MERITOR INC
Form 10-Q
August 02, 2018
Index

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended July 1, 2018
Commission File No. 1-15983

MERITOR, INC.

(Exact name of registrant as specified in its charter)

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

(248) 435-1000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YesXNo
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Registration S-T during the preceding twelve months (or for such shorter period that the registrant was required to submit and post such files).
YesXNo
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	X	Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes NoX
86,482,913 shares of Common Stock, $1.00 par value, of Meritor, Inc. were outstanding on July 31, 2018.

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MERITOR, INC.

PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(in millions, except per share amounts)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
	(Unaudited)			
Sales	$1,129	$920	$3,098	$2,425
Cost of sales	(952)	(778)	(2,603)	(2,073)
GROSS MARGIN	177	142	495	352
Selling, general and administrative	(76)	(73)	(217)	(192)
Restructuring costs	(3)	—	(6)	(4)
Other operating expense, net	—	—	(12)	(5)
OPERATING INCOME	98	69	260	151
Other income, net	2	1	1	1
Equity in earnings of affiliates	9	14	20	32
Interest expense, net	(14)	(21)	(54)	(63)
INCOME BEFORE INCOME TAXES	95	63	227	121
Provision for income taxes	(26)	(11)	(131)	(30)
INCOME FROM CONTINUING OPERATIONS	69	52	96	91
LOSS FROM DISCONTINUED OPERATIONS, net of tax	(2)	(1)	(3)	(1)
NET INCOME	67	51	93	90
Less: Net income attributable to noncontrolling interests	(3)	(3)	(8)	(5)
NET INCOME ATTRIBUTABLE TO MERITOR, INC.	$64	$48	$85	$85
NET INCOME (LOSS) ATTRIBUTABLE TO MERITOR, INC.				
Net income from continuing operations	$66	$49	$88	$86
Loss from discontinued operations	(2)	(1)	(3)	(1)
Net income	$64	$48	$85	$85
BASIC EARNINGS (LOSS) PER SHARE				
Continuing operations	$0.76	$0.55	$1.00	$0.98
Discontinued operations	(0.02)	(0.01)	(0.03)	(0.01)
Basic earnings per share	$0.74	$0.54	$0.97	$0.97
DILUTED EARNINGS (LOSS) PER SHARE				
Continuing operations	$0.73	$0.52	$0.96	$0.94
Discontinued operations	(0.02)	(0.01)	(0.03)	(0.01)
Diluted earnings per share	$0.71	$0.51	$0.93	$0.93
Basic average common shares outstanding	87.2	88.4	88.1	87.9
Diluted average common shares outstanding	89.8	93.3	91.2	91.4

See notes to condensed consolidated financial statements.

MERITOR, INC.

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
	(Unaudited)			
Net income	$67	$51	$93	$90
Other comprehensive income (loss):				
Foreign currency translation adjustments:				
Attributable to Meritor, Inc.	(52)	17	(46)	8
Attributable to noncontrolling interest	(2)	—	(1)	(1)
Pension and other postretirement benefit related adjustments	3	11	9	33
Unrealized gain on investments and foreign exchange contracts	1	(2)	4	—
Other comprehensive income (loss), net of tax	(50)	26	(34)	40
Total comprehensive income	17	77	59	130
Less: Comprehensive income attributable to noncontrolling interest	(1)	(3)	(7)	(4)
Comprehensive income attributable to Meritor, Inc.	$16	$74	$52	$126

See notes to condensed consolidated financial statements.

MERITOR, INC.

CONDENSED CONSOLIDATED BALANCE SHEET
(in millions)

	June 30, 2018 (Unaudited)	September 30, 2017
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents [1]	$100	$ 88
Receivables, trade and other, net [1]	609	789
Inventories [1]	466	378
Other current assets	36	43
TOTAL CURRENT ASSETS	1,211	1,298
NET PROPERTY [1]	447	474
GOODWILL [1]	419	414
OTHER ASSETS [1]	539	596
TOTAL ASSETS	$2,616	$ 2,782
LIABILITIES, MEZZANINE EQUITY AND EQUITY		
CURRENT LIABILITIES:		
Short-term debt	$48	$ 288
Accounts and notes payable [1]	731	622
Other current liabilities	278	272
TOTAL CURRENT LIABILITIES	1,057	1,182
LONG-TERM DEBT	728	750
RETIREMENT BENEFITS	282	314
OTHER LIABILITIES	244	239
TOTAL LIABILITIES	2,311	2,485
COMMITMENTS AND CONTINGENCIES (See Note 20)		
MEZZANINE EQUITY:		
Convertible debt with cash settlement	2	2
EQUITY:		
Common stock (June 30, 2018 and September 30, 2017, 102.1 and 101.4 shares issued and 86.5 and 88.6 shares outstanding, respectively)	102	101
Additional paid-in capital	779	765
Retained earnings	168	83
Treasury stock, at cost (June 30, 2018 and September 30, 2017, 15.6 and 12.8 shares, respectively)	(199)	(136)
Accumulated other comprehensive loss	(578)	(545)
Total equity attributable to Meritor, Inc.	272	268
Noncontrolling interests [1]	31	27
TOTAL EQUITY	303	295
TOTAL LIABILITIES, MEZZANINE EQUITY AND EQUITY	$2,616	$ 2,782

[1] As of June 30, 2018, Assets and liabilities held for sale consisted of $1 million Net property. As of September 30, 2017, Assets and liabilities held for sale were: (i) $1 million Cash and cash equivalents; (ii) $13 million Receivables, trade and other, net; (iii) $2 million Inventories; (iv) $3 million Net property; (v) $1 million Goodwill; (vi) $1 million Other assets; (vii) $12 million Accounts and notes payable; and (viii) $2 million Noncontrolling interests.
See notes to condensed consolidated financial statements.

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MERITOR, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions)

	Nine Months Ended June 30,	
	2018	2017
	(Unaudited)	
OPERATING ACTIVITIES		
CASH PROVIDED BY OPERATING ACTIVITIES (See Note 10)	$191	$136
INVESTING ACTIVITIES		
Capital expenditures	(52)	(52)
Proceeds from prior year sale of equity method investment	250	—
Cash paid for acquisition of AA Gear & Manufacturing, Inc.	(36)	—
Cash paid for investment in Transportation Power, Inc.	(6)	—
Proceeds from sale of a business	4	—
Proceeds from sale of assets	2	—
Net investing cash flows provided by discontinued operations	—	2
CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	162	(50)
FINANCING ACTIVITIES		
Borrowings and securitization	(89)	—
Redemption of notes	(181)	—
Debt issuance costs	—	(4)
Other financing activities	(3)	(12)
Net change in debt	(273)	(16)
Repurchase of common stock	(63)	—
CASH USED FOR FINANCING ACTIVITIES	(336)	(16)
EFFECT OF CHANGES IN FOREIGN CURRENCY EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(5)	1
CHANGE IN CASH AND CASH EQUIVALENTS	12	71
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	88	160
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$100	$231

See notes to condensed consolidated financial statements.

MERITOR, INC.

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

	Common Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Treasury Stock	Accumulated Other Comprehensive Loss	Total Equity (Deficit) Attributable to Meritor, Inc.	Noncontrolling Interests	Total
Beginning balance at September 30, 2017	$ 101	$ 765	$ 83	$ (136)	$ (545)	$ 268	$ 27	$ 295
Comprehensive income (loss)	—	—	85	—	(33)	52	7	59
Equity based compensation expense	—	14	—	—	—	14	—	14
Vesting of equity based awards	1	(1)	—	—	—	—	—	—
Repurchase of common stock	—	—	—	(63)	—	(63)	—	(63)
Noncontrolling interest dividend	—	—	—	—	—	—	(1)	(1)
Other equity adjustments	—	1	—	—	—	1	(2)	(1)
Ending Balance at June 30, 2018	$ 102	$ 779	$ 168	$ (199)	$ (578)	$ 272	$ 31	$ 303
Beginning balance at September 30, 2016	$ 99	$ 876	$ (241)	$ (136)	$ (809)	$ (211)	$ 25	$ (186)
Comprehensive income	—	—	85	—	41	126	4	130
Equity based compensation expense	—	12	—	—	—	12	—	12
Vesting of equity based awards	2	(2)	—	—	—	—	—	—
Stock option exercises	—	2	—	—	—	2	—	2
Convertible debt with cash settlement	—	(12)	—	—	—	(12)	—	(12)
Noncontrolling interest dividends	—	—	—	—	—	—	(1)	(1)
Other equity adjustments	—	(1)	—	—	—	(1)	—	(1)
Ending Balance at June 30, 2017	$ 101	$ 875	$ (156)	$ (136)	$ (768)	$ (84)	$ 28	$ (56)

See notes to condensed consolidated financial statements.

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

1. Basis of Presentation
Meritor, Inc. (the “company” or “Meritor”), headquartered in Troy, Michigan, is a premier global supplier of a broad range of integrated systems, modules and components to original equipment manufacturers (“OEMs”) and the aftermarket for the commercial vehicle, transportation and industrial sectors. The company serves commercial truck, trailer, military, bus and coach, construction and other industrial OEMs and certain aftermarkets. The condensed consolidated financial statements are those of the company and its consolidated subsidiaries.
Certain businesses are reported in discontinued operations in the condensed consolidated statement of operations, condensed consolidated statement of cash flows and related notes for all periods presented. Additional information regarding discontinued operations is discussed in Note 4.
In the opinion of the company, the unaudited condensed consolidated financial statements contain all adjustments, consisting solely of adjustments of a normal, recurring nature, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. These statements should be read in conjunction with the company’s audited consolidated financial statements and notes thereto included in the company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017, as amended. The condensed consolidated balance sheet data as of September 30, 2017 was derived from audited financial statements but does not include all annual disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the three and nine months ended June 30, 2018 are not necessarily indicative of the results for the full year.
The company’s fiscal year ends on the Sunday nearest September 30, and its fiscal quarters generally end on the Sundays nearest December 31, March 31 and June 30. The third quarter of fiscal years 2018 and 2017 ended on July 1, 2018 and July 2, 2017, respectively. All year and quarter references relate to the company’s fiscal year and fiscal quarters, unless otherwise stated. For ease of presentation, September 30 and June 30 are used consistently throughout this report to represent the fiscal year end and third fiscal quarter end, respectively.
2. Earnings per Share
Basic earnings (loss) per share is calculated using the weighted average number of shares outstanding during each period. The diluted earnings (loss) per share calculation includes the impact of dilutive common stock options, restricted shares, restricted share units, performance share unit awards and convertible securities, if applicable.
A reconciliation of basic average common shares outstanding to diluted average common shares outstanding is as follows (in millions):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Basic average common shares outstanding	87.2	88.4	88.1	87.9
Impact of restricted shares, restricted share units and performance share units	1.7	1.8	2.1	1.4
Impact of convertible notes	0.9	3.1	1.0	2.1
Diluted average common shares outstanding	89.8	93.3	91.2	91.4

In November 2017, the Board of Directors approved a grant of performance share units to all executives eligible to participate in the long-term incentive plan. Each performance share unit represents the right to receive one share of common stock or its cash equivalent upon achievement of certain performance and time vesting criteria. The fair value of each performance share unit was $24.79, which was the company’s share price on the grant date of December 1, 2017. The Board of Directors also approved a grant of 0.3 million restricted share units to these executives. The restricted share units vest at the earlier of three years from the date of grant or upon termination of employment with the company under certain circumstances. The fair value of each restricted share unit was $24.79, which was the

company's share price on the grant date of December 1, 2017.
The actual number of performance share units that will vest depends upon the company’s performance relative to the established performance metrics for the three-year performance period of October 1, 2017 to September 30, 2020, measured at the end of the performance period. The number of performance share units that vest will depend on adjusted EBITDA margin and adjusted diluted earnings per share from continuing operations at the following weights: 50% associated with achieving an adjusted EBITDA

margin target and 50% associated with achieving an adjusted diluted earnings per share from continuing operations target. The number of performance share units that vest will be between 0% and 200% of the grant date amount of 0.3 million performance share units.

In November 2016, the Board of Directors approved a grant of performance share units to all executives eligible to participate in the long-term incentive plan. Each performance share unit represents the right to receive one share of common stock or its cash equivalent upon achievement of certain performance and time vesting criteria. The fair value of each performance share unit was $12.77, which was the company's share price on the grant date of December 1, 2016. The Board of Directors also approved a grant of 0.5 million restricted share units to these executives. The restricted share units vest at the earlier of three years from the date of grant or upon termination of employment with the company under certain circumstances. The fair value of each restricted share unit was $12.77, which was the company's share price on the grant date of December 1, 2016.

The actual number of performance share units that will vest depends upon the company's performance relative to the established M2019 goals for the three-year performance period of October 1, 2016 to September 30, 2019, measured at the end of the performance period. The number of performance share units will depend on meeting the established M2019 goals at the following weights: 50% associated with achieving an adjusted diluted earnings per share from continuing operations target, 25% associated with achieving revenue growth above market and 25% associated with achieving a net debt to adjusted EBITDA target. The number of performance share units that vest will be between 0% and 200% of the grant date amount of 0.6 million performance share units.

In November 2015, the Board of Directors approved a grant of performance share units to all executives eligible to participate in the long-term incentive plan. Each performance share unit represents the right to receive one share of common stock or its cash equivalent upon achievement of certain performance and time vesting criteria. The fair value of each performance share unit was $10.51, which was the company's share price on the grant date of December 1, 2015. The Board of Directors also approved a grant of 0.5 million restricted share units to these executives. The restricted share units vest at the earlier of three years from the date of grant or upon termination of employment with the company under certain circumstances. The fair value of each restricted share unit was $10.51, which was the company's share price on the grant date of December 1, 2015.

The actual number of performance share units that will vest depends upon the company's performance relative to the established performance metrics for the three-year performance period of October 1, 2015 to September 30, 2018, measured at the end of the performance period. The number of performance share units that vest will depend on adjusted EBITDA margin and adjusted diluted earnings per share from continuing operations at the following weights: 50% associated with achieving an adjusted EBITDA margin target and 50% associated with achieving an adjusted diluted earnings per share from continuing operations target. The number of performance share units that vest will be between 0% and 200% of the grant date amount of 0.7 million performance share units.

For each of the three and nine months ended June 30, 2018, the dilutive impact of previously issued restricted shares, restricted share units and performance share units was 1.7 million and 2.1 million shares, respectively. For the three and nine months ended June 30, 2017, the dilutive impact of previously issued restricted shares, restricted share units, and performance share units was 1.8 million and 1.4 million shares, respectively. For the three and nine months ended June 30, 2018, compensation cost related to restricted shares, restricted share units and performance share units was $4 million and $14 million, respectively. For the three and nine months ended June 30, 2017, compensation cost related to restricted shares, restricted share units and performance share units was $5 million and $12 million, respectively.

For the three and nine months ended June 30, 2018, 0.9 million and 1.0 million shares, respectively, were included in the computation of diluted earnings per share, as the company's average stock price during these periods exceeded the conversion price for the 7.875 percent convertible notes due 2026. For the three and nine months ended June 30, 2017, 3.1 million and 2.1 million shares, respectively, were included in the computation of diluted earnings per share, as the

company's average stock price during these periods exceeded the conversion price for the 7.875 percent convertible notes due 2026.
3. New Accounting Standards
Accounting standards implemented during fiscal year 2018
In July 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-09, Codification Improvements. The amendments in this ASU result from the FASB’s standing project to address suggestions on the Accounting Standards Codification and to make other incremental improvements to Generally Accepted Accounting Principles

("GAAP"). The amendments include changes to clarify the Codification or correct unintended application of guidance that is not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities.

Some of the amendments in this ASU were effective upon issuance. Others have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. And some are conforming amendments that have been made to recently issued guidance that is not yet effective that may require application of the transition and effective date guidance in the original ASU.

The amendments that were effective upon issuance did not have a material impact on the company's consolidated financial statements. The company plans to implement the remaining amendments beginning October 1, 2019 and is currently evaluating the potential impact on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The amendment changes the recognition and presentation requirements of hedge accounting, including eliminating the requirement to separately measure and report hedge ineffectiveness and presenting all items that affect earnings in the same income statement line as the hedged item. The guidance also eases certain documentation and assessment requirements and modifies the accounting components excluded from the assessment of hedge effectiveness. Changes to income statement classification and financial statement disclosures will be applied prospectively from the date of adoption. The company adopted this standard in the first quarter of fiscal year 2018. This guidance did not have a material impact on the consolidated financial statements.

In October 2016, the FASB issued ASU 2016-17, Consolidation (Topic 810): Interests held through Related Parties that are under Common Control, which alters how a decision maker needs to consider indirect interests in a variable interest entity ("VIE") held through an entity under common control. Under the ASU, if a decision maker is required to evaluate whether it is the primary beneficiary of a VIE, it will need to consider only its proportionate indirect interest in the VIE held through a common control party. The company adopted this standard in the first quarter of fiscal year 2018. This guidance did not have a material impact on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation—Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting. The ASU intends to simplify how share-based payments are accounted for, including accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. The company adopted this standard in the first quarter of fiscal year 2018. Following adoption of this standard, all excess tax benefits and all tax deficiencies generated in the current and future periods will be prospectively recorded as income tax benefit or expense in the company’s consolidated statement of operations in the reporting period in which they occur. An income tax benefit of approximately $1 million was recognized in the quarterly period ended December 31, 2017 as a result of the adoption of ASU 2016-09 and a corresponding $1 million increase in income from continuing operations and net income was recognized during the period. The amendments in the guidance that require application using a modified retrospective transition method did not impact the company. Therefore, there was no cumulative-effect adjustment to retained earnings recognized as of October 2, 2017. The company has elected to continue to estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized in each period.

In March 2016, the FASB issued ASU 2016-07, Investments—Equity Method and Joint Ventures (Topic 323), Simplifying the Transition to the Equity Method of Accounting. The ASU eliminates the requirement to apply the equity method of accounting retrospectively when a reporting entity obtains significant influence over a previously held investment. The company adopted this standard in the first quarter of fiscal year 2018. This guidance did not have a material impact on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging (Topic 815), Contingent Put and Call Options in Debt Instruments. The ASU clarifies that an exercise contingency itself does not need to be evaluated to determine whether it is in an embedded derivative, just the underlying option. The company adopted this standard in the first quarter of fiscal year 2018. This guidance did not have a material impact on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815), Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. The update clarifies that a change in a counterparty to a derivative instrument designated as a hedging instrument would not require the entity to dedesignate the hedging relationship and discontinue the application of hedge accounting. The company adopted this standard in the first quarter of fiscal year 2018. This guidance did not have a material impact on the consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which requires entities that measure inventory using first-in, first-out ("FIFO") or average cost to measure inventory at the lower of cost and net realizable value. The company adopted this standard in the first quarter of fiscal year 2018. This guidance did not have a material impact on the consolidated financial statements.

Accounting standards to be implemented

In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements. The amendments in this ASU affect the guidance issued in ASU 2016-02, Leases (Topic 842), which is not yet effective. The amendments provide entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The amendments also provide lessors with a practical expedient to not separate nonlease components from the associated lease component and, instead, to account for those components as a single component in certain circumstances. The effective date for this ASU are the same as those for ASU 2016-02 as described below. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2019 in connection with its planned implementation of ASU 2016-02 and is currently assessing the potential impact of this new guidance on its accounting policies and its consolidated financial statements.

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842. The amendments in this ASU affect narrow aspects of the guidance issued in ASU 2016-02, Leases (Topic 842), which is not yet effective. The effective date and transition requirements for this ASU are the same as those for ASU 2016-02 as described below. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2019 in connection with its planned implementation of ASU 2016-02 and is currently assessing the potential impact of this new guidance on its accounting policies and its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220). The guidance in ASU 2018-02 allows an entity to elect to reclassify the stranded tax effects related to the Tax Cuts and Jobs Act of 2017 ("U.S. tax reform") from accumulated other comprehensive income into retained earnings. ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The company is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In January 2018, the FASB issued ASU 2018-01, Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842. ASU 2018-01 permits an entity to elect an optional transition practical expedient to not evaluate land easements that exist or expired before the entity’s adoption of Topic 842 and that were not previously accounted for as leases under Topic 840. The amendments in this update affect the guidance in ASU 2016-02, which is not effective yet. The effective date and the transition requirements for the amendments in ASU 2018-01 are the same as the effective date and transition requirements in ASU 2016-02 as described below. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2019 in connection with its planned implementation of ASU 2016-02 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting. ASU 2017-09 amends the scope of modification accounting for share-based payment arrangements and provides guidance on when an entity would be required to apply modification accounting. This standard is effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15,

2017. Early adoption is permitted, including adoption in any interim period. The amendments in this update should be applied prospectively. The company is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. ASU 2017-08 affects entities who own investments in callable debt securities and aligns the amortization period of premiums on callable debt securities to expectations incorporated in market pricing on the underlying securities. This standard is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. The amendments in this update should be applied on a modified retrospective basis through a cumulative-effective adjustment directly to retained earnings at the beginning of the adoption period. The company does not expect a material impact on its consolidated financial statements from adoption of this guidance.

In March 2017, the FASB issued ASU 2017-07, Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The new guidance requires entities to only include the service cost component of net periodic pension cost and net periodic postretirement benefit cost in operating expenses (together with other employee compensation costs). The other components of net benefit cost, including amortization of prior service cost/credit, are to be included in a separate line item(s) outside of any sub-total of operating income. ASU 2017-07 also provides guidance that only the service cost component of net benefit cost is eligible for capitalization. This standard is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The revisions in this amendment are to be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The company is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. ASU 2017-05 provides guidance which defines an “in substance nonfinancial asset”; unifies guidance related to partial sales of nonfinancial assets; eliminates rules specifically addressing sales of real estate; removes exceptions to the financial asset derecognition model; and clarifies the accounting for contributions of nonfinancial assets to joint ventures. The effective date and the transition requirements for the amendments in ASU 2017-05 are the same as the effective date and transition requirements in Topic 606, described below. The company is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The new guidance eliminates the need to determine the fair value of individual assets and liabilities of a reporting unit to measure a goodwill impairment. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value. The revised guidance will be applied prospectively, and is effective for calendar year-end Securities and Exchange Commission ("SEC") filers in 2020. Early adoption is permitted for any impairment tests performed after January 1, 2017. The new guidance is not expected to have a material impact on the company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The ASU provides clarification on the definition of a business and adds guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. To be considered a business under the new guidance, it must include an input and a substantive process that together significantly contribute to the ability to create output. The amendment removes the evaluation of whether a market participant could replace missing elements. The amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and will be applied prospectively. The potential impact of this new guidance will be assessed for future acquisitions or dispositions, but it is not expected to have a material impact on the company's consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory. The ASU was issued to remove the prohibition in FASB ASC 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The amendments in this update are effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted; however, the guidance can only be adopted in the first interim period of a fiscal year. The company is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). The ASU was issued to reduce differences in practice with respect to how specific transactions are classified in the statement of cash flows. The update provides guidance on the following eight types of transactions: debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investments, beneficial interests in securitization transactions and separately identifiable cash flows and application of the predominance principle. The amendments in this update are effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, provided that all of the amendments are adopted in the same period. The guidance requires application using a retrospective transition method. The company is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments, including accounts receivable. The ASU also modifies the impairment model for available-for-sale ("AFS") debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The amendments in this update are required to be adopted by public business entities in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The company is currently evaluating the potential impact of this new guidance on its accounting policies and its consolidated financial statements.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. The ASU clarifies the assessment of the likelihood that revenue will be collected from a contract, the guidance for presenting sales taxes and similar taxes, and the timing for measuring customer payments that are not in cash. The ASU also establishes a practical expedient for contract modifications at the transition. The amendments in this update affect the guidance in ASU 2014-09, which is not effective yet. The effective date and the transition requirements for the amendments in ASU 2016-12 are the same as the effective date and transition requirements in ASU 2014-09 as described below. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2018 in connection with its planned implementation of ASU 2014-09 and is currently evaluating the potential impact of this new guidance on its accounting policies and its consolidated financial statements.

In May 2016, the FASB issued ASU 2016-11, Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update). The ASU was issued to remove from the Accounting Standards Codification ("Codification") certain SEC staff guidance that the SEC staff stated would be rescinded: Revenue and Expense Recognition for Freight Services in Process; Accounting for Shipping and Handling Fees and Costs; and Accounting for Consideration Given by a Vendor to a Customer (including a Reseller of the Vendor’s Products). The amendments in this update affect the guidance in ASU 2014-09, which is not effective yet. The effective date and the transition requirements for the amendments in ASU 2016-11 are the same as the effective date and transition requirements in ASU 2014-09 as described below. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2018 in connection with its planned implementation of ASU 2014-09 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

In April, 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing. The ASU provides guidance regarding the identification of performance and licensing obligations. The amendments in this update affect the guidance in ASU 2014-09, which is not effective yet. The effective date and the transition requirements for the amendments in ASU 2016-10 are the same as the effective date and transition requirements in ASU 2014-09 as described below. Therefore, the company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2018 in connection with its planned implementation of ASU 2014-09 and is currently evaluating the potential impact of this new guidance on its consolidated financial statements.

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

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

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

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which requires companies to recognize revenue when a customer obtains control rather than when companies have transferred substantially all risks and rewards of a good or service and requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. ASU 2014-09 was originally effective for fiscal periods beginning after December 15, 2016, including interim periods within those fiscal periods. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year making it effective for fiscal periods beginning after December 15, 2017, including interim periods within those fiscal periods, while also providing for early adoption but not before the original effective date. The company plans to implement this standard in the first quarter of the fiscal year beginning October 1, 2018 using the modified-retrospective transition method.

The company is concluding the assessment phase of its implementation of this standard. The company does not expect a material impact on its consolidated financial statements from adoption of this guidance. Disclosure requirements under this standard have been significantly expanded in comparison to the disclosure requirements under current GAAP. The company is concluding its assessment of the new disclosure requirements and is in the process of drafting its disclosures for both interim and annual periods under Topic 606.

4. Discontinued Operations

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Sales	$—	$—	$—	$—
Loss before income taxes	$(2)	$(1)	$(4)	$(1)
Benefit from income taxes	—	—	1	—
Loss from discontinued operations attributable to Meritor, Inc.	$(2)	$(1)	$(3)	$(1)

Loss from discontinued operations attributable to the company for the three and nine months ended June 30, 2018 was primarily related to environmental remediation and changes in estimates related to legal costs incurred in connection with a previously divested business.

Total discontinued operations assets as of both June 30, 2018 and September 30, 2017 were $1 million, and total discontinued operations liabilities as of June 30, 2018 and September 30, 2017 were $11 million and $6 million, respectively.

5. Goodwill

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

The company tests goodwill for impairment at a level of reporting referred to as a reporting unit, which is an operating segment or one level below an operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. When two or more components of an operating segment have similar economic characteristics, the components are aggregated and deemed a single reporting unit. An operating segment is deemed to be a reporting unit if all of its components are similar, if none of its components are a reporting unit, or if the segment comprises only a single component.

Realignment of Reporting Units

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As discussed in Note 22, "Business Segment Information," the company realigned its operations in the second quarter of fiscal year 2018, resulting in a change to its reportable segments. As a result of the change in reportable segments, the company's reporting units changed. The Commercial Truck & Trailer segment contains two reporting units. The Aftermarket & Industrial segment contains three reporting units. Goodwill was reassigned to the new reporting units using a relative fair value allocation.

Acquisition of AA Gear & Manufacturing, Inc. Business

On April 30, 2018, the company acquired substantially all of the assets of AA Gear & Manufacturing, Inc. and its subsidiaries (“AAG”) for a cash purchase price of approximately $36 million. The AAG acquisition was accounted for as a business combination. The company recorded provisional goodwill in the amount of $9 million for the excess of consideration paid over the fair value of the individual assets acquired and liabilities assumed. This recorded goodwill consists largely of the synergies and economies of scale expected from combining the operations of the company and AAG. All of the goodwill was assigned to the Commercial Truck & Trailer reportable segment. All goodwill recognized is expected to be deductible for income tax purposes over the next 15 years.

A summary of the changes in the carrying value of goodwill by the company’s two reportable segments are presented below (in millions):

	Commercial Truck & Trailer	Aftermarket & Industrial	Total
Goodwill [1]	$ 283	$ 146	$429
Accumulated impairment losses [1]	—	(15)	(15)
Beginning balance at September 30, 2017 [1]	283	131	414
Adjustment due to sale of a business (see Note 8)	(1)	—	(1)
Fabco measurement period adjustment (see Note 8)	—	(1)	(1)
Goodwill acquired from acquisition (see Note 8)	9	—	9
Foreign currency translation	(2)	—	(2)
Balance at June 30, 2018	$ 289	$ 130	$419

[1] Amounts have been recast to reflect reportable segment changes (see Note 22).

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6. Restructuring Costs

Restructuring reserves, primarily related to unpaid employee termination benefits, were $5 million at June 30, 2018 and $6 million at September 30, 2017. The changes in restructuring reserves for the nine months ended June 30, 2018 and 2017 are as follows (in millions):

	Employee Termination Benefits	Plant Shutdown & Other	Total
Beginning balance at September 30, 2017	$ 5	$ 1	$ 6
Activity during the period:			
Charges to continuing operations	6	—	6
Cash payments – continuing operations	(6)	(1)	(7)
Total restructuring reserves at June 30, 2018	5	—	5
Less: non-current restructuring reserves	(1)	—	(1)
Restructuring reserves – current, at June 30, 2018	$ 4	$ —	$ 4
Balance at September 30, 2016	$ 15	$ 1	$ 16
Activity during the period:			
Charges to continuing operations	4	—	4
Cash payments – continuing operations	(10)	(1)	(11)
Other	(1)	—	(1)
Total restructuring reserves at June 30, 2017	8	—	8
Less: non-current restructuring reserves	(1)	—	(1)
Restructuring reserves – current, at June 30, 2017	$ 7	$ —	$ 7

Segment Realignment Program: On March 12, 2018, the company announced a realignment of operations to further drive long-term strategic objectives while also assigning new responsibilities as part of its commitment to leadership development. As a part of this program, the company approved various labor restructuring actions in the Commercial Truck & Trailer segment and Aftermarket & Industrial segment. The company recorded $3 million and $4 million of restructuring costs during the third quarter and first nine months of fiscal year 2018, respectively, in connection with this program. These actions will be substantially complete by the end of fiscal year 2018.

Other Restructuring Actions: During the first nine months of fiscal year 2018, the company recorded restructuring costs of $2 million primarily associated with labor reduction programs in the Commercial Truck & Trailer segment and Aftermarket & Industrial segment.

Aftermarket Actions: During the third quarter of fiscal year 2017, the company approved various restructuring plans in the North American and European Aftermarket businesses. The company recorded $4 million of restructuring costs during the first nine months of fiscal year 2017. Restructuring actions with these plans were substantially complete as of September 30, 2017.

7. Income Taxes

For each interim reporting period, the company makes an estimate of the effective tax rate expected to be applicable for the full fiscal year pursuant to FASB ASC Topic 740-270, “Accounting for Income Taxes in Interim Periods.” The rate so determined is used in providing for income taxes on a year-to-date basis. Jurisdictions with a projected loss for the year or an actual year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of including these jurisdictions on the quarterly effective rate calculation could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings versus annual projections.

Income tax expense (benefit) is allocated among continuing operations, discontinued operations and other comprehensive income ("OCI"). Such allocation is applied by tax jurisdiction, and in periods in which there is a pre-tax loss from continuing operations and pre-tax income in another category, such as discontinued operations or OCI, income tax expense is allocated to the other sources of income, with a related benefit recorded in continuing operations.

On December 22, 2017, the U.S. government enacted the U.S. tax reform. The U.S. tax reform makes broad and complex changes to the U.S. tax code that will affect the company's fiscal year ending September 30, 2018, including, but not limited to, reducing the U.S. federal corporate tax rate and requiring a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries. The U.S. tax reform reduces the federal corporate tax rate to 21 percent in the fiscal year ending September 30, 2018. Section 15 of the Internal Revenue Code stipulates that the company's fiscal year ending September 30, 2018 will have a blended corporate tax rate of 24.5 percent, which is based on the applicable tax rates before and after the U.S. tax reform and the number of days in the year.

The SEC staff issued Staff Accounting Bulletin (“SAB”) 118, which provides guidance on accounting for the tax effects of the U.S. tax reform. SAB 118 provides a measurement period that should not extend beyond one year from the U.S. tax reform enactment date for companies to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the U.S. tax reform for which the accounting under ASC 740 is complete. To the extent that a company’s accounting for certain income tax effects of the U.S. tax reform is incomplete but the company is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the U.S. tax reform.

Specifically, the company included discrete tax expense in its first quarter financial statements for fiscal year 2018 related to provisional amounts under SAB 118 for the impact of the revaluation of U.S. deferred tax assets and liabilities due to the federal income tax rate reduction from 35 percent to 21 percent. In order to properly account for the blended tax rate in place for fiscal year 2018, the company estimated the deferred tax assets and liabilities expected to reverse during the current fiscal year and applied a tax rate of 24.5 percent. All other deferred tax assets and liabilities are expected to reverse in fiscal year 2019 or later and were revalued at 21 percent. Additionally, the company estimated its liability and included provisional amounts for the one-time transition tax as a discrete tax expense. The company will elect to offset the liability associated with this transition tax by utilizing foreign tax credit carryovers. The revaluation of the deferred tax assets and the transition tax resulted in a non-cash charge of $77 million in the first quarter of fiscal year 2018. That amount remains the same for the nine months ended June 30, 2018.

Tax expense recognized in fiscal year 2018 related to the transition tax and rate change on net deferred tax assets and liabilities are considered provisional under SAB 118. The company will continue to refine its accumulated earnings and profit pools and the allocation of cash and non-cash earnings for purposes of calculating the transition tax liability. Additionally, net deferred tax assets were reevaluated as of the enactment date using estimated fiscal year 2018 utilization amounts. The company will update the impact of the rate change on the net deferred tax assets as it continues to account for deferred activity throughout the current year.

The company has not accounted for the tax impacts related to the Global Intangible Low Tax Income (“GILTI”), Base Erosion Anti Abuse Tax (“BEAT”) or Foreign Derived Intangible Income (“FDII”) regimes or any of the other provisions of the U.S. tax reform that are not effective until fiscal year 2019. The company has elected to treat GILTI as a period cost and, therefore, has not recognized deferred taxes for basis differences that may reverse as GILTI tax in future periods.

In evaluating its ability to recover these net deferred tax assets, the company utilizes a consistent approach which considers its historical operating results, including an assessment of the degree to which any gains or losses are driven by items that are unusual in nature, and tax planning strategies. In addition, the company reviews changes in near-term market conditions and other factors that impact future operating results. In the first quarter of fiscal year 2018, a tax planning strategy was implemented that resulted in a $4 million tax benefit from the reversal of a tax valuation allowance in Sweden. As of June 30, 2018, the company continues to maintain the valuation allowances in Brazil, France, the U.K., along with certain U.S. states and other jurisdictions, as the company believes the negative evidence that it will be able to recover these net deferred tax assets continues to outweigh the positive evidence. If, in the future, the company generates taxable income on a sustained basis, its conclusion regarding the need for valuation allowances in these jurisdictions could change.

The company has recently returned to profitability in Brazil. However, given the volatility in the Brazilian truck market, the company believes that sustaining profitability for a reasonable period of time is necessary before determining that a valuation allowance should be reversed. To the extent positive trends and forecasts of future profitability continue, including after development and review of the company’s 2019 annual operating plan, management’s conclusion regarding the need for a valuation allowance could change, leading to a reversal of all or a portion of the valuation allowance. The company anticipates the potential range of a full reversal to be approximately $8 million to $12 million.

For the three months ended June 30, 2018, the company had approximately $7 million of net pre-tax income compared to $3 million of net pre-tax income in the same period in fiscal year 2017 in tax jurisdictions in which tax expense (benefit) is not recorded.

For the nine months ended June 30, 2018, the company had approximately $20 million of net pre-tax income compared to an insignificant net pre-tax loss in the same period in fiscal year 2017 in tax jurisdictions in which tax expense (benefit) is not recorded.

8. Acquisition and Divestiture

Acquisition of AA Gear & Manufacturing, Inc. Business

On April 30, 2018, the company acquired substantially all of the assets of AAG for a cash purchase price of approximately $36 million. AAG provides low-to-medium volume batch manufacturing for complex gear and shaft applications, as well as quick-turnaround prototyping solutions and emergency plant support. The AAG acquisition was accounted for as a business combination.

The purchase price was allocated on a provisional basis as of April 30, 2018. The identifiable net assets acquired of $27 million, which consisted of accounts receivable and accounts payable, net of $2 million, inventories of $5 million, fixed assets of $5 million, and an identifiable intangible of $15 million, were recorded at estimated fair values based on management's estimates, available information, and reasonable and supportable assumptions. The company recorded a provisional goodwill amount of $9 million (see Note 5).

Pro forma financial information of the company is presented in the following table for the three and nine months ended June 30, 2018 and 2017 as if the AAG acquisition had occurred on October 1, 2016. The pro forma financial information is unaudited and is provided for informational purposes only and does not purport to be indicative of the results which would have actually been attained had the acquisition occurred on October 1, 2016 (in millions).

	Pro Forma Combined			
	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
	(Unaudited)			
Sales	$1,133	$926	$3,111	$2,441
Net income attributable to Meritor, Inc.	$64	$61	$86	$120

Actual amounts of revenue and earnings included in the consolidated financial statements for the three and nine months ended June 30, 2018 were not material.

Acquisition of Fabco Business

On August 31, 2017, the company acquired certain assets, including the product portfolio and related technologies of Fabco Holdings, Inc., and its subsidiaries ("Fabco") and assumed certain liabilities, for a cash purchase price of $34 million. The Fabco acquisition was accounted for as a business combination.

Since completion of initial estimates in the fourth quarter of fiscal year 2017, the company recorded a net $1 million measurement period adjustment to increase the provisional fair value of identifiable net assets acquired in the Fabco transaction, resulting in a corresponding $1 million decrease to goodwill. This adjustment was made to reflect additional available information and updated preliminary valuation results, which included valuation of trademarks, technology and customer relationships. The company is reviewing and may record other additional measurement period adjustments in fiscal year 2018. All goodwill resulting from the acquisition of Fabco was assigned to the Aftermarket and Industrial reportable segment.

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	Estimated Fair Value		
	As of September 30, 2017	Measurement Period Adjustments	As of June 30, 2018
Purchase price	$ 34	$ —	$ 34
Acquired assets and liabilities			
Receivables	5	—	5
Inventories	13	(1)	12
Property, plant and equipment	9	(2)	7
Intangible assets	—	3	3
Accounts payable	(6)	—	(6)
Other current liabilities	(6)	1	(5)
Total identifiable net assets acquired	15	1	16
Goodwill resulting from the acquisition of Fabco	19	(1)	18
	$ 34	$ —	$ 34

Divestiture of Meritor Huayang Vehicle Braking Company Ltd.

On February 7, 2018, Meritor completed the sale of its equity interest in Meritor Huayang Vehicle Braking Company Ltd. All assets and liabilities of the business were transferred at closing. As a result of the divestiture and prior period held for sale classification, a pretax impairment charge of $3 million previously recorded within other operating expense, net in the company’s condensed consolidated statement of operations for fiscal year 2017.

9. Accounts Receivable Factoring and Securitization

Off-balance sheet arrangements

Swedish Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo through one of its European subsidiaries. Under this arrangement with Nordea Bank, which expires in March 2020, the company can sell up to, at any point in time, €155 million ($179 million) of eligible trade receivables. The amount of eligible receivables sold may exceed Nordea Bank's commitment at Nordea Bank's discretion. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €165 million ($190 million) and €139 million ($164 million) of this accounts receivable factoring facility as of June 30, 2018 and September 30, 2017, respectively.

The facility is backed by a 364-day liquidity commitment from Nordea Bank which extends through February 12, 2019. The commitment is subject to standard terms and conditions for this type of arrangement.

U.S. Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its U.S. subsidiaries through one of its U.S. subsidiaries. Under this arrangement with Nordea Bank, which expires in February 2019, the company can sell up to, at any point in time, €80 million ($93 million) of eligible trade receivables. The amount of eligible receivables sold may exceed Nordea Bank’s commitment at Nordea Bank’s discretion. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €45 million ($52 million) and €37 million ($43 million) of this accounts receivable factoring facility as of June 30, 2018 and September 30, 2017, respectively.

United Kingdom Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its European subsidiaries through one of its United Kingdom subsidiaries. Under this arrangement with Nordea Bank, which expires in February 2022, the company can sell up to, at any point in time, €25 million ($29 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €10 million ($12 million) and €7 million ($9 million) of this accounts receivable factoring facility as of June 30, 2018 and September 30, 2017, respectively. The agreement is subject to standard terms and conditions for these types of arrangements, including a sole discretion clause whereby the bank retains the right to not purchase receivables, which has not been invoked since the inception of the program.

Italy Factoring Facility: The company has an arrangement to sell trade receivables from AB Volvo and its European subsidiaries through one of its Italian subsidiaries. Under this arrangement with Nordea Bank, which expires in June 2022, the company can sell up to, at any point in time, €30 million ($35 million) of eligible trade receivables. The receivables under this program are sold at face value and are excluded from the consolidated balance sheet. The company had utilized €30 million ($35 million) and €22 million ($26 million) of this accounts receivable factoring facility as of June 30, 2018 and September 30, 2017, respectively. The agreement is subject to standard terms and conditions for these types of arrangements, including a sole discretion clause whereby the bank retains the right to not purchase receivables, which has not been invoked since the inception of the program.

In addition to the above facilities, a number of the company’s subsidiaries, primarily in Europe, factor eligible accounts receivable with financial institutions. Certain receivables are factored without recourse to the company and are excluded from accounts receivable in the consolidated balance sheet. The amount of factored receivables excluded from accounts receivable under these arrangements was $21 million and $19 million at June 30, 2018 and September 30, 2017, respectively.

Total costs associated with all of the off-balance sheet arrangements described above were $1 million and $2 million in the three months ended June 30, 2018 and 2017, respectively, and $3 million and $4 million in the nine months ended June 30, 2018 and 2017, respectively, and are included in selling, general and administrative expenses in the condensed consolidated statements of operations.

On-balance sheet arrangements

U.S. Securitization Facility: The company has a $100 million U.S. accounts receivables securitization facility with PNC Bank, which expires December 2020. The maximum permitted priority debt-to-EBITDA ratio as of the last day of each fiscal quarter under the facility is 2.25 to 1.00. This program is provided by PNC Bank, National Association, as Administrator and Purchaser, and the other Purchasers and Purchaser Agents from time to time (participating lenders), which are party to the agreement. Under this program, the company has the ability to sell an undivided percentage ownership interest in substantially all of its trade receivables (excluding the receivables due from AB Volvo and subsidiaries eligible for sale under the U.S. accounts receivable factoring facility) of certain U.S. subsidiaries to ArvinMeritor Receivables Corporation (“ARC”), a wholly-owned, special purpose subsidiary. ARC funds these purchases with borrowings from participating lenders under a loan agreement. This program also includes a letter of credit facility pursuant to which ARC may request the issuance of letters of credit issued for the company’s U.S. subsidiaries (originators) or their designees, which when issued will constitute a utilization of the facility for the amount of letters of credit issued. Amounts outstanding under this agreement are collateralized by eligible receivables purchased by ARC and are reported as short-term debt in the condensed consolidated balance sheet. At June 30, 2018, no amounts were outstanding under this program. At September 30, 2017, $89 million was outstanding under this program. At June 30, 2018, $11 million was outstanding for letters of credit under this program. At September 30, 2017, no amounts were outstanding for letters of credit. This securitization program contains a cross default to the revolving credit facility. At certain times during any given month, the company may sell eligible accounts receivable under this program to fund intra-month working capital needs. In such months, the company would then typically utilize the cash received from customers throughout the month to repay the borrowings under the program. Accordingly, during any given month, the company may borrow under this program amounts exceeding the amounts shown as outstanding at fiscal quarter ends.

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10. Operating Cash Flows

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

	Nine Months Ended June 30,	
	2018	2017
OPERATING ACTIVITIES		
Net income	$93	$90
Less: Loss from discontinued operations, net of tax	(3)	(1)
Income from continuing operations	96	91
Adjustments to income from continuing operations to arrive at cash provided by operating activities:		
Depreciation and amortization	64	55
Deferred income tax expense	92	19
Loss on debt extinguishment	8	—
Restructuring costs	6	4
Asset impairment charges	2	2
Equity in earnings of affiliates	(20)	(32)
Pension and retiree medical expense (income)	(23)	11
Other adjustments to income from continuing operations	13	12
Dividends received from equity method investments	9	25
Pension and retiree medical contributions	(17)	(28)
Restructuring payments	(7)	(11)
Changes in off-balance sheet accounts receivable securitization and factoring programs	65	62
Changes in assets and liabilities, excluding effects of acquisitions, divestitures, foreign currency adjustments and discontinued operations	(98)	(73)
Operating cash flows provided by continuing operations	190	137
Operating cash flows provided by (used for) discontinued operations	1	(1)
CASH PROVIDED BY OPERATING ACTIVITIES	$191	$136

11. Inventories

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

	June 30, 2018	September 30, 2017
Finished goods	$ 172	$ 139
Work in process	36	34
Raw materials, parts and supplies	258	205
Total	$ 466	$ 378

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12. Other Current Assets

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

	June 30, 2018	September 30, 2017
Asbestos-related recoveries (see Note 20)	$ 10	$ 14
Prepaid and other	26	29
Other current assets	$ 36	$ 43

13. Net Property

Net property is summarized as follows (in millions):

	June 30, 2018	September 30, 2017
Property at cost:		
Land and land improvements	$ 29	$ 30
Buildings	228	240
Machinery and equipment	901	892
Company-owned tooling	129	126
Construction in progress	52	69
Total	1,339	1,357
Less: accumulated depreciation	(892)	(883)
Net property	$ 447	$ 474

14. Other Assets

Other assets are summarized as follows (in millions):

	June 30, 2018	September 30, 2017
Investments in non-consolidated joint ventures	$ 105	$ 101
Asbestos-related recoveries (see Note 20) (1)	27	32
Unamortized revolver debt issuance costs	6	8
Capitalized software costs, net	24	27
Deferred income tax assets, net	138	229
Assets for uncertain tax positions	45	48
Prepaid pension costs	150	135
Intangible assets (2)	18	1
Other	26	15
Other assets	$ 539	$ 596

(1) Includes reserves for Rockwell insurance policies in dispute.

(2) Primarily relates to customer relationships. As of June 30, 2018, the gross carrying value was $18 million and the accumulated amortization was insignificant. As of September 30, 2017, the gross carrying value was $1 million and the accumulated amortization was insignificant. The weighted average amortization periods for customer relationships is approximately 19 years.

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

The company holds a variable interest in a joint venture that is a variable interest entity ("VIE") accounted for under the equity method of accounting. The joint venture manufactures components for commercial vehicle applications primarily on behalf of the company. The variable interest relates to a supply arrangement between the company and the joint venture whereby the company supplies certain components to the joint venture on a cost-plus basis. The company is not the primary beneficiary of the joint venture, as the joint venture partner has shared or absolute control over key manufacturing operations, labor relationships, financing activities and certain other functions of the joint venture. Therefore, the company does not consolidate the joint venture. At June 30, 2018 and September 30, 2017, the company’s investment in the joint venture was $63 million and $54 million, respectively.

TransPower

Meritor completed a $3 million strategic investment in Transportation Power, Inc. (“TransPower”) in each of the first and third quarters of fiscal year 2018. The company holds a variable interest in TransPower, a VIE. TransPower develops electrical drive solutions and supplies integrated drive systems, full electric truck solutions and energy-storage subsystems to major manufacturers of trucks, school buses, refuse vehicles and terminal tractors. The company is not the primary beneficiary of TransPower, as other owners have control over the significant activities of TransPower, including the development of intellectual property and manufacturing. Therefore, the company does not consolidate TransPower. At June 30, 2018, the company’s investment in TransPower was $6 million, representing the company’s maximum exposure to loss.

15. Other Current Liabilities

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

	June 30, 2018	September 30, 2017
Compensation and benefits	$ 116	$ 117
Income taxes	24	11
Taxes other than income taxes	24	34
Accrued interest	15	9
Product warranties	18	18
Environmental reserves (see Note 20)	5	5
Restructuring (see Note 6)	4	5
Asbestos-related liabilities (see Note 20)	18	19
Indemnity obligations (see Note 20)	2	2
Other	52	52
Other current liabilities	$ 278	$ 272

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

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

	Nine Months Ended June 30, 2018	2017
Total product warranties – beginning of period	$45	$44
Accruals for product warranties	14	8
Payments	(12)	(10)
Change in estimates and other	4	1
Total product warranties – end of period	51	43
Less: Non-current product warranties	(33)	(25)
Product warranties – current	$18	$18

16. Other Liabilities

Other liabilities are summarized as follows (in millions):

	June 30, 2018	September 30, 2017
Asbestos-related liabilities (see Note 20)	$ 119	$ 124
Restructuring (see Note 6)	1	1
Non-current deferred income tax liabilities	11	12
Liabilities for uncertain tax positions	29	32
Product warranties (see Note 15)	33	27
Environmental (see Note 20)	12	4
Indemnity obligations (see Note 20)	10	10
Other	29	29
Other liabilities	$ 244	$ 239

17. Long-Term Debt

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

	June 30, 2018	September 30, 2017
3.25 percent convertible notes due 2037(1)(3)	$ 318	$ 317
4.0 percent convertible notes due 2027(1)(4)	24	24
7.875 percent convertible notes due 2026(1)(5)	22	22
6.75 percent notes due 2021(2)(6)	—	173
6.25 percent notes due 2024(2)(7)	444	443
Capital lease obligation	7	12
Borrowings and securitization	—	89
Unamortized discount on convertible notes (8)	(39)	(42)
Subtotal	776	1,038
Less: current maturities	(48)	(288)
Long-term debt	$ 728	$ 750

(1) The 3.25 percent convertible notes, 4.0 percent convertible notes and 7.875 percent convertible notes contain a put and call feature, which allows for earlier redemption beginning in 2025, 2019 and 2020, respectively.

(2) The 6.75 percent notes and 6.25 percent notes contain a call option, which allows for early redemption.

(3) The 3.25 percent convertible notes are presented net of $7 million and $8 million unamortized issuance costs as of June 30, 2018 and September 30, 2017, respectively.

(4) The 4.0 percent convertible notes are presented net of unamortized issuance costs of an insignificant amount as of June 30, 2018 and September 30, 2017.
(5) The 7.875 percent convertible notes are presented net of unamortized issuance costs of an insignificant amount as of June 30, 2018 and September 30, 2017, and $1 million original issuance discount as of June 30, 2018 and September 30, 2017.
(6) The 6.75 percent notes are presented net of $2 million unamortized issuance costs as of September 30, 2017.
(7) The 6.25 percent notes are presented net of $6 million and $7 million unamortized issuance costs as of June 30, 2018 and September 30, 2017, respectively.
(8) The carrying amount of the equity component related to convertible debt.

Repurchase of Debt Securities

On November 2, 2017, the company redeemed the remaining $175 million aggregate principal amount outstanding of the company's 6.75 percent notes due 2021 (the “6.75 Percent Notes”) at a price of $1,033.75 per $1,000 of principal amount, plus accrued and unpaid interest. The redemption resulted in a loss on debt extinguishment of approximately $8 million. The loss on debt extinguishment is included in Interest expense, net in the condensed consolidated statement of operations. The redemption was made pursuant to a special authorization from the Board of Directors in connection with the sale of the company's interest in Meritor WABCO Vehicle Control Systems ("Meritor WABCO") in the fourth quarter of fiscal year 2017. As of September 30, 2017, the 6.75 Percent Notes were classified as current because the company had announced its intention to redeem all of the remaining $175 million aggregate principal amount then outstanding.

On September 28, 2017, the company redeemed $100 million of the $275 million aggregate principal amount outstanding of the company's 6.75 Percent Notes at a price of $1,033.75 per $1,000 of principal amount, plus accrued and unpaid interest. As a result, a loss on debt extinguishment of $5 million was recorded in the company's consolidated statement of operations within Interest expense, net during the fourth quarter of fiscal year 2017. The redemption was made under the company's July 2016 debt repurchase authorization (see Note 21).

The company used the net proceeds, after issuance costs and discounts, of approximately $317 million from the offering of the 3.25 percent senior convertible notes due 2037 (the “3.25 Percent Convertible Notes”) to acquire portions of its outstanding 7.875 percent senior convertible notes due 2026 (the “7.875 Percent Convertible Notes”) and its 4.0 percent senior convertible notes due 2027 (the “4.0 Percent Convertible Notes”) in transactions that settled concurrently with the closing of the 3.25 Percent Convertible Note offering on September 22, 2017. In total, the company repurchased $117 million of the $140 million principal amount of its 7.875 Percent Convertible Notes and $119 million of the $143 million principal amount of its 4.0 Percent Convertible Notes. The 7.875 Percent Convertible Notes and 4.0 Percent Convertible Notes were repurchased at premiums equal to 130 percent and 16 percent, respectively, above their principal amount. These repurchases were accounted for as extinguishments of debt, and accordingly the company recognized a loss on debt extinguishment of $31 million in the aggregate ($23 million with respect to the 7.875 Percent Convertible Notes and $8 million with respect to the 4.0 Percent Convertible Notes). The loss on extinguishment was recorded in the condensed consolidated statement of operations within Interest expense, net during fiscal year 2017.

Current Classification of 4.0 Percent Convertible Notes

The 4.0 Percent Convertible Notes were classified as current as of June 30, 2018 as the securities are redeemable at the option of the holder on February 15, 2019, at a repurchase price in cash equal to 100 percent of the accreted principal amount of the securities to be repurchased plus accrued and unpaid interest. The 4.0 Percent Convertible Notes were classified as noncurrent as of September 30, 2017.

Current Classification of 7.875 Percent Convertible Notes
The 7.875 Percent Convertible Notes were classified as current as of June 30, 2018 as the holders are entitled to convert all or a portion of their 7.875 Percent Convertible Notes at any time beginning July 2, 2018 and prior to the close of business on September 28, 2018 at a rate of 83.3333 shares of common stock per $1,000 principal amount at maturity of the 7.875 Percent Convertible Notes (representing a conversion price of approximately $12.00 per share). The 7.875 Percent Convertible Notes are convertible as the closing price of shares of the company's common stock for at least 20 trading days during the 30 consecutive trading-day period ending on June 29, 2018 was greater than 120 percent of the $12.00 conversion price associated with the 7.875 Percent Convertible Notes.

The 7.875 Percent Convertible Notes were classified as current as of September 30, 2017 as the holders were entitled to convert all or a portion of their 7.875 Percent Convertible Notes at any time beginning October 1, 2017 and prior to the close of business on December 30, 2017 at a rate of 83.3333 shares of common stock per $1,000 principal amount at maturity of the 7.875 Percent Convertible Notes (representing a conversion price of approximately $12.00 per share). The 7.875 Percent Convertible Notes were convertible as the closing price of shares of the company's common stock for at least 20 trading days during the 30 consecutive trading-day period ending on September 29, 2017 was greater than 120 percent of the $12.00 conversion price associated with the 7.875 Percent Convertible Notes.

The 7.875 Percent Convertible Notes surrendered for conversion, if any, would be settled in cash up to the principal amount at maturity of the 7.875 Percent Convertible Notes and cash, stock or a combination of cash and stock, at the company's election, for the remainder of the conversion value of the 7.875 Percent Convertible Notes in excess of the principal amount at maturity and cash in lieu of any fractional shares, subject to and in accordance with the provisions of the indenture that governs the 7.875 Percent Convertible Notes.

As a result of the 7.875 Percent Convertible Notes becoming currently convertible for cash up to the principal amount of $23 million at the holder's option, $2 million of permanent equity was reclassified as mezzanine equity as of June 30, 2018.

Revolving Credit Facility

On March 31, 2017, the company amended and restated its revolving credit facility. Pursuant to the revolving credit agreement as amended, the company has a $525 million revolving credit facility that matures in March 2022. Additionally, $4 million was capitalized as deferred issuance costs and will be amortized over the term of the agreement. The availability under this facility is dependent upon various factors, including performance against certain financial covenants as highlighted below.

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

The availability under the revolving credit facility is also subject to a collateral test, pursuant to which borrowings on the revolving credit facility cannot exceed 1.0x the collateral test value. The collateral test is performed on a quarterly basis. At June 30, 2018, the revolving credit facility was collateralized by approximately $864 million of the company's assets, primarily consisting of eligible domestic U.S. accounts receivable, inventory, plant, property and equipment, intellectual property and the company's investment in all or a portion of certain of its wholly-owned subsidiaries.

Borrowings under the revolving credit facility are subject to interest based on quoted LIBOR rates plus a margin and a commitment fee on undrawn amounts, both of which are based upon the company's current corporate credit rating. At June 30, 2018, the margin over LIBOR rate was 275 basis points and the commitment fee was 37.5 basis points. Overnight revolving credit loans are at the prime rate plus a margin of 175 basis points.

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

No borrowings were outstanding under the revolving credit facility at June 30, 2018 and September 30, 2017. The amended and extended revolving credit facility includes $100 million of availability for the issuance of letters of credit. At June 30, 2018 and September 30, 2017, there were no letters of credit outstanding under the revolving credit facility.

Debt Securities

In December 2017, the company filed a shelf registration statement with the Securities and Exchange Commission, registering an unlimited amount of debt and/or equity securities that the company may offer in one or more offerings on terms to be determined at the time of sale. The December 2017 shelf registration statement superseded and replaced the shelf registration statement filed in December 2014, as amended.

Capital Leases

In March 2012, the company entered into a master lease agreement with Wells Fargo Equipment Finance, under which the company can enter into lease arrangements for equipment. Each lease term is 60 months and the lease interest rate is equal to the

5-year Swap Rate published by the Federal Reserve Board plus 564 basis points. The company had $1 million and $3 million outstanding under this capital lease arrangement as of June 30, 2018 and September 30, 2017, respectively. In addition, the company had another $6 million and $10 million outstanding through other capital lease arrangements at June 30, 2018 and September 30, 2017, respectively.

Letter of Credit Facilities

On February 21, 2014, the company entered into an arrangement to amend and restate the letter of credit facility with Citicorp USA, Inc., as administrative agent and issuing bank, and the other lenders party thereto. Under the terms of this amended credit agreement, which expires in March 2019, the company has the right to obtain the issuance, renewal, extension and increase of letters of credit up to an aggregate availability of $25 million. This facility contains covenants and events of default generally similar to those existing in the company's public debt indentures. There were $3 million and $18 million of letters of credit outstanding under this facility at June 30, 2018 and September 30, 2017, respectively. The company had another $16 million and $5 million of letters of credit outstanding through other letter of credit facilities at June 30, 2018 and September 30, 2017, respectively.

Export Financing Arrangements

The company entered into a number of export financing arrangements through its Brazilian subsidiary during fiscal year 2014. The export financing arrangements were issued under an incentive program of the Brazilian government to fund working capital for Brazilian companies in exportation programs. The arrangements bore interest at 5.5 percent and had maturity dates in 2017. These financing arrangements were paid off at maturity, as of March 31, 2017.

Other

One of the company's consolidated joint ventures in China participates in a bills of exchange program to settle its obligations with its trade suppliers. These programs are common in China and generally require the participation of local banks. Under these programs, the company's joint venture issues notes payable through the participating banks to its trade suppliers. If the issued notes payable remain unpaid on their respective due dates, this could constitute an event of default under the company's revolving credit facility if the defaulted amount exceeds $35 million per bank. As of June 30, 2018 and September 30, 2017, the company had $14 million and $24 million, respectively, outstanding under this program at more than one bank.

18. Financial Instruments

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

	June 30, 2018		September 30, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$ 100	$ 100	$ 88	$ 88
Short-term debt	48	73	288	329
Long-term debt	728	782	750	859
Foreign exchange forward contracts (other assets)	—	—	—	—
Foreign exchange forward contracts (other liabilities)	—	—	3	3
Foreign currency option contracts (other assets)	1	1	3	3
Cross-currency Swap (other assets)	6	6	—	—

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

	June 30, 2018			September 30, 2017		
	Gross Amounts Recognized	Gross Amounts Offset	Net Amounts Reported	Gross Amounts Recognized	Gross Amounts Offset	Net Amounts Reported
Derivative Assets						
Foreign exchange forward contracts	—	—	—	—	—	—
Derivative Liabilities						
Foreign exchange forward contracts	—	—	—	3	—	3

Fair Value

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

- Level 1 inputs use quoted prices in active markets for identical instruments.
- Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar instruments in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related instrument.

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

Fair value of financial instruments by the valuation hierarchy at June 30, 2018 is as follows (in millions):

	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 100	$ —	$ —
Short-term debt	—	71	2
Long-term debt	—	777	5
Foreign exchange forward contracts (other assets)	—	—	—
Foreign exchange forward contracts (other liabilities)	—	—	—
Foreign currency option contracts (other assets)	—	—	1
Cross-currency Swap (other assets)	—	6	—

Fair value of financial instruments by the valuation hierarchy at September 30, 2017 is as follows (in millions):

	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 88	$ —	$ —
Short-term debt	—	325	4
Long-term debt	—	851	8
Foreign exchange forward contracts (other assets)	—	—	—
Foreign exchange forward contracts (other liabilities)	—	3	—
Foreign currency option contracts (other assets)	—	—	3

Cross-currency Swap (other assets)	—	—	—

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The tables below provide a reconciliation of changes in fair value of the Level 3 financial assets and liabilities measured at fair value in the condensed consolidated balance sheet for the three and nine months ended June 30, 2018 and 2017, respectively. No transfers of assets between any of the Levels occurred during these periods.

Three months ended June 30, 2018 (in millions)	Short-term foreign currency option contracts	Long-term foreign currency option contracts	Total
Fair Value as of March 31, 2018	$ 1	$ —	$ 1
Total unrealized gains (losses):			
Included in other income	1	—	1
Included in cost of sales	—	—	—
Total realized gains (losses):			
Included in other income	—	—	—
Included in cost of sales	—	—	—
Purchases, issuances, sales and settlements:			
Purchases	—	—	—
Settlements	(1)	—	(1)
Transfer in and / or out of Level 3 (1)	—	—	—
Reclass between short-term and long-term	—	—	—
Fair Value as of June 30, 2018	$ 1	$ —	$ 1

Three months ended June 30, 2017 (in millions)	Short-term foreign currency option contracts (asset)	Long-term foreign currency option contracts (asset)	Total
Fair Value as of March 31, 2017	$ 3	$ 2	$ 5
Total unrealized gains (losses):			
Included in other income	—	—	—
Included in cost of sales	(1)	—	(1)
Total realized gains (losses):			
Included in other income	—	—	—
Included in cost of sales	—	—	—
Purchases, issuances, sales and settlements:			
Purchases	—	1	1
Settlements	(2)	(1)	(3)
Transfer in and / or out of Level 3 (1)	—	—	—
Reclass between short-term and long-term	1	(1)	—
Fair Value as of June 30, 2017	$ 1	$ 1	$ 2

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Nine months ended June 30, 2018 (in millions)	Short-term foreign currency option contracts	Long-term foreign currency option contracts	Total
Fair Value as of September 30, 2017	$ 2	$ 1	$ 3
Total unrealized gains (losses):			
Included in other income	1	—	1
Included in cost of sales	(1)	(1)	(2)
Total realized gains (losses):			
Included in other income	—	—	—
Included in cost of sales	—	—	—
Purchases, issuances, sales and settlements:			
Purchases	—	—	—
Settlements	(1)	—	(1)
Transfer in and / or out of Level 3 (1)	—	—	—
Reclass between short-term and long-term	—	—	—
Fair Value as of June 30, 2018	$ 1	$ —	$ 1

Nine months ended June 30, 2017 (in millions)	Short-term foreign currency option contracts (asset)	Long-term foreign currency option contracts (asset)	Total
Fair Value as of September 30, 2016	$ —	$ 2	$ 2
Total unrealized gains (losses):			
Included in other income	—	—	—
Included in cost of sales	—	2	2
Total realized gains (losses):			
Included in other income	—	—	—
Included in cost of sales	—	—	—
Purchases, issuances, sales and settlements:			
Purchases	—	1	1
Settlements	(2)	(1)	(3)
Transfer in and / or out of Level 3 (1)	—	—	—
Reclass between short-term and long-term	3	(3)	—
Fair Value as of June 30, 2017	$ 1	$ 1	$ 2

(1) Transfers as of the last day of the reporting period.

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. The company did not have any cash equivalents as of June 30, 2018 or September 30, 2017.

Short- and long-term debt — Fair values are based on transaction prices at public exchange for publicly traded debt. For debt instruments that are not publicly traded, 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.

Foreign exchange forward contracts — The company uses foreign exchange forward purchase and sale contracts with terms of 18 months or less to hedge its exposure to changes in foreign currency exchange rates. The fair value of foreign exchange forward contracts is based on a model which incorporates observable inputs including quoted spot rates, forward exchange rates and discounted future expected cash flows utilizing market interest rates with similar quality and maturity characteristics. For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of changes in the fair value of the contracts is recorded in Accumulated Other Comprehensive Loss in the statement of shareholders’ equity and is recognized in operating income when the underlying forecasted transaction impacts earnings.

Foreign currency option contracts — The company uses option contracts to mitigate foreign exchange exposure on expected future Indian Rupee-denominated purchases. As of June 30, 2018 and September 30, 2017, the notional amount of the company's Indian rupee foreign exchange contracts outstanding was $201 million and $172 million, respectively. The company did not elect hedge accounting for these derivatives. Changes in fair value associated with these contracts are recorded in cost of sales in the consolidated statement of operations.

The company uses option contracts to mitigate the risk of volatility in the translation of euro earnings to U.S. dollars. As of June 30, 2018 and September 30, 2017, the notional amount of the company's euro option contracts outstanding was $14 million and $58 million, respectively. These option contracts did not qualify for a hedge accounting election. Changes in fair value associated with these contracts are recorded in the consolidated statement of operations in other income, net.

The company uses option contracts to mitigate the risk of volatility in the translation of Swedish krona to U.S. dollars. As of June 30, 2018 and September 30, 2017, the notional amount of the company's Swedish krona option contracts outstanding was $13 million and $71 million, respectively. These option contracts did not qualify for a hedge accounting election. Changes in fair value associated with these contracts are recorded in the consolidated statement of operations in other income, net.

The company uses option contracts to mitigate foreign exchange exposure on expected future South Korean won-denominated purchases. As of June 30, 2018 and September 30, 2017, there were no South Korean won foreign exchange option contracts outstanding. The company did not elect hedge accounting for these derivatives. Changes in fair value associated with these contracts are recorded in cost of sales in the consolidated statement of operations.

The company uses foreign currency option contracts to mitigate foreign currency exposure on expected future Brazilian real-denominated purchases. As of June 30, 2018, the notional amount of the company's Brazilian real foreign exchange contracts outstanding was $13 million. As of September 30, 2017, there were no Brazilian real foreign exchange option contracts outstanding. The company did not elect hedge accounting for these derivatives. Changes in fair value associated with these contracts are recorded in cost of sales in the consolidated statement of operations.

The fair value of foreign exchange option contracts is based on third-party proprietary models, which incorporate inputs at varying unobservable weights of quoted spot rates, market volatility, forward rates and time utilizing market instruments with similar quality and maturity characteristics.

Cross-currency swap contracts — The company uses cross-currency swap contracts to hedge a portion of its net investment in a foreign subsidiary against volatility in foreign exchange rates. These derivative instruments are designated and qualify as hedges of net investments in foreign operations using the spot method to assess effectiveness. Settlements and changes in fair values of the instruments are recognized in foreign currency translation adjustments, a component of other comprehensive income (loss) on the consolidated statement of comprehensive income (loss), to offset the changes in the values of the net investments being hedged. Any portion of net investment hedges that is determined to be ineffective is recorded in other expenses, net on the consolidated statements of operations.

In the third quarter of fiscal year 2018, the company entered into multiple cross-currency swaps with a combined notional amount of $225 million. As of June 30, 2018, the notional amount of the company's cross-currency swap contracts outstanding was $225 million. These swaps hedged a portion of the net investment in a certain European subsidiary against volatility in the EUR/USD foreign exchange rate. They mature in May 2021.

The fair value of cross-currency swap contracts is based on a model which incorporates observable inputs, including quoted spot rates, forward exchange rates and discounted future expected cash flows, utilizing market interest rates with similar quality and maturity characteristics.

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19. Retirement Benefit Liabilities

Retirement benefit liabilities consisted of the following (in millions):

	June 30, 2018	September 30, 2017
Retiree medical liability	$ 94	$ 104
Pension liability	199	219
Other	13	15
Subtotal	306	338
Less: current portion (included in compensation and benefits, Note 15)	(24)	(24)
Retirement benefits	$ 282	$ 314

The components of net periodic pension and retiree medical expense included in continuing operations for the three months ended June 30 are as follows (in millions):

	2018		2017	
	Pension	Retiree Medical	Pension	Retiree Medical
Interest cost	$14	$ 1	$13	$ 4
Assumed return on plan assets	(25)	—	(24)	—
Amortization of prior service costs	—	(9)	—	(1)
Recognized actuarial loss	7	5	8	4
Total expense (income)	$(4)	$ (3)	$(3)	$ 7

The components of net periodic pension and retiree medical expense included in continuing operations for the nine months ended June 30 are as follows (in millions):

	2018		2017	
	Pension	Retiree Medical	Pension	Retiree Medical
Interest cost	$41	$ 2	$39	$ 11
Assumed return on plan assets	(74)	—	(71)	—
Amortization of prior service costs	—	(26)	—	(2)
Recognized actuarial loss	21	13	23	11
Total expense (income)	$(12)	$ (11)	$(9)	$ 20

20. 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 operations of the company. The process of estimating environmental liabilities is complex and dependent upon evolving physical and scientific data at the sites, 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 they are considered to be probable 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 Meritor is the only potentially responsible

party, the company records a liability for the total probable and estimable costs of remediation before consideration of recovery from insurers or other third parties.

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The company has been designated as a potentially responsible party at nine Superfund sites, excluding sites as to which the company's records disclose no involvement or as to which the company's liability has been finally determined. Additionally, one site operated by a predecessor of the company has been proposed for addition to the Superfund National Priorities List. Management estimates the total reasonably possible costs the company could incur for the remediation of the nine Superfund sites at June 30, 2018 to be approximately $5 million, of which $2 million is probable and recorded as a liability. Included in reasonably possible amounts are estimates for certain remediation actions that may be required if current actions are deemed inadequate by the regulators.

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 June 30, 2018 to be approximately $34 million, of which $15 million is probable and recorded as a liability.

Included in the company's environmental liabilities are costs for on-going operation, maintenance and monitoring at environmental sites in which remediation has been put into place. This liability is discounted using discount rates in the range of 1.75 to 2.75 percent and is approximately $14 million at June 30, 2018. The undiscounted estimate of these costs is approximately $16 million.

The following are the components of the Superfund and non-Superfund environmental reserves (in millions):

	Superfund Sites	Non-Superfund Sites	Total
Beginning balance at September 30, 2017	$ 2	$ 7	$ 9
Payments and other	—	(4)	(4)
Accruals	—	12	12
Balance at June 30, 2018	$ 2	$ 15	$ 17

Environmental reserves are included in Other Current Liabilities (see Note 15) and Other Liabilities (see Note 16) in the condensed consolidated balance sheet.

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, discovery of new contamination 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 effect on the company's business, financial condition or results of operations. In addition, in future periods, new laws and regulations, changes in remediation plans, advances in technology and additional information about the ultimate clean-up remedies could significantly change the company's estimates. Management cannot assess the possible effect of compliance with future requirements.

In April 2016, the company was served with several complaints filed against the company and other defendants in the United States District Court for the Northern District of Mississippi. The complaints were amended in July 2016. These complaints allege damages, including diminution of property value, concealment/fraud and emotional distress resulting from alleged environmental pollution in and around a neighborhood in Grenada, Mississippi. Rockwell owned and operated a facility near the neighborhood from 1965 to 1985. The company filed answers to the complaints in July 2016. In May 2017, the company was served with a complaint filed against the company and other defendants by the Mississippi Attorney General in the Chancery Court of Grenada County, Mississippi. The complaint alleges that operations at the above-referenced Grenada facility caused contamination of off-site groundwater and surface waters. Subsequently, the company removed this action to the United States District Court for the Northern District of

Mississippi. However, plaintiffs' motion to remand the case to the Chancery Court was granted in March 2018. In April, May and July 2018, the company was served with additional property damage, personal injury and wrongful death lawsuits naming the company and others as defendants, which were brought by current and former residents of the same neighborhood. The company intends to defend itself vigorously against these claims. The company believes at this time that liabilities associated with these cases, while possible, are not probable and estimable, and therefore has not recorded any accrual for them as of June 30, 2018 and September 30, 2017. Further, a reasonably possible range of loss cannot be estimated at this time.

Asbestos

Maremont Corporation (“Maremont”), a subsidiary of Meritor, manufactured friction products containing asbestos from 1953 through 1977, when it sold its friction product business. Arvin Industries, Inc., a predecessor of the company, 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 1,700 and 2,800 pending asbestos-related claims at June 30, 2018 and September 30, 2017, 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, 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, the total number of claims filed is not necessarily the most meaningful factor in determining Maremont's asbestos-related liability.

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

	June 30, 2018	September 30, 2017
Pending and future claims	$ 68	$ 68
Billed but unpaid claims	2	2
Asbestos-related liabilities	$ 70	$ 70
Asbestos-related insurance recoveries	$ 18	$ 25

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 Note 12, Note 14, Note 15 and Note 16).

Pending and Future Claims: Maremont engaged Bates White LLC (“Bates White”), a consulting firm with extensive experience estimating costs associated with asbestos litigation, to assist with determining the estimated cost of resolving pending and future asbestos-related claims that have been, and could reasonably be expected to be, filed against Maremont. Although it is not possible to estimate the full range of costs because of various uncertainties, Bates White advised Maremont that it would be possible to determine an estimate of a reasonable forecast of the cost of the probable settlement and defense costs of resolving pending and future asbestos-related claims, based on historical data and certain assumptions with respect to events that may occur in the future.

As of September 30, 2017, Bates White provided a reasonable and probable estimate that consisted of a range of equally likely possibilities of Maremont’s obligation for asbestos personal injury claims over the next ten years of $68 million to $82 million. After consultation with Bates White, management recognized a liability of $68 million as of each of June 30, 2018 and September 30, 2017 for pending and future claims over the next ten years. 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. Maremont has recognized incremental insurance receivables associated with recoveries expected for asbestos-related liabilities as the estimate of asbestos-related liabilities for pending and future claims changes.

Assumptions: 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 ten-year period ending in fiscal year 2027;
- Maremont believes that the litigation environment could change significantly beyond ten years and that the reliability of estimates of future probable expenditures in connection with asbestos-related personal injury claims will decline for each year further in the future. As a result, estimating a probable liability beyond ten years is difficult and uncertain;
-

On a per claim basis, defense and processing costs for pending and future claims will be at the level consistent with Maremont's prior experience; and

- The ultimate indemnity cost of resolving nonmalignant claims with plaintiffs' law firms in jurisdictions without an established history with Maremont cannot be reasonably estimated.

Recoveries: Maremont has historically had insurance that reimburses a substantial portion of the costs incurred defending against asbestos-related claims. The insurance receivable related to asbestos-related liabilities was $18 million and $25 million as of June 30, 2018 and September 30, 2017, respectively. The receivable is for coverage provided by one insurance carrier based on a coverage-in-place agreement. Maremont currently expects to exhaust the remaining limits provided by this coverage sometime in the next ten years. The difference between the estimated liability and insurance receivable is primarily related to exhaustion of settled insurance coverage within the forecasted period.

Maremont maintained insurance coverage with other insurance carriers that management believed also covers indemnity and defense costs. During fiscal year 2013, Maremont re-initiated lawsuits against these carriers, seeking a declaration of its rights to coverage for asbestos claims and to facilitate an orderly and timely collection of insurance proceeds. During the first quarter of fiscal year 2016, the dispute related to these insurance policies was settled. As a part of this settlement, on December 12, 2015, Maremont received $17 million in cash, of which $5 million was recognized as a reduction in asbestos expense and $12 million was recorded as a liability to the insurance carrier as it is required to be returned to the carrier if additional asbestos liability is not incurred. During the fourth quarter of fiscal year 2016, Maremont recognized an additional $9 million of the cash settlement proceeds as a reduction in asbestos expense. During the first quarter of fiscal year 2017, the company recognized the remaining $3 million of the cash settlement proceeds as a reduction in asbestos expense. The settlement also provides additional recovery for Maremont if certain future defense and indemnity spending thresholds are met.

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 firms, jurisdictions and diseases; 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 estimation period, the nature of pending and future 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 condition and results of operations.

Rockwell International ("Rockwell") — ArvinMeritor, Inc. ("AM"), a subsidiary of Meritor, 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 at the time of the spin-off of the automotive business from Rockwell in 1997. Rockwell had approximately 1,600 pending active asbestos claims in lawsuits that name AM, together with many other companies, as defendants at June 30, 2018 and September 30, 2017.

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 likely never identify any of Rockwell's products. Historically, AM has been dismissed from the vast majority of similar claims filed in the past with no payment to claimants. 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 and the lack of any impairing medical condition on the part of many claimants.

The Rockwell legacy asbestos-related reserves and corresponding asbestos-related recoveries are summarized as follows (in millions):

	June 30, 2018	September 30, 2017
Pending and future claims	$ 63	$ 63
Billed but unpaid claims	2	2
Asbestos-related liabilities	$ 65	$ 65
Asbestos-related insurance recoveries	$ 36	$ 38

Pending and Future Claims: 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. As of September 30, 2017, Bates White provided a reasonable and probable estimate that consisted of a range of equally likely possibilities of Rockwell’s obligation for asbestos personal injury claims over the next

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ten years of $63 million to $74 million. After consultation with Bates White, management recognized a liability for the pending and future claims over the next ten years of $63 million as of each of June 30, 2018 and September 30, 2017. 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 Rockwell.

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

- Pending and future claims were estimated for a ten-year period ending in fiscal year 2027;
- The company believes that the litigation environment could change significantly beyond ten years and that the reliability of estimates of future probable expenditures in connection with asbestos-related personal injury claims will decline for each year further in the future. As a result, estimating a probable liability beyond ten years is difficult and uncertain;
- On a per claim basis, defense and processing costs for pending and future claims will be at the level consistent with the company’s prior experience; and
- The ultimate indemnity cost of resolving nonmalignant claims with plaintiff’s law firms in jurisdictions without an established history with Rockwell cannot be reasonably estimated.

Recoveries: Rockwell has insurance coverage that management believes covers indemnity and defense costs, over and above self-insurance retentions, for a significant portion of these claims. In 2004, the company initiated litigation against certain of these carriers to enforce the insurance policies. During the fourth quarter of fiscal year 2016, the company executed settlement agreements with two of these carriers, thereby resolving the litigation against those particular carriers. Pursuant to the terms of one of those settlement agreements, in the fourth quarter of fiscal year 2016 the company received $32 million in cash from an insurer, of which $10 million was recognized as a reduction in asbestos expense, and $22 million was recorded as a liability to the insurance carrier as it is required to be returned to the carrier if additional asbestos liability is not ultimately incurred. During fiscal year 2017 and the first nine months of fiscal year 2018, Rockwell recognized an additional $10 million and $7 million, respectively, of the cash settlement proceeds as a reduction in asbestos expense. Pursuant to the terms of a second settlement agreement, in the fourth quarter of fiscal year 2016 the company recorded a $12 million receivable to reflect expected reimbursement of future defense and indemnity payments under a coverage-in-place arrangement with that insurer. In addition to the coverage provided from the settlement agreements executed during the fourth quarter of fiscal year 2016, the company maintains a receivable of $7 million related to a previously executed coverage-in-place arrangement with other insurers. The insurance receivable for Rockwell's asbestos-related liabilities totaled $36 million and $38 million as of June 30, 2018 and September 30, 2017, respectively. Included in these amounts are insurance receivables of $17 million as of each of June 30, 2018 and September 30, 2017, which are associated with policies in dispute and have been fully reserved. From time to time the company negotiates with insurance carriers regarding policies in dispute.
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 Rockwell could change significantly from its past experience, due, for example, to changes in the mix of claims filed against Rockwell in terms of plaintiffs’ law firms, jurisdictions and diseases; legislative or regulatory developments; Rockwell’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 estimation period, 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 Rockwell 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 condition and results of operations.

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.

In December 2005, the company guaranteed a third party’s obligation to reimburse another 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 it being acquired by the company. The wholly-owned subsidiary, which was part of the company’s light vehicle aftermarket business, was sold by the company in fiscal year 2006. Prior to May 2009, except as set forth hereinafter, the third party met its obligations to reimburse the other party. In May 2009, the third party filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code, requiring the company to recognize its obligations under the guarantee. The company recorded a $28 million liability in fiscal year 2009 for this matter. At each of June 30, 2018 and September 30, 2017, the remaining estimated liability for this matter was approximately $10 million.

In connection with the sale of its interest in MSSC in October 2009, the company provided certain indemnities to the buyer for its share of potential obligations related to pension funding shortfall, environmental and other contingencies, and valuation of certain accounts receivable and inventories. At each of June 30, 2018 and September 30, 2017, the company's remaining exposure was approximately $1 million, which is included in other liabilities in the condensed consolidated balance sheet.

The company is not aware of any other claims or other information that would give rise to material payments under such indemnifications.

Other

The company identified certain sales transactions for which value-added tax was potentially required to be remitted to certain tax jurisdictions for tax years 2010 through 2017. At June 30, 2018 and September 30, 2017, the company’s estimate of the probable liability was $4 million and $12 million, respectively.

In addition, various lawsuits, claims and proceedings, other than those specifically disclosed in the condensed consolidated financial statements, 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, warranty or recall claims, intellectual property, safety and health, contract and employment matters. Although the outcome of other 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 effect on the company’s business, financial condition, results of operations or cash flows.

21. Shareholders' Equity

Common Stock and Debt Repurchase Authorizations

On July 21, 2016, the Board of Directors authorized the repurchase of up to $100 million of the company’s common stock and up to $150 million aggregate principal amount of any of the company’s debt securities (including convertible debt securities), in each case from time to time through open market purchases, privately negotiated transactions or otherwise, until September 30, 2019, subject to compliance with legal and regulatory requirements and the company's debt covenants. As of June 30, 2018, $63 million of common stock and $100 million in debt security repurchases had been made under these authorizations.

Accumulated Other Comprehensive Loss (“AOCL”)

The components of AOCL and the changes in AOCL by components, net of tax, for three months ended June 30, 2018 and 2017 are as follows (in millions):

	Foreign Currency Translation	Employee Benefit Related Adjustments	Unrealized Loss	Total
Balance at March 31, 2018	$ (35)	$ (494)	$ (1)	$ (530)
Other comprehensive income before reclassification	(52)	—	1	(51)

Amounts reclassified from accumulated other comprehensive loss	—	3	—	3
Net current-period other comprehensive income	$ (52)	$ 3	$ 1	$(48)
Balance at June 30, 2018	$ (87)	$ (491)	$ —	$(578)

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Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Consolidated Statement of Operations
Employee Benefit Related Adjustment		
Prior service costs	$ (9)	(a)
Actuarial losses	12	(a)
	3	Total before tax
	—	Tax benefit
Total reclassifications for the period	$ 3	Net of tax

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and retiree medical expense (see Note 19 for additional details), which is recorded in cost of sales and selling, general and administrative expenses.

	Foreign Currency Translation	Employee Benefit Related Adjustments	Unrealized Loss	Total
Balance at March 31, 2017	$ (75)	$ (718)	$ (1)	$ (794)
Other comprehensive income (loss) before reclassification	17	—	(2)	15
Amounts reclassified from accumulated other comprehensive loss	—	11	—	11
Net current-period other comprehensive income (loss)	$ 17	$ 11	$ (2)	$ 26
Balance at June 30, 2017	$ (58)	$ (707)	$ (3)	$ (768)

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Consolidated Statement of Operations
Employee Benefit Related Adjustment		
Prior service costs	$ (1)	(b)
Actuarial losses	$ 12	(b)
	11	Total before tax
	(3)	Tax expense
Total reclassifications for the period	$ 8	Net of tax

(b) These accumulated other comprehensive income components are included in the computation of net periodic pension and retiree medical expense (see Note 19 for additional details), which is recorded in cost of sales and selling, general and administrative expenses.

The components of AOCL and the changes in AOCL by components, net of tax, for nine months ended June 30, 2018 and 2017 are as follows (in millions):

Total

	Foreign Currency Translation	Employee Benefit Related Adjustments	Unrealized Loss	
Balance at September 30, 2017	$ (41)	$ (500)	$ (4)	$(545)
Other comprehensive income before reclassification	(46)	1	4	(41)
Amounts reclassified from accumulated other comprehensive loss	—	8	—	8
Net current-period other comprehensive income	$ (46)	$ 9	$ 4	$(33)
Balance at June 30, 2018	$ (87)	$ (491)	$ —	$(578)

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Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Consolidated Statement of Operations
Employee Benefit Related Adjustment		
Prior service costs	$ (26)	[a]
Actuarial losses	34	[a]
	8	Total before tax
	(1)	Tax benefit
Total reclassifications for the period	$ 7	Net of tax

[a] These accumulated other comprehensive income components are included in the computation of net periodic pension and retiree medical expense (see Note 19 for additional details), which is recorded in cost of sales and selling, general and administrative expenses.

	Foreign Currency Translation	Employee Benefit Related Adjustments	Unrealized Loss	Total
Balance at September 30, 2016	$ (66)	$ (740)	$ (3)	$(809)
Other comprehensive income (loss) before reclassification	8	1	—	9
Amounts reclassified from accumulated other comprehensive loss	—	32	—	32
Net current-period other comprehensive income (loss)	$ 8	$ 33	$ —	$41
Balance at June 30, 2017	$ (58)	$ (707)	$ (3)	$(768)

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Consolidated Statement of Operations
Employee Benefit Related Adjustment		
Prior service costs	$ (2)	[a]
Actuarial losses	34	[a]
	32	Total before tax
	(10)	Tax benefit
Total reclassifications for the period	$ 22	Net of tax

[a] These accumulated other comprehensive income components are included in the computation of net periodic pension and retiree medical expense (see Note 19 for additional details), which is recorded in cost of sales and selling, general and administrative expenses.

22. 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. On March 12, 2018, the company announced a realignment of operations to further drive long-term strategic objectives while also assigning new responsibilities as part of its commitment to leadership development. As part of this realignment, reportable segments changed. As of the second quarter of fiscal year 2018, the company's reportable segments are (1) Commercial Truck & Trailer and (2) Aftermarket & Industrial. Prior year reportable segment financial results have been recast for these changes.

The company has two reportable segments at June 30, 2018, as follows:

- The Commercial Truck & Trailer segment supplies drivetrain systems and components, including axles, drivelines and braking and suspension systems, primarily for medium- and heavy-duty trucks and other applications in North America, South America, Europe and Asia Pacific. It also supplies a wide variety of undercarriage products and systems for trailer applications in North America. This segment also includes the company's aftermarket businesses in Asia Pacific and South America.
- The Aftermarket & Industrial segment supplies axles, brakes, drivelines, suspension parts and other replacement parts to commercial vehicle and industrial aftermarket customers, primarily in North America and Europe. In addition, this segment supplies drivetrain systems and certain components, including axles, drivelines, brakes and suspension systems for military, construction, bus and coach, fire and emergency and other applications in North America.

Segment adjusted EBITDA is defined as income (loss) from continuing operations before interest expense, income taxes, depreciation and amortization, non-controlling interests in consolidated joint ventures, loss on sale of receivables, restructuring expense, asset impairment charges and other special items as determined by management. Segment adjusted EBITDA excludes unallocated legacy and corporate income (expense), net. The company uses segment adjusted EBITDA as the primary basis for the CODM to evaluate the performance of each of its reportable segments.

The accounting policies of the segments are the same as those applied in the condensed consolidated financial statements, except for the use of segment adjusted 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 and certain legacy and other corporate costs not directly associated with the segment.

Segment information is summarized as follows (in millions):

	Commercial Truck & Trailer	Aftermarket & Industrial	Eliminations	Total
Three Months Ended June 30, 2018				
External Sales	$ 861	$ 268	$ —	$1,129
Intersegment Sales	43	5	(48)	—
Total Sales	$ 904	$ 273	$ (48)	$1,129
Three Months Ended June 30, 2017 (1)				
External Sales	$ 689	$ 231	$ —	$920
Intersegment Sales	39	6	(45)	—
Total Sales	$ 728	$ 237	$ (45)	$920

	Commercial Truck & Trailer	Aftermarket & Industrial	Eliminations	Total
Nine Months Ended June 30, 2018				
External Sales	$ 2,354	$ 744	$ —	$3,098
Intersegment Sales	117	14	(131)	—
Total Sales	$ 2,471	$ 758	$ (131)	$3,098
Nine Months Ended June 30, 2017 (1)				
External Sales	$ 1,779	$ 646	$ —	$2,425

Intersegment Sales	104	13	(117)	—
Total Sales	$ 1,883	$ 659	$ (117)	$2,425

(1) Amounts for the three and nine months ended June 30, 2017 have been recast to reflect reportable segment changes.

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	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017 (2)	2018	2017 (2)
Segment adjusted EBITDA:				
Commercial Truck & Trailer	$103	$71	$268	$163
Aftermarket & Industrial	35	30	103	86
Segment adjusted EBITDA	138	101	371	249
Unallocated legacy and corporate income, net (1)	(3)	2	(15)	—
Interest expense, net	(14)	(21)	(54)	(63)
Provision for income taxes	(26)	(11)	(131)	(30)
Depreciation and amortization	(22)	(18)	(64)	(55)
Noncontrolling interests	(3)	(3)	(8)	(5)
Loss on sale of receivables	(1)	(2)	(3)	(4)
Asset impairment charges	—	1	(2)	(2)
Restructuring costs	(3)	—	(6)	(4)
Income from continuing operations attributable to Meritor, Inc.	$66	$49	$88	$86

(1) Unallocated legacy and corporate income (expense), net represents items that are not directly related to the company's business segments. These items primarily include asbestos-related charges and settlements, pension and retiree medical costs associated with sold businesses, and other legacy costs for environmental and product liability.

(2) Amounts for the three and nine months ended June 30, 2017 have been recast to reflect reportable segment changes.

	June 30, 2018	September 30, 2017 (3)
Segment Assets:		
Commercial Truck & Trailer	$1,884	$ 1,708
Aftermarket & Industrial	498	466
Total segment assets	2,382	2,174
Corporate (1)	544	869
Less: Accounts receivable sold under off-balance sheet factoring programs(2)	(310)	(261)
Total assets	$2,616	$ 2,782

(1) Corporate assets consist primarily of cash, deferred income taxes and prepaid pension costs.

(2) At June 30, 2018 and September 30, 2017, segment assets include $310 million and $261 million, respectively, of accounts receivable sold under off-balance sheet accounts receivable factoring programs (see Note 9). These sold receivables are included in segment assets as the CODM reviews segment assets inclusive of these balances.

(3) Amounts as of September 30, 2017 have been recast to reflect reportable segment changes, including the reallocation of goodwill.

23. Supplemental Guarantor Condensed Consolidating Financial Statements

Rule 3-10 of Regulation S-X requires that separate financial information for issuers and guarantors of registered securities be filed in certain circumstances. Certain of the company's 100-percent-owned subsidiaries, as defined in the credit agreement (the “Guarantors”), irrevocably and unconditionally guarantee amounts outstanding under the senior secured revolving credit facility on a joint and several basis. Similar subsidiary guarantees were provided for the benefit of the holders of the notes outstanding under the company's indentures (see Note 17).

In lieu of providing separate audited financial statements for the Parent and Guarantors, the company has included the accompanying condensed consolidating financial statements as permitted by Regulation S-X Rules 3-10. 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 distribution and other equity changes. The Guarantors are combined in the condensed consolidating financial statements.

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MERITOR, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
(In millions)
(Unaudited)

	Three Months Ended June 30, 2018				
	Parent	Guarantors	Non-Guarantors	Elims	Consolidated
Sales					
External	$—	$ 629	$ 500	$—	$ 1,129
Subsidiaries	—	40	61	(101)	—
Total sales	—	669	561	(101)	1,129
Cost of sales	(15)	(559)	(479)	101	(952)
GROSS MARGIN	(15)	110	82	—	177
Selling, general and administrative	(31)	(27)	(18)	—	(76)
Restructuring costs	(2)	(1)	—	—	(3)
Other operating income, net	—	—	—	—	—
OPERATING INCOME (LOSS)	(48)	82	64	—	98
Other income (expense), net	24	(15)	(7)	—	2
Equity in earnings of affiliates	—	6	3	—	9
Interest income (expense), net	(26)	6	6	—	(14)
INCOME (LOSS) BEFORE INCOME TAXES	(50)	79	66	—	95
Benefit (provision) for income taxes	7	(13)	(20)	—	(26)
Equity income from continuing operations of subsidiaries	109	39	—	(148)	—
INCOME FROM CONTINUING OPERATIONS	66	105	46	(148)	69
LOSS FROM DISCONTINUED OPERATIONS, net of tax	(2)	(2)	(2)	4	(2)
NET INCOME	64	103	44	(144)	67
Less: Net income attributable to noncontrolling interests	—	—	(3)	—	(3)
NET INCOME ATTRIBUTABLE TO MERITOR, INC.	$64	$ 103	$ 41	$(144)	$ 64

MERITOR, INC.
CONDENSED CONSOLIDATING STATEMENT OF COMPREHENSIVE INCOME (LOSS)
(In millions)
(Unaudited)

	Three Months Ended June 30, 2018				
	Parent	Guarantors	Non-Guarantors	Elims	Consolidated
Net income	$64	$ 103	$ 44	$(144)	$ 67
Other comprehensive loss, net of tax	(48)	(57)	(8)	63	(50)
Total comprehensive income	16	46	36	(81)	17
Less: Comprehensive income attributable to noncontrolling interests	—	—	(1)	—	(1)
Comprehensive income attributable to Meritor, Inc.	$16	$ 46	$ 35	$(81)	$ 16

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MERITOR, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
(In millions)
(Unaudited)

	Three Months Ended June 30, 2017 [1]				
	Parent	Guarantors	Non-Guarantors	Elims	Consolidated
Sales					
External	$—	$ 528	$ 392	$—	$ 920
Subsidiaries	—	33	77	(110)	—
Total sales	—	561	469	(110)	920
Cost of sales	(13)	(480)	(395)	110	(778)
GROSS MARGIN	(13)	81	74	—	142
Selling, general and administrative	(34)	(12)	(27)	—	(73)
Restructuring costs	—	1	(1)	—	—
Other operating income (expense), net	(1)	—	1	—	—
OPERATING INCOME (LOSS)	(48)	70	47	—	69
Other income (expense), net	12	(7)	(4)	—	1
Equity in earnings of affiliates	—	12	2	—	14
Interest income (expense), net	(32)	7	4	—	(21)
INCOME (LOSS) BEFORE INCOME TAXES	(68)	82	49	—	63
Benefit (provision) for income taxes	19	(22)	(8)	—	(11)
Equity income from continuing operations of subsidiaries	98	35	—	(133)	—
INCOME FROM CONTINUING OPERATIONS	49	95	41	(133)	52
LOSS FROM DISCONTINUED OPERATIONS, net of tax	(1)	—	—	—	(1)
NET INCOME	48	95	41	(133)	51
Less: Net income attributable to noncontrolling interests	—	—	(3)	—	(3)
NET INCOME ATTRIBUTABLE TO MERITOR, INC.	$48	$ 95	$ 38	$(133)	$ 48

(1) Amounts have been recast to reflect the release of certain guarantors in accordance with the company’s senior secured revolving credit facility.

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MERITOR, INC.
CONDENSED CONSOLIDATING STATEMENT OF COMPREHENSIVE INCOME (LOSS)
(In millions)
(Unaudited)

	Three Months Ended June 30, 2017 [1]				
	Parent	Guarantors	Non-Guarantors	Elims	Consolidated
Net income	$48	$ 95	$ 41	$(133)	$ 51
Other comprehensive income, net of tax	27	18	18	(37)	26
Total comprehensive income	75	113	59	(170)	77
Less: Comprehensive loss (income) attributable to noncontrolling interests	—	—	(3)	—	(3)
Comprehensive income attributable to Meritor, Inc.	$75	$ 113	$ 56	$(170)	$ 74

(1) Amounts have been recast to reflect the release of certain guarantors in accordance with the company's senior secured revolving credit facility.

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MERITOR, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
(In millions)
(Unaudited)

	Nine Months Ended June 30, 2018				
	Parent	Guarantors	Non-Guarantors	Elims	Consolidated
Sales					
External	$ —	$ 1,663	$ 1,435	$ —	$ 3,098
Subsidiaries	—	107	159	(266)	—
Total sales	—	1,770	1,594	(266)	3,098
Cost of sales	(44)	(1,477)	(1,348)	266	(2,603)
GROSS MARGIN	(44)	293	246	—	495
Selling, general and administrative	(90)	(74)	(53)	—	(217)