MERITOR INC
Form 10-Q
May 05, 2016
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 April 3, 2016
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.
YesXNo
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).
YesXNo
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 NoX
91,473,543 shares of Common Stock, $1.00 par value, of Meritor, Inc. were outstanding on April 3, 2016.

INDEX

			Page No.
PART I.	FINANCIAL INFORMATION:		
	Item 1.	Financial Statements:	
		Condensed Consolidated Statement of Operations - - Three and Six Months Ended March 31, 2016 and 2015	3
		Condensed Consolidated Statement Of Comprehensive Income (Loss) - - Three and Six Months Ended March 31, 2016 and 2015	4
		Condensed Consolidated Balance Sheet - - March 31, 2016 and September 30, 2015	5
		Condensed Consolidated Statement of Cash Flows - - Six Months Ended March 31, 2016 and 2015	6
		Condensed Consolidated Statement of Equity (Deficit) - - Six Months Ended March 31, 2016 and 2015	7
		Notes to Condensed Consolidated Financial Statements	8
	Item 2.	Management's Discussion and Analysis of Financial Conditions and Results of Operations	50
	Item 3.	Quantitative and Qualitative Disclosures About Market Risk	67
	Item 4.	Controls and Procedures	69
PART II.	OTHER INFORMATION:		
	Item 1.	Legal Proceedings	70
	Item 1A.	Risk Factors	70
	Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	70
	Item 5.	Other Information	71
	Item 6.	Exhibits	72
Signatures			73

MERITOR, INC.

PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
	(Unaudited)			
Sales	$821	$864	$1,630	$1,743
Cost of sales	(700)	(749)	(1,405)	(1,513)
GROSS MARGIN	121	115	225	230
Selling, general and administrative	(60)	(57)	(116)	(122)
Restructuring costs	(2)	(3)	(3)	(6)
Other operating income (expense), net	(3)	—	(3)	1
OPERATING INCOME	56	55	103	103
Other income (expense), net	(2)	2	(1)	4
Equity in earnings of affiliates	7	9	17	18
Interest expense, net	(21)	(21)	(43)	(40)
INCOME BEFORE INCOME TAXES	40	45	76	85
Provision for income taxes	(7)	(6)	(14)	(13)
INCOME FROM CONTINUING OPERATIONS	33	39	62	72
INCOME (LOSS) FROM DISCONTINUED OPERATIONS, net of tax	(1)	4	(3)	1
NET INCOME	32	43	59	73
Less: Net income attributable to noncontrolling interests	—	—	(1)	(1)
NET INCOME ATTRIBUTABLE TO MERITOR, INC.	$32	$43	$58	$72
NET INCOME ATTRIBUTABLE TO MERITOR, INC.				
Net income from continuing operations	$33	$39	$61	$71
Income (Loss) from discontinued operations	(1)	4	(3)	1
Net income	$32	$43	$58	$72
BASIC EARNINGS (LOSS) PER SHARE				
Continuing operations	$0.36	$0.40	$0.66	$0.73
Discontinued operations	(0.01)	0.04	(0.03)	0.01
Basic earnings per share	$0.35	$0.44	$0.63	$0.74
DILUTED EARNINGS (LOSS) PER SHARE				
Continuing operations	$0.36	$0.38	$0.65	$0.70
Discontinued operations	(0.01)	0.04	(0.03)	0.01
Diluted earnings per share	$0.35	$0.42	$0.62	$0.71
Basic average common shares outstanding	91.3	97.9	91.9	97.9
Diluted average common shares outstanding	92.5	102.9	93.5	102.0

See notes to condensed consolidated financial statements.

3

MERITOR, INC.

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
	(Unaudited)			
Net income	$32	$43	$59	$73
Other comprehensive income (loss):				
Foreign currency translation adjustments:				
Attributable to Meritor, Inc.	10	(33)	4	(67)
Attributable to noncontrolling interest	—	—	—	(1)
Other reclassification adjustment	—	—	—	1
Pension and other postretirement benefit related adjustments	9	11	18	23
Unrealized gain (loss) on investments and foreign exchange contracts	(1)	—	2	(1)
Other comprehensive income (loss), net of tax	18	(22)	24	(45)
Total comprehensive income	50	21	83	28
Less: Comprehensive income attributable to noncontrolling interest	—	—	(1)	—
Comprehensive income attributable to Meritor, Inc.	$50	$21	$82	$28

See notes to condensed consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED BALANCE SHEET
(in millions)

	March 31, 2016 (Unaudited)	September 30, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$94	$ 193
Receivables, trade and other, net	426	461
Inventories	362	338
Other current assets	53	50
TOTAL CURRENT ASSETS	935	1,042
NET PROPERTY	427	419
GOODWILL	399	402
OTHER ASSETS	332	332
TOTAL ASSETS	$2,093	$ 2,195
LIABILITIES AND EQUITY (DEFICIT)		
CURRENT LIABILITIES:		
Short-term debt	$25	$ 15
Accounts and notes payable	511	574
Other current liabilities	253	279
TOTAL CURRENT LIABILITIES	789	868
LONG-TERM DEBT	978	1,036
RETIREMENT BENEFITS	611	632
OTHER LIABILITIES	316	305
TOTAL LIABILITIES	2,694	2,841
COMMITMENTS AND CONTINGENCIES (See Note 20)		
EQUITY (DEFICIT):		
Common stock (March 31, 2016 and September 30, 2015, 99.6 and 98.8 shares issued and 91.5 and 94.6 shares outstanding, respectively)	99	99
Additional paid-in capital	871	865
Accumulated deficit	(756)	(814)
Treasury stock, at cost (March 31, 2016 and September 30, 2015, 8.1 and 4.2 shares, respectively)	(98)	(55)
Accumulated other comprehensive loss	(742)	(766)
Total deficit attributable to Meritor, Inc.	(626)	(671)
Noncontrolling interests	25	25
TOTAL DEFICIT	(601)	(646)
TOTAL LIABILITIES AND DEFICIT	$2,093	$ 2,195

See notes to condensed consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions)

	Six Months Ended March 31,	
	2016	2015
	(Unaudited)	
OPERATING ACTIVITIES		
CASH PROVIDED BY OPERATING ACTIVITIES (See Note 9)	$39	$29
INVESTING ACTIVITIES		
Capital expenditures	(47)	(23)
Other investing activities	3	—
Net investing cash flows provided by discontinued operations	4	4
CASH USED FOR INVESTING ACTIVITIES	(40)	(19)
FINANCING ACTIVITIES		
Repayment of notes	(55)	(16)
Repurchase of common stock	(43)	(16)
Other financing activities	(2)	(6)
CASH USED FOR FINANCING ACTIVITIES	(100)	(38)
EFFECT OF CHANGES IN FOREIGN CURRENCY EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	2	(12)
CHANGE IN CASH AND CASH EQUIVALENTS	(99)	(40)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	193	247
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$94	$207

See notes to condensed consolidated financial statements.

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, 2015	$ 99	$ 865	$ (814)	$ (55)	$ (766)	$ (671)	$ 25	$ (646)
Comprehensive income	—	—	58	—	24	82	1	83
Equity based compensation expense	—	6	—	—	—	6	—	6
Repurchase of common stock	—	—	—	(43)	—	(43)	—	(43)
Noncontrolling interest dividend	—	—	—	—	—	—	(1)	(1)
Ending Balance at March 31, 2016	$ 99	$ 871	$ (756)	$ (98)	$ (742)	$ (626)	$ 25	$ (601)
Beginning balance at September 30, 2014	$ 97	$ 918	$ (878)	$ —	$ (749)	$ (612)	$ 27	$ (585)
Comprehensive income (loss)	—	—	72	—	(44)	28	—	28
Vesting of restricted stock	2	(2)	—	—	—	—	—	—
Repurchase of convertible notes	—	(2)	—	—	—	(2)	—	(2)
Equity based compensation expense	—	5	—	—	—	5	—	5
Repurchase of common stock	—	—	—	(16)	—	(16)	—	(16)
Noncontrolling interest dividends	—	—	—	—	—	—	(1)	(1)
Other equity adjustments	—	1	—	—	—	1	—	1
Ending Balance at March 31, 2015	$ 99	$ 920	$ (806)	$ (16)	$ (793)	$ (596)	$ 26	$ (570)

See notes to condensed consolidated financial statements.

Index
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. Additional information regarding discontinued operations is discussed in Note 4.

In the opinion of the company, the unaudited condensed consolidated 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, 2015, as amended. The condensed consolidated balance sheet data as of September 30, 2015 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 six months ended March 31, 2016 are not necessarily indicative of the results for the full year.

The company’s fiscal year ends on the Sunday nearest September 30. The second quarter of fiscal years 2016 and 2015 ended on April 3, 2016 and March 29, 2015, 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 March 31 are used consistently throughout this report to represent the fiscal year end and second fiscal 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 March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Basic average common shares outstanding	91.3	97.9	91.9	97.9
Impact of restricted shares, restricted share units and performance share units	1.2	1.9	1.6	2.0
Impact of stock options	—	0.1	—	0.1
Impact of convertible notes	—	3.0	—	2.0
Diluted average common shares outstanding	92.5	102.9	93.5	102.0

In November 2015, 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 was $10.51, which was the company’s share price on the grant date of December 1, 2015. The Board of Directors also approved a grant of 0.5 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 was $10.51, which was the company's share price on the grant date of December 1, 2015.

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, 2015 to September 30, 2018, 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: 50% associated with achieving an Adjusted EBITDA margin target and 50% 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 0.7 million performance share units.

In November 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 was $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 was $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 performance share units.

In November 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 was $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 performance share units including incremental share units that were issued subsequent to the December 1, 2013 grant date. There were 1.1 million and 1.0 million shares related to these performance share units included in the diluted earnings per share calculation for the three and six months ended March 31, 2016, respectively, as certain payout thresholds were achieved in the second quarter of fiscal year 2016 relative to the Adjusted EBITDA, net debt reduction and incremental booked revenue targets. There were 1.0 million and 0.8 million shares related to these performance share units included in the diluted earnings per share calculation for the three and six months ended March 31, 2015, respectively, as certain payout thresholds were achieved in the second quarter of fiscal year 2015.

For the three months ended March 31, 2016, the dilutive impact of previously issued restricted shares, restricted share units, and performance share units was 1.2 million, compared to 1.9 million share units for the same period in the prior fiscal year. For the six months ended March 31, 2016, the dilutive impact of previously issued restricted shares, restricted share units, and performance share units was 1.6 million, compared to 2.0 million share units for the same

period in the prior fiscal year. For the three and six months ended March 31, 2016, compensation cost related to restricted shares, restricted share units, performance share units and stock options was $3 million and $6 million, respectively, compared to $3 million and $5 million, respectively for the three and six months ended March 31, 2015.

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

For each of the three- and six-month period ended March 31, 2016, options to purchase 0.7 million and 0.3 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 six months ended March 31, 2016 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 this period was less than conversion price for the notes. For the three and six months ended March 31, 2015, 3.0 million and 2.0 million shares, respectively, were included in the computation of diluted earnings per share because the average stock price during this period exceeded the conversion price for the 7.875 percent convertible notes due 2026.

3. New Accounting Standards

Accounting standards to be implemented

In April, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-10, Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing. The ASU provides guidance regarding the identification of performance and licensing obligations. The amendments in this update affect the guidance in ASU 2014-09, which is not effective yet. The effective date and the transition requirements for the amendments in ASU 2016-10 are the same as the effective date and transition requirements in ASU 2014-09 as described below. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2018 in connection with its planned implementation of ASU 2014-09 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.
In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting. The ASU intends to simplify how share-based payments are accounted for. The standard is required to be adopted by public business entities in fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. Early adoption is permitted. The company is assessing the potential impact of this new guidance on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606), Principal versus Agent Considerations (Reporting Revenue Gross versus Net) to clarify certain aspects of the principal-versus-agent guidance in its new revenue recognition standard. The amendments in this update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in ASU 2016-08 are the same as the effective date and transition requirements of ASU 2014-09. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2018 in connection with its planned implementation of ASU 2014-09. The company is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-07, Investments-Equity Method and Joint Ventures (Topic 323), Simplifying the Transition to the Equity Method of Accounting. The ASU will eliminate the requirement to apply the equity method of accounting retrospectively when a reporting entity obtains significant influence over a previously held investment. The standard is required to be adopted by public business entities in fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. Early adoption is permitted. The company does not expect a material impact on its consolidated financial statements from adoption of this guidance.

In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging (Topic 815), Contingent Put and Call Options in Debt Instruments. The ASU clarifies that an exercise contingency itself does not need to be evaluated to determine whether it is in an embedded derivative, just the underlying option.The standard is required to be adopted by public business entities in fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. Early adoption is permitted. The company does not expect a material impact on its consolidated

financial statements from adoption of this guidance.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815), Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. The update clarifies that a change in a counterparty to a derivative instrument designated as a hedging instrument would not require the entity to dedesignate the hedging relationship and discontinue the application of hedge accounting. The standard is required to be adopted by public business entities in fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. Early adoption is permitted. The company does not expect a material impact on its consolidated financial statements from adoption of this guidance.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The update will require lessees to recognize a right-of-use asset and lease liability for substantially all leases. The standard is required to be adopted by public business entities in fiscal periods beginning after December 15, 2018, including interim periods within those fiscal periods. Early adoption is permitted. The company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2019 and is currently assessing the potential impact of this new guidance on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities, which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The guidance is effective for fiscal periods beginning after December 15, 2017, including interim periods within those fiscal periods. Early adoption is permitted. The company does not expect a material impact on its consolidated financial statements from adoption of this guidance.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, as part of its Simplification Initiative, which updates Income Taxes (Topic 740) guidance to eliminate the requirement for an entity to separate deferred tax liabilities and tax assets between current and noncurrent amounts in a classified balance sheet. Deferred taxes will be presented as noncurrent under the new standard. The guidance is effective for fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. Early adoption is permitted. The company plans to implement this standard in the fourth quarter of fiscal year 2016 and is assessing the potential impact of this new guidance on its consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which requires entities that measure inventory using first-in, first-out (FIFO) or average cost to measure inventory at the lower of cost and net realizable value. The standard is required to be adopted by public business entities in fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. The company is assessing 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), which provides guidance about management's responsibility in evaluating whether there is substantial doubt relating to an entity’s ability to continue as a going concern and to provide related footnote disclosures as applicable. ASU 2014-15 is effective for the interim and fiscal periods ending after December 15, 2016. Early adoption is permitted. The company does not expect a material impact on its consolidated financial statements from adoption of this guidance.

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. This guidance requires that an award with a performance target that affects vesting, and that could be achieved after the requisite service period, such as when an employee retires, but may still vest if and when the performance target is achieved, be treated as an award with performance conditions that affect vesting and the company apply existing guidance under ASC Topic 718, Compensation - Stock Compensation. The guidance is effective for fiscal periods beginning after December 15, 2015, including interim periods within those fiscal periods and may be applied either prospectively or retrospectively. The company is assessing the potential impact of this new guidance on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which requires companies to recognize revenue when a customer obtains control rather than when companies have transferred substantially all risks and rewards of a good or service and requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. ASU 2014-09 was originally effective for fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year making it effective for fiscal periods beginning after December 15, 2017, including interim periods within those fiscal periods, while also providing for early adoption but not before the original effective date. 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.

Accounting standards implemented during fiscal year 2016

In September 2015, the FASB issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments, which updates Business Combination (Topic 805) guidance to eliminate the requirement to restate prior period financial statements for measurement period adjustments. The guidance should be applied prospectively to measurement period adjustments that occur

after the effective date. The guidance is effective for fiscal periods beginning after December 15, 2015, including interim periods within those fiscal periods. Early adoption is permitted. The company adopted this standard in the first quarter of the fiscal year 2016. This guidance did not have a material impact on the company's consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) - Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This guidance changes the definition of a discontinued operation to include only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The guidance also requires new disclosure of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. This guidance is to be applied prospectively and is effective for fiscal periods beginning on or after December 15, 2014, including interim periods within those fiscal periods. The company adopted this guidance in the first quarter of fiscal year 2016. The impact of this new guidance on the company's consolidated financial statements is dependent upon future business divestitures. Previous divestitures and amounts currently included in discontinued operations were not impacted.

4. Discontinued Operations

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Sales	$—	$ —	$—	$ 1
Income (loss) before income taxes	$(1)	$ 3	$(4)	$ —
Benefit from income taxes	—	1	1	1
Income (loss) from discontinued operations attributable to Meritor, Inc.	$(1)	$ 4	$(3)	$ 1

Loss from discontinued operations attributable to the company for the three and six months ended March 31, 2016 was primarily related to changes in estimates related to legal costs incurred in connection with a previously divested business. Income from discontinued operations attributable to the company for the three and six months ended March 31, 2015 was primarily attributable to the settlement of indemnities on certain contingencies of previously divested businesses.

Total discontinued operations assets as of March 31, 2016 and September 30, 2015 were $1 million and $4 million, respectively, and total discontinued operations liabilities as of March 31, 2016 and September 30, 2015 were $6 million and $10 million, respectively.

5. Goodwill

In accordance with FASB Accounting Standards Codification (ASC) Topic 350-20, “Intangibles - Goodwill and Other”, goodwill is reviewed for impairment annually during the fourth quarter of the fiscal year or more frequently if certain indicators arise. If business conditions or other factors cause the operating results and cash flows of a reporting unit to decline, the company may be required to record impairment charges for goodwill at that time.

The company tests goodwill for impairment at a level of reporting referred to as a reporting unit, which is an operating segment or one level below an operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. When two or more components of an operating segment have similar economic characteristics, the components are aggregated and deemed a single

reporting unit. An operating segment is deemed to be a reporting unit if all of its components are similar, if none of its components are a reporting unit, or if the segment comprises only a single component.

Index
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, 2015	$ 239	$ 163	$ 402
Foreign currency translation	(3)	—	(3)
Balance at March 31, 2016	$ 236	$ 163	$ 399

6. Restructuring Costs

Restructuring reserves, primarily related to unpaid employee termination benefits attributable mainly to the company's Commercial Truck & Industrial segment were $9 million at March 31, 2016 and $10 million at September 30, 2015, respectively. The changes in restructuring reserves for the six months ended March 31, 2016 and 2015 are as follows (in millions):

	Employee Termination Benefits	Plant Shutdown & Other	Total
Beginning balance at September 30, 2015	$ 10	$ —	$ 10
Activity during the period:			
Charges to continuing operations	2	1	3
Cash payments – continuing operations	(4)	—	(4)
Total restructuring reserves at March 31, 2016	8	1	9
Less: non-current restructuring reserves	(3)	—	(3)
Restructuring reserves – current, at March 31, 2016	$ 5	$ 1	$ 6
Balance at September 30, 2014	$ 11	$ —	$ 11
Activity during the period:			
Charges to continuing operations	6	—	6
Cash payments – continuing operations	(3)	—	(3)
Other	(2)	—	(2)
Total restructuring reserves at March 31, 2015	12	—	12
Less: non-current restructuring reserves	(2)	—	(2)
Restructuring reserves – current, at March 31, 2015	$ 10	$ —	$ 10

2016 Restructuring Costs: During the first six months of fiscal year 2016, the company recorded restructuring costs of $3 million primarily associated with a labor reduction programs in China in the Commercial Truck & Industrial and Aftermarket and Trailer segments.

Consolidation of Certain Operations in 2015: 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. Restructuring actions associated with this program were substantially complete as of September 30, 2015.

Closure of a Corporate Engineering Facility in 2015: 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 for the six months ended March 31, 2015. Restructuring actions associated with this program

were substantially complete as of September 30, 2015.

European Labor Reduction in 2015: 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 among 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.

In prior years, the company established valuation allowances against its U.S. net deferred tax assets and the net deferred tax assets of its 100-percent-owned subsidiaries in France, the United Kingdom and certain other countries. In evaluating its ability to recover these net deferred tax assets, the company utilizes a consistent approach which considers its historical operating results, including an assessment of the degree to which any gains or losses are driven by items that are unusual in nature, and tax planning strategies. In addition, the company reviews changes in near-term market conditions and other factors that impact future operating results. Continued improvement in the company's operating results could lead to reversal of some or all of these valuation allowances in the future. However, the company continues to maintain the valuation allowances in these jurisdictions, as the company believes the negative evidence that it will be able to recover these net deferred tax assets continues to outweigh the positive evidence. In addition, the company performs the same analysis in jurisdictions not in a valuation allowance to determine if a valuation allowance is required.

Although the company was profitable in the U.S. in 2014 and 2015, it has not generated enough positive evidence to warrant a reversal of the U.S. valuation allowance, so it continues to record a full valuation allowance against the U.S. net deferred tax assets. While the weight of negative evidence related to cumulative losses continues to decrease, the company believes that the objectively-measured negative evidence outweighs the subjectively-determined positive evidence.

For the three months ended March 31, 2016, the company had approximately $17 million of net pre-tax income compared to $24 million of net pre-tax income in the same period in fiscal year 2015 in tax jurisdictions in which tax expense (benefit) is not recorded.

For the six months ended March 31, 2016, the company had approximately $28 million of net pre-tax income compared to $36 million of net pre-tax income in the same period in fiscal year 2015 in tax jurisdictions in which tax expense is not recorded. Income arising from these jurisdictions resulted in an adjustment to the valuation allowance,

rather than an adjustment to income tax expense.

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 terminates on June 28, 2016, the company can sell up to, at any point in time, €155 million ($176 million) of eligible trade receivables. On March 29, 2016, Meritor signed an amendment to increase the commitment to €155 million from €150 million. All other terms of the arrangement remain unchanged. The company is working to extend this arrangement before its current maturity date. The receivables under this program are sold at face value and are excluded from the condensed consolidated balance sheet. The company had utilized €107 million ($121 million) and €108 million ($121 million) of this accounts receivable factoring facility as of March 31, 2016 and September 30, 2015, respectively.

The above facility is backed by a 364-day liquidity commitment from Nordea Bank which extends through December 2016. The commitment is subject to standard terms and conditions for this type of arrangement.

U.S. Factoring Facility: On February 19, 2016, the company entered into a new Receivables Purchase Agreement with Nordea Bank replacing a similar agreement that expired February 28, 2016. Under this new arrangement, which terminates on February 19, 2019, the company can sell up to, at any point in time, €80 million ($91 million) of eligible trade receivables from AB Volvo and its U.S. subsidiaries through one of the company's U.S. subsidiaries, an increase of €15 million compared to the previous agreement. The amount of eligible receivables sold may exceed Nordea Bank's commitment at Nordea Bank's discretion. The receivables under this program are sold at face value and are excluded from the condensed consolidated balance sheet. The company had utilized €42 million ($48 million) and €74 million ($83 million) of this accounts receivable factoring facility as of March 31, 2016 and September 30, 2015, respectively.

United Kingdom Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its European subsidiaries through one of its United Kingdom subsidiaries. Under this arrangement, which expires in February 2018, the company can sell up to, at any point in time, €25 million ($28 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the condensed consolidated balance sheet. The company had utilized €6 million ($7 million) and €8 million ($8 million) of this accounts receivable factoring facility as of March 31, 2016 and September 30, 2015, respectively. The agreement is subject to standard terms and conditions for these types of arrangements, including a sole discretion clause whereby the bank retains the right to not purchase receivables, which has not been invoked since the inception of the program.

Italy Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its European subsidiaries through one of its Italian subsidiaries. Under this arrangement, which expires in June 2017, the company can sell up to, at any point in time, €30 million ($34 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the condensed consolidated balance sheet. The company had utilized €17 million ($19 million) and €22 million ($24 million) of this accounts receivable factoring facility as of March 31, 2016 and September 30, 2015, respectively. The agreement is subject to standard terms and conditions for these types of arrangements including a sole discretion clause whereby the bank retains the right to not purchase receivables, which has not been invoked since the inception of the program.

In addition to the above facilities, a number of the company's subsidiaries, primarily in Europe, factor eligible accounts receivable with financial institutions. Certain receivables are factored without recourse to the company and are excluded from accounts receivable in the condensed consolidated balance sheet. The amount of factored receivables excluded from accounts receivable under these arrangements was $14 million and $18 million at March 31, 2016 and September 30, 2015, respectively.

Total costs associated with all of the off-balance sheet arrangements described above were $2 million and $1 million in the three months ended March 31, 2016 and 2015, respectively, and $4 million and $3 million in the six months ended March 31, 2016 and 2015, respectively, and are included in selling, general and administrative expenses in the condensed consolidated statements of operations.

On-balance sheet arrangements

The company has a $100 million U.S. accounts receivables securitization facility. On December 4, 2015, the company entered into an amendment which extends the facility expiration date to December 4, 2018. The maximum permitted priority-debt-to-EBITDA ratio as of the last day of each fiscal quarter under the facility is 2.25 to 1.00. This program is provided by PNC Bank, National Association, as Administrator and Purchaser, and the other Purchasers and Purchaser Agents from time to time (participating lenders), which are party to the agreement. Under this program, the company has the ability to sell an undivided percentage ownership interest in substantially all of its trade receivables (excluding the receivables due from AB Volvo and subsidiaries eligible for sale under the U.S. accounts receivable factoring facility) of certain U.S. subsidiaries to ArvinMeritor Receivables Corporation ("ARC"), a wholly-owned, special purpose subsidiary. ARC funds these purchases with borrowings from participating lenders under a loan agreement. This program also includes a letter of credit facility pursuant to which ARC may request the issuance of letters of credit issued for the company’s U.S. subsidiaries (originators) or their designees, which when issued will constitute a utilization of the facility for the amount of letters of credit issued. Amounts outstanding under this agreement are collateralized by eligible receivables purchased by ARC and are reported as short-term debt in the condensed consolidated balance sheet. At March 31, 2016 and September 30, 2015, no amounts, including letters of credit, were outstanding under this program. This securitization program contains a cross default to the revolving credit facility. At certain times during any given month, the company may sell eligible accounts receivable under this program to fund intra-month working capital needs. In such months, the company would then typically utilize the cash received from customers throughout the month to repay the borrowings under the program. Accordingly, during any given month, the company may borrow under this program, amounts exceeding the amounts shown as outstanding at fiscal quarter ends.

9. Operating Cash Flow

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

	Six Months Ended March 31,	
	2016	2015
OPERATING ACTIVITIES		
Net income	$59	$73
Less: Income (loss) from discontinued operations, net of tax	(3)	1
Income from continuing operations	62	72
Adjustments to income from continuing operations to arrive at cash provided by operating activities:		
Depreciation and amortization	31	32
Restructuring costs	3	6
Loss on debt extinguishment	—	1
Gain on sale of property	(2)	—
Equity in earnings of affiliates	(17)	(18)
Pension and retiree medical expense	10	14
Other adjustments to income from continuing operations	4	5
Dividends received from equity method investments	19	10
Pension and retiree medical contributions	(22)	(24)
Restructuring payments	(4)	(3)
Changes in off-balance sheet accounts receivable factoring	(51)	40
	7	(99)

Changes in assets and liabilities, excluding effects of acquisitions, divestitures, foreign currency adjustments and discontinued operations		
Operating cash flows provided by continuing operations	40	36
Operating cash flows used for discontinued operations	(1)	(7)
CASH PROVIDED BY OPERATING ACTIVITIES	$39	$29

16

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

10. Inventories

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

	March 31, 2016	September 30, 2015
Finished goods	$ 146	$ 133
Work in process	31	28
Raw materials, parts and supplies	185	177
Total	$ 362	$ 338

11. Other Current Assets

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

	March 31, 2016	September 30, 2015
Current deferred income tax assets	$ 20	$ 20
Asbestos-related recoveries (see Note 20)	14	13
Prepaid and other	19	17
Other current assets	$ 53	$ 50

12. Net Property

Net property is summarized as follows (in millions):

	March 31, 2016	September 30, 2015
Property at cost:		
Land and land improvements	$ 31	$ 31
Buildings	221	214
Machinery and equipment	852	864
Company-owned tooling	116	116
Construction in progress	67	62
Total	1,287	1,287
Less: accumulated depreciation	(860)	(868)
Net property	$ 427	$ 419

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

13. Other Assets

Other assets are summarized as follows (in millions):

	March 31, 2016	September 30, 2015
Investments in non-consolidated joint ventures	$ 98	$ 96
Asbestos-related recoveries (see Note 20)	37	42
Unamortized revolver debt issuance costs	8	10
Capitalized software costs, net	27	28
Non-current deferred income tax assets, net	28	28
Assets for uncertain tax positions	3	3
Prepaid pension costs	114	110
Other	17	15
Other assets	$ 332	$ 332

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

The company holds a variable interest in a joint venture accounted for under the equity method of accounting. The joint venture manufactures components for commercial vehicle applications primarily on behalf of the company. The variable interest relates to a supply arrangement between the company and the joint venture whereby the company supplies certain components to the joint venture on a cost-plus basis. The company is not the primary beneficiary of the joint venture, as the joint venture partner has shared or absolute control over key manufacturing operations, labor relationships, financing activities and certain other functions of the joint venture. Therefore, the company does not consolidate the joint venture. At March 31, 2016 and September 30, 2015, the company's investment in the joint venture was $45 million and $42 million, respectively.

14. Unconsolidated Significant Subsidiary

Article 10 of Regulation S-X (Rule 10-01(b)(1)) requires separate interim period summarized income statement information for each 50-percent-or-less-owned subsidiary not consolidated that would have been a significant subsidiary for annual periods in accordance with Rule 3-09 of Regulation S-X. In accordance with this guidance, the company's non-consolidated joint venture Meritor WABCO Vehicle Control Systems' summarized income statement information is as follows (in millions):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
	(Unaudited)			
Sales	$83	$ 88	$168	$170
Gross margin	$21	$ 19	$43	$37
Income from continuing operations	$13	$ 13	$29	$24
Net income	$13	$ 13	$29	$24

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

15. Other Current Liabilities

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

	March 31, 2016	September 30, 2015
Compensation and benefits	$ 98	$ 122
Income taxes	13	9
Taxes other than income taxes	23	23
Accrued interest	14	14
Product warranties (see Note 16)	19	22
Environmental reserves (see Note 20)	8	9
Restructuring (see Note 6)	6	7
Asbestos-related liabilities (see Note 20)	17	17
Indemnity obligations (see Note 20)	2	2
Other	53	54
Other current liabilities	$ 253	$ 279

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

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

	Six Months Ended March 31,	
	2016	2015
Total product warranties – beginning of period	$48	$51
Accruals for product warranties	7	7
Payments	(9)	(9)
Change in estimates and other	1	—
Total product warranties – end of period	47	49
Less: Non-current product warranties	(28)	(26)
Product warranties – current	$19	$23

16. Other Liabilities

Other liabilities are summarized as follows (in millions):

	March 31, 2016	September 30, 2015
Asbestos-related liabilities (see Note 20)	$ 121	$ 109
Restructuring (see Note 6)	3	3
Non-current deferred income tax liabilities	99	99
Liabilities for uncertain tax positions	15	15
Product warranties (see Note 15)	28	26
Environmental (see Note 20)	8	8

Indemnity obligations (see Note 20)	12	13
Other	30	32
Other liabilities	$ 316	$ 305

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

17. Long-Term Debt

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

	March 31, 2016	September 30, 2015
4.625 percent convertible notes due 2026 [1]	$ —	$ 55
4.0 percent convertible notes due 2027[2][4]	142	142
7.875 percent convertible notes due 2026[2][5]	128	127
6.75 percent notes due 2021[3][6]	270	270
6.25 percent notes due 2024[3][7]	442	442
Capital lease obligation	17	17
Export financing arrangements and other	21	18
Unamortized discount on convertible notes	(17)	(20)
Subtotal	1,003	1,051
Less: current maturities	(25)	(15)
Long-term debt	$ 978	$ 1,036

[1] The 4.625 percent, convertible notes contained a put and call feature, which allowed for earlier redemption beginning in 2016. Substantially all of these notes were redeemed on March 1, 2016.
[2] The 4.0 percent and 7.875 percent convertible notes contain a put and call feature, which allows for earlier redemption beginning in 2019 and 2020, respectively.
[3] The 6.75 percent and 6.25 percent notes contain a call option, which allows for early redemption.
[4] The 4.0 percent convertible notes due 2027 are presented net of $1 million unamortized issuance costs as of March 31, 2016 and September 30, 2015.
[5] The 7.875 percent convertible notes due 2026 are presented net of $2 million and $3 million unamortized issuance costs as of March 31, 2016 and September 30, 2015, respectively, and $10 million original issuance discount as of March 31, 2016 and September 30, 2015.
[6] The 6.75 percent notes due 2021 are presented net of $5 million unamortized issuance costs as of March 31, 2016 and September 30, 2015.
[7] The 6.25 percent notes due 2024 are presented net of $8 million unamortized issuance costs as of March 31, 2016 and September 30, 2015.

Revolving Credit Facility

On May 22, 2015, the company entered into a second amendment of its senior secured revolving credit facility. Pursuant to the revolving credit agreement as amended, the company has a $499 million revolving credit facility, $40 million of which matures in April 2017 for banks not electing to extend their commitments under the revolving credit facility, and $459 million of which matures in February 2019. The availability under this facility is dependent upon various factors, including principally performance against certain financial covenants as highlighted below. Prior to May 22, 2015, $89 million of the $499 million revolving credit facility was scheduled to mature in April 2017 for banks not electing to extend their commitments under the revolving credit facility, and $410 million was scheduled to mature in February 2019.

The availability under the revolving credit facility is subject to certain financial covenants based on (i) the ratio of the company’s priority debt (consisting principally of amounts outstanding under the revolving credit facility, U.S. accounts receivable securitization and factoring programs, and third-party non-working capital foreign debt) to EBITDA and (ii) the amount of annual capital expenditures. The company is required to maintain a total priority-debt-to-EBITDA ratio, as defined in the agreement, of 2.25 to 1.00 or less as of the last day of each fiscal quarter throughout the term of the agreement.

The availability under the revolving credit facility is also subject to a collateral test, pursuant to which borrowings on the revolving credit facility cannot exceed 1.0x the collateral test value. The collateral test is performed on a quarterly basis. At March 31, 2016, the revolving credit facility was collateralized by approximately $647 million of the company's assets, primarily consisting of eligible domestic U.S. accounts receivable, inventory, plant, property and equipment, intellectual property and the company's investment in all or a portion of certain of its wholly-owned subsidiaries.

Borrowings under the revolving credit facility are subject to interest based on quoted LIBOR rates plus a margin and a commitment fee on undrawn amounts, both of which are based upon the company’s current corporate credit rating. At March 31, 2016, the margin over LIBOR rate was 325 basis points, and the commitment fee was 50 basis points. Overnight revolving credit loans are at the prime rate plus a margin of 225 basis points.

Certain of the company’s subsidiaries, as defined in the revolving credit agreement, irrevocably and unconditionally guarantee amounts outstanding under the revolving credit facility. Similar subsidiary guarantees are provided for the benefit of the holders of the publicly held notes outstanding under the company’s indentures (see Note 23).

No borrowings were outstanding under the revolving credit facility at March 31, 2016 and September 30, 2015. The amended and extended revolving credit facility includes $100 million of availability for the issuance of letters of credit. At March 31, 2016 and September 30, 2015, there were no letters of credit outstanding under the revolving credit facility.

Debt Securities

In December 2014, the company filed a shelf registration statement with the Securities and Exchange Commission, registering an unlimited amount of debt and/or equity securities that the company may offer in one or more offerings on terms to be determined at the time of sale. The December 2014 shelf registration statement superseded and replaced the shelf registration statement filed in February 2012, as amended.

Repurchase of Debt Securities

In February 2015, the company repurchased $15 million principal amount of the company's 4.0 percent convertible notes due 2027. The notes were repurchased at a premium equal to approximately 6 percent of their principal amount. The repurchase of $15 million principal amount of the company's 4.0 percent convertible notes was accounted for as an extinguishment of debt, and accordingly the company recognized an insignificant net loss on debt extinguishment, the majority of which is premium. The net loss on debt extinguishment is included in the consolidated statement of operations in interest expense, net. The repurchase was made under the company's equity and equity-linked repurchase authorizations (see Note 21).

On March 1, 2016, substantially all of the $55 million of principal amount 4.625 percent convertible notes were repurchased at 100 percent of the face value of the notes. The repurchase was made under the company's equity and equity linked repurchase authorizations (see Note 21). The amount remaining available for repurchases under these authorizations was $39 million at March 31, 2016.

Capital Leases

On March 20, 2012, the company entered into an arrangement to finance equipment acquisitions for various U.S. locations. Under this arrangement, the company can request financing from GE Capital Commercial, Inc. (GE Capital) for progress payments for equipment under construction, not to exceed $10 million at any time. The financing rate is equal to the 30-day LIBOR plus 475 basis points per annum. Under this arrangement, the company can also enter into lease arrangements with GE Capital for completed equipment. The lease term is 60 months and the lease interest rate is equal to the 5-year Swap Rate published by the Federal Reserve Board plus 564 basis points. The company had $8 million and $10 million outstanding under this capital lease arrangement as of March 31, 2016 and September 30, 2015, respectively. In addition, the company had another $9 million and $7 million outstanding through other capital lease arrangements at March 31, 2016 and September 30, 2015, respectively.

Letter of Credit Facilities

On February 21, 2014, the company entered into an arrangement to amend and restate the letter of credit facility with Citicorp USA, Inc., as administrative agent and issuing bank, and the other lenders party thereto. Under the terms of

this amended credit agreement, the company has the right to obtain the issuance, renewal, extension and increase of letters of credit up to an aggregate availability of $30 million through December 19, 2015. From December 20, 2015 through March 19, 2019, the aggregate availability is $25 million. This facility contains covenants and events of default generally similar to those existing in the company's public debt indentures. There were $22 million and $24 million of letters of credit outstanding under this facility at March 31, 2016 and September 30, 2015, respectively. The company had another $6 million of letters of credit outstanding through other letter of credit facilities at March 31, 2016 and September 30, 2015.

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

Export Financing Arrangements

The company entered into a number of export financing arrangements through its Brazilian subsidiary during fiscal year 2014. The export financing arrangements are issued under an incentive program of the Brazilian government to fund working capital for Brazilian companies in exportation programs. The arrangements bear interest at 5.5 percent and have maturity dates in 2016 and 2017. There was $19 million and $18 million outstanding under these arrangements at March 31, 2016 and September 30, 2015, respectively.

Other

One of the company's consolidated joint ventures in China participates in a bills of exchange program to settle its obligations with its trade suppliers. These programs are common in China and generally require the participation of local banks. Under these programs, the company's joint venture issues notes payable through the participating banks to its trade suppliers. If the issued notes payable remain unpaid on their respective due dates, this could constitute an event of default under the company’s revolving credit facility if the defaulted amount exceeds $35 million per bank. As of March 31, 2016 and September 30, 2015, the company had $8 million and $13 million, respectively, outstanding under this program at more than one bank.

18. Financial Instruments

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

	March 31, 2016		September 30, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$ 94	$ 94	$ 193	$ 193
Short-term debt	25	24	15	15
Long-term debt	978	958	1,036	1,123
Foreign exchange forward contracts (asset)	—	—	1	1
Foreign exchange forward contracts (liability)	2	2	3	3
Short-term foreign currency option contracts (asset)	—	—	1	1
Long-term foreign currency option contracts (asset)	—	—	1	1

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

	March 31, 2016			September 30, 2015		
	Gross Amounts Recognized	Gross Amounts Offset	Net Amounts Reported	Gross Amounts Recognized	Gross Amounts Offset	Net Amounts Reported
Derivative Asset						
Foreign exchange forward contract	—	—	—	1	—	1
Derivative Liabilities						
Foreign exchange forward contract	2	—	2	3	—	3

Fair Value

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

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

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

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

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

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

Fair value of financial instruments by the valuation hierarchy at March 31, 2016 is as follows (in millions):

	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 94	$ —	$ —