ARVINMERITOR INC
Form 10-Q
January 29, 2008
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 December 30, 2007

Commission File No. 1-15983

ARVINMERITOR, 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer X **Accelerated filer** **Non-accelerated filer**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes **No** X

72,826,118 shares of Common Stock, $1.00 par value, of ArvinMeritor, Inc. were outstanding on December 30, 2007.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

ARVINMERITOR, INC.

CONSOLIDATED STATEMENT OF OPERATIONS

(in millions, except per share amounts)

	Three Months Ended December 31, 2007	2006
	(Unaudited)	
Sales	$ 1,663	$ 1,568
Cost of sales	(1,533)	(1,464)
GROSS MARGIN	130	104
Selling, general and administrative	(92)	(73)
Restructuring costs	(10)	
Gain on divestitures		2
OPERATING INCOME	28	33
Equity in earnings of affiliates	11	7
Interest expense, net	(27)	(27)
INCOME BEFORE INCOME TAXES	12	13
Provision for income taxes	(10)	(1)
Minority interests	(3)	(2)
INCOME (LOSS) FROM CONTINUING OPERATIONS	(1)	10
LOSS FROM DISCONTINUED OPERATIONS	(11)	(3)
NET INCOME (LOSS)	$ (12)	$ 7
BASIC EARNINGS (LOSS) PER SHARE		
Continuing operations	$ (0.01)	$ 0.14
Discontinued operations	(0.16)	(0.04)
Basic earnings (loss) per share	$ (0.17)	$ 0.10
DILUTED EARNINGS (LOSS) PER SHARE		
Continuing operations	$ (0.01)	$ 0.14
Discontinued operations	(0.16)	(0.04)
Diluted earnings (loss) per share	$ (0.17)	$ 0.10
Basic average common shares outstanding	71.9	69.4
Diluted average common shares outstanding	71.9	70.5
Cash dividends per common share	$ 0.10	$ 0.10

See notes to consolidated financial statements. Amounts for the three months ended December 31, 2006 have been restated for discontinued operations.

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ARVINMERITOR, INC.

CONSOLIDATED BALANCE SHEET

(in millions)

	December 31, 2007 (Unaudited)	September 30, 2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 164	$ 409
Receivables, trade and other, net	1,154	1,144
Receivables, EMCON Technologies Holdings Limited	58	79
Inventories	569	541
Other current assets	234	216
TOTAL CURRENT ASSETS	2,179	2,389
NET PROPERTY	741	738
GOODWILL	524	520
OTHER ASSETS	1,114	1,142
TOTAL ASSETS	$4,558	$4,789
LIABILITIES AND SHAREOWNERS EQUITY		
CURRENT LIABILITIES:		
Short-term debt	$ 95	$ 18
Accounts payable	1,116	1,342
Liabilities, EMCON Technologies Holdings Limited	57	61
Other current liabilities	528	658
TOTAL CURRENT LIABILITIES	1,796	2,079
LONG-TERM DEBT	1,141	1,130
RETIREMENT BENEFITS	768	763
OTHER LIABILITIES	241	209
MINORITY INTERESTS	68	65
SHAREOWNERS EQUITY:		
Common stock (December 31, 2007 and September 30, 2007, 72.8 and 72.6 shares issued and outstanding, respectively)	72	72
Additional paid-in capital	622	618
Retained earnings	104	128
Treasury stock (December 31, 2007 and September 30, 2007, 0.1 shares)	(3)	(3)
Accumulated other comprehensive loss	(251)	(272)
TOTAL SHAREOWNERS EQUITY	544	543
TOTAL LIABILITIES AND SHAREOWNERS EQUITY	$4,558	$4,789

See notes to consolidated financial statements.

ARVINMERITOR, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(in millions)

	Three Months Ended December 31, 2007	2006
	(Unaudited)	
OPERATING ACTIVITIES		
Income (loss) from continuing operations	$ (1)	$ 10
Adjustments to income (loss) from continuing operations to arrive at cash used for operating activities:		
Depreciation and amortization	32	30
Gain on divestitures		(2)
Restructuring costs, net of payments		(8)
Pension and retiree medical expense	26	33
Loss on debt extinguishment	3	
Other adjustments to income (loss) from continuing operations	(7)	
Pension and retiree medical contributions	(22)	(39)
Changes in receivable securitization and factoring	115	3
Changes in assets and liabilities, excluding effects of acquisitions, divestitures foreign currency adjustments and discontinued operations	(413)	(31)
Operating cash flows used for continuing operations	(267)	(4)
Operating cash flows used for discontinued operations	(4)	(29)
CASH USED FOR OPERATING ACTIVITIES	(271)	(33)
INVESTING ACTIVITIES		
Capital expenditures	(34)	(20)
Acquisitions of businesses and investments, net of cash acquired	(43)	(2)
Proceeds from disposition of property and businesses	8	5
Proceeds from sale of marketable securities		5
Net investing cash flows provided by (used for) discontinued operations	23	(14)
CASH USED FOR INVESTING ACTIVITIES	(46)	(26)
FINANCING ACTIVITIES		
Borrowings on revolving credit facility	4	
Borrowings on accounts receivable securitization program	70	80
Borrowings on lines of credit and other, net	7	1
Net change in debt	81	81
Debt issuance and extinguishment costs	(6)	
Cash dividends	(7)	(7)
CASH PROVIDED BY FINANCING ACTIVITIES	68	74
EFFECT OF CHANGES IN FOREIGN CURRENCY EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	4	4
CHANGE IN CASH AND CASH EQUIVALENTS	(245)	19
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	409	350
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 164	$ 369

See notes to consolidated financial statements. Amounts for the three months ended December 31, 2006 have been restated for discontinued operations.

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ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

1. Basis of Presentation

ArvinMeritor, Inc. (the company or ArvinMeritor) is a global supplier of a broad range of integrated systems, modules and components serving commercial truck, trailer, light vehicle and specialty original equipment manufacturers (OEM) and certain aftermarkets. The consolidated financial statements are those of the company and its consolidated subsidiaries.

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, 2007. The results of operations for the three months ended December 31, 2007, are not necessarily indicative of the results for the full year.

The company s fiscal year ends on the Sunday nearest September 30. The company s fiscal quarters end on the Sundays nearest December 31, March 31 and June 30. The first quarter of fiscal years 2008 and 2007 ended on December 30, 2007, and December 31, 2006, 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 December 31 are used consistently throughout this report to represent the fiscal year end and first quarter end, respectively.

2. Earnings per Share

Basic earnings per share is calculated using the weighted average number of shares outstanding during each period. The 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 December 31,	
	2007	**2006**
Basic average common shares outstanding	71.9	69.4
Impact of restricted stock		0.9
Impact of stock options		0.2
Diluted average common shares outstanding	71.9	70.5

The potential effects of restricted stock, performance shares and stock options were excluded from the diluted earnings per share calculation for the three months ended December 31, 2007 because their inclusion in a net loss period would reduce the net loss per share. Therefore, at December 31, 2007, options to purchase 2.0 million shares were excluded from the computation of diluted earnings per share. At December 31, 2006, options to purchase 3.2 million shares of common stock were not included in the computation of diluted earnings per share because their exercise price exceeded the average market price for the period and thus their inclusion would be anti-dilutive.

The company s convertible senior unsecured notes are excluded from the computation of diluted earnings per share, as the company s average stock price during the quarter is less than the conversion price.

3. New Accounting Standards

New accounting standards to be implemented:

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements which provides a definition of fair value, establishes a framework for measuring fair value and requires expanded disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The provisions of SFAS 157 will be applied prospectively and are not expected to have a material impact on the company s consolidated financial position, results of operations or cash flows.

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R). This statement requires an entity to recognize the funded status of its defined benefit pension plans and other postretirement benefit plans, such as a retiree health care plan, on the balance sheet and to recognize changes in the funded status that arise during the period but are not recognized as components of net periodic benefit cost, within other comprehensive income, net of income taxes. The recognition requirements of SFAS 158 were adopted by the company as of September 30, 2007. The initial adoption of SFAS 158 resulted in a reduction in shareowners equity of $357 million. This reduction is net of taxes of $193 million and is recorded in Accumulated Other Comprehensive Loss in the Consolidated Statement of Shareowners Equity. SFAS 158 also requires that companies measure the funded status of their defined benefit pension plans and other postretirement benefit plans as of the balance sheet date. Currently, the company uses a measurement date of June 30 for its defined benefit and other postretirement benefit plans. The measurement date provisions of SFAS 158 are effective for fiscal years ending after December 15, 2008 and will require the company to change its measurement date to September 30 from June 30.

Accounting standards implemented in fiscal year 2008:

In June 2006, the Financial Accounting Standards Board (FASB) Issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which supplements SFAS No. 109, Accounting for Income Taxes, by defining the confidence level that a tax position must meet in order to be recognized in the financial statements. FIN 48 requires that the tax effects of a position be recognized only if it is more-likely-than-not to be sustained based solely on its technical merits as of the reporting date. The more-likely-than-not threshold represents a positive assertion by management that a company is entitled to the economic benefits of a tax position. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the position are to be recognized. Moreover, the more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of a benefit. At adoption, companies must adjust their financial statement to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any necessary adjustment would be recorded directly to retained earnings in the period of adoption and reported as a change in accounting principle.

During the first quarter of fiscal year 2008, the company adopted FIN 48 and recognized a $5 million decrease to retained earnings in the consolidated balance sheet as of October 1, 2007 as the cumulative effect of a change in accounting principle. See Note 6 for further information regarding the adoption of FIN 48.

4. Discontinued Operations

Emissions Technologies

The company s Emissions Technologies (ET) business supplied exhaust systems and exhaust system components, including mufflers, exhaust pipes, catalytic converters, diesel particulate filters and exhaust manifolds, primarily to original equipment manufacturers. On May 17, 2007, the company sold its ET business to EMCON Technologies Holdings Limited (EMCON), a private equity affiliate of J.P. Morgan Securities Inc. Total consideration was $310 million, including cash, a $20 million note and the assumption of certain liabilities, and is subject to adjustments for working capital and other items. Charges associated with the sale of ET are included in the results of discontinued operations in the consolidated statement of operations. ET is reported in discontinued operations in the consolidated statement of operations, statement of cash flows and related notes through the date of sale for all periods presented.

Receivables due from EMCON include an estimated adjustment to the purchase price based upon closing working capital. The final working capital adjustment was settled in January 2008, resulting in no change to the receivable recorded at December 31, 2007. Pre-sale funding obligations that are expected to be completed in the second quarter of fiscal year 2008 resulted in an additional receivable from EMCON and an offsetting payable that is included in the consolidated balance sheet at December 31 and September 30, 2007. Certain assets and liabilities of ET were retained by the company and are included in receivables and liabilities due from (to) EMCON in the consolidated balance sheet.

As of the May 17, 2007 closing date, assets and liabilities of certain businesses were not legally transferred to EMCON due to delays in certain procedures required to be completed by the buyer. Pursuant to the sale agreement, legal ownership will be transferred upon receipt by the buyer of required licenses and establishment of appropriate entities to receive the transferred assets. Sale values were fixed and EMCON assumed operational control of the businesses as of the May 17, 2007 closing date. The steps required to complete the legal transfer were considered perfunctory by the company and the company recorded these assets and liabilities as sold and excluded them from the consolidated balance sheet effective on May 17, 2007. Consideration for these assets and assumed liabilities was deposited in an escrow account by EMCON and is reflected as a receivable due from EMCON in the consolidated balance sheet at September 30, 2007. The legal transfer of these operations was substantially completed and related proceeds were received by the company as of December 31, 2007.

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(Unaudited)

In the first quarter of fiscal year 2008, the company recognized approximately $9 million of additional costs related to the sale of the ET business. These costs are primarily related to revised estimates for certain pre-sale liabilities retained by the company.

Light Vehicle Aftermarket

In October 2004, the company announced plans to divest its Light Vehicle Aftermarket (LVA) businesses. This plan was part of the company s long-term strategy to focus on core competencies and support its global light vehicle systems OEM customers and its commercial vehicle systems OEM and aftermarket customers. LVA supplied exhaust, ride control, motion control and filter products, as well as other automotive parts to the passenger car, light truck and sport utility vehicle aftermarket. As of September 30, 2007, the company had completed the sale of its LVA filters, exhaust and motion control businesses, and its Gabriel South Africa ride control business. These businesses represented a significant portion of its combined LVA business and are reported as discontinued operations in the consolidated statement of operations through the date of sale.

In the second quarter of fiscal year 2007, the company made a strategic decision to retain its Gabriel North America and Europe ride control aftermarket business. Restructuring actions contemplated through the company s Performance Plus initiative (see Note 5) are expected to make this business viable as part of the company s core light vehicle strategy. As a result of this decision, the results of operations, assets and liabilities and cash flows of the Gabriel Ride Control aftermarket business are presented in continuing operations in the consolidated financial statements for all periods presented.

At December 31, 2007 and at September 30, 2007, $2 million of restructuring reserves primarily related to unpaid employee termination benefits are included in liabilities of continuing operations (see Note 5).

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

	Three Months Ended December 31,	
	2007	**2006**
Sales:		
Emissions Technologies	$	$ 808
Light Vehicle Aftermarket and other	5	48
Total sales	$ 5	$ 856
Loss before income taxes	$ (14)	$ (2)
Benefit (provision) for income taxes	3	(1)
Loss from discontinued operations	$ (11)	$ (3)

5. Restructuring Costs

At December 31, 2007 and September 30, 2007, $61 million and $59 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 three months ended December 31, 2007 are as follows (in millions):

	Employee Termination Benefits	**Plant Shutdown and Other**	**Total**
Balance at September 30, 2007	$ 59	$	$ 59
Activity during the period:			

Charges to continuing operations	9	1	10
Cash payments	(9)	(1)	(10)
Currency translation and other	2		2
Balance at December 31, 2007	$61		61

Performance Plus: During fiscal year 2007, the company launched a profit improvement and cost reduction initiative called Performance Plus. As part of this program, the company identified significant restructuring actions which would eliminate up to

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ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

2,800 positions in North America and Europe and consolidate and combine certain global facilities. The company s Light Vehicle Systems business recorded $10 million of costs associated with this restructuring program in the first quarter of fiscal year 2008. Restructuring costs recorded in the three months ended December 31, 2007 primarily relate to employee termination benefits in connection with a reduction of approximately 110 salaried and hourly employees. Remaining costs of this restructuring program will be incurred over the next several years.

6. 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. 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. In the first quarter of fiscal year 2008, the company recorded approximately $6 million of unfavorable tax items discrete to the quarter. These discrete items increased the company s effective tax rate for the three months ended December 31, 2007.

As of December 31, 2007 the company had approximately $648 million in U.S. net deferred tax assets. These deferred tax assets include net operating loss carryovers that can be used to offset taxable income in future periods and reduce income taxes payable in those future periods. However, many of these deferred taxes will expire if they are not utilized within certain time periods. At this time, the company considers it more likely than not that it will have U.S. taxable income in the future that will allow it to realize these deferred tax assets. Significant factors considered by management in its determination of the probability of the realization of the deferred tax benefits include: (a) historical operating results, (b) expectations of future earnings, and (c) tax planning strategies.

It is possible that some or all of these deferred tax assets could ultimately expire unused. Risk factors include (a) a slower then anticipated recovery in the fiscal year 2008 outlook for the company s CVS segment, which has significant U.S. operations, (b) higher than planned volume or price reductions from the company s key customers and (c) higher than planned material cost increases.

These risk factors are offset by the following strategic initiatives: (a) the company has undertaken numerous restructuring initiatives in 2007 which are expected to result in significant savings in future periods, (b) the commercial vehicle market in the United States is expected to recover in 2008 and 2009 significantly benefiting the company and (c) the company has embarked on a major cost reduction and value creation program that is expected to generate improvements in earnings in future periods.

On October 1, 2007, the company adopted FIN 48, Accounting for Uncertainty in Income Taxes. The effect of applying the provisions of FIN 48 on the company s consolidated balance sheet as of October 1, 2007 is as follows (in millions):

	Before Adoption of FIN 48	Adjustments	After Adoption of FIN 48
Non-current deferred income tax assets - other assets (see Note 12)	$ 781	$ (99)	$ 682
Other assets (see Note 12)	1,142	42	1,184
Income taxes - other current liabilities (see Note 13)	(130)	97	(33)
Other liabilities (see Note 14)	(209)	(45)	(254)
Retained earnings	(128)	5	(123)

At October 1, 2007, the company had approximately $200 million of gross unrecognized tax benefits of which, $151 million represents the amount that, if recognized, would favorably affect the effective income tax rate in future periods.

The company files tax returns in multiple jurisdictions and is subject to examination by taxing authorities throughout the world. The company s U.S. and Canadian federal income tax returns for fiscal years 2003 through 2005 are currently under audit. The company s French subsidiary is currently under audit for fiscal years 2005 through 2007. In addition, the company is under audit in various U.S. state tax jurisdictions for various years. It is reasonably possible that audit settlements, the conclusion of current examinations or the expiration of the statute of limitations in several jurisdictions could significantly change the company s unrecognized tax benefits during the next twelve months. However, quantification of an estimated range cannot be made at this time.

In addition to the audits discussed above, the company has open tax years primarily from 1999-2007 with various significant taxing jurisdictions including the United States, Brazil, Canada, France, Germany, Mexico and the United Kingdom. These open years contain matters that could be subject to differing interpretations of applicable tax laws and regulations as they relate to the amount,

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

timing or inclusion of revenue and expenses or the sustainability of income tax credits for a given audit cycle. The company has recorded a tax benefit only for those positions that meet the more-likely-than-not standard.

The company s continuing practice is to recognize interest and penalties on uncertain tax positions in the provision for income taxes in the consolidated statement of operations. At December 31, and at October 1, 2007, the company has recorded $2 million of interest and $8 million of penalties in the consolidated balance sheet.

7. Acquisitions and Divestitures

On December 19, 2007, the company s Commercial Vehicle Systems (CVS) business acquired Mascot Truck Parts Ltd (Mascot) for a cash purchase price of $19 million. Mascot remanufactures transmissions, drive axles, steering gears and drivelines. This acquisition did not have a material impact on the company s consolidated financial position or results of operations for the three months ended December 31, 2007.

8. Accounts Receivable Securitization and Factoring

The company participates in a European arrangement to sell trade receivables through certain of its European subsidiaries. Under the arrangement, the company sells up to, at any point in time, 125 million of eligible trade receivables. The receivables under this program are sold at face value and excluded from the company s consolidated balance sheet. The company continues to perform collection and administrative functions related to these receivables. Costs associated with this securitization arrangement were $2 million and $1 million in the three months ended December 31, 2007 and 2006, respectively, and are included in operating income in the consolidated statement of income. The gross amount of proceeds received from the sale of receivables under this arrangement were $152 million and $116 million for the three months ended December 31, 2007 and 2006, respectively. The company s retained interest in receivables sold was $10 million and $5 million at December 31 and September 30, 2007, respectively. The company had utilized, net of retained interests, 100 million ($146 million) and 73 million ($104 million) of this accounts receivable securitization facility as of December 31 and September 30, 2007, respectively.

In November 2007 the company entered into another European arrangement to sell trade receivables. Under this arrangement the company can sell up to 85 million of eligible trade receivables. The receivables under this program are sold at face value and excluded from the company s consolidated balance sheet. The company continues to perform collection and administrative functions related to these receivables. The company had utilized 35 million ($51 million) of this accounts receivable securitization program as of December 31, 2007. The company has no retained interest in these trade receivables and costs associated with this arrangement were not significant in the three months ended December 31, 2007.

The company also participates in a U.S. accounts receivable securitization program to enhance financial flexibility and lower interest costs. Under this $175 million program, which was established in September 2005, and amended in fiscal years 2006 and 2007, the company sells substantially all of the trade receivables of certain U.S. subsidiaries to ArvinMeritor Receivables Corporation (ARC), a wholly-owned, special purpose subsidiary. ARC funds these purchases with borrowings under a loan agreement with a bank. 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 (see Note 15). At December 31, 2007, the company had utilized $70 million of this accounts receivable securitization facility. As of September 30, 2007, no amounts were outstanding under this program. Borrowings under this arrangement are collateralized by approximately $237 million of receivables held at ARC at December 31, 2007. If certain receivables performance-based covenants are not met, it would constitute a termination event, which, at the option of the banks, could result in termination of the accounts receivable securitization arrangement. At December 31, 2007, the company was in compliance with all covenants.

In addition, several of the company s European subsidiaries factor eligible accounts receivable with financial institutions. Certain receivables are factored without recourse to the company and are excluded from accounts receivable. The amount of factored receivables excluded from accounts receivable was $203 million and $181 million at December 31 and September 30, 2007, respectively.

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ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

9. Inventories

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

	December 31, 2007	September 30, 2007
Finished goods	$ 223	$ 218
Work in process	112	103
Raw materials, parts and supplies	234	220
Total	$ 569	$ 541

10. Other Current Assets

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

	December 31, 2007	September 30, 2007
Current deferred income tax assets	$ 119	$ 111
Customer reimbursable tooling and engineering	22	22
Asbestos-related recoveries (see Note 18)	8	8
Investment in debt defeasance trust	6	6
Assets held for sale	8	19
Prepaid and other	71	50
Other current assets	$ 234	$ 216

Costs incurred for tooling and engineering, principally for light vehicle products, for which customer reimbursement is contractually guaranteed, are classified as customer reimbursable tooling and engineering. These costs are billed to the customer based on the terms of the contract. Provisions for losses are provided at the time management expects costs to exceed anticipated customer reimbursements.

The company holds certain assets as held for sale. These assets primarily relate to land and buildings that have been previously closed through restructuring and other rationalization actions. The company sold certain of these properties in the first quarter of fiscal year 2008 and expects to complete the sale of the remainder of these properties in fiscal year 2008.

11. Goodwill

A summary of the changes in the carrying value of goodwill, by segment, is as follows (in millions):

	LVS	CVS	Total
Balance at September 30, 2007	$ 71	$ 449	$ 520
Acquisition of Mascot (see Note 7)		6	6
Foreign currency translation		(2)	(2)
Balance at December 31, 2007	$ 71	$ 453	$ 524

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

12. Other Assets

Other Assets are summarized as follows (in millions):

	December 31, 2007	September 30, 2007
Non-current deferred income tax assets (see Note 6)	$680	$ 781
Investments in non-consolidated joint ventures	132	116
Long-term receivables (see Note 14)	48	47
Assets for uncertain tax positions (see Note 6)	42	
Prepaid pension costs	35	32
Unamortized debt issuance costs	33	31
Capitalized software costs, net	24	25
Asbestos-related recoveries (see Note 18)	32	32
Note receivable due from EMCON, net of $9 million discount (see Note 4)	11	11
Patents, licenses and other intangible assets (less accumulated amortization: $4 at December 31, 2007 and September 30, 2007)	3	3
Investment in debt defeasance trust	6	6
Other	68	58
Other assets	$1,114	$1,142

The note receivable due from EMCON bears interest at rate of 4 percent per annum and is payable in June 2012 or earlier upon a change in control. EMCON may prepay the note at any time. The company recorded the note, net of a $9 million discount, to reflect the difference between the stated rate per the agreement of 4 percent and the effective interest rate of approximately 9 percent. This discount will be amortized over the term of the note as interest income.

In accordance with Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, 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.

Patents, licenses and other intangible assets are amortized over their contractual or estimated useful lives, as appropriate. The company anticipates amortization expense for patents, licenses and other intangible assets of approximately $3 million to be recorded over the remaining five years of the assets useful lives.

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

13. Other Current Liabilities

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

	December 31, 2007	September 30, 2007
Compensation and benefits	$ 183	$ 223
Income taxes (see Note 6)	19	130
Taxes other than income taxes	51	56
Product warranties	52	50
Restructuring (see Note 5)	61	59
AB Volvo joint venture payable		27
Asbestos-related liabilities (see Note 18)	15	11
Interest	21	7
Environmental (see Note 18)	12	11
Current deferred income tax liabilities	7	6
Other	107	78
Other current liabilities	$ 528	$ 658

On October 4, 2004, the company formed two joint ventures in France with AB Volvo to manufacture and distribute axles. The company acquired its 51-percent interest for a purchase price of 19 million ($25 million). The company had an option to purchase and AB Volvo had an option to require the company to purchase the remaining 49-percent interest in one of the joint ventures beginning in the first quarter of fiscal year 2008 for 16 million ($23 million) plus interest at EURIBOR rates, plus a margin. In December 2007, this option was exercised and the related liability was settled. The option to purchase the minority interest was essentially a financing arrangement, as the minority shareholder did not participate in any profits or losses of the joint venture. Therefore, no minority interest was recognized in prior periods for the 49-percent interest in this joint venture.

The company s CVS segment records 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 known 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.

The company s LVS segment records product warranty liabilities based on individual customer or warranty-sharing agreements. Product warranties are recorded for known warranty issues when amounts can be reasonably estimated.

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

	Three Months Ended December 31,	
	2007	2006
Total product warranties -- beginning of period	$ 103	$ 122
Accruals for product warranties	11	14

Payments	(16)	(13)
Change in estimates and other	(1)	4
Total product warranties end of period	97	127
Less: Non-current product warranties (see Note 14)	(45)	(59)
Product warranties current	$ 52	$ 68

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14. Other Liabilities

Other Liabilities are summarized as follows (in millions):

	December 31, 2007	September 30, 2007
Asbestos-related liabilities (see Note 18)	$ 40	$ 44
Non-current deferred income tax liabilities	6	6
Liabilities for uncertain tax positions (see Note 6)	48	
Product warranties (see Note 13)	45	53
Environmental (see Note 18)	8	13
Long-term payable (see Note 12)	48	47
Other	46	46
Other liabilities	$ 241	$ 209

15. Long-Term Debt

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

	December 31, 2007	September 30, 2007
6-3/4 percent notes due 2008	$ 5	$ 5
7-1/8 percent notes due 2009	6	6
6.8 percent notes due 2009	77	77
8-3/4 percent notes due 2012	276	276
8-1/8 percent notes due 2015	251	251
4.625 percent convertible notes due 2026[1]	300	300
4.0 percent convertible notes due 2027[1]	200	200
Accounts receivable securitization (see Note 8)	70	
Revolving credit facility	4	
Lines of credit and other	27	20
Unamortized gain on swap unwind	8	9
Fair value adjustment of notes	12	4
Subtotal	1,236	1,148
Less: current maturities	(95)	(18)
Long-term debt	$ 1,141	$ 1,130

[1] The 4.625 percent and 4.0 percent convertible notes contain a put and call feature, which allows for earlier redemption beginning in 2016 and 2019, respectively.

Senior Secured Credit Facilities

In October and December 2007, the company amended its revolving credit facility. Under the terms of the December amendment, the borrowing capacity of the revolving credit facility was reduced to $700 million from $900 million. The amended revolving credit facility replaced the existing financial covenants with new financial covenants based on (i) the ratio of the company s senior secured indebtedness to EBITDA and (ii) the amount of annual capital expenditures. The company is required to maintain a total senior secured-debt-to-EBITDA ratio, as defined in the agreement, no greater than 2.50x on the last day of any fiscal quarter through and including the fiscal quarter ending March 31, 2009 and (ii) 2.00 to 1.00 on the last day of any fiscal quarter thereafter. At

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December 31, 2007, the company was in compliance with all covenants. As a result of the amendments, the company recognized a $3 million loss on debt extinguishment associated with the write-off of debt issuance costs. The remaining unamortized debt issuance costs are being amortized over the remaining term of the amended credit facility.

Borrowings under the amended 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 credit rating for the senior secured facility. At December 31, 2007, the margin over the LIBOR rate was 225 basis points, and the commitment fee was 50 basis points. The amended revolving credit facility includes a $150 million limit on the issuance of letters of credit. At December 31, 2007 and September 30, 2007, approximately $26 million and $30 million letters of credit, respectively, were issued. The company had an additional $11 million outstanding at December 31, 2007 and at September 30, 2007 on letters of credit available through other facilities.

Borrowings under the amended revolving credit facility are collateralized by approximately $905 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.

Certain of the company s subsidiaries, as defined in the credit agreement, irrevocably and unconditionally guarantee amounts outstanding under the amended revolving credit facility. Similar subsidiary guarantees are provided for the benefit of the holders of the publicly-held notes outstanding under the company s indentures (see Note 21).

Convertible Securities

In February 2007, the company issued $200 million of 4.00 percent convertible senior unsecured notes due 2027 (the 2007 convertible notes). In March 2006, the company issued $300 million of 4.625 percent convertible senior unsecured notes due 2026 (the 2006 convertible notes). The 2007 convertible notes bear cash interest at a rate of 4.00 percent per annum from the date of issuance through February 15, 2019, payable semi-annually in arrears on February 15 and August 15 of each year. After February 15, 2019, the principal amount of the notes will be subject to accretion at a rate that provides holders with an aggregate annual yield to maturity of 4.00 percent. The 2006 convertible notes bear cash interest at a rate of 4.625 percent per annum from the date of issuance through March 1, 2016, payable semi-annually in arrears on March 1 and September 1 of each year. After March 1, 2016, the principal amount of the notes will be subject to accretion at a rate that provides holders with an aggregate annual yield to maturity of 4.625 percent.

The 2007 and 2006 convertible notes are convertible in to shares of the company s common stock at an initial conversion rate, subject to adjustment, equivalent to 37.4111 and 47.6667 shares of common stock, respectively, per $1,000 initial principal amount of notes. The maximum number of shares the 2007 and 2006 convertible notes are convertible into is approximately 7 million and 14 million, respectively.

Accounts Receivable Securitization

The company participates in a U.S. accounts receivable securitization program to enhance financial flexibility and lower interest costs (see Note 8). Under this $175 million program, which was established in September 2005, and amended in fiscal years 2006 and 2007, the company sells substantially all of the trade receivables of certain U.S. subsidiaries to ARC. ARC funds these purchases with borrowings under a loan agreement with a bank. The weighted average interest rate on borrowings under this arrangement was approximately 5.50 percent at December 31, 2007. Amounts outstanding under this agreement are reported as short-term debt in the consolidated balance sheet and are collateralized by $237 million of eligible receivables purchased and held by ARC at December 31, 2007. If certain receivables performance-based covenants are not met, it would constitute a termination event, which, at the option of the banks, could result in termination of the accounts receivable securitization arrangement. At December 31, 2007, the company was in compliance with all covenants.

Related Parties

A 57-percent owned consolidated joint venture of the company has a $6 million, 6.5-percent loan with its minority partner. This loan matures in fiscal year 2009 and is included in long-term debt in the consolidated balance sheet.

Interest Rate Swap Agreements

As of December 31, 2007, the company had interest rate swap agreements that effectively converted $221 million of the company s 8-3/4 percent notes, $63 million of the 6.8 percent notes and $175 million of the 8-1/8 percent notes to variable interest rates. The fair value of the 8-3/4 percent swaps was a liability of $2 million at both December 31 and September 30, 2007 and is included in Other Liabilities. The fair value of the 6.8 percent swap was not significant at the end of December 31, 2007 and September 30, 2007. The fair value of the 8-1/8% swaps was $11 million and $4 million at December 31 and September 30, 2007,

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respectively and is included in Other Assets. The terms of the interest rate swap agreements require the company to place cash on deposit as collateral if the fair value of the interest rate swaps declines below a certain threshold. No amounts were posted as collateral at December 31, 2007 and September 30, 2007. The swaps have been designated as fair value hedges and the impact of the changes in their fair values is offset by an equal and opposite change in the carrying value of the related notes. Under the terms of the swap agreements, the company receives a fixed rate of interest of 8.75 percent, 6.8 percent and 8.125 percent on notional amounts of $221 million, $63 million and $175 million, respectively, and pays variable rates based on three-month LIBOR plus a weighted-average spread of 3.13 percent. The payments under the agreements coincide with the interest payment dates on the hedged debt instruments, and the difference between the amounts paid and received is included in interest expense, net and other. In January 2008, the company terminated all of its interest rate swaps. Included in the fair value adjustment of notes is $8 million related to previously terminated interest rate swaps, which is being amortized to earnings as a reduction of interest expense over the remaining life of the related debt.

The company classifies the cash flows associated with its interest rate swaps in cash flows from operating activities in its consolidated statement of cash flows. This is consistent with the classification of the cash flows associated with the underlying hedged item.

Leases

The company has various operating leasing arrangements. Future minimum lease payments under these operating leases are $21 million in 2008, $16 million in 2009, $12 million in 2010, $10 million in 2011, $5 million in 2012 and $9 million thereafter.

16. Financial Instruments

The company s financial instruments include cash and cash equivalents, short-term debt, long-term debt, interest rate swaps, and foreign exchange forward contracts. The company uses derivatives for hedging and non-trading purposes in order to manage its interest rate and foreign exchange rate exposures. The company s interest rate swap agreements are discussed in Note 15.

Foreign Exchange Contracts

The company s operations are exposed to global market risks, including the effect of changes in foreign currency exchange rates. The company has a foreign currency cash flow hedging program to reduce the company s exposure to changes in exchange rates. The company uses foreign currency forward contracts to manage the company s exposures arising from foreign currency exchange risk. Gains and losses on the underlying foreign currency exposures are partially offset with gains and losses on the foreign currency forward contracts.

Under this program, the company has designated the foreign exchange contracts (the contracts) as cash flow hedges of underlying forecasted foreign currency purchases and sales. The effective portion of changes in the fair value of the contracts is recorded in Accumulated Other Comprehensive Loss (AOCL) in the consolidated statement of shareowners equity and is recognized in operating income when the underlying forecasted transaction impacts earnings. The contracts generally mature within 12-24 months. The impact to operating income associated with hedge ineffectiveness was not significant for the three months ended December 31, 2007 and 2006.

At December 31 and September 30, 2007, there was a loss of $5 million and a gain of $1 million, respectively, recorded in AOCL. The company expects to reclassify this amount from AOCL to operating income during the next three months as the forecasted hedged transactions are recognized in earnings.

The company classifies the cash flows associated with the contracts in cash flows from operating activities in the consolidated statement of cash flows. This is consistent with the classification of the cash flows associated with the underlying hedged item.

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Fair Value

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

	December 31, 2007		September 30, 2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$ 164	164	409	409
Interest rate swaps - asset	11	11	4	4
Foreign exchange contracts - asset	7	7	6	6