HARLEY DAVIDSON INC
Form 10-Q
October 31, 2006

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 **September 24, 2006**

or

( ) Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______________________ to ______________________

Commission File Number 1-9183

Harley-Davidson, Inc.

(Exact name of registrant as specified in its Charter)

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

(Registrant s telephone number, including area code) (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 filing requirements for the past 90 days. Yes _X_ No ___

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

Large accelerated filer (X) Accelerated filer ( ) Non-accelerated filer ( )

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

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

Common Stock Outstanding as of October 27, 2006: 259,134,379 shares

HARLEY-DAVIDSON, INC.

Form 10-Q Index
For the Quarter Ended September 24, 2006

PART I FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Harley-Davidson, Inc.
Condensed Consolidated Statements of Income
(Unaudited)
(In thousands, except per share amounts)

	Three months ended		Nine months ended	
	September 24, 2006	September 25, 2005	September 24, 2006	September 25, 2005
	$ 1,635,916	$ 1,431,151	$ 4,298,053	$ 3,999,879

	Three months ended		Nine months ended	
Net revenue				
Cost of goods sold	983,661	869,879	2,636,258	2,473,890
Gross profit	652,255	561,272	1,661,795	1,525,989
Financial services income	97,344	81,444	291,812	255,558
Financial services expense	42,154	33,869	128,734	103,403
Operating income from financial services	55,190	47,575	163,078	152,155
Selling, administrative and engineering expense	223,458	197,985	607,226	558,781
Income from operations	483,987	410,862	1,217,647	1,119,363
Investment income and other, net	4,659	(79)	17,861	11,739
Income before provision for income taxes	488,646	410,783	1,235,508	1,131,102
Provision for income taxes	175,912	145,829	444,781	401,542
Net income	$ 312,734	$ 264,954	$ 790,727	$ 729,560
Earnings per common share:				
Basic	$ 1.20	$ 0.97	$ 2.96	$ 2.58
Diluted	$ 1.20	$ 0.96	$ 2.96	$ 2.57
Cash dividends per common share	$ 0.21	$ 0.16	$ 0.60	$ 0.445

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)

	September 24, 2006 (Unaudited)	December 31, 2005	September 25, 2005 (Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 506,139	$ 140,975	$ 437,007
Marketable securities	446,543	905,197	580,826
Accounts receivable, net	149,951	122,087	139,759
Finance receivables held for sale	100,109	299,373	223,758
Finance receivables held for investment, net	1,273,841	1,342,393	1,135,001
Inventories	281,536	221,418	232,240
Other current assets	124,837	113,794	114,568

	September 24, 2006 (Unaudited)	December 31, 2005	September 25, 2005 (Unaudited)
Total current assets	2,882,956	3,145,237	2,863,159
Finance receivables held for investment, net	706,695	600,831	587,315
Property, plant and equipment, net	982,204	1,011,612	981,848
Prepaid pension costs	334,044	368,165	131,400
Goodwill	58,151	56,563	56,909
Other assets	69,012	72,801	73,837
	$ 5,033,062	$ 5,255,209	$ 4,694,468
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 348,605	$ 270,614	$ 322,700
Accrued liabilities	531,689	397,525	540,510
Current portion of finance debt	96,374	204,973	--
Total current liabilities	976,668	873,112	863,210
Finance debt	900,000	1,000,000	776,626
Postretirement healthcare benefits	70,571	60,975	57,732
Other long-term liabilities	239,452	237,517	134,786
Commitments and contingencies (Note 9)			
Total shareholders equity	2,846,371	3,083,605	2,862,114
	$ 5,033,062	$ 5,255,209	$ 4,694,468

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

Harley-Davidson, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Nine months ended September 24, 2006	Nine months ended September 25, 2005
Net cash provided by operating activities (Note 3)	$ 1,286,474	$ 1,186,903
Cash flows from investing activities:		
Capital expenditures	(137,468)	(122,128)
Origination of finance receivables held for investment	(272,881)	(255,366)
Collections on finance receivables held for investment	197,171	142,968
Collection of retained securitization interests	73,974	84,766

	Nine months ended	
Purchase of marketable securities	(638,541)	(707,345)
Sales and redemptions of marketable securities	1,103,182	1,462,613
Other, net	2,512	(10,586)
Net cash provided by investing activities	327,949	594,922
Cash flows from financing activities:		
Net decrease in finance-credit facilities and commercial paper	(208,996)	(510,720)
Dividends	(158,738)	(124,330)
Purchase of common stock for treasury	(910,957)	(1,014,645)
Excess tax benefits from share-based payments	3,550	5,319
Issuance of common stock under employee stock option plans	25,882	24,399
Net cash used by financing activities	(1,249,259)	(1,619,977)
Net increase in cash and cash equivalents	365,164	161,848
Cash and cash equivalents:		
At beginning of period	140,975	275,159
At end of period	$ 506,139	$ 437,007

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)

Note 1 Basis of Presentation and Use of Estimates

The condensed interim consolidated financial statements included in this quarterly report on Form 10-Q have been prepared by Harley-Davidson, Inc. (the Company) without audit. 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 and U.S. generally accepted accounting principles for interim financial information. However, the foregoing statements contain all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of Company management, necessary to present fairly the condensed consolidated balance sheets as of September 24, 2006 and September 25, 2005, the condensed consolidated statements of income for the three and nine month periods then ended and the condensed consolidated statements of cash flows for the nine month periods then ended. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

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

Note 2 New Accounting Standards

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is required to adopt FIN 48 beginning in fiscal year 2007 and is currently evaluating the impact that the adoption of FIN 48 will have on its consolidated financial statements and notes thereto.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, which requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which changes occur through comprehensive income. Additionally, an employer is required to measure the funded status of a plan as of the date of its year-end statement of financial position. The Company is required to adopt SFAS No. 158, as it relates to recognizing the overfunded or underfunded status of its defined benefit postretirement plans and the related disclosure requirements, at December 31, 2006; the requirement to measure the funded status as of the date of the year-end statement of financial position is required by December 31, 2008. The Company is currently evaluating the impact that the adoption of SFAS No. 158 will have on its consolidated financial statements and notes thereto.

Note 3 Additional Balance Sheet and Cash Flow Information

The Company values its inventories at the lower of cost or market, principally using the last-in, first-out (LIFO) method, or market. Inventories consist of the following (in thousands):

	September 24, 2006	December 31, 2005	September 25, 2005
Components at the lower of first-in, first-out (FIFO) cost or market:			
Raw materials and work-in-process	$ 95,482	$ 90,955	$ 76,989
Motorcycle finished goods	113,009	73,736	77,736
Parts and accessories and general merchandise	100,615	80,017	100,044
	309,106	244,708	254,769
Excess of FIFO over LIFO	27,570	23,290	22,529
	$ 281,536	$ 221,418	$ 232,240

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

	Nine months ended September 24, 2006	Nine months ended September 25, 2005
Cash flows from operating activities:		
Net income	$ 790,727	$ 729,560
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	164,722	159,773
Provision for employee long-term benefits	62,327	42,991
Stock compensation expense	16,583	19,233
Gain on current year securitizations	(32,316)	(42,355)
Net change in wholesale finance receivables	93,409	17,529
Origination of retail finance receivables held for sale	(2,291,243)	(2,009,832)
Collections on retail finance receivables held for sale	77,610	87,590
Proceeds from securitization of retail finance receivables	2,303,562	2,128,608
Contributions to pension and postretirement plans	(9,378)	(109,000)
Other, net	16,374	18,438
Changes in current assets and liabilities:		
Accounts receivable, net	(24,400)	(18,426)

	Nine months ended	
Finance receivables - accrued interest and other	(17,955)	(6,734)
Inventories	(55,016)	(5,347)
Accounts payable and accrued liabilities	208,586	187,161
Other	(17,118)	(12,286)
Total adjustments	495,747	457,343
Net cash provided by operating activities	$ 1,286,474	$ 1,186,903

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Note 4 Product Warranty and Recall Campaigns

The Company currently provides a standard two-year limited warranty on all new motorcycles sold. The warranty coverage for the retail customer includes parts and labor and begins when the motorcycle is sold to a retail customer. The Company maintains reserves for future warranty claims using an estimated cost per unit sold which is based on historical Company claim information. Additionally, the Company has from time to time initiated certain voluntary recall campaigns. The Company reserves for all estimated costs associated with recalls in the period that the recalls are announced. Changes in the Company s warranty and product recall liability were as follows (in thousands):

	Three months ended		Nine months ended	
	September 24, 2006	September 25, 2005	September 24, 2006	September 25, 2005
Balance, beginning of period	$ 52,915	$ 46,863	$ 43,073	$ 44,868
Warranties issued during the period	12,708	12,853	34,417	31,318
Settlements made during the period	(17,170)	(11,436)	(41,416)	(26,001)
Recalls and changes to pre-existing warranty liabilities	4,969	1,259	17,348	(646)
Balance, end of period	$ 53,422	$ 49,539	$ 53,422	$ 49,539

During the three and nine month periods ended September 24, 2006, the liability related to warranties issued in prior periods was adjusted to reflect an increase in the estimated cost associated with the second year of the Company s two-year warranty plan. Beginning with shipments of 2004 model year motorcycles, the Company extended its warranty coverage from one year to two years. The Company has determined, based on data that is now available, that the cost associated with extending the warranty period is higher than originally anticipated. The liability for product recall campaigns was $4.6 million and $5.3 million as of September 24, 2006 and September 25, 2005, respectively.

Note 5 Business Segments

The Company operates in two business segments: Motorcycles & Related Products (Motorcycles) and Financial Services (Financial Services). The Company s reportable segments are strategic business units that offer different products and services. They are managed separately based on the fundamental differences in their operations. Selected segment information is set forth below (in thousands):

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	Three months ended		Nine months ended	
	September 24, 2006	September 25, 2005	September 24, 2006	September 25, 2005
Net revenue	$ 1,635,916	$ 1,431,151	$ 4,298,053	$ 3,999,879
Gross profit	652,255	561,272	1,661,795	1,525,989
Operating expenses	218,243	194,270	590,503	540,780
Operating income from Motorcycles	434,012	367,002	1,071,292	985,209
	97,344	81,444	291,812	255,558

	Three months ended		Nine months ended	
Financial Services income				
Financial Services expense	42,154	33,869	128,734	103,403
Operating income from Financial Services	55,190	47,575	163,078	152,155
Corporate expenses	5,215	3,715	16,723	18,001
Income from operations	$ 483,987	$ 410,862	$ 1,217,647	$ 1,119,363

Note 6 Earnings Per Share

The following table sets forth the computation for basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended September 24, 2006	Three months ended September 25, 2005	Nine months ended September 24, 2006	Nine months ended September 25, 2005
Numerator				
Net income used in computing basic and diluted earnings per common share	$ 312,734	$ 264,954	$ 790,727	$ 729,560
Denominator				
Denominator for basic earnings per common share - weighted-average common shares	260,270	274,415	266,772	282,519
Effect of dilutive securities - employee stock options and nonvested stock	959	1,045	753	887
Denominator for diluted earnings per common share - adjusted weighted-average common shares outstanding	261,229	275,460	267,525	283,406
Basic earnings per common share	$ 1.20	$ 0.97	$ 2.96	$ 2.58
Diluted earnings per common share	$ 1.20	$ 0.96	$ 2.96	$ 2.57

Outstanding options to purchase 0.8 million and 3.3 million shares of common stock for the three months ended September 24, 2006 and September 25, 2005, respectively, and 2.6 million and 2.3 million shares of common stock for the nine months ended September 24, 2006 and September 25, 2005, respectively, were not included in the Company s computation of dilutive securities because the exercise price was greater than the market price and therefore the effect would have been anti-dilutive.

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Note 7 Comprehensive Income

The following table sets forth the reconciliation of net income to comprehensive income (in thousands):

	Three months ended September 24, 2006	Three months ended September 25, 2005	Nine months ended September 24, 2006	Nine months ended September 25, 2005
Net income	$ 312,734	$ 264,954	$ 790,727	$ 729,560
Foreign currency translation adjustments	2,511	(2,753)	9,152	(14,760)
Changes in net unrealized gains and losses, net of tax:				

	Three months ended		Nine months ended	
Retained securitization interest	3,472	(850)	(12,031)	(6,461)
Derivative financial instruments	(2,858)	1,938	(5,955)	24,279
Marketable securities	3,128	(400)	3,706	(504)
Comprehensive income	$ 318,987	$ 262,889	$ 785,599	$ 732,114

Note 8 Employee Benefit Plans

The Company has several defined benefit pension plans and postretirement healthcare benefit plans (Retirement Plans), which cover substantially all employees of the Motorcycles segment. The Company also has unfunded supplemental employee retirement plan agreements (SERPA) which were instituted to replace benefits lost under the Tax Revenue Reconciliation Act of 1993. Components of net periodic benefit costs were as follows (in thousands):

	Three months ended		Nine months ended	
	September 24, 2006	September 25, 2005	September 24, 2006	September 25, 2005
Pension and SERPA Benefits				
Service cost	$ 12,190	$ 10,093	$ 36,570	$ 30,279
Interest cost	13,110	12,486	39,330	37,458
Expected return on plan assets	(19,104)	(15,641)	(57,312)	(46,923)
Amortization of unrecognized prior service cost	1,749	1,759	5,247	5,277
Amortization of unrecognized net loss	4,389	3,265	13,167	9,795
Net periodic benefit cost	$ 12,334	$ 11,962	$ 37,002	$ 35,886
Postretirement Healthcare Benefits				
Service cost	$ 3,236	$ 2,634	$ 9,708	$ 7,902
Interest cost	4,019	3,685	12,057	11,055
Expected return on plan assets	(2,278)	(1,108)	(6,834)	(3,324)
Amortization of unrecognized prior service credit	(281)	(329)	(843)	(987)
Amortization of unrecognized net loss	1,629	1,248	4,887	3,744
Net periodic benefit cost	$ 6,325	$ 6,130	$ 18,975	$ 18,390

During the remainder of 2006, the Company expects to continue its practice of funding the SERPA and postretirement healthcare plans in amounts equal to benefits paid during the year. The Company does not expect to make contributions in 2006 to further pre-fund its pension and postretirement plans.

Note 9 Commitments and Contingencies

The Company is subject to lawsuits and other claims related to environmental, product and other matters. In determining required reserves related to these items, the Company carefully analyzes cases and considers the likelihood of adverse judgments or outcomes, as well as the potential range of possible loss. The required reserves are monitored on an ongoing basis and are updated based on new developments or new information in each matter.

Shareholder Lawsuits:

A number of shareholder class action lawsuits were filed between May 18, 2005 and July 1, 2005 in the United States District Court for the Eastern District of Wisconsin. On February 14, 2006, the court consolidated all of the actions into a single case, captioned *In re Harley-Davidson, Inc. Securities Litigation*, and appointed Lead Plaintiffs and Co-Lead Plaintiffs Counsel. Pursuant to the schedule set by the court, on October 2, 2006, the Lead Plaintiffs filed a Consolidated Class Action Complaint, which names the Company and Jeffrey L. Bleustein, James L. Ziemer, and James M. Brostowitz, who are Company officers, as defendants. The Consolidated Complaint alleges securities law violations and seeks unspecified damages relating generally to the Company s April 13, 2005 announcement that it was reducing short-term production growth and planned increases of motorcycle shipments from 317,000 units in 2004 to a new 2005 target of 329,000 units (compared to its original target of 339,000 units).

Three shareholder derivative lawsuits were filed in the United States District Court for the Eastern District of Wisconsin on June 3, 2005, October 25, 2005 (this lawsuit was later voluntarily dismissed) and December 2, 2005 and two shareholder derivative lawsuits were filed in Milwaukee County Circuit Court on July 22, 2005 and November 16, 2005 against some or all of the following current or former directors and officers of the Company: Jeffrey L. Bleustein, James L. Ziemer, James M. Brostowitz, Barry K. Allen, Richard I. Beattie, George H. Conrades, Judson C. Green, Donald A. James, Sara L. Levinson, George L. Miles, Jr., James A. Norling, James A. McCaslin, Donna F. Zarcone, Jon R. Flickinger, Gail A. Lione, Ronald M. Hutchinson, W. Kenneth Sutton, Jr. and John A. Hevey. The lawsuits also name the Company as a nominal defendant. In general, the shareholder derivative complaints include factual allegations similar to those in the class action complaints and allegations that officers and directors breached their fiduciary duties to the Company. On February 14, 2006, the state court consolidated the two state court derivative actions and appointed Lead Plaintiffs and Lead Plaintiffs counsel, and on April 24, 2006, the state court ordered that the consolidated state court derivative action be stayed until after motions to dismiss the federal securities class action are decided. On February 15, 2006, the federal court consolidated the federal derivative lawsuits with the securities and ERISA (see below) actions for administrative purposes.

On July 11, 2005, the staff of the Enforcement Division of the United States Securities and Exchange Commission (SEC) advised the Company that it is inquiring into matters relating generally to the Company s April 13, 2005 announcement and certain allegations contained in the shareholder complaints. The Company is cooperating with the SEC.

On August 25, 2005, a class action lawsuit alleging violations of the Employee Retirement Income Security Act (ERISA) was filed in the United States District Court for the Eastern District of Wisconsin. As noted above, on February 15, 2006, the court ordered the ERISA action consolidated with the federal derivative and securities actions for administrative purposes. Pursuant to the schedule set by the court, on October 2, 2006, the ERISA plaintiff filed an Amended Class Action Complaint, which named the Company, the Harley-Davidson Motor Company Retirement Plans Committee, the Company s Leadership and Strategy Council, Harold A. Scott, James L. Ziemer, James M. Brostowitz, Gail A. Lione, Joanne M. Bischmann, Karl M. Eberle, Jon R. Flickinger, Ronald M. Hutchinson, James A. McCaslin, W. Kenneth Sutton, Jr., and Donna F. Zarcone, who are current or former Company officers or employees, as defendants. In general, the ERISA complaint includes factual allegations similar to those in the shareholder class action lawsuits and alleges on behalf of participants in certain Harley-Davidson retirement savings plans that the plan fiduciaries breached their ERISA fiduciary duties.

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The Company believes the allegations against all of the defendants in the lawsuits against the Company are without merit and it intends to vigorously defend against them. Since all of these matters are in the preliminary stages, the Company is unable to predict the scope or outcome or quantify their eventual impact, if any, on the Company. At this time, the Company is also unable to estimate associated expenses or possible losses. The Company maintains insurance that may limit its financial exposure for defense costs and liability for an unfavorable outcome, should it not prevail, for claims covered by the insurance coverage.

Cam Bearing Lawsuit:

In January 2001, the Company, on its own initiative, notified each owner of 1999 and early-2000 model year Harley-Davidson motorcycles equipped with Twin Cam 88® and Twin Cam 88B engines that the Company was extending the warranty for a rear cam bearing to 5 years or 50,000 miles. Subsequently, on June 28, 2001, a putative nationwide class action was filed against the Company in state court in Milwaukee County, Wisconsin, which was amended by a complaint filed September 28, 2001. The complaint alleged that this cam bearing is defective and asserted various legal theories. The complaint sought unspecified compensatory and punitive damages for affected owners, an order compelling the Company to repair the engines and other relief. On February 27, 2002, the Company s motion to dismiss the amended complaint was granted by the Court and the amended complaint was dismissed in its entirety. An appeal was filed with the Wisconsin Court of Appeals. On April 12, 2002, the same attorneys filed a second putative nationwide class action against the Company in state court in Milwaukee County, Wisconsin relating to this cam bearing issue and asserting different legal theories than in the first action. The complaint sought unspecified compensatory damages, an order compelling the Company to repair the engines and other relief. On September 23, 2002, the Company s motion to dismiss was granted by the Court, the complaint was dismissed in its entirety, and no appeal was taken. On January 14, 2003, the Wisconsin Court of Appeals reversed the trial court s February 27, 2002 dismissal of the complaint in the first action, and the Company petitioned the Wisconsin Supreme Court for review. On March 26, 2004, the Wisconsin Supreme Court reversed the Court of Appeals and dismissed the remaining claims in the action. On April 12, 2004, the same attorneys filed a third action in the state court in Milwaukee County, on behalf of the same plaintiffs from the action dismissed by the Wisconsin Supreme Court. This third action was dismissed by the court on July 26, 2004. In addition, the plaintiffs in the original case moved to reopen that matter and amend the complaint to add new causes of action. On September 9, 2004, Milwaukee County Circuit Court refused to allow the reopening or amendment. Plaintiffs again appealed to the Wisconsin Court of Appeals, and on December 13, 2005, the Court of Appeals again reversed the trial court. On January 12, 2006, the Company filed a petition for review with the Wisconsin Supreme Court. Oral arguments were heard on September 7, 2006 and the Company is awaiting a decision from the court.

The Company believes that the 5-year/50,000 mile warranty extension it announced in January 2001 adequately addressed the condition for affected owners, and the Company intends to continue to vigorously defend this matter.

Environmental Matters:

The Company is involved with government agencies and groups of potentially responsible parties in various environmental matters, including a matter involving the cleanup of soil and groundwater contamination at its York, Pennsylvania facility. The York facility was formerly used by the U.S. Navy and AMF prior to the purchase of the York facility by the Company from AMF in 1981. Although the Company is not certain as to the full extent of the environmental contamination at the York facility, it has been working with the Pennsylvania Department of Environmental Protection (PADEP) since 1986 in undertaking environmental investigation and remediation activities, including an ongoing site-wide remedial investigation/feasibility study (RI/FS).

In January 1995, the Company entered into a settlement agreement (the Agreement) with the Navy. The Agreement calls for the Navy and the Company to contribute amounts into a trust equal to 53% and 47%, respectively, of future costs associated with environmental investigation and remediation activities at the York facility (Response Costs). The trust administers the payment of the Response Costs incurred at the York facility as covered by the Agreement.

In February 2002, the Company was advised by the U.S. Environmental Protection Agency (EPA) that it considers some of the Company s remediation activities at the York facility to be subject to the EPA s corrective action program under the Resource Conservation and Recovery Act (RCRA) and offered the Company the option of addressing corrective action under a RCRA facility lead agreement. In July 2005, the York facility was designated as the first site in Pennsylvania to be addressed under the One Cleanup Program. The program provides a more streamlined and efficient oversight of voluntary remediation by both PADEP and EPA and will be carried out consistent with the Agreement with the Navy. As a result, the RCRA facility lead agreement has been superseded.

Although the RI/FS is still under way and substantial uncertainty exists concerning the nature and scope of the additional environmental investigation and remediation that will ultimately be required at the York facility, the Company estimates that its share of the future Response Costs at the York facility will be approximately $7.7 million. The Company has established reserves for this amount, which are included in Accrued Expenses and Other Liabilities in the Condensed Consolidated Balance Sheets.

The estimate of the Company s future Response Costs that will be incurred at the York facility is based on reports of independent environmental consultants retained by the Company, the actual costs incurred to date and the estimated costs to complete the necessary investigation and remediation activities. Response Costs related to the remediation of soil are expected to be incurred over a period of several years ending in 2012. Response Costs related to ground water remediation may continue for some time beyond 2012. However, these Response Costs are expected to be much lower than those related to the remediation of soil.

Under the terms of the sale of the Commercial Vehicles Division in 1996, the Company has agreed to indemnify Utilimaster Corporation, until 2008, for certain claims related to environmental contamination present at the date of sale, up to $20.0 million. Based on the environmental studies performed, the Company does not expect to incur any material expenditures under this indemnification.

Product Liability Matters:

Additionally, the Company is involved in product liability suits related to the operation of its business. The Company accrues for claim exposures that are probable of occurrence and can be reasonably estimated. The Company also maintains insurance coverage for product liability exposures. The Company believes that its accruals and insurance coverage are adequate and that product liability will not have a material adverse effect on the Company s consolidated financial statements.

Note 10 Reclassifications

Prior to December 31, 2005, finance receivables held for sale were not separately classified in the balance sheet; therefore, prior period balances have been reclassified to conform to the current year presentation. In addition, cash flows relating to finance receivables held for sale, which were previously reported in cash flows from investing activities, have been reclassified to cash flows from operating activities to conform to the current year presentation. As a result of the reclassifications, net cash provided by operating activities increased by $206.4 million during the period ended September 25, 2005 offset by a decrease in net cash provided by investing activities in the same amount.

Prior year amounts relating to prepaid pension costs and other assets have also been reclassified to conform to the current year presentation.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Harley-Davidson, Inc. is the parent company for the groups of companies doing business as Harley-Davidson Motor Company (HDMC), Buell Motorcycle Company (Buell) and Harley-Davidson Financial Services (HDFS). HDMC produces heavyweight motorcycles and offers a complete line of motorcycle parts, accessories, apparel and general merchandise. HDMC manufactures five families of motorcycles: Touring, Dyna , Softail®, VRSC and Sportster®. Buell produces sport motorcycles, including seven twin-cylinder XB models and the single-cylinder Buell® Blast®. Buell also offers a line of motorcycle parts, accessories, apparel and general merchandise. HDFS provides wholesale and retail financing and insurance programs primarily to Harley-Davidson/Buell dealers and customers.

The % Change figures included in this section have been calculated using unrounded dollar amounts and may differ from calculations using the rounded dollar amounts presented.

Overview

The Company s net revenue for the third quarter of 2006 was $1.64 billion, up 14.3% over the same quarter last year driven by a 10.8% increase in shipments of Harley-Davidson® motorcycles over the third quarter of 2005. Net income and diluted earnings per share for the third quarter of 2006 were up 18.0% and 25.0%, respectively, over the third quarter of 2005. The increase in diluted earnings per share includes the benefit of fewer weighted average shares outstanding when compared to the same quarter last year. Weighted-average shares outstanding were 14.3 million shares lower in the third quarter of 2006 compared to the same quarter last year, as a result of the Company s repurchases of common stock occurring over the last year. The Company s independent dealer network also reported increases in retail motorcycle unit sales during the third quarter of 2006.

For the third quarter of 2006, worldwide dealer retail sales of Harley-Davidson motorcycles were up 8.9% over the same period last year. In the United States, retail sales of Harley-Davidson motorcycles grew 6.7% during the third quarter of 2006 when compared to the same quarter last year. Internationally, retail sales were up 18.7% over the third quarter of 2005 with increases of 9.9% in Europe, 13.7% in Japan and 30.2% in Canada.

In July 2006, independent dealers began offering the Company s new 2007 model year motorcycles. The Company s 2007 model offering includes the new larger Twin Cam 96™ engine and a new six-speed transmission for all Touring and Softail motorcycles, the addition of electronic fuel injection on all Sportster models, and a number of new models and other features.

In addition, the Company believes that the continued momentum in international dealer retail sales is due in part to the strategies that it has been implementing over the last couple of years. These strategies include improvements within the international dealer base, enhanced marketing programs and a more effective and efficient distribution of motorcycles worldwide.

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[1] **Note Regarding Forward-Looking Statements**
The Company intends that certain matters discussed in this report are forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements can generally be identified as such by reference to this footnote or because the context of the statement will include words such as the Company believes, anticipates, expects, plans, or estimates or words o similar meaning. Similarly, statements that describe future plans, objectives, outlooks, targets, guidance or goals are also forward-looking statements. Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated as of the date of this report. Certain of such risks and uncertainties are described in close proximity to such statements or elsewhere in this report, including under the caption Cautionary Statements included in this report, and in Item 1A Risk Factors of the Company s 2005 Annual Report on Form 10-K for the year ended December 31, 2005. Shareholders, potential investors, and other readers are urged to consider these factors in evaluating the forward-looking statements and cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included in this report are made only as of the date of the filing of this report (October 31, 2006), and the Company disclaims any obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances.

During the first nine months of 2006, Harley-Davidson dealers delivered a worldwide retail sales growth rate of 8.9% over the same period in 2005. The Company continues to be pleased with worldwide retail sales and believes its dealers are positioned to continue their retail momentum.[1] At the same time, the Company continues to monitor the economy and its potential impact on the Company s business.

Outlook[(1)]

Over the past several months, the Company has carefully reviewed its guidance practices. This has included industry comparisons, a review of historical practices and discussions with shareholders. As result of this review, the Company has made a decision to streamline its guidance. The guidance provided below is indicative of what the Company will provide going forward and supersedes all prior guidance provided by the Company.

Looking forward, the Company believes that it will continue to grow revenue and that shipments in its international markets will grow at a faster rate than in the U.S. market. The Company believes its opportunities for growth will be driven by a focus on providing customers around the world with a continuous stream of exciting new motorcycles, surrounded by a unique Harley-Davidson experience. Harley-Davidson customers enjoy a unique lifestyle experience through organized rides and rallies, through membership in the Harley Owners Group® (H.O.G.®) organization, and through the use of MotorClothes® merchandise and Harley-Davidson® Genuine Motor Accessories to personalize their experience.

The Company also expects that it will continue to expand margins. The Company believes its manufacturing expertise and focus on operational excellence, and other factors, position it to continue to drive a net income growth rate in excess of its revenue growth rate. Operational excellence involves employees and suppliers continuously pursuing process improvements and innovation. Over the last several years, the Company has made considerable strides in manufacturing efficiency and automation and believes there continues to be opportunities for improvement in these areas and across other parts of the organization. The Company also expects that other factors such as increased production, quality, product mix and pricing for features will also continue to contribute to expanding margins.

The Company expects that its business model will continue to generate cash that will allow it to invest in the business, fund future growth opportunities and return value to shareholders. The Company s expected annual capital expenditures are provided under Liquidity and Capital Resources . The Company will continue to provide expected annual capital expenditures in the future.

The Company expects to continue to deliver earnings-per-share growth of 11% to 17% annually through 2009. The Company believes that earnings growth will be driven by solid revenue growth, margin improvement and the benefits of strong free cash flow.

The Company s wholesale motorcycle shipment target for the full year of 2006 has been narrowed to between 349,000 and 351,000 units. Given the 256,348 Harley-Davidson motorcycles shipped through the end of the third quarter, the fourth quarter wholesale shipment plan for Harley-Davidson motorcycles is in the range of approximately 92,600 to 94,600 units. Going forward, the Company will continue to provide shipment guidance for the coming quarter. In the Company s reports on Form 10-Q and Form 10-K, it will provide a range of expected wholesale shipments for the next quarter.

In the future, the Company will no longer supply annual or longer-term shipment guidance and will also discontinue the practice of providing guidance on growth rates for Parts & Accessories, General Merchandise and Harley-Davidson Financial Services.

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Results of Operations for the Three Months Ended September 24, 2006
Compared to the Three Months Ended September 25, 2005

Overall

For the quarter ended September 24, 2006, net revenue totaled $1.64 billion, a $204.7 million or 14.3% increase over the same period last year. Net income for the third quarter of 2006 was $312.7 million compared to $265.0 million in the third quarter of 2005, an increase of 18.0%. Diluted earnings per share for the third quarter of 2006 were $1.20 representing a 25.0% increase over 2005 third quarter diluted earnings per share of $0.96. Diluted earnings per share during the third quarter of 2006 were positively impacted by a decrease in the weighted-average shares outstanding, which were 261.2 million in the third quarter of 2006 compared to 275.5 million in the same quarter last year. The decrease in weighted-average shares outstanding was driven by the Company s repurchases of common stock occurring over the last year. The Company s third quarter 2006 share repurchases are discussed in further detail under Liquidity and Capital Resources.

Motorcycle Unit Shipments & Net Revenue

The following table includes wholesale motorcycle unit shipments and net revenue for the Motorcycles segment for the three months ended September 24, 2006 and September 25, 2005 (dollars in millions):

	2006	2005	Increase (Decrease)	% Change

Motorcycle Unit Shipments				
Touring motorcycle units	36,041	29,492	6,549	22.2%
Custom motorcycle units*	44,096	40,730	3,366	8.3%
Sportster motorcycle units	16,909	17,363	(454)	-2.6%
Harley-Davidson motorcycle units	97,046	87,585	9,461	10.8%
Buell motorcycle units	2,529	2,914	(385)	-13.2%
Total motorcycle units	99,575	90,499	9,076	10.0%
Net Revenue				
Harley-Davidson motorcycles	$ 1,293.4	$ 1,110.2	$ 183.2	16.5%
Buell motorcycles	21.4	25.3	(3.9)	-15.2%
Total motorcycles	1,314.8	1,135.5	179.3	15.8%
Parts & Accessories	248.4	231.2	17.2	7.5%
General Merchandise	71.3	64.5	6.8	10.5%
Other	1.4	0.0	1.4	N/M
Net revenue	$ 1,635.9	$ 1,431.2	$ 204.7	14.3%

* Custom motorcycle units, as used in this table, include Softail, Dyna, VRSC and other custom models.

The Company shipped 97,046 Harley-Davidson motorcycle units during the third quarter of 2006, an increase of 9,461 units or 10.8% over the same quarter last year. Harley-Davidson motorcycle revenue was up 16.5% during the third quarter of 2006 over the same quarter last year driven by the increase in Harley-Davidson motorcycle shipments. Harley-Davidson motorcycle revenue also benefited during the third quarter of 2006 from favorable changes in product mix and higher wholesale prices on its 2007 model year Harley-Davidson motorcycles. Changes in foreign currency exchange rates did not have a material impact on revenue during the third quarter of 2006 when compared to the same quarter last year.

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During the third quarter of 2006, shipments of higher-priced Touring models increased as a percentage of total shipments while Custom and Sportster model shipments decreased slightly. The percentage of Touring motorcycles shipped in the third quarter of 2006 increased to 37.1% compared to 33.4% in the third quarter of 2005. The mix changes were related to particularly strong early demand for the 2007 Touring models. However, the Company expects that the percentage of Touring model shipments will return to the 33% to 35% range in the fourth quarter of 2006.(1)

During the third quarter of 2006, net revenue from Parts and Accessories (P&A) was up 7.5% over the third quarter of 2005. General Merchandise net revenue during the third quarter of 2006 was up 10.5% over the same period last year.

Gross Profit

Gross profit was $652.3 million for the Motorcycles segment in the third quarter of 2006, an increase of $91.0 million or 16.2% over the same quarter last year. Gross margin for the third quarter of 2006 was 39.9% compared to 39.2% in the third quarter of 2005. During the third quarter of 2006, the gross margin was positively impacted by favorable product mix, wholesale price increases and manufacturing efficiencies, partially offset by higher raw material costs. Raw material costs are discussed in more detail under Gross Profit in the *Results of Operations for the Nine Months Ended September 24, 2006.*

Financial Services

The following table includes the condensed statements of operations for the Financial Services segment (which consists of HDFS) for the three months ended September 24, 2006 and September 25, 2005 (in millions):

	2006	2005	Increase	% Change
Interest income	$ 37.7	$ 28.7	$ 9.0	31.1%
Income from securitizations	32.2	29.3	2.9	9.9%
Other income	27.5	23.4	4.1	17.4%
Financial services income				