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PACCAR INC

Form 10-Q

May 02, 2019

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2019

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File No. 001-14817

PACCAR Inc

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

91-0351110
(I.R.S. Employer Identification No.)

777 - 106th Ave. N.E., Bellevue, WA 98004
(Address of principal executive offices) (Zip Code)
(425) 468-7400

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer 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

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

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common stock, \$1 par value	PCAR	The NASDAQ Global Select Market LLC

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$1 par value — 346,443,375 shares as of April 30, 2019

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Consolidated Statements of Comprehensive Income (Unaudited)

(Millions Except Per Share Amounts)

	Three Months Ended March 31	
	2019	2018
TRUCK, PARTS AND OTHER:		
Net sales and revenues	\$6,138.1	\$5,321.8
Cost of sales and revenues	5,217.1	4,535.5
Research and development	78.3	76.0
Selling, general and administrative	136.9	137.1
Interest and other (income), net	(10.3)	(18.7)
	5,422.0	4,729.9
Truck, Parts and Other Income Before Income Taxes	716.1	591.9
FINANCIAL SERVICES:		
Interest and fees	137.1	115.7
Operating lease, rental and other revenues	212.4	216.5
Revenues	349.5	332.2
Interest and other borrowing expenses	53.4	41.3
Depreciation and other expenses	177.4	186.4
Selling, general and administrative	32.5	31.1
Provision for losses on receivables	2.2	5.9
	265.5	264.7
Financial Services Income Before Income Taxes	84.0	67.5
Investment income	19.3	10.0
Total Income Before Income Taxes	819.4	669.4
Income taxes	190.4	157.3
Net Income	\$629.0	\$512.1
Net Income Per Share		
Basic	\$1.81	\$1.45
Diluted	\$1.81	\$1.45
Weighted Average Number of Common Shares Outstanding		
Basic	347.2	352.5
Diluted	347.8	353.5

Comprehensive Income	\$632.0	\$587.4
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See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheets (Millions)

	March 31 2019 (Unaudited)	December 31 2018*
ASSETS		
TRUCK, PARTS AND OTHER:		
Current Assets		
Cash and cash equivalents	\$ 2,733.1	\$ 3,279.2
Trade and other receivables, net	1,736.2	1,314.4
Marketable debt securities	1,081.6	1,020.4
Inventories, net	1,272.6	1,184.7
Other current assets	401.7	364.7
Total Truck, Parts and Other Current Assets	7,225.2	7,163.4
Equipment on operating leases, net	757.4	786.6
Property, plant and equipment, net	2,521.5	2,480.9
Other noncurrent assets, net	744.2	651.9
Total Truck, Parts and Other Assets	11,248.3	11,082.8
FINANCIAL SERVICES:		
Cash and cash equivalents	109.5	156.7
Finance and other receivables, net	11,355.7	10,840.8
Equipment on operating leases, net	2,824.1	2,855.0
Other assets	619.4	547.1
Total Financial Services Assets	14,908.7	14,399.6
	\$ 26,157.0	\$ 25,482.4

*The December 31, 2018 consolidated balance sheet has been derived from audited financial statements. See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheets (Millions)

	March 31 2019 (Unaudited)	December 31 2018*
LIABILITIES AND STOCKHOLDERS' EQUITY		
TRUCK, PARTS AND OTHER:		
Current Liabilities		
Accounts payable, accrued expenses and other	\$ 3,507.4	\$ 3,027.7
Dividend payable		695.1
Total Truck, Parts and Other Current Liabilities	3,507.4	3,722.8
Residual value guarantees and deferred revenues	813.2	842.4
Other liabilities	1,272.2	1,145.7
Total Truck, Parts and Other Liabilities	5,592.8	5,710.9
FINANCIAL SERVICES:		
Accounts payable, accrued expenses and other	570.3	523.2
Commercial paper and bank loans	3,424.8	3,540.8
Term notes	6,771.6	6,409.7
Deferred taxes and other liabilities	692.0	704.9
Total Financial Services Liabilities	11,458.7	11,178.6
STOCKHOLDERS' EQUITY:		
Preferred stock, no par value - authorized 1.0 million shares, none issued		
Common stock, \$1 par value - authorized 1.2 billion shares, issued 347.0 and 346.6 million shares	347.0	346.6
Additional paid-in capital	94.3	69.4
Treasury stock, at cost - .5 million and nil shares	(33.4)	
Retained earnings	9,793.1	9,275.4
Accumulated other comprehensive loss	(1,095.5)	(1,098.5)
Total Stockholders' Equity	9,105.5	8,592.9
	\$ 26,157.0	\$ 25,482.4

*The December 31, 2018 consolidated balance sheet has been derived from audited financial statements. See Notes to Consolidated Financial Statements.

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Condensed Consolidated Statements of Cash Flows (Unaudited)

(Millions)

	Three Months Ended March 31	
	2019	2018
OPERATING ACTIVITIES:		
Net Income	\$629.0	\$512.1
Adjustments to reconcile net income to cash provided by operations:		
Depreciation and amortization:		
Property, plant and equipment	81.4	93.6
Equipment on operating leases and other	177.7	179.9
Provision for losses on financial services receivables	2.2	5.9
Other, net	(9.0)	(47.7)
Pension contributions	(5.8)	(75.6)
Change in operating assets and liabilities:		
Trade and other receivables	(442.5)	(353.7)
Wholesale receivables on new trucks	(402.7)	(233.0)
Inventories	(92.8)	(135.5)
Accounts payable and accrued expenses	405.3	441.3
Income taxes, warranty and other	20.2	138.0
Net Cash Provided by Operating Activities	363.0	525.3
INVESTING ACTIVITIES:		
Originations of retail loans and finance leases	(888.1)	(849.4)
Collections on retail loans and finance leases	764.8	696.5
Net decrease in wholesale receivables on used equipment	4.3	21.8
Purchases of marketable debt securities	(202.6)	(128.5)
Proceeds from sales and maturities of marketable debt securities	146.6	448.6
Payments for property, plant and equipment	(102.8)	(98.4)
Acquisitions of equipment for operating leases	(287.4)	(276.7)
Proceeds from asset disposals	164.5	130.0
Net Cash Used in Investing Activities	(400.7)	(56.1)
FINANCING ACTIVITIES:		
Payments of cash dividends	(806.1)	(510.1)
Purchases of treasury stock	(32.9)	(13.5)
Proceeds from stock compensation transactions	15.9	9.5
Net (decrease) increase in commercial paper, short-term bank loans and other	(113.9)	284.3
Proceeds from term debt	636.7	398.7
Payments on term debt	(250.0)	(508.2)
Net Cash Used in Financing Activities	(550.3)	(339.3)
Effect of exchange rate changes on cash	(5.3)	9.5

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Net (Decrease) Increase in Cash and Cash Equivalents	(593.3)	139.4
Cash and cash equivalents at beginning of period	3,435.9	2,364.7
Cash and cash equivalents at end of period	\$2,842.6	\$2,504.1

See Notes to Consolidated Financial Statements.

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Consolidated Statements of Stockholders' Equity (Unaudited)

(Millions Except Per Share Amounts)

	Three Months Ended	
	March 31	
	2019	2018
COMMON STOCK, \$1 PAR VALUE:		
Balance at beginning of quarter	\$346.6	\$351.8
Stock compensation	.4	.3
Balance at end of quarter	347.0	352.1
ADDITIONAL PAID-IN CAPITAL:		
Balance at beginning of quarter	69.4	123.2
Stock compensation	24.9	16.9
Balance at end of quarter	94.3	140.1
TREASURY STOCK, AT COST:		
Balance at beginning of quarter		
Purchases, shares: 2019 - .50; 2018 - .26	(33.4)	(16.7)
Balance at end of quarter	(33.4)	(16.7)
RETAINED EARNINGS:		
Balance at beginning of quarter	9,275.4	8,369.1
Net income	629.0	512.1
Cash dividends declared on common stock,		
per share: 2019 - \$.32, 2018 - \$.25	(111.3)	(88.2)
Cumulative effect of change in accounting principles		17.1
Balance at end of quarter	9,793.1	8,810.1
ACCUMULATED OTHER COMPREHENSIVE LOSS:		
Balance at beginning of quarter	(1,098.5)	(793.6)
Other comprehensive income	3.0	75.3
Balance at end of quarter	(1,095.5)	(718.3)
Total Stockholders' Equity	\$9,105.5	\$8,567.3

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE A - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10 Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019. For further information, refer to the consolidated financial statements and footnotes included in PACCAR Inc's (PACCAR or the Company) Annual Report on Form 10 K for the year ended December 31, 2018.

Earnings per Share: Basic earnings per common share are computed by dividing earnings by the weighted average number of common shares outstanding, plus the effect of any participating securities. Diluted earnings per common share are computed assuming that all potentially dilutive securities are converted into common shares under the treasury stock method. The dilutive and antidilutive options are shown separately in the table below.

<u>Three Months Ended March 31,</u>	2019	2018
Additional shares	592,400	1,007,800
Antidilutive options	2,037,400	1,173,100

Reclassifications: The Company reclassified certain prior period balances to conform to the 2019 presentation. Operating cash flows from sales-type finance leases and dealer direct loans on new trucks for the three months ended March 31, 2018 were reclassified to Income taxes, warranty and other (\$30.0 million) and Trade and other receivables (\$1.7 million), respectively, within cash provided by operating activities in the Consolidated Statements of Cash Flows. The Company changed its presentation of Finance leases as of December 31, 2018 in Note E from gross to net of unearned interest on finance leases for comparability with the current period. As of December 31, 2018, unearned interest on finance leases was \$387.5 million.

New Accounting Pronouncements

New Lease Standard

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*, including subsequently issued ASUs to clarify the implementation guidance in ASU 2016-02. Under the new lease standard, lessees recognize a right-of-use asset and a lease liability for virtually all leases (other than short-term leases). Lessor accounting is largely unchanged, except for a reduction in the capitalization of certain initial direct costs and the classification of certain cash flows. This ASU may be applied

retrospectively in each reporting period presented or modified retrospectively with the cumulative effect adjustment to the opening balance of retained earnings. The Company adopted this ASU on January 1, 2019 on a modified retrospective basis, with no effect on Retained earnings.

The Company elected the package of practical expedients for its leases existing prior to the adoption of this ASU that will retain prior conclusions about lease identification, lease classification and initial direct costs under the new standard. For lessee accounting, the Company elected the short-term lease exemption to not recognize right-of-use assets and lease liabilities for any leases with a duration of twelve months or less. For lessor accounting, the Company elected to exclude taxes collected from customers, such as sales and use and value added, from the measurement of lease income and expense.

The new standard requires lessors within the scope of ASC 942, *Financial Services – Depository and Lending*, to classify principal payments received from sales-type and direct financing leases in investing activities in the statement of cash flows. The Company continues to present cash receipts from direct finance leases as an investing cash inflow and reclassified cash flows from sales-type leases from operating to investing activities. For the three months ended March 31, 2019, total cash originations and cash receipts from sales-type leases were \$30.5 million and \$50.3 million, respectively.

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The cumulative effect of the changes made to the Company's Consolidated Balance Sheet on January 1, 2019 for the adoption of ASU 2016-02 was as follows:

	BALANCE AT	CHANGE	BALANCE AT
	DECEMBER 31, 2018	DUE TO NEW STANDARD	JANUARY 1, 2019
Consolidated Balance Sheets			
ASSETS			
TRUCK, PARTS AND OTHER:			
Other noncurrent assets, net	\$ 651.9	\$ 40.9	\$ 692.8
FINANCIAL SERVICES:			
Other assets	547.1	5.8	552.9
LIABILITIES AND STOCKHOLDERS' EQUITY			
TRUCK, PARTS AND OTHER:			
Accounts payable, accrued expenses and other	3,027.7	12.6	3,040.3
Other liabilities	1,145.7	28.5	1,174.2
FINANCIAL SERVICES:			
Accounts payable, accrued expenses and other	523.2	1.3	524.5
Deferred taxes and other liabilities	704.9	4.3	709.2

Other Standards

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendment requires entities having financial assets measured at amortized cost to estimate credit reserves under an expected credit loss model rather than the current incurred loss model. Under this new model, expected credit losses will be based on relevant information about past events, including historical experience, current conditions and reasonable and supportable forecasts that affect collectability. The ASU is effective for annual periods beginning after December 15, 2019 and interim periods within those annual periods. Early adoption is permitted. This amendment should be applied on a modified retrospective basis with a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the impact on its consolidated financial statements.

In addition to adopting the ASUs disclosed above, the Company adopted the following standards effective January 1, 2019, none of which had a material impact on the Company's consolidated financial statements.

STANDARD DESCRIPTION

2018-07 * Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting.

*The Company adopted on the effective date of January 1, 2019.

The FASB also issued the following standards which are not expected to have a material impact on the Company’s consolidated financial statements.

STANDARD DESCRIPTION

EFFECTIVE
DATE

2018-13 *	Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement.	January 1, 2020
2018-14 *	Compensation – Retirement Benefits – Defined Benefit Plans – General (Topic 715-20) Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans.	January 1, 2021
2018-15 *	Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.	January 1, 2020

*The Company will adopt on the effective date.

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Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE B – Sales and Revenues

Truck, Parts and Other

The Company enters into sales contracts with customers associated with purchases of the Company's products and services including trucks, parts, product support, and other related services. Generally, the Company recognizes revenue for the amount of consideration it will receive for delivering a product or service to a customer. Revenue is recognized when the customer obtains control of the product or receives benefits of the service. The Company excludes sales taxes, value added taxes and other related taxes assessed by government agencies from revenue. There are no significant financing components included in product or service revenue since generally customers pay shortly after the products or services are transferred. In the Truck and Parts segment, when the Company grants extended payment terms on selected receivables and charges interest, interest income is recognized when earned.

The following table disaggregates Truck, Parts and Other revenues by major sources:

<u>Three Months Ended March 31,</u>	2019	2018
Truck		
Truck sales	\$4,913.6	\$4,174.4
Revenues from extended warranties, operating leases and other	193.7	178.6
	5,107.3	4,353.0
Parts		
Parts sales	976.6	912.1
Revenues from dealer services and other	28.1	27.8
	1,004.7	939.9
Winch sales and other	26.1	28.9
Truck, Parts and Other sales and revenues	\$6,138.1	\$5,321.8

The Company recognizes truck and parts sales as revenue when control of the products is transferred to customers which generally occurs upon shipment, except for certain truck sales which are subject to a residual value guarantee (RVG) by the Company. The standard payment term for trucks and aftermarket parts is typically within 30 days, but the Company may grant extended payment terms on selected receivables. The Company recognizes revenue for the invoice amount adjusted for estimated sales incentives and returns. Sales incentives and returns are estimated based on historical experience and are adjusted to current period revenue when the most likely amount of consideration the Company expects to receive changes or becomes fixed. Truck and part sales include a standard product warranty which is included in cost of sales. The Company has elected to treat delivery services as a fulfillment activity with

revenues recognized when the customer obtains control of the product. Delivery revenue is included in revenues and the related costs are included in cost of sales. As a practical expedient, the Company is not disclosing truck order backlog, as a significant majority of the backlog has a duration of less than one year.

Truck sales with RVG that allow customers the option to return their truck are accounted for as a sale when the customer does not have an economic incentive to return the truck to the Company, or as an operating lease when the customer does have an economic incentive to return the truck. The estimate of customers' economic incentive to return the trucks is based on an analysis of historical guaranteed buyback value and estimated market value. When truck sales with RVGs are accounted for as a sale, revenue is recognized when the truck is transferred to the customer less an amount for expected returns. Expected return rates are estimated by using a historical weighted average return rate over a four-year period. The estimated value of the truck assets to be returned and the related return liabilities at March 31, 2019 were \$364.4 and \$376.6, respectively, compared to \$319.8 and \$329.3 at December 31, 2018, respectively. The Company's total commitment to acquire trucks at a guaranteed value for contracts accounted for as a sale was \$781.8 at March 31, 2019.

Revenues from extended warranties, operating leases and other includes optional extended warranty and repair and maintenance service contracts which can be purchased for periods generally ranging up to five years. The Company defers revenue based on stand-alone observable selling prices when it receives payments in advance and generally recognizes the revenue on a straight-line basis over the warranty or repair and maintenance contract periods. See Note H, Product Support Liabilities, in the Notes to the Consolidated Financial Statements for further information. Also included are truck sales with an RVG accounted for as an operating lease. A liability is created for the residual value obligation with the remainder of the proceeds recorded as deferred revenue. The deferred revenue is recognized on a straight-line basis over the guarantee period, which typically ranges from three to five years. Total operating lease income from truck sales with RVGs was \$41.7 for the three months ended March 31, 2019.

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Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Aftermarket parts sales allow for returns which are estimated at the time of sale based on historical data. At March 31, 2019, the estimated value of the returned goods asset and the related return liability were \$49.3 and \$109.3, respectively, compared to \$49.0 and \$104.5 at December 31, 2018, respectively. Parts dealer services and other revenues are recognized as services are performed.

Revenue from winch sales and other is primarily derived from the industrial winch business. Winch sales are recognized when the product is transferred to a customer, which generally occurs upon shipment. Also within this category are other revenues not attributable to a reportable segment.

Financial Services

The Company's Financial Services segment products include loans to customers collateralized by the vehicles being financed, finance leases to lease equipment to retail customers and dealers, dealer wholesale financing which includes floating-rate wholesale loans to PACCAR dealers for new and used trucks, and operating leases which includes rentals on Company owned equipment. Interest income from loans, finance leases and other receivables is recognized using the interest method. Certain loan origination costs are deferred and amortized to interest income over the expected life of the contracts using the straight-line method which approximates the interest method. Operating lease rental revenue is recognized on a straight-line basis over the term of the lease. Customer contracts may include additional services such as excess mileage, repair and maintenance and other services on which revenue is recognized when earned. The Company's full-service lease arrangements bundles these additional services. Rents for full-service lease contracts are allocated between lease and non-lease components based on the relative stand-alone price of each component. Taxes, such as sales and use and value added, which are collected by the Company from a customer, are excluded from the measurement of lease income and expenses.

Recognition of interest income and rental revenue is suspended (put on non-accrual status) when the receivable becomes more than 90 days past the contractual due date or earlier if some other event causes the Company to determine that collection is not probable. Accordingly, no finance receivables more than 90 days past due were accruing interest at March 31, 2019 or December 31, 2018. Recognition is resumed if the receivable becomes current by the payment of all amounts due under the terms of the existing contract and collection of remaining amounts is considered probable (if not contractually modified) or if the customer makes scheduled payments for three months and collection of remaining amounts is considered probable (if contractually modified). Payments received while the finance receivable is on non-accrual status are applied to interest and principal in accordance with the contractual terms.

Finance leases are secured by the trucks and related equipment being leased and the lease terms generally range from three to five years depending on the type and use of the equipment. The lessee is required to either purchase the equipment or guarantee to the Company a stated residual value upon the disposition of the equipment at the end of the finance lease term.

Operating lease terms generally range from three to five years. At the end of the operating lease term, the lessee has the option to return the equipment to the Company or purchase the equipment at its fair market value.

The Company determines its estimate of the residual value of leased vehicles by considering the length of the lease term, the truck model, the expected usage of the truck and anticipated market demand. If the sales price of the truck at the end of the agreement differs from the Company's estimated residual value, a gain or loss will result. Future market conditions, changes in government regulations and other factors outside the Company's control could impact the ultimate sales price of trucks returned under these contracts. Residual values are reviewed regularly and adjusted if market conditions warrant.

The Company recognized lease income as follows:

<u>Three Months Ended March 31,</u>	2019
Finance lease income	\$35.3
Operating lease income	200.7
Total lease income	\$236.0

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Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE C - Investments in Marketable Debt Securities

The Company's investments in marketable debt securities are classified as available-for-sale. These investments are stated at fair value with any unrealized gains or losses, net of tax, included as a component of accumulated other comprehensive income (loss) (AOCI).

The Company utilizes third-party pricing services for all of its marketable debt security valuations. The Company reviews the pricing methodology used by the third party pricing services, including the manner employed to collect market information. On a quarterly basis, the Company also performs review and validation procedures on the pricing information received from the third party providers. These procedures help ensure the fair value information used by the Company is determined in accordance with applicable accounting guidance.

The Company evaluates its investment in marketable debt securities at the end of each reporting period to determine if a decline in fair value is other-than-temporary. Realized losses are recognized upon management's determination that a decline in fair value is other-than-temporary. The determination of other-than-temporary impairment is a subjective process, requiring the use of judgments and assumptions regarding the amount and timing of recovery. The Company reviews and evaluates its investments at least quarterly to identify investments that have indications of other-than-temporary impairments. It is reasonably possible that a change in estimate could occur in the near term relating to other-than-temporary impairment. Accordingly, the Company considers several factors when evaluating debt securities for other-than-temporary impairment, including whether the decline in fair value of the security is due to increased default risk for the specific issuer or market interest-rate risk.

In assessing default risk, the Company considers the collectability of principal and interest payments by monitoring changes to issuers' credit ratings, specific credit events associated with individual issuers as well as the credit ratings of any financial guarantor, and the extent and duration to which amortized cost exceeds fair value.

In assessing market interest rate risk, including benchmark interest rates and credit spreads, the Company considers its intent for selling the securities and whether it is more likely than not the Company will be able to hold these securities until the recovery of any unrealized losses.

Marketable debt securities at March 31, 2019 and December 31, 2018 consisted of the following:

	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
<u>At March 31, 2019</u>				
U.S. tax-exempt securities	\$ 304.2	\$ 1.1	\$.4	\$304.9
U.S. corporate securities	162.4	1.1	.1	163.4
U.S. government and agency securities	110.9	.3	.2	111.0
Non-U.S. corporate securities	301.8	1.5	.5	302.8
Non-U.S. government securities	74.2	.2		74.4
Other debt securities	125.0	.6	.5	125.1
	\$ 1,078.5	\$ 4.8	\$ 1.7	\$1,081.6

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<u>At December 31, 2018</u>	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
U.S. tax-exempt securities	\$ 326.0	\$.3	\$ 1.2	\$325.1
U.S. corporate securities	147.6	.2	.4	147.4
U.S. government and agency securities	98.9	.2	.4	98.7
Non-U.S. corporate securities	272.5	.4	1.6	271.3
Non-U.S. government securities	55.9	.1	.1	55.9
Other debt securities	122.6	.2	.8	122.0
	\$ 1,023.5	\$ 1.4	\$ 4.5	\$1,020.4

The cost of marketable debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Amortization, accretion, interest and dividend income and realized gains and losses are included in investment income. The cost of securities sold is based on the specific identification method. Gross realized gains were \$.2 and \$.9 and gross realized losses were \$.1 and \$.5 for the three months periods ended March 31, 2019 and 2018, respectively.

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Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Marketable debt securities with continuous unrealized losses and their related fair values were as follows:

	March 31, 2019		December 31, 2018	
	LESS		LESS	
	THAN	TWELVE MONTHS	THAN	TWELVE MONTHS
	TWELVE MONTHS	OR GREATER	TWELVE MONTHS	OR GREATER
Fair value	\$ 53.5	\$ 370.3	\$ 252.8	\$ 397.9
Unrealized losses		1.7	.8	3.7

For the investment securities in gross unrealized loss positions identified above, the Company does not intend to sell the investment securities. It is more likely than not that the Company will not be required to sell the investment securities before recovery of the unrealized losses, and the Company expects that the contractual principal and interest will be received on the investment securities. As a result, the Company recognized no other-than-temporary impairments during the periods presented.

Contractual maturities on marketable debt securities at March 31, 2019 were as follows:

	AMORTIZED COST	FAIR VALUE
<u>Maturities:</u>		
Within one year	\$ 319.1	\$318.8
One to five years	740.7	744.1
Six to ten years	3.7	3.7
More than ten years	15.0	15.0
	\$ 1,078.5	\$1,081.6

NOTE D - Inventories

Inventories are stated at the lower of cost or market. Cost of inventories in the U.S. is determined principally by the last in, first-out (LIFO) method. Cost of all other inventories is determined principally by the first-in, first-out (FIFO) method.

Inventories include the following:

	March 31 2019	December 31 2018
Finished products	\$641.8	\$ 563.2

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Work in process and raw materials	814.6	803.3
	1,456.4	1,366.5
Less LIFO reserve	(183.8)	(181.8)
	\$1,272.6	