MERITOR INC
Form 10-Q
July 30, 2015
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 28, 2015
Commission File No. 1-15983

MERITOR, INC.

(Exact name of registrant as specified in its charter)

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

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

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

Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Registration S-T during the preceding twelve months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No

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

Large accelerated filer	X	Accelerated filer
Non-accelerated filer		Smaller reporting company

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

Yes No X

96,551,713 shares of Common Stock, $1.00 par value, of Meritor, Inc. were outstanding on June 28, 2015.

INDEX

MERITOR, INC.

PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
	(Unaudited)			
Sales	$909	$979	$2,652	$2,833
Cost of sales	(785)	(855)	(2,298)	(2,486)
GROSS MARGIN	124	124	354	347
Selling, general and administrative	(65)	(53)	(187)	(178)
Restructuring costs	(9)	—	(15)	(3)
Other operating income (expense), net	1	(1)	2	(2)
OPERATING INCOME	51	70	154	164
Other income (expense), net	(1)	—	3	—
Equity in earnings of ZF Meritor	—	190	—	190
Equity in earnings of other affiliates	10	11	28	28
Interest expense, net	(38)	(22)	(78)	(97)
INCOME BEFORE INCOME TAXES	22	249	107	285
Provision for income taxes	(6)	(12)	(19)	(31)
INCOME FROM CONTINUING OPERATIONS	16	237	88	254
LOSS FROM DISCONTINUED OPERATIONS, net of tax	(2)	(3)	(1)	(4)
NET INCOME	14	234	87	250
Less: Net income attributable to noncontrolling interests	(1)	—	(2)	(4)
NET INCOME ATTRIBUTABLE TO MERITOR, INC.	$13	$234	$85	$246
NET INCOME ATTRIBUTABLE TO MERITOR, INC.				
Net income from continuing operations	$15	$237	$86	$250
Loss from discontinued operations	(2)	(3)	(1)	(4)
Net income	$13	$234	$85	$246
BASIC EARNINGS (LOSS) PER SHARE				
Continuing operations	$0.15	$2.43	$0.88	$2.56
Discontinued operations	(0.02)	(0.03)	(0.01)	(0.04)
Basic earnings per share	$0.13	$2.40	$0.87	$2.52
DILUTED EARNINGS (LOSS) PER SHARE				
Continuing operations	$0.15	$2.34	$0.85	$2.52
Discontinued operations	(0.02)	(0.03)	(0.01)	(0.04)
Diluted earnings per share	$0.13	$2.31	$0.84	$2.48
Basic average common shares outstanding	96.9	97.6	97.6	97.5
Diluted average common shares outstanding	100.3	101.1	101.0	99.1

See notes to condensed consolidated financial statements.
Amounts for prior periods have been recast for discontinued operations.

3

MERITOR, INC.

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
	(Unaudited)			
Net income	$14	$234	$87	$250
Other comprehensive income (loss):				
Foreign currency translation adjustments:				
Attributable to Meritor, Inc.	13	8	(54)	8
Attributable to noncontrolling interest	—	—	(1)	—
Other reclassification adjustment	—	—	1	—
Pension and other postretirement benefit related adjustments	12	11	35	31
Unrealized gain (loss) on investments and foreign exchange contracts	(2)	—	(3)	2
Other comprehensive income (loss), net of tax	23	19	(22)	41
Total comprehensive income	37	253	65	291
Less: Comprehensive income attributable to noncontrolling interest	(1)	—	(1)	(4)
Comprehensive income attributable to Meritor, Inc.	$36	$253	$64	$287

See notes to condensed consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED BALANCE SHEET
(in millions)

	June 30, 2015 (Unaudited)	September 30, 2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$345	$247
Receivables, trade and other, net	530	610
Inventories	365	379
Other current assets	52	56
TOTAL CURRENT ASSETS	1,292	1,292
NET PROPERTY	393	424
GOODWILL	420	431
OTHER ASSETS	348	355
TOTAL ASSETS	$2,453	$2,502
LIABILITIES AND EQUITY (DEFICIT)		
CURRENT LIABILITIES:		
Short-term debt	$18	$7
Accounts and notes payable	611	680
Other current liabilities	303	351
TOTAL CURRENT LIABILITIES	932	1,038
LONG-TERM DEBT	1,079	965
RETIREMENT BENEFITS	729	775
OTHER LIABILITIES	304	309
TOTAL LIABILITIES	3,044	3,087
COMMITMENTS AND CONTINGENCIES (See Note 19)		
EQUITY (DEFICIT):		
Common stock (June 30, 2015 and September 30, 2014, 98.8 and 97.8 shares issued and 96.6 and 97.8 shares outstanding, respectively)	99	97
Additional paid-in capital	876	918
Accumulated deficit	(793)	(878)
Treasury stock, at cost (June 30, 2015 and September 30, 2014, 2.3 and 0.0 shares, respectively)	(30)	—
Accumulated other comprehensive loss	(770)	(749)
Total deficit attributable to Meritor, Inc.	(618)	(612)
Noncontrolling interests	27	27
TOTAL DEFICIT	(591)	(585)
TOTAL LIABILITIES AND DEFICIT	$2,453	$2,502

See notes to condensed consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions)

	Nine Months Ended June 30,	
	2015	2014
	(Unaudited)	
OPERATING ACTIVITIES		
CASH PROVIDED BY OPERATING ACTIVITIES (See Note 9)	$122	$103
INVESTING ACTIVITIES		
Capital expenditures	(45)	(39)
Proceeds from sale of property	4	—
Net investing cash flows provided by discontinued operations	4	3
CASH USED FOR INVESTING ACTIVITIES	(37)	(36)
FINANCING ACTIVITIES		
Repayment of notes and term loan	(159)	(308)
Proceeds from debt issuance	225	225
Debt issuance costs	(4)	(9)
Repurchase of common stock	(30)	—
Other financing activities	(7)	10
CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES	25	(82)
EFFECT OF CHANGES IN FOREIGN CURRENCY EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(12)	—
CHANGE IN CASH AND CASH EQUIVALENTS	98	(15)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	247	318
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$345	$303

See notes to condensed consolidated financial statements.
Amounts for prior periods have been recast for discontinued operations.

MERITOR, INC.

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

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Loss	Total Deficit Attributable to Meritor, Inc.	Noncontrolling Interests	Total
Beginning balance at September 30, 2014	$97	$918	$ (878)	$—	$ (749)	$ (612)	$ 27	$(585)
Comprehensive income (loss)	—	—	85	—	(21)	64	1	65
Equity based compensation expense	—	8	—	—	—	8	—	8
Vesting of restricted stock	2	(2)	—	—	—	—	—	—
Repurchase of convertible notes	—	(48)	—	—	—	(48)	—	(48)
Repurchase of common stock	—	—	—	(30)	—	(30)	—	(30)
Noncontrolling interest dividend	—	—	—	—	—	—	(1)	(1)
Ending Balance at June 30, 2015	$99	$876	$ (793)	$(30)	$ (770)	$ (618)	$ 27	$(591)
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)

See notes to condensed consolidated financial statements.

MERITOR, INC.
NOTES TO CONDENSED 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, military, bus and coach, construction and other industrial OEMs and certain aftermarkets. The condensed consolidated financial statements are those of the company and its consolidated subsidiaries.

Certain businesses are reported in discontinued operations in the condensed consolidated statement of operations, condensed consolidated statement of cash flows and related notes for all periods presented. In the fourth quarter of fiscal year 2014, the company exited its Mascot business, a remanufacturer and distributor of all makes differentials, transmissions and steering gears. The results of operations and cash flows of the company’s former Mascot business are presented in discontinued operations in the condensed consolidated statement of operations and condensed consolidated statement of cash flows, and prior period information has been recast to reflect this presentation. 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, 2014, as amended. The quarter end condensed balance sheet data was derived from audited financial statements but does not include all annual disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the three and nine months ended June 30, 2015 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 2015 and 2014 ended on June 28, 2015 and June 29, 2014, 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 (loss) per share is calculated using the weighted average number of shares outstanding during each period. The diluted earnings (loss) per share calculation includes the impact of dilutive common stock options, restricted shares, restricted share units, performance share unit awards, and convertible securities, if applicable.

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
Basic average common shares outstanding	96.9	97.6	97.6	97.5
Impact of stock options	0.1	0.1	0.1	0.1
Impact of restricted shares, restricted share units and performance share units	1.8	1.6	2.0	1.5
Impact of convertible notes	1.5	1.8	1.3	—
Diluted average common shares outstanding	100.3	101.1	101.0	99.1

On November 8, 2014, the Board of Directors approved a grant of performance 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 or its cash equivalent upon achievement of certain performance and time vesting criteria. The fair value of each performance share unit is $13.74, which was the company’s share price on the grant date of December 1, 2014.

The Board of Directors also approved a grant of 0.4 million restricted share units to these executives. The restricted share units vest at the earlier of three years from the date of grant or upon termination of employment with the company under certain circumstances. The fair value of each restricted share unit is $13.74, which was the company's share price on the grant date of December 1, 2014.

The actual number of performance share units that will vest depends upon the company's performance relative to the established performance metrics for the three-year performance period of October 1, 2014 to September 30, 2017, measured at the end of the performance period. The number of performance share units will depend on Adjusted EBITDA margin and Adjusted diluted earnings per share from continuing operations at the following weights: 75% associated with achieving an Adjusted EBITDA margin target and 25% associated with achieving an Adjusted diluted earnings per share from continuing operations target. The number of performance share units that vest will be between 0% and 200% of the grant date amount of 0.6 million shares.

On November 7, 2013, the Board of Directors approved a grant of performance 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 or its cash equivalent upon achievement of certain performance and time vesting criteria. The fair value of each performance share unit is $7.97, which was the company's share price on the grant date of December 1, 2013. The actual number of performance share units that will vest depends 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 performance share units will depend on meeting the established M2016 goals at the following weights: 50% associated with achieving an Adjusted EBITDA margin target, 25% associated with achieving a net debt including retirement benefit liabilities target, and 25% associated with achieving an incremental booked revenue target. The number of performance share units that vest will be between 0% and 200% of the grant date amount of 1.8 million units including incremental share units that were issued subsequent to the December 1, 2013 grant date. There were 0.9 million and 0.8 million shares related to these performance share units included in the diluted earnings per share calculation for the three and nine months ended June 30, 2015, respectively, as certain payout thresholds were achieved in the third quarter of fiscal year 2015 relative to the Adjusted EBITDA, net debt reduction and incremental booked revenue targets.

For the three months ended June 30, 2015, the dilutive impact of previously issued restricted shares, restricted share units, and performance share units was 1.8 million, compared to 1.6 million units for the same period in the prior fiscal year. For the nine months ended June 30, 2015, the dilutive impact of previously issued restricted shares, restricted share units, and performance share units was 2.0 million shares, compared to 1.5 million shares for the same period in the prior fiscal year. For the three and nine months ended June 30, 2015, compensation cost related to restricted shares, restricted share units, performance share units and stock options was $3 million and $8 million, respectively, compared to $2 million and $6 million for the three and nine months ended June 30, 2014, respectively.

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 in 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 the three and nine months ended June 30, 2015, 1.5 million and 1.3 million shares, respectively, were included in the computation of diluted earnings per share because the average stock price exceeded the conversion price for the 7.875 percent convertible notes due 2026. 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 nine months ended June 30, 2014, the company's convertible senior unsecured notes were excluded from the computation of diluted earnings per share, as the company's average stock price, during these periods was less than the conversion price.

3. New Accounting Standards

Accounting standards to be implemented

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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. The potential impact of this new guidance on its consolidated financial statements is dependent upon future business divestitures. Previous divestitures and amounts currently in discontinued operations will not be impacted.

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 after December 15, 2017 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, 2018 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. ASU 2014-12 applies to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target (for example, an initial public offering or a profitability target) could be achieved and still be eligible to vest in the award if and when the performance target is achieved. The standard is required to be adopted by public business entities in annual periods beginning on or after December 15, 2015 and interim periods within those annual periods. The company plans to implement this standard in the first quarter of the fiscal year beginning on October 1, 2016 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. ASU 2014-15 requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, ASU 2014-15 (1) provides a definition of the term substantial doubt, (2) requires an evaluation every reporting period including interim periods, (3) provides principles for considering the mitigating effect of management's plans, (4) requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (5) requires an express statement and other disclosures when substantial doubt is not alleviated, and (6) requires an assessment for a period of one year after the date that the financial statements are issued (or are available to be issued). The standard is required to be adopted by public business entities in annual periods ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The company plans to implement this standard in the fiscal year beginning October 1, 2016 and currently expects this new guidance to have no impact on the company's consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 changes the presentation of debt issuance costs for term debt in the balance sheet by requiring the debt issuance costs to be presented as a direct deduction from the related debt liability, rather than recorded as an asset. The standard is required to be adopted by public business entities in annual periods beginning on or after December 15, 2015, and interim periods within those annual periods and will need to be applied retrospectively. Early adoption is permitted. The company plans to implement this standard in the fourth quarter of fiscal year 2015. Debt issuance costs associated with term debt as of June 30, 2015 and September 30, 2014, were $18 million and $17 million, respectively.

Accounting standards implemented during fiscal year 2015

In April 2015, the FASB issued ASU 2015-05, Intangibles — Goodwill and Other — Internal-Use Software. ASU 2015-05 requires a company to determine whether a cloud computing arrangement contains a software license. If the arrangement contains a software license, the customer would account for the fees related to the software license element in a manner consistent with how the acquisition of other software licenses is accounted for under ASC 350-40; if the arrangement does not contain a software license, the customer would account for the arrangement as a service contract. The standard is required to be adopted by public business entities in annual periods beginning after December 15, 2015, and interim periods within those annual periods. Early adoption is permitted. The company adopted this guidance concurrent with an annual review of the company's accounting for internal-use computer software costs policy. The new accounting standard will be applied prospectively. The adoption did not have a material impact on the company's consolidated statement of financial position, results of operations, or cash flows. As new contracts are entered into or existing contracts are materially modified, the adoption may impact fixed assets, selling, general and administrative costs, or cost of sales.

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

4. Discontinued Operations

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
Sales	$—	$7	$1	$22
Loss before income taxes	$(2)	$(3)	$(1)	$(9)
Benefit from income taxes	—	—	—	5
Loss from discontinued operations attributable to Meritor, Inc.	$(2)	$(3)	$(1)	$(4)

Total discontinued operations assets as of June 30, 2015 and September 30, 2014 were $4 million and $8 million, respectively, and total discontinued operations liabilities as of June 30, 2015 and September 30, 2014 were $11 million and $21 million, respectively.

Loss from discontinued operations attributable to the company for the three months ended June 30, 2015 was primarily related to changes in estimates related to legal matters retained from previously divested businesses. Loss from discontinued operations attributable to the company for the nine months ended June 30, 2015 was primarily related to changes in estimates related to legal matters retained from previously divested businesses, partially offset by the settlement of indemnities on certain contingencies of previously divested businesses.

Loss before income taxes from discontinued operations for the three and nine months ended June 30, 2014 was primarily related to the company's former Mascot business. The benefit for income taxes for the nine months ended June 30, 2014 was primarily related to the expiration of the statute of limitations on certain tax contingencies of a previously divested business.

Mascot Divestiture

In the fourth quarter of fiscal year 2014, the company disposed of its Mascot business which was part of the company’s Aftermarket & Trailer segment. The results of operations and cash flows of the company’s Mascot business are presented in discontinued operations in the condensed consolidated statements of operations and condensed consolidated statement of cash flows, and prior period information has been recast to reflect this presentation.

Sales for the three and nine months ended June 30, 2014 were related to the company’s former Mascot business.

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. Given that the company’s primary military program is winding down, failure to secure new military contracts could result in a significant decline in the projected cash flows of the Defense reporting unit, which could require the company to impair goodwill. The Defense reporting unit is included within the Commercial Truck & Industrial segment and has $20 million of goodwill allocated to it.

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 are a reporting unit, or if the segment comprises only a single component.

11

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

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, 2014	$261	$170	$431
Foreign currency translation	(5)	(6)	(11)
Balance at June 30, 2015	$256	$164	$420

6. Restructuring Costs

At June 30, 2015 and September 30, 2014, $13 million and $11 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, 2015 and 2014 are as follows (in millions):

	Employee Termination Benefits	Asset Impairment	Plant Shutdown & Other	Total
Beginning balance at September 30, 2014	$11	$—	$—	$11
Activity during the period:				
Charges to continuing operations	15	—	—	15
Cash payments – continuing operations	(10)	—	—	(10)
Other	(3)	—	—	(3)
Total restructuring reserves at June 30, 2015	13	—	—	13
Less: non-current restructuring reserves	(2)	—	—	(2)
Restructuring reserves – current, at June 30, 2015	$11	$—	$—	$11
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

M2016 Actions: The company continues to implement certain footprint actions as part of its M2016 strategy. During the first quarter of fiscal year 2015, the company recorded severance charges of $3 million associated with the elimination of approximately 50 hourly and 20 salaried positions in the Commercial Truck & Industrial segment in connection with the consolidation of certain gearing and machining operations in North America.

During the third quarter of fiscal year 2015, the company notified approximately 40 hourly and salaried employees in the Commercial Truck & Industrial segment that their positions were being eliminated due to the planned closure of a North America manufacturing facility. The company expects this restructuring action will result in $3 million in costs, of which $2 million was incurred in the third quarter of fiscal year 2015. Restructuring actions associated with this plan are expected to be completed by the end of fiscal year 2015.

South America Labor Reduction I: During the fourth quarter of fiscal year 2014, the company initiated a South America headcount reduction plan intended to reduce labor costs in response to decreasing production volumes in the region. The company eliminated approximately 190 hourly and 20 salaried positions and incurred $7 million of restructuring costs in the fourth quarter of fiscal year 2014, primarily severance benefits, in the Commercial Truck & Industrial segment.

12

South America Labor Reduction II: During the third quarter of fiscal year 2015, a restructuring plan to further reduce headcount in South America was approved by the local union. This restructuring plan is in response to the current economic environment in South America which has continued to weaken in 2015. With this restructuring plan, the company expects to eliminate approximately 230 hourly and 20 salaried positions and incur $9 million in employee separation costs in the Commercial Truck & Industrial segment. The company recorded severance expenses of $6 million associated with this plan during the third quarter of fiscal year 2015. Restructuring actions associated with this plan are expected to be completed by the end of the first quarter of fiscal year 2016.

Closure of a Corporate Engineering Facility: During the second quarter of fiscal year 2015, the company notified approximately 30 salaried and contract employees that their positions were being eliminated due to the planned closure of a corporate engineering facility. The company recorded severance expenses of $1 million associated with this plan. The company expects to incur approximately $2 million in lease termination and other exit costs in North America associated with this closure. Restructuring actions associated with this program are expected to be completed by the end of fiscal year 2015.

European Labor Reduction: During the second quarter of fiscal year 2015, the company initiated a European headcount reduction plan intended to reduce labor costs in response to continued soft markets in the region. The company eliminated approximately 20 hourly and 20 salaried positions and recorded $2 million of expected severance expenses in the Commercial Truck & Industrial segment in the second quarter of fiscal year 2015. Restructuring actions associated with this program were substantially complete as of June 30, 2015.

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 three months ended June 30, 2015, the company had approximately $6 million of net pre-tax income compared to $149 million of net pre-tax income in the same period in fiscal year 2014 in tax jurisdictions in which tax expense (benefit) is not recorded. For the first nine months of fiscal year 2015, the company had approximately $42 million of net pre-tax income compared to $184 million in the same period in fiscal year 2014 in tax jurisdictions in which 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 three months ended June 30, 2014 and the first nine months of fiscal year 2014 is $210 million of earnings from the antitrust lawsuit settlement with Eaton Corporation, including the recovery of $20 million of legal expenses, 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.

During the first nine months of fiscal year 2015, the company experienced profitability in the U.S. and certain European jurisdictions in which a valuation allowance is recorded. The company continues to evaluate the material positive and negative factors to determine whether there is sufficient evidence to reverse some or all of the valuation allowance.

8. Accounts Receivable Factoring and 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 recently renewed and now terminates on June 28, 2016, the company can sell up to, at any point in time, €150 million ($168 million) o