

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 (State or other jurisdiction of incorporation or organization)	38-3354643 (I.R.S. Employer Identification No.)
2135 West Maple Road, Troy, Michigan (Address of principal executive offices)	48084-7186 (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  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  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	<input checked="" type="checkbox"/>
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

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		Nine Months Ended June	
	June 30,		30,	
	2014	2013	2014	2013
	(Unaudited)			
Sales	\$986	\$993	\$2,855	\$2,792
Cost of sales	(863 )	(884 )	(2,513 )	(2,505 )
<b>GROSS MARGIN</b>	<b>123</b>	<b>109</b>	<b>342</b>	<b>287</b>
Selling, general and administrative	(54 )	(67 )	(179 )	(194 )
Pension settlement loss	—	(36 )	—	(36 )
Restructuring costs	—	(12 )	(3 )	(29 )
Other operating expense	(1 )	—	(2 )	(2 )
<b>OPERATING INCOME (LOSS)</b>	<b>68</b>	<b>(6)</b>	<b>158</b>	<b>26</b>
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 )
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>247</b>	<b>(36)</b>	<b>279</b>	<b>(39)</b>
Provision for income taxes	(11 )	(1 )	(30 )	(18 )
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>	<b>236</b>	<b>(37)</b>	<b>249</b>	<b>(57)</b>
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS, net</b>	<b>(2)</b>	<b>(1)</b>	<b>1</b>	<b>(6)</b>
of tax				
<b>NET INCOME (LOSS)</b>	<b>234</b>	<b>(38)</b>	<b>250</b>	<b>(63)</b>
Less: Net income attributable to noncontrolling interests	—	—	(4 )	—
<b>NET INCOME (LOSS) ATTRIBUTABLE TO MERITOR, INC.</b>	<b>\$234</b>	<b>\$(38)</b>	<b>\$246</b>	<b>\$(63)</b>
<b>NET INCOME (LOSS) ATTRIBUTABLE TO MERITOR, INC.</b>				
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)
<b>BASIC EARNINGS (LOSS) PER SHARE</b>				
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)
<b>DILUTED EARNINGS (LOSS) PER SHARE</b>				
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, 2014 (Unaudited)		Nine Months Ended June 30, 2014 2013	
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		Nine Months Ended June 30,	
	June 30,		2014	2013
	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.

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MERITOR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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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MERITOR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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		Nine Months Ended	
	June 30,		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 statute 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

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Balance at June 30, 2014	\$265	\$174	\$439
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MERITOR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

## 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.



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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.

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**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
<b>OPERATING ACTIVITIES</b>		
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 )
<b>CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES</b>	<b>\$103</b>	<b>\$(73 )</b>

## 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,	September 30,
	2014	2013
Finished goods	\$193	\$184
Work in process	37	32
Raw materials, parts and supplies	211	198
<b>Inventories</b>	<b>\$441</b>	<b>\$414</b>

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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.

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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

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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 <sup>(1)</sup>	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

<sup>(1)</sup> 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,	September 30,
	2014	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-Term Debt

Long-Term Debt, net of discounts where applicable, is summarized as follows (in millions):

	June 30, 2014	September 30, 2013
8.125 percent notes due 2015	\$84	\$84
10.625 percent notes due 2018 (net of issuance discount of \$3)	—	247
4.625 percent convertible notes due 2026 <sup>(1)</sup>	55	55
4.0 percent convertible notes due 2027 <sup>(1)</sup>	200	200
7.875 percent convertible notes due 2026 (net of issuance discount of \$21 and \$23, respectively) <sup>(1)</sup>	229	227
6.75 percent notes due 2021 <sup>(2)</sup>	275	275
6.25 percent notes due 2024 <sup>(2)</sup>	225	—
Term loan	—	45
Capital lease obligation	28	28
Export financing arrangements	32	18
Unamortized gain on interest rate swap termination	1	2
Unamortized discount on convertible notes	(38	) (43
Subtotal	1,091	1,138
Less: current maturities	(5	) (13
Long-term debt	\$1,086	\$1,125

<sup>(1)</sup> The 4.625 percent, 4.0 percent and 7.875 percent convertible notes contain a put and call feature, which allows for earlier redemption beginning in 2016, 2019 and 2020, respectively.

<sup>(2)</sup> The 6.75 percent and 6.25 percent notes contain a call option, which allows for early redemption.

## Revolving Credit Facility

On February 13, 2014, the company amended and restated its revolving credit facility. Pursuant to the revolving credit agreement as amended, the company has a \$499 million revolving credit facility, \$89 million of which matures in April 2017 for banks not electing to extend their commitments under the revolving credit facility, and \$410 million of which matures in February 2019. The availability under this facility is dependent upon various factors, including performance against certain financial covenants as highlighted below.

The availability under the revolving credit facility is subject to certain financial covenants based on (i) the ratio of the company's priority debt (consisting principally of amounts outstanding under the revolving credit facility, U.S. accounts receivable securitization and factoring programs, and third-party non-working capital foreign debt) to EBITDA and (ii) the amount of annual capital expenditures. The company is required to maintain a total priority-debt-to-EBITDA ratio, as defined in the agreement, of 2.25 to 1.00 as of the last day of the fiscal quarter throughout the term of the agreement. At June 30, 2014, the company was in compliance with all covenants under the revolving credit facility with a ratio of approximately 0.39x for the priority debt-to-EBITDA covenant.

Availability under the revolving credit facility is also subject to a collateral test, pursuant to which borrowings on the revolving credit facility cannot exceed 1.0x the collateral test value. The collateral test is performed on a quarterly basis. At June 30, 2014, the revolving credit facility was collateralized by approximately \$651 million of the company's assets, primarily consisting of eligible domestic U.S. accounts receivable, inventory, plant, property and equipment, intellectual property and the company's investment in all or a portion of certain of its wholly-owned subsidiaries.

Borrowings under the revolving credit facility are subject to interest based on quoted LIBOR rates plus a margin and a commitment fee on undrawn amounts, both of which are based upon the company's current corporate credit rating for senior secured facilities. At June 30, 2014, the margin over LIBOR rate was 350 basis points, and the commitment fee

was 50 basis points. Overnight revolving credit loans are at the prime rate plus a margin of 250 basis points. Certain of the company's subsidiaries, as defined in the revolving credit agreement, irrevocably and unconditionally guarantee amounts outstanding under the revolving credit facility. Similar subsidiary guarantees are provided for the benefit of the holders of the notes outstanding under the company's indentures (see Note 23).

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No borrowings were outstanding under the revolving credit facility at June 30, 2014 and September 30, 2013. The amended and extended revolving credit facility includes \$100 million of availability for the issuance of letters of credit. At June 30, 2014 and September 30, 2013, there were no letters of credit outstanding under the revolving credit facility.

Term Loan

On February 13, 2014, the company repaid the outstanding balance on the term loan of \$41 million and recognized a \$2 million loss on the repayment associated with unamortized debt issuance costs.

Debt Securities

In February 2012, the company filed a shelf registration statement with the Securities and Exchange Commission, which was amended in November 2012, registering up to \$750 million of debt and/or equity securities that may be offered in one or more series on terms to be determined at the time of sale. The amount remaining at June 30, 2014 is \$250 million.

Issuance of Debt Securities - 2024 Notes

On February 13, 2014, the company completed an offering of debt securities consisting of the issuance of \$225 million of 10-year, 6.25 percent notes due February 15, 2024 (the "2024 Notes"). The offering and sale were made pursuant to the company's shelf registration statement. The 2024 Notes were issued under the company's indenture dated as of April 1, 1998, as supplemented. The 2024 Notes were issued at 100 percent of their principal amount. The proceeds from the sale of the 2024 Notes were \$225 million and were primarily used to redeem the company's previously outstanding \$250 million 10.625 percent notes due 2018.

The 2024 Notes mature on February 15, 2024 and bear interest at a fixed rate of 6.25 percent per annum. The company pays interest on the 2024 Notes semi-annually, in arrears, on February 15 and August 15 of each year. The 2024 Notes constitute senior unsecured obligations of the company and rank equally in right of payment with existing and future senior unsecured indebtedness, and effectively junior to existing and future secured indebtedness to the extent of the security therefor. The 2024 Notes are guaranteed on a senior unsecured basis by each of the company's subsidiaries from time to time guaranteeing its senior secured credit facility. The guarantees rank equally with existing and future senior unsecured indebtedness of the guarantors and will be effectively subordinated to all of the existing and future secured indebtedness of the guarantors, to the extent of the value of the assets securing such indebtedness. Prior to February 15, 2019, the company may redeem, at its option, from time to time, the 2024 Notes, in whole or in part, at a redemption price equal to 100 percent of the principal amount of the 2024 Notes to be redeemed plus an applicable premium (as defined in the indenture under which the 2024 Notes were issued) and any accrued and unpaid interest. On or after February 15, 2019, the company may redeem, at its option, from time to time, the 2024 Notes, in whole or in part, at the redemption prices (expressed as percentages of the principal amount of the 2024 Notes to be redeemed) set forth below, plus accrued and unpaid interest, if any, if redeemed during the 12-month period beginning on February 15 of the years indicated below:

Year	Redemption Price
2019	103.125%
2020	102.083%
2021	101.042%
2022 and thereafter	100.000%

Prior to February 15, 2017, the company also may redeem, at its option, from time to time, up to 35 percent of the aggregate principal amount of the 2024 Notes with the net cash proceeds of one or more public sales of the company's common stock at a redemption price equal to 106.25 percent of the principal amount, plus accrued and unpaid interest, if any, so long as at least 65 percent of the aggregate principal amount of 2024 Notes originally issued remains outstanding after each such redemption and notice of any such redemption is mailed within 90 days of any such sale

of common stock.

If a Change of Control (as defined in the indenture under which the 2024 Notes were issued) occurs, unless the company has exercised its right to redeem the 2024 Notes, each holder of 2024 Notes may require the company to repurchase some or all of such holder's 2024 Notes at a purchase price equal to 101 percent of the principal amount of the 2024 Notes to be repurchased, plus accrued and unpaid interest, if any.

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## Issuance of Debt Securities - 2021 Notes

On May 31, 2013, the company completed an offering of debt securities consisting of the issuance of \$275 million of 8-year, 6.75 percent notes due June 15, 2021 (the "2021 Notes"). The offering and sale were made pursuant to the company's shelf registration statement. The 2021 Notes were issued under the company's indenture dated as of April 1, 1998, as supplemented. The 2021 Notes were issued at 100 percent of their principal amount. The proceeds from the sale of the 2021 Notes were \$275 million and were primarily used to complete a cash tender offer for \$167 million of the company's previously outstanding \$250 million 8.125 percent notes due 2015.

The 2021 Notes mature on June 15, 2021 and bear interest at a fixed rate of 6.75 percent per annum. The company pays interest on the 2021 Notes semi-annually, in arrears, on June 15 and December 15 of each year. The 2021 Notes constitute senior unsecured obligations of the company and rank equally in right of payment with existing and future senior unsecured indebtedness, and effectively junior to existing and future secured indebtedness to the extent of the security therefor. The 2021 Notes are guaranteed on a senior unsecured basis by each of the company's subsidiaries from time to time guaranteeing its senior secured credit facility. The guarantees rank equally with existing and future senior unsecured indebtedness of the guarantors and will be effectively subordinated to all of the existing and future secured indebtedness of the guarantors, to the extent of the value of the assets securing such indebtedness.

Prior to June 15, 2016, the company may redeem, at its option, from time to time, the 2021 Notes, in whole or in part, at a redemption price equal to the 100 percent of the principal amount of the 2021 Notes to be redeemed plus an applicable premium (as defined in the indenture under which the 2021 Notes were issued) and any accrued and unpaid interest. On or after June 15, 2016, the company may redeem, at its option, from time to time, the 2021 Notes, in whole or in part, at the redemption prices (expressed as percentages of the principal amount of the 2021 Notes to be redeemed) set forth below, plus accrued and unpaid interest, if any, if redeemed during the 12-month period beginning on June 15 of the years indicated below:

Year	Redemption Price
2016	105.063%
2017	103.375%
2018	101.688%
2019 and thereafter	100.000%

Prior to June 15, 2016, the company also may redeem, at its option, from time to time, up to 35 percent of the aggregate principal amount of the 2021 Notes with the net cash proceeds of one or more public sales of the company's common stock at a redemption price equal to 106.75 percent of the principal amount, plus accrued and unpaid interest, if any, so long as at least 65 percent of the aggregate principal amount of 2021 Notes originally issued remains outstanding after each such redemption and notice of any such redemption is mailed within 90 days of any such sale of common stock.

If a Change of Control (as defined in the indenture under which the 2021 Notes were issued) occurs, unless the company has exercised its right to redeem the 2021 Notes, each holder of 2021 Notes may require the company to repurchase some or all of such holder's 2021 Notes at a purchase price equal to 101 percent of the principal amount of the 2021 Notes to be repurchased, plus accrued and unpaid interest, if any.

## Repurchase of Debt Securities

On March 15, 2014, the company exercised a call option on its 10.625 percent notes due March 15, 2018. The notes were redeemed at 105.313 percent of their principal amount. The repurchase of \$250 million of 10.625 percent notes was accounted for as an extinguishment of debt and, accordingly, the company recognized a net loss on debt extinguishment of \$19 million, which consist of \$6 million of unamortized discount and deferred issuance costs, and \$13 million of premium. The net loss on debt extinguishment is included in interest expense, net in the consolidated statement of operations.

On June 5, 2013, the company completed a cash tender offer for its 8.125 percent notes due September 15, 2015. The notes were repurchased at approximately 114 percent of their principal amount. The repurchase of \$167 million of 8.125 percent notes was accounted for as an extinguishment of debt and, accordingly, the company recognized a net loss on debt extinguishment of \$19 million, which is included in interest expense, net in the consolidated statement of operations.

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## Capital Leases

On March 20, 2012, the company entered into an arrangement to finance equipment acquisitions for various U.S. locations. Under this arrangement, the company can request financing from GE Capital Commercial, Inc. (GE Capital) for progress payments for equipment under construction, not to exceed \$10 million at any point in time. The financing rate is equal to the 30-day LIBOR plus 475 basis points per annum. Under this arrangement, the company can also enter into lease arrangements with GE Capital for completed equipment. The lease term is 60 months and the lease interest rate is equal to the 5-year Swap Rate published by the Federal Reserve Board plus 564 basis points. As of June 30, 2014 and September 30, 2013, the company had \$14 million and \$15 million, respectively, outstanding under this capital lease arrangement. In addition, the company had another \$14 million and \$13 million, respectively, outstanding through other capital lease arrangements at June 30, 2014 and September 30, 2013.

## Letter of Credit Facilities

On February 21, 2014, the company entered into an arrangement to amend and restate the letter of credit facility with Citicorp USA, Inc., as administrative agent and issuing bank, and the other lenders party thereto. Under the terms of this amended credit agreement, the company has the right to obtain the issuance, renewal, extension and increase of letters of credit up to an aggregate availability of \$30 million through December 19, 2015. From December 20, 2015 through March 19, 2019 the aggregate availability is \$25 million. This facility contains covenants and events of default generally similar to those existing in our public debt indentures. There were \$26 million and \$27 million of letters of credit outstanding under this facility at June 30, 2014 and September 30, 2013, respectively. In addition, the company had another \$9 million of letters of credit outstanding through other letter of credit facilities at June 30, 2014 and September 30, 2013.

## Export financing arrangements

The company entered into a number of export financing arrangements through its Brazilian subsidiary during fiscal years 2013 and 2014. The export financing arrangements are issued under an incentive program of the Brazilian government to fund working capital for Brazilian companies in exportation programs. The arrangements bear interest at 5.5 percent and have maturity dates in 2016 and 2017. There were \$32 million and \$18 million outstanding under these arrangements at June 30, 2014 and September 30, 2013, respectively.

## 18. Financial Instruments

Fair values of financial instruments are summarized as follows (in millions):

	June 30, 2014		September 30, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	\$303	\$303	\$318	\$318
Short-term debt	5	5	13	13
Long-term debt	1,086	1,351	1,125	1,266
Foreign exchange forward contracts (liability)	—	—	1	1
Short-term foreign currency option contracts	1	1	—	—
Long-term foreign currency option contracts	1	1	—	—

The following table reflects the offsetting of derivative assets and liabilities (in millions):

	June 30, 2014			September 30, 2013		
	Gross Amounts Recognized	Gross Offset	Net Amounts Reported	Gross Amounts Recognized	Gross Offset	Net Amounts Reported
Derivative Asset						
Foreign exchange forward contract	—	—	—	—	—	—

Derivative Liabilities

Foreign exchange forward contract	—	—	—	1	—	1
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## Fair Value

The current FASB guidance provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical instruments (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level 1 inputs use quoted prices in active markets for identical instruments.

Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar instruments in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related instrument.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The company's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

Fair value of financial instruments by the valuation hierarchy at June 30, 2014 is as follows (in millions):

	Level 1	Level 2	Level 3
Cash and cash equivalents	\$303	\$—	\$—
Short-term debt	—	—	5
Long-term debt	—	1,296	55
Short-term foreign currency option contracts	—	—	1
Long-term foreign currency option contracts	—	—	1

Cash and cash equivalents — All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents. The carrying value approximates fair value because of the short maturity of these instruments. The company did not have any cash equivalents at June 30, 2014 or September 30, 2013.

Short- and Long-term debt — Fair values are based on transaction prices at public exchange for publicly traded debt. For debt instruments that are not publicly traded, fair values are based on interest rates that would be currently available to the company for issuance of similar types of debt instruments with similar terms and remaining maturities.

Foreign exchange forward contracts — The company uses foreign exchange forward purchase and sale contracts with terms of one year or less to hedge its exposure to changes in foreign currency exchange rates. The fair value of foreign exchange forward contracts is based on a model which incorporates observable inputs including quoted spot rates, forward exchange rates and discounted future expected cash flows utilizing market interest rates with similar quality and maturity characteristics.

Foreign currency option contracts — The company uses foreign currency option contracts on expected future purchases tied to the Indian Rupee due to increasing foreign currency exchange risk. The contracts were entered into during April 2014 with effective dates beginning at the start of fiscal year 2015 and mature at the end of fiscal year 2016. The fair value of foreign currency option contracts is based on a third-party proprietary model which incorporates inputs at varying unobservable weights of quoted spot rates, market volatility, forward rates, and time element utilizing market rates with similar quality and maturity characteristics. Changes in fair value associated with these contracts are recorded in cost of sales in the consolidated statement of operations.



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## 19. Retirement Benefit Liabilities

Retirement benefit liabilities consisted of the following (in millions):

	June 30, 2014	September 30, 2013
Retiree medical liability	\$504	\$513
Pension liability	386	396
Other	19	25
Subtotal	909	934
Less: current portion (included in compensation and benefits, Note 15)	(48	) (48
Retirement benefits	\$861	\$886

The components of net periodic pension and retiree medical expense included in continuing operations for the three months ended June 30 are as follows (in millions):

	2014		2013	
	Pension	Retiree Medical	Pension	Retiree Medical
Service cost	\$1	\$—	\$1	\$—
Interest cost	19	6	21	6
Assumed return on plan assets	(26	) —	(29	) —
Amortization of prior service costs	—	(2	) —	(2
Recognized actuarial loss	6	6	7	7
Settlement charge	—	—	36	—
Total expense	\$—	\$10	\$36	\$11

The components of net periodic pension and retiree medical expense included in continuing operations for the nine months ended June 30 are as follows (in millions):

	2014		2013	
	Pension	Retiree Medical	Pension	Retiree Medical
Service cost	\$1	\$—	\$2	\$1
Interest cost	59	19	64	16
Assumed return on plan assets	(78	) —	(86	) —
Amortization of prior service costs	—	(6	) —	(6
Recognized actuarial loss	18	17	20	20
Settlement charge	—	—	38	—
Total expense	\$—	\$30	\$38	\$31

**Canadian Pension Plans Settlement:** During the quarter ended June 30, 2013, the company settled five of its Canadian defined benefit pension plans via non-participating annuity contract purchases and lump-sum payments. These actions relieve the company of primary responsibility for the pension obligations associated with these plans and eliminate significant risks related to the obligation and assets used to effect the settlement. The company recognized a pre-tax settlement loss of \$36 million (\$27 million after-tax) associated with these actions in the third quarter of fiscal year 2013. This loss is primarily due to the recognition of previously unrecognized actuarial losses that were included in accumulated other comprehensive loss.

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U.S. Plan Lump-sum Actions: In June 2013, the company amended its U.S. Retirement Plan to allow all terminated vested participants with an accrued benefit of \$5,000 or less to receive a full lump-sum distribution of their benefit. The lump-sum amount was rolled into an individual retirement account for those participants that have an accrued benefit of \$1,000 to \$5,000 who do not make an affirmative election to receive their benefits. For those participants with an accrued benefit of less than \$1,000, the benefits were automatically distributed to the participant.

Additionally, in June 2013, the company announced a special election window to offer voluntary lump-sum pension payouts to eligible terminated vested participants with an accrued benefit in the U.S. Retirement Plan that, if accepted, would settle the company's obligation to them. The program provided participants with a one-time choice of electing to receive a lump-sum settlement of their remaining pension benefit. Lump-sum distributions under this election window were paid in September 2013.

## 20. Contingencies

## Environmental

Federal, state and local requirements relating to the discharge of substances into the environment, the disposal of hazardous wastes and other activities affecting the environment have, and will continue to have, an impact on the operations of the company. The process of estimating environmental liabilities is complex and dependent upon evolving physical and scientific data at the sites, uncertainties as to remedies and technologies to be used and the outcome of discussions with regulatory agencies. The company records liabilities for environmental issues in the accounting period in which they are considered to be probable and the cost can be reasonably estimated. At environmental sites in which more than one potentially responsible party has been identified, the company records a liability for its allocable share of costs related to its involvement with the site, as well as an allocable share of costs related to insolvent parties or unidentified shares. At environmental sites in which Meritor is the only potentially responsible party, the company records a liability for the total probable and estimable costs of remediation before consideration of recovery from insurers or other third parties.

The company has been designated as a potentially responsible party at nine Superfund sites, excluding sites as to which the company's records disclose no involvement or as to which the company's liability has been finally determined. Management estimates the total reasonably possible costs the company could incur for the remediation of Superfund sites at June 30, 2014 to be approximately \$18 million, of which \$2 million is probable and recorded as a liability. Included in reasonably possible amounts are estimates for certain remediation actions that may be required if current actions are deemed inadequate by the regulators.

In addition to the Superfund sites, various other lawsuits, claims and proceedings have been asserted against the company, alleging violations of federal, state and local environmental protection requirements, or seeking remediation of alleged environmental impairments, principally at previously disposed-of properties. For these matters, management has estimated the total reasonably possible costs the company could incur at June 30, 2014 to be approximately \$38 million, of which \$17 million is probable and recorded as a liability.

Included in the company's environmental liabilities are costs for on-going operation, maintenance and monitoring at environmental sites in which remediation has been put into place. This liability is discounted using discount rates in the range of 0.25 to 3 percent and is approximately \$9 million at June 30, 2014. The undiscounted estimate of these costs is approximately \$10 million.

Following are the components of the Superfund and non-Superfund environmental reserves (in millions):

	Superfund Sites	Non-Superfund Sites	Total
Beginning balance at September 30, 2013	\$2	\$17	\$19
Payments and other	—	(4	) (4
Accruals	—	4	4

Balance at June 30, 2014	\$2	\$17	\$19
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Environmental reserves are included in Other Current Liabilities (see Note 15) and Other Liabilities (see Note 16) in the consolidated balance sheet.

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The actual amount of costs or damages for which the company may be held responsible could materially exceed the foregoing estimates because of uncertainties, including the financial condition of other potentially responsible parties, the success of the remediation, discovery of new contamination and other factors that make it difficult to predict actual costs accurately. However, based on management's assessment, after consulting with outside advisors that specialize in environmental matters, and subject to the difficulties inherent in estimating these future costs, the company believes that its expenditures for environmental capital investment and remediation necessary to comply with present regulations governing environmental protection and other expenditures for the resolution of environmental claims will not have a material effect on the company's business, financial condition or results of operations. In addition, in future periods, new laws and regulations, changes in remediation plans, advances in technology and additional information about the ultimate clean-up remedies could significantly change the company's estimates. Management cannot assess the possible effect of compliance with future requirements.

**Asset Retirement Obligations**

The company has identified conditional asset retirement obligations for which a reasonable estimate of fair value could not be made because the potential settlement dates cannot be determined at this time. Due to the long term, productive nature of the company's manufacturing operations, absent plans or expectations of plans to initiate asset retirement activities, the company was not able to reasonably estimate the settlement date for the related obligations. Therefore, the company has not recognized conditional asset retirement obligations for which there are no plans or expectations of plans to retire the asset.

**Asbestos**

Maremont Corporation ("Maremont"), a subsidiary of Meritor, manufactured friction products containing asbestos from 1953 through 1977, when it sold its friction product business. Arvin Industries, Inc., a predecessor of the company, acquired Maremont in 1986. Maremont and many other companies are defendants in suits brought by individuals claiming personal injuries as a result of exposure to asbestos-containing products. Maremont had approximately 5,800 and 5,400 pending asbestos-related claims at June 30, 2014 and September 30, 2013, respectively. Although Maremont has been named in these cases, in the cases where actual injury has been alleged, very few claimants have established that a Maremont product caused their injuries. Plaintiffs' lawyers often sue dozens or even hundreds of defendants in individual lawsuits on behalf of hundreds or thousands of claimants, seeking damages against all named defendants irrespective of the disease or injury and irrespective of any causal connection with a particular product. For these reasons, Maremont does not consider the number of claims filed or the damages alleged to be a meaningful factor in determining its asbestos-related liability.

Maremont's asbestos-related reserves and corresponding asbestos-related recoveries are summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Pending and future claims	\$73	\$73
Billed but unpaid claims	1	1
Asbestos-related liabilities	74	74
Asbestos-related insurance recoveries	58	58

A portion of the asbestos-related recoveries and reserves are included in Other Current Assets and Liabilities, with the majority of the amounts recorded in Other Assets and Liabilities (see Notes 11, 13, 15 and 16).

Pending and Future Claims: Maremont engages Bates White LLC (Bates White), a consulting firm with extensive experience estimating costs associated with asbestos litigation, to assist with determining the estimated cost of resolving pending and future asbestos-related claims that have been, and could reasonably be expected to be, filed against Maremont. Bates White prepares these cost estimates annually in September. Although it is not possible to estimate the full range of costs because of various uncertainties, Bates White advised Maremont that it would be

possible to determine an estimate of a reasonable forecast of the cost of the probable settlement and defense costs of resolving pending and future asbestos-related claims, based on historical data and certain assumptions with respect to events that may occur in the future.

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Bates White provided a reasonable and probable estimate that consisted of a range of equally likely possibilities of Maremont's obligation for asbestos personal injury claims over the next ten years of \$73 million to \$80 million. Management recognized a liability of \$73 million as of June 30, 2014 and September 30, 2013, as the probable liability for pending and future claims over the next ten years. The ultimate cost of resolving pending and future claims is estimated based on the history of claims and expenses for plaintiffs represented by law firms in jurisdictions with an established history with Maremont. Historically, Maremont has recognized incremental insurance receivables associated with recoveries expected for asbestos-related liabilities as the estimate of asbestos-related liabilities for pending and future claim changes. Maremont currently expects to exhaust the limits of its settled insurance coverage prior to the end of the ten-year forecasted liability period. Maremont believes it has additional insurance coverage; however, certain carriers have disputed coverage under policies they issued (see "Recoveries" below). Because no insurance receivable is currently recognized for these policies in dispute, Maremont recognized a \$9 million charge in the fourth quarter of fiscal year 2013 associated with its annual valuation of asbestos-related liabilities. If Maremont is unable to recognize recoveries from disputed policies, it is reasonably possible that the annual valuation could result in a charge to be recognized in the fourth quarter of fiscal year 2014.

Assumptions: The following assumptions were made by Maremont after consultation with Bates White and are included in their study:

- Pending and future claims were estimated for a ten-year period ending in fiscal year 2023. The ten-year assumption is considered appropriate as Maremont has reached certain longer-term agreements with key plaintiff law firms, and filings of mesothelioma claims have been relatively stable over the last few years;

- Maremont believes that the litigation environment may change significantly beyond ten years and that the reliability of estimates of future probable expenditures in connection with asbestos-related personal injury claims will likely decline for each year further in the future. As a result, estimating a probable liability beyond ten years is difficult and uncertain;

- Defense and processing costs for pending and future claims will be at the level consistent with Maremont's prior experience;

- Potential payments made to claimants from other sources, including other defendants and 524(g) trusts favorably impact the company's estimated liability in the future; and

- The ultimate indemnity cost of resolving nonmalignant claims with plaintiffs' law firms in jurisdictions without an established history with Maremont cannot be reasonably estimated.

Recoveries: Maremont has insurance that reimburses a substantial portion of the costs incurred defending against asbestos-related claims. The insurance receivable related to asbestos-related liabilities is \$58 million as of June 30, 2014 and September 30, 2013. The receivable at June 30, 2014 is for coverage provided by two insurance carriers based on coverage in place agreements. Maremont currently expects to exhaust the remaining limits provided by this coverage sometime in the next ten years. Maremont maintained insurance coverage with other insurance carriers that management believes covers indemnity and defense costs. Maremont has incurred liabilities allocable to these policies but has not yet billed these insurance carriers, and no receivable has been recorded for disputed policies. During fiscal year 2013, Maremont reinitiated a lawsuit against these carriers, seeking a declaration of its rights to insurance for asbestos claims and to facilitate an orderly and timely collection of insurance proceeds. The difference between the estimated liability and insurance receivable is primarily related to proceeds received from settled insurance policies and claims for which coverage under Maremont's insurance policies is in dispute with the insurer. Certain insurance policies have been settled in cash prior to the ultimate settlement of the related asbestos liabilities. Amounts received from insurance settlements generally reduce recorded insurance receivables.

The amounts recorded for the asbestos-related reserves and recoveries from insurance companies are based upon assumptions and estimates derived from currently known facts. All such estimates of liabilities and recoveries for asbestos-related claims are subject to considerable uncertainty because such liabilities and recoveries are influenced



by variables that are difficult to predict. The future litigation environment for Maremont could change significantly from its past experience, due, for example, to changes in the mix of claims filed against Maremont in terms of plaintiffs' law firm, jurisdiction and disease; legislative or regulatory developments; Maremont's approach to defending claims; or payments to plaintiffs from other defendants. Estimated recoveries are influenced by coverage issues among insurers and the continuing solvency of various insurance companies. If the assumptions with respect to the estimation period, nature of pending and future claims, the cost to resolve claims and the amount of available insurance prove to be incorrect, the actual amount of liability for Maremont's asbestos-related claims, and the effect on the company, could differ materially from current estimates and, therefore, could have a material impact on the company's financial condition and results of operations.

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Rockwell International (Rockwell) — ArvinMeritor, Inc. (AM), a subsidiary of Meritor, along with many other companies, has also been named as a defendant in lawsuits alleging personal injury as a result of exposure to asbestos used in certain components of Rockwell products many years ago. Liability for these claims was transferred at the time of the spin-off of the automotive business from Rockwell in 1997. At June 30, 2014 and September 30, 2013, there were approximately 2,800 and 2,600, respectively, pending active asbestos claims in lawsuits that name AM, together with many other companies, as defendants. A significant portion of the claims do not identify any of Rockwell's products or specify which of the claimants, if any, were exposed to asbestos attributable to Rockwell's products, and past experience has shown that the vast majority of the claimants will likely never identify any of Rockwell's products. Historically, AM has been dismissed from the vast majority of similar claims filed in the past with no payment to claimants. For those claimants who do show that they worked with Rockwell's products, management nevertheless believes it has meritorious defenses, in substantial part due to the integrity of the products involved and the lack of any impairing medical condition on the part of many claimants. For these reasons, the company does not consider the number of claims filed or the damages alleged to be a meaningful factor in determining asbestos-related liabilities.

The Rockwell legacy asbestos-related reserves and corresponding asbestos-related recoveries are summarized as follows (in millions):

	June 30, 2014	September 30, 2013
Pending and future claims	\$40	\$40
Asbestos-related insurance recoveries	13	13

The company engages Bates White to assist with determining whether it would be possible to estimate the cost of resolving pending and future Rockwell legacy asbestos-related claims that have been, and could reasonably be expected to be, filed against the company. As of September 30, 2013, Bates White provided a reasonable and probable estimate that consisted of a range of equally likely possibilities of Rockwell's obligation for asbestos personal injury claims over the next ten years of \$40 million to \$45 million. Management recognized a liability of \$40 million as of June 30, 2014 and September 30, 2013, as the probable liability for pending and future claims over the next ten years. The company is experiencing higher-than-expected defense costs in the first nine months of fiscal year 2014. Therefore, the next annual valuation at September 30, 2014 may result in an increased obligation estimate. The ultimate cost of resolving pending and future claims is estimated based on the history of claims and expenses for plaintiffs represented by law firms in jurisdictions with an established history with Rockwell.

The following assumptions were made by the company after consultation with Bates White and are included in their study:

Pending and future claims were estimated for a ten-year period ending in fiscal year 2023. The ten-year assumption is considered appropriate as Rockwell has reached certain longer-term agreements with key plaintiff law firms, and filings of mesothelioma claims have been relatively stable over the last few years;

The company believes that the litigation environment may change significantly beyond ten years and that the reliability of estimates of future probable expenditures in connection with asbestos-related personal injury claims will likely decline for each year further in the future. As a result, estimating a probable liability beyond ten years is difficult and uncertain;

Defense and processing costs for pending and future claims will be at the level consistent with the company's longer-term experience and will not have the significant volatility experienced in the recent years;

Potential payments made to claimants from other sources, including other defendants and 524(g) trusts favorably impact the company's estimated liability in the future; and

The ultimate indemnity cost of resolving nonmalignant claims with plaintiff's law firms in jurisdictions without an established history with Rockwell cannot be reasonably estimated.



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The insurance receivable related to asbestos-related liabilities is \$13 million at June 30, 2014 and September 30, 2013. Included in these amounts are insurance receivables of \$9 million at June 30, 2014 and September 30, 2013 that are associated with policies in dispute. Rockwell maintained insurance coverage that management believes covers indemnity and defense costs, over and above self-insurance retentions, for most of these claims. The company shares these policies with two other nonrelated companies. The three companies have collectively initiated claims against certain of these carriers to enforce the insurance policies, which are in various stages of the litigation process. Rockwell expects to recover some portion of defense and indemnity costs it has incurred to date, over and above self-insured retentions, and some portion of the costs for defending asbestos claims going forward. The amounts recognized for policies in dispute are based on consultation with advisors, status of settlement negotiations with certain insurers, expected rights of the nonrelated companies, and underlying analysis performed by management. The remaining un-disputed receivable recognized is related to coverage provided by one carrier based on an insurance agreement in place. If the assumptions with respect to the estimation period, nature of pending claims, the cost to resolve claims and the amount of available insurance prove to be incorrect, the actual amount of liability for Rockwell asbestos-related claims, and the effect on the company, could differ materially from current estimates and, therefore, could have a material impact on the company's financial condition and results of operations.

**Indemnifications**

In December 2005, the company guaranteed a third party's obligation to reimburse another party for payment of health and prescription drug benefits to a group of retired employees. The retirees were former employees of a wholly-owned subsidiary of the company prior to it being acquired by the company. The wholly-owned subsidiary, which was part of the company's light vehicle aftermarket business, was sold by the company in fiscal year 2006. Prior to May 2009, except as set forth hereinafter, the third party met its obligations to reimburse the other party. In May 2009, the third party filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code requiring the company to recognize its obligations under the guarantee. The company recorded a \$28 million liability in fiscal year 2009 for this matter. At June 30, 2014 and September 30, 2013, the remaining estimated liability for this matter was approximately \$15 million and \$17 million