

Eaton Corp plc  
Form 10-Q  
October 30, 2015  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2015  
Commission file number 000-54863

EATON CORPORATION plc

(Exact name of registrant as specified in its charter)

Ireland

98-1059235

(State or other jurisdiction of incorporation or  
organization)

(IRS Employer Identification Number)

Eaton House, 30 Pembroke Road, Dublin 4, Ireland  
(Address of principal executive offices)

-  
(Zip Code)

+1 353 1637 2900

(Registrant's telephone number, including area code)

Not applicable

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

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

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

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

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

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

There were 462.8 million Ordinary Shares outstanding as of September 30, 2015.

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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

EATON CORPORATION plc  
CONSOLIDATED STATEMENTS OF INCOME

(In millions except for per share data)	Three months ended		Nine months ended	
	September 30		September 30	
	2015	2014	2015	2014
Net sales	\$5,203	\$5,728	\$15,798	\$16,987
Cost of products sold	3,597	3,916	10,865	11,799
Selling and administrative expense	907	961	2,723	2,907
Litigation settlements	—	—	—	644
Research and development expense	156	163	472	493
Interest expense - net	59	56	175	173
Other income - net	(3	) (10	) (27	) (181
Income before income taxes	487	642	1,590	1,152
Income tax expense (benefit)	42	37	143	(66
Net income	445	605	1,447	1,218
Less net loss (income) for noncontrolling interests	1	(3	) —	(6
Net income attributable to Eaton ordinary shareholders	\$446	\$602	\$1,447	\$1,212
Net income per ordinary share				
Diluted	\$0.96	\$1.26	\$3.09	\$2.53
Basic	0.96	1.27	3.10	2.55
Weighted-average number of ordinary shares outstanding				
Diluted	466.4	477.2	468.5	478.2
Basic	465.1	474.8	466.8	475.5
Cash dividends declared per ordinary share	\$0.55	\$0.49	\$1.65	\$1.47

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	Three months ended		Nine months ended		
	September 30		September 30		
	2015	2014	2015	2014	
Net income	\$445	\$605	\$1,447	\$1,218	
Less net loss (income) for noncontrolling interests	1	(3	) —	(6	)
Net income attributable to Eaton ordinary shareholders	446	602	1,447	1,212	
Other comprehensive income (loss), net of tax					
Currency translation and related hedging instruments	(372	) (609	) (883	) (598	)
Pensions and other postretirement benefits	60	45	164	118	
Cash flow hedges	—	(3	) 3	(1	)
Other comprehensive loss attributable to Eaton ordinary shareholders	(312	) (567	) (716	) (481	)
Total comprehensive income attributable to Eaton ordinary shareholders	\$134	\$35	\$731	\$731	

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

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CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)	September 30, 2015	December 31, 2014
Assets		
Current assets		
Cash	\$418	\$781
Short-term investments	150	245
Accounts receivable - net	3,656	3,667
Inventory	2,395	2,428
Deferred income taxes	550	593
Prepaid expenses and other current assets	410	386
Total current assets	7,579	8,100
Property, plant and equipment - net	3,590	3,750
Other noncurrent assets		
Goodwill	13,540	13,893
Other intangible assets	6,139	6,556
Deferred income taxes	246	228
Other assets	1,107	1,002
Total assets	\$32,201	\$33,529
Liabilities and shareholders' equity		
Current liabilities		
Short-term debt	\$1	\$2
Current portion of long-term debt	841	1,008
Accounts payable	1,997	1,940
Accrued compensation	373	420
Other current liabilities	1,888	1,985
Total current liabilities	5,100	5,355
Noncurrent liabilities		
Long-term debt	7,830	8,024
Pension liabilities	1,539	1,812
Other postretirement benefits liabilities	502	513
Deferred income taxes	820	901
Other noncurrent liabilities	997	1,085
Total noncurrent liabilities	11,688	12,335
Shareholders' equity		
Eaton shareholders' equity	15,366	15,786
Noncontrolling interests	47	53
Total equity	15,413	15,839
Total liabilities and equity	\$32,201	\$33,529

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



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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	Nine months ended	
	September 30	
	2015	2014
Operating activities		
Net income	\$1,447	\$1,218
Adjustments to reconcile to net cash provided by operating activities		
Depreciation and amortization	692	743
Deferred income taxes	(101)	(286)
Pension and other postretirement benefits expense	244	260
Contributions to pension plans	(290)	(333)
Contributions to other postretirement benefits plans	(24)	(38)
Excess tax benefit from equity-based compensation	—	(20)
Gain on sale of businesses	—	(68)
Changes in working capital	(184)	(391)
Other - net	(155)	(151)
Net cash provided by operating activities	1,629	934
Investing activities		
Cash paid for acquisitions of businesses, net of cash acquired	(38)	—
Capital expenditures for property, plant and equipment	(368)	(378)
Sales of short-term investments - net	76	445
Proceeds from sale of businesses	1	282
Other - net	(44)	(56)
Net cash (used in) provided by investing activities	(373)	293
Financing activities		
Proceeds from borrowings	1	—
Payments on borrowings	(405)	(580)
Cash dividends paid	(771)	(700)
Exercise of employee stock options	48	50
Repurchase of shares	(454)	(267)
Excess tax benefit from equity-based compensation	—	20
Other - net	(8)	(3)
Net cash used in financing activities	(1,589)	(1,480)
Effect of currency on cash	(30)	(7)
Total decrease in cash	(363)	(260)
Cash at the beginning of the period	781	915
Cash at the end of the period	\$418	\$655

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

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EATON CORPORATION plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Note 1. BASIS OF PRESENTATION

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

This Form 10-Q should be read in conjunction with the consolidated financial statements and related notes included in Eaton's 2014 Form 10-K. The interim period results are not necessarily indicative of the results to be expected for the full year. Management has evaluated subsequent events through the date this Form 10-Q was filed with the Securities and Exchange Commission.

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

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (ASU 2014-09). This accounting standard supersedes all existing US GAAP revenue recognition guidance. Under ASU 2014-09, a company will recognize revenue when it transfers the control of promised goods or services to customers in an amount that reflects the consideration which the company expects to collect in exchange for those goods or services. ASU 2014-09 will require additional disclosures in the notes to the consolidated financial statements and is effective for annual and interim reporting periods beginning after December 15, 2016. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date (ASU 2015-14). This accounting standard defers the effective date of ASU 2014-09 for one year and permit early adoption as of the original effective date. Eaton is evaluating the impact of ASU 2014-09 and an estimate of the impact to the consolidated financial statements cannot be made at this time.

Note 2. ACQUISITION AND SALE OF BUSINESSES

Acquisition of Ephesus Lighting, Inc.

On October 28, 2015, Eaton acquired Ephesus Lighting, Inc. (Ephesus). Ephesus is a leader in LED lighting for stadiums and other high lumen outdoor and industrial applications. Its sales over the last twelve months were \$22. Ephesus will be reported within the Electrical Products business segment.

Acquisition of UK Safety Technology Manufacturer Oxalis Group Ltd.

On January 12, 2015, Eaton acquired Oxalis Group Ltd. (Oxalis). Oxalis is a manufacturer of closed-circuit television camera stations, public address and general alarm systems and other electrical products for the hazardous area, marine and industrial communications markets. Oxalis is reported within the Electrical Systems and Services business segment.

Sale of Aerospace Power Distribution Management Solutions and Integrated Cockpit Solutions

On May 9, 2014, Eaton sold the Aerospace Power Distribution Management Solutions and Integrated Cockpit Solutions businesses to Safran for \$270, which resulted in a pre-tax gain of \$154.



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## Note 3. ACQUISITION INTEGRATION CHARGES

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

	Three months ended		Nine months ended	
	September 30		September 30	
	2015	2014	2015	2014
Business segment				
Electrical Products	\$5	\$8	\$17	\$49
Electrical Systems and Services	3	4	10	43
Hydraulics	—	2	2	11
Total business segments	8	14	29	103
Corporate	2	5	4	19
Total acquisition integration charges before income taxes	\$10	\$19	\$33	\$122
Total after income taxes	\$7	\$14	\$22	\$81
Per ordinary share - diluted	\$0.01	\$0.03	\$0.05	\$0.17

Business segment acquisition integration charges for the three and nine months ended September 30, 2015 and 2014 were related primarily to the integration of Cooper Industries plc (Cooper) to gain efficiencies in selling, marketing, traditional back-office functions, manufacturing, and distribution. These charges were included in Cost of products sold or Selling and administrative expense, as appropriate. In Business Segment Information the charges reduced Operating profit of the related business segment. See Note 13 for additional information about business segments. Corporate acquisition integration charges in 2015 and 2014 were related to the acquisition of Cooper. These charges were included in Selling and administrative expense. In Business Segment Information the charges were included in Other corporate expense - net.

The Cooper integration initiatives are expected to continue throughout 2015.

## Note 4. RESTRUCTURING CHARGES

During the third quarter of 2015, Eaton took actions to reduce its cost structure in all business segments and at corporate. The restructuring charges were \$113 in the third quarter of 2015. These restructuring activities are anticipated to be \$10 in the fourth quarter of 2015 and \$30 in 2016.

A summary of restructuring charges by segment follows:

	Three months ended
	September 30, 2015
Electrical Products	11
Electrical Systems & Services	26
Hydraulics	25
Aerospace	5
Vehicle	29
Corporate	17
Total	113

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A summary of liabilities related to workforce reductions, plant closings and other associated costs follows:

	Workforce reductions	Plant closing and other	Total
Balance at December 31, 2014	—	—	—
Liability recognized	99	14	113
Payments	(29	) (1	) (30
Other adjustments	—	(12	) (12
Balance at September 30, 2015	70	1	71

These charges were included in Cost of products sold, Selling and administrative expenses or Other income-net, as appropriate. In Business Segment Information, the charges reduced Operating profit of the related business segment. See Note 13 for additional information about business segments.

## Note 5. GOODWILL

A summary of goodwill follows:

	Electrical Products	Electrical Systems and Services	Hydraulics	Aerospace	Vehicle	Total
December 31, 2014	\$6,940	\$4,314	\$1,327	\$962	\$350	\$13,893
Additions	—	21	—	—	—	21
Reclassifications	(106	) 106	—	—	—	—
Translation	(170	) (129	) (65	) (3	) (7	) (374
September 30, 2015	\$6,664	\$4,312	\$1,262	\$959	\$343	\$13,540

## Note 6. RETIREMENT BENEFITS PLANS

The components of retirement benefits expense follow:

	United States pension benefit expense		Non-United States pension benefit expense		Other postretirement benefits expense	
	2015	2014	2015	2014	2015	2014
Three months ended September 30						
Service cost	\$31	\$30	\$18	\$17	\$2	\$4
Interest cost	39	41	18	21	6	9
Expected return on plan assets	(65	) (61	) (25	) (25	) (2	) (1
Amortization	29	23	10	7	—	1
Settlements	34	33	21	20	6	13
Total expense	\$59	\$47	\$21	\$20	\$6	\$13
	United States pension benefit expense		Non-United States pension benefit expense		Other postretirement benefits expense	
	2015	2014	2015	2014	2015	2014
Nine months ended September 30						
Service cost	\$92	\$88	\$55	\$50	\$5	\$13
Interest cost	117	122	54	65	18	28
Expected return on plan assets	(196	) (184	) (75	) (75	) (4	) (4
Amortization	89	69	30	21	1	5
Settlements	102	95	64	61	20	42
Total expense	\$160	\$157	\$64	\$61	\$20	\$42



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Note 7. LEGAL CONTINGENCIES

Eaton is subject to a broad range of claims, administrative and legal proceedings such as lawsuits that relate to contractual allegations, tax audits, patent infringement, personal injuries, antitrust matters and employment-related matters. Eaton is also subject to asbestos claims from historic products which may have contained asbestos. Historically, significant insurance coverage has been available to cover costs associated with these claims. Although it is not possible to predict with certainty the outcome or cost of these matters, the Company believes they will not have a material adverse effect on the consolidated financial statements.

In 2010, a Brazilian court held that a judgment obtained by a Brazilian company, Raysul, against another Brazilian company, Saturnia, which was sold by Eaton in 2006, could be enforced against Eaton Ltda. and Eaton Holding S.à.r.l. This judgment is based on an alleged violation of an agency agreement between Raysul and Saturnia. At September 30, 2015, the Company has a total accrual of 91 Brazilian Reais related to this matter (\$23 based on current exchange rates), comprised of 60 Brazilian Reais recognized in the fourth quarter of 2010 (\$15 based on current exchange rates) with an additional 31 Brazilian Reais recognized through September 30, 2015 (\$8 based on current exchange rates). In 2010, Eaton filed motions for clarification with the Brazilian court of appeals which were denied on April 6, 2011. Eaton filed appeals on various issues to the Superior Court of Justice in Brasilia. In April 2013, the Superior Court of Justice ruled in favor of Raysul. Additional motions for clarification have been filed with the Superior Court of Justice in Brasilia and were denied. On February 2, 2015, a final appeal was filed with the Superior Court of Justice in Brasilia. The Company expects that any sum it may be required to pay in connection with this matter will not exceed the amount of the recorded liability.

On October 5, 2006, ZF Meritor LLC and Meritor Transmission Corporation (collectively, Meritor) filed an action against Eaton in the United States District Court of Delaware. The action sought damages, which would have been trebled under United States antitrust laws, as well as injunctive relief and costs. The suit alleged that Eaton engaged in anti-competitive conduct against Meritor in the sale of heavy-duty truck transmissions in North America. On June 23, 2014, Eaton announced it signed a settlement agreement with Meritor in the amount of \$500 that resolved the lawsuit and removed the uncertainty of a trial and appeal process. On July 16, 2014, Eaton paid Meritor the \$500.

Frisby Corporation, now known as Triumph Actuation Systems, LLC, and other claimants (collectively, Triumph) asserted claims alleging, among other things, unfair competition, defamation, malicious prosecution, deprivation of civil rights, and antitrust in the Hinds County Circuit Court of Mississippi in 2004 and in the Federal District Court of North Carolina in 2011. Eaton had asserted claims against Triumph regarding improper use of trade secrets and these claims were dismissed by the Hinds County Circuit Court. On June 18, 2014, Eaton announced it signed a settlement agreement with Triumph in the amount of \$147.5 that resolved all claims and lawsuits and removed the uncertainty of a trial and appeal process. On July 8, 2014, Eaton paid Triumph the \$147.5.

Note 8. INCOME TAXES

The effective income tax rate for the third quarter and first nine months of 2015 was an expense of 9%, compared to an expense of 6% and a benefit of 6% for the third quarter and first nine months of 2014, respectively. Excluding the litigation settlements and related legal costs as well as the gain on the sale of Eaton's Aerospace businesses, all of which represents a total pre-tax expense of \$494 in the second quarter of 2014, the effective income tax rate for the first nine months of 2014 was an expense of 6%. See Note 7 and Note 2 for additional information about legal contingencies and the sale of businesses, respectively.

The increase in the effective tax rate in the third quarter and first nine months of 2015 is primarily due to more income earned in higher tax jurisdictions, including the United States.

At the end of the fourth quarter of 2011, the IRS issued a Notice for Eaton Corporation and Includible Subsidiaries 2005 and 2006 tax years (the 2011 Notice). The 2011 Notice proposed assessments of \$75 in additional taxes plus \$52 in penalties related primarily to transfer pricing adjustments for products manufactured in the Company's facilities in Puerto Rico and the Dominican Republic and sold to affiliated companies located in the U.S., net of agreed credits and deductions. The Company has set its transfer prices for products sold between these affiliates at the same prices that the Company sells such products to third parties as required by two successive Advance Pricing Agreements (APAs)

the Company entered into with the IRS. For the years 2001 through 2004, the IRS had previously accepted the transfer pricing methodology related to these APAs after a comprehensive review conducted in two separate audit cycles. On December 16, 2011, immediately prior to the 2011 Notice being issued, the IRS sent a letter stating that it was retrospectively canceling the APAs, even though their respective APA terms had already expired.

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The Company is contesting the proposed assessments. The Company believes that it was in full compliance with the terms of the two APAs, and that the IRS's cancellation of these two APAs is without merit. On February 29, 2012, the Company filed a Petition with the U.S. Tax Court in which it asserted that the transfer pricing established in the APAs meets the arms-length standard set by the U.S. income tax laws, and accordingly, that the APAs should be enforced in accordance with their terms. The case involves both whether the APAs should be enforced and, if not, the appropriate transfer pricing methodology. The case was tried before the U.S. Tax Court in August and September 2015. The case will be fully submitted to the Court after the parties complete post-trial briefing on February 29, 2016, and it will likely be several months to a year before the Court renders a decision in the case.

During the third quarter of 2014, the Company received a Notice from the IRS for the 2007 through 2010 tax years (the 2014 Notice) proposing assessments of \$190 in additional taxes plus \$72 in penalties, net of agreed credits and deductions. The proposed assessments pertain primarily to the same transfer pricing issues that are currently in litigation for the 2011 Notice, as noted above. During 2007 through 2010, the Company set its transfer prices for products sold between these affiliates consistent with the terms of a written APA between it and the IRS that covered the years at issue. To establish the relevant transfer prices, the APA relied on prices at which the Company sells the products to third parties. The 2014 Notice includes a separate proposed assessment involving the recognition of income for several of the Company's controlled foreign corporations. The Company believes that these proposed assessments are without merit. On November 25, 2014, the Company filed a Petition with the U.S. Tax Court in which it challenged the IRS's adjustments. The Company expects the outcome of the 2014 Notice on the transfer pricing matter to be determined by the judicial decision related to the 2011 Notice. The Company has continued to apply the arms-length transfer pricing methodology for 2011 through the current reporting period.

## Note 9. EQUITY

Eaton has an ordinary share repurchase program (2013 Program) that authorizes the repurchase of 40 million ordinary shares. During the third quarter of 2015 and 2014, 4.8 million and 3.4 million ordinary shares were repurchased under the 2013 Program in the open market at a total cost of \$284 and \$225, respectively. During the first nine months of 2015 and 2014, 7.2 million and 4.8 million ordinary shares were repurchased under the 2013 Program in the open market at a total cost of \$454 and \$324, respectively.

The changes in Shareholders' equity follow:

	Eaton shareholders' equity	Noncontrolling interests	Total equity
Balance at December 31, 2014	\$15,786	\$53	\$15,839
Net income	1,447	—	1,447
Other comprehensive loss	(716)	) —	(716)
Cash dividends paid	(771)	) (6	) (777)
Issuance of shares under equity-based compensation plans - net	77	—	77
Repurchase of shares	(454)	) —	(454)
Change in Capital	(3)	) —	(3)
Balance at September 30, 2015	\$15,366	\$47	\$15,413

The changes in Accumulated other comprehensive loss follow:

	Currency translation and related hedging instruments	Pensions and other postretirement benefits	Cash flow hedges	Total
Balance at December 31, 2014	\$(1,414)	) \$(1,485)	) \$—	) \$(2,899)
Other comprehensive (loss) income before reclassifications	(883)	) 48	10	) (825)
Amounts reclassified from Accumulated other comprehensive loss	—	116	(7)	) 109

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Net current-period Other comprehensive (loss) income	(883	)	164	3	(716	)	
Balance at September 30, 2015	\$(2,297	)	\$(1,321	)	\$3	\$(3,615	)

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The reclassifications out of Accumulated other comprehensive loss follow:

	Nine months ended September 30, 2015	Consolidated statements of income classification
Amortization of pensions and other postretirement benefits items		
Actuarial loss and prior service cost	\$(178)	) <sup>1</sup>
Tax benefit	62	
Total, net of tax	(116)	)
Gains and (losses) on cash flow hedges		
Currency exchange contracts	11	Cost of products sold
Tax expense	(4)	)
Total, net of tax	7	
Total reclassifications for the period	\$(109)	)

<sup>1</sup> These components of Accumulated other comprehensive loss are included in the computation of net periodic benefit cost. See Note 6 for additional information about pension and other post retirement benefits items.

#### Net Income per Ordinary Share

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

(Shares in millions)	Three months ended September 30		Nine months ended September 30	
	2015	2014	2015	2014
Net income attributable to Eaton ordinary shareholders	\$446	\$602	\$1,447	\$1,212
Weighted-average number of ordinary shares outstanding - diluted	466.4	477.2	468.5	478.2
Less dilutive effect of equity-based compensation	1.3	2.4	1.7	2.7
Weighted-average number of ordinary shares outstanding - basic	465.1	474.8	466.8	475.5
Net income per ordinary share				
Diluted	\$0.96	\$1.26	\$3.09	\$