

POLARIS INDUSTRIES INC/MN

Form 10-Q

July 25, 2018

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

FORM 10-Q

(Mark
one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended June 30, 2018

OR

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 1-11411

POLARIS INDUSTRIES INC.
(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of
incorporation or organization)

41-1790959
(I.R.S.
Employer
Identification
No.)

2100 Highway 55, Medina MN
(Address of principal executive offices)

55340
(Zip Code)

(763) 542-0500
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of July 19, 2018, 62,244,677 shares of Common Stock, \$.01 par value, of the registrant were outstanding.

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 FORM 10-Q
 For Quarterly Period Ended June 30, 2018

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Part I FINANCIAL INFORMATION
Item 1 – FINANCIAL STATEMENTS
POLARIS INDUSTRIES INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

| | June 30, 2018 (Unaudited) | December 31, 2017 |
|---|---------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 181,753 | \$ 138,345 |
| Trade receivables, net | 190,343 | 200,144 |
| Inventories, net | 925,243 | 783,961 |
| Prepaid expenses and other | 106,586 | 101,453 |
| Income taxes receivable | 10,269 | 29,601 |
| Total current assets | 1,414,194 | 1,253,504 |
| Property and equipment, net | 762,268 | 747,189 |
| Investment in finance affiliate | 92,954 | 88,764 |
| Deferred tax assets | 115,399 | 115,511 |
| Goodwill and other intangible assets, net | 765,050 | 780,586 |
| Other long-term assets | 89,613 | 104,039 |
| Total assets | \$3,239,478 | \$3,089,593 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Current portion of debt, capital lease obligations and notes payable | \$40,120 | \$47,746 |
| Accounts payable | 361,717 | 317,377 |
| Accrued expenses: | | |
| Compensation | 129,719 | 168,014 |
| Warranties | 106,155 | 123,840 |
| Sales promotions and incentives | 184,811 | 162,298 |
| Dealer holdback | 125,016 | 114,196 |
| Other | 161,659 | 186,103 |
| Income taxes payable | 5,973 | 10,737 |
| Total current liabilities | 1,115,170 | 1,130,311 |
| Long-term income taxes payable | 25,332 | 20,114 |
| Capital lease obligations | 17,135 | 18,351 |
| Long-term debt | 1,055,367 | 846,915 |
| Deferred tax liabilities | 8,667 | 10,128 |
| Other long-term liabilities | 127,529 | 120,398 |
| Total liabilities | \$2,349,200 | \$2,146,217 |
| Deferred compensation | \$12,768 | \$11,717 |
| Shareholders' equity: | | |
| Preferred stock \$0.01 par value, 20,000 shares authorized, no shares issued and outstanding | — | — |
| Common stock \$0.01 par value, 160,000 shares authorized, 62,214 and 63,075 shares issued and outstanding, respectively | \$622 | \$631 |
| Additional paid-in capital | 791,148 | 733,894 |
| Retained earnings | 140,033 | 242,763 |
| Accumulated other comprehensive loss, net | (54,293) | (45,629) |
| Total shareholders' equity | 877,510 | 931,659 |

| | | |
|--|-------------|-------------|
| Total liabilities and shareholders' equity | \$3,239,478 | \$3,089,593 |
|--|-------------|-------------|

The accompanying footnotes are an integral part of these consolidated statements.

Table of ContentsPOLARIS INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

| | Three months ended June | | Six months ended June | |
|--------------------------------------|-------------------------|-------------|-----------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Sales | \$1,502,532 | \$1,364,920 | \$2,800,005 | \$2,518,702 |
| Cost of sales | 1,117,356 | 1,014,534 | 2,091,348 | 1,925,825 |
| Gross profit | 385,176 | 350,386 | 708,657 | 592,877 |
| Operating expenses: | | | | |
| Selling and marketing | 122,859 | 118,531 | 240,566 | 232,844 |
| Research and development | 68,330 | 60,753 | 133,560 | 112,758 |
| General and administrative | 92,874 | 91,063 | 171,567 | 166,577 |
| Total operating expenses | 284,063 | 270,347 | 545,693 | 512,179 |
| Income from financial services | 21,344 | 19,143 | 42,769 | 39,573 |
| Operating income | 122,457 | 99,182 | 205,733 | 120,271 |
| Non-operating expense: | | | | |
| Interest expense | 9,216 | 8,032 | 17,264 | 15,946 |
| Equity in loss of other affiliates | 3,954 | 1,336 | 25,465 | 3,236 |
| Other expense (income), net | (3,561) | (2,152) | (23,536) | 9,456 |
| Income before income taxes | 112,848 | 91,966 | 186,540 | 91,633 |
| Provision for income taxes | 20,308 | 29,925 | 38,286 | 32,503 |
| Net income | \$92,540 | \$62,041 | \$148,254 | \$59,130 |
| Net income per share: | | | | |
| Basic | \$1.46 | \$0.99 | \$2.34 | \$0.94 |
| Diluted | \$1.43 | \$0.97 | \$2.28 | \$0.92 |
| Weighted average shares outstanding: | | | | |
| Basic | 63,172 | 62,895 | 63,238 | 63,012 |
| Diluted | 64,886 | 63,807 | 65,052 | 63,970 |

The accompanying footnotes are an integral part of these consolidated statements.

Table of ContentsPOLARIS INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income | \$92,540 | \$62,041 | \$148,254 | \$59,130 |
| Other comprehensive income, net of tax: | | | | |
| Foreign currency translation adjustments | (24,881) | 17,020 | (13,903) | 30,436 |
| Unrealized gain (loss) on derivative instruments | 580 | (1,397) | 5,109 | (1,041) |
| Retirement benefit plan activity | 45 | — | 130 | — |
| Comprehensive income | \$68,284 | \$77,664 | \$139,590 | \$88,525 |

The accompanying footnotes are an integral part of these consolidated statements.

Table of ContentsPOLARIS INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Six months ended June 30, | |
|---|------------------------------|--------------|
| | 2018 | 2017 |
| Operating Activities: | | |
| Net income | \$148,254 | \$59,130 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 98,584 | 91,124 |
| Noncash compensation | 33,001 | 31,416 |
| Noncash income from financial services | (14,626) | (13,328) |
| Deferred income taxes | (1,704) | (4,083) |
| Impairment charges | 20,249 | 18,760 |
| Other, net | (8,262) | 3,236 |
| Changes in operating assets and liabilities: | | |
| Trade receivables | 5,326 | 12,370 |
| Inventories | (146,661) | (59,421) |
| Accounts payable | 45,835 | 75,576 |
| Accrued expenses | (35,693) | 6,406 |
| Income taxes payable/receivable | 19,828 | 40,727 |
| Prepaid expenses and others, net | 1,018 | 1,130 |
| Net cash provided by operating activities | 165,149 | 263,043 |
| Investing Activities: | | |
| Purchase of property and equipment | (104,569) | (81,803) |
| Investment in finance affiliate, net | 10,436 | 20,785 |
| Investment in other affiliates, net | 7,366 | (1,814) |
| Acquisition and disposal of businesses, net of cash acquired | — | 1,645 |
| Net cash used for investing activities | (86,767) | (61,187) |
| Financing Activities: | | |
| Borrowings under debt arrangements / capital lease obligations | 1,511,810 | 932,317 |
| Repayments under debt arrangements / capital lease obligations | (1,310,863) | (1,010,870) |
| Repurchase and retirement of common shares | (192,367) | (65,622) |
| Cash dividends to shareholders | (75,694) | (72,612) |
| Proceeds from stock issuances under employee plans | 43,448 | 7,027 |
| Net cash used for financing activities | (23,666) | (209,760) |
| Impact of currency exchange rates on cash balances | (6,370) | 6,951 |
| Net increase (decrease) in cash, cash equivalents and restricted cash | 48,346 | (953) |
| Cash, cash equivalents and restricted cash at beginning of period | 161,618 | 145,170 |
| Cash, cash equivalents and restricted cash at end of period | \$209,964 | \$144,217 |
| Supplemental Cash Flow Information: | | |
| Interest paid on debt borrowings | \$17,013 | \$15,466 |
| Income taxes paid (refunded) | \$20,614 | \$(4,735) |

The following presents cash, cash equivalents and restricted cash by category within the consolidated balance sheets:

| | | |
|---------------------------|-----------|-----------|
| Cash and cash equivalents | \$181,753 | \$127,378 |
|---------------------------|-----------|-----------|

| | | |
|------------------------|-----------|-----------|
| Other long-term assets | 28,211 | 16,839 |
| Total | \$209,964 | \$144,217 |

The accompanying footnotes are an integral part of these consolidated statements.

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POLARIS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Significant Accounting Policies

Basis of presentation. The accompanying unaudited consolidated financial statements of Polaris Industries Inc. (“Polaris” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements and, therefore, do not include all information and disclosures of results of operations, financial position and changes in cash flow in conformity with accounting principles generally accepted in the United States for complete financial statements. Accordingly, such statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 previously filed with the Securities and Exchange Commission (“SEC”). In the opinion of management, such statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. Due to the seasonality trends for certain products and to certain changes in production and shipping cycles, results of such periods are not necessarily indicative of the results to be expected for the complete year.

Fair value measurements. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Assets and liabilities measured at fair value are classified using the following hierarchy, which is based upon the transparency of inputs to the valuation as of the measurement date:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In making fair value measurements, observable market data must be used when available. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement. The Company utilizes the market approach to measure fair value for its non-qualified deferred compensation assets and liabilities, and the income approach for foreign currency contracts and commodity contracts. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities, and for the income approach, the Company uses significant other observable inputs to value its derivative instruments used to hedge foreign currency and commodity transactions.

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

| Asset (Liability) | Fair Value Measurements as of June 30, 2018 | | | |
|---|---|--------------|----------|---------|
| | Total | Level 1 | Level 2 | Level 3 |
| Non-qualified deferred compensation assets | \$ 54,828 | \$ 54,828 | \$ — | \$ — |
| Foreign exchange contracts, net | 5,931 | — | 5,931 | — |
| Total assets at fair value | \$ 60,759 | \$ 54,828 | \$ 5,931 | \$ — |
| Non-qualified deferred compensation liabilities | \$ (54,828) | \$ (54,828) | \$ — | \$ — |
| Total liabilities at fair value | \$ (54,828) | \$ (54,828) | \$ — | \$ — |

| Asset (Liability) | Fair Value Measurements as of December 31, 2017 | | | |
|---|---|--------------|-----------|---------|
| | Total | Level 1 | Level 2 | Level 3 |
| Non-qualified deferred compensation assets | \$ 54,244 | \$ 54,244 | \$ — | \$ — |
| Total assets at fair value | \$ 54,244 | \$ 54,244 | \$ — | \$ — |
| Non-qualified deferred compensation liabilities | \$ (54,244) | \$ (54,244) | \$ — | \$ — |
| Foreign exchange contracts, net | (426) | — | (426) | — |
| Total liabilities at fair value | \$ (54,670) | \$ (54,244) | \$ (426) | \$ — |

Fair value of other financial instruments. The carrying values of the Company's short-term financial instruments, including cash and cash equivalents, trade receivables and short-term debt, including current maturities of long-term debt, capital lease

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obligations and notes payable, approximate their fair values. At June 30, 2018 and December 31, 2017, the fair value of the Company's long-term debt, capital lease obligations and notes payable was approximately \$1,117,197,000 and \$922,123,000, respectively, and was determined using Level 2 inputs, including quoted market prices or discounted cash flows based on quoted market rates for similar types of debt. The carrying value of long-term debt, capital lease obligations and notes payable including current maturities was \$1,112,622,000 and \$913,012,000 as of June 30, 2018 and December 31, 2017, respectively.

Inventories. Inventory costs include material, labor and manufacturing overhead costs, including depreciation expense associated with the manufacture and distribution of the Company's products. Inventories are stated at the lower of cost (first-in, first-out method) or net realizable value. The major components of inventories are as follows (in thousands):

| | June 30, 2018 | December 31, 2017 |
|---|------------------|----------------------|
| Raw materials and purchased components | \$208,501 | \$194,108 |
| Service parts, garments and accessories | 320,396 | 307,684 |
| Finished goods | 443,039 | 329,288 |
| Less: reserves | (46,693) | (47,119) |
| Inventories | \$925,243 | \$783,961 |

Product warranties. Polaris provides a limited warranty for its vehicles for a period of six months to two years, depending on the product. Polaris provides longer warranties in certain geographical markets as determined by local regulations and market conditions and may also provide longer warranties related to certain promotional programs. Polaris' standard warranties require the Company or its dealers to repair or replace defective products during such warranty periods at no cost to the consumer. The warranty reserve is established at the time of sale to the dealer or distributor based on management's best estimate using historical rates and trends. Adjustments to the warranty reserve are made from time to time as actual claims become known in order to properly estimate the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. Factors that could have an impact on the warranty accrual in any given period include the following: change in manufacturing quality, shifts in product mix, changes in warranty coverage periods, snowfall and its impact on snowmobile usage, product recalls and any significant changes in sales volume. The activity in the warranty reserve during the periods presented was as follows (in thousands):

| | Three months ended June 30, | | Six months ended June 30, | |
|--------------------------------|--------------------------------|-----------|------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| Balance at beginning of period | \$116,286 | \$109,852 | \$123,840 | \$119,274 |
| Additions charged to expense | 26,141 | 30,122 | 42,172 | 61,816 |
| Warranty claims paid, net | (36,272) | (31,571) | (59,857) | (72,687) |
| Balance at end of period | \$106,155 | \$108,403 | \$106,155 | \$108,403 |

New accounting pronouncements.

Revenue from contracts with customers. Effective January 1, 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers, ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), and ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients using the modified retrospective approach. The adoption of these ASUs did not have a material impact on the Company's consolidated financial position, results of operations, equity or cash flows as of the adoption date or for the three or six months ended June 30, 2018. The Company has included the disclosures required by ASU 2014-09 in Note 2.

Statement of cash flows. During the first quarter of 2018, the Company adopted ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that restricted cash 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.

Prior periods were retrospectively adjusted to conform to the current period's presentation. As a result of the adoption of ASU 2016-18, the Company recorded a decrease of \$1,006,000 in net cash provided by operating activities for the

six months ended June 30, 2017 related to reclassifying the changes in our restricted cash balance from operating activities to the cash and cash equivalent balances within the Consolidated Statements of Cash Flows.

Leases. In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This ASU requires most lessees to recognize right of use assets and lease liabilities, but recognize expenses in a manner similar with current accounting standards. The standard is effective for fiscal years and interim periods beginning after December 15, 2018 and is effective

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for the Company's fiscal year beginning January 1, 2019. Entities are required to use a modified retrospective approach, with early adoption permitted. The Company developed a project plan to guide the implementation of ASU 2016-02. The Company made progress on this plan including surveying the Company's businesses, assessing the Company's portfolio of leases, compiling information on active leases, and selecting a lease accounting software. The Company is currently identifying and implementing appropriate changes to its policies, business processes, systems and controls to support lease accounting and disclosures under Topic 842. The Company is currently evaluating the impact of this new standard on the consolidated financial statements.

Derivatives and hedging. In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This ASU better aligns accounting rules with a company's risk management activities; better reflects economic results of hedging in financial statements; and simplifies hedge accounting treatment. The standard is effective for fiscal years and interim periods beginning after December 15, 2018 and is effective for the Company's fiscal year beginning January 1, 2019, with early adoption permitted. The Company is evaluating the impact of this new standard on the financial statements.

Income Taxes. The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign-sourced earnings.

The Company has applied the guidance in ASU 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118, when accounting for the enactment-date effects of the Act. At June 30, 2018, the Company has not completed its accounting for the tax effects of the Act, as the Company is in the process of analyzing certain aspects of the Act, obtaining information, and refining its calculations of the Act's impact. There have been no material measurement period adjustments made during the three and six months ended June 30, 2018 related to the provisional amounts recorded and disclosed in the Company's fiscal 2017 Annual Report filed on Form 10-K. The Company expects to complete the accounting for the tax effects of the Act during 2018.

There are no other new accounting pronouncements that are expected to have a significant impact on the Company's consolidated financial statements.

Note 2. Revenue Recognition

The following tables disaggregate the Company's revenue by major product type and geography (in thousands):

| | Three months ended June 30, 2018 | | | | |
|--------------------------------|----------------------------------|-------------|---------------------------|-------------|--------------|
| | ORV / Snowmobiles | Motorcycles | Global Adj. Markets | Aftermarket | Consolidated |
| Revenue by product type | | | | | |
| Wholegoods | \$820,850 | \$ 146,671 | \$93,550 | — | \$ 1,061,071 |
| PG&A | 169,991 | 24,741 | 19,868 | \$ 226,861 | 441,461 |
| Total revenue | \$990,841 | \$ 171,412 | \$ 113,418 | \$ 226,861 | \$ 1,502,532 |
| Revenue by geography | | | | | |
| United States | \$818,318 | \$ 113,561 | \$49,740 | \$ 215,572 | \$ 1,197,191 |
| Canada | 68,576 | 10,769 | 10,216 | 11,289 | 100,850 |
| EMEA | 64,632 | 31,667 | 52,169 | — | 148,468 |
| APLA | 39,315 | 15,415 | 1,293 | — | 56,023 |
| Total revenue | \$990,841 | \$ 171,412 | \$ 113,418 | \$ 226,861 | \$ 1,502,532 |

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Six months ended June 30, 2018

| | ORV / Snowmobiles | Motorcycles | Global Adj. Markets | Aftermarket | Consolidated |
|-------------------------|----------------------|-------------|---------------------------|-------------|--------------|
| Revenue by product type | | | | | |
| Wholegoods | \$1,504,353 | \$ 260,779 | \$ 185,562 | — | \$ 1,950,694 |
| PG&A | 319,052 | 42,190 | 41,183 | \$ 446,886 | 849,311 |
| Total revenue | \$1,823,405 | \$ 302,969 | \$ 226,745 | \$ 446,886 | \$ 2,800,005 |

Revenue by geography

| | | | | | |
|---------------|-------------|------------|------------|------------|--------------|
| United States | \$1,480,913 | \$ 197,458 | \$99,794 | \$ 426,566 | \$ 2,204,731 |
| Canada | 126,331 | 17,709 | 15,585 | 20,320 | 179,945 |
| EMEA | 143,561 | 58,338 | 109,089 | — | 310,988 |
| APLA | 72,600 | 29,464 | 2,277 | — | 104,341 |
| Total revenue | \$1,823,405 | \$ 302,969 | \$ 226,745 | \$ 446,886 | \$ 2,800,005 |

Revenue is recognized when obligations under the terms of a contract with the Company's customer are satisfied which generally occurs with the transfer of control of the wholegood vehicles, parts, garments or accessories, and upon completion of the service or over the term of the agreement in proportion to the costs expected to be incurred in satisfying the obligations under the contract, for services. Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring goods or providing services. Sales, value add, and other taxes the Company collects concurrent with revenue-producing activities are excluded from revenue. Incidental items that are immaterial in the context of the contract are recognized as expense. The expected costs associated with the Company's limited warranties and field service bulletin actions continue to be recognized as expense when the products are sold. The Company recognizes revenue for vehicle service contracts that extend mechanical and maintenance beyond the Company's limited warranties over the life of the contract.

ORV/Snowmobiles, Motorcycles and Global Adjacent Markets segments

Wholegood vehicles and parts, garments and accessories. For the majority of wholegood vehicles, parts, garments and accessories (PG&A), the Company transfers control and recognizes a sale when it ships the product from its manufacturing facility, distribution center, or vehicle holding center to its customer (primarily dealers and distributors). The amount of consideration the Company receives and revenue it recognizes varies with changes in marketing incentives and returns it offers to its dealers and their customers. Sales returns are not material. The Company adjusts its estimate of revenue at the earlier of when the most likely amount of consideration it expects to receive changes or when the consideration becomes fixed.

Depending on the terms of the arrangement, the Company may also defer the recognition of a portion of the consideration received because it has to satisfy a future obligation (e.g., free extended service contracts). The Company uses an observable price to determine the stand-alone selling price for separate performance obligations. The Company has elected to recognize the cost for freight and shipping when control over vehicles, parts, garments or accessories have transferred to the customer as an expense in Cost of sales.

Extended Service Contracts. The Company sells separately-priced service contracts that extend mechanical and maintenance coverages beyond its base limited warranty agreements to vehicle owners. The separately priced service contracts range from 12 months to 84 months. The Company primarily receives payment at the inception of the contract and recognizes revenue over the term of the agreement in proportion to the costs expected to be incurred in satisfying the obligations under the contract.

Aftermarket segment

The Company's Aftermarket products are sold through dealer, distributor, retail, and e-commerce channels. The Company transfers control and recognizes a sale when products are shipped or delivered to its customer. The amount of consideration the Company receives and revenue it recognizes varies with changes in marketing incentives and return rights it offers to its customers and their customers. When the Company gives its customers the right to return eligible parts and accessories, it estimates the expected returns based on an analysis of historical experience. The

Company adjusts its estimate of revenue at the earlier of when the most likely amount of consideration it expects to receive changes or when the consideration becomes fixed.

Service revenue. At the Company's Transamerican Auto Parts ("TAP") retail stores (4 Wheel Parts), it offers installation services for parts that the retail store sells. Service revenues are recognized upon completion of the service.

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Depending on the terms of the arrangement, the Company may also defer the recognition of a portion of the consideration received because it has to satisfy a future obligation (e.g., extended service contracts). The Company uses an observable price to determine the stand-alone selling price for separate performance obligations. The Company has elected to recognize the cost for freight and shipping when control over parts, garments or accessories have transferred to the customer as an expense in cost of sales.

Deferred revenue

In 2016, Polaris began financing its self-insured risks related to extended service contracts (“ESCs”). The premiums for ESCs are primarily recognized in income in proportion to the costs expected to be incurred over the contract period. Warranty costs are recognized as incurred. Revenues related to sales of its extended warranty program and related accrued costs for claims are deferred and amortized over the warranty period, generally five years, while warranty administrative costs are recognized as incurred. TAP recognizes revenues related to sales of its extended warranty programs for tires and other products over the term of the warranty period, which varies from two to five years. At January 1, 2018, \$45,760,000 of unearned revenue associated with outstanding contracts was reported in other current liabilities and other long-term liabilities. At June 30, 2018, the unearned amount was \$52,620,000. The Company expects to recognize approximately \$22,265,000 of the unearned amount in 2018 and \$30,355,000 thereafter. The activity in the deferred revenue reserve during the periods presented was as follows (in thousands):

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Balance at beginning of period | \$49,345 | \$30,445 | \$45,760 | \$26,157 |
| New contracts sold | 8,848 | 8,772 | 17,172 | 15,114 |
| Less: reductions for revenue recognized | (5,573) | (3,029) | (10,312) | (5,083) |
| Balance at end of period (1) | \$52,620 | \$36,188 | \$52,620 | \$36,188 |

(1) The unamortized ESC premiums (deferred revenue) recorded in other current liabilities totaled \$22,265,000 and \$14,678,000 at June 30, 2018 and 2017, respectively, while the amount recorded in other long-term liabilities totaled \$30,355,000 and \$21,510,000 at June 30, 2018 and 2017, respectively.

Note 3. Share-Based Compensation

The amount of compensation cost for share-based awards to be recognized during a period is based on the portion of the awards that are ultimately expected to vest. The Company estimates forfeitures at the time of grant and revises those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company analyzes historical data to estimate pre-vesting forfeitures and records share-based compensation expense for those awards expected to vest.

Total share-based compensation expenses were comprised as follows (in thousands):

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Option plan | \$6,758 | \$5,649 | \$9,815 | \$7,071 |
| Other share-based awards | 13,847 | 13,018 | 19,736 | 22,110 |
| Total share-based compensation before tax | 20,605 | 18,667 | 29,551 | 29,181 |
| Tax benefit | 4,904 | 6,933 | 7,033 | 10,838 |
| Total share-based compensation expense included in net income | \$15,701 | \$11,734 | \$22,518 | \$18,343 |

In addition to the above share-based compensation expenses, Polaris sponsors a qualified non-leveraged employee stock ownership plan (ESOP). Shares allocated to eligible participants’ accounts vest at various percentage rates based on years of service and require no cash payments from the recipient.

At June 30, 2018, there was \$134,342,000 of total unrecognized share-based compensation expense related to unvested share-based equity awards. Unrecognized share-based compensation expense is expected to be recognized over a weighted-average period of 1.67 years. Included in unrecognized share-based compensation expense is approximately \$37,441,000 related to stock options and \$96,901,000 for restricted stock.

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Note 4. Financing Agreements

The carrying value of debt, capital lease obligations, and notes payable and the average related interest rates were as follows (in thousands):

| | Average interest rate at June 30, 2018 | Maturity | June 30, 2018 | December 31, 2017 |
|--|---|-------------------------|------------------|----------------------|
| Revolving loan facility | 2.98% | May 2021 | \$240,000 | \$3,000 |
| Term loan facility | 3.22% | May 2021 | 670,000 | 680,000 |
| Senior notes—fixed rate | 3.81% | May 2018 | — | 25,000 |
| Senior notes—fixed rate | 4.60% | May 2021 | 75,000 | 75,000 |
| Senior notes—fixed rate | 3.13% | December 2020 | 100,000 | 100,000 |
| Capital lease obligations | 5.22% | Various through 2029 | 18,547 | 19,889 |
| Notes payable and other | 3.50% | June 2027 | 10,875 | 12,384 |
| Debt issuance costs | | | (1,800) | (2,261) |
| Total debt, capital lease obligations, and notes payable | | | \$1,112,622 | \$913,012 |
| Less: current maturities | | | 40,120 | 47,746 |
| Total long-term debt, capital lease obligations, and notes payable | | | \$1,072,502 | \$865,266 |

In August 2011, Polaris entered into a \$350,000,000 unsecured revolving loan facility. In March 2015, Polaris amended the loan facility to increase the facility to \$500,000,000 and to provide more beneficial covenant and interest rate terms. The amended terms also extended the expiration date to March 2020. Interest is charged at rates based on a LIBOR or “prime” base rate. In May 2016, Polaris amended the revolving loan facility to increase the facility to \$600,000,000 and extend the expiration date to May 2021. The amended terms also established a \$500,000,000 term loan facility. In November 2016, Polaris amended the revolving loan facility to increase the term loan facility to \$750,000,000, of which \$670,000,000 is outstanding as of June 30, 2018. Under the facility, the Company is required to make principal payments totaling \$37,500,000 over the next 12 months, which are classified as current maturities. In December 2010, the Company entered into a Master Note Purchase Agreement to issue \$25,000,000 of unsecured senior notes due May 2018 and \$75,000,000 of unsecured senior notes due May 2021 (collectively, the “Senior Notes”). The Senior Notes were issued in May 2011. In December 2013, the Company entered into a First Supplement to Master Note Purchase Agreement, under which the Company issued \$100,000,000 of unsecured senior notes due December 2020.

The unsecured revolving loan facility and the Master Note Purchase Agreement contain covenants that require Polaris to maintain certain financial ratios, including minimum interest coverage and maximum leverage ratios. Polaris was in compliance with all such covenants at June 30, 2018.

The debt issuance costs are recognized as a reduction in the carrying value of the related long-term debt in the consolidated balance sheets and are being amortized to interest expense in our consolidated statements of income over the expected remaining terms of the related debt.

On July 2, 2018, in connection with the acquisition of Boat Holdings, LLC, the Company amended the revolving loan facility to increase the facility to \$700,000,000 and increase the term loan facility to \$1,180,000,000. The expiration date of the facility was extended to July 2023, and interest will continue to be charged at rates based on a LIBOR or “prime” base rate. Additionally, on July 2, 2018, the Company entered into a Master Note Purchase Agreement to issue \$350,000,000 of 4.23% unsecured senior notes due July 2028.

A property lease agreement for a manufacturing facility which Polaris began occupying in Opole, Poland commenced in February 2014. The Poland property lease is accounted for as a capital lease.

The Company has a mortgage note payable agreement for land, on which Polaris built the Huntsville, Alabama manufacturing facility in 2016. The original mortgage note payable was for \$14,500,000, of which \$10,875,000 is outstanding as of June 30, 2018. The payment of principal and interest for the note payable is forgivable if the Company satisfies certain job commitments over the term of the note. The Company has met the required

commitments to date. Forgivable loans related to other Company facilities are also included within notes payable.

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Note 5. Goodwill and Other Intangible Assets

Goodwill and other intangible assets, net of accumulated amortization, at June 30, 2018 and December 31, 2017 are as follows (in thousands):

| | June 30, 2018 | December 31, 2017 |
|---|------------------|----------------------|
| Goodwill | \$430,705 | \$433,374 |
| Other intangible assets, net | 334,345 | 347,212 |
| Total goodwill and other intangible assets, net | \$765,050 | \$780,586 |

There were no material additions to goodwill and other intangible assets for the three and six months ended June 30, 2018 and 2017.

The changes in the carrying amount of goodwill for the six months ended June 30, 2018 were as follows (in thousands):

| | Six months ended June 30, 2018 |
|--|--|
| Goodwill, beginning of period | \$433,374 |
| Currency translation effect on foreign goodwill balances | (2,669) |
| Goodwill, end of period | \$430,705 |

The components of other intangible assets were as follows (in thousands):

| | Total estimated life (years) | June 30, 2018 | December 31, 2017 |
|---------------------------------------|------------------------------|------------------|----------------------|
| Non-amortizable—indefinite lived: | | | |
| Brand names | | \$230,346 | \$230,709 |
| Amortizable: | | | |
| Non-compete agreements | 5 | 540 | 540 |
| Dealer/customer related | 5-10 | 168,419 | 169,694 |
| Developed technology | 5-7 | 22,769 | 22,903 |
| Total amortizable | | 191,728 | 193,137 |
| Less: Accumulated amortization | | (87,729) | (76,634) |
| Net amortized other intangible assets | | 103,999 | 116,503 |
| Total other intangible assets, net | | \$334,345 | \$347,212 |

Amortization expense for intangible assets for the three months ended June 30, 2018 and 2017 was \$6,058,000 and \$6,238,000, respectively. Estimated amortization expense for the remainder of 2018 through 2023 is as follows: 2018 (remainder), \$11,800,000; 2019, \$22,300,000; 2020, \$17,300,000; 2021, \$14,400,000; 2022, \$9,800,000; 2023, \$7,600,000; and after 2023, \$20,800,000. The preceding expected amortization expense is an estimate and actual amounts could differ due to additional intangible asset acquisitions, changes in foreign currency rates or impairment of intangible assets.

Note 6. Shareholders' Equity

During the six months ended June 30, 2018, Polaris paid \$192,367,000 to repurchase and retire approximately 1,562,000 shares of its common stock. As of June 30, 2018, the Board of Directors has authorized the Company to repurchase up to an additional 4,874,000 shares of Polaris stock. The repurchase of any or all such shares authorized for repurchase will be governed by applicable SEC rules and dependent on management's assessment of market conditions. Polaris paid a regular cash dividend of \$0.60 per share on June 15, 2018 to holders of record at the close of business on June 1, 2018. On July 25, 2018, the Polaris Board of Directors declared a regular cash dividend of \$0.60 per share payable on September 17, 2018 to holders of record of such shares at the close of business on August 31, 2018.

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Cash dividends declared and paid per common share for the three and six months ended June 30, 2018 and 2017, were as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------------|--------|---------------------------------|--------|
| | 2018 | 2017 | 2018 | 2017 |
| Cash dividends declared and paid per common share | \$0.60 | \$0.58 | \$1.20 | \$1.16 |

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Net income per share

Basic income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during each period, including shares earned under the Deferred Compensation Plan for Directors (“Director Plan”) and the ESOP and deferred stock units under the 2007 Omnibus Incentive Plan (“Omnibus Plan”). Diluted income per share is computed under the treasury stock method and is calculated to compute the dilutive effect of outstanding stock options and certain shares issued under the Omnibus Plan. A reconciliation of these amounts is as follows (in thousands):

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|--------|------------------------------|--------|
| | 2018 | 2017 | 2018 | 2017 |
| Weighted average number of common shares outstanding | 62,913 | 62,638 | 62,982 | 62,756 |
| Director Plan and deferred stock units | 177 | 157 | 171 | 151 |
| ESOP | 82 | 100 | 85 | 105 |
| Common shares outstanding—basic | 63,172 | 62,895 | 63,238 | 63,012 |
| Dilutive effect of Omnibus Plan | 1,714 | 912 | 1,814 | 958 |
| Common and potential common shares outstanding—diluted | 64,886 | 63,807 | 65,052 | 63,970 |

During the three and six months ended June 30, 2018, the number of options that were not included in the computation of diluted income per share because the option exercise price was greater than the market price, and therefore, the effect would have been anti-dilutive, were 1,812,000 and 1,677,000, respectively, compared to 3,626,000 and 3,398,000 for the same periods in 2017.

Accumulated other comprehensive loss

Changes in the accumulated other comprehensive loss balance are as follows (in thousands):

| | Foreign Currency Items | Cash Flow Hedging | Retirement Benefit Plan Activity | Accumulated Other Comprehensive Loss |
|---|------------------------------|----------------------|---|--|
| Balance as of December 31, 2017 | \$(42,442) | \$ (34) | \$ (3,153) | \$ (45,629) |
| Reclassification to the statement of income | — | (2,616) | 130 | (2,486) |
| Change in fair value | (13,903) | 7,725 | — | (6,178) |
| Balance as of June 30, 2018 | \$(56,345) | \$ 5,075 | \$(3,023) | \$ (54,293) |

The table below provides data about the amount of gains and losses, net of tax, reclassified from accumulated other comprehensive loss into the statements of income for cash flow derivatives designated as hedging instruments for the three and six months ended June 30, 2018 and 2017 (in thousands):

| Derivatives in Cash Flow Hedging Relationships | Location of (Gain) Loss Reclassified from Accumulated Other Comprehensive Loss into Income | Three months ended June 30, | | Six months ended June 30, | |
|--|--|--------------------------------|---------|------------------------------|---------|
| | | 2018 | 2017 | 2018 | 2017 |
| Foreign currency contracts | Other expense, net | \$1,937 | \$1,380 | \$2,094 | \$2,607 |
| Foreign currency contracts | Cost of sales | 554 | (32) | 522 | (436) |
| Retirement benefit plan activity | Operating expenses | (45) | — | (130) | — |
| Total | | \$2,446 | \$1,348 | \$2,486 | \$2,171 |

The net amount of the existing gains or losses at June 30, 2018 that is expected to be reclassified into the statements of income within the next 12 months is not expected to be material. See Note 10 for further information regarding Polaris’ derivative activities.

Note 7. Financial Services Arrangements

Polaris Acceptance, a joint venture between Polaris and Wells Fargo Commercial Distribution Finance, a direct subsidiary of Wells Fargo Bank, N.A. (“Wells Fargo”), which is supported by a partnership agreement between their respective wholly owned subsidiaries, finances substantially all of Polaris’ United States sales whereby Polaris receives payment within a few days of shipment of the product.

Polaris’ subsidiary has a 50 percent equity interest in Polaris Acceptance. Polaris Acceptance sells a majority of its receivable portfolio to a securitization facility (the “Securitization Facility”) arranged by Wells Fargo. The sale of receivables from

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Polaris Acceptance to the Securitization Facility is accounted for in Polaris Acceptance's financial statements as a "true-sale" under Accounting Standards Codification ("ASC") Topic 860. Polaris' allocable share of the income of Polaris Acceptance has been included as a component of income from financial services in the accompanying consolidated statements of income. The partnership agreement is effective through February 2022.

Polaris' total investment in Polaris Acceptance of \$92,954,000 at June 30, 2018 is accounted for under the equity method, and is recorded in investment in finance affiliate in the accompanying consolidated balance sheets. At June 30, 2018, the outstanding amount of net receivables financed for dealers under this arrangement was \$1,172,207,000, which included \$539,732,000 in the Polaris Acceptance portfolio and \$632,475,000 of receivables within the Securitization Facility ("Securitized Receivables").

Polaris has agreed to repurchase products repossessed by Polaris Acceptance up to an annual maximum of 15 percent of the aggregate average month-end outstanding Polaris Acceptance receivables and Securitized Receivables during the prior calendar year. For calendar year 2018, the potential 15 percent aggregate repurchase obligation is approximately \$164,969,000. Polaris' financial exposure under this arrangement is limited to the difference between the amounts unpaid by the dealer with respect to the repossessed product plus costs of repossession and the amount received on the resale of the repossessed product. No material losses have been incurred under this agreement during the periods presented.

Polaris has agreements with Performance Finance, Sheffield Financial and Synchrony Bank, under which these financial institutions provide financing to end consumers of Polaris products. Polaris' income generated from these agreements has been included as a component of income from financial services in the accompanying consolidated statements of income.

Polaris also administers and provides extended service contracts to consumers and certain insurance contracts to dealers and consumers through various third-party suppliers. Polaris finances its self-insured risks related to extended service contracts, but does not retain any insurance or financial risk under any of the other arrangements. Polaris' service fee income generated from these arrangements has been included as a component of income from financial services in the accompanying consolidated statements of income.

Note 8. Investment in Other Affiliates

The Company has certain investments in nonmarketable securities of strategic companies. As of December 31, 2017, the Company's investment in Eicher-Polaris Private Limited (EPPL) represented the majority of these investments and is recorded as a component of other long-term assets in the accompanying consolidated balance sheets.

EPPL is a joint venture established in 2012 with Eicher Motors Limited ("Eicher"). Polaris and Eicher each control 50 percent of the joint venture, which is intended to design, develop and manufacture a full range of new vehicles for India and other emerging markets. The investment in EPPL is accounted for under the equity method, with Polaris' proportionate share of income or loss recorded within the consolidated financial statements on a one month lag due to financial information not being available timely.

During the first quarter of 2018, the Board of Directors of EPPL approved a shut down of the operations of the EPPL joint venture. As a result of the expected closure, the Company fully impaired its investment in EPPL by recognizing an impairment charge of \$18,733,000 within Equity in loss of other affiliates in the consolidated statement of income. The Company has recognized \$3,817,000 and \$23,447,000 of costs, including impairment, associated with the wind-down of EPPL for the three and six months ended June 30, 2018, respectively.

As of June 30, 2018 and December 31, 2017, the carrying value of the Company's investment in EPPL was \$0 and \$18,616,000, respectively.

Polaris will impair or write off an investment and recognize a loss if and when events or circumstances indicate there is impairment in the investment that is other-than-temporary. When necessary, Polaris evaluates investments in nonmarketable securities for impairment, utilizing Level 3 fair value inputs. As a result of the Victory® Motorcycles wind down, the Company recognized an impairment of substantially all of its cost-method investment in Brammo, Inc. in the first quarter of 2017. See Note 12 for additional discussion related to charges incurred related to the Victory Motorcycles wind down.

In October 2017, an agreement was signed to sell the assets of Brammo, Inc. to a third party. The sale was completed in the fourth quarter of 2017, and as a result of the sale, Polaris recognized a gain, which is included in Other expense (income), net on the 2017 consolidated statements of income. During the first quarter of 2018, Polaris received additional distributions from Brammo and recognized a gain of \$13,478,000, which is included in Other expense (income) on the consolidated statements of income.

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Note 9. Commitments and Contingencies

Polaris is subject to product liability claims in the normal course of business. The Company carries excess insurance coverage for catastrophic product liability claims. Polaris self-insures product liability claims before the policy date and up to the purchased catastrophic insurance coverage after the policy date. The estimated costs resulting from any losses are charged to operating expenses when it is probable a loss has been incurred and the amount of the loss is reasonably determinable. The Company utilizes historical trends and actuarial analysis tools, along with an analysis of current claims, to assist in determining the appropriate loss reserve levels. At June 30, 2018, the Company had an accrual of \$49,195,000 for the probable payment of pending claims related to continuing product liability litigation associated with Polaris products. This accrual is included as a component of other accrued expenses in the accompanying consolidated balance sheets.

Polaris is a defendant in lawsuits and subject to other claims arising in the normal course of business, including putative class action lawsuits. As of June 30, 2018, the Company is aware of two putative class actions pending against Polaris in the United States. As these proceedings are in the early stages, the Company is unable to provide an evaluation of the likelihood that a loss will be incurred or an estimate of the range of possible loss. In the opinion of management, it is unlikely that any legal proceedings pending against or involving Polaris will have a material adverse effect on Polaris' financial position or results of operations.

In the normal course of business, the Company's products are subject to extensive laws and regulations relating to safety, environmental and other regulations promulgated by the United States federal government and individual states, as well as international regulatory authorities. Failure to comply with applicable regulations could result in fines, penalties or other costs.

On April 2, 2018, the Company agreed to a \$27,250,000 settlement with the Consumer Product Safety Commission that resolves two 2016 late-reporting claims. The settlement was paid in the second quarter of 2018.

Note 10. Derivative Instruments and Hedging Activities

The Company is exposed to certain risks relating to its ongoing business operations. From time to time, the primary risks managed by using derivative instruments are foreign currency risk, interest rate risk and commodity price fluctuations. Derivative contracts on various currencies are entered into in order to manage foreign currency exposures associated with certain product sourcing activities and intercompany cash flows. Interest rate swaps are occasionally entered into in order to maintain a balanced risk of fixed and floating interest rates associated with the Company's long-term debt. Commodity hedging contracts are occasionally entered into in order to manage fluctuating market prices of certain purchased commodities and raw materials that are integrated into the Company's end products.

The Company's foreign currency management objective is to mitigate the potential impact of currency fluctuations on the value of its U.S. dollar cash flows and to reduce the variability of certain cash flows at the subsidiary level. The Company actively manages certain forecasted foreign currency exposures and uses a centralized currency management operation to take advantage of potential opportunities to naturally offset foreign currency exposures against each other. The decision of whether and when to execute derivative instruments, along with the duration of the instrument, can vary from period to period depending on market conditions, the relative costs of the instruments and capacity to hedge. The duration is linked to the timing of the underlying exposure, with the connection between the two being regularly monitored. Polaris does not use any financial contracts for trading purposes.

At June 30, 2018, Polaris had the following open foreign currency contracts (in thousands):

| Foreign Currency | Notional Amounts (in U.S. Dollars) | Net Unrealized Gain |
|-------------------|---------------------------------------|---------------------|
| Australian Dollar | \$ 17,658 | \$ 985 |
| Canadian Dollar | 132,052 | 5,336 |
| Mexican Peso | 20,760 | (390) |
| Total | \$ 170,470 | \$ 5,931 |

These contracts, with maturities through September 2019, met the criteria for cash flow hedges, and the unrealized gains or losses, after tax, are recorded as a component of accumulated other comprehensive loss in shareholders' equity.

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The table below summarizes the carrying values of derivative instruments as of June 30, 2018 and December 31, 2017 (in thousands):

| | Carrying Values of Derivative Instruments as of June 30, 2018 | | |
|---|--|------------------------------|----------------------------------|
| | Fair Value— Assets | Fair Value— (Liabilities) | Derivative Net Carrying Value |
| Derivatives designated as hedging instruments | | | |
| Foreign exchange contracts(1) | \$ 6,422 | \$ (491) | \$ 5,931 |
| Total derivatives designated as hedging instruments | \$ 6,422 | \$ (491) | \$ 5,931 |
| Total derivatives | \$ 6,422 | \$ (491) | \$ 5,931 |
| | Carrying Values of Derivative Instruments as of December 31, 2017 | | |
| | Fair Value— Assets | Fair Value— (Liabilities) | Derivative Net Carrying Value |
| Derivatives designated as hedging instruments | | | |
| Foreign exchange contracts(1) | \$ 621 | \$ (1,047) | \$ (426) |
| Total derivatives designated as hedging instruments | \$ 621 | \$ (1,047) | \$ (426) |
| Total derivatives | \$ 621 | \$ (1,047) | \$ (426) |

(1) Assets are included in prepaid expenses and other and liabilities are included in other accrued expenses on the accompanying consolidated balance sheets.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive loss and reclassified into the statements of income in the same period or periods during which the hedged transaction affects the statements of income. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in the current statement of income.

The amount of gains (losses), net of tax, related to the effective portion of derivative instruments designated as cash flow hedges included in accumulated other comprehensive income (loss) for the three and six months ended June 30, 2018 were \$580,000 and \$5,109,000, respectively, compared to \$(1,397,000) and \$(1,041,000) for the same respective periods in 2017.

See Note 6 for information about the amount of gains and losses, net of tax, reclassified from accumulated other comprehensive loss into the statements of income for derivative instruments designated as hedging instruments. The ineffective portion of foreign currency contracts was not material for the three and six month period ended June 30, 2018.

Note 11. Segment Reporting

The Company's reportable segments are based on the Company's method of internal reporting, which generally segregates the operating segments by product line, inclusive of wholegoods and PG&A. The internal reporting of these operating segments is defined based, in part, on the reporting and review process used by the Company's Chief Executive Officer. The Company has five operating segments: 1) ORV, 2) Snowmobiles, 3) Motorcycles, 4) Global Adjacent Markets and 5) Aftermarket, and four reportable segments: 1) ORV/Snowmobiles, 2) Motorcycles, 3) Global Adjacent Markets, and 4) Aftermarket.

The ORV/Snowmobiles segment includes the aggregated results of our ORV and Snowmobiles operating segments. The Motorcycles, Global Adjacent Markets and Aftermarket segments include the results for those respective operating segments. The Corporate amounts include costs that are not allocated to individual segments, which include incentive-based compensation and other unallocated manufacturing costs. Additionally, given the commonality of customers, manufacturing and asset management, the Company does not maintain separate balance sheets for each segment. Accordingly, the segment information presented below is limited to sales and gross profit data (in thousands):

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| | Three months ended June 30, | | Six months ended June 30, | |
|-------------------------|--------------------------------|-------------|------------------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Sales | | | | |
| ORV/Snowmobiles | \$990,841 | \$845,508 | \$1,823,405 | \$1,569,611 |
| Motorcycles | 171,412 | 197,997 | 302,969 | 318,286 |
| Global Adjacent Markets | 113,418 | 97,022 | 226,745 | 188,577 |
| Aftermarket | 226,861 | 224,393 | 446,886 | 442,228 |
| Total sales | \$1,502,532 | \$1,364,920 | \$2,800,005 | \$2,518,702 |
| Gross profit | | | | |
| ORV/Snowmobiles | \$297,221 | \$266,150 | \$540,782 | \$479,109 |
| Motorcycles | 24,672 | 21,116 | 41,240 | 1,235 |
| Global Adjacent Markets | 28,107 | 21,216 | 59,365 | 49,314 |
| Aftermarket | 57,747 | 59,918 | 116,199 | 101,482 |
| Corporate | (22,571) | (18,014) | (48,929) | (38,263) |
| Total gross profit | \$385,176 | \$350,386 | \$708,657 | \$592,877 |

Note 12. Victory Motorcycles Wind Down

In January 2017, the Company's Board of Directors approved a strategic plan to wind down the Victory Motorcycles brand. The Company began wind down activities during the first quarter of 2017. As a result of the activities, the Company recognized total pretax charges of \$1,242,000 and \$2,630,000 for the three and six month periods ended June 30, 2018, respectively, compared to \$10,683,000 and \$56,465,000 for the same respective periods in 2017, that are within the scope of ASC 420, Exit or Disposal Cost Obligations (ASC 420). These totals exclude the positive pretax impact of \$1,668,000 and \$2,387,000 incurred for other wind-down activities for the three and six month periods ended June 30, 2018, respectively, and the negative pretax impact of \$168,000 and \$11,966,000 incurred for other wind-down activities for the three and six month periods ended June 30, 2017, respectively. The Company estimates that the total impact of wind down activities in 2018 will be \$5,000,000, inclusive of promotional activity. Substantially all costs related to wind down activities are expected to be recognized by the end of 2018.

As a result of the wind down activities, the Company has incurred expenses within the scope of ASC 420 consisting of dealer termination, supplier termination, dealer litigation, employee separation, asset impairment charges, including the impairment of a cost method investment, inventory write-down charges and other costs. The wind down expenses have been included as components of cost of sales, selling and marketing expenses, general and administrative expenses or other expense (income), net, in the consolidated statements of income. Charges related to the wind down plan for the three and six months ended June 30, 2018 and 2017 within the scope of ASC 420 were as follows (in thousands):

| | Three months ended June 30, | | Six months ended June 30, | |
|------------------------------|--------------------------------|----------|------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Contract termination charges | \$953 | \$3,388 | \$1,717 | \$17,695 |
| Asset impairment charges | — | — | — | 18,760 |
| Inventory charges | — | 5,229 | — | 12,680 |
| Other costs | 289 | 2,066 | 913 | 7,330 |
| Total | \$1,242 | \$10,683 | \$2,630 | \$56,465 |

Total reserves related to the Victory Motorcycles wind down activities are \$3,172,000 as of June 30, 2018. These reserves are included in other accrued expenses and inventory in the consolidated balance sheets. Changes to the reserves during the six months ended June 30, 2018 were as follows (in thousands):

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| | Contract termination charges | Inventory charges | Other costs | Total |
|--|------------------------------------|----------------------|----------------|----------|
| Reserves balance as of December 31, 2017 | \$ 3,187 | \$ 777 | \$ 1,681 | \$ 5,645 |
| Expenses | 1,717 | — | 913 | 2,630 |
| Cash payments / scrapped inventory | (3,768) | (73) | (1,262) | (5,103) |
| Reserves balance as of June 30, 2018 | \$ 1,136 | \$ 704 | \$ 1,332 | \$ 3,172 |

Note 13. Subsequent Event

On July 2, 2018, pursuant to the Agreement and Plan of Merger dated May 29, 2018, the Company completed the acquisition of Boat Holdings, LLC, a privately held Delaware limited liability company which manufactures boats (“Boat Holdings”). Headquartered in Elkhart, Indiana, Boat Holdings had approximately \$560,000,000 of sales in 2017. The transaction was structured as an acquisition of 100% of the outstanding equity interests in Boat Holdings for aggregate consideration of \$825,000,000, subject to customary adjustments based on, among other things, the amount of cash, debt and working capital in the business of Boat Holdings at the closing date. A portion of the aggregate consideration equal to \$100,000,000 will be paid in the form of a series of deferred annual payments over 12 years following the closing date.

The Company funded the purchase price for the acquisition by amending, extending, and up-sizing the Credit Facility and the proceeds of the issuance of 4.23% Senior Notes, Series 2018, due July 3, 2028, described in Note 4.

Due to the limited time since the date of the acquisition, it is impracticable for the Company to make certain business combination disclosures at this time as the Company is still gathering information necessary to provide those disclosures.

Item 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The following discussion pertains to the results of operations and financial position of Polaris Industries Inc., a Minnesota corporation, for the three and six month period ended June 30, 2018 compared to the three and six month period ended June 30, 2017. The terms “Polaris,” the “Company,” “we,” “us,” and “our” as used herein refer to the business and operations of Polaris Industries Inc., its subsidiaries and its predecessors, which began doing business in 1954. We design, engineer and manufacture powersports vehicles, which include Off-Road Vehicles (ORV), including all-terrain vehicles (ATV) and side-by-side vehicles; motorcycles; Global Adjacent Markets vehicles, including Commercial, Government, and Defense vehicles; and related Parts, Garments and Accessories (PG&A), as well as Aftermarket accessories and apparel. Due to the seasonality of certain products and to certain changes in production and shipping cycles, results of such periods are not necessarily indicative of the results to be expected for the complete year.

We reported net income of \$92.5 million, or \$1.43 per diluted share, compared to 2017 second quarter net income of \$62.0 million, or \$0.97 per diluted share. Second quarter sales totaled \$1,502.5 million, an increase of 10 percent from last year’s second quarter sales of \$1,364.9 million. The sales increase was driven primarily by strong ORV and Global Adjacent Market sales. Our unit retail sales to consumers in North America increased six percent in the second quarter of 2018, primarily driven by increased retail demand for ATVs and side-by-sides. Our second quarter sales to North American customers increased 11 percent, driven by growth in ORV. Our sales to customers outside of North America increased 7 percent, primarily driven by foreign exchange movements and strong sales in the Company’s EMEA business for ORV and motorcycles. Our gross profit of \$385.2 million increased 10 percent from \$350.4 million in the comparable prior year second quarter. The increase in gross profit dollars during the quarter was primarily driven by increased sales. The slight decrease in gross profit margins was driven by the impact of commodity, freight and tariff cost pressure, partially offset by lower warranty costs, Value Improvement Process (“VIP”) savings, freight surcharges, and favorable exchange rates. Additionally, quarter gross profit in 2018 was affected negatively as a result of \$5.2 million of wind-down, realignment and supply chain transformation costs, while

2017 was impacted negatively by \$8.9 million of Victory Motorcycle wind down costs and \$4.3 million of restructuring and realignment costs. Our liquidity remained adequate with \$181.8 million of cash on hand and \$359.6 million of availability on the revolving loan facility at June 30, 2018.

As a result of our decision to wind down the Victory Motorcycles brand, total non-recurring wind down activities had a positive pretax impact of \$0.4 million for the three month period ended June 30, 2018 and a negative pretax impact of \$0.2 million for the six month period ended June 30, 2018. Total wind down activities had a negative pretax impact of \$10.9 million and \$68.4 million for the three and six month periods ended June 30, 2017, respectively. We estimate the total pre-tax

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impact of non-recurring wind down activities in 2018 to be approximately \$5.0 million. Substantially all costs related to wind down activities are expected to be recognized by the end of 2018.

Subsequent to the end of the second quarter, the Company completed the acquisition of Boat Holdings, LLC, a privately held limited liability company which manufactures boats (“Boat Holdings”). Headquartered in Elkhart, Indiana, Boat Holdings had approximately \$560.0 million of sales in 2017.

The transaction was structured as an acquisition of 100% of the outstanding equity interests in Boat Holdings for aggregate consideration of \$825.0 million, subject to customary adjustments based on, among other things, the amount of cash, debt and working capital in the business of Boat Holdings at the closing date. A portion of the aggregate consideration equal to \$100.0 million will be paid in the form of a series of deferred annual payments over 12 years following the closing date. The Company funded the purchase price for the acquisition by amending, extending, and up-sizing the Credit Facility and the proceeds of the issuance of 4.23% Senior Notes, Series 2018, due July 3, 2028.

Results of Operations

Unless otherwise noted, all “quarter” comparisons are from the second quarter 2018 to the second quarter 2017, and all “year-to-date” comparisons are from the six month period ended June 30, 2018 to the six month period ended June 30, 2017.

Sales:

Quarter sales were \$1,502.5 million, a 10 percent increase from \$1,364.9 million of quarter sales in the prior year. Year to date sales were \$2,800.0 million, an 11 percent increase from \$2,518.7 million of sales in the comparable prior year period. The following table is an analysis of the percentage change in total Company sales:

| | Percent change in total Company sales compared to corresponding period of the prior year | | | |
|-----------------------|---|---|---------------------|---|
| | Three months ended | | Six months ended | |
| | June 30, 2018 | | June 30, 2018 | |
| Volume | 9 | % | 10 | % |
| Product mix and price | — | | — | |
| Currency | 1 | | 1 | |
| | 10 | % | 11 | % |

The volume increase is primarily driven by strong ORV and Global Adjacent Market sales.

Our sales by reporting segment, which includes the respective PG&A, were as follows:

| (\$ in millions) | Three months ended June 30, | | | | Six months ended June 30, | | | | | |
|----------------------------|-----------------------------|------------------------------|-----------|------------------------------|---------------------------------------|-----------|------------------------------|-----------|------------------------------|---------------------------------------|
| | 2018 | Percent of Total Sales | 2017 | Percent of Total Sales | Percent Change 2018 vs. 2017 | 2018 | Percent of Total Sales | 2017 | Percent of Total Sales | Percent Change 2018 vs. 2017 |
| ORV/Snowmobiles | \$990.8 | 66 % | \$845.5 | 62 % | 17 % | \$1,823.4 | 65 % | \$1,569.6 | 62 % | 16 % |
| Motorcycles | 171.4 | 11 % | 198.0 | 15 % | (13)% | 303.0 | 11 % | 318.3 | 13 % | (5)% |
| Global Adjacent Markets | 113.4 | 8 % | 97.0 | 7 % | 17 % | 226.7 | 8 % | 188.6 | 7 % | 20 % |
| Aftermarket | 226.9 | 15 % | 224.4 | 16 % | 1 % | 446.9 | 16 % | 442.2 | 18 % | 1 % |
| Total sales | \$1,502.5 | 100 % | \$1,364.9 | 100 % | 10 % | \$2,800.0 | 100 % | \$2,518.7 | 100 % | 11 % |
| ORV/Snowmobiles | | | | | | | | | | |

ORVs: Quarter and year-to-date sales, including PG&A, increased 18 percent primarily due to strong RANGER®, RZR®, and ATV shipments. Sales outside North America increased six percent in the quarter, primarily due to increased side-by-side shipments. The quarter average per unit sales price increased three percent compared to the prior year.

Our North American ORV quarter unit retail sales to consumers increased mid-single digit percent compared to the 2017 second quarter, with consumer purchases of side-by-side vehicles, which include RANGER, RZR, and Polaris GENERAL,™ and ATVs increasing mid-single digit percent over the prior year. Side-by-Sides and ATVs again gained market share during the quarter in their respective categories. The Company estimates that North American industry ORV retail sales were flat from the second quarter of 2017. Polaris' North American dealer unit inventory was up high single digit percent compared to the second quarter of 2017 due to increased shipments of newly introduced products.

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Snowmobiles: Historically, the first half of the year are slow quarters for shipments to dealers due to the seasonality of the business. Quarter and year-to-date sales at June 30, 2018 were \$7.3 million and \$45.2 million, respectively, compared to \$10.5 million and \$42.8 million for the comparable prior year period. The changes are due to the timing of shipments year-over-year.

Motorcycles

Quarter and year-to-date sales decreased compared to the prior year, due to a weak motorcycle industry and timing of shipments for Indian Motorcycles® year over year. Slingshot® sales were down also due to the weak motorcycle industry. The quarter average per unit sales price decreased six percent, excluding Victory Motorcycles, driven by a shift in sales mix towards more mid-sized motorcycles.

North American consumer retail sales for Indian Motorcycle and Slingshot increased low-single digits percent for the quarter. Indian Motorcycle retail sales increased mid-single digit percent and gained market share. Slingshot retail sales decreased mid-single digit percent during the quarter. North American industry retail sales, 900cc and above, decreased mid-single digit percent in the quarter. North American Polaris dealer inventory decreased low-single digits percent in the 2018 second quarter compared to the same period last year due to moderated shipments in an overall weak motorcycle market.

Global Adjacent Markets

Quarter and year-to-date sales increased due primarily to strong Commercial, Government, and Defense sales, including our light-utility business at Goupil.

Aftermarket

Quarter and year-to-date sales, which include Transamerican Auto Parts (TAP), along with our other aftermarket brands of Klim, Kolpin, ProArmor, Trail Tech and 509, increased one percent. Growth at TAP's retail stores and online platforms were largely offset by lower accessory sales for the new Jeep Wrangler which was available for sale later than anticipated.

Sales by Geography

Sales by geographic region were as follows:

| (\$ in millions) | Three months ended June 30, | | | | | Six months ended June 30, | | | | |
|-------------------------|-----------------------------|---------------------------------|-----------|---------------------------------|---------------------------------------|---------------------------|---------------------------------|-----------|---------------------------------|---------------------------------------|
| | 2018 | Percent of Total Sales | 2017 | Percent of Total Sales | Percent Change 2018 vs. 2017 | 2018 | Percent of Total Sales | 2017 | Percent of Total Sales | Percent Change 2018 vs. 2017 |
| United States | \$1,197.1 | 80 % | \$1,084.6 | 79 % | 10 % | \$2,204.7 | 79 % | \$2,015.2 | 80 % | 9 % |
| Canada | 100.8 | 7 % | 89.1 | 7 % | 13 % | 179.9 | 6 % | 146.1 | 6 % | 23 % |
| Other foreign countries | 204.6 | 13 % | 191.2 | 14 % | 7 % | 415.4 | 15 % | 357.4 | 14 % | 16 % |
| Total sales | \$1,502.5 | 100 % | \$1,364.9 | 100 % | | | | | | |