HARLEY DAVIDSON INC
Form 10-Q
May 07, 2015

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 29, 2015
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-9183

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

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

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	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 x
Number of shares of the registrant’s common stock outstanding at May 1, 2015: 208,135,149 shares

Harley-Davidson, Inc.

Form 10-Q

For The Quarter Ended March 29, 2015

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

	Three months ended	
	March 29, 2015	March 30, 2014
Revenue:		
Motorcycles and Related Products	$1,510,570	$1,571,688
Financial Services	162,375	154,360
Total revenue	1,672,945	1,726,048
Costs and expenses:		
Motorcycles and Related Products cost of goods sold	920,295	979,557
Financial Services interest expense	38,536	38,857
Financial Services provision for credit losses	26,247	20,331
Selling, administrative and engineering expense	277,749	276,421
Total costs and expenses	1,262,827	1,315,166
Operating income	410,118	410,882
Investment income	1,322	1,659
Interest expense	9	3,677
Income before provision for income taxes	411,431	408,864
Provision for income taxes	141,577	142,947
Net income	$269,854	$265,917
Earnings per common share:		
Basic	$1.28	$1.21
Diluted	$1.27	$1.21
Cash dividends per common share	$0.310	$0.275

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

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

	Three months ended	
	March 29, 2015	March 30, 2014
Net income	$269,854	$265,917
Other comprehensive (loss) income, net of tax		
Foreign currency translation adjustments	(27,021)	2,948
Derivative financial instruments	11,072	(227)
Marketable securities	(67)	(42)
Pension and postretirement benefit plans	8,798	6,068
Total other comprehensive (loss) income, net of tax	$(7,218)	$8,747
Comprehensive income	$262,636	$274,664

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

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

	(Unaudited) March 29, 2015	December 31, 2014	(Unaudited) March 30, 2014
ASSETS			
Current assets:			
Cash and cash equivalents	$1,168,724	$906,680	$935,820
Marketable securities	57,219	57,325	92,940
Accounts receivable, net	280,497	247,621	324,979
Finance receivables, net	2,357,993	1,916,635	2,223,199
Inventories	480,941	448,871	449,044
Restricted cash	120,428	98,627	117,883
Deferred income taxes	83,519	89,916	89,070
Other current assets	164,484	182,420	127,536
Total current assets	4,713,805	3,948,095	4,360,471
Finance receivables, net	4,490,599	4,516,246	4,214,496
Property, plant and equipment, net	873,518	883,077	823,061
Prepaid pension costs	—	—	250,575
Goodwill	25,632	27,752	30,427
Deferred income taxes	72,176	77,835	3,023
Other long-term assets	88,094	75,092	47,738
	$10,263,824	$9,528,097	$9,729,791
LIABILITIES AND SHAREHOLDERS’ EQUITY			
Current liabilities:			
Accounts payable	$440,920	$196,868	$454,366
Accrued liabilities	497,027	449,317	566,755
Short-term debt	70,329	731,786	974,153
Current portion of long-term debt	1,500,611	1,011,315	848,840
Total current liabilities	2,508,887	2,389,286	2,844,114
Long-term debt	4,357,538	3,761,528	3,271,648
Pension liability	71,263	76,186	37,261
Postretirement healthcare liability	199,645	203,006	212,887
Deferred income taxes	—	—	35,973
Other long-term liabilities	190,651	188,805	168,073
Commitments and contingencies (Note 16)			
Shareholders’ equity:			
Preferred stock, none issued	—	—	—
Common stock	3,445	3,442	3,435
Additional paid-in-capital	1,286,991	1,265,257	1,198,655
Retained earnings	8,663,427	8,459,040	8,058,119
Accumulated other comprehensive loss	(522,161)	(514,943)	(323,929)
Treasury stock, at cost	(6,495,862)	(6,303,510)	(5,776,445)
Total shareholders' equity	2,935,840	2,909,286	3,159,835
	$10,263,824	$9,528,097	$9,729,791

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

	(Unaudited) March 29, 2015	December 31, 2014	(Unaudited) March 30, 2014
Balances held by consolidated variable interest entities (Note 5)			
Current finance receivables, net	$364,936	$312,645	$274,797
Other assets	$3,754	$3,409	$3,387
Non-current finance receivables, net	$1,511,659	$1,113,801	$922,060
Restricted cash - current and non-current	$138,574	$110,017	$105,536
Current portion of long-term debt	$414,665	$366,889	$309,250
Long-term debt	$1,356,112	$904,644	$787,383

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

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

	Three months ended	
	March 29, 2015	March 30, 2014
Net cash provided by operating activities (Note 3)	$174,700	$203,586
Cash flows from investing activities:		
Capital expenditures	(38,069)	(25,881)
Origination of finance receivables	(752,404)	(757,965)
Collections on finance receivables	729,666	707,431
Sales and redemptions of marketable securities	—	6,001
Other	9	51
Net cash used by investing activities	(60,798)	(70,363)
Cash flows from financing activities:		
Repayments of senior unsecured notes	—	(303,000)
Proceeds from issuance of medium-term notes	595,386	—
Proceeds from securitization debt	697,591	—
Repayments of securitization debt	(200,695)	(159,938)
Net (decrease) increase in credit facilities and unsecured commercial paper	(661,241)	307,803
Borrowings of asset-backed commercial paper	16,798	13,746
Repayments of asset-backed commercial paper	(15,744)	(16,981)
Net change in restricted cash	(28,579)	26,924
Dividends paid	(65,467)	(60,527)
Purchase of common stock for treasury	(192,700)	(87,690)
Excess tax benefits from share-based payments	2,207	4,763
Issuance of common stock under employee stock option plans	9,605	8,894
Net cash provided by (used by) financing activities	157,161	(266,006)
Effect of exchange rate changes on cash and cash equivalents	(9,019)	1,991
Net increase (decrease) in cash and cash equivalents	$262,044	$(130,792)
Cash and cash equivalents:		
Cash and cash equivalents—beginning of period	$906,680	$1,066,612
Net increase (decrease) in cash and cash equivalents	262,044	(130,792)
Cash and cash equivalents—end of period	$1,168,724	$935,820

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

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

1. Basis of Presentation and Use of Estimates

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

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the condensed consolidated balance sheets as of March 29, 2015 and March 30, 2014, the condensed consolidated statements of income for the three month periods then ended, the condensed consolidated statements of comprehensive income for the three month periods then ended and the condensed consolidated statements of cash flows for the three month periods then ended.

Certain information and footnote disclosures normally included in complete financial statements have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and U.S. generally accepted accounting principles (U.S. GAAP) for interim financial reporting. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

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

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

2. New Accounting Standards

Accounting Standards Not Yet Adopted

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09 Revenue from Contracts with Customers (ASU No. 2014-09). ASU No. 2014-09 is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The Company is required to adopt ASU No. 2014-09 for fiscal years beginning after December 15, 2016 and for interim periods therein. The Company is currently evaluating the impact of adoption. In April 2015, the FASB proposed a one-year deferral of the effective date for its new revenue standard for public and nonpublic entities reporting under GAAP. Under the proposal, the standard would be effective for public entities for annual reporting periods beginning after December 15, 2017 and interim periods therein.

In February 2015, the FASB issued ASU No. 2015-02 Amendments to the Consolidation Analysis (ASU 2015-02). ASU No. 2015-02 amends the guidance within Accounting Standards Codification (ASC) Topic 810, "Consolidation,” to change the analysis that a reporting entity must perform to determine whether it should consolidate certain legal entities. The Company is required to adopt ASU No, 2015-02 for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. The Company believes the adoption of ASU No. 2015-02 will not have an impact its financial results, the adoption of ASU No. 2015-02 will only impact the content of the current disclosure.

In April 2015, the FASB issued ASU No. 2015-03 Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03). ASU No. 2015-03 amends the guidance within ASC Topic 835, "Interest", to require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt premiums and discounts. The Company is required to adopt ASU No, 2015-03 for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015 on a retrospective basis. Upon adoption, the Company will reclassify its debt issuance costs from other assets to debt on the balance sheet. At March 29, 2015, the Company had $19.1 million of debt issuance costs recorded as assets on the balance sheet.

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3. Additional Balance Sheet and Cash Flow Information

Marketable Securities

The Company’s marketable securities consisted of the following (in thousands):

	March 29, 2015	December 31, 2014	March 30, 2014
Available-for-sale: Corporate bonds	$57,219	$57,325	$92,940
Trading securities: Mutual funds	37,667	33,815	33,182
	$94,886	$91,140	$126,122

The Company’s available-for-sale securities are carried at fair value with any unrealized gains or losses reported in other comprehensive income. During the first three months of 2015 and 2014, the Company recognized gross unrealized losses of approximately $106,000 and $67,000, respectively, or $67,000 and $42,000 net of taxes, respectively, to adjust amortized cost to fair value. The marketable securities have contractual maturities that generally come due over the next 1 to 25 months.

The Company's trading securities relate to investments held by the Company to fund certain deferred compensation obligations. The trading securities are carried at fair value with gains and losses recorded in net income and investments are included in other long-term assets on the consolidated balance sheets.

Inventories

Inventories are valued at the lower of cost or market. Substantially all inventories located in the United States are valued using the last-in, first-out (LIFO) method. Other inventories are valued at the lower of cost or market using the first-in, first-out (FIFO) method. Inventories consist of the following (in thousands):

	March 29, 2015	December 31, 2014	March 30, 2014
Components at the lower of FIFO cost or market			
Raw materials and work in process	$153,734	$151,254	$141,381
Motorcycle finished goods	253,922	230,309	222,649
Parts and accessories and general merchandise	123,187	117,210	133,740
Inventory at lower of FIFO cost or market	530,843	498,773	497,770
Excess of FIFO over LIFO cost	(49,902)	(49,902)	(48,726)
	$480,941	$448,871	$449,044

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Operating Cash Flow

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

	Three months ended	
	March 29, 2015	March 30, 2014
Cash flows from operating activities:		
Net income	$269,854	$265,917
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	46,028	43,398
Amortization of deferred loan origination costs	22,932	22,101
Amortization of financing origination fees	2,215	2,085
Provision for employee long-term benefits	12,318	8,425
Contributions to pension and postretirement plans	(6,627)	(6,879)
Stock compensation expense	8,046	9,239
Net change in wholesale finance receivables related to sales	(465,598)	(439,422)
Provision for credit losses	26,247	20,331
Deferred income taxes	2,820	(474)
Foreign currency adjustments	18,154	(4,172)
Other, net	(2,507)	3,055
Changes in current assets and liabilities:		
Accounts receivable, net	(49,936)	(61,217)
Finance receivables—accrued interest and other	2,067	793
Inventories	(51,934)	(20,317)
Accounts payable and accrued liabilities	305,102	356,430
Derivative instruments	399	1,222
Other	35,120	3,071
Total adjustments	(95,154)	(62,331)
Net cash provided by operating activities	$174,700	$203,586

4. Finance Receivables

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

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

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

	March 29, 2015	December 31, 2014	March 30, 2014
Retail	$5,576,558	$5,607,924	$5,254,133
Wholesale	1,404,854	952,321	1,298,091
	6,981,412	6,560,245	6,552,224
Allowance for credit losses	(132,820)	(127,364)	(114,529)
	$6,848,592	$6,432,881	$6,437,695

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A provision for credit losses on finance receivables is charged or credited to earnings in amounts that the Company believes are sufficient to maintain the allowance for credit losses at a level that is adequate to cover losses of principal inherent in the existing portfolio. The allowance for credit losses represents management's estimate of probable losses inherent in the finance receivable portfolio as of the balance sheet date. However, due to the use of projections and assumptions in estimating the losses, the amount of losses actually incurred by the Company could differ from the amounts estimated.

Changes in the allowance for credit losses on finance receivables by portfolio were as follows (in thousands):

	Three months ended March 29, 2015		
	Retail	Wholesale	Total
Balance, beginning of period	$122,025	$5,339	$127,364
Provision for credit losses	22,543	3,704	26,247
Charge-offs	(32,733)	—	(32,733)
Recoveries	11,942	—	11,942
Balance, end of period	$123,777	$9,043	$132,820

	Three months ended March 30, 2014		
	Retail	Wholesale	Total
Balance, beginning of period	$106,063	$4,630	$110,693
Provision for credit losses	17,208	3,123	20,331
Charge-offs	(27,343)	—	(27,343)
Recoveries	10,848	—	10,848
Balance, end of period	$106,776	$7,753	$114,529

Finance receivables are considered impaired when management determines it is probable that the Company will be unable to collect all amounts due according to the terms of the loan agreement. Portions of the allowance for credit losses are established to cover estimated losses on finance receivables specifically identified for impairment. The unspecified portion of the allowance for credit losses covers estimated losses on finance receivables which are collectively reviewed for impairment.

The retail portfolio primarily consists of a large number of small balance, homogeneous finance receivables. The Company performs a periodic and systematic collective evaluation of the adequacy of the retail allowance for credit losses. The Company utilizes loss forecast models which consider a variety of factors including, but not limited to, historical loss trends, origination or vintage analysis, known and inherent risks in the portfolio, the value of the underlying collateral, recovery rates, and current economic conditions including items such as unemployment rates. Retail finance receivables are not evaluated individually for impairment prior to charge-off and therefore are not reported as impaired loans.

The wholesale portfolio is primarily composed of large balance, non-homogeneous loans. The Company's evaluation for the wholesale allowance for credit losses is first based on a loan-by-loan review. A specific allowance for credit losses is established for wholesale finance receivables determined to be individually impaired when management concludes that the borrower will not be able to make full payment of the contractual amounts due based on the original terms of the loan agreement. The impairment is determined based on the cash that the Company expects to receive discounted at the loan's original interest rate or the fair value of the collateral, if the loan is collateral-dependent. Finance receivables in the wholesale portfolio that are not considered impaired on an individual basis are segregated, based on similar risk characteristics, according to the Company's internal risk rating system and collectively evaluated for impairment. The related allowance for credit losses is based on factors such as the specific borrower's financial performance and ability to repay, the Company's past loan loss experience, current economic conditions, and the value of the underlying collateral.

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

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

	March 29, 2015		
	Retail	Wholesale	Total
Allowance for credit losses, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	123,777	9,043	132,820
Total allowance for credit losses	$123,777	$9,043	$132,820
Finance receivables, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	5,576,558	1,404,854	6,981,412
Total finance receivables	$5,576,558	$1,404,854	$6,981,412

	December 31, 2014		
	Retail	Wholesale	Total
Allowance for credit losses, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	122,025	5,339	127,364
Total allowance for credit losses	$122,025	$5,339	$127,364
Finance receivables, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	5,607,924	952,321	6,560,245
Total finance receivables	$5,607,924	$952,321	$6,560,245

	March 30, 2014		
	Retail	Wholesale	Total
Allowance for credit losses, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	106,776	7,753	114,529
Total allowance for credit losses	$106,776	$7,753	$114,529
Finance receivables, ending balance:			
Individually evaluated for impairment	$—	$—	$—
Collectively evaluated for impairment	5,254,133	1,298,091	6,552,224
Total finance receivables	$5,254,133	$1,298,091	$6,552,224

There were no wholesale finance receivables at March 29, 2015, December 31, 2014, or March 30, 2014 that were individually deemed to be impaired under ASC Topic 310, “Receivables.”

Retail finance receivables are contractually delinquent if the minimum payment is not received by the specified due date. Retail finance receivables are generally charged-off when the receivable is 120 days or more delinquent, the related asset is repossessed or the receivable is otherwise deemed uncollectible. All retail finance receivables accrue interest until either collected or charged-off. Accordingly, as of March 29, 2015, December 31, 2014 and March 30, 2014, all retail finance receivables were accounted for as interest-earning receivables, of which $19.0 million, $28.7 million and $17.0 million, respectively, were 90 days or more past due.

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Wholesale finance receivables are delinquent if the minimum payment is not received by the contractual due date. Interest continues to accrue on past due finance receivables until the date the finance receivable becomes uncollectible and the finance receivable is placed on non-accrual status. The Company will resume accruing interest on these accounts when payments are current according to the terms of the loans and future payments are reasonably assured. While on non-accrual status, all cash received is applied to principal or interest as appropriate. Wholesale finance receivables are written down once management determines that the specific borrower does not have the ability to repay the loan in full. There were no wholesale receivables on non-accrual status at March 29, 2015, December 31, 2014 or March 30, 2014. At March 29, 2015, December 31, 2014 and March 30, 2014, $0.1 million, $0.2 million, and $0.1 million of wholesale finance receivables were 90 days or more past due and accruing interest, respectively.
An analysis of the aging of past due finance receivables was as follows (in thousands):

	March 29, 2015					
	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Finance Receivables
Retail	$5,451,248	$82,302	$24,013	$18,995	$125,310	$5,576,558
Wholesale	1,404,160	443	107	144	694	1,404,854
Total	$6,855,408	$82,745	$24,120	$19,139	$126,004	$6,981,412
	December 31, 2014					
	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Finance Receivables
Retail	$5,427,719	$113,007	$38,486	$28,712	$180,205	$5,607,924
Wholesale	951,660	383	72	206	661	952,321
Total	$6,379,379	$113,390	$38,558	$28,918	$180,866	$6,560,245
	March 30, 2014					
	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Finance Receivables
Retail	$5,134,053	$80,344	$22,767	$16,969	$120,080	$5,254,133
Wholesale	1,297,761	144	96	90	330	1,298,091
Total	$6,431,814	$80,488	$22,863	$17,059	$120,410	$6,552,224

A significant part of managing the Company's finance receivable portfolios includes the assessment of credit risk associated with each borrower. As the credit risk varies between the retail and wholesale portfolios, the Company utilizes different credit risk indicators for each portfolio.
The Company manages retail credit risk through its credit approval policy and ongoing collection efforts. The Company uses FICO scores, a standard credit rating measurement, to differentiate the expected default rates of retail credit applicants enabling the Company to better evaluate credit applicants for approval and to tailor pricing according to this assessment. Retail loans with a FICO score of 640 or above at origination are considered prime, and loans with a FICO score below 640 are considered sub-prime. These credit quality indicators are determined at the time of loan origination and are not updated subsequent to the loan origination date.
The recorded investment of retail finance receivables, by credit quality indicator, was as follows (in thousands):

	March 29, 2015	December 31, 2014	March 30, 2014
Prime	$4,400,440	$4,435,352	$4,128,996
Sub-prime	1,176,118	1,172,572	1,125,137
Total	$5,576,558	$5,607,924	$5,254,133

The Company's credit risk on the wholesale portfolio is different from that of the retail portfolio. Whereas the retail portfolio represents a relatively homogeneous pool of retail finance receivables that exhibit more consistent loss patterns, the wholesale portfolio exposures are less consistent. The Company utilizes an internal credit risk rating system to manage credit risk exposure consistently across wholesale borrowers and individually evaluates credit risk factors for each borrower.

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The Company uses the following internal credit quality indicators, based on an internal risk rating system, listed from highest level of risk to lowest level of risk for the wholesale portfolio: Doubtful, Substandard, Special Mention, Medium Risk and Low Risk. Based upon management’s review, the dealers classified in the Doubtful category are the dealers with the greatest likelihood of being charged off, while the dealers classified as Low Risk are least likely to be charged off. The internal rating system considers factors such as the specific borrowers’ ability to repay and the estimated value of any collateral. Dealer risk rating classifications are reviewed and updated on a quarterly basis.
The recorded investment of wholesale finance receivables, by internal credit quality indicator, was as follows (in thousands):

	March 29, 2015	December 31, 2014	March 30, 2014
Doubtful	$1,523	$954	$5,508
Substandard	21,854	7,025	3,888
Special Mention	—	—	10,950
Medium Risk	19,634	11,557	11,103
Low Risk	1,361,843	932,785	1,266,642
Total	$1,404,854	$952,321	$1,298,091

5. Asset-Backed Financing

The Company participates in asset-backed financing through both term asset-backed securitization transactions and through asset-backed commercial paper conduit facilities. The Company treats these transactions as secured borrowings because either they are transferred to consolidated variable interest entities (VIEs) or the Company maintains effective control over the assets and does not meet the accounting sale requirements under ASC Topic 860, "Transfers and Servicing" (ASC Topic 860). In the Company's asset-backed financing programs, the Company transfers retail motorcycle finance receivables to special purpose entities (SPE), which are considered VIEs under U.S. GAAP. Each SPE then converts those assets into cash, through the issuance of debt.
The Company is required to consolidate any VIE in which it is deemed to be the primary beneficiary through having power over the significant activities of the entity and having an obligation to absorb losses or the right to receive benefits from the VIE which are potentially significant to the VIE. The Company is considered to have the power over the significant activities of its term asset-backed securitization and asset-backed U.S. commercial paper conduit facility VIEs due to its role as servicer. Servicing fees are typically not considered potentially significant variable interests in a VIE. However, the Company retains a residual interest in the VIEs in the form of a debt security, which gives the Company the right to receive benefits that could be potentially significant to the VIE. Therefore, the Company is the primary beneficiary and consolidates all of these VIEs within its consolidated financial statements.
The Company is not the primary beneficiary of the asset-backed Canadian commercial paper conduit facility VIE; therefore, the Company does not consolidate this VIE. However, the Company treats the conduit facility as a secured borrowing as it maintains effective control over the assets transferred to the VIE and therefore does not meet the requirements for sale accounting under ASC Topic 860. As such, the Company retains the transferred assets and the related debt within its Consolidated Balance Sheet.
Servicing fees paid by VIEs to the Company are eliminated in consolidation and therefore are not recorded on a consolidated basis. The Company is not required, and does not currently intend, to provide any additional financial support to its VIEs. Investors and creditors only have recourse to the assets held by the VIEs.

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The following table shows the assets and liabilities related to the asset-backed financings that were included in the financial statements (in thousands):

	March 29, 2015					
	Finance receivables	Allowance for credit losses	Restricted cash	Other assets	Total assets	Asset-backed debt
On-balance sheet assets and liabilities						
Consolidated VIEs						
Term asset-backed securitizations	$1,919,723	$(43,128)	$138,574	$3,443	$2,018,612	$1,770,777
Asset-backed U.S. commercial paper conduit facility	—	—	—	311	311	—
Unconsolidated VIEs						
Asset-backed Canadian commercial paper conduit facility	169,278	(2,999)	12,057	398	178,734	154,035
Total on-balance sheet assets and liabilities	$2,089,001	$(46,127)	$150,631	$4,152	$2,197,657	$1,924,812

	December 31, 2014					
	Finance receivables	Allowance for credit losses	Restricted cash	Other assets	Total assets	Asset-backed debt
On-balance sheet assets and liabilities						
Consolidated VIEs						
Term asset-backed securitizations	$1,458,602	$(32,156)	$110,017	$2,987	$1,539,450	$1,271,533
Asset-backed U.S. commercial paper conduit facility	—	—	—	422	422	—
Unconsolidated VIEs						
Asset-backed Canadian commercial paper conduit facility	185,099	(2,965)	12,035	262	194,431	166,912
Total on-balance sheet assets and liabilities	$1,643,701	$(35,121)	$122,052	$3,671	$1,734,303	$1,438,445

	March 30, 2014					
	Finance receivables	Allowance for credit losses	Restricted cash	Other assets	Total assets	Asset-backed debt
On-balance sheet assets and liabilities						
Consolidated VIEs						
Term asset-backed securitizations	$1,221,855	$(24,998)	$105,536	$3,083	$1,305,476	$1,096,633
Asset-backed U.S. commercial paper conduit facility	—	—	—	304	304	—
Unconsolidated VIEs						
Asset-backed Canadian commercial paper conduit facility	200,147	(3,257)	12,347	238	209,475	164,704
Total on-balance sheet assets and liabilities	$1,422,002	$(28,255)	$117,883	$3,625	$1,515,255	$1,261,337

Term Asset-Backed Securitization VIEs

The Company transfers U.S. retail motorcycle finance receivables to SPEs which in turn issue secured notes to investors, with various maturities and interest rates, secured by future collections of the purchased U.S. retail motorcycle finance receivables. Each term asset-backed securitization SPE is a separate legal entity and the U.S. retail motorcycle finance receivables included in the term asset-backed securitizations are only available for payment of the secured debt and other obligations arising from the term asset-backed securitization transaction and are not available to pay other obligations or claims of the Company's creditors until the associated secured debt and other obligations are satisfied. Restricted cash balances held by the SPEs are used only to support the securitizations. There are no amortization schedules for the secured notes; however, the debt is reduced monthly as available collections on the related U.S. retail motorcycle finance receivables are applied to outstanding principal. The secured notes' contractual lives have various maturities ranging from 2015 to 2022.

During the first quarter of 2015, the Company issued $700.0 million of secured notes through one term asset-backed securitization transaction. There were no term asset-backed securitization transactions during the first quarter of 2014.

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Asset-Backed U.S. Commercial Paper Conduit Facility VIE

In September 2014, the Company amended and restated its facility (U.S. Conduit) with a third-party bank sponsored asset-backed commercial paper conduit, which provides for a total aggregate commitment of $600.0 million based on, among other things, the amount of eligible U.S. retail motorcycle loans held by a SPE as collateral. Under the facility, the Company may transfer U.S. retail motorcycle finance receivables to a SPE, which in turn may issue debt to third-party bank-sponsored asset-backed commercial paper conduits.

The assets of the SPE are restricted as collateral for the payment of the debt or other obligations arising in the transaction and are not available to pay other obligations or claims of the Company’s creditors. The terms for this debt provide for interest on the outstanding principal generally based on prevailing commercial paper rates plus a program fee based on outstanding principal, or LIBOR plus a specified margin to the extent the advance is not funded by a conduit lender through the issuance of commercial paper. The U.S. Conduit also provides for an unused commitment fee based on the unused portion of the total aggregate commitment of $600.0 million. There is no amortization schedule; however, the debt is reduced monthly as available collections on the related finance receivables are applied to outstanding principal. Upon expiration of the U.S. Conduit, any outstanding principal will continue to be reduced monthly through available collections. Unless earlier terminated or extended by mutual agreement of the Company and the lenders, the U.S. Conduit has an expiration date of October 30, 2015.

The SPE had no borrowings outstanding under the U.S. Conduit at March 29, 2015, December 31, 2014 or March 30, 2014; therefore, U.S. Conduit assets are restricted as collateral for the payment of fees associated with the unused portion of the total aggregate commitment.

Asset-Backed Canadian Commercial Paper Conduit Facility

In June 2014, the Company amended its facility agreement (Canadian Conduit) with a Canadian bank-sponsored asset-backed commercial paper conduit. Under the agreement, the Canadian Conduit is contractually committed, at the Company's option, to purchase eligible Canadian retail motorcycle finance receivables for proceeds up to C$200.0 million. The transferred assets are restricted as collateral for the payment of the debt. The terms for this debt provide for interest on the outstanding principal based on prevailing market interest rates plus a specified margin. The Canadian Conduit also provides for a program fee and an unused commitment fee based on the unused portion of the total aggregate commitment of C$200.0 million. There is no amortization schedule; however, the debt is reduced monthly as available collections on the related finance receivables are applied to outstanding principal. Upon expiration of the Canadian Conduit, any outstanding principal will continue to be reduced monthly through available collections. Unless earlier terminated or extended by mutual agreement of the Company and the lenders, the Canadian Conduit has an expiration date of June 30, 2015. The contractual maturity of the debt is approximately 5 years.

As the Company participates in and does not consolidate the Canadian bank-sponsored, multi-seller conduit VIE, the maximum exposure to loss associated with this VIE, which would only be incurred in the unlikely event that all the finance receivables and underlying collateral have no residual value, was $24.7 million at March 29, 2015. The maximum exposure is not an indication of the Company's expected loss exposure.

During the first quarter of 2015, the Company transferred $19.2 million of Canadian retail motorcycle finance receivables to the Canadian Conduit for proceeds of $16.8 million. During the first quarter of 2014, HDFS transferred $15.7 million of Canadian retail motorcycle finance receivables to the Canadian Conduit for proceeds of $13.8 million.

6. Fair Value Measurements

Certain assets and liabilities are recorded at fair value in the financial statements; some of these are measured on a recurring basis while others are measured on a non-recurring basis. Assets and liabilities measured on a recurring basis are those that are adjusted to fair value each time a financial statement is prepared. Assets and liabilities measured on a non-recurring basis are those that are adjusted to fair value when required by particular events or circumstances. In determining the fair value of assets and liabilities, the Company uses various valuation techniques. The availability of inputs observable in the market varies from instrument to instrument and depends on a variety of factors including the type of instrument, whether the instrument is actively traded, and other characteristics particular to the transaction. For many financial instruments, pricing inputs are readily observable in the market, the valuation methodology used is widely accepted by market participants, and the valuation does not require significant management discretion. For other financial instruments, pricing inputs are less observable in the market and may require management judgment. The Company assesses the inputs used to measure fair value using a three-tier hierarchy. The hierarchy indicates the extent to which inputs used in measuring fair value are observable in the market. Level 1 inputs include quoted prices for identical instruments and are the most observable.

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Level 2 inputs include quoted prices for similar assets and observable inputs such as interest rates, foreign currency exchange rates, commodity rates and yield curves. The Company uses the market approach to derive the fair value for its level 2 fair value measurements. Foreign currency exchange contracts are valued using publicly quoted spot and forward prices; commodity contracts are valued using publicly quoted prices, where available, or dealer quotes; interest rate swaps were valued using publicized swap curves; and investments in marketable securities and cash equivalents are valued using publicly quoted prices.

Level 3 inputs are not observable in the market and include management's judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the following tables.

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Recurring Fair Value Measurements

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

	March 29, 2015			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$975,411	$ 510,090	$465,321	$—
Marketable securities	94,886	37,667	57,219	—
Derivatives	49,290	—	49,290	—
	$1,119,587	$ 547,757	$571,830	$—
Liabilities:				
Derivatives	$1,886	$ —	$1,886	$—

	December 31, 2014			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$737,024	$ 482,686	$254,338	$—
Marketable securities	91,140	33,815	57,325	—
Derivatives	32,244	—	32,244	—
	$860,408	$ 516,501	$343,907	$—
Liabilities:				
Derivatives	$2,027	$ —	$2,027	$—

	March 30, 2014			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$602,421	$ 359,438	$242,983	$—
Marketable securities	126,122	33,182	92,940	—
Derivatives	105	—	105	—
	$728,648	$ 392,620	$336,028	$—
Liabilities:				
Derivatives	$3,681	$ —	$3,681	$—

Nonrecurring Fair Value Measurements

Repossessed inventory is recorded at the lower of cost or net realizable value through a nonrecurring fair value measurement. The nonrecurring fair value measurement represents the loss recognized to adjust the related finance receivable to the fair value of the repossessed inventory. Repossessed inventory was $14.5 million, $13.4 million and $15.2 million at March 29, 2015, December 31, 2014 and March 30, 2014, for which the fair value adjustment was $3.5 million, $5.0 million and $3.5 million at March 29, 2015, December 31, 2014 and March 30, 2014, respectively. Fair value is estimated using Level 2 inputs based on the recent market values of repossessed inventory.

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7. Fair Value of Financial Instruments

The Company’s financial instruments consist primarily of cash and cash equivalents, marketable securities, trade receivables, finance receivables, net, trade payables, debt, and foreign currency exchange and commodity contracts (derivative instruments are discussed further in Note 8).

The following table summarizes the fair value and carrying value of the Company’s financial instruments (in thousands):

	March 29, 2015		December 31, 2014		March 30, 2014	
	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value
Assets:						
Cash and cash equivalents	$1,168,724	$ 1,168,724	$906,680	$ 906,680	$935,820	$ 935,820
Marketable securities	$94,886	$ 94,886	$91,140	$ 91,140	$126,122	$ 126,122
Derivatives	$49,290	$ 49,290	$32,244	$ 32,244	$105	$ 105
Finance receivables, net	$6,927,898	$ 6,848,592	$6,519,500	$ 6,432,881	$6,531,145	$ 6,437,695
Restricted cash	$150,631	$ 150,631	$122,052	$ 122,052	$117,883	$ 117,883
Liabilities:						
Derivatives	$1,886	$ 1,886	$2,027	$ 2,027	$3,681	$ 3,681
Unsecured commercial paper	$70,329	$ 70,329	$731,786	$ 731,786	$974,153	$ 974,153
Asset-backed Canadian commercial paper conduit facility	$154,035	$ 154,035	$166,912	$ 166,912	$164,704	$ 164,704
Medium-term notes	$4,176,254	$ 3,933,337	$3,502,536	$ 3,334,398	$3,060,408	$ 2,859,151
Term asset-backed securitization debt	$1,771,363	$ 1,770,777	$1,270,656	$ 1,271,533	$1,099,596	$ 1,096,633

Cash and Cash Equivalents, Restricted Cash, Accounts Receivable, Net and Accounts Payable – With the exception of certain cash equivalents, the carrying values of these items in the financial statements are based on historical cost. The historical cost basis for these amounts is estimated to approximate their respective fair values due to the short maturity of these instruments. Fair value is based on Level 1 or Level 2 inputs.

Marketable Securities – The carrying value of marketable securities in the financial statements is based on fair value. The fair value of marketable securities is determined primarily based on quoted prices for identical instruments or on quoted market prices of similar financial assets. Fair value is based on Level 1 or Level 2 inputs.

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

Derivatives – Foreign currency exchange contracts and commodity contracts are derivative financial instruments and are carried at fair value on the balance sheet. The fair value of foreign currency exchange and commodity contracts is determined using publicly quoted prices. Fair value is calculated using Level 2 inputs.

Debt – The carrying value of debt in the financial statements is generally amortized cost. The carrying value of unsecured commercial paper approximates fair value due to its short maturity. Fair value is calculated using Level 2 inputs.

The carrying value of debt provided under the Canadian Conduit approximates fair value since the interest rates charged under the facility are tied directly to market rates and fluctuate as market rates change. Fair value is calculated using Level 2 inputs.

The fair values of the medium-term notes are estimated based upon rates currently available for debt with similar terms and remaining maturities. Fair value is calculated using Level 2 inputs.

The fair value of the senior unsecured notes was estimated based upon rates then available for debt with similar terms and remaining maturities. Fair value was calculated using Level 2 inputs.

The fair value of the debt related to term asset-backed securitization transactions is estimated based on pricing currently available for transactions with similar terms and maturities. Fair value is calculated using Level 2 inputs.

8. Derivative Instruments and Hedging Activities

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

All derivative instruments are recognized on the balance sheet at fair value (see Note 6). In accordance with ASC Topic 815, “Derivatives and Hedging,” the accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. Changes in the fair value of derivatives that are designated as fair value hedges, along with the gain or loss on the hedged item, are recorded in current period earnings. For derivative instruments that are designated as cash flow hedges, the effective portion of gains and losses that result from changes in the fair value of derivative instruments is initially recorded in other comprehensive income (OCI) and subsequently reclassified into earnings when the hedged item affects income. The Company assesses, both at the inception of each hedge and on an on-going basis, whether the derivatives that are used in its hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. Any ineffective portion is immediately recognized in earnings. No component of a hedging derivative instrument’s gain or loss is excluded from the assessment of hedge effectiveness. Derivative instruments that do not qualify for hedge accounting are recorded at fair value, and any changes in fair value are recorded in current period earnings.

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

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

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

The following table summarizes the fair value of the Company’s derivative financial instruments (in thousands):

	March 29, 2015			December 31, 2014	March 30, 2014
Derivatives Designated As Hedging Instruments Under ASC Topic 815	Notional Value	Asset Fair Value(a)	Liability Fair Value(b)	Notional Value	