

ARVINMERITOR INC  
Form 10-Q  
February 09, 2007  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended December 31, 2006

Commission File No. 1-15983

## **ARVINMERITOR, INC.**

(Exact name of registrant as specified in its charter)

**Indiana**  
(State or other jurisdiction of incorporation or organization)

**38-3354643**  
(I.R.S. Employer Identification No.)

**2135 West Maple Road, Troy, Michigan**  
(Address of principal executive offices)

**48084-7186**  
(Zip Code)

**(248) 435-1000**

(Registrant's telephone number, including area code)

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

Yes            No



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**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****ARVINMERITOR, INC.****CONSOLIDATED STATEMENT OF INCOME**

(in millions, except per share amounts)

|   | <b>Three Months Ended December 31,</b> |              |
|---|--|--------------|
|   | <b>2006</b>                            | <b>2005</b>  |
|   | <b>(Unaudited)</b>                     |              |
| Sales   | \$ 2,340                               | \$ 2,098     |
| Cost of sales                                     | (2,222)                                | (1,966)      |
| <b>GROSS MARGIN</b>                               | <b>118</b>                             | <b>132</b>   |
| Selling, general and administrative               | (86)                                   | (88)         |
| Restructuring costs                               | (1)                                    | (1)          |
| Gain on divestitures                              | 2                                      | 23           |
| <b>OPERATING INCOME</b>                           | <b>33</b>                              | <b>66</b>    |
| Equity in earnings of affiliates                  | 9                                      | 7            |
| Interest expense, net and other                   | (27)                                   | (32)         |
| <b>INCOME BEFORE INCOME TAXES</b>                 | <b>15</b>                              | <b>41</b>    |
| Provision for income taxes                        | (2)                                    | (10)         |
| Minority interests                                | (2)                                    | (3)          |
| <b>INCOME FROM CONTINUING OPERATIONS</b>          | <b>11</b>                              | <b>28</b>    |
| <b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS</b> | <b>(4)</b>                             | <b>6</b>     |
| <b>NET INCOME</b>                                 | <b>\$ 7</b>                            | <b>\$ 34</b> |
| <br><b>BASIC EARNINGS (LOSS) PER SHARE</b>        |  |              |
| Continuing operations                             | \$ 0.16                                | \$ 0.40      |
| Discontinued operations                           | (0.06)                                 | 0.09         |
| Basic earnings per share                          | \$ 0.10                                | \$ 0.49      |
| <br><b>DILUTED EARNINGS (LOSS) PER SHARE</b>      |  |              |
| Continuing operations                             | \$ 0.16                                | \$ 0.40      |
| Discontinued operations                           | (0.06)                                 | 0.09         |
| Diluted earnings per share                        | \$ 0.10                                | \$ 0.49      |
| <br>Basic average common shares outstanding       |  |              |
|   | 69.4                                   | 69.0         |
| <br>Diluted average common shares outstanding     |  |              |
|   | 70.5                                   | 69.8         |
| <br>Cash dividends per common share               |  |              |
|   | \$ 0.10                                | \$ 0.10      |

See notes to consolidated financial statements. Amounts for the three months ended December 31, 2005 have been restated for discontinued operations.

## ARVINMERITOR, INC.

## CONSOLIDATED BALANCE SHEET

(in millions)

|   | December<br>31,<br>2006<br>(Unaudited) | September<br>30,<br>2006<br>(Unaudited) |
|---|--|---|
| <b>ASSETS</b>   |  |   |
| CURRENT ASSETS:   |  |   |
| Cash and cash equivalents   | \$ 369                                 | \$ 331                                  |
| Receivables, net  | 1,564                                  | 1,600                                   |
| Inventories   | 628                                    | 590                                     |
| Other current assets  | 292                                    | 290                                     |
| Assets of discontinued operations   | 204                                    | 200                                     |
| <b>TOTAL CURRENT ASSETS</b>   | <b>3,057</b>                           | <b>3,011</b>                            |
| NET PROPERTY  | 984                                    | 980                                     |
| GOODWILL  | 510                                    | 500                                     |
| OTHER ASSETS  | 945                                    | 940                                     |
| <b>TOTAL ASSETS</b>   | <b>\$5,496</b>                         | <b>\$5,431</b>                          |
| <b>LIABILITIES AND SHAREOWNERS EQUITY</b>   |  |   |
| CURRENT LIABILITIES:  |  |   |
| Short-term debt   | \$ 137                                 | \$ 130                                  |
| Accounts payable  | 1,551                                  | 1,600                                   |
| Other current liabilities   | 698                                    | 740                                     |
| Liabilities of discontinued operations  | 99                                     | 100                                     |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>2,485</b>                           | <b>2,570</b>                            |
| LONG-TERM DEBT  | 1,185                                  | 1,180                                   |
| RETIREMENT BENEFITS   | 526                                    | 500                                     |
| OTHER LIABILITIES   | 234                                    | 200                                     |
| MINORITY INTERESTS  | 67                                     | 60                                      |
| SHAREOWNERS EQUITY:   |  |   |
| Common stock (December 31, 2006, 71.1 shares issued and outstanding; September 30, 2006, 71.0 shares issued and 70.6 outstanding) | 71                                     | 70                                      |
| Additional paid-in capital  | 591                                    | 590                                     |
| Retained earnings   | 376                                    | 370                                     |
| Treasury stock (December 31, 2006, none and September 30, 2006, 0.4 shares)   | (11)                                   | (10)                                    |
| Accumulated other comprehensive loss  | (28)                                   | (20)                                    |
| <b>TOTAL SHAREOWNERS EQUITY</b>   | <b>999</b>                             | <b>990</b>                              |
| <b>TOTAL LIABILITIES AND SHAREOWNERS EQUITY</b>   | <b>\$5,496</b>                         | <b>\$5,431</b>                          |

*See notes to consolidated financial statements*

## ARVINMERITOR, INC.

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(in millions)

|   | Three Months Ended December 31, |             |
|---|---------------------------------|-------------|
|   | 2006                            | 2005        |
|   | (Unaudited)                     |             |
| OPERATING ACTIVITIES  |                                 |             |
| Income from continuing operations   | \$ 11                           | \$ 28       |
| Adjustments to income from continuing operations to arrive at cash provided by (used for) operating activities:     |                                 |             |
| Depreciation and amortization   | 43                              | 40          |
| Gain on divestitures  | (2)                             | (23)        |
| Restructuring costs, net of payments  | (7)                             | (7)         |
| Pension and retiree medical expense   | 33                              | 33          |
| Other adjustments to income   | (1)                             | 1           |
| Pension and retiree medical contributions   | (39)                            | (28)        |
| Changes in receivable securitization and factoring  | 15                              | 37          |
| Changes in assets and liabilities, excluding effects of acquisitions, divestitures and foreign currency adjustments | (85)                            | 81          |
| Cash flows provided by (used for) continuing operations   | (32)                            | 162         |
| Cash flows used for discontinued operations   | (1)                             | (11)        |
| <b>CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES</b>   | <b>(33)</b>                     | <b>151</b>  |
| INVESTING ACTIVITIES  |                                 |             |
| Capital expenditures  | (30)                            | (38)        |
| Acquisitions of businesses and investments, net of cash acquired  | (5)                             | (1)         |
| Proceeds from disposition of property and businesses  | 5                               | 39          |
| Proceeds from marketable securities   | 5                               |             |
| Net investing cash flows provided by (used for) discontinued operations   | (1)                             | 8           |
| <b>CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES</b>   | <b>(26)</b>                     | <b>8</b>    |
| FINANCING ACTIVITIES  |                                 |             |
| Borrowings (payments) on accounts receivable securitization program   | 80                              | (24)        |
| Repayment of notes  |                                 | (3)         |
| Borrowings (payments) on lines of credit and other, net   | 1                               | (12)        |
| Net change in debt  | 81                              | (39)        |
| Cash dividends  | (7)                             | (7)         |
| <b>CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES</b>   | <b>74</b>                       | <b>(46)</b> |
| EFFECT OF CHANGES IN FOREIGN CURRENCY EXCHANGE RATES ON CASH AND CASH EQUIVALENTS                                   | 4                               | 2           |
| CHANGE IN CASH AND CASH EQUIVALENTS   | 19                              | 115         |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD  | 350                             | 187         |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD  | \$ 369                          | \$ 302      |

See notes to consolidated financial statements. Amounts for the three months ended December 31, 2005 have been restated for discontinued operations.

ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS

(Unaudited)

**1. Basis of Presentation**

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

The company's Light Vehicle Aftermarket (LVA) businesses and Light Vehicle Systems (LVS) ride control business are presented as discontinued operations in the consolidated statement of income and related notes. The company sold its LVA North American filters, exhaust and motion control businesses, its Gabriel South Africa LVA ride control business and its 39 percent interest in its Purolator India joint venture during fiscal year 2006. Results of operations related to these businesses are presented as discontinued operations in the consolidated statement of income through the date of sale. The assets and liabilities of LVA are classified as held for sale and included in assets and liabilities of discontinued operations in the consolidated balance sheet. In the fourth quarter of fiscal year 2006, the company decided to retain its 51 percent interest in its Gabriel de Venezuela light vehicle aftermarket joint venture. As a result, the results of operations, assets and liabilities and cash flows of this business are presented in continuing operations in the consolidated financial statements and prior periods have been restated to reflect this presentation (see Note 4).

In the opinion of the company, the unaudited financial statements contain all adjustments, consisting solely of adjustments of a normal, recurring nature, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. These statements should be read in conjunction with the company's audited consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the fiscal year ended September 30, 2006. The results of operations for the three months ended December 31, 2006, are not necessarily indicative of the results for the full year.

The company's fiscal year ends on the Sunday nearest September 30. The company's fiscal quarters end on the Sundays nearest December 31, March 31 and June 30. The first quarter of fiscal years 2007 and 2006 ended on December 31, 2006, and January 1, 2006, respectively. All year and quarter references relate to the company's fiscal year and fiscal quarters, unless otherwise stated. For ease of presentation, September 30 and December 31 are used consistently throughout this report to represent the fiscal year end and first quarter end, respectively.

For each interim reporting period, the company makes an estimate of the effective tax rate expected to be applicable for the full fiscal year. The rate so determined is used in providing for income taxes on a year-to-date basis.

**2. Earnings per Share**

Basic earnings per share is calculated using the weighted average number of shares outstanding during each period. The diluted earnings per share calculation includes the impact of dilutive common stock options, restricted stock, performance share awards and convertible securities, if applicable.

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

|   | Three Months Ended<br>December 31, |      |
|---|------------------------------------|------|
|   | 2006                               | 2005 |
| Basic average common shares outstanding   | 69.4                               | 69.0 |
| Impact of restricted stock                | 0.9                                | 0.8  |
| Impact of stock options                   | 0.2                                |      |
| Diluted average common shares outstanding | 70.5                               | 69.8 |



**ARVINMERITOR, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

**(Unaudited)**

At December 31 2006 and 2005, options to purchase 3.2 million and 4.9 million shares of common stock, respectively, were not included in the computation of diluted earnings per share because their inclusion would be anti-dilutive.

The company issued \$300 million of convertible senior unsecured notes in the second quarter of fiscal year 2006 (see Note 14). Since the company's stock price during the quarter is less than the conversion price, these convertible notes are not included in the computation of diluted earnings per share because their inclusion would be anti-dilutive.

**3. New Accounting Standards**

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes* which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides criteria for subsequently recognizing, derecognizing and measuring changes in uncertain tax positions and requires expanded disclosures with respect to the uncertainty of income taxes. The accounting provisions of FIN 48 will be effective for the company beginning October 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The company is in the process of determining the effect the adoption of FIN 48 will have on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* which provides a definition of fair value, establishes a framework for measuring fair value and requires expanded disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The provisions of SFAS 157 will be applied prospectively.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106, and 132(R). This statement requires an entity to recognize the funded status of its defined benefit pension plans and other postretirement benefit plans, such as a retiree health care plan, on the balance sheet and to recognize changes in the funded status that arise during the period but are not recognized as components of net periodic benefit cost, within other comprehensive income, net of income taxes. SFAS 158 also requires measurement of the funded status of the plans as of the balance sheet date. SFAS 158 is effective for recognition of the funded status of the plans for fiscal years ending after December 15, 2006 and is effective for the measurement date provisions for fiscal years ending after December 15, 2008. The impact of this statement will be dependent upon the company's June 30, 2007 actuarial valuation of these liabilities and related changes in assumptions compared to the current year's valuation. However, if this standard had been effective for the year ended September 30, 2006, the impact would have been a reduction to shareowners' equity, net of tax, of approximately \$300 million.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, *Quantifying Financial Misstatements*, which expresses the Staff's views regarding the process of quantifying financial statement misstatements. Registrants are required to quantify the impact of correcting all misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. The financial statements would require adjustment when either approach results in quantifying a misstatement that is material, after considering all relevant quantitative and qualitative factors. SAB 108 is effective for financial statements covering the first fiscal year ending after November 15, 2006. The company will adopt SAB 108 in the fourth quarter of fiscal year 2007 and is in the process of determining the effect, if any, it will have on its consolidated financial statements.

**4. Discontinued Operations**

*Light Vehicle Aftermarket*

In October 2004, the company announced plans to divest its LVA business. This plan is part of the company's long-term strategy to focus on core competencies and support its global light vehicle systems original equipment manufacturing (OEM) customers and its commercial vehicle systems OEM and aftermarket customers. LVA supplied exhaust, ride control, motion control and filter products, as well as other automotive parts to the passenger car, light truck and sport utility vehicle aftermarket. LVA is reported as discontinued operations in the consolidated statement of income. The assets and liabilities of LVA are held for sale and included in assets and liabilities of discontinued operations in the consolidated balance sheet. Accordingly, net property and amortizable intangible assets are no longer being depreciated or amortized. In the fourth quarter of fiscal year 2006, the company decided to retain its 51 percent interest in its Gabriel de Venezuela light vehicle aftermarket joint venture. As a result, the results of operations, assets and liabilities and cash flows of this business are presented in continuing operations in the consolidated financial statements and prior periods have been restated to reflect this presentation.



## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

## (Unaudited)

In November 2005, the company sold its 39-percent equity ownership interest in its light vehicle aftermarket joint venture, Purolator India. Cash proceeds from the sale were \$9 million, resulting in a \$2 million after-tax gain, which is recorded in income from discontinued operations.

In order to reduce costs and improve profitability, LVA recorded restructuring costs of \$2 million in the first quarter of fiscal year 2006. At December 31 and September 30, 2006, \$3 million and \$4 million of restructuring reserves primarily related to unpaid employee termination benefits are included in liabilities of discontinued operations.

*Light Vehicle Ride Control*

In December 2005, the company sold its light vehicle ride control business located in Asti, Italy and recorded an after-tax loss on the sale of \$2 million. This sale, along with the previous divestiture of the company's 75-percent shareholdings in AP Amortiguadores, S.A. (APA) in the second quarter of fiscal year 2004, substantially completed the company's plan to exit its LVS ride control business (ride control). Therefore, ride control is presented as discontinued operations in the consolidated statement of income and consolidated statement of cash flows for all periods presented. Ride control provides shock absorbers, struts, ministruts, and corner modules to the light vehicle industry. The company previously expected to close the ride control business in Asti, Italy during fiscal year 2006 and recorded approximately \$31 million of restructuring costs in fiscal year 2005 related to the expected closure. These costs included \$16 million of employee termination benefits and \$15 million of asset impairment charges. As a result of the sale of the ride control operations located in Asti, Italy in the first quarter of fiscal year 2006, the company reversed \$12 million of restructuring costs related to employee termination benefits that will no longer be paid by the company. These restructuring costs, including the subsequent reversals, are recorded in discontinued operations in the consolidated statement of income.

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

|  | <b>Three Months Ended<br/>December 31,</b> |             |
|--|--|-------------|
|  | <b>2006</b>                                | <b>2005</b> |
| Sales:                                     |  |             |
| Light Vehicle Aftermarket                  | \$ 78                                      | \$ 182      |
| Ride Control                               | 6  | 15          |
| Total sales                                | \$ 84                                      | \$ 197      |
| Income (loss) before income taxes          | \$ (4)                                     | \$ 9        |
| Provision for income taxes                 |  | (3)         |
| Income (loss) from discontinued operations | \$ (4)                                     | \$ 6        |

Assets and liabilities of the discontinued operations are summarized as follows (in millions):

|                                   | <b>December 31,</b> |     | <b>September 30,</b> |     |
|-----------------------------------|---------------------|-----|----------------------|-----|
|                                   | <b>2006</b>         |     | <b>2006</b>          |     |
| Current assets                    | \$                  | 132 | \$                   | 137 |
| Net property                      |                     | 46  |                      | 44  |
| Other assets                      |                     | 26  |                      | 26  |
| Assets of discontinued operations | \$                  | 204 | \$                   | 207 |
| Current liabilities               | \$                  | 93  | \$                   | 96  |
| Other liabilities                 |                     | 6   |                      | 7   |

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|  |    |    |    |     |
|--|----|----|----|-----|
| Liabilities of discontinued operations | \$ | 99 | \$ | 103 |
|--|----|----|----|-----|

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## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**5. Goodwill**

Goodwill is reviewed for impairment annually or more frequently if certain indicators arise. If business conditions or other factors cause the profitability and cash flows of the reporting unit to decline, the company may be required to record impairment charges for goodwill at that time. The goodwill impairment review is a two-step process. Step one consists of a comparison of the fair value of a reporting unit with its carrying amount. An impairment loss may be recognized if the review indicates that the carrying value of a reporting unit exceeds its fair value. Estimates of fair value are primarily determined by using discounted cash flows and market multiples on earnings. If the carrying amount of a reporting unit exceeds its fair value, step two requires the fair value of the reporting unit to be allocated to the underlying assets and liabilities of that reporting unit, resulting in an implied fair value of goodwill. If the carrying amount of the goodwill of the reporting unit exceeds the implied fair value, an impairment charge is recorded equal to the excess.

The impairment review is highly judgmental and involves the use of significant estimates and assumptions. These estimates and assumptions have a significant impact on the amount of any impairment charge recorded. Discounted cash flow methods are dependent upon assumption of future sales trends, market conditions and cash flows of each reporting unit over several years. Actual cash flows in the future may differ significantly from those previously forecasted. Other significant assumptions include growth rates and the discount rate applicable to future cash flows.

In fiscal year 2006, our light vehicle emissions technologies reporting unit continued to face significant challenges, including higher raw material costs, intense pricing pressures and increased competition. These factors were greater than previously anticipated and partially offset the expected benefits from the company's fiscal year 2005 restructuring actions. In addition, higher stainless steel prices and recent downturns in production at certain North American manufacturers are expected to further negatively impact the financial performance of this reporting unit in fiscal year 2007. These combined factors resulted in a decline in the fair value of the light vehicle emissions technologies reporting unit in fiscal year 2006.

Step one of the company's fiscal 2006 annual goodwill impairment review indicated the carrying value of its LVS emissions technology reporting unit exceeded its fair value. The fair value of this reporting unit was estimated using a probability weighted average cash flow analysis. This analysis considered multiple cash flow scenarios, including earnings multiples and the expected present value of future cash flows. Based on the step one analysis, the company recorded a \$310 million non-cash goodwill impairment charge in the fourth quarter of fiscal year 2006 as its best estimate of the impairment loss. The company completed the step two analysis in the first quarter of fiscal year 2007, which supported the original goodwill impairment charge recorded in the prior year.

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

|                               | LVS |    | CVS |     | Total  |
|-------------------------------|-----|----|-----|-----|--------|
| Balance at September 30, 2006 | \$  | 70 | \$  | 433 | \$ 503 |
| Foreign currency translation  |     |    |     | 7   | 7      |
| Balance at December 31, 2006  | \$  | 70 | \$  | 440 | \$ 510 |

**6. Restructuring Costs**

The company recorded restructuring charges of \$1 million during the first three months of each of fiscal years 2007 and 2006. At December 31 and September 30, 2006, \$32 million and \$40 million, respectively, of restructuring reserves primarily related to unpaid employee termination benefits remained in the consolidated balance sheet.

*Fiscal year 2005 program:* In the second quarter of fiscal year 2005, the company announced the elimination of approximately 400 to 500 salaried positions and approved plans to consolidate, downsize, close or sell certain underperforming businesses or facilities. During fiscal year 2006, the company identified approximately 550 additional salaried and hourly headcount reductions in its LVS and ET business segments. Including these additional headcount reductions, the fiscal year 2005 actions resulted in the reduction of approximately 900 salaried and 1,900

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hourly employees and the sale, closure or consolidation of 11 global facilities, primarily in the LVS and ET business segments. These actions were intended to align capacity with industry conditions, utilize assets more efficiently, and improve operations. The total estimated cost of these actions is approximately \$132 million over the life of the program, of which approximately \$105 million is estimated to be cash costs. Estimated costs included employee severance and other exit costs, as well as asset impairments. Asset impairment charges related to manufacturing facilities that were closed or sold and machinery and equipment that have become idle and obsolete as a result of the facility closures.

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

## (Unaudited)

Cumulative restructuring costs recorded for the fiscal year 2005 program, including amounts recorded in discontinued operations, are \$127 million as of December 31, 2006. These costs include \$92 million of employee termination benefits, \$29 million of asset impairment charges and \$6 million of other closure costs.

The changes in the restructuring reserves for the three months ended December 31, 2006 are as follows (in millions):

|                               |    | <b>Employee<br/>Termination<br/>Benefits</b> |
|-------------------------------|----|--|
| Balance at September 30, 2006 | \$ | 40   |
| Activity during the period:   |    |  |
| Charges to expense            |    | 1  |
| Ride control reversal (1)     |    | (1)  |
| Cash payments                 |    | (8)  |
| Balance at December 31, 2006  | \$ | 32   |

(1) Restructuring charges related to ride control are included in discontinued operations in the consolidated statement of income.

**7. Acquisitions and Divestitures**

In October 2005, the company completed the sale of certain assets of its commercial vehicle off-highway brake business for cash proceeds of approximately \$39 million and recognized a pre-tax gain on the sale of \$23 million. The sale includes equipment and certain assets from manufacturing facilities in York, South Carolina and Cwmbran, U.K. The divestiture of the off-highway brakes operation is aligned with the company's strategy to focus on its core products.

**8. Accounts Receivable Securitization and Factoring**

In March 2006, the company entered into a European arrangement to sell trade receivables through one of its European subsidiaries. Under this arrangement, the company can sell up to, at any point in time, 100 million of eligible trade receivables. The receivables under this program are sold at face value and excluded from the company's consolidated balance sheet. The company continues to perform collection and administrative functions related to these receivables. Costs associated with this securitization arrangement were \$1 million in the three months ended December 31, 2006 and are included in operating income in the consolidated statement of income. The gross amount of proceeds received from the sale of receivables under this arrangement was \$116 million for the three months ended December 31, 2006. The company's retained interest in receivables sold is \$14 million and \$6 million at December 31 and September 30, 2006, respectively. The company had utilized 48 million (\$63 million) and 48 million (\$61 million) of this accounts receivable securitization facility as of December 31 and September 30, 2006, respectively.

The company also participates in a U.S. accounts receivable securitization program to enhance financial flexibility and lower interest costs. Under this \$250 million program, which was established in September 2005, and amended in fiscal year 2006, the company sells substantially all of the trade receivables of certain U.S. subsidiaries to ArvinMeritor Receivables Corporation (ARC), a wholly-owned, special purpose subsidiary. ARC funds these purchases with borrowings under a loan agreement with a bank. Amounts outstanding under this agreement are collateralized by eligible receivables purchased by ARC and are reported as short-term debt in the consolidated balance sheet (see Note 14). As of December 31, 2006 and September 30, 2006 the company had utilized \$120 million and \$40 million, respectively, of this accounts receivable securitization facility. Borrowings under this arrangement are collateralized by approximately \$311 million of receivables held at ARC at December 31, 2006. If certain receivables performance-based covenants are not met, it would constitute a termination event, which, at the option of the banks, could result in termination of the accounts receivable securitization arrangement. At December 31, 2006, the company was in compliance with all covenants.

In addition, several of the company's European subsidiaries factor eligible accounts receivable with financial institutions. Certain receivables are factored without recourse to the company and are excluded from accounts receivable. The amount of factored receivables excluded from accounts receivable was \$105 million and \$84 million at December 31, 2006 and September 30, 2006, respectively.

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**9. Inventories**

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

|                                   | December 31,<br>2006 |     | September 30,<br>2006 |     |
|-----------------------------------|----------------------|-----|-----------------------|-----|
| Finished goods                    | \$                   | 209 | \$                    | 198 |
| Work in process                   |                      | 150 |                       | 147 |
| Raw materials, parts and supplies |                      | 269 |                       | 251 |
| Total                             | \$                   | 628 | \$                    | 596 |

**10. Other Current Assets**

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

|   | December 31,<br>2006 |     | September 30,<br>2006 |     |
|---|----------------------|-----|-----------------------|-----|
| Current deferred income tax assets            | \$                   | 147 | \$                    | 134 |
| Customer reimbursable tooling and engineering |                      | 61  |                       | 63  |
| Asbestos-related recoveries (see Note 17)     |                      | 8   |                       | 8   |
| Assets held for sale                          |                      | 6   |                       | 7   |
| Prepaid and other                             |                      | 70  |                       | 83  |
| Other current assets                          | \$                   | 292 | \$                    | 295 |

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

The company records certain assets as held for sale. These assets primarily relate to land and buildings that have been previously closed through restructuring and other rationalization actions.



## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**11. Other Assets**

Other assets are summarized as follows (in millions):

|  | December 31,<br>2006 |    | September 30,<br>2006 |        |
|--|----------------------|----|-----------------------|--------|
| Non-current deferred income tax assets   | \$ 555               | \$ | 560                   |        |
| Investments in non-consolidated joint ventures   | 143                  |    | 133                   |        |
| Long-term receivables  | 41                   |    | 41                    |        |
| Prepaid pension costs  |                      |    | 46                    | 35     |
| Unamortized debt issuance costs  |                      |    | 30                    | 31     |
| Capitalized software costs, net  |                      |    | 26                    | 27     |
| Asbestos-related recoveries (see Note 17)  |                      |    | 30                    | 30     |
| Patents, licenses and other intangible assets (less accumulated amortization: \$7 at December 31 and September 30, 2006) |                      |    | 17                    | 20     |
| Investment in debt defeasance trust (see Note 14)  |                      |    | 11                    | 11     |
| Other  |                      |    | 46                    | 41     |
| Other assets   |                      | \$ | 945                   | \$ 929 |

In accordance with Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, costs relating to internally developed or purchased software in the preliminary project stage and the post-implementation stage are expensed as incurred. Costs in the application development stage that meet the criteria for capitalization are capitalized and amortized using the straight-line basis over the estimated economic useful life of the software.

Patents, licenses and other intangible assets include trademarks and other indefinite lived intangibles of \$5 million, an intangible asset associated with the retirement pension plans of \$9 million and other amortizable intangible assets of \$3 million. The company's trademarks, which were determined to have an indefinite life, and pension intangible asset are not amortized. Patents, licenses and other intangible assets are amortized over their contractual or estimated useful lives, as appropriate. The company anticipates amortization expense for patents, licenses and other intangible assets of approximately \$1 million for fiscal year 2007 and \$2 million total thereafter.

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**12. Other Current Liabilities**

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

|  | December 31,<br>2006 | September 30,<br>2006 |
|--|----------------------|-----------------------|
| Compensation and benefits                  | \$ 191               | \$ 251                |
| Income taxes                               | 150                  | 163                   |
| Taxes other than income taxes              | 55                   | 53                    |
| Product warranties                         | 66                   | 51                    |
| Restructuring (see Note 6)                 | 32                   | 40                    |
| Reserve for labor disruption (see Note 17) | 17                   | 29                    |
| Current deferred income tax liabilities    | 8                    | 7                     |
| Asbestos-related liabilities (see Note 17) | 11                   | 11                    |
| Interest                                   | 26                   | 8                     |
| AB Volvo joint venture payable             | 23                   |                       |
| Environmental (see Note 17)                | 14                   | 14                    |
| Other                                      | 105                  | 114                   |
| Other current liabilities                  | \$ 698               | \$ 741                |

On October 4, 2004, the company formed two joint ventures in France with AB Volvo to manufacture and distribute axles. The company acquired its 51-percent interest for a purchase price of 19 million (\$25 million). The company has an option to purchase and AB Volvo has an option to require the company to purchase the remaining 49-percent interest in one of the joint ventures beginning in the first quarter of fiscal year 2008 for 16 million (\$21 million) plus interest at EURIBOR rates, plus a margin. This option to purchase the minority interest is essentially a financing arrangement as the minority shareholder does not participate in any profits or losses of the joint venture. Therefore, this option, including accreted interest to date, is recorded as a current obligation of the company and included in Other Current Liabilities and no minority interest is recognized for the 49-percent interest in this joint venture. At September 30, 2006, this obligation is recorded in Other Long-term Liabilities.

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

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

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

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

|  | Three Months Ended |       |
|--|--------------------|-------|
|  | December 31,       |       |
|  | 2006               | 2005  |
| Total product warranties -- beginning of period    | \$ 121             | \$ 93 |
| Accruals for product warranties                    | 15                 | 11    |
| Payments   | (11)               | (12)  |
| Change in estimates and other                      |                    | (3)   |
| Total product warranties -- end of period          | 125                | 89    |
| Less: Non-current product warranties (see Note 13) | (59)               | (39)  |
| Product warranties -- current portion              | \$ 66              | \$ 50 |

In fiscal year 2004, the company, as a result of receiving the wrong grade of steel from one of its steel suppliers, manufactured and shipped certain products that were out of specification with various customers' orders. The company was notified by a customer in fiscal year 2005 that it was initiating a field service campaign covering approximately 35,000 vehicles that were manufactured by the customer during the relevant time frame, prior to the aforementioned steel issue being identified, and would expect the company to reimburse it for the cost of the campaign. Associated with this matter, in fiscal year 2005, the company recorded a warranty charge of \$4 million, net of probable recoveries from the supplier, which are recorded in receivables. In the first quarter of fiscal year 2006, the company reached a settlement with the supplier regarding the field service campaign. This settlement resulted in a \$1 million reduction in the company's recorded liability, net of recoveries, related to this matter. Additionally, in fiscal year 2005 another customer notified the company that it has initiated a field service campaign to replace an affected part in approximately 8,300 vehicles. Although this field service campaign is associated with the same steel issue and the same supplier, it relates to a different part on the vehicle. Based on the currently available facts and circumstances, the company does not believe it has a probable liability, net of recoveries, related to this matter.

**13. Other Liabilities**

Other Liabilities are summarized as follows (in millions):

|   | December 31,<br>2006 | September 30,<br>2006 |
|---|----------------------|-----------------------|
| Asbestos-related liabilities (see Note 17)  | \$ 46                | \$ 46                 |
| Non-current deferred income tax liabilities | 30                   | 30                    |
| Product warranties (see Note 12)            | 59                   | 70                    |
| Environmental (see Note 17)                 | 11                   | 13                    |
| Long-term payable                           | 41                   | 64                    |
| Fair value of interest rate swaps           | 6                    |                       |
| Other                                       | 41                   | 41                    |
| Other liabilities                           | \$ 234               | \$ 264                |

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**14. Long-Term Debt**

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

|   | December 31,<br>2006 |       | September 30,<br>2006 |
|---|----------------------|-------|-----------------------|
| 6-5/8 percent notes due 2007                            | \$                   | 5     | \$ 5                  |
| 6-3/4 percent notes due 2008                            |                      | 5     | 5                     |
| 7-1/8 percent notes due 2009                            |                      | 6     | 6                     |
| 6.8 percent notes due 2009                              |                      | 77    | 77                    |
| 8-3/4 percent notes due 2012                            |                      | 311   | 311                   |
| Term Loan B due 2012                                    |                      | 170   | 170                   |
| 8-1/8 percent notes due 2015                            |                      | 251   | 251                   |
| 4.625 percent convertible notes due 2026 <sup>(1)</sup> |                      | 300   | 300                   |
| 9.5 percent subordinated debentures due 2027            |                      | 39    | 39                    |
| Bank revolving credit facilities                        |                      |       |                       |
| Accounts receivable securitization (see Note 8)         |                      | 120   | 40                    |
| Lines of credit and other                               |                      | 30    | 28                    |
| Fair value adjustment of notes                          |                      | 8     | 8                     |
| Subtotal  |                      | 1,322 | 1,240                 |
| Less: current maturities                                |                      | (137) | (56)                  |
| Long-term debt  | \$                   | 1,185 | \$ 1,184              |

<sup>(1)</sup> These convertible notes contain a put and call feature, which allows for earlier redemption beginning in 2016 (see *Convertible Securities* below).

*Debt Securities*

The company previously filed a shelf registration statement with the Securities and Exchange Commission registering \$750 million aggregate principal amount of debt securities to be offered in one or more series on terms determined at the time of sale. At December 31, 2006 the company had \$150 million of debt securities available for issuance under this shelf registration.

*Investment in Debt Defeasance Trust*

During fiscal year 2006, the company purchased \$12 million of U.S. government securities and placed those securities into an irrevocable trust, for the sole purpose of funding payments of principal and interest through the stated maturity on the \$5 million of outstanding 6-3/4 percent notes due 2008 and the \$6 million of outstanding 7-1/8 percent notes due 2009, in order to defease certain covenants under the associated indenture. As these securities are restricted and can only be withdrawn and used for payments of the principal and interest on the aforementioned notes, the assets of the trust are primarily recorded in Other Assets (see Note 11) in the consolidated balance sheet.

*Convertible Securities*

In March 2006, the company issued \$300 million of 4.625 percent convertible senior unsecured notes due 2026 (convertible notes). The convertible notes were sold by the company to qualified institutional buyers in a private placement exempt from the registration requirements of the Securities Act of 1933. These convertible notes were registered with the Securities and Exchange Commission under the Securities Act of 1933 on May 23, 2006. Net proceeds received by the company, after issuance costs, were \$289 million. The related debt issuance costs are being amortized over a ten-year term, which represents the earliest date that the company can redeem the convertible notes. The company used the net proceeds from this offering, together with proceeds from the sales of its LVA North American filters and exhaust businesses and other sources to fund the repurchase of \$600 million aggregate principal amount of previously outstanding notes



ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

Cash interest at a rate of 4.625 percent per annum from the date of issuance through March 1, 2016 is payable semi-annually in arrears on March 1 and September 1 of each year. After March 1, 2016, the principal amount of the convertible notes will be subject to accretion at a rate that provides holders with an aggregate annual yield to maturity of 4.625 percent.

The notes are convertible into shares of the company's common stock at an initial conversion rate, subject to adjustment, equivalent to 47.6667 shares of common stock per \$1,000 initial principal amount of notes, which represents an initial conversion price of approximately \$20.98 per share. If converted, the accreted principal amount will be settled in cash and the remainder of the company's conversion obligation, if any, in excess of such accreted principal amount will be settled in cash, shares of common stock, or a combination thereof, at the company's election.

Holders may convert their notes at any time on or after March 1, 2024. Prior to March 1, 2024, holders may convert their notes only under the following circumstances:

during any calendar quarter, after the calendar quarter ending June 30, 2006, if the closing price of the company's common stock for 20 or more trading days during the five business day period after any five consecutive trading day period in which the average trading price per \$1,000 initial principal amount of notes is less than 100 percent of the then-current conversion price; or upon the occurrence of specified corporate transactions; or if the notes are called by us for redemption.

On or after March 1, 2016, the company may redeem the convertible notes, in whole or in part, for cash at a redemption price equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest. On each of March 1, 2016, 2018, 2020, 2022, and 2024, or upon certain fundamental changes, holders may require the company to purchase all or a portion of their convertible notes at a purchase price in cash equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest.

The convertible notes are fully and unconditionally guaranteed by certain subsidiaries of the company that currently guarantee the company's obligations under its senior secured credit facilities and other publicly-held notes (see *Senior Secured Credit Facilities* below).

*Subordinated Debentures*

The company, through Arvin Capital I (the trust), a wholly-owned finance subsidiary trust, issued \$39 million of 9.5 percent Company-Obligated Mandatorily Redeemable Preferred Capital Securities of a Subsidiary Trust (preferred capital securities), due February 1, 2027, and callable in February 2007 at a premium and in February 2017 at par. The proceeds from the capital securities are invested entirely in 9.5 percent junior subordinated debentures of the company, which are the sole assets of the trust. The company fully and unconditionally guarantees the trust's obligation to the holders of the preferred capital securities.

Under the provisions of FASB Interpretation No. 46, it was determined that the trust is a variable interest entity in which the company does not have a variable interest and therefore is not the primary beneficiary and accordingly has included in long-term debt \$39 million of junior subordinated debentures due to the trust.

*Senior Secured Credit Facilities*

In June 2006, the company replaced its \$900 million revolving credit facility that was to expire in 2008 with two new senior secured credit facilities totaling \$1.15 billion (the new credit facilities). The new credit facilities include a \$980 million revolving credit facility and a \$170 million term loan maturing in 2011 and 2012, respectively. Debt issuance costs associated with the new credit facilities of \$10 million are being amortized over the five year term of the revolving credit facility. Borrowings under the new revolving credit facility are subject to interest based on quoted LIBOR rates plus a margin, and a commitment fee on undrawn amounts, both of which are based upon the company's current credit rating for the senior secured facilities. At December 31, 2006, the margin over the LIBOR rate was 150 basis points, and the commitment fee was 30 basis points. Similar to the prior revolving credit facility, the new revolving credit facility includes a \$150 million limit on the issuance of letters of credit. At December 31 and September 30, 2006, approximately \$30 million and \$25 million letters of credit, respectively, were issued.



**ARVINMERITOR, INC.**

**NOTES TO CONSOLIDATED STATEMENTS (Continued)**

**(Unaudited)**

The term loan is payable in quarterly installments of \$0.25 million with the remaining balance due at maturity. Borrowings under the term loan are subject to interest based on quoted LIBOR rates plus a margin. At December 31, 2006, the margin over the LIBOR rate was 175 basis points.

Borrowings under the revolving credit facility and term loan are collateralized by approximately \$1.0 billion 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.

The new credit facilities require the company to maintain a total net debt to earnings before interest, taxes, depreciation and amortization (EBITDA) ratio no greater than 4.25x and a minimum fixed charge coverage ratio (EBITDA less capital expenditures to interest expense) no less than 1.50x. At December 31, 2006 the company was in compliance with all covenants.

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

*Accounts Receivable Securitization*

In September 2005, the company entered into a new \$250 million accounts receivable securitization arrangement. As discussed in Note 8, the company's previous accounts receivable securitization facility expired in September 2005. Under the accounts receivable securitization arrangement, the company sells substantially all of the trade receivables of certain U.S. subsidiaries to ARC. ARC funds these purchases with borrowings under a loan agreement with a bank. The weighted average interest rate on borrowings under this arrangement was approximately 5.30 percent at December 31, 2006. Amounts outstanding under this agreement are reported as short-term debt in the consolidated balance sheet and are collateralized by \$311 million of eligible receivables purchased and held by ARC at December 31, 2006. If certain receivables performance-based covenants are not met, it would constitute a termination event, which, at the option of the banks, could result in termination of the accounts receivable securitization arrangement. At December 31, 2006, the company was in compliance with all covenants.

*Related Parties*

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

The company also has an arrangement with a non-consolidated joint venture that allows the company to borrow funds from time to time, at LIBOR plus 50 basis points. No amounts were outstanding under this arrangement at December 31 and September 30, 2006.

*Interest Rate Swap Agreements*

As of December 31, 2006, the company had interest rate swap agreements that effectively convert \$221 million of the company's 8-3/4 percent notes, \$63 million of the 6.8 percent notes, and \$25 million of the 8-1/8 percent notes to variable interest rates. The fair value of the 8-3/4 percent swaps was a liability of \$6 million and is included in Other Liabilities and the fair value of the 6.8 percent swaps and 8-1/8 percent notes were not significant as of December 31 and September 30, 2006. The terms of the interest rate swap agreements require the company to place cash on deposit as collateral if the fair value of the interest rate swaps is greater than a liability position of \$10 million. At September 30, 2006, the company had placed \$6 million on deposit with the counterparty as collateral and recorded such deposit as a reduction in the carrying value of the associated interest rate swap. At December 31, 2006 no amounts were on deposit with the counterparty as collateral. The swaps have been designated as fair value hedges and the impact of the changes in their fair values is offset by an equal and opposite change in the carrying value



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of the related notes. Under the terms of the swap agreements, the company receives a fixed rate of interest of 8.75 percent, 6.8 percent and 8.125 percent on notional amounts of \$221 million, \$63 million and \$25 million, respectively, and pays variable rates based on three-month LIBOR plus a weighted-average spread of 3.41 percent. The payments under the agreements coincide with the interest payment dates on the hedged debt instruments, and the difference between the amounts paid and received is included in interest expense, net and other. Included in the fair value adjustment of notes is \$12 million related to previously terminated interest rate swaps, which is being amortized to earnings as a reduction of interest expense over the remaining life of the related debt.

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ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

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

*Leases*

The company has various operating leasing arrangements. Future minimum lease payments under these operating leases are \$23 million in 2007, \$17 million in 2008, \$14 million in 2009, \$10 million in 2010, \$8 million in 2011 and \$11 million thereafter.

**15. Financial Instruments**

The company's financial instruments include cash and cash equivalents, short-term debt, long-term debt, interest rate swaps, and foreign exchange forward contracts. The company uses derivatives for hedging and non-trading purposes in order to manage its interest rate and foreign exchange rate exposures. The company's interest rate swap agreements are discussed in Note 14.

*Foreign Exchange Contracts*

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

Under this program, the company has designated the foreign exchange contracts (the contracts) as cash flow hedges of underlying forecasted foreign currency purchases and sales. The effective portion of changes in the fair value of the contracts is recorded in Accumulated Other Comprehensive Income (AOCI) in the consolidated statement of shareowners' equity and is recognized in operating income when the underlying forecasted transaction impacts earnings. The contracts generally mature within 12 months. The impact to operating income associated with hedge ineffectiveness was not significant in the three months ended December 31, 2006 and 2005.

Amounts recorded in AOCI were not material at December 31, 2006. At September 30, 2006, there was a \$1 million loss recorded in AOCI. Amounts recorded in AOCI are generally recorded in operating income over the next twelve months as the forecasted hedged transactions are recognized in earnings.

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

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

| December 31,<br>2006 |      | September 30,<br>2006 |      |
|----------------------|------|-----------------------|------|
| Carrying             | Fair | Carrying              | Fair |

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|  | Value  | Value | Value  | Value |
|--|--------|-------|--------|-------|
| Cash and cash equivalents                  | \$ 369 | 369   | \$ 350 | 350   |
| Short-term investments                     |        |       | 5      | 5     |
| Interest rate swaps - asset                |        |       | 1      | 1     |
| Foreign exchange contracts - asset         | 2      | 2     |        |       |
| Investment in debt defeasance trust        | 12     | 12    | 12     | 12    |
| Collateral on interest rate swap liability |        |       | 6      | 6     |
| Interest rate swaps - liability            | 6      | 6     | 6      | 6     |
| Foreign exchange contracts - liability     | 2      | 2     | 1      | 1     |
| Short-term debt                            | 137    | 137   | 56     | 56    |
| Long-term debt                             | 1,185  | 1,200 | 1,184  | 1,151 |

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

## (Unaudited)

Cash and cash equivalents All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents. The carrying value approximates fair value because of the short maturity of these instruments.

Interest rate swaps and foreign exchange forward contracts Fair values are estimated by obtaining quotes from external sources.

Short-term debt The carrying value of short-term debt approximates fair value because of the short maturity of these borrowings.

Long-term debt Fair values are based on interest rates that would be currently available to the company for issuance of similar types of debt instruments with similar terms and remaining maturities.

**16. Retirement Benefit Liabilities**

Retirement Benefit Liabilities consisted of the following (in millions):

|   | December 31,<br>2006 |    | September 30,<br>2006 |
|---|----------------------|----|-----------------------|
| Retiree medical liability                                     | \$ 258               | \$ | 255                   |
| Pension liability   | 267                  |    | 259                   |
| Other   | 55                   |    | 47                    |
| Subtotal  | 580                  |    | 561                   |
| Less: current portion (included in compensation and benefits) | (54)                 |    | (54)                  |
| Retirement benefit liabilities                                | \$ 526               | \$ | 507                   |

The components of net periodic pension and retiree medical expense, including discontinued operations, for the three months ended December 31, are as follows:

|                                     | 2006    |                 | 2005    |                 |
|-------------------------------------|---------|-----------------|---------|-----------------|
|                                     | Pension | Retiree Medical | Pension | Retiree Medical |
| Service cost                        | \$ 9    | \$ 1            | \$ 12   | \$ 1            |
| Interest cost                       | 25      | 9               | 23      | 5               |
| Assumed return on plan assets       | (26)    |                 | (24)    |                 |
| Amortization of prior service costs | 1       | (2)             | 1       | (6)             |
| Recognized actuarial loss           | 10      | 6               | 14      | 7               |
| Total expense                       | \$ 19   | \$ 14           | \$ 26   | \$ 7            |

*Retirement Medical Plans*

The company approved amendments to certain retiree medical plans in fiscal years 2002 and 2004. The cumulative effect of these amendments was a reduction in the accumulated postretirement benefit obligation (APBO) of \$293 million, which is being amortized as a reduction of retiree medical expense over the average remaining service period of approximately 12 years. These plan amendments have been challenged in three separate class action lawsuits that have been filed in the United States District Court for the Eastern District of Michigan (District Court). The lawsuits allege that the changes breach the terms of various collective bargaining agreements entered into with the United Auto Workers (the UAW lawsuit) and the United Steel Workers (the USW lawsuit) at facilities that have either been closed or sold. The complaints also allege a companion claim under the Employee Retirement Income Security Act of 1974 (ERISA) essentially restating the alleged collective bargaining

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breach claims and seeking to bring them under ERISA. Plaintiffs sought injunctive relief requiring the company to provide lifetime retiree health care benefits under the applicable collective bargaining agreements.

ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

On December 22, 2005, the District Court issued an order granting a motion by the UAW for a preliminary injunction. The order enjoined the company from implementing the changes to retiree health benefits that had been scheduled to become effective on January 1, 2006, and ordered the company to reinstate and resume paying the full cost of health benefits for the UAW retirees at the levels existing prior to the changes approved in 2002 and 2004. On August 17, 2006, the District Court denied a motion by the company and the other defendants for summary judgment, granted a motion by the UAW for summary judgment, and granted the UAW's request to make the terms of the preliminary injunction permanent (the injunction). Due to the uncertainty related to the ongoing lawsuits and since the injunction has the impact of at least temporarily changing the benefits provided under the existing postretirement medical plans, the company accounted for the injunction as a partial rescission of the 2002 and 2004 plan amendments. The company recalculated the APBO as of December 22, 2005, which resulted in an increase in the APBO of \$168 million. The increase in APBO will offset the remaining unamortized negative prior service cost of the 2002 and 2004 plan amendments and will increase retiree medical expense over the average remaining service period associated with the original plan amendments of approximately 10 years. In addition, the increase in APBO will result in higher interest cost, a component of retiree medical expense. The company began recording the impact of the injunction in March 2006, 90 days from the December 22, 2005 measurement date, which is consistent with the 90-day lag between the company's normal plan measurement date of June 30 and its fiscal year-end. In addition, the injunction ordered defendants to reimburse the plaintiffs for out-of-pocket expenses incurred since the date of the earlier benefit modifications. The company recorded a \$5 million reserve at September 30, 2006 as the best estimate of its liability for these retroactive benefits. The company continues to believe it has meritorious defenses to these actions and has appealed the District Court's order to the U.S. Court of Appeals for the Sixth Circuit. The ultimate outcome of the UAW lawsuit may result in future plan amendments. The impact of any future plan amendments cannot be currently estimated.

Based on management's assessment of the USW lawsuit, the 2002 and 2004 plan amendments are still in effect for USW retirees. The ultimate outcome of the USW lawsuit may result in future plan amendments. The impact of any future plan amendments cannot be currently estimated.

**17. Contingencies***Environmental*

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

The company has been designated as a potentially responsible party at seven Superfund sites, excluding sites as to which the company's records disclose no involvement or as to which the company's potential liability has been finally determined. Management estimates the total reasonably possible costs the company could incur for the remediation of Superfund sites at December 31, 2006 to be approximately \$25 million, of which \$9 million is recorded as a liability.

In addition to the Superfund sites, various other lawsuits, claims and proceedings have been asserted against the company, alleging violations of federal, state and local environmental protection requirements, or seeking remediation of alleged environmental impairments, principally at previously disposed-of properties. For these matters, management has estimated the total reasonably possible costs the company could incur at December 31, 2006 to be approximately \$65 million, of which \$16 million is recorded as a liability.

Included in the company's environmental liabilities are costs for on-going operating, maintenance and monitoring at environmental sites in which remediation have been put into place. This liability is discounted using a discount rate of 5-percent and is approximately \$9 million at December 31, 2006. The undiscounted estimate of these costs is approximately \$12 million.



## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

## (Unaudited)

Following are the components of the Superfund and Non-Superfund Environmental reserves (in millions):

|                               |    | <b>Superfund Sites</b> |     | <b>Non-Superfund Sites</b> |     | <b>Total</b> |
|-------------------------------|----|------------------------|-----|----------------------------|-----|--------------|
| Balance at September 30, 2006 | \$ |                        | 10  | \$                         | 17  | \$ 27        |
| Payments                      |    |                        | (1) |                            | (1) | (2)          |
| Balance at December 31, 2006  | \$ |                        | 9   |                            | 16  | \$ 25        |

Environmental reserves are included in Other Current Liabilities (see Note 12) and Other Liabilities (see Note 13).

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

*Asbestos*

**Maremont** Corporation (Maremont), a subsidiary of ArvinMeritor, manufactured friction products containing asbestos from 1953 through 1977, when it sold its friction product business. Arvin acquired Maremont in 1986. Maremont and many other companies are defendants in suits brought by individuals claiming personal injuries as a result of exposure to asbestos-containing products. Maremont had approximately 44,049 and 51,895 pending asbestos-related claims at December 31, and September 30, 2006, respectively. Although Maremont has been named in these cases, in the cases where actual injury has been alleged very few claimants have established that a Maremont product caused their injuries. Plaintiffs' lawyers often sue dozens or even hundreds of defendants in individual lawsuits on behalf of hundreds or thousands of claimants, seeking damages against all named defendants irrespective of the disease or injury and irrespective of any causal connection with a particular product. For these reasons, Maremont does not consider the number of claims filed or the damages alleged to be a meaningful factor in determining its asbestos-related liability.

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

|                             |    | <b>December 31, 2006</b> |    | <b>September 30, 2006</b> |
|-----------------------------|----|--------------------------|----|---------------------------|
| Pending and future claims   | \$ | 41                       | \$ | 41                        |
| Shortfall and other         |    | 9                        |    | 9                         |
| Asbestos-related reserves   | \$ | 50                       | \$ | 50                        |
| Asbestos-related recoveries | \$ | 31                       | \$ | 31                        |

A portion of the asbestos-related recoveries and reserves are included in Other Current Assets and Liabilities, with the majority of the amounts recorded in Other Assets and Liabilities (see Notes 10, 11, 12 and 13).



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Prior to February 2001, Maremont participated in the Center for Claims Resolution ( CCR ) and shared with other CCR members in the payment of defense and indemnity costs for asbestos-related claims. The CCR handled the resolution and processing of asbestos claims on behalf of its members until February 2001, when it was reorganized and discontinued negotiating shared settlements. Upon dissolution of the CCR in February 2001, Maremont began handling asbestos-related claims through its own defense counsel and has taken a more aggressive defensive approach that involves examining the merits of each asbestos-related claim. Although the company expects legal defense costs to continue at higher levels than when it participated in the CCR, the company believes its litigation strategy has reduced the average indemnity cost per claim.

*Pending and Future Claims:* At the end of fiscal year 2004 and through the third quarter of fiscal year 2005, Maremont established reserves for pending asbestos-related claims that reflected internal estimates of its defense and indemnity costs. These estimates were based on the history and nature of filed claims to date and Maremont's experience. Maremont developed experience factors for estimating indemnity and litigation costs using data on actual experience in resolving claims since dissolution of the CCR and its assessment of the nature of the claims. Maremont did not accrue reserves for its potential liability for asbestos-related claims that may be asserted against it in the future, because it did not have sufficient information to make a reasonable estimate of these unknown claims.

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

Maremont engaged Bates White LLC (Bates White), a consulting firm with extensive experience estimating costs associated with asbestos litigation, to assist with determining whether it would be possible to estimate the cost of resolving pending and future asbestos-related claims that have been, and could reasonably be expected to be, filed against Maremont, as well as the cost of Maremont's share of committed but unpaid settlements entered into by the CCR. Although it is not possible to estimate the full range of costs because of various uncertainties, Bates White advised Maremont that it would be able to determine an estimate of probable costs to resolve pending and future asbestos-related claims, based on historical data and certain assumptions with respect to events that occur in the future. The company engaged Bates White to update the study as of September 30, 2006.

Bates White provided an estimate of the reasonably possible range of Maremont's obligation for asbestos personal injury claims over the next three to four years of \$31 million to \$44 million. After consultation with Bates White, Maremont determined that as of September 30, 2006 the most likely and probable liability for pending and future claims over the next four years is \$41 million. The ultimate cost of resolving pending and future claims is estimated based on the history of claims and expenses for plaintiffs represented by law firms in jurisdictions with an established history with Maremont.

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

Pending and future claims were estimated for a four year period ending in fiscal year 2010. Maremont believes that the litigation environment will change significantly in several years, and that the reliability of estimates of future probable expenditures in connection with asbestos-related personal injury claims declines for each year further in the future. As a result, estimating a probable liability beyond four years is difficult and uncertain;

The ultimate cost of resolving pending and future claims filed in Madison County, Illinois, a jurisdiction where a substantial amount of Maremont's claims are filed, will decline to reflect average outcomes throughout the United States;

Defense and processing costs for pending and future claims filed outside of Madison County, Illinois will be at the level consistent with Maremont's prior experience; and

The ultimate cost of resolving nonmalignant claims with plaintiffs' law firms in jurisdictions without an established history with Maremont cannot be reasonably estimated. Recent changes in tort law and insufficient settlement history make estimating a liability for these nonmalignant claims difficult and uncertain.

*Shortfall and other:* Several former members of the CCR have filed for bankruptcy protection, and these members have failed, or may fail, to pay certain financial obligations with respect to settlements that were reached while they were CCR members. Maremont is subject to claims for payment of a portion of these defaulted member shares (shortfall). In an effort to resolve the affected settlements, Maremont has entered into negotiations with plaintiffs' attorneys, and an estimate of Maremont's obligation for the shortfall is included in the total asbestos-related reserves. In addition, Maremont and its insurers are engaged in legal proceedings to determine whether existing insurance coverage should reimburse any potential liability related to this issue. Payments by the company related to shortfall and other were not significant in the three months ended December 31, 2006 and 2005.

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*Recoveries:* Maremont has insurance that reimburses a substantial portion of the costs incurred defending against asbestos-related claims. The coverage also reimburses Maremont for any indemnity paid on those claims. The coverage is provided by several insurance carriers based on insurance agreements in place. Incorporating historical information with respect to buy-outs and settlements of coverage, and excluding any policies in dispute, the insurance receivable related to asbestos-related liabilities is \$31 million. The difference between the estimated liability and insurance receivable is related to proceeds received from settled insurance policies and liabilities for shortfall and other. Certain insurance policies have been settled in cash prior to the ultimate settlement of related asbestos liabilities. Amounts received from insurance settlements generally reduce recorded insurance receivables. Receivables for policies in dispute are not recorded.

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

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**Rockwell** ArvinMeritor, along with many other companies, has also been named as a defendant in lawsuits alleging personal injury as a result of exposure to asbestos used in certain components of Rockwell products many years ago. Liability for these claims was transferred to the company at the time of the spin-off of the automotive business to Meritor from Rockwell in 1997. Currently there are thousands of claimants in lawsuits that name the company, together with many other companies, as defendants. However, the company does not consider the number of claims filed or the damages alleged to be a meaningful factor in determining asbestos-related liabilities. A significant portion of the claims do not identify any of Rockwell's products or specify which of the claimants, if any, were exposed to asbestos attributable to Rockwell's products, and past experience has shown that the vast majority of the claimants will never identify any of Rockwell's products. For those claimants who do show that they worked with Rockwell's products, management nevertheless believes it has meritorious defenses, in substantial part due to the integrity of the products involved, the encapsulated nature of any asbestos-containing components, and the lack of any impairing medical condition on the part of many claimants. The company defends these cases vigorously. Historically, ArvinMeritor has been dismissed from the vast majority of these claims with no payment to claimants.

In the fourth quarter of fiscal year 2006, the company engaged Bates White to assist with determining whether it would be possible to estimate the cost of resolving pending and future Rockwell legacy asbestos-related claims that have been, and could reasonably be expected to be, filed against the company. Although it is not possible to estimate the full range of costs because of various uncertainties, Bates White advised the company that it would be able to determine an estimate of probable defense costs which could be incurred to resolve pending and future Rockwell legacy asbestos-related claims. Accordingly, the company has recorded a \$7 million liability at December 31 and September 30, 2006 for defense costs associated with these claims. This estimate was based on historical data and certain assumptions with respect to events that occur in the future. Bates White was unable to determine an estimate of indemnity costs for pending or future Rockwell legacy asbestos-related claims. Bates White and management cannot reasonably estimate the ultimate liabilities for these costs, primarily because the company does not have a sufficient history of claims settlement from which to develop reliable assumptions. The uncertainties of asbestos claim litigation and resolution of the litigation with the insurance companies make it difficult to predict accurately the ultimate resolution of asbestos claims. That uncertainty is increased by the possibility of adverse rulings or new legislation affecting asbestos claim litigation or the settlement process. Subject to these uncertainties and based on the company's experience defending these asbestos claims, the company does not believe these lawsuits will have a material adverse effect on its financial condition or results of operations. Rockwell was not a member of the CCR and handled its asbestos-related claims using its own litigation counsel. As a result, the company does not have any additional potential liabilities for committed CCR settlements or shortfall (as described above) in connection with the Rockwell-legacy cases.

Rockwell maintained insurance coverage that management believes covers indemnity and defense costs, over and above self-insurance retentions, for most of these claims. The company has initiated claims against these carriers to enforce the insurance policies. Although the status of one carrier as a financially viable entity is in question, the company expects to recover the majority of defense and indemnity costs it has incurred to date, over and above self-insured retentions, and a substantial portion of the costs for defending asbestos claims going forward. Accordingly, the company has recorded an insurance receivable related to Rockwell legacy asbestos-related liabilities of \$7 million at December 31 and September 30, 2006.

*Contingencies Related to Work Stoppage*

The company's collective bargaining agreement with the Canadian Auto Workers (CAW) at its CVS brakes facility in Tilbury, Ontario, Canada, expired on June 3, 2006. On June 4, 2006, the company announced that, after lengthy negotiations, a new tentative agreement with the CAW had not yet been reached and, as a result, the company had suspended operations at the facility. On June 12, 2006, the company reached a tentative agreement with the CAW, which was subsequently ratified on June 14, 2006, and resumed operations. As a result of this work stoppage, the company experienced temporary manufacturing inefficiencies and incurred certain costs in order to return to normal production. The company was temporarily unable to completely fulfill certain customer orders, resulting in temporary production interruptions at some customer manufacturing facilities. The impact of this labor disruption on operating income in fiscal year 2006 was \$45 million. Included in this amount are premium labor costs, expedited freight and logistical costs and other costs associated with production disruptions at certain customers facilities. At December 31, 2006, \$17 million is recorded as a contingent liability in the consolidated balance sheet. The ultimate settlement of

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this liability will be determinable over a period of time and may be negotiated, as a commercial matter, with the affected customers. The amount of this liability may change in future periods depending on our customers' ability to schedule additional production to compensate for prior disruptions, the results of the negotiations with the affected customers and other factors. The company believes that any future adjustment to this liability will not have a material effect on the company's results of operations and financial position.

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

*Guarantees*

In December 2005, the company guaranteed a third party's obligation to reimburse another party (the other party) for payment of health and prescription drug benefits to a group of retired employees. The retirees were former employees of a wholly-owned subsidiary of the company prior to the subsidiary's being acquired by the company. To date, the third party has met its obligations to reimburse the other party. The APBO associated with these retiree medical benefits is considered the maximum potential exposure under this guarantee, and is estimated to be approximately \$25 million. No amount has been recorded for this guarantee based on the probability of the company having to perform under the guarantee. Due to the nature of this guarantee it is difficult to estimate its approximate term.

The company has guaranteed certain trade payable balances of one of its non-consolidated joint ventures. In the event of a default by the joint venture, the company would be required to pay the guaranteed party. The maximum exposure under the guarantee is \$4 million and can be terminated by the company at any time on thirty days written notice. The estimated fair value of this guarantee is not significant, and therefore, no liability is recorded.

*Indemnifications*

The company has provided indemnifications in conjunction with certain transactions, primarily divestitures. These indemnities address a variety of matters, which may include environmental, tax, asbestos, and employment-related matters, and the periods of indemnification vary in duration. The company's maximum obligations under such indemnifications cannot be reasonably estimated. The company is not aware of any claims or other information that would give rise to material payments under such indemnifications.

In connection with the sale of the LVA North American filters business, the company agreed to indemnify the purchaser against liabilities from litigation and commercial losses in connection with specific intellectual property claims, with a maximum indemnity of \$4 million for commercial losses, which is included in the consolidated balance sheet at December 31, 2006.

*Other*

Various other lawsuits, claims and proceedings have been or may be instituted or asserted against the company, relating to the conduct of the company's business, including those pertaining to product liability, intellectual property, safety and health, and employment matters. Although the outcome of litigation cannot be predicted with certainty, and some lawsuits, claims or proceedings may be disposed of unfavorably to the company, management believes the disposition of matters that are pending will not have a material adverse effect on the company's business, financial condition or results of operations.

**18. Comprehensive Income**

On an annual basis, disclosure of comprehensive income is incorporated into the Consolidated Statement of Shareowners' Equity. This statement is not presented on a quarterly basis. Comprehensive income includes net income and components of other comprehensive income, such as foreign currency translation adjustments, and unrealized gains and losses on derivatives and equity securities.

Comprehensive income is summarized as follows (in millions):

**Three Months Ended  
December 31,**

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|  | <b>2006</b> |    | <b>2005</b> |
|--|-------------|----|-------------|
| Net income   | \$ 7        | \$ | 34          |
| Foreign currency translation adjustments                         | 50          |    | (27)        |
| Unrealized gain (loss) on foreign exchange contracts, net of tax | 1           |    | (2)         |
| Comprehensive income   | \$ 58       | \$ | 5           |

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**19. Business Segment Information**

The company defines its operating segments as components of its business where separate financial information is available and is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The company's chief operating decision maker (CODM) is the Chief Executive Officer.

Beginning in fiscal year 2007, the company changed its reportable operating segments to three: Light Vehicle Systems (LVS), Commercial Vehicle Systems (CVS), and Emissions Technologies (ET). All prior period segment information has been restated to reflect the new segment structure. LVS is a major supplier of aperture systems (roof and door systems), chassis systems (suspension systems and modules) and wheel products for passenger cars, motorcycles and all-terrain vehicles, light trucks and sport utility vehicles to original equipment manufacturers (OEMs). CVS supplies drivetrain systems and components, including axles and drivelines, braking systems, suspension systems and ride control products, for medium- and heavy-duty trucks, trailers and specialty vehicles to OEMs and the commercial vehicle aftermarket. ET is a major supplier of exhaust systems and exhaust system components, including mufflers, exhaust pipes, catalytic converters, diesel particulate filters and exhaust manifolds, for light and commercial vehicles to OEMs primarily as original equipment, while also supporting manufacturers' needs for replacement parts and dealers' needs for service parts.

Effective with the 2007 fiscal year, the company measures segment operating performance based on earnings before interest, taxes, depreciation and amortization, and loss on sale of receivables (EBITDA). The company uses EBITDA as the primary basis for the CODM to evaluate the performance of each of the company's reportable segments.

The accounting policies of the segments are the same as those applied in the Consolidated Financial Statements, except for the use of EBITDA. The company may allocate certain common costs, primarily corporate functions, between the segments differently than the company would for stand alone financial information prepared in accordance with GAAP. These allocated costs include expenses for shared services such as information technology, finance, communications, legal and human resources. The company does not allocate interest expense, equity in earnings of affiliates and certain legacy and other corporate costs not directly associated with the segments' operating income.



## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

Segment information is summarized as follows (in millions):

|                            | Three Months Ended |          |
|----------------------------|--------------------|----------|
|                            | December 31,       |          |
|                            | 2006               | 2005     |
| <i>Sales:</i>              |                    |          |
| Light Vehicle Systems      | \$ 470             | \$ 497   |
| Commercial Vehicle Systems | 1,062              | 931      |
| Emissions Technologies     | 808                | 670      |
| Total sales                | \$ 2,340           | \$ 2,098 |

|                                   | Three Months Ended |       |
|-----------------------------------|--------------------|-------|
|                                   | December 31,       |       |
|                                   | 2006               | 2005  |
| <i>EBITDA:</i>                    |                    |       |
| Light Vehicle Systems             | \$ 15              | \$ 13 |
| Commercial Vehicle Systems        | 64                 | 92    |
| Emissions Technologies            | 6                  | 5     |
| Segment EBITDA                    | 85                 | 110   |
| Depreciation and amortization     | (43)               | (40)  |
| Loss on sale of receivables       | (2)                |       |
| Interest expense, net and other   | (27)               | (32)  |
| Provision for income taxes        | (2)                | (10)  |
| Income from continuing operations | \$ 11              | \$ 28 |

|                            | December 31, | September 30, |
|----------------------------|--------------|---------------|
|                            | 2006         | 2005          |
| <i>Segment Assets:</i>     |              |               |
| Light Vehicle Systems      | \$ 920       | \$ 951        |
| Commercial Vehicle Systems | 2,203        | 2,246         |
| Emissions Technologies     | 1,162        | 1,117         |
| Segment total assets       | 4,285        | 4,314         |
| Corporate (1)              | 1,007        | 992           |
| Discontinued operations    | 204          | 207           |
| Total assets               | \$ 5,496     | \$ 5,513      |

(1) Corporate assets consist primarily of cash, taxes and prepaid pension costs. For December 31 and September 30, 2006 segment assets include \$311 million and \$384 million, respectively, of receivables sold to ARC under the accounts receivable securitization and factoring agreements (see Note 8).

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

**20. Subsequent Events**

On February 2, 2007, the company signed a definitive agreement to sell its Emissions Technologies business to an affiliate of One Equity Partners II, L.P., a private equity affiliate of J.P. Morgan Securities Inc. Total consideration is expected to be approximately \$310 million, including cash, a \$20 million note and the assumption of certain liabilities, and is subject to adjustments for working capital and other items. The transaction is expected to close during the third quarter of the company's 2007 fiscal year subject to customary conditions, including receipt of necessary regulatory consents and approvals and receipt by the purchaser of financing under its debt financing commitment letter.

On February 8, 2007, the company completed a private placement to qualified institutional buyers of \$175 million aggregate principal amount of convertible senior unsecured notes due 2027 (the "notes"). The company has granted to the initial purchasers of the notes a 30-day option to purchase up to an additional \$25 million aggregate principal amount of notes. Net proceeds from the notes were approximately \$169 million before exercise of the initial purchasers' over-allotment option. Proceeds will be used for general corporate purposes, including retiring other indebtedness or funding certain pension or other long-term liabilities.

The notes will rank equally in right of payment to all of the company's existing and future senior unsecured indebtedness. The notes bear cash interest at a rate of 4.0 percent per annum payable semiannually in arrears until February 15, 2019, after which no cash interest will be paid. Commencing February 15, 2019, the principal amount of the notes will be subject to accretion at a rate that provides holders with an aggregate annual yield to maturity of 4.0%.

The notes are convertible into shares of the company's common stock at an initial conversion rate, subject to adjustment, equivalent to 37.4111 shares of common stock per \$1,000 initial principal amount of notes, which represents an initial conversion price of approximately \$26.73 per share. If converted, the accreted principal amount will be settled in cash and the remainder of the company's conversion obligation, if any, in excess of such accreted principal amount will be settled in cash, shares of common stock, or a combination thereof, at the company's election. General conversion terms are substantially consistent with the company's existing 4.625% convertible senior notes due 2026.

On or after February 15, 2019, the company may redeem the convertible notes, in whole or in part, for cash at a redemption price equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest. On each of February 15, 2019 and February 15, 2022, or upon certain fundamental changes, holders may require the company to purchase all or a portion of their convertible notes at a purchase price in cash equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest.

**21. Supplemental Guarantor Condensed Consolidating Financial Statements**

Certain of the company's wholly-owned subsidiaries, as defined in the credit agreement (the Guarantors) irrevocably and unconditionally guarantee amounts outstanding under the senior credit facilities. Similar subsidiary guarantees were provided for the benefit of the holders of the publicly-held notes outstanding under the company's indentures (see Note 14).

In lieu of providing separate audited financial statements for the Guarantors subsidiaries, the company has included the accompanying condensed consolidating financial statements. These condensed consolidating financial statements are presented on the equity method. Under this method, the investments in subsidiaries are recorded at cost and adjusted for the parent's share of the subsidiary's cumulative results of operations, capital contributions and distributions and other equity changes. The Guarantor subsidiaries are combined in the condensed consolidating financial statements.

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

## Condensed Consolidating Statement of Income

(In millions)

|   | Three Months Ended December 31, 2006 |            |                |       | Consolidated |
|---|--------------------------------------|------------|----------------|-------|--------------|
|   | Parent                               | Guarantors | Non-Guarantors | Elims |              |
| Sales   |                                      |            |                |       |              |
| External                                      | \$                                   | \$         | 839            | \$    | \$           |
| Subsidiaries                                  |                                      |            | 25             | 97    | (122)        |
| Total sales                                   |                                      |            | 864            | 1,598 | (122)        |
| Cost of sales                                 | (4)                                  | (801)      | (1,539)        | 122   | (2,222)      |
| GROSS MARGIN                                  | (4)                                  | 63         | 59             |       | 118          |
| Selling, general and administrative           | (18)                                 | (31)       | (37)           |       | (86)         |
| Gain on divestitures                          |                                      | (3)        | 5              |       | 2            |
| Restructuring costs                           |                                      |            | (1)            |       | (1)          |
| OPERATING INCOME (LOSS)                       | (22)                                 | 29         | 26             |       | 33           |
| Equity in earnings of affiliates              | 1                                    | 7          | 1              |       | 9            |
| Other income (expense), net                   |                                      | (2)        | 2              |       |              |
| Interest expense, net and other               | (24)                                 | 8          | (11)           |       | (27)         |
| INCOME (LOSS) BEFORE INCOME TAXES             | (45)                                 | 42         | 18             |       | 15           |
| Benefit (provision) for income taxes          | 15                                   | (22)       | 5              |       | (2)          |
| Minority interests                            |                                      |            | (2)            |       | (2)          |
| Equity in income of consolidated subsidiaries | 41                                   | 19         |                | (60)  |              |
| INCOME (LOSS) FROM CONTINUING OPERATIONS      | 11                                   | 39         | 21             | (60)  | 11           |
| INCOME FROM DISCONTINUED OPERATIONS           | (4)                                  | (4)        | (2)            | 6     | (4)          |
| NET INCOME (LOSS)                             | \$                                   | 7          | \$             | 19    | \$           |
|   |                                      |            |                | (54)  | \$           |
|   |                                      |            |                |       | 7            |

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

## Condensed Consolidating Statement of Income

(In millions)

|   | Three Months Ended December 31, 2005 |            |                |         | Consolidated |
|---|--------------------------------------|------------|----------------|---------|--------------|
|   | Parent                               | Guarantors | Non-Guarantors | Elims   |              |
| Sales   |                                      |            |                |         |              |
| External  | \$                                   | \$         | 805            | \$      | \$           |
| Subsidiaries                                      |                                      |            | 30             | 92      | (122)        |
| Total sales                                       |                                      |            | 835            | 1,385   | (122)        |
| Cost of sales                                     |                                      | (5)        | (787)          | (1,296) | 122          |
| GROSS MARGIN                                      |                                      | (5)        | 48             | 89      | 132          |
| Selling, general and administrative               |                                      | (16)       | (36)           | (36)    | (88)         |
| Gain on divestitures                              |                                      |            | 17             | 6       | 23           |
| Restructuring costs                               |                                      |            | (2)            | 1       | (1)          |
| OPERATING INCOME (LOSS)                           |                                      | (21)       | 27             | 60      | 66           |
| Equity in earnings of affiliates                  |                                      | 1          | 4              | 2       | 7            |
| Other income (expense), net                       |                                      | 15         | (159)          | 144     |              |
| Interest expense, net and other                   |                                      | (29)       | (4)            | 1       | (32)         |
| INCOME (LOSS) BEFORE INCOME TAXES                 |                                      | (34)       | (132)          | 207     | 41           |
| Benefit (provision) for income taxes              |                                      | 12         | 72             | (94)    | (10)         |
| Minority interests                                |                                      |            |                | (3)     | (3)          |
| INCOME (LOSS) FROM CONTINUING OPERATIONS          |                                      | (22)       | (60)           | 110     | 28           |
| INCOME FROM DISCONTINUED OPERATIONS               |                                      |            | 1              | 5       | 6            |
| Equity in net income of consolidated subsidiaries |                                      | 56         | 115            | (171)   |              |
| NET INCOME (LOSS)                                 | \$                                   | 34         | \$             | 115     | \$           |
|   |                                      |            | 56             | \$      | (171)        |
|   |                                      |            |                |         | 34           |

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

## Condensed Consolidating Balance Sheet

(In millions)

|   | December 31, 2006 |                 |                 |                   |           | Consolidated |
|---|-------------------|-----------------|-----------------|-------------------|-----------|--------------|
|   | Parent            | Guarantors      | Non-Guarantors  | Elims             |           |              |
| <b>CURRENT ASSETS</b>                           |                   |                 |                 |                   |           |              |
| Cash and cash equivalents                       | \$ 136            | \$ 2            | \$ 231          | \$                | \$        | 369          |
| Receivables, net                                | 3                 | 157             | 1,404           |                   |           | 1,564        |
| Inventories                                     |                   | 249             | 379             |                   |           | 628          |
| Other current assets                            | 43                | 125             | 124             |                   |           | 292          |
| Assets of discontinued operations               |                   | 48              | 156             |                   |           | 204          |
| <b>TOTAL CURRENT ASSETS</b>                     | <b>182</b>        | <b>581</b>      | <b>2,294</b>    |                   |           | <b>3,057</b> |
| <b>NET PROPERTY</b>                             | <b>33</b>         | <b>306</b>      | <b>645</b>      |                   |           | <b>984</b>   |
| <b>GOODWILL</b>                                 |                   | <b>341</b>      | <b>169</b>      |                   |           | <b>510</b>   |
| <b>OTHER ASSETS</b>                             | <b>416</b>        | <b>136</b>      | <b>393</b>      |                   |           | <b>945</b>   |
| <b>INVESTMENTS IN CONSOLIDATED SUBSIDIARIES</b> |                   |                 |                 |                   |           |              |
|   | 3,520             | 1,172           |                 | (4,692)           |           |              |
| <b>TOTAL ASSETS</b>                             | <b>\$ 4,151</b>   | <b>\$ 2,536</b> | <b>\$ 3,501</b> | <b>\$ (4,692)</b> | <b>\$</b> | <b>5,496</b> |
| <b>CURRENT LIABILITIES</b>                      |                   |                 |                 |                   |           |              |
| Short-term debt                                 | \$ 7              | \$              | \$ 130          | \$                | \$        | 137          |
| Accounts payable                                | 24                | 437             | 1,090           |                   |           | 1,551        |
| Other current liabilities                       | 191               | 136             | 371             |                   |           | 698          |
| Liabilities of discontinued operations          |                   | 48              | 51              |                   |           | 99           |
| <b>TOTAL CURRENT LIABILITIES</b>                | <b>222</b>        | <b>621</b>      | <b>1,642</b>    |                   |           | <b>2,485</b> |
| <b>LONG-TERM DEBT</b>                           | <b>1,164</b>      |                 | <b>21</b>       |                   |           | <b>1,185</b> |
| <b>RETIREMENT BENEFITS</b>                      | <b>348</b>        |                 | <b>178</b>      |                   |           | <b>526</b>   |
| <b>INTERCOMPANY PAYABLE (RECEIVABLE)</b>        | <b>1,363</b>      | <b>(1,803)</b>  | <b>440</b>      |                   |           |              |
| <b>OTHER LIABILITIES</b>                        | <b>55</b>         | <b>131</b>      | <b>48</b>       |                   |           | <b>234</b>   |
| <b>MINORITY INTERESTS</b>                       |                   |                 | <b>67</b>       |                   |           | <b>67</b>    |
| <b>SHAREOWNERS EQUITY</b>                       | <b>999</b>        | <b>3,587</b>    | <b>1,105</b>    | <b>(4,692)</b>    |           | <b>999</b>   |
| <b>TOTAL LIABILITIES AND SHAREOWNERS EQUITY</b> | <b>\$ 4,151</b>   | <b>\$ 2,536</b> | <b>\$ 3,501</b> | <b>\$ (4,692)</b> | <b>\$</b> | <b>5,496</b> |

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

## Condensed Consolidating Balance Sheet

(In millions)

|   | September 30, 2006 |                 |                 |                   |                 |
|---|--------------------|-----------------|-----------------|-------------------|-----------------|
|   | Parent             | Guarantors      | Non-Guarantors  | Elims             | Consolidated    |
| <b>CURRENT ASSETS</b>                           |                    |                 |                 |                   |                 |
| Cash and cash equivalents                       | \$ 97              | \$ 3            | \$ 250          | \$                | \$ 350          |
| Receivables, net                                | 14                 | 166             | 1,465           |                   | 1,645           |
| Inventories                                     |                    | 264             | 332             |                   | 596             |
| Other current assets                            | 49                 | 109             | 137             |                   | 295             |
| Assets of discontinued operations               |                    | 54              | 153             |                   | 207             |
| <b>TOTAL CURRENT ASSETS</b>                     | <b>160</b>         | <b>596</b>      | <b>2,337</b>    |                   | <b>3,093</b>    |
| <b>NET PROPERTY</b>                             | <b>34</b>          | <b>313</b>      | <b>641</b>      |                   | <b>988</b>      |
| <b>GOODWILL</b>                                 |                    | <b>341</b>      | <b>162</b>      |                   | <b>503</b>      |
| <b>OTHER ASSETS</b>                             | <b>418</b>         | <b>143</b>      | <b>368</b>      |                   | <b>929</b>      |
| <b>INVESTMENTS IN CONSOLIDATED</b>              |                    |                 |                 |                   |                 |
| <b>SUBSIDIARIES</b>                             | <b>3,435</b>       | <b>1,047</b>    |                 | <b>(4,482)</b>    |                 |
| <b>TOTAL ASSETS</b>                             | <b>\$ 4,047</b>    | <b>\$ 2,440</b> | <b>\$ 3,508</b> | <b>\$ (4,482)</b> | <b>\$ 5,513</b> |
| <b>CURRENT LIABILITIES</b>                      |                    |                 |                 |                   |                 |
| Short-term debt                                 | \$ 7               | \$              | \$ 49           | \$                | \$ 56           |
| Accounts payable                                | 27                 | 521             | 1,101           |                   | 1,649           |
| Other current liabilities                       | 207                | 192             | 342             |                   | 741             |
| Liabilities of discontinued operations          |                    | 53              | 50              |                   | 103             |
| <b>TOTAL CURRENT LIABILITIES</b>                | <b>241</b>         | <b>766</b>      | <b>1,542</b>    |                   | <b>2,549</b>    |
| <b>LONG-TERM DEBT</b>                           | <b>1,165</b>       |                 | <b>19</b>       |                   | <b>1,184</b>    |
| <b>RETIREMENT BENEFITS</b>                      | <b>337</b>         |                 | <b>170</b>      |                   | <b>507</b>      |
| <b>INTERCOMPANY PAYABLE (RECEIVABLE)</b>        | <b>1,311</b>       | <b>(1,535)</b>  | <b>224</b>      |                   |                 |
| <b>OTHER LIABILITIES</b>                        | <b>49</b>          | <b>136</b>      | <b>79</b>       |                   | <b>264</b>      |
| <b>MINORITY INTERESTS</b>                       |                    |                 | <b>65</b>       |                   | <b>65</b>       |
| <b>SHAREOWNERS EQUITY</b>                       | <b>944</b>         | <b>3,073</b>    | <b>1,409</b>    | <b>(4,482)</b>    | <b>944</b>      |
| <b>TOTAL LIABILITIES AND SHAREOWNERS EQUITY</b> | <b>\$ 4,047</b>    | <b>\$ 2,440</b> | <b>\$ 3,508</b> | <b>\$ (4,482)</b> | <b>\$ 5,513</b> |

## ARVINMERITOR, INC.

## NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

## Condensed Consolidating Statement of Cash Flows

(In millions)

|  | Three Months Ended December 31, 2006 |            |                |       |              |
|--|--------------------------------------|------------|----------------|-------|--------------|
|  | Parent                               | Guarantors | Non-Guarantors | Elims | Consolidated |
| CASH FLOWS PROVIDED BY OPERATING ACTIVITIES                  | \$ 77                                | \$ 8       | \$ (118)       | \$    | \$ (33)      |
| INVESTING ACTIVITIES   |                                      |            |                |       |              |
| Capital expenditures   |                                      | (9)        | (21)           |       | (30)         |
| Acquisitions of businesses and investments                   |                                      |            | (5)            |       | (5)          |
| Proceeds from disposition of property and businesses         |                                      |            | 5              |       | 5            |
| Proceeds from marketable securities                          |                                      |            | 5              |       | 5            |
| Net investing cash flows provided by discontinued operations |                                      |            | (1)            |       | (1)          |
| CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES             |                                      | (9)        | (17)           |       | (26)         |
| FINANCING ACTIVITIES   |                                      |            |                |       |              |
| Net change in debt   | (1)                                  |            | 82             |       | (81)         |
| Intercompany advances  | (30)                                 |            | 30             |       |              |
| Cash dividends   | (7)                                  |            |                |       | (7)          |
| CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES             | (38)                                 |            | 112            |       | 74           |
| EFFECT OF FOREIGN CURRENCY ON CASH                           |                                      |            | 4              |       | 4            |
| CHANGE IN CASH AND CASH EQUIVALENTS                          | 39                                   | (1)        | (19)           |       | 19           |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD             | 97                                   | 3          | 250            |       | 350          |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD                   | \$ 136                               | \$ 2       | \$ 231         | \$    | \$ 369       |

ARVINMERITOR, INC.

NOTES TO CONSOLIDATED STATEMENTS (Continued)

(Unaudited)

Condensed Consolidating Statement of Cash Flows

(In millions)

|  | Three Months Ended December 31, 2005 |            |                |       |              |
|--|--------------------------------------|------------|----------------|-------|--------------|
|  | Parent                               | Guarantors | Non-Guarantors | Elims | Consolidated |
| CASH FLOWS PROVIDED BY OPERATING ACTIVITIES                  | \$ 86                                | \$ 8       | \$ 57          | \$    | \$ 151       |
| INVESTING ACTIVITIES   |                                      |            |                |       |              |
| Capital expenditures   |                                      | (7)        | (31)           |       | (38)         |
| Acquisitions of businesses and investments                   |                                      |            | (1)            |       | (1)          |
| Proceeds from disposition of property and businesses         |                                      |            | 39             |       | 39           |
| Net investing cash flows provided by discontinued operations |                                      | 6          | 2              |       | 8            |
| CASH PROVIDED (USED FOR) INVESTING ACTIVITIES                |                                      | (1)        | 9              |       | 8            |
| FINANCING ACTIVITIES   |                                      |            |                |       |              |
| Net change in debt   | (3)                                  | (7)        | (29)           |       | (39)         |
| Intercompany advances  | (94)                                 |            | 94             |       |              |
| Cash dividends   | (7)                                  |            |                |       | (7)          |
| CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES             | (104)                                | (7)        | 65             |       | (46)         |
| EFFECT OF FOREIGN CURRENCY ON CASH                           |                                      |            | 2              |       | 2            |
| CHANGE IN CASH AND CASH EQUIVALENTS                          | (18)                                 |            | 133            |       | 115          |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD             | 63                                   |            | 124            |       | 187          |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD                   | \$ 45                                | \$         | 257            | \$    | \$ 302       |



**ARVINMERITOR, INC.**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**OVERVIEW**

ArvinMeritor, Inc. is a global supplier of a broad range of integrated systems, modules and components to the motor vehicle industry. The company serves light vehicle, commercial truck, trailer and specialty original equipment manufacturers and certain aftermarkets. Headquartered in Troy, Michigan, the company employs approximately 27,500 people at more than 112 manufacturing facilities in 26 countries. ArvinMeritor common stock is traded on the New York Stock Exchange under the ticker symbol ARM.

In the first quarter of fiscal year 2007, we merged our light and commercial vehicle emissions businesses into a combined Emissions Technologies (ET) reporting segment. Prior year comparisons have been restated to reflect this new segment structure.

On February 2, 2007, we signed a definitive agreement to sell our Emissions Technologies business to an affiliate of One Equity Partners II, L.P., a private equity affiliate of J.P. Morgan Securities Inc. Total consideration is expected to be approximately \$310 million, including cash, a \$20 million note and the assumption of certain liabilities, and is subject to adjustments for working capital and other items. The transaction is expected to close during our third fiscal quarter of 2007 subject to customary conditions, including receipt of necessary regulatory consents and approvals and receipt by the purchaser of financing under its debt financing commitment letter. We expect to realize a loss on the sale of the business ranging from \$80 million to \$130 million, subject to finalizing closing assets and liabilities that will be assumed in the sale.

Our first fiscal quarter ended December 31, 2006 had mixed financial results. Our financial results for the first quarter of fiscal year 2007 were favorably impacted by strong volumes in the principal markets served by our Commercial Vehicle Systems (CVS) business. When compared to the prior year, the North American heavy-duty (commonly referred to as Class 8) truck market increased approximately 11 percent, while the North American medium-duty truck market increased by 14 percent. Western European heavy and medium duty truck production volumes decreased approximately 2 percent. The benefits of the higher volumes in our CVS business were partially offset by production interruptions and higher costs at a European axle facility related to the simultaneous launch of a new axle product line and the implementation of a new enterprise resource planning (ERP) system. Our Emissions Technologies business was unfavorably impacted by higher steel costs in the first quarter of fiscal year 2007 compared to the prior year.

A summary of our results for the three months ended December 31, 2006 is as follows:

Sales were \$2.3 billion, up twelve percent from the same period last year.

EBITDA margins were 3.6 percent, down from 5.2 percent a year ago.

Diluted earnings per share from continuing operations were \$0.16, compared to \$0.40 per share in the first quarter of fiscal year 2006. Included in the prior

Diluted loss per share from discontinued operations was \$0.06, compared to earnings per share of \$0.09 in the first quarter of fiscal year 2006. Included in

Net income was \$7 million or \$0.10 per diluted share, compared to net income of \$34 million, or \$0.49 per diluted share, last year.

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

Excess capacity;

High commodity prices, particularly for steel;

Weakened financial strength of some of the original equipment (OE) manufacturers;

Employee labor relations;

Reduced production volumes and changes in product mix in North America;

Higher energy and transportation costs;

OE pricing pressures; and

Currency exchange rate volatility.



**ARVINMERITOR, INC.**

Higher raw material costs and intense competition, coupled with global excess capacity most notably in the light vehicle industry, have created pressure from customers to reduce our prices. We continue to address these competitive challenges and offset price decreases by reducing costs, improving productivity and rationalizing operations. The company's cost reduction and productivity programs, including savings from our fiscal year 2005 restructuring actions, substantially offset the impact of lower selling prices to our customers.

Cash used for operating activities for the three months ended December 31, 2006 was \$33 million, compared to cash provided by operating activities of \$151 million in the same period last year. The decrease in cash flow was largely driven by an increase in working capital levels. Higher working capital levels are primarily due to increased sales volumes resulting in additional investment in accounts receivable and inventory and funding of payments to our suppliers relative to our fiscal quarter end.

**MARKET OUTLOOK**

Our fiscal year 2007 outlook for light vehicle production for North America and Western Europe is 15.3 million and 16.1 million units, respectively, in each region. We expect that North American heavy-duty (also referred to as Class 8) truck production will decrease in fiscal year 2007 to 235,000 units, down from 352,000 last year, and European heavy and medium truck production will increase to 475,000 units, up from 439,000 in 2006.

**COMPANY OUTLOOK**

We believe that the cyclical downturn of the Class 8 truck market and continued production cuts in our North American markets will pose short term challenges to our 2007 results. However, we believe that our current liquidity, diversified customer base and global footprint should allow us to weather these short term challenges while continuing to focus on product strategies and long term growth initiatives.

We also believe the price of steel will continue to challenge our industry during fiscal year 2007. While we generally do not expect this issue to significantly impact our results of operations when compared to the prior year, rising stainless steel prices are expected to negatively impact earnings. We have taken actions to help mitigate this issue, including finding new global steel sources, identifying alternative materials, finding ways to re-engineer our products to be less dependent on steel, working with our suppliers to reduce material costs, consolidating and selling scrap from many of our facilities and negotiating with our customers to recover some of the higher steel costs.

Significant factors that could affect the company's results in fiscal year 2007 include:

- Higher than planned price reductions to our customers;
- Additional restructuring actions and the timing and recognition of restructuring charges;
- The expected 2007 Class 8 downturn in North America or Europe is more severe than currently planned;
- Lower volume of orders from key customers;
- Our ability to recover steel price increases from our customers;
- The financial strength of our suppliers and customers, including potential bankruptcies;
- Any unplanned extended shutdowns or production interruptions; including additional work stoppages at one of our customer's facilities in Europe;
- Our ability to implement planned productivity and cost reduction initiatives;
- The impact of any acquisitions or divestitures; including the recently announced agreement to sell our Emissions Technologies business;
- Significant gains or losses of existing business;
- The ultimate outcome of the three class action lawsuits concerning our retiree medical plans;
- The impact of currency fluctuations on sales and operating income;
- The emergence from bankruptcy of certain competitors;
- Higher than planned warranty expenses;
- Any adjustments to the contingent liability associated with the Tilbury labor disruption;
- Our ability to continue to access our bank revolving credit facilities and capital markets;
- Issuance of new securities or refinancing of existing securities;
- A significant reduction of business activity in the key markets of our customers;
- Ability to implement enterprise resource planning systems at our locations successfully; and
- The impact of any new accounting rules.



**ARVINMERITOR, INC.****NON-GAAP MEASURES**

In addition to the results reported in accordance with accounting principles generally accepted in the United States (GAAP), we have provided information regarding EBITDA. EBITDA is defined as earnings before interest, income taxes, depreciation and amortization and loss on sale of receivables. We use EBITDA as the primary basis to evaluate the performance of each of our reportable segments.

Management believes EBITDA is a meaningful measure of performance as it is commonly utilized by management and investors to analyze operating performance and entity valuation. Management, the investment community and banking institutions routinely use EBITDA, together with other measures, to measure operating performance in our industry. Further, management uses EBITDA for planning and forecasting in future periods.

EBITDA should not be considered a substitute for the reported results prepared in accordance with GAAP and should not be considered as an alternative to net income as an indicator of our operating performance or to cash flows as a measure of liquidity. EBITDA, as determined and presented by the company, may not be comparable to related or similarly titled measures reported by other companies.

**RESULTS OF OPERATIONS**

The following is a summary of the financial results (in millions, except per share amounts):

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>December 31,</b>       |             |
|  | <b>2006</b>               | <b>2005</b> |
| Sales:                                     |                           |             |
| Light Vehicle Systems                      | \$ 470                    | \$ 497      |
| Commercial Vehicle Systems                 | 1,062                     | 931         |
| Emissions Technologies                     | 808                       | 670         |
| SALES                                      | \$ 2,340                  | \$ 2,098    |
| Segment EBITDA:                            |                           |             |
| Light Vehicle Systems                      | \$ 15                     | \$ 13       |
| Commercial Vehicle Systems                 | 64                        | 92          |
| Emissions Technologies                     | 6                         | 5           |
| SEGMENT EBITDA                             | 85                        | 110         |
| Depreciation and amortization              | (43)                      | (40)        |
| Loss on sale of receivables                | (2)                       |             |
| Interest expense, net and other            | (27)                      | (32)        |
| Provision for income taxes                 | (2)                       | (10)        |
| INCOME FROM CONTINUING OPERATIONS          | 11                        | 28          |
| INCOME (LOSS) FROM DISCONTINUED OPERATIONS | (4)                       | 6           |
| NET INCOME                                 | \$ 7                      | \$ 34       |
| DILUTED EARNINGS (LOSS) PER SHARE          |                           |             |
| Continuing operations                      | \$ 0.16                   | \$ 0.40     |
| Discontinued operations                    | (0.06)                    | 0.09        |
| Diluted earnings per share                 | \$ 0.10                   | \$ 0.49     |
| DILUTED AVERAGE COMMON SHARES OUTSTANDING  | 70.5                      | 69.8        |

## ARVINMERITOR, INC.

## Three Months Ended December 31, 2006 Compared to Three Months Ended December 31, 2005

*Sales*

The following table reflects geographical business segment sales for the three months ended December 31, 2006 and 2005. The reconciliation is intended to reflect the trend in business segment sales and to illustrate the impact that changes in foreign currency exchange rates had on sales (in millions).

|                | December 31, |          | Dollar<br>Change | %<br>Change | Dollar Change Due To |                   |  |
|----------------|--------------|----------|------------------|-------------|----------------------|-------------------|--|
|                | 2006         | 2005     |                  |             | Currency             | Volume<br>/ Other |  |
| <b>LVS:</b>    |              |          |                  |             |                      |                   |  |
| North America  | \$ 172       | \$ 215   | (43)             | (20)%       | \$ 2                 | (45)              |  |
| Europe         | 213          | 209      | 4                | 2%          | 20                   | (16)              |  |
| Asia and other | 85           | 73       | 12               | 16%         | 2                    | 10                |  |
|                | 470          | 497      | (27)             | (5)%        | 24                   | (51)              |  |
| <b>CVS:</b>    |              |          |                  |             |                      |                   |  |
| North America  | \$ 654       | \$ 562   | 92               | 16%         | \$ 1                 | 91                |  |
| Europe         | 279          | 258      | 21               | 8%          | 22                   | (1)               |  |
| Asia and other | 129          | 111      | 18               | 16%         | 3                    | 15                |  |
|                | 1,062        | 931      | 131              | 14%         | 26                   | 105               |  |
| <b>ET:</b>     |              |          |                  |             |                      |                   |  |
| North America  | \$ 232       | \$ 261   | (29)             | (11)%       | \$                   | (29)              |  |
| Europe         | 502          | 337      | 165              | 49%         | 32                   | 133               |  |
| Asia and other | 74           | 72       | 2                | 3%          | 2                    |                   |  |
|                | 808          | 670      | 138              | 21%         | 34                   | 104               |  |
| <b>SALES</b>   | \$ 2,340     | \$ 2,098 | 242              | 12%         | \$ 84                | 158               |  |

*Continuing Operations*

Sales for the three months ended December 31, 2006 were \$2,340 million, up \$242 million, or twelve percent, from the same period last year. The increase in sales was attributable to stronger North American commercial vehicle truck volumes in our CVS business segment, and higher pass-through sales in our ET business segment. Foreign currency translation also favorably impacted sales by \$84 million, primarily due to the stronger euro in relation to the U.S. dollar.

*Business Segments*

**Light Vehicle Systems (LVS)** sales were \$470 million for the three months ended December 31, 2006, down \$27 million, or five percent, from a year ago, primarily due to lower production volumes with domestic North American OEMs. Also negatively impacting sales was a work stoppage at one of our customer's facilities in Europe, which caused us to temporarily shut down one of our door module facilities. The effect of foreign currency translation increased sales by \$24 million.

**Commercial Vehicle Systems (CVS)** sales were \$1,062 million, up \$131 million, or fourteen percent, from the first quarter of fiscal year 2006. The increase in sales was primarily attributable to stronger North American commercial vehicle truck volumes. Compared to the first quarter of fiscal year 2006, production volumes in North American heavy duty and medium duty trucks increased approximately twelve percent. The effect of foreign currency translation increased sales by \$26 million.

**Emissions Technologies (ET)** sales were \$808 million for the three months ended December 31, 2006, up \$138 million, or twenty-one percent, from a year ago. Pass-through sales were approximately \$406 million in the first quarter of fiscal year 2007 compared to approximately \$291 million in the first quarter of fiscal year 2006. Pass-through sales are products sold to our customers where we acquire certain components and assemble them into the final product. These pass-through sales carry minimal margins, as we have little engineering or manufacturing responsibility. The effect of foreign currency translation increased sales by \$34 million.



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### ARVINMERITOR, INC.

#### *Segment EBITDA and EBITDA Margins*

The following table reflects Segment EBITDA and EBITDA margins for three months ended December 31, 2006 and 2005 (in millions).

|                | Segment EBITDA |        |                  |             |              | Segment EBITDA Margin |        |     |  |
|----------------|----------------|--------|------------------|-------------|--------------|-----------------------|--------|-----|--|
|                | December 31,   |        | Dollar<br>Change | %<br>Change | December 31, |                       | Change |     |  |
|                | 2006           | 2005   |                  |             | 2006         | 2005                  |        |     |  |
| LVS:           | \$ 15          | \$ 13  | \$ 2             | 15%         | 3.2%         | 2.6%                  | 0.6    | pts |  |
| CVS:           | 64             | 92     | (28)             | (30)%       | 6.0%         | 9.9%                  | (3.9)  | pts |  |
| ET:            | 6              | 5      | 1                | 20%         | 0.7%         | 0.7%                  |        | pts |  |
| SEGMENT EBITDA | \$ 85          | \$ 110 | \$ (25)          | (23)%       | 3.6%         | 5.2%                  | (1.6)  | pts |  |

**LVS** EBITDA was \$15 million in the first three months of fiscal year 2007, compared to EBITDA of \$13 million in the same period last year. The impact of lower North American sales volumes was partially offset by cost savings resulting from restructuring actions. In addition, the labor disruption at one of our customer's facilities in Europe, which caused us to temporarily shut down one of our door module facilities negatively impacted EBITDA in the first quarter of fiscal year 2007 by \$2 million. LVS was able to more than offset customer pricing pressures with material savings, productivity and cost reduction actions.

**CVS** EBITDA was \$64 million, down \$28 million compared to the same period last year. EBITDA margin decreased to 6.0 percent from 9.9 percent a year ago. Production interruptions and higher costs at a European axle facility related to the simultaneous launch of a new axle product line and the implementation of a new ERP system unfavorably impacted EBITDA by \$13 million in the first quarter of fiscal year 2007. These costs along with higher pension and retiree medical costs of \$5 million offset the benefits of higher CVS sales volumes. The higher pension and retiree medical costs are associated with a permanent injunction reinstating retiree medical benefits to certain UAW retirees granted by the court in fiscal year 2006 (see Note 16). The unfavorable impact of this injunction was not recorded until March 2006. Included in EBITDA for the three months ended December 31, 2005 was a \$23 million gain on the sale of certain assets of CVS off-highway brakes business.

**ET** EBITDA was \$6 million, up \$1 million compared to the same period last year. The savings from our restructuring actions were more than offset by higher steel costs, net of recoveries, of \$7 million.

#### *Other Income Statement Items*

**Operating income** for the three months ended December 31, 2006 was \$33 million, a decrease of \$33 million compared to the three months ended December 31, 2005. Operating margin was 1.4 percent, down from 3.1 percent. Operating income in the first three months of fiscal year 2007 was favorably impacted by lower incentive compensation expenses due to company performance versus plan. Included in operating income in the prior year was the \$23 million gain on the sale of certain assets of CVS off-highway brakes business.

Selling, general and administrative expenses as a percentage of sales decreased slightly to 3.7 percent in the first quarter of fiscal year 2007 from 4.2 percent a year ago.

**Equity in earnings of affiliates** was \$9 million for the three months ended December 31, 2006, compared to \$7 million in the three months ended December 31, 2005. The increase was primarily related to higher earnings of our commercial vehicle affiliates.

**Interest expense, net and other** was \$27 million, compared to \$32 million in the same period last year. The decrease in interest expense is primarily due to lower debt levels compared with the prior year.

The **provision for income taxes** was \$2 million for the three months ended December 31, 2006, compared to \$10 million in the same period last year. Lower income levels were the primary reason for the decrease. The effective tax rate was 13 percent for the quarter ended December 31, 2006 compared to 24 percent in the same period last year. The decrease in the effective tax rate is primarily due to increased earnings from foreign subsidiaries whose tax rates are less than the statutory rate as well as certain items discrete to the quarter, including recording the benefits of prior year research and development credits which were extended by legislation during the quarter.

**Income from continuing operations** for the first quarter of fiscal year 2007 was \$11 million, or \$0.16 per diluted share, compared to \$28 million, or \$0.40 per diluted share, in the prior year.





**ARVINMERITOR, INC.**

**Loss from discontinued operations** was \$4 million for the three months ended December 31, 2006 compared to income from discontinued operations of \$6 million a year ago. Included in income from discontinued operations in the first quarter of fiscal year 2006 is an after-tax loss of \$2 million on the sale of the LVS ride control business located in Asti, Italy. Income from discontinued operations in the prior year also includes a reversal of approximately \$8 million of after-tax employee severance costs that were recorded in the prior year as part of our fiscal year 2005 restructuring actions. As a result of the sale of the ride control operations in Asti, Italy these employee termination benefits were not paid by the company. The company previously expected to incur these costs as part of the closure of the ride control business in Asti, Italy. Also included in income from discontinued operations in the first quarter of fiscal year 2006 was an after-tax gain of approximately \$2 million on the sale of our 39-percent equity ownership interest in our light vehicle aftermarket joint venture, Purolator India.

**Net income** for the first quarter of fiscal year 2006 was \$7 million, or \$0.10 per diluted share, compared to net income of \$34 million, or \$0.49 per diluted share, in the prior year.

**FINANCIAL CONDITION***Capitalization*

|                      | December 31, 2006 |       | September 30, 2006 |       |
|----------------------|-------------------|-------|--------------------|-------|
| Short-term debt      | \$                | 137   | \$                 | 56    |
| Long-term debt       |                   | 1,185 |                    | 1,184 |
| Total debt           |                   | 1,322 |                    | 1,240 |
| Minority interests   |                   | 67    |                    | 65    |
| Shareowners equity   |                   | 999   |                    | 944   |
| Total capitalization | \$                | 2,388 | \$                 | 2,249 |

Ratio of debt to capitalization 55% 55%

We remain committed to strong cash flow generation, the reduction of debt and regaining investment grade financial metrics. For the first three months of fiscal 2007, our primary source of liquidity was cash from our accounts receivables securitization and factoring programs and, as required, borrowings on our revolving credit facility. Our total debt to capitalization ratio was 55 percent at both December 31 and September 30, 2006.

*Cash Flows*

|   | Three Months Ended |       |      |      |
|---|--------------------|-------|------|------|
|   | December 30,       |       |      |      |
|   | 2006               |       | 2005 |      |
| <b>OPERATING CASH FLOWS</b>                             |                    |       |      |      |
| Income from continuing operations                       | \$                 | 11    | \$   | 28   |
| Depreciation and amortization                           |                    | 43    |      | 40   |
| Gain on divestitures                                    |                    | (2)   |      | (23) |
| Restructuring costs, net of payments                    |                    | (7)   |      | (7)  |
| Pension and retiree medical expense                     |                    | 33    |      | 33   |
| Pension and retiree medical contributions               |                    | (39)  |      | (28) |
| Change in working capital                               |                    | (120) |      | 68   |
| Changes in sale of receivables                          |                    | 15    |      | 37   |
| Other   |                    | 34    |      | 14   |
| Cash provided by (used for) continuing operations       |                    | (32)  |      | 162  |
| Cash used by discontinued operations                    |                    | (1)   |      | (11) |
| <b>CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES</b> | \$                 | (33)  | \$   | 151  |

## ARVINMERITOR, INC.

**Cash used for operating activities** was \$33 million in the first three months of fiscal year 2007, compared to \$151 million of cash provided by operating activities in the prior year. The decrease in cash flow is primarily attributable to higher working capital levels and higher pension and retiree medical contributions. Higher working capital levels are primarily due to increased sales volumes resulting in additional investment in accounts receivable and inventory and funding of payments to our suppliers relative to our fiscal quarter end. Cash used by discontinued operations was \$1 million in the first quarter of fiscal year 2007 compared to \$11 million a year ago.

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>December 31,</b>       |             |
|   | <b>2006</b>               | <b>2005</b> |
| <b>INVESTING CASH FLOWS</b>   |                           |             |
| Capital expenditures  | \$ (30)                   | \$ (38)     |
| Acquisitions of businesses and investments, net of cash acquired        | (5)                       | (1)         |
| Proceeds from disposition of property and businesses                    | 5                         | 39          |
| Proceeds from marketable securities                                     | 5                         |             |
| Net investing cash flows provided by (used for) discontinued operations | (1)                       | 8           |
| <b>CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES</b>                 | <b>\$ (26)</b>            | <b>\$ 8</b> |

**Cash used for investing activities** was \$26 million in the first three months of fiscal year 2007, compared to cash provided by investing activities of \$8 million in the first three months of fiscal year 2006. Capital expenditures decreased to \$30 million compared to \$38 million in the same period last year. During the three months ended December 31, 2005, we received proceeds of \$39 million from the disposition of certain assets of our off-highway brakes business.

Discontinued operations used cash of \$1 million for capital expenditures in the first three months of fiscal year 2007 and 2006. Discontinued operations provided cash flows from investing activities of \$8 million in the first quarter of fiscal year 2006, primarily related to the cash received from the sale of our 39-percent equity ownership interest in Purolator India, a light vehicle aftermarket joint venture.

|   | <b>Three Months Ended</b> |                |
|---|---------------------------|----------------|
|   | <b>December 31,</b>       |                |
|   | <b>2006</b>               | <b>2005</b>    |
| <b>FINANCING CASH FLOWS</b>   |                           |                |
| Borrowings (payments) on accounts receivable securitization program | \$ 80                     | \$ (24)        |
| Repayment of notes  |                           | (3)            |
| Borrowings (payments) on lines of credit and other, net             | 1                         | (12)           |
| Net change in debt  | 81                        | (39)           |
| Cash dividends  | (7)                       | (7)            |
| <b>CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES</b>             | <b>\$ 74</b>              | <b>\$ (46)</b> |

**Cash provided by financing activities** was \$74 million in the first three months of fiscal year 2007, compared to cash used for financing activities of \$46 million in the first three months of fiscal year 2006. Amounts outstanding under the U.S. accounts receivable securitization program increased \$80 million during the first three months of fiscal year 2007. In the first three months of fiscal year 2006, we purchased, at a discount, \$3 million of our 6.8 percent notes on the open market. We paid dividends of \$7 million in the first three months of fiscal years 2007 and 2006.

ARVINMERITOR, INC.

## LIQUIDITY

**Revolving and Other Debt** In June 2006, we replaced our \$900 million revolving credit facility that was to expire in 2008 with two new senior secured credit facilities totaling \$1.15 billion (the new credit facilities). The new credit facilities include a \$980 million revolving credit facility and a \$170 million term loan maturing in 2011 and 2012, respectively. Borrowings under the new revolving credit facility are subject to interest based on quoted LIBOR rates plus a margin, and a commitment fee on undrawn amounts, both of which are based upon the company's current credit rating for the new credit facilities. At December 31, 2006, the margin over the LIBOR rate was 150 basis points, and the commitment fee was 30 basis points. Similar to the prior revolving credit facility, the new revolving credit facility includes a \$150 million limit on the issuance of letters of credit. At December 31 and September 30, 2006, approximately \$30 million and \$25 million of letters of credit, respectively, were issued.

The term loan is payable in quarterly installments of \$0.25 million, with the remaining balance due at maturity. Borrowings under the term loan are subject to interest based on quoted LIBOR rates plus a margin. At December 31, 2006, the margin over the LIBOR rate was 175 basis points.

Borrowings under the revolving credit facility and term loan are collateralized by approximately \$1.0 billion of the company's assets, primarily consisting of eligible domestic U.S. accounts receivable, inventory, plant, property, and equipment, intellectual property and the company's investment in all or a portion of certain of its wholly-owned subsidiaries.

Certain of the company's subsidiaries, as defined in the credit agreement, irrevocably and unconditionally guarantee amounts outstanding under the new credit facilities. The new credit facility requires us to maintain a total net debt to earnings before interest, taxes, depreciation and amortization (EBITDA) ratio of no greater than 4.25x and a minimum fixed charge coverage ratio (EBITDA less capital expenditures to interest expense) of no less than 1.50x. At December 31, 2006, we were in compliance with all covenants.

We also have an arrangement with a non-consolidated joint venture that allows us to borrow funds from time to time, at LIBOR plus 50 basis points. No amounts were outstanding under this arrangement at December 31 and September 30, 2006.

**Debt Securities** - In fiscal year 2006, we completed several transactions which strengthened our ongoing liquidity by extending or eliminating certain debt maturities. Specifically, we purchased, at a discount, \$69 million of our \$380 million outstanding 8-3/4 percent notes and \$3 million of our outstanding 6.8 percent notes on the open market and we completed an offer to repurchase \$600 million aggregate principal amount of our previously outstanding notes in the following amounts: \$195 million of our outstanding \$200 million 6.625 percent notes due in 2007; \$95 million of our outstanding \$100 million 6.75 percent notes due in 2008; \$225 million of our outstanding \$302 million 6.8 percent notes due in 2009; and \$85 million of our outstanding \$91 million 7.125 percent notes also due in 2009. Also in fiscal year 2006, we purchased \$12 million of U.S. government securities and placed those securities into an irrevocable trust, for the sole purpose of funding payments of principal and interest through the stated maturity on the \$5 million outstanding 6-3/4% notes due 2008 and the \$6 million outstanding 7.125% notes due 2009, in order to defease certain covenants under the associated indenture.

We have \$150 million of debt securities remaining unissued under our shelf registration filed with the SEC in April 2001.

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**Convertible Notes** In March 2006, the company issued \$300 million of 4.625 percent convertible senior unsecured notes due 2026 (the convertible notes ). The convertible notes were sold by the company to qualified institutional buyers in a private placement exempt from the registration requirements of the Securities Act of 1933. These convertible notes were registered with the Securities and Exchange Commission under the Securities Act of 1933 on May 23, 2006. Net proceeds received by the company, after issuance costs, were \$289 million. Cash interest at a rate of 4.625 percent per annum from the date of issuance through March 1, 2016 is payable semi-annually in arrears on March 1 and September 1 of each year. After March 1, 2016, the principal amount of the convertible notes will be subject to accretion at a rate that provides holders with an aggregate annual yield to maturity of 4.625 percent.

The notes are convertible into shares of the company s common stock at an initial conversion rate, subject to adjustment, equivalent to 47.6667 shares of common stock per \$1,000 initial principal amount of notes, which represents an initial conversion price of approximately \$20.98 per share. If converted, the accreted principal amount will be settled in cash and the remainder of the company s conversion obligation, if any, in excess of such accreted principal amount will be settled in cash, shares of common stock, or a combination thereof, at the company s election.

**ARVINMERITOR, INC.**

Holders may convert their notes at any time on or after March 1, 2024. Prior to March 1, 2024, holders may convert their notes only under the following circumstances:

during any calendar quarter, after the calendar quarter ending June 30, 2006, if the closing price of our common stock for 20 or more trading days in a period during the five business day period after any five consecutive trading day period in which the average trading price per \$1,000 initial principal amount of notes is at least 150 percent of the average trading price per \$1,000 initial principal amount of notes during the five business day period immediately preceding such period; or upon the occurrence of specified corporate transactions; or if the notes are called by us for redemption.

On or after March 1, 2016, we may redeem the convertible notes, in whole or in part, for cash at a redemption price equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest. On each of March 1, 2016, 2018, 2020, 2022, and 2024, or upon certain fundamental changes, holders may require the company to purchase all or a portion of their convertible notes at a purchase price in cash equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest.

On February 8, 2007, we completed a private placement to qualified institutional buyers of \$175 million aggregate principal amount of convertible senior unsecured notes due 2027 (the "notes"). We have granted to the initial purchasers of the notes a 30-day option to purchase up to an additional \$25 million aggregate principal amount of notes. Net proceeds from the notes were approximately \$169 million before exercise of the initial purchasers' over-allotment option. Proceeds will be used for general corporate purposes, including retiring other indebtedness or funding certain pension or other long-term liabilities. The notes bear cash interest at a rate of 4.0 percent per annum payable semiannually in arrears until February 15, 2019, after which no cash interest will be paid. Commencing February 15, 2019, the principal amount of the notes will be subject to accretion at a rate that provides holders with an aggregate annual yield to maturity of 4%. The notes are convertible into shares of our common stock at an initial conversion rate, subject to adjustment, equivalent to 37.4111 shares of common stock per \$1,000 initial principal amount of notes, which represents an initial conversion price of approximately \$26.73 per share. General conversion terms are substantially consistent with the company's existing 4.625% convertible senior notes due 2026. On or after February 15, 2019, we may redeem the convertible notes, in whole or in part, for cash at a redemption price equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest. On each of February 15, 2019 and February 15, 2022, holders may require us to purchase all or a portion of their convertible notes at a purchase price in cash equal to 100 percent of the accreted principal amount plus any accrued and unpaid interest.

**Accounts Receivable Securitization and Factoring** In March 2006, we entered into a new European arrangement to sell trade receivables through one of our European subsidiaries. Under the new arrangement, we can sell up to, at any point in time, 100 million (\$132 million) of eligible trade receivables. The receivables under this program are sold at face value and excluded from the consolidated balance sheet. We continue to perform collection and administrative functions related to these receivables. We had utilized 48 million (\$63 million) and 48 million (\$61 million) of this accounts receivable securitization facility as of December 31 and September 30, 2006, respectively.

We also participate in a U.S. accounts receivable securitization program to enhance financial flexibility and lower interest costs. Under this \$250 million program, which was established in September 2005 and amended in fiscal year 2006, we sell substantially all of the trade receivables of certain U.S. subsidiaries to ArvinMeritor Receivables Corporation (ARC), a wholly-owned, special purpose subsidiary. ARC funds these purchases with borrowings under a loan agreement with a bank. Amounts outstanding under this agreement are collateralized by eligible receivables purchased by ARC and are reported as short-term debt in the consolidated balance sheet (see Note 8). As of December 31, 2006 and September 30, 2006 we had utilized \$120 million and \$40 million, respectively, of this accounts receivable securitization facility. Borrowings under this arrangement are collateralized by approximately \$311 million of receivables held at ARC at December 31, 2006. If certain receivables performance-based covenants are not met, it would constitute a termination event, which, at the option of the banks, could result in termination of the accounts receivable securitization arrangement. At December 31, 2006, we were in compliance with all covenants.

In addition, several of our European subsidiaries factor eligible accounts receivable with financial institutions. Certain receivables are factored without recourse to the company and are excluded from accounts receivable. The amount of factored receivables excluded from accounts receivable was \$105 million and \$84 million at December 31, 2006 and September 30, 2006, respectively.



**ARVINMERITOR, INC.**

**Credit Ratings** - Our corporate credit rating at Moody's Investors Service was lowered on January 19, 2007, to Ba3 from Ba2. On January 23, 2007, Standard & Poor's lowered our corporate credit rating to BB- from BB. Based on current credit ratings, the applicable margin over LIBOR rate on our \$980 million revolving credit facility will increase to 175 basis points from 150 basis points, and the commitment fee will increase to 37.5 basis points from 30 basis points.

**Off-Balance Sheet Arrangements**

**Guarantees** - In December 2005, we guaranteed a third party's obligation to reimburse another party (the other party) for payment of health and prescription drug benefits to a group of retired employees. The retirees were former employees of a wholly-owned subsidiary of the company prior to its being acquired by the company. To date, the third party has met its obligations to reimburse the other party. The APBO associated with these retiree medical benefits is considered the maximum potential exposure under this guarantee, and is estimated to be approximately \$25 million. No amount has been recorded for this guarantee based on the probability of our having to perform under the guarantee. Due to the nature of this guarantee it is difficult to estimate its approximate term.

We have guaranteed certain trade payable balances of one of its non-consolidated joint ventures. In the event of a default by the joint venture, we would be required to pay the guaranteed party. The maximum exposure under the guarantee is \$4 million and can be terminated by the company at any time on thirty days written notice. The estimated fair value of this guarantee is not significant, and therefore, no liability is recorded.

In addition to these guarantees we have other off-balance sheet arrangements, primarily related to our European accounts receivable securitization program and letters of credit under our senior secured credit facilities. See *Revolving and Other Debt* and *Accounts Receivable Securitization and Factoring*.

**New Accounting Pronouncements**

New accounting pronouncements are discussed in Note 3 of the Notes to Consolidated Financial Statements.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

We are exposed to global market risks including foreign currency exchange rate risk related to our transactions denominated in currencies other than the U.S. dollar and interest rate risk associated with our debt.

We use foreign currency forward contracts to manage the exposures arising from foreign currency exchange risk. Gains and losses on the underlying foreign currency exposures are partially offset with gains and losses on the foreign currency forward contracts. Under this program, we have designated the foreign currency contracts (the contracts) as cash flow hedges of underlying foreign currency forecasted purchases and sales. The effective portion of changes in the fair value of the contracts is recorded in Accumulated Other Comprehensive Income (AOCI) in the statement of shareowners' equity and is recognized in operating income when the underlying forecasted transaction impacts earnings. The contracts generally mature within 12 months. Prior to this program, we used foreign exchange contracts to offset the effect of exchange rate fluctuations on foreign currency denominated payables and receivables but did not designate these contracts as hedges for accounting purposes. These contracts were generally of short duration (less than three months). It is difficult to predict the impact the euro and other currencies will have on our sales and operating income in the upcoming year.

We also use interest rate swaps to manage the proportion of variable rate debt to fixed rate debt. It is our policy not to enter into derivative instruments for speculative purposes, and therefore, we hold no derivative instruments for trading purposes.

*Sensitivity Analysis:* We use sensitivity models to calculate the fair value and cash flow impact that a hypothetical change in market currency rates and interest rates would have on derivative and debt instruments. Actual gains or losses in the future may differ significantly from that analysis, however, based on changes in the timing and amount of interest rate and foreign currency exchange rate movements and the company's actual exposures.





**ARVINMERITOR, INC.**

The results of the sensitivity analysis are as follows (in millions):

|   |    | Assuming a 10% Increase in Rates | Assuming a 10% Decrease in Rates | Increase / (Decrease) on |
|---|----|----------------------------------|----------------------------------|--------------------------|
| <b>Market Risk</b>                                |    |                                  |                                  |                          |
| <b>Foreign Currency Sensitivity:</b>              |    |                                  |                                  |                          |
| Forward contracts <sup>(1)</sup>                  | \$ | 9.0                              | (9.0)                            | Fair Value               |
| Foreign currency denominated debt                 | \$ | 1.5                              | (1.5)                            | Fair Value               |
| <b>Interest Rate Sensitivity:</b>                 |    |                                  |                                  |                          |
| Debt - fixed rate                                 | \$ | (38.7)                           | 41.2                             | Fair Value               |
| Debt - variable rate                              | \$ | (3.6)                            | 3.6                              | Cash Flow                |
| Interest rate swaps (pay variable, receive fixed) | \$ | (6.6)                            | 6.6                              | Fair Value               |

<sup>(1)</sup> Includes only the risk related to the derivative instruments that serve as hedges and does not include the risk related to the underlying hedged item or on other operating transactions. The analyses assume overall derivative instruments and debt levels remain unchanged for each hypothetical scenario.

**Item 4. Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934, management, with the participation of Charles G. McClure, Jr., Chairman of the Board, Chief Executive Officer and President, and James D. Donlon, III, Senior Vice President and Chief Financial Officer, evaluated the effectiveness of the design and operation of the company's disclosure controls and procedures as of December 31, 2006. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2006, the company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports the company files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

In December 2006, the company implemented a new enterprise resource planning system in a large European plant. This change is part of the company's plan to integrate, consolidate, and standardize its information systems. Except for the described system implementation, there have been no changes in the company's internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

In connection with the rule, the company continues to review and document its disclosure controls and procedures, including the company's internal control over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and ensuring that the company's systems evolve with the business.

ARVINMERITOR, INC.

**PART II. OTHER INFORMATION**

**Item 5. Other Information**

Cautionary Statement

This Quarterly Report on Form 10-Q contains statements relating to future results of the company (including certain projections and business trends) that are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are typically identified by words or phrases such as believe, expect, anticipate, estimate, should, are likely to be, will and similar expressions. Results may differ materially from those projected as a result of certain risks and uncertainties, including but not limited to global economic and market cycles and conditions; the demand for commercial, specialty and light vehicles for which the company supplies products; risks inherent in operating abroad (including foreign currency exchange rates and potential disruption of production and supply due to terrorist attacks or acts of aggression); availability and cost of raw materials, including steel; OEM program delays; demand for and market acceptance of new and existing products; successful development of new products; reliance on major OEM customers; labor relations of the company, its suppliers and customers, including potential disruptions in supply of parts to our facilities or demand for our products due to work stoppages; the financial condition of the company's suppliers and customers, including potential bankruptcies; possible adverse effects of any future suspension of normal trade credit terms by our suppliers; potential difficulties competing with companies that have avoided their existing contracts in bankruptcy and reorganization proceedings; successful integration of acquired or merged businesses; the ability to achieve the expected annual savings and synergies from past and future business combinations and the ability to achieve the expected benefits of restructuring actions; success and timing of potential divestitures, including our recently announced agreement to sell our Emissions Technologies business; potential impairment of long-lived assets, including goodwill; competitive product and pricing pressures; the amount of the company's debt; the ability of the company to continue to comply with covenants in its financing agreements; the ability of the company to access capital markets; credit ratings of the company's debt; the outcome of existing and any future legal proceedings, including any litigation with respect to environmental or asbestos-related matters; rising costs of pension and other post-retirement benefits and possible changes in pension and other accounting rules; as well as other risks and uncertainties, including but not limited to those detailed herein and from time to time in other filings of the company with the SEC. See also Management's Discussion and Analysis of Results of Operations and Financial Condition and Quantitative and Qualitative Disclosures about Market Risk herein. These forward-looking statements are made only as of the date hereof, and the company undertakes no obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise, except as otherwise required by law.

**Item 6. Exhibits.**

- 10-a 2007 Long Term Incentive Plan, filed as Exhibit 10 to the company's Current Report on Form 8-K dated January 26, 2007 (File No. 1-15983), is incorporated by reference.
- 12 Computation of ratio of earnings to fixed charges
- 23 Consent of Bates White LLC
- 31-a Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended (Exchange Act)
- 31-b Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Exchange Act
- 32-a Certification of the Chief Executive Officer pursuant to Rule 13a-14(b) under the Exchange Act and 18 U.S.C. Section 1350
- 32-b Certification of the Chief Financial Officer pursuant to Rule 13a-14(b) under the Exchange Act and 18 U.S.C. Section 1350

ARVINMERITOR, INC.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARVINMERITOR, INC.

Date: February 9, 2007

By: /s/

V. G. Baker, II  
V. G. Baker, II  
Senior Vice President and General Counsel  
(For the registrant)

Date: February 9, 2007

By: /s/

J.A. Craig  
J.A. Craig  
Vice President and Controller  
(Chief Accounting Officer)