

# BULL'S EYE



**MERITOR**

M2016: ALIGN. ACHIEVE. ADVANCE.

JANUARY 2015

## Local Economies Directly Impact Key Truck Markets

When the U.S. government recently reported that real gross domestic product (GDP) grew by a strong 5.0 percent in the third quarter of 2014, it meant that American consumers were spending more money and that more freight was being moved by the nation's trucking industry.

Brazil's industrial and agricultural GDP, which grew at 0.1 percent in the third quarter, also directly impacts the truck industry in South America's biggest economy as it struggles to emerge from recession. But in Europe, India and Australia, Meritor's forecasters are challenged to look beyond GDP when assessing the prospects for the trucking industry.



"We're getting better at reading economic conditions so we can more closely align with future market needs around the world."

**ERIC GIERAHN**

DIRECTOR, M2016 PROGRAM MANAGEMENT

Across Meritor's global markets, GDP, housing construction, interest rates, employment levels, government spending and other economic factors have a direct impact on the commercial vehicle business.

"Global companies face significant challenges when they have markets

around the world, but today, Meritor is less tied to one particular region and resilient enough to weather a mix of local economic conditions," said Eric Gierahn, director, M2016 Program Management. "We're getting better at reading economic conditions so we can more closely align with future market needs around the world."

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**KEVIN NOWLAN**


SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

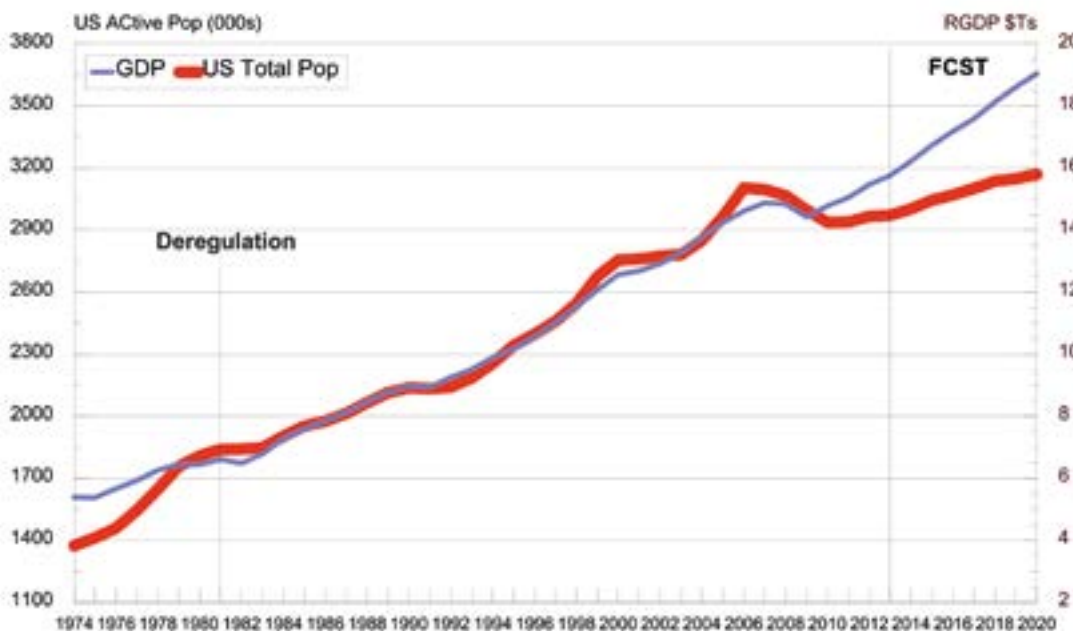
## Let's Work to Build a Thriving Company

As we begin a new calendar year, everyone should take great pride in what we accomplished in FY14. Our results were a good step in the journey toward where Meritor should be as a company. But there's still work to do before we declare victory.

Although we've improved Meritor's financial viability and have achieved our debt reduction target, we still have to drive toward M2016 goals of growing margin and achieving incremental revenue of \$500 million. Even with the PACCAR win, we're still short of that goal and still at least a point of away from our 10 percent margin in FY16.

During the next two years, we need to drive toward margins that are consistent with M2016 goals. We have to sustain the momentum we created last year by continuing to execute on material, labor and burden performance initiatives and driving tactical pricing actions. Successful launch of 16 new global product programs should account for more than 40 percent of product-related incremental EBITDA through 2017, while helping us to achieve our revenue growth objective.

It's a lot to do, but M2016 goals are achievable. And once we achieve these results in 2016, we'll be more than a viable company — we'll be a thriving one. 



In the United States, where the Class 8 market has rebounded sharply, growth in the commercial vehicle populations is tied closely to Gross Domestic Product (GDP). (Source: ACT Research Co. LLC.)

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# Local Economies

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## Booming U.S. Heavy-Duty Sales Tied to GDP

In the United States, the heavy-duty market is dependent on the broader economy. Medium-duty is influenced strongly by the housing market as well as consumer and local government spending, according to Jamie Adams, market analyst.

Class 8 trucks are responsible for 81 percent of the U.S. economy's \$796 billion freight business, according to ACT Research Co. In December, Class 8 truck orders exceeded 40,000 for the third straight month. "Class 8 follows the path of the

broader economy, and with GDP expected to continue rising, we're experiencing a healthy market that we expect to continue growing in 2015," Adams said. "In 2014, fleets became more profitable, and they're willing to invest in new vehicles for replacement and to add capacity."


In an economy where consumer spending accounts for more than 70 percent of the \$16.8 trillion GDP, Classes 5-7 sales are directly tied not only to big-ticket items like housing, but also to furniture purchases and

investments by cities in waste-removal trucks and other vehicles.

Total construction spending, which impacts the medium-duty segment, dropped unexpectedly by 0.3 percent in November after a significant 1.2 percent gain in October. "The medium-duty segment was relatively flat in 2014," Adams said. "When new housing starts to grow, we could see an uptick in Classes 5-7."

Meritor also follows major U.S. economic indices as an indicator of

future consumer spending and potential impact on trucking. Some economists believe interest rates will rise in late 2015 to keep inflation in check as the economy continues to grow.

"Our industry is directly impacted by the amount of freight that is moved from the manufacturer to the end-user," Adams said. "High interest rates can reduce consumer spending, which lowers the amount of freight moved and impacts fleet investments in new equipment." 

## Multiple Conditions Affect European Commercial Vehicle Sales

While macroeconomic indicators are important in some regions, Europe's trucking business depends more on specific business and consumer activity and large government-financed projects.

"GDP movement is probably too broad to gauge truck production and sales," said Witold Chmielewski, marketing manager, Europe. "Even when GDP is underperforming, utilization rates and average vehicle age can be high, which means that fleets are forced to swap their old trucks for new ones even during unfavorable overall economic conditions."

Heavy-duty demand among large

freight and construction fleets in Europe is driven by industrial production for transportation of raw materials, unfinished goods, fuels and equipment. The medium-duty segment, which is dominated by independent owner-operators and small fleets, is linked largely to consumer spending and the distribution and delivery of consumer products. Eurozone industrial production and consumer spending have been sluggish, according to recent reports.


New housing starts are generally not as significant as in the United States, but European governments are not funding large-scale construction and infrastructure projects, Chmielewski said. Overall Eurozone construction



European sales of heavy-duty trucks, such as Volvo's FH series, is heavily dependent on industrial production (Image: Raymondo166)

output rose in October but declined in the middle of 2014, which adds to economic uncertainty.

"Public financing is key to large construction projects, and

governments have reined in spending to reduce debts," Chmielewski said. "This has marked the end of some megaprojects and has affected the construction vehicle segment significantly." 

## Economic Rebound in India Expected to Impact Trucking

Trucks account for 70 percent of industrial freight movement and 30 percent of agricultural output in India's slowly rebounding economy.

GDP directly impacts the light- and small-commercial vehicle segments while heavy-haul truck sales are generally influenced by industrial production, according to

S. Raghunathan, senior vice president and executive director, Meritor India. Haulage truck volume, which comprises about 65 percent of the medium- and heavy-duty

segment, depends on many factors, such as industrial production, infrastructure spending and fuel prices, he said. Regulatory

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## India Economic Rebound

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measures, including overloading restrictions, highway projects and interest rates also contribute to volume.

Growth in India's core industries, such as mining and construction, influence the tipper segment. This segment is likely to post better growth once infrastructure projects, which have been dormant for the last two to three years, gain momentum, Raghunathan said.

Prime Minister Narendra Modi's new government has taken steps to make fundamental and structural changes to reverse India's unprecedented slow growth in recent years and build sustainable economic progress.

Economists expect the economy to grow by 5.5 percent in FY15 and 6.5 percent in FY16, which would revive multiple sectors, including the commercial vehicle market, Raghunathan said.

Government spending on highway infrastructure and specialty military vehicles has led to an uptick in the specialty trucking industry and Meritor's business. Consumer spending, which depends on employment and inflation levels, drives the broader economy and triggers demand for the movement of consumer goods and construction materials. Economists forecast housing, durable goods, transport and communication to account for 65



India's mining industry is a key driver of tipper sales. Meritor's MT1495 axle is used on Mahindra's Torro 25 Tipper.

percent of all consumption by 2020.

Interest rates, which are high in India but expected to decline gradually, impact fleets' cost of borrowing for vehicle purchases.

"Although many fleets have deferred replacing old vehicles for two to three years, demand is expected to pick up as the pace of economic reform and revival sets in," Raghunathan said. ➔

## Australia Truck Markets Driven by Mining and Key Indicators

Construction activity, automotive sales and mining are mutually dependent economic factors that impact transportation and freight movement in Australia.

"The mining industry had been in capital investment mode two years ago, driven by high commodity prices," said Sanjay Bhat, manager, Product Marketing, Australia. "All

automotive activities, including new vehicle sales and the spare parts businesses, were booming."

Now that mining has moved from the construction to the production phase, capital-intensive activities such as truck purchases have stalled. And falling commodity prices and a devalued Australian dollar affect Australia's terms of

trade and make imports costly. "These conditions have resulted in a marked cooling off in new truck sales and the parts business," Bhat said.

Other key indicators for the truck market include GDP growth, new housing starts and employment and interest rates. Australia's central bank has maintained historically low interest rates for 15 months. Inflation

and unemployment are also low. "Traditionally, low interest rates get new home construction going, but the Reserve Bank of Australia is worried about creating a property bubble that could burst," Bhat said. "Many economists expect rates to remain unchanged, which could positively impact the truck industry." ➔

## Broader Economy Impacts Brazil's Commercial Vehicle Industry

In Brazil, declining commercial vehicle and bus sales in 2014 reflect the current economic situation. Economists are forecasting continued low GDP growth of 0.4 percent in 2015.

Market size is dictated by the \$2.246 trillion GDP, and long-term recovery is based on reducing inflation and subsidies, a tighter monetary policy

and adjustments to interest rates and the tax structure, said Luis Marques, manager, Sales & Marketing, Brazil. "Broad growth is also linked to restored confidence and global growth," he said.

Investments in energy infrastructure, transportation and housing affect demand for trucks. Agriculture also drives the industry, because more than 70 percent of Brazil's agricultural

production is transported by trucks, often requiring trips of 1,000 miles or more from farms to ports.

In Brazil, 55 percent of commercial trucks are operated by individual owners. The average age of owner-operated trucks is 21 years. Fleet vehicles average 9 years old, compared with 7 in the United States. Only 12 percent of Brazil's highways

are paved, which impacts suspension systems, axles and other parts. Meritor has a key role in supplying a range of systems, including axles for half the country's trucks and buses.

"Brazil offers huge potential for our business, but economic conditions have deteriorated, and independent truckers can't afford to buy new vehicles," Marques said. ➔



# Six Sigma at Work

Another in a series of articles highlighting Six Sigma projects and how they benefit Meritor.



**Name:** Florin Patrascu, principal engineer, Driveline Engineering

**Location:** Troy, Michigan, United States

Florin Patrascu recently became the first Meritor Certified DFSS Black Belt through the use of the Design for Six Sigma (DFSS) methodology on three different projects:

## Super Duty Center Bearing Development

**Business Issue:** Meritor wanted to develop a driveshaft center bearing for Class 8 trucks that

could handle the extreme conditions faced in mining and agriculture during tropical rainy seasons.

**Description:** Using Six Sigma methodology, Patrascu identified multiple designs that would meet the criteria. He then tested those designs to determine the one that would deliver superior performance and optimize cost.

**Solution:** A new add-on component to Meritor's current center bearing prevents water moisture from penetrating the components for a longer-lasting part.

**Results:** The design, which is available both to manufacturers and the aftermarket, has enhanced customer satisfaction by preventing seized bearings that can lead to part failure.

## Competitive Analysis of Driveline Products

**Business Issue:** Meritor benchmarked the lifetime of its driveline against a competitor's product to support a new business opportunity in Brazil.

**Description:** Patrascu used Six Sigma methodology to compare Meritor's RPL 25 with the competitive offering

**Solution:** The drivelines were evaluated to measure the torque and functional performance capability to quantify the benefits of using the Meritor product.

**Results:** After finding that Meritor's driveline is longer lasting and with greater capability from an ultimate strength standpoint, Meritor won the new business.

## Universal Joint Seal Development

**Business Issue:** Meritor wanted to secure new business in Brazil by offering a new U-joint system that meets customer validation criteria for Class 7 trucks.

**Description:** The Design for Six Sigma project focused on improving the seal in the bearing cap to prevent premature wear due to water contamination.

**Solution:** Based on extensive analysis of the component, Patrascu redesigned the seal so the component is free of water but retains grease to prevent bearing damage.

**Results:** Meritor gained new business in Brazil and positioned itself for additional customer wins in the market.

# India Joint Venture Celebrates Family Day 2014

Families of Meritor India (AAL and MHSVIL) employees learned about the company's business and enjoyed cultural programs at its annual Family Day 2014.

The plant showcased its specialty on-highway and defense axles, recent improvements in quality, new machinery, robotics and other advanced technologies. Families also learned about Meritor's product development initiatives and customer recognition.

"Family Day is a significant event because families can see for

themselves how their spouses and parents work in dignity and take pride in their accomplishments," said NP Thimmaiah, managing director, Meritor India.

The afternoon included lunch, sports competitions and a cultural program featuring dance, yoga and a safety skit — all performed by employees for their families.

Meritor and the Kalyani Group formed the AAL and MHSVIL joint ventures in 1981 to serve markets in Asia, North and South America, Australia and Europe.



AAL/MHSVIL honored employees who completed 25 years of service and entertained family members at the joint venture's recent Family Day in Bangalore.



# Profile: Joyce Beeker, EHS Manager, Frankfort, Kentucky

## Tell us about your career at Meritor.

I started in HR, with safety responsibilities, at a Rockwell facility in Lenoir, North Carolina in 1986. In 1997, I joined the Laurinburg, North Carolina team just as they were implementing the ISO 14001 environmental management system, then moved to Frankfort in 2003.

## What does an Environmental Health & Safety (EHS) manager do?

My main goal is to protect employees at this facility through hazard identification and elimination and to prevent health problems through the use of safety training programs. I'm very involved in incident investigation and implementation of corrective and preventive actions. And, it goes without saying that I'm also responsible for ensuring compliance with government regulations.

## How do you keep people safe on the job?

I interact with all levels of our workforce, and we work together as a team to stay focused on safety. Whenever a first-aid or near-miss incident occurs, no matter how minor, we fill out an incident report, which includes a five-why analysis, to get to root cause and implement corrective and preventive actions. Our goal is to treat every incident as though it was OSHA recordable so we can prevent a reoccurrence and work for zero injuries. We have monthly safety training that's mandatory for the entire workforce, weekly safety topics that are discussed at start-up meetings and layered EHS audits to identify potential hazards. We've also completed the five core units of SafeStart.

## Frankfort seems to have a good safety record.

Although we haven't had a lost-time injury in five years, it's never acceptable for anybody to get hurt on the job. That's why communication and building awareness is so critical. We have a "Safety Gemba Board" in the employee break area where we track closure of all incidents. The management team reviews this once a week with the supervisors reporting on the incidents for their respective areas.

## How does Frankfort work to prevent injuries?

It's all about building awareness. You have to constantly remind people that it's important they work hard to stay safe and to look out for each other. It's good to hear team members starting to use some SafeStart lingo like "eyes and mind on task." We recently started having team members share a personal SafeStart story during the monthly safety training. I think it's pretty powerful to hear stories from your peers. When we asked our employees about the biggest challenge for preventing injuries, complacency was absolutely on top of the list, which we all know is the hardest challenge to overcome. We're brainstorming on ways to reduce complacency in our plant.

## What's your biggest challenge?

Making sure people report all near-misses and incidents so we can get to the root causes and prevent injuries. Sometimes, people think it's not a big deal if they run into a basket and scrape their elbow or pinch their finger between two cams. But if you don't take care of the small things, they can turn into big things, and we



Joyce Beeker talks with Matt Gaines about the Frankfort plant's new recyclable paint filters.

don't want that to happen. It's also a challenge to come up with good corrective actions for some of the small things. But at least if we let our team members know that something small has happened, it might keep them from doing the same thing.

## What's the most rewarding part of about your job?

People not getting injured. It's very difficult for me not to take it personally when someone does get hurt.

## If someone is injured, what are your responsibilities?

To ensure that the injured employee gets first aid or medical treatment. Secondly, ensure that everyone in the plant is made aware that an injury has occurred through an email from the supervisor, and then start an investigation and work on an incident report. We want everyone to know that we're serious about safety.

## What can you tell us about the environmental aspect of your job?

We take our commitment to the environment very seriously. We had

our ISO 14001 recertification audit in October and have been recommended for recertification. Our employees do a great job of recording data and completing inspections that are critical to complying with the requirements of our environmental permits. In addition to compliance, we work very hard to recycle as much waste as possible. We recycled 86 percent of our total waste generated in FY14. We're looking forward to a higher percentage in FY15.

## What do you do when you're not at work?

My husband and I used to enjoy golfing and sailing, but we've had to put these activities on hold while we take care of my mom, who has Alzheimer's. We've really become homebodies.

## How do you like living in Frankfort?

Frankfort is not a big city (27,453 people in 2013, according to the most recent U.S. Census estimate), but it's the biggest town I've ever lived in, and most likely, will be where my husband and I retire. 