MERITOR INC
Form 10-Q
August 01, 2014
Index

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

FORM 10-Q

QUARTERLY REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 29, 2014
Commission File No. 1-15983

MERITOR, INC.

(Exact name of registrant as specified in its charter)

Indiana	38-3354643
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2135 West Maple Road, Troy, Michigan	48084-7186
(Address of principal executive offices)	(Zip Code)

(248) 435-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 Registration S-T during the preceding twelve 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. (Check one)

Large accelerated filer		Accelerated filer	X
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

97,844,611 shares of Common Stock, $1.00 par value, of Meritor, Inc. were outstanding on June 29, 2014.

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MERITOR, INC.

PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements

CONSOLIDATED STATEMENT OF OPERATIONS
(in millions, except per share amounts)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)			
Sales	$986	$993	$2,855	$2,792
Cost of sales	(863)	(884)	(2,513)	(2,505)
GROSS MARGIN	123	109	342	287
Selling, general and administrative	(54)	(67)	(179)	(194)
Pension settlement loss	—	(36)	—	(36)
Restructuring costs	—	(12)	(3)	(29)
Other operating expense	(1)	—	(2)	(2)
OPERATING INCOME (LOSS)	68	(6)	158	26
Equity in earnings of ZF Meritor	190	—	190	—
Equity in earnings of other affiliates	11	15	28	34
Interest expense, net	(22)	(45)	(97)	(99)
INCOME (LOSS) BEFORE INCOME TAXES	247	(36)	279	(39)
Provision for income taxes	(11)	(1)	(30)	(18)
INCOME (LOSS) FROM CONTINUING OPERATIONS	236	(37)	249	(57)
INCOME (LOSS) FROM DISCONTINUED OPERATIONS, net of tax	(2)	(1)	1	(6)
NET INCOME (LOSS)	234	(38)	250	(63)
Less: Net income attributable to noncontrolling interests	—	—	(4)	—
NET INCOME (LOSS) ATTRIBUTABLE TO MERITOR, INC.	$234	$(38)	$246	$(63)
NET INCOME (LOSS) ATTRIBUTABLE TO MERITOR, INC.				
Net income (loss) from continuing operations	$236	$(37)	$245	$(57)
Income (loss) from discontinued operations	(2)	(1)	1	(6)
Net income (loss)	$234	$(38)	$246	$(63)
BASIC EARNINGS (LOSS) PER SHARE				
Continuing operations	$2.42	$(0.38)	$2.51	$(0.58)
Discontinued operations	(0.02)	(0.01)	0.01	(0.07)
Basic earnings (loss) per share	$2.40	$(0.39)	$2.52	$(0.65)
DILUTED EARNINGS (LOSS) PER SHARE				
Continuing operations	$2.33	$(0.38)	$2.47	$(0.58)
Discontinued operations	(0.02)	(0.01)	0.01	(0.07)
Diluted earnings (loss) per share	$2.31	$(0.39)	$2.48	$(0.65)
Basic average common shares outstanding	97.6	97.2	97.5	97.0
Diluted average common shares outstanding	101.1	97.2	99.1	97.0

See notes to consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)
(in millions)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)			
Net income (loss)	$234	$(38)	$250	$(63)
Other comprehensive income (loss):				
Foreign currency translation adjustments	8	(33)	8	(34)
Pension and other postretirement benefit related adjustments	11	25	31	23
Unrealized gain (loss) on investments and foreign exchange contracts	—	(1)	2	(1)
Other comprehensive income (loss), net of tax	19	(9)	41	(12)
Total comprehensive income (loss)	253	(47)	291	(75)
Less: Comprehensive (income) loss attributable to noncontrolling interest	—	1	(4)	—
Comprehensive income (loss) attributable to Meritor, Inc.	$253	$(46)	$287	$(75)

See notes to consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED BALANCE SHEET
(in millions)

	June 30, 2014 (Unaudited)	September 30, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$303	$318
Receivables, trade and other, net	644	596
Inventories	441	414
Other current assets	56	56
TOTAL CURRENT ASSETS	1,444	1,384
NET PROPERTY	411	417
GOODWILL	439	434
OTHER ASSETS	516	335
TOTAL ASSETS	$2,810	$2,570
LIABILITIES AND EQUITY (DEFICIT)		
CURRENT LIABILITIES:		
Short-term debt	$5	$13
Accounts and notes payable	715	694
Other current liabilities	351	339
TOTAL CURRENT LIABILITIES	1,071	1,046
LONG-TERM DEBT	1,086	1,125
RETIREMENT BENEFITS	861	886
OTHER LIABILITIES	319	335
TOTAL LIABILITIES	3,337	3,392
COMMITMENTS AND CONTINGENCIES (See Note 20)		
EQUITY (DEFICIT):		
Common stock (June 30, 2014 and September 30, 2013, 97.8 and 97.4 shares issued and outstanding, respectively)	97	97
Additional paid-in capital	919	914
Accumulated deficit	(881)	(1,127)
Accumulated other comprehensive loss	(693)	(734)
Total deficit attributable to Meritor, Inc.	(558)	(850)
Noncontrolling interests	31	28
TOTAL DEFICIT	(527)	(822)
TOTAL LIABILITIES AND DEFICIT	$2,810	$2,570

See notes to consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions)

	Nine Months Ended June 30,	
	2014	2013
	(Unaudited)	
OPERATING ACTIVITIES		
CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES (See Note 9)	$103	$(73)
INVESTING ACTIVITIES		
Capital expenditures	(39)	(31)
Other investing activities	—	1
Net investing cash flows provided by discontinued operations	3	6
CASH USED FOR INVESTING ACTIVITIES	(36)	(24)
FINANCING ACTIVITIES		
Repayment of notes and term loan	(308)	(427)
Proceeds from debt issuance	225	500
Debt issuance costs	(9)	(12)
Other financing activities	10	10
CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES	(82)	71
EFFECT OF CHANGES IN FOREIGN CURRENCY EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	—	(3)
CHANGE IN CASH AND CASH EQUIVALENTS	(15)	(29)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	318	257
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$303	$228

See notes to consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED STATEMENT OF EQUITY (DEFICIT)
(In millions)
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Deficit Attributable to Meritor, Inc.	Noncontrolling Interests	Total
Beginning balance at September 30, 2013	$97	$914	$ (1,127)	$ (734)	$(850)	$ 28	$(822)
Comprehensive income	—	—	246	41	287	4	291
Equity based compensation expense	—	6	—	—	6	—	6
Noncontrolling interest dividends	—	—	—	—	—	(1)	(1)
Other equity adjustments	—	(1)	—	—	(1)	—	(1)
Ending Balance at June 30, 2014	$97	$919	$ (881)	$ (693)	$(558)	$ 31	$(527)
Beginning balance at September 30, 2012	$96	$901	$ (1,105)	$ (915)	$(1,023)	$ 41	$(982)
Comprehensive loss	—	—	(63)	(12)	(75)	—	(75)
Vesting of restricted stock	1	(1)	—	—	—	—	—
Repurchase of convertible notes	—	(2)	—	—	(2)	—	(2)
Issuance of convertible notes	—	9	—	—	9	—	9
Equity based compensation expense	—	5	—	—	5	—	5
Noncontrolling interest dividends	—	—	—	—	—	(14)	(14)
Ending Balance at June 30, 2013	$97	$912	$ (1,168)	$ (927)	$(1,086)	$ 27	$(1,059)

See notes to consolidated financial statements.

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MERITOR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

Meritor, Inc., (the "company" or "Meritor"), headquartered in Troy, Michigan, is a premier global supplier of a broad range of integrated systems, modules and components to original equipment manufacturers (“OEMs”) and the aftermarket for the commercial vehicle, transportation and industrial sectors. The company serves commercial truck, trailer, off-highway, military, bus and coach and other industrial OEMs and certain aftermarkets. The consolidated financial statements are those of the company and its consolidated subsidiaries.

Certain businesses are reported in discontinued operations in the consolidated statement of operations, statement of cash flows and related notes for all periods presented. Additional information regarding discontinued operations is discussed in Note 4.

In the opinion of the company, the unaudited financial statements contain all adjustments, consisting solely of adjustments of a normal, recurring nature, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. These statements should be read in conjunction with the company’s audited consolidated financial statements and notes thereto included in the Annual Report on Form 10-K, for the fiscal year ended September 30, 2013. The results of operations for the three and nine months ended June 30, 2014, are not necessarily indicative of the results for the full year.

The company’s fiscal year ends on the Sunday nearest September 30. The third quarter of fiscal years 2014 and 2013 ended on June 29, 2014 and June 30, 2013, respectively. All year and quarter references relate to the company’s fiscal year and fiscal quarters, unless otherwise stated. For ease of presentation, September 30 and June 30 are used consistently throughout this report to represent the fiscal year end and third quarter end, respectively.

2. Earnings per Share

Basic earnings per share is calculated using the weighted average number of shares outstanding during each period. Diluted earnings per share calculation includes the impact of dilutive common stock options, restricted stock, performance share awards, and convertible securities, if applicable.

A reconciliation of basic average common shares outstanding to diluted average common shares outstanding is as follows (in millions):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Basic average common shares outstanding	97.6	97.2	97.5	97.0
Impact of stock options	0.1	—	0.1	—
Impact of restricted shares	1.6	—	1.5	—
Impact of convertible notes	1.8	—	—	—
Diluted average common shares outstanding	101.1	97.2	99.1	97.0

On November 7, 2013, the Board of Directors approved a grant of performance restricted share units to all executives eligible to participate in the long-term incentive plan. Each performance share unit represents the right to receive one share of common stock upon achievement of certain performance and time vesting criteria. The fair value of each share unit is $7.97, the company’s share price on the grant date of December 1, 2013.

The actual number of performance units that will vest will depend upon the company’s performance relative to the established M2016 goals for the three-year performance period of October 1, 2013 to September 30, 2016, measured at the end of the performance period. The number of potential performance units will depend on meeting the established M2016 goals at the following weights: 50% associated with achieving 10% Adjusted EBITDA margin, 25% associated with reducing net debt, including retirement benefit liabilities, by $400 million to less than $1.5 billion, and 25% associated with generating incremental booked revenue of $500 million per year (at run-rate). The number of shares that vest will be between 0% and 200% of the estimated grant date amount of 1.5 million shares. For the three and nine months ended June 30, 2014, compensation cost recognized related to the performance shares was $1 million and $2 million, respectively. Performance shares are excluded from the diluted earnings per share calculation for the three and nine months ended June 30, 2014 as the shares are contingent upon the satisfaction of certain conditions that have not been satisfied as of the respective reporting periods.

For the three months ended June 30, 2014, 1.8 million shares were included in the computation of diluted earnings per share because the average share price exceeded the conversion price for the 7.875 percent convertible notes due 2026. For the three months ended June 30, 2013, and nine months ended June 30, 2014 and 2013, the average share price during each period did not exceed the conversion price.

For the three and nine months ended June 30, 2014, options to purchase 0.1 million and 0.4 million shares of common stock, respectively, were excluded from the computation of diluted earnings per share because their exercise price exceeded the average market price for the periods and thus their inclusion would be anti-dilutive. For both the three and nine months ended June 30, 2013, options to purchase 0.5 million shares of common stock, were excluded from the computation of diluted earnings per share because their exercise price exceeded the average market price for the periods and thus their inclusion would be anti-dilutive.

The potential effects of restricted shares and share units were excluded from the diluted earnings per share calculation for the three and nine months ended June 30, 2013 because their inclusion in a loss from continuing operations period would reduce the loss per share from continuing operations attributable to common shareholders.

3. New Accounting Standards

Accounting standards implemented during fiscal year 2014

In January 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. ASU 2013-01 clarifies which instruments and transactions are subject to the offsetting disclosure requirements established by ASU 2011-11, Disclosures about Offsetting Assets and Liabilities. The new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. The company adopted this guidance at the beginning of its first quarter of fiscal year 2014 within Note 18.

In February 2013, the FASB issued ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-02 requires that reclassification adjustments for items that are reclassified from accumulated other comprehensive income to net income be presented on the financial statements or in a note to the financial statements. The new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The company adopted this guidance at the beginning of its first quarter of fiscal year 2014 within Note 21.

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU 2013-11 eliminates the option of presenting unrecognized tax benefits as a liability or as a reduction of a deferred tax asset for a net operating loss or tax credit carryforward. An unrecognized tax benefit, or portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 with early adoption permitted. The company adopted this guidance at the beginning of its first quarter of fiscal year 2014. The adoption of ASU 2013-11 did not have a material effect on the company's consolidated statement of financial position, results of operations, or cash flows.

Accounting standards to be implemented

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU 2014-08 changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. A strategic shift could include a disposal of: (1) a major geographical area of operations; (2) a major line of business; and (3) a major equity method investment. The standard is required to be adopted by public business entities in annual periods beginning on or after December 15, 2014, and interim periods within those annual periods. The company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2015 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

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In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. ASU 2014-09 merges revenue recognition standards of the FASB and International Accounting Standards Board (IASB). The FASB and IASB initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards (IFRS) that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosure requirements; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The standard is required to be adopted by public business entities in annual periods beginning on or after December 15, 2016, and interim periods within those annual periods. The company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2017 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

4. Discontinued Operations

Results of discontinued operations are summarized as follows (in millions):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Sales	$—	$—	$—	$—
Loss before income taxes	$(1)	$(1)	(3)	(6)
Benefit (provision) for income taxes	(1)	—	4	—
Income (loss) from discontinued operations attributable to Meritor, Inc.	$(2)	$(1)	$1	$(6)

Pre-tax loss from discontinued operations for the three and nine months ended June 30, 2014 and 2013 was primarily due to environmental remediation costs. The benefit for income taxes for the nine months ended June 30, 2014 was primarily attributable to the expiration of the statue of limitations on certain tax contingencies of previously divested businesses.

5. Goodwill

In accordance with FASB Accounting Standards Codification (ASC) Topic 350-20, “Intangibles – Goodwill and Other”, goodwill is reviewed for impairment annually during the fourth quarter of the fiscal year or more frequently if certain indicators arise. If business conditions or other factors cause the operating results and cash flows of a reporting unit to decline, the company may be required to record impairment charges for goodwill at that time. The company tests goodwill for impairment at a level of reporting referred to as a reporting unit, which is an operating segment or one level below an operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. When two or more components of an operating segment have similar economic characteristics, the components are aggregated and deemed a single reporting unit. An operating segment is deemed to be a reporting unit if all of its components are similar, if none of its components is a reporting unit, or if the segment comprises only a single component.

A summary of the changes in the carrying value of goodwill by the company's two reportable segments are presented below (in millions):

	Commercial Truck & Industrial	Aftermarket & Trailer	Total
Beginning balance at September 30, 2013	$262	$172	$434
Foreign currency translation	3	2	5

Balance at June 30, 2014	$265	$174	$439

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6. Restructuring Costs

At both June 30, 2014 and September 30, 2013, $9 million and $12 million, respectively, of restructuring reserves primarily related to unpaid employee termination benefits remained in the consolidated balance sheet. The changes in restructuring reserves for the nine months ended June 30, 2014 and 2013 are as follows (in millions):

	Employee Termination Benefits	Asset Impairment	Plant Shutdown & Other	Total
Beginning balance at September 30, 2013	$12	$—	$—	$12
Activity during the period:				
Charges to continuing operations	3	—	—	3
Cash payments – continuing operations	(6)	—	—	(6)
Total restructuring reserves at June 30, 2014	9	—	—	9
Less: non-current restructuring reserves	(3)	—	—	(3)
Restructuring reserves – current, at June 30, 2014	$6	$—	$—	$6
Balance at September 30, 2012	$15	$—	$—	$15
Activity during the period:				
Charges to continuing operations	18	1	10	29
Asset write-offs	—	(1)	—	(1)
Cash payments – continuing operations	(17)	—	—	(17)
Other	(1)	—	(1)	(2)
Total restructuring reserves at June 30, 2013	15	—	9	24
Less: non-current restructuring reserves	(3)	—	(7)	(10)
Restructuring reserves – current, at June 30, 2013	$12	$—	$2	$14

M2016 Footprint Actions: As part of the company's M2016 Strategy, a three-year plan to achieve sustainable financial strength, the company approved a North American footprint realignment action and a European Shared Services Reorganization. As part of these actions, the company eliminated 74 hourly and 27 salaried positions and incurred $2 million of restructuring costs, primarily related to severance benefits, in the Commercial Truck & Industrial segment during fiscal year 2013.

Variable Labor Reductions: During the fourth quarter of fiscal year 2012, the company initiated a global variable labor headcount reduction plan intended to reduce labor and other costs in response to market conditions. As part of this action, the company eliminated approximately 600 hourly and 120 salaried positions and incurred $10 million of restructuring costs in the Commercial Truck & Industrial segment, primarily severance benefits, of which $5 million was recognized in fiscal year 2013 and $5 million was recognized in fiscal year 2012. Restructuring actions associated with the variable labor reductions were substantially complete as of March 31, 2014.

Remanufacturing Consolidation: During the first quarter of fiscal year 2013, the company announced the planned consolidation of its remanufacturing operations in the Aftermarket & Trailer segment resulting in the closure of one remanufacturing plant in Canada. The closure resulted in the elimination of 85 hourly positions including approximately 65 positions which were transferred to the company's facility in Indiana. The company recorded restructuring charges of $3 million during fiscal year 2013, primarily associated with employee severance charges. Restructuring actions associated with the remanufacturing consolidation were substantially complete as of March 31, 2014.

Segment Reorganization and Asia Pacific Realignment: On November 12, 2012, the company announced a revised management reporting structure resulting in two business segments to drive efficiencies. On January 8, 2013, the company announced restructuring actions related to this business segment rationalization. On March 26, 2013, the company announced plans to consolidate its operations in China by transferring manufacturing operations to the company's off-highway facility and closing its facility in Wuxi, China.

During fiscal year 2013, the company recorded employee severance charges and other exit costs associated with the elimination of approximately 200 salaried positions (including contract employees) and 50 hourly positions of $8 million and $3 million in the Commercial Truck & Industrial and Aftermarket & Trailer segments, respectively, as well as $3 million at a corporate location. The company also recognized $2 million within the Commercial Truck & Industrial segment related to a lease termination. Restructuring actions associated with this program were substantially complete as of March 31, 2014.

7. Income Taxes

For each interim reporting period, the company makes an estimate of the effective tax rate expected to be applicable for the full fiscal year pursuant to FASB ASC Topic 740-270, "Accounting for Income Taxes in Interim Periods." The rate so determined is used in providing for income taxes on a year-to-date basis. Jurisdictions with a projected loss for the year or an actual year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of including these jurisdictions on the quarterly effective rate calculation could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings versus annual projections.

Income tax expense (benefit) is allocated between continuing operations, discontinued operations and other comprehensive income (OCI). Such allocation is applied by tax jurisdiction, and in periods in which there is a pre-tax loss from continuing operations and pre-tax income in another category, such as discontinued operations or OCI, income tax expense is allocated to the other sources of income, with a related benefit recorded in continuing operations.

For the first nine months of fiscal year 2014, the company had approximately $181 million of net pre-tax income compared to a net pre-tax loss of $91 million in the first nine months of fiscal year 2013 in tax jurisdictions in which a tax expense (benefit) is not recorded. Income or losses arising from these jurisdictions resulted in an adjustment to the valuation allowance, rather than an adjustment to income tax expense.

Included in the net pre-tax income for the first nine months of fiscal year 2014 is $210 million of earnings on the antitrust lawsuit settlement with Eaton Corporation inclusive of the $20 million recovery of legal expenses (see Note 14), which was recorded in a jurisdiction with a valuation allowance. This income resulted in a $79 million decrease to the valuation allowance, rather than an increase to income tax expense.

8. Accounts Receivable Factoring & Securitization

Off-balance sheet arrangements

Swedish Factoring Facility: The company has an arrangement to sell trade receivables due from AB Volvo through one of its European subsidiaries. Under this arrangement, which was renewed on June 27, 2014 and terminates on June 28, 2015, the company can sell up to, at any point in time, €150 million ($204 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €103 million ($140 million) and €148 million ($199 million) of this accounts receivable factoring facility as of June 30, 2014 and September 30, 2013, respectively.

U.S. Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its subsidiaries. Under this arrangement, which was renewed on June 27, 2014 and terminates on October 29, 2015, the company can sell up to, at any point in time, €65 million ($89 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €61 million ($83 million) and €48 million ($65 million) of this accounts receivable factoring facility as of June 30, 2014 and September 30, 2013, respectively.

The above facilities are backed by 364-day liquidity commitments from Nordea Bank which were renewed through May 2015. The commitments are subject to standard terms and conditions for these types of arrangements.

United Kingdom Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its European subsidiaries through one of its United Kingdom subsidiaries. Under this arrangement, which was renewed on January 24, 2013 and expires in February 2018, the company can sell up to, at any point in time, €25 million ($34 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €8 million ($11 million) and €7 million ($9 million) of this accounts receivable factoring facility as of June 30, 2014 and September 30, 2013, respectively. The agreement is subject to standard terms and conditions for these types of arrangements including a sole discretion clause whereby the bank retains the right to not purchase receivables, which has not been invoked since the inception of the program.

Italy Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its European subsidiaries through one of its Italian subsidiaries. Under this arrangement, which expires in June 2017, the company can sell up to, at any point in time, €30 million ($41 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €12 million ($16 million) and €10 million ($14 million) of this accounts receivable factoring facility as of June 30, 2014 and September 30, 2013, respectively. The agreement is subject to standard terms and conditions for these types of arrangements including a sole discretion clause whereby the bank retains the right to not purchase receivables, which has not been invoked since the inception of the program.

Brazil Factoring Facility: The company entered into an arrangement to sell trade receivables from MAN and its subsidiaries. Under this arrangement, which began in October 2013 and was valid for invoices dated no later than March 31, 2014, the company could sell up to, at any point in time, R$100 million of eligible trade receivables. The receivables under this program were sold at face value and were excluded from the consolidated balance sheet. The company had no balance utilized on this accounts receivable factoring facility as of June 30, 2014, and the agreement has expired.

In addition, several of the company's subsidiaries, primarily in Europe, factor eligible accounts receivable with financial institutions. Certain receivables are factored without recourse to the company and are excluded from accounts receivable in the consolidated balance sheet. The amount of factored receivables excluded from accounts receivable was $23 million and $18 million at June 30, 2014 and September 30, 2013, respectively.

Total costs associated with all of the off-balance sheet arrangements described above were $2 million in the three months ended June 30, 2014 and 2013, respectively, and $7 million and $5 million in the nine months ended June 30, 2014 and 2013, respectively, and are included in selling, general and administrative expenses in the consolidated statement of operations.

On-balance sheet arrangements

The company has a $100 million U.S. accounts receivables securitization facility. On June 21, 2013, the company entered into a one-year extension of the facility expiration date, which after the amendment, expires on June 18, 2016. On October 11, 2013, the company entered into an amendment whereby Market Street Funding, LLC assigned its purchase commitment to PNC Bank National Association (PNC). This program is provided by PNC, as Administrator and Purchaser, and the other Purchasers and Purchaser Agents from time to time (participating lenders), which are party to the agreement. Under this program, the company has the ability to sell an undivided percentage ownership interest in substantially all of its trade receivables (excluding the receivables due from AB Volvo and subsidiaries eligible for sale under the U.S. Factoring Facility) of certain U.S. subsidiaries to ArvinMeritor Receivables Corporation (ARC), a wholly-owned, special purpose subsidiary. ARC funds these purchases with borrowings from participating lenders under a loan agreement. This program also includes a letter of credit facility pursuant to which ARC may request the issuance of letters of credit issued for the company's U.S. subsidiaries (originators) or their designees, which when issued will constitute a utilization of the facility for the amount of letters of credit issued. Amounts outstanding under this agreement are collateralized by eligible receivables purchased by ARC and are reported as short-term debt in the consolidated balance sheet. At June 30, 2014, no amounts, including letters of credit, were outstanding under this program. This program contains a financial covenant related to the company's priority-debt-to-EBITDA ratio, which is 2.00 to 1.00 as of the last day of the fiscal quarter throughout the remaining term of the agreement. At June 30, 2014, the company was in compliance with all covenants under its credit agreement (see Note 17).

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9. Operating Cash Flow

The reconciliation of net income (loss) to cash flows provided by (used for) operating activities is as follows (in millions):

	Nine Months Ended June 30,	
	2014	2013
OPERATING ACTIVITIES		
Net income (loss)	$250	$(63)
Less: Income (loss) from discontinued operations, net of tax	1	(6)
Income (loss) from continuing operations	249	(57)
Adjustments to income (loss) from continuing operations to arrive at cash provided by (used for) operating activities:		
Depreciation and amortization	50	49
Restructuring costs	3	29
Loss on debt extinguishment	21	24
Equity in earnings of ZF Meritor	(190)	—
Equity in earnings of other affiliates	(28)	(34)
Pension and retiree medical expense	30	69
Other adjustments to income (loss) from continuing operations	7	4
Dividends received from affiliates	28	14
Pension and retiree medical contributions	(31)	(88)
Restructuring payments	(6)	(17)
Changes in off-balance sheet accounts receivable factoring	(27)	46
Changes in assets and liabilities, excluding effects of acquisitions, divestitures, foreign currency adjustments and discontinued operations	4	(98)
Operating cash flows provided by (used for) continuing operations	110	(59)
Operating cash flows used for discontinued operations	(7)	(14)
CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	$103	$(73)

10. Inventories

Inventories are stated at the lower of cost (using FIFO or average methods) or market (determined on the basis of estimated realizable values) and are summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Finished goods	$193	$184
Work in process	37	32
Raw materials, parts and supplies	211	198
Inventories	$441	$414

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11. Other Current Assets

Other current assets are summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Current deferred income tax assets	$23	$23
Asbestos-related recoveries (see Note 20)	12	12
Deposits and collateral	5	4
Prepaid and other	16	17
Other current assets	$56	$56

12. Net Property

Net property is summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Property at cost:		
Land and land improvements	$35	$35
Buildings	243	239
Machinery and equipment	928	915
Company-owned tooling	157	152
Construction in progress	49	48
Total	1,412	1,389
Less: Accumulated depreciation	(1,001)	(972)
Net property	$411	$417

13. Other Assets

Other assets are summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Investment in ZF Meritor (see Note 14)	190	—
Investments in other non-consolidated joint ventures (see Note 14)	$107	$102
Asbestos-related recoveries (see Note 20)	59	59
Non-current deferred income tax assets, net	9	13
Unamortized debt issuance costs	32	32
Capitalized software costs, net	25	28
Prepaid pension costs	65	55
Other	29	46
Other assets	$516	$335

In accordance with FASB ASC Topic 350-40, costs relating to internally developed or purchased software in the preliminary project stage and the post-implementation stage are expensed as incurred. Costs in the application development stage that meet the criteria for capitalization are capitalized and amortized using the straight-line basis over the estimated economic useful life of the software.

The company holds a variable interest in a joint venture accounted for under the equity method of accounting. The joint venture manufactures components for commercial vehicle applications primarily on behalf of the company. The variable interest relates to a supply arrangement between the company and the joint venture whereby the company supplies certain components to the joint venture on a cost-plus basis. The company is not the primary beneficiary of the joint venture, as the joint venture partner has shared or absolute control over key manufacturing operations, labor relationships, financing activities and certain other functions of the joint venture. Therefore, the company does not consolidate the joint venture. At June 30, 2014, the company’s investment in the joint venture was $41 million representing the company’s maximum exposure to loss. This amount is included in investments in non-consolidated joint ventures in the table above.

14. INVESTMENTS IN NON-CONSOLIDATED JOINT VENTURES

The company’s non-consolidated joint ventures and related direct ownership interest are as follows:

	June 30, 2014		September 30, 2013	
Meritor WABCO Vehicle Control Systems (Commercial Truck)	50	%	50	%
Master Sistemas Automotivos Ltda. (Commercial Truck)	49	%	49	%
ZF Meritor LLC (Commercial Truck)	50	%	50	%
Sistemas Automotrices de Mexico S.A. de C.V. (Commercial Truck)	50	%	50	%
Ege Fren Sanayii ve Ticaret A.S. (Commercial Truck)	49	%	49	%
Automotive Axles Limited (Industrial)	36	%	36	%

The company’s investments in non-consolidated joint ventures as of June 30, 2014 and September 30, 2013 are $297 million and $102 million, respectively.

In June 2014, ZF Meritor LLC (“ZF Meritor”), a joint venture between ZF Friedrichshafen AG, and Meritor Transmission LLC (“Meritor Transmission”), entered into a settlement agreement with Eaton Corporation (“Eaton”) relating to an antitrust lawsuit filed in 2006. Pursuant to the terms of the settlement agreement, Eaton agreed to pay $500 million to ZF Meritor. In July 2014, ZF Meritor received proceeds of $400 million net of attorney's contingency fees. In July 2014, the company received proceeds of $210 million based on the company's ownership interest in ZF Meritor including recovery of current and prior years attorney expenses paid by Meritor. ZF Meritor and Meritor Transmission have agreed to dismiss all pending antitrust litigation with Eaton. ZF Meritor did not have any operating activity or assets other than the receivable related to the settlement with Eaton.

The company's pre-tax share of the settlement was $210 million ($209 million after-tax), of which $190 million was recognized as equity in earnings of ZF Meritor and $20 million for the recovery of legal expenses from ZF Meritor was recognized as a reduction of selling, general and administrative expenses in the consolidated statement of operations. In July 2014, ZF Meritor reimbursed the company $20 million for the recovery of current and prior year legal expenses. We recognized the recovery in SG&A as the historical incurrence of these costs was included in SG&A in the consolidated statement of operations in prior periods.

15. Other Current Liabilities

Other current liabilities are summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Compensation and benefits	$ 149	$ 141
Income taxes	12	8
Taxes other than income taxes	51	47
Accrued interest	14	16

Product warranties	23	20
Restructuring (see Note 6)	6	9
Asbestos-related liabilities (see Note 20)	18	18
Indemnity obligations (see Note 20)	12	12
Other	66	68
Other current liabilities	$351	$339

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The company records estimated product warranty costs at the time of shipment of products to customers. Warranty reserves are primarily based on factors that include past claims experience, sales history, product manufacturing and engineering changes and industry developments. Liabilities for product recall campaigns are recorded at the time the company's obligation is probable and can be reasonably estimated. Policy repair actions to maintain customer relationship are recorded as other liabilities at the time an obligation is probable and can be reasonably estimated. Product warranties, including recall campaigns, not expected to be paid within one year are recorded as a non-current liability.

A summary of the changes in product warranties is as follows (in millions):

	Nine Months Ended June 30,	
	2014	2013
Total product warranties – beginning of period	$57	$44
Accruals for product warranties[1]	14	24
Payments	(18)	(13)
Change in estimates and other	3	1
Total product warranties – end of period	56	56
Less: Non-current product warranties	(33)	(36)
Product warranties – current	$23	$20

[1] Includes a $12 million specific warranty contingency related to a non-safety, product performance issue recognized during the quarter ended June 30, 2013 (see Note 20).

16. Other Liabilities

Other liabilities are summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Asbestos-related liabilities (see Note 20)	$96	$96
Restructuring (see Note 6)	3	3
Non-current deferred income tax liabilities	104	100
Liabilities for uncertain tax positions	11	17
Product warranties (see Note 15)	33	37
Environmental	8	11
Indemnity obligations	20	26
Other	44	45
Other liabilities	$319	$335

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17. Long