EATON CORP
Form 10-Q
October 29, 2010

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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, 2010
Commission file number 1-1396
EATON CORPORATION

(Exact name of registrant as specified in its charter)

Ohio	34-0196300
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
Eaton Center, Cleveland, Ohio	44114-2584
(Address of principal executive offices)	(Zip Code)

(216) 523-5000
(Registrant s telephone number, including area code)
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, and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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 þ No o

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

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

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

There were 168.3 million Common Shares outstanding as of September 30, 2010.

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PART 1 FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

EATON CORPORATION
STATEMENTS OF CONSOLIDATED INCOME

(Millions except for per share data)	Three months ended September 30 2010	Three months ended September 30 2009	Nine months ended September 30 2010	Nine months ended September 30 2009
Net sales	$ 3,571	$ 3,028	$ 10,052	$ 8,742
Cost of products sold	2,480	2,178	7,068	6,541
Selling & administrative expense	651	553	1,842	1,665
Research & development expense	104	99	308	292
Interest expense-net	33	38	102	116
Other (income) expense-net	(2)	(6)	(11)	(5)
Income before income taxes	305	166	743	133
Income tax expense (benefit)	36	(28)	89	(40)
Net income	269	194	654	173
Adjustment of net income for noncontrolling interests	(1)	(1)	(5)	(1)
Net income attributable to common shareholders	$ 268	$ 193	$ 649	$ 172
Net income per common share diluted	$ 1.57	$ 1.14	$ 3.80	$ 1.02
Average number of common shares outstanding diluted	170.3	169.2	170.0	168.2
Net income per common share basic	$ 1.59	$ 1.16	$ 3.86	$ 1.03
Average number of common shares outstanding basic	167.6	167.0	167.4	166.9
Cash dividends paid per common share	$ .58	$ .50	$ 1.58	$ 1.50

See accompanying notes.

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EATON CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(Millions)	September 30, 2010	December 31, 2009
Current assets		
Cash	$ 395	$ 340
Short-term investments	493	433
Accounts receivable	2,332	1,899
Inventories	1,533	1,326
Deferred income taxes & other current assets	600	526
Total current assets	5,353	4,524
Property, plant & equipment-net	2,381	2,445
Goodwill	5,440	5,435
Other intangible assets	2,360	2,441
Deferred income taxes & other long-term assets	1,481	1,437
Total assets	$ 17,015	$ 16,282
Current liabilities		
Short-term debt	$ 93	$ 113
Current portion of long-term debt	5	5
Accounts payable	1,353	1,057
Accrued compensation	437	256
Other current liabilities	1,425	1,258
Total current liabilities	3,313	2,689
Long-term debt	3,406	3,349
Pension liabilities	1,263	1,586
Other postretirement benefits liabilities	748	754
Deferred income taxes & other long-term liabilities	1,036	1,086
Equity		
Eaton shareholders equity	7,207	6,777
Noncontrolling interests	42	41
Total equity	7,249	6,818
Total liabilities & equity	$ 17,015	$ 16,282

See accompanying notes.

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EATON CORPORATION
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

(Millions)	Nine months ended September 30 2010	2009
Net cash provided by (used in) operating activities		
Net income	$ 654	$ 173
Adjustments to reconcile to net cash provided by operating activities		
Depreciation & amortization	413	429
Deferred income taxes	(11)	(164)
Pension expense	134	223
Contributions to pension plans	(378)	(209)
Changes in working capital	(70)	553
Other-net	(15)	(102)
Net cash provided by operating activities	727	903
Net cash provided by (used in) investing activities		
Expenditures for property, plant & equipment	(207)	(136)
Cash paid for acquisitions of businesses	(172)	(10)
Sales (purchases) of short-term investments-net	(47)	(92)
Other-net	(6)	4
Net cash used in investing activities	(432)	(234)
Net cash provided by (used in) financing activities		
Borrowings with original maturities of more than three months		
Proceeds	55	557
Payments	(59)	(597)
Borrowings (payments) with original maturities of less than three months-net (primarily commercial paper)	(19)	(425)
Cash dividends paid	(265)	(250)
Other-net	62	14
Net cash used in financing activities	(226)	(701)
Effect of foreign exchange rate changes on cash	(14)	36
Total increase in cash	55	4
Cash at the beginning of the year	340	188
Cash at the end of the period	$ 395	$ 192

See accompanying notes.

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EATON CORPORATION
NOTES TO THE THIRD QUARTER 2010 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Millions of dollars and shares unless indicated otherwise (per share data assume dilution)

PREPARATION OF FINANCIAL STATEMENTS

The accompanying unaudited condensed consolidated financial statements of Eaton Corporation (Eaton) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and notes required by generally accepted accounting principles 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 results of operations, financial position, and cash flows for the stated periods. Management has evaluated subsequent events through the date the financial statements were filed with the SEC. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in Eaton s 2009 Annual Report on Form 10-K. The interim period results are not necessarily indicative of the results to be expected for the full year.

ACQUISITIONS OF BUSINESSES

In 2010 and 2009, Eaton acquired certain businesses and entered into joint ventures. The Statements of Consolidated Income include the results of these businesses from the dates of the transactions. These transactions are summarized below:

Acquired business	Date of transaction	Business segment	Annual sales
Wright Line Holding, Inc. *A U.S. provider of customized enclosures, rack systems, and air flow management systems to store, power, and secure mission-critical IT data center electronics.*	August 25, 2010	Electrical Americas	$101 for year ended June 30, 2010
EMC Engineers, Inc. *A U.S. energy engineering and energy services company that delivers energy efficiency solutions for a wide range of governmental, educational, commercial and industrial facilities.*	July 15, 2010	Electrical Americas	$24 for 2009
Joint venture agreement to support the COMAC C919 single-aisle commercial aircraft program *A 49%-owned joint venture in China focusing on the design, development, manufacturing and support of fuel and hydraulic conveyance systems for the global civil aviation market.*	July 12, 2010	Aerospace	New joint venture
Micro Innovation Holding AG *A Switzerland-based manufacturer of human machine interfaces, programmable logic controllers*	September 1, 2009	Electrical Rest of World	$33 for 2008

and input/output devices. Eaton acquired the remaining shares to increase its ownership from 50% to 100%.			
SEG Middle East Power Solutions & Switchboard Manufacture LLC *A 49%-owned joint venture in Abu Dhabi that manufactures low voltage switchboards and control panels assemblies for use in the Middle East power generation and industrial markets.*	July 2, 2009	Electrical Rest of World	$10 for 2008

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On October 1, 2010, Eaton acquired CopperLogic, Inc., a North American manufacturer of electrical and electromechanical systems. This business had sales of $35 for the year ended August 31, 2010.

ACQUISITION INTEGRATION, WORKFORCE REDUCTION & PLANT CLOSING CHARGES

Acquisition Integration Charges

In 2010 and 2009, Eaton incurred charges related to the integration of acquired businesses. These charges were recognized as expense as incurred. A summary of these charges follows:

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Electrical Americas		$ 1	$ 2	$ 4
Electrical Rest of World	$ 6	12	20	38
Hydraulics		2		3
Aerospace	1	4	3	9
Automotive				1
Pretax charges	$ 7	$ 19	$ 25	$ 55
After-tax charges	$ 4	$ 12	$ 16	$ 36
Per common share	$ .03	$ .07	$ .10	$ .21

Charges in 2010 were related primarily to Moeller and Phoenixtec. Charges in 2009 were related primarily to Integrated Hydraulics, Kirloskar, Moeller, Phoenixtec and Argo-Tech.

Workforce Reduction Charges

Eaton took significant actions in 2009 to reduce its workforce in response to the severe economic downturn. The reductions totaled approximately 17% of the full-time workforce. These actions resulted in the recognition of severance and pension and other postretirement benefits expense of $22 in the third quarter of 2009 and $156 in the first nine months of 2009.

Summary of Acquisition Integration, Workforce Reduction & Plant Closing Liabilities

A summary of liabilities related to acquisition integration, workforce reduction, and plant closing charges, follows:

	Workforce reductions		Plant closing	Total
	Employees	Dollars	& other	dollars
Balance at December 31, 2009	1,418	$ 43	$ 12	$ 55
Liabilities recognized			25	25
Utilized	(1,157)	(30)	(30)	(60)
Balance at September 30, 2010	261	$ 13	$ 7	$ 20

These charges were included in the Statements of Consolidated Income in Cost of products sold or Selling & administrative expense, as appropriate. In Business Segment Information, the charges reduced Operating profit of the related business segment.

RETIREMENT BENEFIT PLANS EXPENSE

The components of retirement benefit plans expense follow:

	Three months ended September 30			
	Pension benefits		Other postretirement benefits	
	2010	2009	2010	2009

Service cost	$ (30)	$ (26)	$ (4)	$ (3)
Interest cost	(50)	(51)	(11)	(13)
Expected return on plan assets	54	47		
Amortization	(15)	(8)	(3)	
	(41)	(38)	(18)	(16)
Curtailment loss		(3)		
Settlement loss	(4)	(8)		
Total expense	$ (45)	$ (49)	$ (18)	$ (16)

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	Nine months ended September 30			
	Pension benefits		Other postretirement benefits	
	2010	2009	2010	2009
Service cost	$ (89)	$ (86)	$ (12)	$ (11)
Interest cost	(150)	(151)	(34)	(37)
Expected return on plan assets	163	142		
Amortization	(45)	(30)	(8)	(1)
	(121)	(125)	(54)	(49)
Curtailment loss		(21)		(1)
Settlement loss	(13)	(77)		
Total expense	$ (134)	$ (223)	$ (54)	$ (50)

Due to limitations imposed by the Pension Protection Act on pension lump sum distributions, Eaton s U.S. Qualified Pension Plan became restricted in 2009 from making 100% lump sum payments. As a result, the plan experienced a significant increase in lump sum payments in 2009 before the limitation went into effect. Total pension settlement expense was $51 in the second quarter of 2009 and $77 in the first nine months of 2009, most of which was attributable to the U.S. pension plans. A portion of the increase was attributable to the workforce reduction in 2009. As a result of the workforce reduction in 2009, curtailment expense related to pension plans of $14 was recognized in the second quarter of 2009 and $21 in the first nine months of 2009. The curtailment expense included recognition of the change in the projected benefit obligation, as well as recognition of a portion of the unrecognized prior service cost.

These charges were primarily included in the Statements of Consolidated Income in Cost of products sold or Selling & administrative expense, as appropriate. In Business Segment Information, the charges were included in Pension & other postretirement benefits expense.

INCOME TAXES

During the third quarter of 2010 and the first nine months of 2010, income tax expense of $36 and $89, respectively, was recognized (an effective tax rate of 11.7% in the third quarter and 12.0% in the first nine months of 2010) compared to income tax benefits of $28 and $40 in the third quarter of 2009 and the first nine months of 2009, respectively (a tax benefit rate of 17.0% in the third quarter and 30.5% for the first nine months of 2009). Income tax expense for the first nine months of 2010 included a non-cash, one-time charge of $23 ($0.14 per common share) that was recorded in the first quarter of 2010 to reflect the impact of the Health Care Reform and Education Reconciliation Act on taxation associated with Medicare Part D. Without this one-time charge, income tax expense of $66 (an effective tax rate of 8.9%) would have been recognized in the first nine months of 2010. Income tax expense for the first nine months of 2010 also reflected a benefit associated with the successful resolution of international tax audit issues; the recognition of state and local income tax attributes involving tax loss carryforwards, tax credits and other temporary differences; the recognition of international tax incentives; and the recognition of other international tax benefits. Included as an offset to the aforementioned income tax benefits that lowered the effective income tax rate in the first nine months of 2010 were adjustments totaling $22 related to an income tax audit of transfer prices for 2005 to 2009. The Company concluded that the effect of these adjustments was not material to the prior period financial statements, as well as the projected 2010 financial statements.

During the third quarter of 2010, Eaton acquired certain businesses and recorded acquired income tax liabilities of $31.

MERITOR LITIGATION

On October 5, 2006, ZF Meritor LLC and Meritor Transmission Corporation (collectively, Meritor) filed an action against Eaton in the U.S. District Court for Delaware. The action sought damages, which would be trebled under U.S.

antitrust laws, as well as injunctive relief and costs. The suit alleged that Eaton engaged in anti-competitive conduct against Meritor in the sale of heavy-duty truck transmissions in North America. Following a four week trial on liability only, on October 8, 2009, the jury returned a verdict in favor of Meritor. Eaton firmly believes that it competes fairly and honestly for business in the marketplace, and that at no time did it act in an anti-competitive manner. During an earlier stage in the case, the judge concluded that damage estimates contained in a report filed by Meritor were not based on reliable data and the report was specifically excluded from the case. On November 3, 2009, Eaton filed a motion for judgment as a matter of law and to set aside the verdict. That motion is currently pending. Accordingly, an estimate of any potential loss related to this action cannot be made at this time.

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COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss) follow:

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Net income	$ 269	$ 194	$ 654	$ 173
Foreign currency translation & related hedging instruments	419	177	(64)	393
Pensions & other postretirement benefits	4	2	51	241
Cash flow hedges	7		(2)	33
Other comprehensive income (loss)	430	179	(15)	667
Total comprehensive income	699	373	639	840
Less comprehensive income attributable to noncontrolling interests	(1)	(1)	(5)	(1)
Comprehensive income attributable to common shareholders	$ 698	$ 372	$ 634	$ 839

TOTAL EQUITY

The changes in Total equity follow:

	Eaton shareholders equity	Noncontrolling interests	Total equity
Balance at December 31, 2009	$ 6,777	$ 41	$ 6,818
Net income	649	5	654
Other comprehensive (loss)	(15)		(15)
Total comprehensive income	634	5	639
Cash dividends paid	(265)	(4)	(269)
Issuance of shares under employee benefit plans-net	61		61
Balance at September 30, 2010	$ 7,207	$ 42	$ 7,249

	Eaton shareholders equity	Noncontrolling interests	Total equity
Balance at December 31, 2008	$ 6,317	$ 48	$ 6,365
Net income	172	1	173
Other comprehensive income	667		667
Total comprehensive income	839	1	840

Cash dividends paid	(250)	(4)	(254)
Issuance of shares under employee benefit plans-net	55		55
Increase in noncontrolling interests due to acquisitions of businesses		1	1
Balance at September 30, 2009	$ 6,961	$ 46	$ 7,007

INVENTORIES

The components of inventories follow:

	September 30, 2010	December 31, 2009
Raw materials	$ 682	$ 608
Work-in-process & finished goods	963	823
Inventories at FIFO	1,645	1,431
Excess of FIFO over LIFO cost	(112)	(105)
Total inventories	$ 1,533	$ 1,326

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NET INCOME PER COMMON SHARE

A summary of the calculation of net income per common share attributable to common shareholders assuming dilution and basic follows:

	Three months ended September 30		Nine months ended September 30	
(Shares in millions)	2010	2009	2010	2009
Net income attributable to common shareholders	$ 268	$ 193	$ 649	$ 172
Average number of common shares outstanding diluted	170.3	169.2	170.0	168.2
Less dilutive effect of stock options and restricted stock awards	2.7	2.2	2.6	1.3
Average number of common shares outstanding basic	167.6	167.0	167.4	166.9
Net income per common share diluted	$ 1.57	$ 1.14	$ 3.80	$ 1.02
Net income per common share basic	$ 1.59	$ 1.16	$ 3.86	$ 1.03

In the first nine months of 2010, 3.4 million stock options were excluded from the calculation of diluted net income per common share because the exercise price of the options exceeded the average market price of the common shares during the period and their effect, accordingly, would have been antidilutive. This compares to 8.1 million antidilutive stock options for the same period in 2009.

FINANCIAL ASSETS & LIABILITIES RECOGNIZED AT FAIR VALUE

Financial instruments are categorized into a fair value hierarchy of three levels, based on the degree of subjectivity inherent in the valuation methodology as follows:

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

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

Level 3 Unobservable prices or inputs.

A summary of financial instruments recognized at fair value, and the fair value measurements used, follows:

	September 30, 2010			
	Level 1	Level 2	Level 3	Recognized value
Cash	$ 395			$ 395
Short-term investments	493			493
Foreign currency forward exchange contracts		$ (9)		(9)
Commodity contracts		11		11
Cross currency swaps		(16)		(16)
Fixed-to-floating interest rate swaps		78		78
Related long-term debt converted to floating interest rates by interest rate swaps		(78)		(78)
Total	$ 888	$ (14)	$	$ 874

Level 2 financial instruments are valued using an industry standard market approach. No financial instruments were recognized using unobservable prices or inputs Level 3.

Long-term debt and current portion of long-term debt had a carrying value of $3,411 and fair value of $3,894 at September 30, 2010.

Assets related to defined benefit pension plans of $2,373 were also measured at fair value at September 30, 2010.

DISCLOSURES ABOUT DERIVATIVE FINANCIAL INSTRUMENTS & HEDGING ACTIVITIES

In the normal course of business, Eaton is exposed to certain risks related to fluctuations in interest rates, foreign currency exchange rates and commodity prices. The Company uses various derivative and non-derivative financial instruments, primarily interest rate swaps, foreign currency forward exchange contracts, foreign currency swaps and, to

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a lesser extent, commodity contracts, to manage risks from these market fluctuations. The derivative financial instruments used by Eaton are straightforward, non-leveraged instruments. The counterparties to these financial instruments are financial institutions with strong credit ratings. Eaton maintains control over the size of positions entered into with any one counterparty and regularly monitors the credit rating of these institutions. Such derivative financial instruments are not purchased and sold for trading purposes.

Derivative financial instruments are measured at fair value and recognized as assets or liabilities in the Consolidated Balance Sheet. Accounting for the gain or loss resulting from the change in the fair value of the derivative financial instrument depends on whether it has been designated, and is effective, as part of a hedging relationship and, if so, on the nature of the hedging activity. Eaton formally documents all relationships between derivative financial instruments accounted for as hedges and the hedged item, as well as its risk-management objective and strategy for undertaking the hedge transaction. This process includes linking all derivative financial instruments to a recognized asset or liability, specific firm commitment, forecasted transaction, or net investment in a foreign operation. These financial instruments can be designated as:

Hedges of the change in the fair value of a recognized fixed-rate asset or liability, or the firm commitment to acquire such an asset or liability (a fair value hedge); for these hedges, the gain or loss from the derivative financial instrument, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in income during the period of change in fair value.

Hedges of the variable cash flows of a recognized variable-rate asset or liability, or the forecasted acquisition of such an asset or liability (a cash flow hedge); for these hedges, the effective portion of the gain or loss from the derivative financial instrument is recognized in Eaton shareholders equity and reclassified to income in the same period when the gain or loss on the hedged item is included in income.

Hedges of the foreign currency exposure related to a net investment in a foreign operation (a net investment hedge); for these hedges, the effective portion of the gain or loss from the derivative financial instrument is recognized in Eaton shareholders equity and reclassified to income in the same period when the gain or loss related to the net investment in the foreign operation is included in income.

The gain or loss from a derivative financial instrument designated as a hedge that is effective as a hedge is included in the same line of the Statement of Consolidated Income as the offsetting loss or gain on the hedged item.

The change in fair value of a derivative financial instrument that is not effective as a hedge is immediately recognized in income.

For derivatives that are not designated as a hedge, any gain or loss is immediately recognized in income. The majority of derivatives used in this manner relate to risks resulting from assets or liabilities denominated in a foreign currency that arise in the normal course of business.

Information as to the fair value of derivative financial instruments recognized in the Consolidated Balance Sheet follows:

	Fair value at September 30, 2010		
	Other current assets	Other long-term assets	Other current liabilities
Derivatives designated as hedges			
Fixed-to-floating interest rate swaps (fair value hedges)		$ 78	
Foreign currency exchange contracts (cash flow hedges)	$ 6		$ 4
Commodity contracts (cash flow hedges)	3		
Cross currency swaps (net investment hedges)			16
Total	$ 9	$ 78	$ 20

Derivatives not designated as hedges		
Foreign currency exchange contracts	$ 28	$ 39
Commodity contracts	8	
Total	$ 36	$ 39

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	Fair value at December 31, 2009		
	Other current assets	Other long-term assets	Other current liabilities
Derivatives designated as hedges			
Fixed-to-floating interest rate swaps (fair value hedges)		$ 29	
Foreign currency exchange contracts (cash flow hedges)	$ 6		$ 4
Commodity contracts (cash flow hedges)	5		
Total	$ 11	$ 29	$ 4
Derivatives not designated as hedges			
Foreign currency exchange contracts	$ 17		$ 31
Commodity contracts	3		
Total	$ 20		$ 31

At September 30, 2010, the notional amount related to derivatives designated as hedges in the table above was $1,129, including $640 of fixed-to-floating interest rate swaps. This compares to $879 of notional value at December 31, 2009, including $700 of fixed-to-floating interest rate swaps.

Amounts recognized in net income follow:

	Three months ended September 30	
	Gain (loss) recognized in net income	
	2010	2009
Derivatives designated as fair value hedges		
Fixed-to-floating interest rate swaps	$ 13	$ 16
Related long-term debt converted to floating interest rates by interest rate swaps	(13)	(16)

	Nine months ended September 30	
	Gain (loss) recognized in net income	
	2010	2009
Derivatives designated as fair value hedges		
Fixed-to-floating interest rate swaps	$ 49	$ (29)
Related long-term debt converted to floating interest rates by interest rate swaps	(49)	29

The gains and losses described above were recognized in the Statements of Consolidated Income in Interest expense.

Amounts recognized in Eaton shareholder s equity follow:

	Three months ended September 30			
	2010		2009	
	Gain (loss)	Gain (loss)	Gain (loss)	Gain (loss)

	recognized in Eaton shareholders equity	reclassified from Eaton shareholders equity	recognized in Eaton shareholders equity	reclassified from Eaton shareholders equity
Derivatives designated as cash flow or net investment hedges				
Foreign currency exchange contracts		$ (1)	$ (3)	$ (1)
Commodity contracts	$ 6		2	
Cross currency swaps	(16)			
Total	$ (10)	$ (1)	$ (1)	$ (1)

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	Nine months ended September 30			
	2010		2009	
	Gain (loss) recognized in Eaton shareholders equity	Gain (loss) reclassified from Eaton shareholders equity	Gain (loss) recognized in Eaton shareholders equity	Gain (loss) reclassified from Eaton shareholders equity
Derivatives designated as cash flow or net investment hedges				
Foreign currency exchange contracts	$ 1		$ (2)	$ (8)
Commodity contracts	2	$ 5	21	(16)
Cross currency swaps	(16)			
Total	$ (13)	$ 5	$ 19	$ (24)

The gains and losses described above that were reclassified from Eaton shareholders equity to the Statements of Consolidated Income were recognized in Cost of products sold.

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EATON CORPORATION
BUSINESS SEGMENT INFORMATION

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Net sales				
Electrical Americas	$ 967	$ 843	$ 2,663	$ 2,583
Electrical Rest of World	707	646	1,980	1,785
Hydraulics	583	418	1,641	1,273
Aerospace	390	394	1,136	1,221
Truck	534	401	1,479	1,014
Automotive	390	326	1,153	866
Total net sales	$ 3,571	$ 3,028	$ 10,052	$ 8,742
Segment operating profit (loss)				
Electrical Americas	$ 141	$ 142	$ 366	$ 392
Electrical Rest of World	81	45	183	55
Hydraulics	76	18	207	38
Aerospace	60	57	157	198
Truck	74	25	179	(12)
Automotive	39	23	120	(42)
Total segment operating profit	471	310	1,212	629
Corporate				
Amortization of intangible assets	(46)	(42)	(134)	(126)
Interest expense-net	(33)	(38)	(102)	(116)
Pension & other postretirement benefits expense	(30)	(36)	(91)	(175)
Stock option expense	(2)	(7)	(9)	(20)
Other corporate expense-net	(55)	(21)	(133)	(59)
Income before income taxes	305	166	743	133
Income tax expense (benefit)	36	(28)	89	(40)
Net income	269	194	654	173
Adjustment of net income for noncontrolling interests	(1)	(1)	(5)	(1)
Net income attributable to common shareholders	$ 268	$ 193	$ 649	$ 172
Segment operating profit was reduced by acquisition integration charges as follows:				
Electrical Americas		$ 1	$ 2	$ 4
Electrical Rest of World	$ 6	12	20	38
Hydraulics		2		3

Aerospace	1	4	3	9
Automotive				1
Total	$ 7	$ 19	$ 25	$ 55

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ITEM 2. MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS.

EATON CORPORATION

Millions of dollars and shares unless indicated otherwise (per share data assume dilution)

Net income refers to net income attributable to Eaton common shareholders

OVERVIEW OF THE COMPANY

Eaton Corporation is a diversified power management company with 2009 sales of $11.9 billion. Eaton is a global technology leader in electrical components and systems for power quality, distribution and control; hydraulics components, systems and services for industrial and mobile equipment; aerospace fuel, hydraulics and pneumatic systems for commercial and military use; and truck and automotive drivetrain and powertrain systems for performance, fuel economy and safety. Eaton has approximately 70,000 employees and sells products to customers in more than 150 countries.

The principal markets for the Electrical Americas and Electrical Rest of World segments are industrial, institutional, government, utility, commercial, residential, information technology and original equipment manufacturers. These products are used wherever there is a demand for electrical power in commercial buildings, data centers, residences, apartment and office buildings, hospitals, factories and utilities. The segments share several common global customers, but a large number of customers are located regionally and sales are made directly and indirectly through distributors, resellers and manufacturers representatives.

The principal markets for the Hydraulics segment include oil and gas, renewable energy, marine, agriculture, construction, mining, forestry, utility, material handling, truck and bus, machine tools, molding, primary metals and power generation. Key manufacturers in these markets and other customers are located globally, and these products are sold and serviced through a variety of channels.

The principal markets for the Aerospace segment are manufacturers of commercial and military aircraft and related after-market customers. These manufacturers and customers are located globally, and products are sold and serviced through a variety of channels.

The principal markets for the Truck and Automotive segments are original equipment manufacturers and after-market customers of heavy-, medium- and light-duty trucks, SUVs, CUVs, or passenger cars. Customers are located globally, and most sales are made directly.

RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

This Management s Discussion & Analysis of Financial Condition & Results of Operations discloses operating earnings, operating earnings per common share, and operating profit (loss) before acquisition integration charges for each business segment, each of which excludes amounts that differ from the most directly comparable measure calculated in accordance with generally accepted accounting principles (GAAP). A reconciliation of each of these financial measures to the most directly comparable GAAP measure is included in the Summary of Results of Operations for 2010 and in Results by Business Segment. This Management s Discussion & Analysis of Financial Condition & Results of Operations also discloses net income and net income per common share, and operating earnings and operating earnings per common share, before the non-cash, one-time income tax charge of $23 ($.14 per share) related to Medicare Part D, recognized in the first quarter of 2010, as discussed below. Management believes that these financial measures are useful to investors because they exclude transactions of an unusual nature, allowing investors to more easily compare Eaton s financial performance period to period. Management uses this information in monitoring and evaluating the on-going performance of Eaton and each business segment.

SUMMARY OF RESULTS OF OPERATIONS FOR 2010 COMPARED TO 2009

Eaton reported net sales of $3.6 billion in the third quarter of 2010 and $10.1 billion in the first nine months of 2010, increases of 18% and 15% over the third quarter and the first nine months of 2009, respectively. Net income of $268 in the third quarter of 2010 and $649 in the first nine months of 2010, increased significantly over net income of $193 in the third quarter of 2009 and $172 in the first nine months of 2009. Net income per common share was $1.57 in the third quarter of 2010 and $3.80 in the first nine months of 2010, which increased 38% and 273%, respectively, over net income per share of $1.14 in the third quarter of 2009 and $1.02 in the first nine months of 2009. The results reflect the continued rebound in Eaton s end markets in 2010 and the benefits of the substantial changes in the

Company s cost structure implemented over the past two years. Additionally, net income in the third quarter and the first nine months of 2010 improved over similar periods in 2009 due to the absence in 2010 of severance and pension and other postretirement benefits expense of $22 in the third quarter of 2009 and $156 in the first nine months of 2009.

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The following are highlights of results for 2010 compared to 2009:

	Three months ended September 30				Nine months ended September 30			
	2010	2009	Increase (Decrease)	% Increase	2010	2009	Increase (Decrease)	% Increase
Net sales	$ 3,571	$ 3,028	$ 543	18%	$ 10,052	$ 8,742	$ 1,310	15%
Gross profit	1,091	850	241	28%	2,984	2,201	783	36%
Percent of net sales	30.6%	28.1%			29.7%	25.2%		
Income before income taxes	$ 305	$ 166	$ 139	84%	$ 743	$ 133	$ 610	459%
Income tax expense (benefit)	36	(28)	64	NM	89	(40)	129	NM
Net income	269	194	75	39%	654	173	481	278%
Adjustment of net income for noncontrolling interests	(1)	(1)			(5)	(1)	(4)	
Net income attributable to common shareholders	$ 268	$ 193	$ 75	39%	$ 649	$ 172	$ 477	277%
Net income per common share diluted	$ 1.57	$ 1.14	$ .43	38%	$ 3.80	$ 1.02	$ 2.78	273%
Average common shares outstanding diluted (in millions)	170.3	169.2	1.1	1%	170.0	168.2	1.8	1%
Reconciliation of net income attributable to common shareholders to operating earnings								
Net income attributable to common shareholders	$ 268	$ 193	$ 75	39%	$ 649	$ 172	$ 477	277%
Excluding acquisition integration charges (after-tax)	4	12	(8)		16	36	(20)	
Operating earnings	$ 272	$ 205	$ 67	33%	$ 665	$ 208	$ 457	220%
Net income per common share diluted	$ 1.57	$ 1.14	$ .43	38%	$ 3.80	$ 1.02	$ 2.78	273%
Per share impact of acquisition integration charges (after-tax)	.03	.07	(.04)		.10	.21	(.11)	
Operating earnings per common share	$ 1.60	$ 1.21	$ .39	32%	$ 3.90	$ 1.23	$ 2.67	217%

Net sales in the third quarter of 2010 increased by 18% compared to the third quarter of 2009. The increase was due to an 18% increase in core sales, as a 1% increase from acquisitions was offset by a 1% decline from foreign exchange. End markets increased 14% in the third quarter of 2010.

Net sales in the first nine months of 2010 increased by 15% compared to the first nine months of 2009. The increase included 13% from core sales and 2% from foreign exchange.

Gross profit increased by 28% in the third quarter of 2010 compared to the third quarter of 2009, and improved to 30.6% of sales. The increase was primarily due to the increase in sales in the third quarter of 2010 and the Company s newly reset cost structure, including savings associated with workforce reductions taken in 2009. The improvement in the third quarter of 2010 also reflected the absence in 2010 of pretax charges of $22 for severance and pension and other postretirement benefits expense in the third quarter of 2009 resulting from work force reductions taken in 2009, a substantial portion of which were recognized in Cost of products sold.

Gross profit increased by 36% in the first nine months of 2010 compared to the first nine months of 2009, and improved to 29.7% of sales. The increase was primarily due to the same factors as in the third quarter of 2010. The improvement in the first nine months of 2010 reflected the absence in 2010 of pretax charges of $156 in the first nine months of 2009 resulting from the work force reductions taken in 2009, a substantial portion of which were recognized in Cost of products sold.

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Net income of $268 in the third quarter of 2010 increased 39% compared to net income of $193 in the third quarter of 2009. Net income per share of $1.57 in the third quarter of 2010 increased 38% over $1.14 per share for the third quarter of 2009. The increases were primarily due to higher sales in 2010 and the factors that affected gross profit discussed above. Before the effect of acquisition integration charges, operating earnings were $272 in the third quarter of 2010, or $1.60 per share, significantly above operating earnings of $205 in the third quarter of 2009, or $1.21 per share.

Net income of $649 in the first nine months of 2010 increased 277% over net income of $172 in the first nine months of 2009. Net income per share of $3.80 in the first nine months of 2010 increased 273% over net income per share of $1.02 in the first nine months of 2009. The increases were primarily due to the same factors as in the third quarter of 2010. Net income in the first nine months of 2010 included a non-cash, one-time income tax charge of $23 ($.14 per common share) that was recognized in the first quarter of 2010 related to Medicare Part D resulting from the new Health Care Reform and Education Reconciliation Act. Adjusting for this one-time income tax charge, net income in the first nine months of 2010 was $672, or $3.94 per share, compared to net income of $172 in the first nine months of 2009, or $1.02 per share. Before the effect of acquisition integration charges, operating earnings were $665 in the first nine months of 2010, or $3.90 per share, significantly above operating earnings of $208 in the first nine months of 2009, or $1.23 per share. Adjusting for the non-cash, one-time income tax charge related to Medicare Part D, operating earnings in the first nine months of 2010 were $688, or $4.04 per share.

Net cash provided by operating activities was $727 in the first nine months of 2010, a decrease of $176 compared to net cash provided by operating activities of $903 in the first nine months of 2009. Operating cash flows in 2010 reflected higher net income in the first nine months of 2010 of $654, before adjusting for noncontrolling interests, compared to $173 in the first nine months of 2009. Cash provided by operating activities in the first nine months of 2010 was lowered by contributions to pension plans of $378 compared to $209 in the first nine months of 2009, and a use of cash of $70 resulting from an increase in funding of working capital in the first nine months of 2010 compared to a decrease of $553 in working capital in the first nine months of 2009. The increase in working capital funding in the first nine months of 2010, primarily accounts receivable and inventory, was due to higher levels of operations in 2010 resulting from the global economic recovery.

Total debt of $3,504 at September 30, 2010 increased by $37 from $3,467 at December 31, 2009. The increase was primarily due to an increase in long-term debt of $57, partially offset by a $20 reduction of short-term debt. Short-term debt was reduced through the use of cash generated from operations. The net-debt-to-capital ratio was 26.6% at September 30, 2010 compared to 28.4% at the end of 2009, reflecting the combined effect of the $37 increase in total debt, the $430 increase in Eaton shareholders equity and the $115 increase in cash and short-term investments. The increase in equity primarily resulted from net income of $649, partially offset by cash dividends paid of $265.

Net working capital of $2,040 at September 30, 2010 increased by $205 from $1,835 at the end of 2009. The increase was primarily due to a net increase in cash and short-term investments, accounts receivable and inventory due to higher levels of operations resulting from the global economic recovery, partially offset by related increases in accounts payable and other current liabilities. Cash and short-term investments totaled $888 at September 30, 2010, an increase of $115 from $773 at December 31, 2009. Accounts receivable days outstanding was even with the end of 2009, and days of inventory on-hand declined 3 days from the end of 2009. The current ratio was 1.6 at September 30, 2010 and 1.7 at year-end 2009.

On October 1, 2010, Eaton acquired CopperLogic, Inc., a North American manufacturer of electrical and electromechanical systems. This business had sales of $35 for the year ended August 31, 2010.

On August 25, 2010, Eaton acquired Wright Line Holding, Inc. This U.S. business provides customized enclosures, rack systems, and air flow management systems to store, power, and secure mission-critical IT data center electronics. The business had sales of $101 for the year ended June 30, 2010.

On July 15, 2010, Eaton acquired EMC Engineers, Inc. This U.S. business is an energy engineering and energy services company that delivers energy efficiency solutions for a wide range of governmental, educational, commercial and industrial facilities. The firm is a leader in retrofitting and modernizing mechanical, electrical and control systems, as well as energy modeling and analysis, facility commissioning, and energy savings performance contracting. The

business had sales of $24 for 2009.

In July 2010, the Company increased the quarterly dividend on its common shares by 16%, from $0.50 per share to $0.58 per share.

As of mid-October, Eaton believes its overall end markets will grow 10% for all of 2010, 2 percentage points higher than expectations at the end of the second quarter of 2010, driven by higher growth in non-U.S. markets.

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OTHER RESULTS OF OPERATIONS

In 2010 and 2009, Eaton incurred charges related to the integration of acquired businesses. These charges were recognized as expense as incurred. A summary of these charges follows:

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Electrical Americas		$ 1	$ 2	$ 4
Electrical Rest of World	$ 6	12	20	38
Hydraulics		2		3
Aerospace	1	4	3	9
Automotive				1
Pretax charges	$ 7	$ 19	$ 25	$ 55
After-tax charges	$ 4	$ 12	$ 16	$ 36
Per common share	$ .03	$ .07	$ .10	$ .21

Charges in 2010 were related primarily to Moeller and Phoenixtec. Charges in 2009 were related primarily to Integrated Hydraulics, Kirloskar, Moeller, Phoenixtec and Argo-Tech. These charges were included in the Statements of Consolidated Income in Cost of products sold or Selling & administrative expense, as appropriate. In Business Segment Information, the charges reduced Operating profit of the related business segment.

Eaton took significant actions in 2009 to reduce its workforce in response to the severe economic downturn. The reductions totaled approximately 17% of the full-time workforce. These actions resulted in the recognition of severance and pension and other postretirement benefits expense of $22 in the third quarter of 2009 and $156 in the first nine months of 2009. These charges were primarily included in the Statements of Consolidated Income in Cost of products sold or Selling & administrative expense, as appropriate. In Business Segment Information, the charges reduced Operating profit of the related business segment.

Due to limitations imposed by the Pension Protection Act on pension lump sum distributions, Eaton s U.S. Qualified Pension Plan became restricted in 2009 from making 100% lump sum payments. As a result, the plan experienced a significant increase in lump sum payments in 2009 before the limitation went into effect. Total pension settlement expense was $51 in the second quarter of 2009 and $77 in the first nine months of 2009, most of which was attributable to the U.S. pension plans. A portion of the increase was attributable to the workforce reduction in 2009. Additionally, as a result of the workforce reduction in 2009, curtailment expense related to pension plans of $14 was recognized in the second quarter of 2009 and $21 in the first nine months of 2009. The curtailment expense included recognition of the change in the projected benefit obligation, as well as recognition of a portion of the unrecognized prior service cost. These charges were primarily included in the Statements of Consolidated Income in Cost of products sold or Selling & administrative expense, as appropriate. In Business Segment Information, the charges were included in Pension & other postretirement benefits expense.

During the third quarter of 2010 and the first nine months of 2010, income tax expense of $36 and $89, respectively, was recognized (an effective tax rate of 11.7% in the third quarter and 12.0% in the first nine months of 2010) compared to income tax benefits of $28 and $40 in the third quarter of 2009 and the first nine months of 2009, respectively (a tax benefit rate of 17.0% in the third quarter and 30.5% for the first nine months of 2009). Income tax expense for the first nine months of 2010 included a non-cash, one-time charge of $23 ($0.14 per common share) that was recorded in the first quarter of 2010 to reflect the impact of the Health Care Reform and Education Reconciliation Act on taxation associated with Medicare Part D. Without this one-time charge, income tax expense of $66 (an effective tax rate of 8.9%) would have been recognized in the first nine months of 2010. Income tax expense for the first nine months of 2010 also reflected a benefit associated with the successful resolution of international tax audit issues; the recognition of state and local income tax attributes involving tax loss carryforwards, tax credits and other temporary differences; the recognition of international tax incentives; and the recognition of other international tax

benefits. Included as an offset to the aforementioned income tax benefits that lowered the effective income tax rate in the first nine months of 2010 were adjustments totaling $22 related to an income tax audit of transfer prices for 2005 to 2009. The Company concluded that the effect of these adjustments was not material to the prior period financial statements, as well as the projected 2010 financial statements.

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RESULTS BY BUSINESS SEGMENT

Electrical Americas

	Three months ended September 30			Nine months ended September 30		
	2010	2009	Increase (Decrease)	2010	2009	Increase (Decrease)
Net sales	$ 967	$ 843	15%	$2,663	$2,583	3%
Operating profit	141	142	(1)%	366	392	(7)%
Operating margin	14.6%	16.8%		13.7%	15.2%	
Acquisition integration charges	$ 0	$ 1		$ 2	$ 4	
Before acquisition integration charges						
Operating profit	141	143	(1)%	368	396	(7)%
Operating margin	14.6%	17.0%		13.8%	15.3%	

Sales of the Electrical Americas segment increased 15% in the third quarter of 2010 compared to the third quarter of 2009. The increase included 12% from core sales, 2% from acquisitions of businesses and 1% from foreign exchange. End markets for this segment grew 3% during the third quarter, with good growth in the early- and mid-cycle markets, particularly in power quality and industrial markets, largely offset by the weakness in the non-residential markets.

Sales in the first nine months of 2010 increased 3% compared to the first nine months of 2009. The increase included 1% from core sales and 2% from foreign exchange. The increase reflected in particular strong sales growth in the third quarter of 2010 compared to the third quarter of 2009. Non-residential end markets declined in the first nine months of 2010, partially offset by growth in the power quality and industrial businesses. For all of 2010, Eaton anticipates end markets for this segment will decline by 1%, as the recovery in early- and mid-cycle markets and the benefits from stimulus programs will have largely offset the decline in the non-residential market.

Operating profit in the third quarter of 2010 was $141 and the operating margin was 14.6%. The decrease in operating profit before acquisition integration charges from the third quarter of 2009 was largely due to the cessation of temporary cost savings measures introduced in 2009 and changes in mix, partially offset by savings resulting from the workforce reductions taken in 2009.

Operating profit in the first nine months of 2010 was $366. Excluding acquisition integration charges of $2 in the first nine months of 2010, operating profit was $368 and the operating margin was 13.8%. The decrease in operating profit before acquisition integration charges from the first nine months of 2009 was primarily due to the same factors as in the third quarter of 2010.

On October 1, 2010, Eaton acquired CopperLogic, Inc., a North American manufacturer of electrical and electromechanical systems. This business had sales of $35 for the year ended August 31, 2010.

On August 25, 2010, Eaton acquired Wright Line Holding, Inc. This U.S. business provides customized enclosures, rack systems, and air flow management systems to store, power, and secure mission-critical IT data center electronics. The business had sales of $101 for the year ended June 30, 2010.

On July 15, 2010, Eaton acquired EMC Engineers, Inc. This U.S. business is an energy engineering and energy services company that delivers energy efficiency solutions for a wide range of governmental, educational, commercial and industrial facilities. The firm is a leader in retrofitting and modernizing mechanical, electrical and control systems, as well as energy modeling and analysis, facility commissioning, and energy savings performance contracting. The business had sales of $24 for 2009.

Electrical Rest of World

	Three months ended September 30			Nine months ended September 30		
	2010	2009	Increase	2010	2009	Increase
Net sales	$ 707	$646	9%	$1,980	$1,785	11%
Operating profit	81	45	80%	183	55	233%
Operating margin	11.5%	7.0%		9.2%	3.1%	

Acquisition integration charges	$ 6	$ 12		$ 20	$ 38	
Before acquisition integration charges						
Operating profit	87	57	53%	203	93	118%
Operating margin	12.3%	8.8%		10.3%	5.2%	

Sales of the Electrical Rest of World segment increased 9% in the third quarter of 2010 compared to the third quarter of 2009. The increase included 12% from core sales and 1% from acquisitions of businesses, partially offset by a 4%

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decrease from foreign exchange. End markets for this segment grew 9% in the third quarter of 2010 compared to the third quarter of 2009, with European electrical markets up 9% and Asian markets up 10%.

Sales in the first nine months of 2010 increased 11% compared to the first nine months of 2009. The increase included 10% from core sales and 1% from acquisitions of businesses. The increase was primarily due to the same factors as in the third quarter of 2010. For all of 2010, Eaton anticipates end markets for this segment will grow 7%.

Operating profit in the third quarter of 2010 was $81. Excluding acquisition integration charges of $6 in the third quarter of 2010, operating profit was $87 and the operating margin was 12.3%, which represents a significant improvement over the second quarter of 2010. The increase in operating profit before acquisition integration charges from the third quarter of 2009 was largely due to the increase in sales in the third quarter of 2010 and savings resulting from the workforce reductions taken in 2009, partially offset by the cessation of temporary cost savings measures introduced in 2009.

Operating profit in the first nine months of 2010 was $183. Excluding acquisition integration charges of $20 in the first nine months of 2010, operating profit was $203 and the operating margin was 10.3%. The increase in operating profit before acquisition integration charges from the first nine months of 2009 was primarily due to the same factors as in the third quarter of 2010.

Hydraulics

	Three months ended September 30			Nine months ended September 30		
	2010	2009	Increase	2010	2009	Increase
Net sales	$ 583	$418	40%	$1,641	$1,273	29%
Operating profit	76	18	322%	207	38	445%
Operating margin	13.0%	4.3%		12.6%	3.0%	
Acquisition integration charges	$ 0	$ 2		$ 0	$ 3	
Before acquisition integration charges						
Operating profit	76	20	280%	207	41	405%
Operating margin	13.0%	4.8%		12.6%	3.2%	

Sales of the Hydraulics segment increased 40% in the third quarter of 2010 compared to the third quarter of 2009. The increase was driven by global hydraulics markets that grew 44% in 2010 compared to 2009, with U.S. markets up 58% and non-U.S. markets up 34%.

Sales for the first nine months of 2010 increased 29% compared to the first nine months of 2009. The increase included 28% from core sales and 1% from foreign exchange. Eaton believes hydraulics markets will show further improvement in the fourth quarter of 2010, although the rate of growth is likely to be somewhat lower than in the third quarter of 2010. For all of 2010, Eaton now expects hydraulics markets to grow 31%.

Operating profit in the third quarter of 2010 was $76 and the operating margin was 13.0%. The increase in operating profit compared to the third quarter of 2009 was primarily due to the increase in sales in the third quarter of 2010 and savings resulting from the workforce reductions taken in 2009.

Operating profit in the first nine months of 2010 was $207 and the operating margin was 12.6%. The increase in operating profit compared to the first nine months of 2009 was primarily due to the same factors as in the third quarter of 2010.

In June 2010, Eaton signed a global strategic alliance with Linde Hydraulics of Germany. The strategic alliance adds important products to Eaton s product offerings and capitalizes on the distribution capabilities of both companies.

Aerospace

	Three months ended September 30			Nine months ended September 30		
	2010	2009	Increase (Decrease)	2010	2009	(Decrease)
Net sales	$ 390	$ 394	(1)%	$1,136	$1,221	(7)%
Operating profit	60	57	5%	157	198	(21)%
Operating margin	15.4%	14.5%		13.8%	16.2%	

Acquisition integration charges	$ 1	$ 4		$ 3	$ 9	
Before acquisition integration charges						
Operating profit	61	61	(0)%	160	207	(23)%
Operating margin	15.6%	15.5%		14.1%	17.0%	

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Sales of the Aerospace segment decreased 1% in the third quarter of 2010 compared to the third quarter of 2009. The reduction resulted from lower foreign exchange rates, as core sales were flat. In the third quarter of 2010, the commercial aerospace aftermarket started to rebound, with both the U.S. and non-U.S. markets showing modest growth. Eaton estimates aerospace end markets increased 3% in the third quarter of 2010 compared to the third quarter of 2009, with U.S. markets increasing 4% and non-U.S. markets increasing 1%.

Sales in the first nine months of 2010 decreased 7% compared to the first nine months of 2009, driven primarily by a decline in the commercial aerospace market. Eaton expects commercial aftermarket growth to continue at a modest pace over the balance of 2010. For all of 2010, Eaton is forecasting that the global aerospace market will decline 1%.

Operating profit in the third quarter of 2010 was $60. Excluding acquisition integration charges of $1 in the third quarter of 2010, operating profit was $61 and the operating margin was 15.6%. The increase in operating profit before acquisition integration charges from the third quarter of 2009 was primarily due to the savings resulting from the workforce reductions taken in 2009, partially offset by the slight decline in sales in the third quarter of 2010.

Operating profit in the first nine months of 2010 was $157. Excluding acquisition integration charges of $3 in the first nine months of 2010, operating profit was $160 and the operating margin was 14.1%. The decrease in operating profit before acquisition integration charges from the first nine months of 2009 was primarily due to the decline in sales for the first nine months of 2010.

On July 14, 2010, Eaton signed a letter of intent to supply cockpit panel assemblies and the dimming control system for the COMAC C919 single-aisle commercial aircraft program. The total value of the assemblies and control system is estimated to exceed $425 over the life of the program, based on an anticipated volume of 2,500 aircraft.

On July 12, 2010, Eaton entered into a joint venture agreement with Shanghai Aircraft Manufacturing Co., Ltd. (SAMC), a subsidiary of Commercial Aircraft Corporation of China (COMAC), to support the COMAC C919 single-aisle commercial aircraft program. The joint venture will be based in Shanghai and will focus on the design, development, manufacturing and support of fuel and hydraulic conveyance systems for the global civil aviation market. Total program value for C919 conveyance systems, including aftermarket opportunities, is estimated at $1.8 billion, based on an anticipated volume of 2,500 aircraft. Eaton will own a 49% interest in the joint venture.

Truck

	Three months ended September 30			Nine months ended September 30		
	2010	2009	Increase	2010	2009	Increase
Net sales	$ 534	$401	33%	$1,479	$1,014	46%
Operating profit (loss)	74	25	196%	179	(12)	NM
Operating margin	13.9%	6.2%		12.1%	(1.2)%	

Sales of the Truck segment increased 33% in the third quarter of 2010 from the third quarter of 2009. The increase included 30% from core sales and 3% from foreign exchange. The increase reflected global end markets that were up 28% in the third quarter of 2010 over the third quarter of 2009, with U.S. markets up 24% and non-U.S. markets up 31%.

Sales in the first nine months of 2010 increased 46% compared to the first nine months of 2009. The increase included 39% from core sales and 7% from foreign exchange. The increase was primarily due to the same factors as in the third quarter of 2010. Eaton expects truck production in the fourth quarter of 2010 will continue to improve, although at a slower rate that in the third quarter of 2010. For all of 2010, Eaton anticipates end markets for this segment will grow 26%.

Operating profit in the third quarter of 2010 was $74 and the operating margin was 13.9%. The increase in operating profit from the third quarter of 2009 was primarily due to the increase in sales in the third quarter of 2010 and the savings resulting from the workforce reductions taken in 2009.

Operating profit in the first nine months of 2010 was $179 and the operating margin was 12.1%. The increase in operating profit from the first nine months of 2009 was primarily due to the same factors as in the third quarter of 2010.

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Automotive

	Three months ended September 30			Nine months ended September 30		
	2010	2009	Increase	2010	2009	Increase
Net sales	$ 390	$326	20%	$1,153	$ 866	33%
Operating profit (loss)	39	23	70%	120	(42)	NM
Operating margin	10.0%	7.1%		10.4%	(4.9)%	
Acquisition integration charges	$ 0	$ 0		$ 0	$ 1	
Before acquisition integration charges						
Operating profit (loss)	39	23	70%	120	(41)	NM
Operating margin	10.0%	7.1%		10.4%	(4.7)%	

Sales of the Automotive segment increased 20% in the third quarter of 2010 from the third quarter of 2009. The increase included 21% from core sales, partially offset by a 1% decrease from foreign exchange. The increase reflected global automotive markets that grew 14% in the third quarter of 2010 compared to the third quarter of 2009, with U.S. markets up 27% and non-U.S. markets up 8%.

Sales in the first nine months of 2010 increased 33% compared to the first nine months of 2009. The increase in sales included 32% from core sales and 1% from foreign exchange. The increase was primarily due to the same factors as in the third quarter of 2010. For all of 2010, Eaton estimates global automotive markets will grow by 24%.

Operating profit in the third quarter of 2010 was $39, an increase of 70% compared to the third quarter of 2009 and the operating margin was 10.0% . The increase in operating profit from the third quarter of 2009 was primarily due to the increase in sales in the third quarter of 2010 and the savings resulting from the workforce reductions taken in 2009.

Operating profit in the first nine months of 2010 was $120 and the operating margin was 10.4%. The increase in operating profit from the first nine months of 2009 was primarily due to the same factors as in the third quarter of 2010.

Corporate

Corporate pension & other postretirement benefits expense was $30 and $91 in the third quarter and the first nine months of 2010, respectively, compared to $36 and $175 for the same periods of 2009. The declines were primarily due to decreased pension curtailment and lump sum settlement losses recognized in 2010 compared to 2009, and charges related to the workforce reduction in 2009. Due to limitations imposed by the Pension Protection Act on pension lump sum distributions, Eaton s U.S. Qualified Pension Plan became restricted in 2009 from making 100% lump sum payments. As a result, the plan experienced a significant increase in lump sum payments in 2009 before the limitation went into effect. Total pension settlement expense was $51 in the second quarter of 2009 and $77 in the first nine months of 2009, most of which was attributable to the U.S. pension plans. A portion of the increase was attributable to the workforce reduction in 2009. Additionally, as a result of the workforce reduction in 2009, curtailment expense related to pension plans of $14 was recognized in the second quarter of 2009 and $21 in the first nine months of 2009.

Other corporate expense-net of $55 in the third quarter of 2010 and $133 in the first nine months of 2010 increased from $21 and $59 in the same periods in 2009, respectively. The increases were primarily due to an increase in costs to support accelerating global growth, as well as the reinstatement of corporate costs, including compensation and employee benefits, which had been reduced in 2009 due to the economic recession.

CHANGES IN FINANCIAL CONDITION DURING 2010

Cash Flow & Working Capital

Cash flow provided by operating activities, including working capital management, and existing cash and short-term investments are Eaton s primary sources of liquidity. Net cash provided by operating activities was $727 in the first nine months of 2010, a decrease of $176 compared to net cash provided by operating activities of $903 in the first nine months of 2009. Operating cash flows in 2010 reflected higher net income in the first nine months of 2010 of $654, before adjusting for noncontrolling interests, compared to $173 in the first nine months of 2009. Cash provided by operating activities in the first nine months of 2010 was lowered by contributions to pension plans of $378

compared to $209 in the first nine months of 2009, and a use of cash of $70 resulting from an increase in funding of working capital in the first nine months of 2010 compared to a decrease of $553 in working capital in the first nine months of 2009. The increase in working capital funding in the first nine months of 2010, primarily accounts receivable and inventory, was due to higher levels of operations in 2010 resulting from the global economic recovery. Net working capital of $2,040 at September 30, 2010 increased by $205 from $1,835 at the end of 2009. The increase was primarily due to a net increase in cash and short-term investments, accounts receivable and inventory due to higher levels of operations resulting from the global economic recovery, partially offset by related increases in accounts payable and other current liabilities. Cash and short-term investments totaled $888 at September 30, 2010, an

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increase of $115 from $773 at December 31, 2009. Accounts receivable days outstanding was even with the end of 2009, and days of inventory on-hand declined 3 days from the end of 2009. The current ratio was 1.6 at September 30, 2010 and 1.7 at year-end 2009.

Debt & Equity

Total debt of $3,504 at September 30, 2010 increased by $37 from $3,467 at December 31, 2009. The increase was primarily due to an increase in long-term debt of $57, partially offset by a $20 reduction of short-term debt. Short-term debt was reduced through the use of cash generated from operations. The net-debt-to-capital ratio was 26.6% at September 30, 2010 compared to 28.4% at the end of 2009, reflecting the combined effect of the $37 increase in total debt, the $430 increase in Eaton shareholders equity and the $115 increase in cash and short-term investments. The increase in equity primarily resulted from net income of $649, partially offset by cash dividends paid of $265.

In July 2010, the Company increased the quarterly dividend on its common shares by 16%, from $0.50 per share to $0.58 per share.

Eaton continues to generate strong operating cash flow. Over the course of a quarter, cash, short-term investments and short-term debt may fluctuate in order to manage global liquidity. The Company maintains ready access to the commercial paper markets and $1.5 billion of existing credit facilities. Eaton believes it has the operating flexibility, cash flow, cash and short-term investment balances, and access to capital markets in excess of the liquidity necessary to meet future operating needs of the business.

CONTRACTUAL OBLIGATIONS

There have been no material changes to the table of contractual obligations presented on page 66 and 67 of Eaton s Annual Report on Form 10-K for the year ended December 31, 2009.

FORWARD-LOOKING STATEMENTS

This Form 10-Q Report contains forward-looking statements concerning the performance in 2010 of Eaton s worldwide end markets. These statements may discuss goals, intentions and expectations as to future trends, plans, events, results of operations or financial condition, or state other information relating to Eaton, based on current beliefs of management as well as assumptions made by, and information currently available to, management. Forward-looking statements generally will be accompanied by words such as anticipate, believe, could, estimate, expect, forecast, guidance, intend, may, possible, potential, predict, project or other similar words, p expressions. These statements should be used with caution and are subject to various risks and uncertainties, many of which are outside Eaton s control. The following factors could cause actual results to differ materially from those in the forward-looking statements: unanticipated changes in the markets for the company s business segments; unanticipated downturns in business relationships with customers or their purchases from the company; competitive pressures on sales and pricing; increases in the cost of material, energy and other production costs, or unexpected costs that cannot be recouped in product pricing; the introduction of competing technologies; unexpected technical or marketing difficulties; unexpected claims, charges, litigation or dispute resolutions; the impact of acquisitions, divestitures, and joint ventures; new laws and governmental regulations; interest rate changes; stock market fluctuations; and unanticipated deterioration of economic and financial conditions in the United States and around the world. Eaton does not assume any obligation to update these forward-looking statements.

ITEM 3. QUANTITATIVE & QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

There have been no material changes in market risk presented on page 66 of Eaton s Annual Report on Form 10-K for the year ended December 31, 2009.

ITEM 4. CONTROLS AND PROCEDURES.

Pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 (the Exchange Act), an evaluation was performed, under the supervision and with the participation of Eaton s management, including Alexander M. Cutler Chairman, Chief Executive Officer and President; and Richard H. Fearon Vice Chairman and Chief Financial and Planning Officer, of the effectiveness of the design and operation of Eaton s disclosure controls and procedures. Based on that evaluation, management concluded that Eaton s disclosure controls and procedures were effective as of September 30, 2010.

Disclosure controls and procedures are designed to ensure that information required to be disclosed in Eaton s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in Eaton s reports filed under the Exchange Act is accumulated and communicated to management, including Eaton s Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

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During the third quarter of 2010, there was no change in Eaton s internal control over financial reporting that materially affected, or is reasonably likely to materially affect, Eaton s internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 6. EXHIBITS.

Exhibits See Exhibit Index attached.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

EATON CORPORATION

Registrant

Date: October 29, 2010

/s/ Richard H. Fearon

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

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Eaton Corporation
Third Quarter 2010 Report on Form 10-Q
Exhibit Index

3 (a)	Amended Articles of Incorporation (amended and restated as of April 24, 2008) Incorporated by reference to the Form 10-Q Report for the three months ended March 31, 2008
3 (b)	Amended Regulations (amended and restated as of April 23, 2008) Incorporated by reference to the Form 8-K Report filed February 24, 2010
4	Pursuant to Regulation S-K Item 601(b)(4), Eaton agrees to furnish to the SEC, upon request, a copy of the instruments defining the rights of holders of its other long-term debt
12	Ratio of Earnings to Fixed Charges Filed in conjunction with this Form 10-Q Report *
31.1	Certification of Chief Executive Officer (Pursuant to Rule 13a-14(a)) Filed in conjunction with this Form 10-Q Report *
31.2	Certification of Chief Financial Officer (Pursuant to Rule 13a-14(a)) Filed in conjunction with this Form 10-Q Report *
32.1	Certification of Chief Executive Officer (Pursuant to Rule 13a-14(b) as adopted pursuant to Section 906 of the Sarbanes-Oxley Act) Filed in conjunction with this Form 10-Q Report *
32.2	Certification of Chief Financial Officer (Pursuant to Rule 13a-14(b) as adopted pursuant to Section 906 of the Sarbanes-Oxley Act) Filed in conjunction with this Form 10-Q Report *
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema Document *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document *
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*

* Submitted electronically herewith.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Income for the quarters ended September 30, 2010 and 2009, (ii) Consolidated Statements of Income for the nine months ended September 30, 2010 and 2009, (iii) Condensed Consolidated Balance Sheets at September 30, 2010 and December 31, 2009, (iv) Condensed Statements of Consolidated Cash Flows for the nine months ended September 30, 2010 and 2009 and (v) Notes to Condensed Consolidated Financial Statements for the nine months ended September 30, 2010.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.