

MERITOR INC
Form 10-K
November 16, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended September 30, 2018
Commission file number 1-15983

MERITOR, INC.

(Exact name of registrant as specified in its charter)

Indiana 38-3354643
(State or other jurisdiction of incorporation (I.R.S. Employer
or organization) identification no)

2135 West Maple Road 48084-7186
Troy, Michigan
(Address of principal executive offices) (Zip Code)

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class Name of each exchange on which registered
Common Stock, \$1 Par Value New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding twelve months (or for such shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company "

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant on March 31, 2018 (the last business day of the most recently completed second fiscal quarter) was approximately \$1,766,433,323

84,876,805 shares of the registrant's Common Stock, par value \$1 per share, were outstanding on November 14, 2018.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information contained in the definitive Proxy Statement for the Annual Meeting of Shareholders of the registrant to be held on January 24, 2019 is incorporated by reference into Part III.

| | Page No. |
|---|-------------|
| <u>PART I.</u> | |
| <u>Item 1. Business</u> | <u>1</u> |
| <u>Item 1A. Risk Factors</u> | <u>12</u> |
| <u>Item 1B. Unresolved Staff Comments</u> | <u>21</u> |
| <u>Item 2. Properties</u> | <u>22</u> |
| <u>Item 3. Legal Proceedings</u> | <u>22</u> |
| <u>Item 4. Mine Safety Disclosures</u> | <u>23</u> |
| <u>Item 4A. Executive Officers of the Registrant</u> | <u>23</u> |
| <u>PART II.</u> | |
| <u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>25</u> |
| <u>Item 6. Selected Financial Data</u> | <u>27</u> |
| <u>Item 7. Management’s Discussion and Analysis of Financial Conditions and Results of Operations</u> | <u>29</u> |
| <u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u> | <u>60</u> |
| <u>Item 8. Financial Statements and Supplementary Data</u> | <u>62</u> |
| <u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | <u>148</u> |
| <u>Item 9A. Controls and Procedures</u> | <u>148</u> |
| <u>Item 9B. Other Information</u> | <u>150</u> |
| <u>PART III.</u> | |
| <u>Item 10. Directors, Executive Officers and Corporate Governance</u> | <u>150</u> |
| <u>Item 11. Executive Compensation</u> | <u>150</u> |
| <u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | <u>150</u> |
| <u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u> | <u>151</u> |
| <u>Item 14. Principal Accountant Fees and Services</u> | <u>151</u> |
| <u>PART IV.</u> | |
| <u>Item 15. Exhibits and Financial Statement Schedules</u> | <u>151</u> |
| <u>Item 16. Form 10-K Summary</u> | <u>151</u> |
| <u>Signatures</u> | <u>158</u> |

PART I

Item 1. Business.

Overview

Meritor, Inc. ("we", "us" or "our"), 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. We serve commercial truck, trailer, military, bus and coach, construction, and other industrial OEMs and certain aftermarkets. Our principal products are axles, undercarriages, drivelines and brakes.

Meritor was incorporated in Indiana in 2000 in connection with the merger of Meritor Automotive, Inc. and Arvin Industries, Inc. As used in this Annual Report on Form 10-K, the terms "company," "Meritor," "we," "us" and "our" include Meritor, its consolidated subsidiaries and its predecessors unless the context indicates otherwise.

Meritor serves a broad range of customers worldwide, including medium- and heavy-duty truck OEMs, specialty vehicle manufacturers, certain aftermarkets, and trailer producers. Our total sales from continuing operations in fiscal year 2018 were approximately \$4.2 billion. Our ten largest customers accounted for approximately 75 percent of fiscal year 2018 sales from continuing operations. Sales from operations outside North America accounted for approximately 38 percent of total sales from continuing operations in fiscal year 2018. Our continuing operations also participated in four unconsolidated joint ventures, which we accounted for under the equity method of accounting and that generated revenues of approximately \$1.1 billion in fiscal year 2018.

Our fiscal year ends on the Sunday nearest to September 30. Fiscal year 2018 ended on September 30, 2018, fiscal year 2017 ended on October 1, 2017, and fiscal year 2016 ended on October 2, 2016. All year and quarter references relate to our fiscal year and fiscal quarters unless otherwise stated. For ease of presentation, September 30 is utilized consistently throughout this report to represent the fiscal year end.

Whenever an item in this Annual Report on Form 10-K refers to information under specific captions in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations or Item 8. Financial Statements and Supplementary Data, the information is incorporated in that item by reference.

References in this Annual Report on Form 10-K to our belief that we are a leading supplier or the world's leading supplier, and other similar statements as to our relative market position are based principally on calculations we have made. These calculations are based on information we have collected, including company and industry sales data obtained from internal and available external sources as well as our estimates. In addition to such quantitative data, our statements are based on other competitive factors such as our technological capabilities, engineering, research and development efforts, innovative solutions and the quality of our products and services, in each case relative to that of our competitors in the markets we address.

Our Business

Our reporting segments are as follows:

The Commercial Truck & Trailer segment supplies drivetrain systems and components, including axles, drivelines and braking and suspension systems, primarily for medium- and heavy-duty trucks and other applications in North America, South America, Europe and Asia Pacific. It also supplies a variety of undercarriage products and systems for trailer applications in North America. This segment also includes the company's aftermarket businesses in Asia Pacific and South America.

-

The Aftermarket & Industrial segment supplies axles, brakes, drivelines, suspension parts and other replacement parts to commercial vehicle and industrial aftermarket customers, primarily in North America and Europe. In addition, this segment supplies drivetrain systems and certain components, including axles, drivelines, brakes and suspension systems for military, construction, bus and coach, fire and emergency and other applications in North America and Europe.

Business Strategies

We are currently a premier global supplier of a broad range of integrated systems, modules and components to OEMs and the aftermarket for the commercial vehicle, transportation and industrial sectors, and we believe we have market-leading positions in many of the markets we serve. We are working to enhance our leadership positions and capitalize on our existing customer, product and geographic strengths. For additional market related discussion, see the Trends and Uncertainties section in Item 7.

1

Our business continues to address a number of challenging industry-wide issues including the following:

• Uncertainty around the global market outlook;

• Volatility in price and availability of steel, components and other commodities;

• Potential for disruptions in the financial markets and their impact on the availability and cost of credit;

• Volatile energy and transportation costs;

• Impact of currency exchange rate volatility; and

• Consolidation and globalization of OEMs and their suppliers.

Other

Other significant factors that could affect our results and liquidity include:

• Significant contract awards or losses of existing contracts or failure to negotiate acceptable terms in contract renewals;

• Ability to successfully launch a significant number of new products, including potential product quality issues, and obtain new business;

• Ability to manage possible adverse effects on our European operations, or financing arrangements related thereto, following the United Kingdom's decision to exit the European Union, or in the event one or more other countries exit the European monetary union;

• Ability to further implement planned productivity, cost reduction, and other margin improvement initiatives;

• Ability to successfully execute and implement strategic initiatives;

• Ability to work with our customers to manage rapidly changing production volumes;

• Ability to recover, and timing of recovery of, steel price and other cost increases from our customers;

• Any unplanned extended shutdowns or production interruptions by us, our customers or our suppliers;

• A significant deterioration or slowdown in economic activity in the key markets in which we operate;

• Competitively driven price reductions to our customers;

• Potential price increases from our suppliers;

• Additional restructuring actions and the timing and recognition of restructuring charges, including any actions associated with prolonged softness in markets in which we operate;

• Higher-than-planned warranty expenses, including the outcome of known or potential recall campaigns;

• Uncertainties of asbestos claim, environmental and other legal proceedings, the long-term solvency of our insurance carriers, and the potential for higher-than-anticipated costs resulting from environmental liabilities, including those related to site remediation;

• Significant pension costs; and

• Restrictive government actions (such as restrictions on transfer of funds and trade protection measures, including import and export duties, quotas and customs duties and tariffs).

Our specific business strategies are influenced by these industry factors and global trends and are focused on leveraging our resources to continue to develop and produce competitive product offerings. We believe the following strategies will allow us to maintain a balanced portfolio of commercial truck, industrial and aftermarket businesses covering key global markets. See Item 1A. Risk Factors below for information on certain risks that could have an impact on our business, financial condition or results of operations in the future.

M2019 Growth-Focused Plan

As we look forward to completing the last year of our M2019 plan, we made significant progress in fiscal year 2018 toward our objectives. The financial targets we set for this plan are the following:

- Grow revenue at 20 percent cumulatively above market levels, measured from the end of fiscal year 2015
- Increase adjusted diluted earnings per share from continuing operations by \$1.25, measured from fiscal year 2015
- Reduce the ratio of net debt to adjusted EBITDA to less than 1.5

(see Non-GAAP Financial Measures in Item 7)

To achieve these targets, we remain focused on three main priorities:

- Exceeding customer expectations
- Transforming to a growth-oriented organization
- Continuing to invest in employees

Exceed Customer Expectations

For more than 100 years, our products have evolved to meet the changing needs of our customers in major regions of the world. As technology has advanced, we have designed products that are more fuel efficient, lighter weight, safer, more durable and more reliable. The Meritor brand is well established globally and reflects a broad and growing portfolio of high-quality products for various applications.

Over the past years, we worked hard to become an innovation partner to our customers. From concept to launch, we work closely together to ensure we are designing reliable and high quality products that meet or exceed their expectations now and in the future. In addition to technology and product collaboration, we also meet regularly with our customers to review our performance in a number of other areas including quality, delivery and cost.

In our M2019 plan, we set an overall quality target of 25 parts per million ("PPM"). We believe this will further differentiate us in the commercial vehicle industry. In fiscal year 2018, Daimler Trucks North America awarded four Meritor production sites with Masters of Quality Awards. An additional three facilities earned the PACCAR's 10 PPM Quality Award that is given to suppliers who meet or exceed its rigorous standard of 10 or fewer defective parts for every 1 million parts shipped to this customer.

We want to continue the excellent delivery performance we have demonstrated at greater than 99 percent. This year, we were proud to receive the 100 Percent Delivery Award from Hino Motors Manufacturing U.S.A., Inc. for perfect on-time delivery of dressed drive and steer axles. Meritor builds the drive and front steer axles for all of Hino's medium-duty conventional cab models in North America. On-time delivery is critical because axles are among the first parts placed on the manufacturer's truck assembly line.

In addition to recognition from our customers for outstanding quality and delivery, we also received a Gold Award from Ashok Leyland in India for new product development for the design of a unique slipper suspension for haulage trucks and assisting the truck manufacturer with the migration to a new emission standard. This new suspension has unique and patented design features that include a lighter-weight design compared to conventional suspensions, and offers a significant reduction in service time and maintenance costs with less tire wear due to more efficient axle alignment. And in Australia, we earned the Penske Supplier of the Year Award for outstanding sales, customer service and marketing support, and maintaining a consistently high fill rate of 95 percent. These recognitions reflect our focus on maintaining excellent customer relationships globally and will continue to be an area to which we devote

significant attention.

We will maintain our focus on driving down operating costs through material cost-reduction and labor and burden improvements with a target achievement of 1.5 percent improvement per year. We are continuing to drive material performance with three different approaches: commercial negotiations, best-cost-country sourcing and technical innovation. And, we are improving in labor and burden by addressing several areas simultaneously including better equipment utilization, reduced changeover time, elimination of waste, improved shift and asset utilization, investing in equipment to improve cycle time and flexibility and employee involvement.

3

We believe we effectively manage complexity for low volumes and support our customers' needs during periods of peak volumes. The quality, durability and on-time delivery of our products has earned us strong positions in the markets we support. As we seek to extend and expand our business with existing customers and establish relationships with new ones, our objective is to ensure we are getting a fair value for the recognized benefits of our products and services and the strong brand equity we hold in the marketplace.

Transform to a Growth-Oriented Organization

We know that despite changes and volatility in global market conditions, it is important that we generate profitable top-line growth. We have designed the M2019 plan to enable us to achieve the growth we are targeting while operating in a cyclical industry that can be greatly impacted by economic and political factors. We are increasing our market share with key customers, renewing long-term contracts and winning new business in all of our regions around the globe across both of our reportable segments.

We have increased the pace of product introduction, which is a key component to growing revenue. Prior to our M2016 plan, we launched approximately three major programs annually. We are developing these jointly with our customers for their future product programs, and we have line of sight to revenue streams for each of these products. In fiscal year 2018, we launched the following six products:

Optimized EX+ Air Disc Brake - Built to maximize productivity by reducing maintenance time and costs, the gear synchronized, twin-piston design delivers even force across the brake pads simultaneously resulting in better performance and uniform pad wear.

79000 Series Axle - Designed to help municipal transit fleets meet federal and industry durability guidelines. By more than tripling the durability of previous offerings, fleets may only need to replace the axle's carrier once instead of multiple times during the vehicle's service life in this heavy stop-and-go segment.

ZL50+ Loader Axle - Designed for the off-highway construction market in China, specifically for loaders.

MT-610 Hub Reduction Axle - DAF Trucks, subsidiary of PACCAR, has equipped its next-generation, heavy-duty lineup for European long-haul and off-road applications with a hub-reduction tandem axle developed by Meritor. Designed for extreme applications, the axle's fast ratios allow the engine to run at lower rpms, improving fuel efficiency for end-users.

DuaLite 156 Axle - Specifically produced for the China bus market with low noise and high efficiency design.

MTC-3203 Transfer Case - Designed for the medium-duty all-wheel drive market and launched with Navistar and Chevrolet.

We expect to continue to broaden our relationships with our global strategic customers, earn the business of new customers, increase aftermarket share in our core product areas, expand our components business by utilizing our time-proven core competencies of forging, machining and gear manufacturing, and enter near adjacent markets and products that we believe will be a good match with our core competencies.

AB Volvo is Meritor's largest global customer with the majority of that business being in Europe. Last year, we extended our long-term agreement with Volvo for an additional three years to 2024. Under the terms of this agreement, Meritor will design and deliver a new family of heavy, single reduction rear axles for both Volvo and Renault brands. These newly designed products will feature fuel efficiency improvement, faster ratios and a higher gross combined weight rating to enable more payload per truck. We also support Volvo in Thailand and India.

During fiscal year 2018, we delivered strong operational execution, won new business and increased market share with key customers in major markets. Meritor was awarded important new contracts with customers globally including front and rear axles for MAN's new delivery truck, axle business with Mercedes Benz and Iveco for school buses in South America, axle and suspension business with Tata, Kenworth and Ashok Leyland in Asia Pacific, and several new awards for Meritor's hub reduction axle around the world. In our Defense business, we have a new contract with Mack Defense for a rear beam and front drive steer axle, as well as drivelines and transfer cases for approximately 700 trucks.

In the electric vehicle space, Meritor currently has 22 active programs across the globe on applications including school buses, yard tractors, medium duty trucks, urban buses and refuse trucks. In addition to supporting these programs with core Meritor content, including front and rear suspensions, wheel ends, drum and disc brakes and gearboxes, Meritor is also offering its

proprietary eAxle and other products now part of its portfolio as a result of our strategic alliance with TransPower. In fiscal year 2018, we earned new business in the electric space with customers including Daimler Trucks North America (DTNA) for its innovation fleet, and with Thomas Built Bus, a subsidiary of DTNA, Ashok Leyland, Kalmar and Peterbilt. For Peterbilt, we will supply all-electric drivetrain systems for two vehicle platforms that will include 12 all-electric Class 8 day cab tractors and three refuse trucks.

As we strive to grow our aftermarket business, we took various actions this year to better serve our customers, including launching the North America Authorized Rebuilder Program for drive axle carriers, including our 145, 14XTM and 160 products. We are partnering with exceptional rebuilders that share our commitment to helping fleets maximize uptime with coast-to-coast, 24-hour guaranteed delivery of highly reliable, rebuilt carriers which meet original performance specifications. Also this year, we launched a comprehensive portfolio of products designed to deliver the right parts, performance and price for each life stage of trucks, trailers and buses. As an example, the MachTM parts brand is designed for customers seeking high-value, delivering quality all-makes parts that improve uptime at affordable prices, while the Meritor[®] and Euclid[®] brands offer top-quality aftermarket parts at more affordable prices. Meritor Genuine brand is designed for newer vehicles still under warranty or for customers who want to maintain original performance and maximize uptime with OEM production parts. Meritor is one of the few suppliers that manufactures or approves for sale lifecycle aftermarket parts that include support and availability.

While we are planning for the majority of Meritor's growth to be organic, we anticipate allocating capital for targeted acquisitions that could be an accelerant in our growth trajectory. To that end, this year we acquired substantially all of the assets of AA Gear & Manufacturing, Inc. and its subsidiaries. This transaction provides our components business with a suite of process engineering and production capabilities for gear and shaft components that will enable us to offer new products and applications. In August, we announced a new five-year contract for a near-net forged part in which Meritor will produce more than three million pieces. Start of production is 2020.

As industry trends continue to drive the need for equipment that complies with environmental and safety-related regulatory provisions, OEMs select suppliers based not only on the cost and quality of their products, but also on their ability to meet stringent environmental and safety requirements and to service and support the customer after the sale. We use our technological and market expertise to develop and engineer products that address mobility, safety, regulatory and environmental concerns.

Our commitment to designing and manufacturing braking solutions for the commercial vehicle market has resulted in more commercial vehicles in North America having Meritor brakes than any other brake manufacturer. We believe Meritor's EX+ air disc brakes are among the highest performing brakes in the marketplace. In Europe, a region where air disc brakes are much more widely adopted, we have sold more than 6 million ELSA air disc brakes - a testament to the quality, reliability and performance of this brake platform.

We believe the quality of our core product lines, our ability to service our products through our aftermarket capabilities, and our sales and service support teams give us a competitive advantage. An important element of being a preferred supplier is the ability to deliver service through the entire life cycle of the product. Also, as our industry becomes more international, our manufacturing footprint around the world and our ability to supply customers with regionally-tailored product solutions are competencies of increasing importance.

Invest in Employees

The safety of our employees is our top priority. Total case rate is a measure of recordable workplace injuries normalized per 100 employees per year. Our target for M2019 is to achieve a rate of less than 0.65. In fiscal year 2018, we achieved an overall case rate of 0.72 injuries per 200,000 hours. Our safety rate in fiscal year 2018 was slightly unfavorable to fiscal year 2017. This was due in large part to the 15-percent increase in hours worked in our

manufacturing facilities this year due to peak markets in North America and high production demand globally. Even with the significant increase in hours, sixteen of our 40 measured facilities had no recordable incidents in the entire fiscal year. We attribute this to the diligence of our employees and the safety programs and equipment we have instituted throughout our global operations to protect them. In an effort to continually improve our safety rate, we will maintain our diligence through training and education of our employees, reducing certain behaviors that are known to create safety issues and continue to maximize risk identification and hazard assessment.

We will also continue to drive the close alignment of our global Meritor team to M2019. Such alignment was a key driver of the success we experienced in our previous M2016 strategic plan. We believe that our strength to compete in the global market is dependent upon the engagement of every Meritor employee and that a high-performing team is critical to the level of performance we want to achieve. We have a strong and experienced leadership group and a committed team, both of which are focused on sustaining the strong foundation we built in M2016 and delivering on our M2019 performance objectives. We will also continue to diversify our workforce because we recognize the value of different opinions and backgrounds in a company as global as Meritor.

We have established various development and training programs to help our employees grow as we grow. This year, we continued the leadership development programs for managers, directors and senior leaders around the world. For managers, we offered eLearning modules and courses that address important areas for advancement including accountability, delegation, and providing and receiving feedback. For certain director-level employees, we led our second annual Leadership Edge - a 10-month program whose objective is to develop advanced leadership skills, prepare high-potential leaders for senior level positions and strengthen business acumen. And for certain senior-level leaders, we continued the Summit, which provides executive coaching, the opportunity to attend specific executive training sessions tailored to each individual's background and career goals, participation in a MBA-level finance course, if needed, and engagement in mentorship opportunities with a member of Meritor's Board of Directors. To ensure we provide a rich experience for our employees, we will continue to measure employee engagement to build on the competencies that are important to our future.

Products

Meritor designs, develops, manufactures, markets, distributes, sells, services and supports a broad range of products for use in the transportation and industrial sectors. In addition to sales of original equipment systems and components, we provide our original equipment, aftermarket and remanufactured products to vehicle OEMs, their dealers (who in turn sell to motor carriers and commercial vehicle users of all sizes), independent distributors, and other end-users in certain aftermarkets.

The following chart sets forth, for each of the fiscal years 2018, 2017 and 2016, information about product sales comprising more than 10% of consolidated revenue in any of those years. A narrative description of our principal products follows the chart.

Product Sales:

| | Fiscal Year Ended | | | | | |
|-------------------------------------|-------------------|------|------|------|------|------|
| | September 30, | | | | | |
| | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| Axles, Undercarriage and Drivelines | 74 | % 73 | % 73 | % | | |
| Brakes and Brake-Related Components | 24 | % 25 | % 25 | % | | |
| Other | 2 | % 2 | % 2 | % | | |
| Total | 100% | 100% | 100% | | | |

Axles, Undercarriage & Drivelines

We believe we are one of the world's leading independent suppliers of axles for medium- and heavy-duty commercial vehicles, with the leading market position in axle manufacturing in North America, South America and Europe, and are one of the major axle manufacturers in the Asia-Pacific region. Our extensive truck axle product line includes a wide range of front steer axles and rear drive axles. Our front steer and rear drive axles can be equipped with our cam, wedge or air disc brakes, automatic slack adjusters, and complete wheel-end equipment such as hubs, rotors and drums.

We supply heavy-duty axles in certain global regions for use in numerous off-highway vehicle applications, including construction, material handling, and mining. We also supply axles for use in military tactical wheeled vehicles, principally in North America. These products are designed to tole