcycle finance receivables, which was the Company’s maximum exposure to loss in the off-balance sheet VIE at July 1, 2018. This is based on the unlikely event that all the receivables have underwriting defects or other defects that trigger a violation of certain covenants and that the underlying collateral has no residual value. This maximum exposure is not an indication of expected losses.

Servicing Activities

The Company services all retail motorcycle finance receivables that it originates. When the Company transfers retail motorcycle finance receivables to SPEs through asset-backed financings, the Company retains the right to service the finance receivables and receives servicing fees based on the securitized finance receivables balance and certain ancillary fees. In on-balance sheet asset-backed financings, servicing fees are eliminated in consolidation and therefore are not recorded on a consolidated basis. In off-balance sheet asset-backed financings, servicing fees and ancillary fees are recorded in Financial Services revenue in the Consolidated Statement of Income. The fees the Company is paid for servicing represent adequate compensation, and consequently, the Company does not recognize a servicing asset or liability. The Company recognized servicing fee income of $0.7 million and $1.1 million during the first half of 2018 and 2017, respectively.

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The unpaid principal balance of retail motorcycle finance receivables serviced by the Company was as follows (in thousands):

	July 1, 2018	December 31, 2017	June 25, 2017
On-balance sheet retail motorcycle finance receivables	$6,227,634	$ 5,993,185	$6,121,372
Off-balance sheet retail motorcycle finance receivables	109,578	146,425	187,769
Total serviced retail motorcycle finance receivables	$6,337,212	$ 6,139,610	$6,309,141

The unpaid principal balance of retail motorcycle finance receivables serviced by the Company 30 days or more delinquent was as follows (in thousands):

	Amount 30 days or more past due:		
	July 1, 2018	December 31, 2017	June 25, 2017
On-balance sheet retail motorcycle finance receivables	$175,020	$ 227,127	$180,619
Off-balance sheet retail motorcycle finance receivables	1,591	2,106	1,659
Total serviced retail motorcycle finance receivables	$176,611	$ 229,233	$182,278

Credit losses, net of recoveries for the retail motorcycle finance receivables serviced by the Company were as follows (in thousands):

	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
On-balance sheet retail motorcycle finance receivables	$15,300	$16,719	$47,473	$49,621
Off-balance sheet retail motorcycle finance receivables	137	152	498	566
Total serviced retail motorcycle finance receivables	$15,437	$16,871	$47,971	$50,187

12. Fair Value

The Company assesses the inputs used to measure fair value using a three-tier hierarchy.

Level 1 inputs include quoted prices for identical instruments and are the most observable.

Level 2 inputs include quoted prices for similar assets and observable inputs such as interest rates, foreign currency exchange rates, commodity prices and yield curves. The Company uses the market approach to derive the fair value for its Level 2 fair value measurements. Forward contracts for foreign currency and commodities are valued using quoted forward rates and prices; interest rate swaps are valued using quoted interest rates and yield curves; investments in marketable securities and cash equivalents are valued using quoted prices.

Level 3 inputs are not observable in the market and include management’s judgments about the assumptions market participants would use in pricing the asset or liability.

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Recurring Fair Value Measurements

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis (in thousands):

	July 1, 2018			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$691,983	$ 446,454	$ 245,529	$ —
Marketable securities	49,537	49,537	—	—
Derivatives	13,446	—	13,446	—
Total	$754,966	$ 495,991	$ 258,975	$ —
Liabilities:				
Derivatives	$625	$ —	$ 625	$ —

	December 31, 2017			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$488,432	$ 358,500	$ 129,932	$ —
Marketable securities	48,006	48,006	—	—
Derivatives	1,769	—	1,769	—
Total	$538,207	$ 406,506	$ 131,701	$ —
Liabilities:				
Derivatives	$21,308	$ —	$ 21,308	$ —

	June 25, 2017			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$625,485	$ 375,550	$ 249,935	$ —
Marketable securities	44,156	44,156	—	—
Derivatives	458	—	458	—
Total	$670,099	$ 419,706	$ 250,393	$ —
Liabilities:				
Derivatives	$4,865	$ —	$ 4,865	$ —

Nonrecurring Fair Value Measurements

Repossessed inventory is recorded at the lower of cost or net realizable value through a nonrecurring fair value measurement. Repossessed inventory was $16.4 million, $19.6 million and $17.9 million at July 1, 2018, December 31, 2017 and June 25, 2017, respectively, for which the fair value adjustment was $2.8 million, $9.0 million and $2.7 million, respectively. Fair value is estimated using Level 2 inputs based on the recent market values of repossessed inventory.

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Fair Value of Financial Instruments Measured at Cost

The carrying value of the Company's cash and cash equivalents and restricted cash approximates their fair values. The following table summarizes the fair value and carrying value of the Company's remaining financial instruments that are measured at cost or amortized cost (in thousands):

	July 1, 2018		December 31, 2017		June 25, 2017	
	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value
Assets:						
Finance receivables, net	$7,375,644	$ 7,313,202	$7,021,549	$ 6,965,086	$7,401,974	$ 7,332,535
Liabilities:						
Unsecured commercial paper	$1,327,307	$ 1,327,307	$1,273,482	$ 1,273,482	$928,445	$ 928,445
Asset-backed U.S. commercial paper conduit facilities	$300,000	$ 300,000	$279,457	$ 279,457	$279,833	$ 279,833
Asset-backed Canadian commercial paper conduit facility	$166,638	$ 166,638	$174,779	$ 174,779	$138,739	$ 138,739
Medium-term notes	$4,398,478	$ 4,435,449	$4,189,092	$ 4,165,706	$4,623,146	$ 4,562,403
Senior unsecured notes	$719,152	$ 742,292	$784,433	$ 741,961	$773,084	$ 741,633
Asset-backed securitization debt	$168,941	$ 169,430	$351,767	$ 352,624	$521,956	$ 521,300

Finance Receivables, Net – The carrying value of retail and wholesale finance receivables in the financial statements is amortized cost less an allowance for credit losses. The fair value of retail finance receivables is generally calculated by discounting future cash flows using an estimated discount rate that reflects current credit, interest rate and prepayment risks associated with similar types of instruments. Fair value is determined based on Level 3 inputs. The amortized cost basis of wholesale finance receivables approximates fair value because they either are short-term or have interest rates that adjust with changes in market interest rates.

Debt – The carrying value of debt in the financial statements is generally amortized cost, net of discounts and debt issuance costs. The carrying value of unsecured commercial paper calculated using Level 2 inputs approximates fair value due to its short maturity. The carrying value of debt provided under the U.S. conduit facilities and Canadian conduit facility calculated using Level 2 inputs approximates fair value since the interest rates charged under the facility are tied directly to market rates and fluctuate as market rates change. The fair values of the medium-term notes and senior unsecured notes are estimated based upon rates currently available for debt with similar terms and remaining maturities (Level 2 inputs). The fair value of the debt related to on-balance sheet asset-backed securitization transactions is estimated based on pricing currently available for transactions with similar terms and maturities (Level 2 inputs).

13. Product Warranty and Recall Campaigns

The Company currently provides a standard two-year limited warranty on all new motorcycles sold worldwide, except for Japan, where the Company currently provides a standard three-year limited warranty on all new motorcycles sold. In addition, the Company provides a one-year warranty for Parts & Accessories (P&A). The warranty coverage for the retail customer generally begins when the product is sold to a retail customer. The Company accrues for future warranty claims using an estimated cost based primarily on historical Company claim information. Additionally, the Company has from time to time initiated certain voluntary recall campaigns. The Company accrues for the estimated cost associated with voluntary recalls in the period that management approves and commits to the recall. Changes in the Company's warranty and recall liability were as follows (in thousands):

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	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Balance, beginning of period	$95,075	$78,211	$94,202	$79,482
Warranties issued during the period	16,904	18,084	31,510	34,836
Settlements made during the period	(21,777)	(21,200)	(38,415)	(40,533)
Recalls and changes to pre-existing warranty liabilities	(259)	5,586	2,646	6,896
Balance, end of period	$89,943	$80,681	$89,943	$80,681

The liability for recall campaigns was $27.4 million, $35.3 million and $7.9 million as of July 1, 2018, December 31, 2017 and June 25, 2017, respectively.

14. Employee Benefit Plans

The Company has a defined benefit qualified pension plan and postretirement healthcare benefit plans that cover certain employees of the Motorcycles segment. The Company also has unfunded supplemental employee retirement plan agreements (SERPA) with certain employees which were instituted to replace benefits lost under the Tax Revenue Reconciliation Act of 1993. Service cost is allocated among selling, administrative and engineering expense, cost of goods sold and inventory. Amounts capitalized in inventory are not significant. Non-service cost components of net periodic benefit cost are presented in other income (expense), net. Refer to Note 2 regarding the adoption of ASU 2017-07 for further discussion of the impact on net periodic benefit costs. Components of net periodic benefit costs were as follows (in thousands):

	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Pension and SERPA Benefits				
Service cost	$8,063	$7,896	$16,218	$15,792
Interest cost	20,729	21,269	41,319	42,538
Expected return on plan assets	(36,926)	(35,345)	(73,817)	(70,690)
Amortization of unrecognized:				
Prior service (credit) cost	(105)	254	(211)	508
Net loss	16,318	10,998	32,137	21,996
Curtailment loss	—	—	1,018	—
Net periodic benefit cost	$8,079	$5,072	$16,664	$10,144
Postretirement Healthcare Benefits				
Service cost	$1,789	$1,875	$3,601	$3,750
Interest cost	2,886	3,412	5,783	6,824
Expected return on plan assets	(3,541)	(3,156)	(7,082)	(6,312)
Amortization of unrecognized:				
Prior service credit	(460)	(543)	(920)	(1,086)
Net loss	454	815	908	1,630
Net periodic benefit cost	$1,128	$2,403	$2,290	$4,806

During the six months ended July 1, 2018, the qualified pension plan and certain postretirement healthcare plan assets and obligations were remeasured as a result of a curtailment of benefits related to the planned closure of the Company's motorcycle assembly plant in Kansas City, Missouri, discussed further in Note 4. As a result of the remeasurement, the Company recorded a benefit of $96.4 million before income taxes in other comprehensive income during the six months ended July 1, 2018.

There are no required or planned qualified pension plan contributions for 2018. The Company expects it will continue to make ongoing benefit payments under the SERPA and postretirement healthcare plans.

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15. Commitments and Contingencies
The Company is subject to lawsuits and other claims related to environmental, product and other matters. In determining costs to accrue related to these items, the Company carefully analyzes cases and considers the likelihood of adverse judgments or outcomes, as well as the potential range of possible loss. Any amounts accrued for these matters are monitored on an ongoing basis and are updated based on new developments or new information as it becomes available for each matter.
Environmental Protection Agency Notice:
In December 2009, the Company received formal, written requests for information from the United States Environmental Protection Agency (EPA) regarding: (i) certificates of conformity for motorcycle emissions and related designations and labels, (ii) aftermarket parts, and (iii) warranty claims on emissions related components. The Company promptly submitted written responses to the EPA’s inquiry and has engaged in information exchanges and discussions with the EPA. In August 2016, the Company entered into a consent decree with the EPA regarding these issues, and the consent decree was subsequently revised in July 2017 (the Settlement). In the Settlement, the Company agreed to, among other things, pay a fine, and not sell tuning products unless they are approved by the EPA or California Air Resources Board. In December 2017, the EPA filed the Settlement with the U.S. District Court for the District of Columbia for the purpose of obtaining court approval of the Settlement. Three amicus briefs opposing portions of the Settlement were filed with the court by the deadline of January 31, 2018. On March 1, 2018, the Company and the EPA each filed separate response briefs. The Company anticipates the court will make a decision whether or not to finalize the Settlement in the following months. The Company has an accrual associated with this matter which is included in accrued liabilities in the Consolidated Balance Sheets, and as a result, if it is finalized, the Settlement would not have a material adverse effect on the Company's financial condition or results of operations. The Settlement is not final until it is approved by the court, and if it is not approved by the court, the Company cannot reasonably estimate the impact of any remedies the EPA might seek beyond the Company's current reserve for this matter.
York Environmental Matters:
The Company is involved with government agencies and groups of potentially responsible parties related to a matter involving the cleanup of soil and groundwater contamination at its York, Pennsylvania facility. The York facility was formerly used by the U.S. Navy and AMF prior to the purchase of the York facility by the Company from AMF in 1981. The Company has been working with the Pennsylvania Department of Environmental Protection (PADEP) since 1986 and with the U.S. Environmental Protection Agency (EPA) in undertaking environmental investigation and remediation activities, including a site-wide remedial investigation/feasibility study (RI/FS).

In January 1995, the Company entered into a settlement agreement (the Agreement) with the Navy, and the parties amended the Agreement in 2013 to address ordnance and explosive waste. The Agreement calls for the Navy and the Company to contribute amounts into a trust equal to 53% and 47%, respectively, of costs associated with environmental investigation and remediation activities at the York facility (Response Costs). The trust administers the payment of the Response Costs incurred at the York facility as covered by the Agreement.
The Company has an accrual for its estimate of its share of the future Response Costs at the York facility which is included in other long-term liabilities in the Consolidated Balance Sheets. While the work on the RI/FS is now complete, the final remedy has not yet been proposed or approved and given the uncertainty that exists concerning the nature and scope of additional environmental remediation that may ultimately be required under the approved final remedy, the Company is unable to make a reasonable estimate of those additional costs, if any, that may result.
The estimate of the Company's future Response Costs that will be incurred at the York facility is based on reports of independent environmental consultants retained by the Company, the actual costs incurred to date and the estimated costs to complete the necessary investigation and remediation activities.
Product Liability Matters:
The Company is involved in product liability suits related to the operation of its business. The Company accrues for claim exposures that are probable of occurrence and can be reasonably estimated. The Company also maintains insurance coverage for product liability exposures. The Company believes that its accruals and insurance coverage are

adequate and that product liability suits will not have a material adverse effect on the Company’s consolidated financial statements.

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16. Accumulated Other Comprehensive Loss

The following tables set forth the changes in accumulated other comprehensive loss (AOCL) (in thousands):

	Three months ended July 1, 2018				
	Foreign currency translation adjustments	Marketable securities	Derivative financial instruments	Pension and postretirement benefit plans	Total
Balance, beginning of period	$(14,937)	$ —	$(16,489)	$(375,178)	$(406,604)
Other comprehensive (loss) income before reclassifications	(26,482)	—	31,794	—	5,312
Income tax expense	—	—	(7,476)	—	(7,476)
Net other comprehensive (loss) income before reclassifications	(26,482)	—	24,318	—	(2,164)
Reclassifications:					
Realized (gains) losses - foreign currency contracts[a]	—	—	(956)	—	(956)
Realized (gains) losses - commodity contracts[a]	—	—	12	—	12
Realized (gains) losses - treasury rate locks[b]	—	—	125	—	125
Realized (gains) losses - interest rate swap[b]	—	—	289	—	289
Prior service credits[c]	—	—	—	(565)	(565)
Actuarial losses[c]	—	—	—	16,772	16,772
Total reclassifications before tax	—	—	(530)	16,207	15,677
Income tax benefit (expense)	—	—	132	(3,805)	(3,673)
Net reclassifications	—	—	(398)	12,402	12,004
Other comprehensive (loss) income	(26,482)	—	23,920	12,402	9,840
Balance, end of period	$(41,419)	$ —	$7,431	$(362,776)	$(396,764)

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	Three months ended June 25, 2017				
	Foreign currency translation adjustments	Marketable securities	Derivative financial instruments	Pension and postretirement benefit plans	Total
Balance, beginning of period	$(52,575)	$(1,204)	$3,472	$(501,323)	$(551,630)
Other comprehensive income (loss) before reclassifications	9,447	1,912	(12,650)	—	(1,291)
Income tax benefit (expense)	190	(708)	4,678	—	4,160
Net other comprehensive income (loss) before reclassifications	9,637	1,204	(7,972)	—	2,869
Reclassifications:					
Realized (gains) losses - foreign currency contracts[a]	—	—	(3,957)	—	(3,957)
Realized (gains) losses - commodity contracts[a]	—	—	(17)	—	(17)
Realized (gains) losses - treasury rate locks[b]	—	—	99	—	99
Prior service credits[c]	—	—	—	(289)	(289)
Actuarial losses[c]	—	—	—	11,813	11,813
Total reclassifications before tax	—	—	(3,875)	11,524	7,649
Income tax benefit (expense)	—	—	1,435	(4,268)	(2,833)
Net reclassifications	—	—	(2,440)	7,256	4,816
Other comprehensive income (loss)	9,637	1,204	(10,412)	7,256	7,685
Balance, end of period	$(42,938)	$—	$(6,940)	$(494,067)	$(543,945)

	Six months ended July 1, 2018				
	Foreign currency translation adjustments	Marketable securities	Derivative financial instruments	Pension and postretirement benefit plans	Total
Balance, beginning of period	$(21,852)	$—	$(17,254)	$(460,943)	$(500,049)
Other comprehensive (loss) income before reclassifications	(19,567)	—	25,888	96,374	102,695
Income tax expense	—	—	(6,089)	(22,629)	(28,718)
Net other comprehensive (loss) income before reclassifications	(19,567)	—	19,799	73,745	73,977
Reclassifications:					
Realized (gains) losses - foreign currency contracts[a]	—	—	5,753	—	5,753
Realized (gains) losses - commodity contracts[a]	—	—	85	—	85
Realized (gains) losses - treasury rate locks[b]	—	—	251	—	251
Realized (gains) losses - interest rate swap[b]	—	—	289	—	289
Prior service credits[c]	—	—	—	(1,131)	(1,131)
Actuarial losses[c]	—	—	—	33,045	33,045
Total reclassifications before tax	—	—	6,378	31,914	38,292
Income tax expense	—	—	(1,492)	(7,492)	(8,984)
Net reclassifications	—	—	4,886	24,422	29,308
Other comprehensive (loss) income	(19,567)	—	24,685	98,167	103,285
Balance, end of period	$(41,419)	$—	$7,431	$(362,776)	$(396,764)

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	Six months ended June 25, 2017				
	Foreign currency translation adjustments	Marketable securities	Derivative financial instruments	Pension and postretirement benefit plans	Total
Balance, beginning of period	$(68,132)	$(1,194)	$12,524	$(508,579)	$(565,381)
Other comprehensive income (loss) before reclassifications	25,080	1,896	(24,553)	—	2,423
Income tax benefit (expense)	114	(702)	9,087	—	8,499
Net other comprehensive income (loss) before reclassifications	25,194	1,194	(15,466)	—	10,922
Reclassifications:					
Realized (gains) losses - foreign currency contracts[(a)]	—	—	(6,473)	—	(6,473)
Realized (gains) losses - commodity contracts[(a)]	—	—	(65)	—	(65)
Realized (gains) losses - treasury rate locks[(b)]	—	—	189	—	189
Prior service credits[(c)]	—	—	—	(578)	(578)
Actuarial losses[(c)]	—	—	—	23,626	23,626
Total reclassifications before tax	—	—	(6,349)	23,048	16,699
Income tax benefit (expense)	—	—	2,351	(8,536)	(6,185)
Net reclassifications	—	—	(3,998)	14,512	10,514
Other comprehensive income (loss)	25,194	1,194	(19,464)	14,512	21,436
Balance, end of period	$(42,938)	$—	$(6,940)	$(494,067)	$(543,945)

(a) Amounts reclassified to net income are included in Motorcycles and Related Products cost of goods sold.
(b) Amounts reclassified to net income are included in interest expense.
(c) Amounts reclassified are included in the computation of net periodic benefit cost. See Note 14 for information related to pension and postretirement benefit plans.

17. Business Segments

Harley-Davidson, Inc. is the parent company for the groups of companies doing business as Harley-Davidson Motor Company (HDMC) and Harley-Davidson Financial Services (HDFS). The Company operates in two segments: the Motorcycles & Related Products (Motorcycles) segment and the Financial Services segment. The Company's reportable segments are strategic business units that offer different products and services and are managed separately based on the fundamental differences in their operations. Selected segment information is set forth below (in thousands):

	Three months ended		Six months ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Motorcycles net revenue	$1,525,121	$1,577,135	$2,889,068	$2,905,846
Gross profit	532,085	572,962	1,005,858	1,047,785
Selling, administrative and engineering expense	276,309	255,610	530,402	493,887
Restructuring expense	12,370	—	59,212	—
Operating income from Motorcycles	243,406	317,352	416,244	553,898
Financial Services revenue	188,102	188,034	366,276	361,255
Financial Services expense	107,561	106,099	222,156	226,684
Operating income from Financial Services	80,541	81,935	144,120	134,571
Operating income	$323,947	$399,287	$560,364	$688,469

As discussed in Note 2, the Company adopted ASU 2017-07 on January 1, 2018 which required the Company to record the non-service cost components of net periodic benefit plan costs in non-operating income on a prospective and retrospective basis. As a result, operating income from Motorcycles excludes these costs for all periods presented.

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18. Supplemental Consolidating Data

The supplemental consolidating data for the periods noted is presented for informational purposes. The supplemental consolidating data may be different than segment information presented elsewhere due to the allocation of intercompany eliminations to the reportable segments. All supplemental data is presented in thousands.

	Three months ended July 1, 2018			
	HDMC Entities	HDFS Entities	Eliminations	Consolidated
Revenue:				
Motorcycles and Related Products	$1,528,045	$ —	$(2,924)	$1,525,121
Financial Services	—	188,788	(686)	188,102
Total revenue	1,528,045	188,788	(3,610)	1,713,223
Costs and expenses:				
Motorcycles and Related Products cost of goods sold	993,036	—	—	993,036
Financial Services interest expense	—	51,943	—	51,943
Financial Services provision for credit losses	—	18,880	—	18,880
Selling, administrative and engineering expense	276,827	39,663	(3,443)	313,047
Restructuring expense	12,370	—	—	12,370
Total costs and expenses	1,282,233	110,486	(3,443)	1,389,276
Operating income	245,812	78,302	(167)	323,947
Other income (expense), net	645	—	—	645
Investment income	2,533	—	—	2,533
Interest expense	7,728	—	—	7,728
Income before provision for income taxes	241,262	78,302	(167)	319,397
Provision for income taxes	59,683	17,376	—	77,059
Net income	$181,579	$ 60,926	$(167)	$242,338

	Six months ended July 1, 2018			
	HDMC Entities	HDFS Entities	Eliminations	Consolidated
Revenue:				
Motorcycles and Related Products	$2,894,291	$ —	$(5,223)	$2,889,068
Financial Services	—	367,248	(972)	366,276
Total revenue	2,894,291	367,248	(6,195)	3,255,344
Costs and expenses:				
Motorcycles and Related Products cost of goods sold	1,883,210	—	—	1,883,210
Financial Services interest expense	—	100,393	—	100,393
Financial Services provision for credit losses	—	48,932	—	48,932
Selling, administrative and engineering expense	531,228	78,054	(6,049)	603,233
Restructuring expense	59,212	—	—	59,212
Total costs and expenses	2,473,650	227,379	(6,049)	2,694,980
Operating income	420,641	139,869	(146)	560,364
Other income (expense), net	865	—	—	865
Investment income	113,736	—	(110,000)	3,736
Interest expense	15,418	—	—	15,418
Income before provision for income taxes	519,824	139,869	(110,146)	549,547
Provision for income taxes	99,916	32,530	—	132,446
Net income	$419,908	$ 107,339	$(110,146)	$417,101

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	Three months ended June 25, 2017			
	HDMC Entities	HDFS Entities	Eliminations	Consolidated
Revenue:				
Motorcycles and Related Products	$1,580,109	$ —	$(2,974)	$1,577,135
Financial Services	—	188,712	(678)	188,034
Total revenue	1,580,109	188,712	(3,652)	1,765,169
Costs and expenses:				
Motorcycles and Related Products cost of goods sold	1,004,173	—	—	1,004,173
Financial Services interest expense	—	44,408	—	44,408
Financial Services provision for credit losses	—	26,217	—	26,217
Selling, administrative and engineering expense	256,147	38,448	(3,511)	291,084
Total costs and expenses	1,260,320	109,073	(3,511)	1,365,882
Operating income	319,789	79,639	(141)	399,287
Other income (expense), net	2,295	—	—	2,295
Investment income	577	—	—	577
Interest expense	7,726	—	—	7,726
Income before provision for income taxes	314,935	79,639	(141)	394,433
Provision for income taxes	106,035	29,531	—	135,566
Net income	$208,900	$ 50,108	$(141)	$258,867

	Six months ended June 25, 2017			
	HDMC Entities	HDFS Entities	Eliminations	Consolidated
Revenue:				
Motorcycles and Related Products	$2,910,727	$ —	$(4,881)	$2,905,846
Financial Services	—	362,269	(1,014)	361,255
Total revenue	2,910,727	362,269	(5,895)	3,267,101
Costs and expenses:				
Motorcycles and Related Products cost of goods sold	1,858,061	—	—	1,858,061
Financial Services interest expense	—	87,697	—	87,697
Financial Services provision for credit losses	—	69,806	—	69,806
Selling, administrative and engineering expense	494,777	74,062	(5,771)	563,068
Total costs and expenses	2,352,838	231,565	(5,771)	2,578,632
Operating income	557,889	130,704	(124)	688,469
Other income (expense), net	4,591	—	—	4,591
Investment income	107,456	—	(106,000)	1,456
Interest expense	15,399	—	—	15,399
Income before provision for income taxes	654,537	130,704	(106,124)	679,117
Provision for income taxes	185,192	48,689	—	233,881
Net income	$469,345	$ 82,015	$(106,124)	$445,236

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	July 1, 2018			
	HDMC Entities	HDFS Entities	Eliminations	Consolidated
ASSETS				
Current assets:				
Cash and cash equivalents	$627,783	$ 350,966	$ —	$ 978,749
Accounts receivable, net	669,266	—	(333,672)	335,594
Finance receivables, net	—	2,252,956	—	