

JOHNSON CONTROLS INC

Form 10-Q

August 08, 2008

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

**Form 10-Q**

(Mark One)

- þ** **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended June 30, 2008**
- OR**
- o** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES**  
**EXCHANGE ACT OF 1934**  
**For the transition period from            to**

**Commission File Number: 1-5097**

**JOHNSON CONTROLS, INC.**

*(Exact name of registrant as specified in its charter)*

**Wisconsin**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**39-0380010**

*(I.R.S. Employer  
Identification No.)*

**5757 North Green Bay Avenue**  
**Milwaukee, Wisconsin**

*(Address of principal executive offices)*

**53209**

*(Zip Code)*

**(414) 524-1200**

*(Registrant's telephone number, including area code)*

**Not Applicable**

*(Former name, former address and former fiscal year, if changed since last report)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **þ** No **o**

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐  
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                                        | Shares Outstanding at June 30, 2008 |
|----------------------------------------------|-------------------------------------|
| Common Stock: \$0.017/18 par value per share | 593,773,517                         |

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**Johnson Controls, Inc.**  
**Condensed Consolidated Statements of Financial Position**  
(in millions; unaudited)

|                                              | June 30,<br>2008 | September<br>30,<br>2007 | June 30,<br>2007 |
|----------------------------------------------|------------------|--------------------------|------------------|
| <b>Assets</b>                                |                  |                          |                  |
| Cash and cash equivalents                    | \$ 256           | \$ 674                   | \$ 189           |
| Accounts receivable net                      | 6,647            | 6,600                    | 6,352            |
| Inventories                                  | 2,292            | 1,968                    | 1,968            |
| Other current assets                         | 1,898            | 1,630                    | 1,638            |
| Current assets                               | 11,093           | 10,872                   | 10,147           |
| Property, plant and equipment net            | 4,385            | 4,208                    | 4,071            |
| Goodwill                                     | 6,425            | 6,131                    | 6,065            |
| Other intangible assets net                  | 779              | 773                      | 787              |
| Investments in partially-owned affiliates    | 859              | 795                      | 609              |
| Other noncurrent assets                      | 1,702            | 1,326                    | 1,600            |
| Total assets                                 | \$ 25,243        | \$ 24,105                | \$ 23,279        |
| <b>Liabilities and Shareholders' Equity</b>  |                  |                          |                  |
| Short-term debt                              | \$ 641           | \$ 264                   | \$ 462           |
| Current portion of long-term debt            | 241              | 899                      | 898              |
| Accounts payable                             | 5,179            | 5,365                    | 4,760            |
| Accrued compensation and benefits            | 1,036            | 978                      | 924              |
| Accrued income taxes                         | 207              | 97                       | 106              |
| Other current liabilities                    | 2,432            | 2,317                    | 2,231            |
| Current liabilities                          | 9,736            | 9,920                    | 9,381            |
| Commitments and contingencies (Note 16)      |                  |                          |                  |
| Long-term debt                               | 3,247            | 3,255                    | 3,257            |
| Postretirement health and other benefits     | 263              | 256                      | 321              |
| Minority interests in equity of subsidiaries | 156              | 128                      | 132              |
| Other noncurrent liabilities                 | 1,845            | 1,639                    | 1,879            |
| Shareholders' equity                         | 9,996            | 8,907                    | 8,309            |
| Total liabilities and shareholders' equity   | \$ 25,243        | \$ 24,105                | \$ 23,279        |

The accompanying notes are an integral part of the financial statements.

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**Johnson Controls, Inc.**  
**Consolidated Statements of Income**  
(in millions, except per share data; unaudited)

|                                                                              | Three Months<br>Ended June 30, |          | Nine Months<br>Ended June 30, |           |
|------------------------------------------------------------------------------|--------------------------------|----------|-------------------------------|-----------|
|                                                                              | 2008                           | 2007     | 2008                          | 2007      |
| Net sales                                                                    |                                |          |                               |           |
| Products and systems*                                                        | \$ 7,969                       | \$ 7,199 | \$ 23,271                     | \$ 20,743 |
| Services*                                                                    | 1,896                          | 1,712    | 5,484                         | 4,870     |
|                                                                              | 9,865                          | 8,911    | 28,755                        | 25,613    |
| Cost of sales                                                                |                                |          |                               |           |
| Products and systems                                                         | 6,869                          | 6,161    | 20,226                        | 18,043    |
| Services                                                                     | 1,511                          | 1,366    | 4,427                         | 3,919     |
|                                                                              | 8,380                          | 7,527    | 24,653                        | 21,962    |
| Gross profit                                                                 | 1,485                          | 1,384    | 4,102                         | 3,651     |
| Selling, general and administrative expenses                                 | (877)                          | (831)    | (2,715)                       | (2,495)   |
| Net financing charges                                                        | (69)                           | (71)     | (204)                         | (209)     |
| Equity income                                                                | 37                             | 20       | 85                            | 68        |
| Income from continuing operations before income taxes and minority interests | 576                            | 502      | 1,268                         | 1,015     |
| Provision for income taxes                                                   | 121                            | 106      | 266                           | 176       |
| Minority interests in net earnings of subsidiaries                           | 16                             |          | 39                            | 13        |
| Income from continuing operations                                            | 439                            | 396      | 963                           | 826       |
| Loss from discontinued operations, net of income taxes                       |                                |          |                               | (10)      |
| Loss on sale of discontinued operations, net of income taxes                 |                                |          |                               | (30)      |
| Net income                                                                   | \$ 439                         | \$ 396   | \$ 963                        | \$ 786    |
| Earnings per share from continuing operations                                |                                |          |                               |           |
| Basic                                                                        | \$ 0.74                        | \$ 0.67  | \$ 1.62                       | \$ 1.40   |
| Diluted                                                                      | \$ 0.73                        | \$ 0.66  | \$ 1.60                       | \$ 1.38   |

|                    |         |         |         |         |
|--------------------|---------|---------|---------|---------|
| Earnings per share |         |         |         |         |
| Basic              | \$ 0.74 | \$ 0.67 | \$ 1.62 | \$ 1.33 |
| Diluted            | \$ 0.73 | \$ 0.66 | \$ 1.60 | \$ 1.32 |

\* Products and systems consist of automotive experience and power solutions products and systems and building efficiency installed systems. Services are building efficiency technical and facility management services.

The accompanying notes are an integral part of the financial statements.

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**Johnson Controls, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
(in millions; unaudited)

|                                                                                   | Three Months<br>Ended June 30, |        | Nine Months<br>Ended June 30, |        |
|-----------------------------------------------------------------------------------|--------------------------------|--------|-------------------------------|--------|
|                                                                                   | 2008                           | 2007   | 2008                          | 2007   |
| <b>Operating Activities</b>                                                       |                                |        |                               |        |
| Net income                                                                        | \$ 439                         | \$ 396 | \$ 963                        | \$ 786 |
| Adjustments to reconcile net income to cash provided by operating activities      |                                |        |                               |        |
| Depreciation                                                                      | 187                            | 182    | 553                           | 532    |
| Amortization of intangibles                                                       | 9                              | 12     | 28                            | 36     |
| Equity in earnings of partially-owned affiliates, net of dividends received       | 10                             | 8      | 10                            | (24)   |
| Minority interests in net earnings of subsidiaries                                | 16                             |        | 39                            | 13     |
| Deferred income taxes                                                             | (53)                           | 3      | (73)                          | (46)   |
| Loss on sale of discontinued operations                                           |                                |        |                               | 30     |
| Equity-based compensation                                                         | 10                             | 11     | 43                            | 36     |
| Other                                                                             | 18                             | 5      | 37                            | 26     |
| Changes in working capital, excluding acquisitions and divestitures of businesses |                                |        |                               |        |
| Accounts receivable                                                               | (169)                          | (351)  | 260                           | (479)  |
| Inventories                                                                       | (57)                           | (102)  | (207)                         | (192)  |
| Other current assets                                                              | (156)                          | (166)  | (117)                         | (123)  |
| Restructuring reserves                                                            | (10)                           | (60)   | (42)                          | (123)  |
| Accounts payable and accrued liabilities                                          | 209                            | 272    | (551)                         | 393    |
| Accrued income taxes                                                              | 99                             | 30     | 85                            | (18)   |
| Cash provided by operating activities                                             | 552                            | 240    | 1,028                         | 847    |
| <b>Investing Activities</b>                                                       |                                |        |                               |        |
| Capital expenditures                                                              | (190)                          | (141)  | (551)                         | (582)  |
| Sale of property, plant and equipment                                             | 10                             | 28     | 42                            | 45     |
| Acquisition of businesses, net of cash acquired                                   | (4)                            | (17)   | (73)                          | (17)   |
| Business divestitures                                                             |                                |        |                               | 35     |
| Recoverable customer engineering expenditures                                     | (32)                           |        | (17)                          |        |
| Settlement of cross-currency interest rate swaps                                  | (62)                           | (64)   | (155)                         | (121)  |
| Changes in long-term investments                                                  | (10)                           |        | (22)                          | 3      |
| Cash used by investing activities                                                 | (288)                          | (194)  | (776)                         | (637)  |
| <b>Financing Activities</b>                                                       |                                |        |                               |        |
| Increase (decrease) in short-term debt net                                        | 66                             | 96     | 349                           | 164    |
| Increase in long-term debt                                                        | 7                              | 4      | 240                           | 109    |
| Repayment of long-term debt                                                       | (215)                          | (103)  | (927)                         | (485)  |

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|                                                         |              |              |                 |                 |
|---------------------------------------------------------|--------------|--------------|-----------------|-----------------|
| Payment of cash dividends                               | (77)         | (65)         | (220)           | (195)           |
| Stock repurchases                                       |              | (3)          | (73)            | (26)            |
| Other                                                   | (22)         | 42           | (39)            | 119             |
| Cash used by financing activities                       | (241)        | (29)         | (670)           | (314)           |
| <b>Increase (decrease) in cash and cash equivalents</b> | <b>\$ 23</b> | <b>\$ 17</b> | <b>\$ (418)</b> | <b>\$ (104)</b> |

The accompanying notes are an integral part of the financial statements.

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**Johnson Controls, Inc.**  
**Notes to Condensed Consolidated Financial Statements**  
**June 30, 2008**  
**(unaudited)**

**1. Financial Statements**

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (which include normal recurring adjustments except as disclosed herein) necessary to present fairly the financial position, results of operations and cash flows for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Johnson Controls, Inc. (the Company) Annual Report on Form 10-K for the year ended September 30, 2007. The results of operations for the three and nine month periods ended June 30, 2008 are not necessarily indicative of results for the Company's 2008 fiscal year because of seasonal and other factors.

Certain prior period amounts have been revised to conform to the current year's presentation. Prior year net sales and cost of sales amounts between Products and systems and Services have been reclassified.

**2. New Accounting Standards**

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures about Derivative Instruments and Hedging Activities*—an amendment of FASB Statement No. 133. SFAS No. 161 enhances required disclosures regarding derivatives and hedging activities, including how an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for the Company beginning in the second quarter of fiscal 2009 (January 1, 2009). The Company is assessing the potential impact that the adoption of SFAS No. 161 will have on its consolidated financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*. SFAS No. 141(R) changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, preacquisition contingencies, transaction costs, in-process research and development and restructuring costs. In addition, under SFAS No. 141(R), changes in an acquired entity's deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS No. 141(R) will be effective for the Company beginning in the first quarter of fiscal 2010 (October 1, 2009). This standard will change the Company's accounting treatment for business combinations on a prospective basis, when adopted.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51. SFAS No. 160 changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method changes the accounting for transactions with minority interest holders. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. SFAS No. 160 will be effective for the Company beginning in the first quarter of fiscal 2010 (October 1, 2009). The Company is assessing the potential impact that the adoption of SFAS No. 160 will have on its consolidated financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*—including an amendment to FASB Statement No. 115. SFAS No. 159 permits entities to measure

certain financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 will be effective for the Company beginning in the first quarter of fiscal 2009 (October 1, 2008). The Company is assessing the potential impact that the adoption of SFAS No. 159 will have on its consolidated financial condition and results of operations.

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**Johnson Controls, Inc.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 also establishes a fair value hierarchy that prioritizes information used in developing assumptions when pricing an asset or liability. SFAS No. 157 will be effective for the Company beginning in the first quarter of fiscal 2009 (October 1, 2008). The Company is assessing the potential impact that the adoption of SFAS No. 157 will have on its consolidated financial condition and results of operations.

In June 2006, the FASB issued FASB Interpretation Number (FIN) 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 allows recognition of only those tax benefits that satisfy a greater than 50% probability threshold. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. See Note 11 for the impact of the Company's adoption of FIN 48 as of October 1, 2007.

**3. Acquisition of Businesses**

In fiscal 2008, the Company completed four acquisitions for a combined purchase price of \$80 million, of which \$73 million was paid in the nine months ended June 30, 2008. None of these acquisitions were material to the Company's consolidated financial statements. In connection with these acquisitions, the Company recorded goodwill of \$55 million.

In September 2007, the Company recorded a \$200 million equity investment in a 48%-owned joint venture with U.S. Airconditioning Distributors, Inc., a California based, privately-owned heating, ventilating and air conditioning (HVAC) distributor serving five western U.S. states, in order to enhance the distribution of residential and light-commercial products in that geography. This investment is accounted for under the equity method as the Company does not have a controlling interest, but does have significant influence.

**4. Discontinued Operations**

In March 2007, the Company completed the sale of the Bristol Compressor business, which was acquired in December 2005 as part of the acquisition of York International Corporation, for approximately \$40 million, of which \$35 million was received in cash in the three months ended March 31, 2007 and \$5 million was received in cash in the three months ended September 30, 2007 after final purchase price adjustments. The sale of the Bristol Compressor business resulted in a loss of approximately \$49 million (\$30 million after-tax), including related costs.

Net assets of the Bristol Compressor business at the disposal date totaled approximately \$86 million, which consisted of current assets of \$97 million, fixed assets of \$6 million and liabilities of \$17 million.

In the second quarter of fiscal 2007, the Company settled a claim related to the February 2005 sale of the engine electronics business that resulted in a loss of approximately \$4 million (\$3 million after-tax).

**5. Percentage-of-Completion Contracts**

The building efficiency business records certain long term contracts under the percentage-of-completion method of accounting. Under this method, sales and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at completion. The Company records costs and earnings in excess of billings on uncompleted contracts within accounts receivable - net and billings in excess of costs and earnings on uncompleted contracts within other current liabilities in the condensed consolidated statements of financial position. Amounts included within accounts receivable - net related to these contracts were \$637 million, \$633 million and \$596 million at June 30, 2008, September 30, 2007, and

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**Johnson Controls, Inc.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

June 30, 2007, respectively. Amounts included within other current liabilities were \$615 million, \$538 million and \$521 million at June 30, 2008, September 30, 2007, and June 30, 2007, respectively.

**6. Inventories**

Inventories consisted of the following (in millions):

|                            | June 30,<br>2008 | September<br>30,<br>2007 | June 30,<br>2007 |
|----------------------------|------------------|--------------------------|------------------|
| Raw materials and supplies | \$ 929           | \$ 774                   | \$ 751           |
| Work-in-process            | 359              | 329                      | 317              |
| Finished goods             | 1,066            | 930                      | 952              |
| FIFO inventories           | 2,354            | 2,033                    | 2,020            |
| LIFO reserve               | (62)             | (65)                     | (52)             |
| Inventories                | \$ 2,292         | \$ 1,968                 | \$ 1,968         |

**7. Goodwill and Other Intangible Assets**

The changes in the carrying amount of goodwill in each of the Company's reporting segments for the three month period ended September 30, 2007 and the nine month period ended June 30, 2008 were as follows (in millions):

|                                | June 30,<br>2007 | Business<br>Acquisitions | Currency<br>Translation<br>and Other | September<br>30,<br>2007 |
|--------------------------------|------------------|--------------------------|--------------------------------------|--------------------------|
| Building efficiency            |                  |                          |                                      |                          |
| North America systems          | \$ 500           | \$                       | \$ (3)                               | \$ 497                   |
| North America service          | 626              |                          | (4)                                  | 622                      |
| North America unitary products | 484              |                          | (3)                                  | 481                      |
| Global workplace solutions     | 178              | 6                        | (3)                                  | 181                      |
| Europe                         | 378              |                          | 14                                   | 392                      |
| Rest of world                  | 517              | 1                        | 10                                   | 528                      |
| Automotive experience          |                  |                          |                                      |                          |
| North America                  | 1,181            |                          | (4)                                  | 1,177                    |
| Europe                         | 1,136            | 2                        | 29                                   | 1,167                    |
| Asia                           | 188              |                          | 17                                   | 205                      |
| Power solutions                | 877              |                          | 4                                    | 881                      |
| Total                          | \$ 6,065         | \$ 9                     | \$ 57                                | \$ 6,131                 |

|  | September<br>30, | Business | Currency<br>Translation | June 30, |
|--|------------------|----------|-------------------------|----------|
|--|------------------|----------|-------------------------|----------|

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|                                | 2007     | Acquisitions | and Other | 2008     |
|--------------------------------|----------|--------------|-----------|----------|
| Building efficiency            |          |              |           |          |
| North America systems          | \$ 497   | \$ 14        | \$ 1      | \$ 512   |
| North America service          | 622      | 41           |           | 663      |
| North America unitary products | 481      |              |           | 481      |
| Global workplace solutions     | 181      |              |           | 181      |
| Europe                         | 392      |              | 24        | 416      |
| Rest of world                  | 528      |              | 65        | 593      |
| Automotive experience          |          |              |           |          |
| North America                  | 1,177    |              |           | 1,177    |
| Europe                         | 1,167    |              | 108       | 1,275    |
| Asia                           | 205      |              |           | 205      |
| Power solutions                | 881      |              | 41        | 922      |
| Total                          | \$ 6,131 | \$ 55        | \$ 239    | \$ 6,425 |

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**Johnson Controls, Inc.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

The Company's other intangible assets, primarily from business acquisitions, consisted of (in millions):

|                                        | June 30, 2008               |                             |        | September 30, 2007          |                             |        | June 30, 2007               |                             |        |
|----------------------------------------|-----------------------------|-----------------------------|--------|-----------------------------|-----------------------------|--------|-----------------------------|-----------------------------|--------|
|                                        | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net    | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net    | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net    |
| Amortized<br>intangible assets         |                             |                             |        |                             |                             |        |                             |                             |        |
| Patented<br>technology                 | \$ 309                      | \$ (167)                    | \$ 142 | \$ 315                      | \$ (147)                    | \$ 168 | \$ 305                      | \$ (138)                    | \$ 167 |
| Unpatented<br>technology               | 26                          | (11)                        | 15     | 21                          | (8)                         | 13     | 33                          | (12)                        | 21     |
| Customer<br>relationships              | 342                         | (39)                        | 303    | 306                         | (24)                        | 282    | 318                         | (24)                        | 294    |
| Miscellaneous                          | 35                          | (13)                        | 22     | 47                          | (32)                        | 15     | 29                          | (25)                        | 4      |
| Total amortized<br>intangible assets   | 712                         | (230)                       | 482    | 689                         | (211)                       | 478    | 685                         | (199)                       | 486    |
| Unamortized<br>intangible assets       |                             |                             |        |                             |                             |        |                             |                             |        |
| Trademarks                             | 297                         |                             | 297    | 295                         |                             | 295    | 295                         |                             | 295    |
| Pension asset                          |                             |                             |        |                             |                             |        | 6                           |                             | 6      |
| Total unamortized<br>intangible assets | 297                         |                             | 297    | 295                         |                             | 295    | 301                         |                             | 301    |
| Total intangible<br>assets             | \$1,009                     | \$ (230)                    | \$ 779 | \$ 984                      | \$ (211)                    | \$ 773 | \$ 986                      | \$ (199)                    | \$ 787 |

Amortization of other intangible assets for the nine month periods ended June 30, 2008 and 2007 was \$28 million and \$36 million, respectively. Excluding the impact of any future acquisitions, the Company anticipates amortization of other intangible assets will average approximately \$36 million per year over the next five years.

## 8. Product Warranties

The Company offers warranties to its customers depending upon the specific product and terms of the customer purchase agreement. A typical warranty program requires that the Company replace defective products within a specified time period from the date of sale. The Company records an estimate for future warranty-related costs based on actual historical return rates. Based on analysis of return rates and other factors, the Company's warranty provisions are adjusted as necessary. While the Company's warranty costs have historically been adequate, it is possible that future warranty costs could exceed those estimates. The Company's product warranty liability is included in other current liabilities in the condensed consolidated statements of financial position.

The change in the carrying amount of the Company's total product warranty liability for the nine months ended June 30, 2008 and 2007 was as follows (in millions):

|                                                                              | 2008   | 2007   |
|------------------------------------------------------------------------------|--------|--------|
| Balance as of September 30                                                   | \$ 186 | \$ 189 |
| Accruals for warranties issued during the period                             | 121    | 85     |
| Accruals from acquisitions                                                   |        | 5      |
| Accruals related to pre-existing warranties (including changes in estimates) | 3      | 6      |
| Settlements made (in cash or in kind) during the period                      | (108)  | (101)  |
| Currency translation                                                         | 6      | 4      |
| Balance as of June 30                                                        | \$ 208 | \$ 188 |

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**9. Restructuring Costs**

As part of its continuing efforts to reduce costs and improve the efficiency of its global operations, the Company committed to a restructuring plan (2006 Plan) in the third quarter of fiscal 2006 and recorded a \$197 million restructuring charge in that quarter. During the fourth quarter of fiscal 2006, the Company increased its 2006 Plan restructuring charge by \$8 million for additional employee severance and termination benefits. The 2006 Plan, which primarily includes workforce reductions and plant consolidations in the automotive experience and building efficiency businesses, is expected to be substantially completed by the end of calendar 2008. The automotive experience business related restructuring focused on improving the profitability associated with the manufacturing and supply of instrument panels, headliners and other interior components in North America and increasing the efficiency of seating component operations in Europe. The charges associated with the building efficiency business primarily related to Europe where the Company has launched a systems redesign initiative.

The 2006 Plan included workforce reductions of approximately 5,000 employees (2,500 for automotive experience North America, 1,400 for automotive experience Europe, 200 for building efficiency North America, 600 for building efficiency Europe, 280 for building efficiency rest of world and 20 for power solutions). Restructuring charges associated with employee severance and termination benefits are paid over the severance period granted to each employee and on a lump sum basis when required in accordance with individual severance agreements. As of June 30, 2008, approximately 4,700 employees have been separated from the Company pursuant to the 2006 Plan. In addition, the 2006 Plan includes 15 plant closures (10 in automotive experience North America, 3 in automotive experience Europe, 1 in building efficiency Europe and 1 in building efficiency rest of world). As of June 30, 2008, 14 of the 15 plants have been closed. The restructuring charge for the impairment of the long-lived assets associated with the plant closures was determined using fair value based on a discounted cash flow analysis.

The following table summarizes the changes in the Company's 2006 Plan reserve, included within other current liabilities in the consolidated statements of financial position (in millions):

|                               | Employee<br>Severance<br>and<br>Termination<br>Benefits | Other | Currency<br>Translation | Total |
|-------------------------------|---------------------------------------------------------|-------|-------------------------|-------|
| Balance at September 30, 2007 | \$ 38                                                   | \$ 6  | \$ 1                    | \$ 45 |
| Utilized Cash                 | (5)                                                     | (4)   |                         | (9)   |
| Balance at December 31, 2007  | 33                                                      | 2     | 1                       | 36    |
| Utilized Cash                 | (12)                                                    |       |                         | (12)  |
| Balance at March 31, 2008     | 21                                                      | 2     | 1                       | 24    |
| Utilized Cash                 | (3)                                                     | (2)   |                         | (5)   |

|                          |    |    |    |    |   |    |    |
|--------------------------|----|----|----|----|---|----|----|
| Balance at June 30, 2008 | \$ | 18 | \$ | \$ | 1 | \$ | 19 |
|--------------------------|----|----|----|----|---|----|----|

Included within the other category are exit costs for terminating supply contracts associated with changes in the Company's manufacturing footprint and strategies, lease termination costs and other direct costs.

The Company recorded restructuring reserves of \$161 million related to the December 2005 York acquisition, including workforce reductions of approximately 3,150 building efficiency employees (850 for North America systems, 300 for North America service, 60 for North America unitary products, 1,150 for Europe and 790 for rest of world), the closure of two manufacturing plants (one in North America systems and one in rest of world), the merging of other plants and branch offices with existing Company facilities and contract terminations. These restructuring activities were recorded as costs of the acquisition and were provided for in accordance with FASB Emerging Issues Task Force (EITF) Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination.

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During the second quarter of fiscal 2008, due primarily to a need for increased manufacturing capacity and changes in the global footprint, the Company reversed its decision to close the two plants originally included in the York restructuring plan. In addition, due to voluntary employee turnover and the decision not to close the two York manufacturing plants, the number of total workforce reductions decreased from 3,150 to 2,800. As such, severance costs will be lower than the original liability recognized. In accordance with EITF 95-3, the excess reserves of \$21 million were reversed to goodwill during the second quarter of fiscal 2008. The Company anticipates that substantially all of the non-contractual restructuring actions under the York restructuring plan will be completed in calendar 2008.

As of June 30, 2008, approximately 2,200 employees have been separated from the Company pursuant to the York restructuring plan, including 295 for North America systems, 50 for North America unitary products, 1,110 for Europe and 745 for rest of world.

The following table summarizes the changes in the Company's York restructuring reserves, included within other current liabilities in the condensed consolidated statements of financial position (in millions):

|                               | Employee<br>Severance<br>and<br>Termination<br>Benefits | Other | Currency<br>Translation | Total |
|-------------------------------|---------------------------------------------------------|-------|-------------------------|-------|
| Balance at September 30, 2007 | \$ 23                                                   | \$ 30 | \$ 3                    | \$ 56 |
| Utilized Cash                 | (3)                                                     | (2)   |                         | (5)   |
| Reclassification              | 9                                                       | (9)   |                         |       |
| Balance at December 31, 2007  | 29                                                      | 19    | 3                       | 51    |
| Utilized Cash                 | (4)                                                     | (2)   |                         | (6)   |
| Noncash adjustments           | (17)                                                    | (4)   | 4                       | (17)  |
| Balance at March 31, 2008     | 8                                                       | 13    | 7                       | 28    |
| Utilized Cash                 | (2)                                                     | (1)   | (2)                     | (5)   |
| Balance at June 30, 2008      | \$ 6                                                    | \$ 12 | \$ 5                    | \$ 23 |

Included within the other category are exit costs for terminating supply contracts associated with changes in the Company's manufacturing footprint and strategies, lease termination costs and other direct costs.

Company management closely monitors its overall cost structure and continually analyzes each of its businesses for opportunities to consolidate current operations, improve operating efficiencies and locate facilities in low cost countries in close proximity to customers. This ongoing analysis includes a review of its manufacturing, engineering and purchasing operations, as well as the overall global footprint for all its businesses. Because of the importance of new vehicle sales by major automotive manufacturers to operations, the Company is affected by the general business conditions in this industry. Future adverse developments in the automotive industry could impact the Company's liquidity position and/or require additional restructuring of its operations.

## **10. Research and Development**

Expenditures for research activities relating to product development and improvement are charged against income as incurred and included within selling, general and administrative expenses. A portion of the costs associated with these activities is reimbursed by customers. Such expenditures amounted to \$95 million and \$121 million for the three months ended June 30, 2008 and 2007, respectively, and \$322 million and \$390 million for the nine months ended June 30, 2008 and 2007, respectively. These expenditures are net of customer reimbursements of \$106 million and \$70 million for the three months ended June 30, 2008 and 2007, respectively, and \$282 million and \$183 million for the nine months ended June 30, 2008 and 2007, respectively.

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**11. Income Taxes**

The more significant components of the Company's income tax provision from continuing operations are as follows (in millions):

|                                               | Three Months<br>Ended June 30, |        | Nine Months<br>Ended June 30, |        |
|-----------------------------------------------|--------------------------------|--------|-------------------------------|--------|
|                                               | 2008                           | 2007   | 2008                          | 2007   |
| Federal, state and foreign income tax expense | \$ 121                         | \$ 106 | \$ 266                        | \$ 213 |
| Change in tax status of foreign subsidiary    |                                |        |                               | (22)   |
| Audit resolutions                             |                                |        |                               | (15)   |
| Provision for income taxes                    | \$ 121                         | \$ 106 | \$ 266                        | \$ 176 |

***Effective Tax Rate***

In calculating the provision for income taxes, the Company uses an estimate of the annual effective tax rate based upon the facts and circumstances known at each interim period. On a quarterly basis, the actual effective tax rate is adjusted, as appropriate, based upon changed facts and circumstances, if any, as compared to those forecasted at the beginning of the fiscal year and each interim period thereafter. For the three and nine months ended June 30, 2008 and 2007, the Company's estimated annual effective income tax rate for continuing operations was 21.0%.

***Change in Tax Status of Foreign Subsidiary***

In the second quarter of fiscal 2007, the tax provision decreased as a result of a \$22 million tax benefit realized by a change in tax status of an automotive experience subsidiary in the Netherlands.

The change in tax status resulted from a voluntary tax election that produced a deemed liquidation for U.S. federal income tax purposes. The Company received a tax benefit in the U.S. for the loss from the decrease in value from the original tax basis of its investment. This election changed the tax status from a controlled foreign corporation (i.e., taxable entity) to a branch (i.e., flow through entity similar to a partnership) for U.S. federal income tax purposes and is thereby reported as a discrete period tax benefit in accordance with the provisions of SFAS No. 109.

***Uncertain Tax Positions***

In June 2006, FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that a company has taken or expects to take on a tax return. The Company adopted FIN 48 as of October 1, 2007.

Upon adoption, the Company increased its existing reserves for uncertain tax positions by \$93 million. The increase was recorded as a cumulative effect adjustment to shareholders' equity of \$68 million and an increase to goodwill of \$25 million related to business combinations in prior years. As of the adoption date, the Company

had gross tax affected unrecognized tax benefits of \$616 million of which \$475 million, if recognized, would affect the effective tax rate. Also as of the adoption date, the Company had accrued interest expense and penalties related to the unrecognized tax benefits of \$75 million (net of tax benefit). The Company accrued approximately \$11 million of additional interest and penalties during the nine months ended June 30, 2008. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense or goodwill, when applicable.

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The Company is subject to income taxes in the U.S. and numerous foreign jurisdictions. Judgment is required in determining its worldwide provision for income taxes and recording the related assets and liabilities. In the ordinary course of the Company's business, there are many transactions and calculations where the ultimate tax determination is uncertain. The Company is regularly under audit by tax authorities including such major jurisdictions as Austria, Belgium, Canada, China, Czech Republic, France, Germany, Italy, Japan, Mexico, the Netherlands, Spain, United Kingdom, and the United States. The statute of limitations for each major jurisdiction is as follows:

| Tax Jurisdiction        | Statute of Limitations |
|-------------------------|------------------------|
| Austria                 | 5 years                |
| Belgium                 | 3 years                |
| Canada                  | 5 years                |
| China                   | 3 to 5 years           |
| Czech Republic          | 3 years                |
| France                  | 3 years                |
| Germany                 | 4 to 5 years           |
| Italy                   | 4 years                |
| Japan                   | 5 to 7 years           |
| Mexico                  | 5 years                |
| Netherlands             | 3 to 5 years           |
| Spain                   | 4 years                |
| United Kingdom          | 6 years                |
| United States - Federal | 3 years                |
| United States - State   | 3 to 5 years           |

In the U.S., the Company's tax returns for fiscal 2004 through fiscal 2006 are currently under exam by the Internal Revenue Service (IRS) and the Company's tax returns for fiscal 1999 through fiscal 2003 are currently under IRS Appeals. Additionally, the Company's tax returns are currently under exam in the following major foreign jurisdictions:

| Tax Jurisdiction | Tax Years Covered |
|------------------|-------------------|
| Austria          | 2003 - 2005       |
| Belgium          | 2005 - 2006       |
| Canada           | 2002 - 2003       |
| France           | 2005 - 2006       |
| Germany          | 2001 - 2003       |
| Italy            | 2003 - 2005       |
| Japan            | 2005 - 2007       |
| Spain            | 2003 - 2005       |

In the nine months ended June 30, 2008, the Company finalized its U.S. federal tax litigation for fiscal 1997 and fiscal 1998 and, consistent with the established reserves, made a tax payment of \$27 million. The associated interest has not yet been assessed. It is reasonably possible that certain other U.S. and non-U.S. tax examinations, appellate proceedings and/or tax litigation will conclude within the next 12 months, including the resolution of the fiscal 1999 through fiscal 2003 U.S. federal tax years. However, it is not possible to reasonably estimate the effect this may have upon the unrecognized tax benefits. There was no other significant change in the total unrecognized tax benefits due to the settlement of audits, the expiration of the statute of limitations, or from other items arising during the nine months ended June 30, 2008. In March 2007, the Company reduced its liability by \$15 million due to the resolution of certain tax audits.



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***Valuation Allowance***

The Company reviews its deferred tax asset valuation allowances on a quarterly basis, or whenever events or changes in circumstances indicate that a review is required. In determining the requirement for a valuation allowance, the historical and projected financial results of the legal entity or consolidated group recording the net deferred tax asset is considered, along with any other positive or negative evidence. Since future financial results may differ from previous estimates, periodic adjustments to the Company's valuation allowances may be necessary.

***Discontinued Operations***

The Company utilized an effective tax rate for discontinued operations of approximately 38% for Bristol Compressors and 35% for its engine electronics business in fiscal 2007. This effective tax rate approximates the local statutory rate adjusted for permanent differences.

**12. Retirement Plans**

The components of the Company's net periodic benefit costs associated with its defined benefit pension plans and other postretirement health and other benefits are shown in the tables below in accordance with SFAS No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits—an amendment of FASB Statements No. 87, 88 and 106 (amounts in millions):

|                                         | U.S. Pension Plans |       |                |       |
|-----------------------------------------|--------------------|-------|----------------|-------|
|                                         | Three Months       |       | Nine Months    |       |
|                                         | Ended June 30,     |       | Ended June 30, |       |
|                                         | 2008               | 2007  | 2008           | 2007  |
| Service cost                            | \$ 20              | \$ 19 | \$ 60          | \$ 56 |
| Interest cost                           | 35                 | 33    | 105            | 97    |
| Expected return on plan assets          | (41)               | (38)  | (124)          | (114) |
| Amortization of transitional obligation |                    |       |                | (1)   |
| Amortization of net actuarial loss      | 1                  | 2     | 4              | 8     |
| Amortization of prior service cost      |                    |       | 1              | 1     |
| Net periodic benefit cost               | \$ 15              | \$ 16 | \$ 46          | \$ 47 |

|                                    | Non-U.S. Pension Plans |       |                |       |
|------------------------------------|------------------------|-------|----------------|-------|
|                                    | Three Months           |       | Nine Months    |       |
|                                    | Ended June 30,         |       | Ended June 30, |       |
|                                    | 2008                   | 2007  | 2008           | 2007  |
| Service cost                       | \$ 10                  | \$ 9  | \$ 29          | \$ 28 |
| Interest cost                      | 20                     | 16    | 56             | 46    |
| Expected return on plan assets     | (17)                   | (14)  | (50)           | (41)  |
| Amortization of net actuarial loss | 1                      | 2     | 5              | 6     |
| Net periodic benefit cost          | \$ 14                  | \$ 13 | \$ 40          | \$ 39 |



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|                                    | Postretirement Health and Other Benefits<br>Three Months<br>Ended June 30, |      | Nine Months<br>Ended June 30, |       |
|------------------------------------|----------------------------------------------------------------------------|------|-------------------------------|-------|
|                                    | 2008                                                                       | 2007 | 2008                          | 2007  |
| Service cost                       | \$ 2                                                                       | \$ 1 | \$ 4                          | \$ 4  |
| Interest cost                      | 4                                                                          | 5    | 13                            | 14    |
| Amortization of net actuarial gain | (1)                                                                        |      | (2)                           |       |
| Amortization of prior service cost | (1)                                                                        | (1)  | (5)                           | (4)   |
| Net postretirement benefit expense | \$ 4                                                                       | \$ 5 | \$ 10                         | \$ 14 |

**13. Earnings Per Share**

On July 25, 2007, the Company's Board of Directors declared a three-for-one split of the Company's outstanding common stock payable October 2, 2007 to shareholders of record on September 14, 2007. All prior year share and per share amounts disclosed in this document have been restated to reflect the three-for-one stock split. The stock split resulted in an increase of approximately 396 million in the outstanding shares of common stock as of the date of the split. In connection with the stock split, the par value of the common stock was changed from \$.04 1/6 per share to \$.01 7/18 per share.

The following table reconciles the denominators used to calculate basic and diluted earnings per share (in millions):

|                                             | Three Months<br>Ended June 30, |       | Nine Months<br>Ended June 30, |       |
|---------------------------------------------|--------------------------------|-------|-------------------------------|-------|
|                                             | 2008                           | 2007  | 2008                          | 2007  |
| <b>Weighted Average Shares Outstanding</b>  |                                |       |                               |       |
| Basic weighted average shares outstanding   | 592.9                          | 591.9 | 593.0                         | 589.8 |
| Effect of dilutive securities:              |                                |       |                               |       |
| Stock options                               | 8.0                            | 9.3   | 8.7                           | 8.1   |
| Diluted weighted average shares outstanding | 600.9                          | 601.2 | 601.7                         | 597.9 |
| <b>Antidilutive Securities</b>              |                                |       |                               |       |
| Options to purchase common shares           | 0.9                            |       | 0.9                           | 0.3   |

**14. Comprehensive Income**

A summary of comprehensive income is shown below (in millions):

|                                                       | Three Months<br>Ended June 30, |        | Nine Months<br>Ended June 30, |        |
|-------------------------------------------------------|--------------------------------|--------|-------------------------------|--------|
|                                                       | 2008                           | 2007   | 2008                          | 2007   |
| Net income                                            | \$ 439                         | \$ 396 | \$ 963                        | \$ 786 |
| Realized and unrealized gains (losses) on derivatives | (49)                           | 41     | (101)                         | 20     |

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|                                          |        |        |          |          |
|------------------------------------------|--------|--------|----------|----------|
| Foreign currency translation adjustments | 70     | 65     | 518      | 204      |
| Other comprehensive income               | 21     | 106    | 417      | 224      |
| Comprehensive income                     | \$ 460 | \$ 502 | \$ 1,380 | \$ 1,010 |

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The Company selectively hedges anticipated transactions that are subject to foreign exchange exposure or commodity price exposure, primarily using foreign currency exchange contracts and commodity contracts, respectively. These instruments are designated as cash flow hedges in accordance with SFAS No. 133,

Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137, No. 138 and No. 149 and are recorded in the condensed consolidated statements of financial position at fair value. The effective portion of the contracts' gains or losses due to changes in fair value are initially recorded as unrealized gains/losses on derivatives, a component of other comprehensive income, and are subsequently reclassified into earnings when the hedged transactions, typically sales or costs related to sales, occur and affect earnings. These contracts are highly effective in hedging the variability in future cash flows attributable to changes in currency exchange rates or commodity price changes.

The favorable foreign currency translation adjustments (CTA) for the nine months ended June 30, 2008 were primarily due to the strengthening of the Euro and other foreign currencies against the U.S. dollar.

The Company has foreign currency-denominated debt obligations and cross-currency interest rate swaps which are designated as hedges of net investments in foreign subsidiaries. Gains and losses, net of tax, attributable to these hedges are deferred as CTA within the accumulated other comprehensive income account until realized. A net loss of approximately \$43 million and \$3 million associated with hedges of net investments in non-U.S. operations was recorded in the accumulated other comprehensive income account for the periods ended June 30, 2008 and 2007, respectively.

**15. Segment Information**

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes the standards for reporting information about segments in financial statements. In applying the criteria set forth in SFAS No. 131, the Company has determined that it has ten reportable segments for financial reporting purposes. Certain segments are aggregated or combined based on materiality within building efficiency, rest of world and power solutions in accordance with the standard. The Company's ten reportable segments are presented in the context of its three primary businesses: building efficiency, automotive experience and power solutions.

***Building efficiency***

North America systems designs, produces, markets and installs mechanical equipment that provides heating and cooling in North American non-residential buildings and industrial applications as well as control systems that integrate the operation of this equipment with other critical building systems.

North America service provides technical services including inspection, scheduled maintenance, repair and replacement of mechanical and control systems in North America, as well as the retrofit and service components of performance contracts and other solutions.

North America unitary products designs and produces heating and air conditioning solutions for residential and light commercial applications and markets products to the replacement and new construction markets.

Global workplace solutions provides on-site staff for complete real estate services, facility operation and management to improve the comfort, productivity, energy efficiency and cost effectiveness of building systems around the globe.

Europe provides HVAC and refrigeration systems and technical services to the European marketplace.

Rest of world provides HVAC and refrigeration systems and technical services to markets in Asia, the Middle East and Latin America.

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***Automotive experience***

Automotive experience designs and manufactures interior systems and products for passenger cars and light trucks, including vans, pick-up trucks and sport utility/crossover vehicles in North America, Europe and Asia. Automotive experience systems and products include complete seating systems and components; cockpit systems, including instrument panels and clusters, information displays and body controllers; overhead systems, including headliners and electronic convenience features; floor consoles; and door systems.

***Power solutions***

Power solutions services both automotive original equipment manufacturers and the battery aftermarket by providing advanced battery technology, coupled with systems engineering, marketing and service expertise.

Management evaluates the performance of the segments based primarily on segment income, which represents income from continuing operations before income taxes and minority interests excluding net financing charges and restructuring costs. General Corporate and other overhead expenses are allocated to business segments in determining segment income. Financial information relating to the Company's reportable segments is as follows (in millions):

|                                | Net Sales              |          |                        |           |
|--------------------------------|------------------------|----------|------------------------|-----------|
|                                | Three Months           |          | Nine Months            |           |
|                                | Ended June 30,<br>2008 | 2007     | Ended June 30,<br>2008 | 2007      |
| Building efficiency            |                        |          |                        |           |
| North America systems          | \$ 605                 | \$ 519   | \$ 1,680               | \$ 1,447  |
| North America service          | 626                    | 590      | 1,749                  | 1,597     |
| North America unitary products | 235                    | 283      | 550                    | 675       |
| Global workplace solutions     | 785                    | 657      | 2,347                  | 1,973     |
| Europe                         | 716                    | 578      | 1,997                  | 1,743     |
| Rest of world                  | 710                    | 620      | 1,897                  | 1,697     |
|                                | 3,677                  | 3,247    | 10,220                 | 9,132     |
| Automotive experience          |                        |          |                        |           |
| North America                  | 1,681                  | 1,988    | 5,199                  | 5,549     |
| Europe                         | 2,705                  | 2,312    | 7,657                  | 6,767     |
| Asia                           | 402                    | 335      | 1,171                  | 1,080     |
|                                | 4,788                  | 4,635    | 14,027                 | 13,396    |
| Power solutions                | 1,400                  | 1,029    | 4,508                  | 3,085     |
| Total net sales                | \$ 9,865               | \$ 8,911 | \$ 28,755              | \$ 25,613 |



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|                                                                              | Segment Income                 |        |                               |          |
|------------------------------------------------------------------------------|--------------------------------|--------|-------------------------------|----------|
|                                                                              | Three Months<br>Ended June 30, |        | Nine Months<br>Ended June 30, |          |
|                                                                              | 2008                           | 2007   | 2008                          | 2007     |
| Building efficiency                                                          |                                |        |                               |          |
| North America systems                                                        | \$ 80                          | \$ 63  | \$ 192                        | \$ 135   |
| North America service                                                        | 76                             | 69     | 144                           | 117      |
| North America unitary products                                               | 3                              | 28     | (20)                          | 42       |
| Global workplace solutions                                                   | 16                             | 17     | 45                            | 49       |
| Europe                                                                       | 38                             | 33     | 78                            | 53       |
| Rest of world                                                                | 88                             | 64     | 202                           | 138      |
|                                                                              | 301                            | 274    | 641                           | 534      |
| Automotive experience                                                        |                                |        |                               |          |
| North America                                                                | 47                             | 52     | 82                            | (1)      |
| Europe                                                                       | 139                            | 139    | 334                           | 339      |
| Asia                                                                         | 13                             | (11)   | 16                            | (2)      |
|                                                                              | 199                            | 180    | 432                           | 336      |
| Power solutions                                                              | 145                            | 119    | 399                           | 354      |
| Total segment income                                                         | \$ 645                         | \$ 573 | \$ 1,472                      | \$ 1,224 |
| Net financing charges                                                        | 69                             | 71     | 204                           | 209      |
| Income from continuing operations before income taxes and minority interests | \$ 576                         | \$ 502 | \$ 1,268                      | \$ 1,015 |

**16. Commitments and Contingencies**

The Company accrues for potential environmental losses in a manner consistent with accounting principles generally accepted in the United States; that is, when it is probable a loss has been incurred and the amount of the loss is reasonably estimable. The Company reviews the status of its environmental sites on a quarterly basis and adjusts its reserves accordingly. Such potential liabilities accrued by the Company do not take into consideration possible recoveries of future insurance proceeds, although the accruals do take into account the likely share other parties will bear at remediation sites. It is difficult to estimate the Company's ultimate level of liability at many remediation sites due to the large number of other parties that may be involved, the complexity of determining the relative liability among those parties, the uncertainty as to the nature and scope of the investigations and remediation to be conducted, the uncertainty in the application of law and risk assessment, the various choices and costs associated with diverse technologies that may be used in corrective actions at the sites, and the often quite lengthy periods over which eventual remediation may occur. Nevertheless, the Company has no reason to

believe at the present time that any claims, penalties or costs in connection with known environmental matters will have a material adverse effect on the Company's financial position, results of operations or cash flows.

The Company is involved in a number of product liability and various other suits incident to the operation of its businesses. Insurance coverages are maintained and estimated costs are recorded for claims and suits of this nature. It is management's opinion that none of these will have a material adverse effect on the Company's financial position, results of operations or cash flows. Costs related to such matters were not material to the periods presented.

A significant portion of the Company's sales are to customers in the automotive industry. Future adverse developments in the automotive industry could impact the Company's liquidity position and/or require additional restructuring of the Company's operations. In addition, the downturn in the North American automotive market is likely to impact certain vendors' financial solvency, including their ability to meet restrictive debt covenants. Such events could result in potential liabilities or additional costs, including impairment charges, to the Company, or investments by the Company, to ensure uninterrupted supply to its customers.

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**17. Subsequent Event**

On July 1, 2008, the Company announced the acquisition of the interior product assets of Plastech Engineered Products, Inc. (Plastech), which filed for bankruptcy in February 2008. The Company owns 70% of the new entity with certain Plastech term lenders holding the minority portion. The Company contributed \$135 million of cash and five injection molding plants to the new entity. The Company is the largest customer of the new entity. The entity's annual sales are expected to total \$1.2 billion, of which \$500 million to \$600 million will be incremental to the Company.

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders  
of Johnson Controls, Inc.

We have reviewed the accompanying condensed consolidated statements of financial position of Johnson Controls, Inc. and its subsidiaries (the Company) as of June 30, 2008 and 2007, and the related consolidated statements of income and the condensed consolidated statements of cash flows for the three-month and nine-month periods ended June 30, 2008 and 2007. These interim financial statements are the responsibility of the Company's management. We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial position as of September 30, 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated November 26, 2007 we expressed an unqualified opinion on those consolidated financial statements. An explanatory paragraph was included in our report for the adoption of Statement of Financial Accounting Standards No. 158, Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R); Statement of Financial Accounting Standards No. 123(R), Share-Based Payment; and Financial Accounting Standards Board Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial position as of September 30, 2007, is fairly stated in all material respects in relation to the consolidated statement of financial position from which it has been derived.

/s/ PricewaterhouseCoopers LLP  
PricewaterhouseCoopers LLP  
Milwaukee, Wisconsin  
August 5, 2008

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Cautionary Statements for Forward-Looking Information**

Unless otherwise indicated, references to Johnson Controls, the Company, we, our and us in this Quarterly Report on Form 10-Q refer to Johnson Controls, Inc. and its consolidated subsidiaries.

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

These forward-looking statements generally are identified by the words believe, project, expect, anticipate, estimate, forecast, outlook, intend, strategy, plan, may, should, will, would, will be, will continue, will not, and the negative thereof or variations thereon or similar terminology generally intended to identify forward-looking statements. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section entitled Risk Factors (Refer to Part I, Item 1A of this Quarterly Report on Form 10-Q). We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

**Overview**

Johnson Controls brings ingenuity to the places where people live, work and travel. By integrating technologies, products and services, the Company creates smart environments that redefine the relationships between people and their surroundings. The Company strives to create a more comfortable, safe and sustainable world through its products and services for more than 200 million vehicles, 12 million homes and one million commercial buildings. The Company provides innovative automotive interiors that help make driving more comfortable, safe and enjoyable. For buildings, it offers products and services that optimize energy use and improve comfort and security. It also provides batteries for automobiles and hybrid electric vehicles, along with related systems engineering, marketing and service expertise.

The Company's building efficiency business is a global market leader in designing, producing, marketing and installing integrated heating, ventilating and air conditioning (HVAC) systems, building management systems, controls, security and mechanical equipment. In addition, the building efficiency business provides technical services, energy management consulting and operations of entire real estate portfolios for the non-residential buildings market. It also provides residential air conditioning and heating systems.

The Company's automotive experience business is one of the world's largest automotive suppliers, providing interior systems to more than 30 million vehicles annually. Its technologies extend into virtually every area of the interior including seating and overhead systems, door systems, floor consoles, instrument panels, cockpits and integrated electronics. Customers include most of the world's major automakers.

The Company's power solutions business is a leading global producer of lead-acid automotive batteries, serving both automotive original equipment manufacturers and the general vehicle battery aftermarket. It produces more than 120 million lead-acid batteries annually. It offers Absorbent Glass Mat (AGM), nickel-metal-hydride and lithium-ion battery technologies to power hybrid vehicles.

The following information should be read in conjunction with the September 30, 2007 consolidated financial statements and notes thereto, along with management's discussion and analysis of financial condition and results of operations, included in the Company's 2007 Annual Report on Form 10-K. References in the following discussion and analysis to Three Months refer to the three months ended June 30, 2008 compared to the three months ended June 30, 2007, while references to Year-to-Date refer to the nine months ended June 30, 2008 compared to the nine months ended June 30, 2007.

**Table of Contents****Summary**

| (in millions)                                                                | Three Months Ended |         |        | Nine Months Ended |          |        |
|------------------------------------------------------------------------------|--------------------|---------|--------|-------------------|----------|--------|
|                                                                              | June 30,           |         | Change | June 30,          |          | Change |
|                                                                              | 2008               | 2007    |        | 2008              | 2007     |        |
| Net sales                                                                    | \$9,865            | \$8,911 | 11%    | \$28,755          | \$25,613 | 12%    |
| Income from continuing operations before income taxes and minority interests | 576                | 502     | 15%    | 1,268             | 1,015    | 25%    |

**Three Months:**

The \$954 million increase in consolidated net sales was primarily due to the favorable effects of foreign currency translation (\$639 million), higher revenues in the power solutions segment (\$297 million) mainly from pass-through pricing of higher lead costs and growth in the building efficiency business (\$263 million) mainly from increased global demand for the Company's offerings for nonresidential buildings that improve energy efficiency and reduce greenhouse gas emissions. These increases were partially offset by lower volumes in the North America unitary products group (\$48 million) from a decline in the U.S. residential housing market and lower net volumes in the North American automotive markets (\$197 million), which is consistent with the decline in North American industry production volumes.

The \$74 million increase in consolidated income from continuing operations before income taxes and minority interests was primarily due to the favorable effects of foreign currency translation (\$50 million), higher sales volume and margin expansion in the building efficiency business (\$41 million) due to process and manufacturing improvements and higher volumes and improved performance mainly in Europe and Asia in the power solutions segment (\$20 million). These increases were partially offset by lower North America volumes in automotive experience (\$12 million) and lower revenues in the North America unitary products group (\$25 million) related to a decline in the U.S. residential housing market.

**Year-to-Date:**

The \$3.1 billion increase in consolidated net sales was primarily due to the favorable impact of foreign currency translation (\$1.6 billion), pass-through pricing of higher lead costs in the power solutions segment (\$1.2 billion) and higher sales volumes in the building efficiency business (\$613 million) mainly from increased global demand for the Company's offerings for nonresidential buildings, partially offset by lower sales in the automotive experience business (\$297 million) reflecting the weaker North American automotive market.

The \$253 million increase in consolidated income from continuing operations before income taxes and minority interests was primarily due to higher sales volume and improving gross margins through pricing and cost savings measures in the building efficiency business (\$146 million) despite higher SG&A expenses to support growth, operational efficiencies in the automotive experience North America segment (\$75 million) despite lower volumes, higher volumes and improved price/product mix in the power solutions segment (\$35 million) and the favorable impact of foreign currency translation (\$109 million). These increases were partially offset by lower revenues in the North America unitary products group (\$65 million) related to a decline in the U.S. residential housing market, the timing of platform pricing adjustments and lower economic recoveries of material costs in automotive experience Europe (\$17 million) and higher SG&A costs in automotive experience Asia and power solutions mainly to support growth (\$30 million).

**Segment Analysis**

Management evaluates the performance of its business units based primarily on segment income, which is defined as income from continuing operations before income taxes and minority interests excluding net financing charges and

restructuring costs.

**Table of Contents*****Building Efficiency   Net Sales***

| (in millions)                  | Net Sales<br>Three Months<br>Ended June 30, |          |        | Net Sales<br>Nine Months<br>Ended June 30, |          |        |
|--------------------------------|---------------------------------------------|----------|--------|--------------------------------------------|----------|--------|
|                                | 2008                                        | 2007     | Change | 2008                                       | 2007     | Change |
| North America systems          | \$ 605                                      | \$ 519   | 17%    | \$ 1,680                                   | \$ 1,447 | 16%    |
| North America service          | 626                                         | 590      | 6%     | 1,749                                      | 1,597    | 10%    |
| North America unitary products | 235                                         | 283      | -17%   | 550                                        | 675      | -19%   |
| Global workplace solutions     | 785                                         | 657      | 19%    | 2,347                                      | 1,973    | 19%    |
| Europe                         | 716                                         | 578      | 24%    | 1,997                                      | 1,743    | 15%    |
| Rest of world                  | 710                                         | 620      | 15%    | 1,897                                      | 1,697    | 12%    |
|                                | \$ 3,677                                    | \$ 3,247 | 13%    | \$ 10,220                                  | \$ 9,132 | 12%    |

**Three Months:**

The increase in North America systems was primarily due to higher product and equipment commercial volumes in the construction and replacement markets.

The increase in North America service was primarily due to growth in the truck-based and energy performance contracting businesses (\$20 million) and the impact of first quarter fiscal 2008 acquisitions (\$16 million).

The decrease in North America unitary products was primarily due to a depressed U.S. residential market which has and continues to impact the need for HVAC equipment in new construction housing starts.

The increase in global workplace solutions primarily reflects a higher volume of global pass-through contracts (\$10 million), a net increase in services to existing customers (\$52 million), new business (\$18 million) and the favorable impact of foreign currency translation (\$48 million).

The increase in Europe reflects the favorable impact of foreign currency translation (\$104 million) and higher systems, equipment and product volumes (\$34 million).

The increase in rest of world is due to volume increases mainly in Latin America, Asia and the Middle East (\$37 million) and the favorable impact of foreign currency translation (\$53 million).

**Year-to-Date:**

The increase in North America systems was primarily due to higher product and equipment commercial volumes in the construction and replacement markets.

The increase in North America service was primarily due to growth in the truck-based and energy performance contracting businesses (\$119 million) and the impact of first quarter fiscal 2008 acquisitions (\$33 million).

The decrease in North America unitary products was primarily due to a depressed U.S. residential market which has and continues to impact the need for HVAC equipment in new construction housing starts.

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The increase in global workplace solutions primarily reflects a higher volume of global pass-through contracts (\$45 million), a net increase in services to existing customers (\$156 million), new business (\$25 million) and the favorable impact of foreign currency translation (\$148 million).

The increase in Europe reflects the favorable impact of foreign currency translation (\$239 million) and higher service, systems and product volumes (\$15 million).

The increase in rest of world is due to volume increases (\$87 million) in Asia, Latin America and the Middle East and the favorable impact of foreign currency translation (\$113 million).

**Table of Contents****Building Efficiency    Segment Income**

| (in millions)                  | Segment Income<br>Three Months<br>Ended June 30, |        |        | Segment Income<br>Nine Months<br>Ended June 30, |        |        |
|--------------------------------|--------------------------------------------------|--------|--------|-------------------------------------------------|--------|--------|
|                                | 2008                                             | 2007   | Change | 2008                                            | 2007   | Change |
| North America systems          | \$ 80                                            | \$ 63  | 27%    | \$ 192                                          | \$ 135 | 42%    |
| North America service          | 76                                               | 69     | 10%    | 144                                             | 117    | 23%    |
| North America unitary products | 3                                                | 28     | -89%   | (20)                                            | 42     | *      |
| Global workplace solutions     | 16                                               | 17     | -6%    | 45                                              | 49     | -8%    |
| Europe                         | 38                                               | 33     | 15%    | 78                                              | 53     | 47%    |
| Rest of world                  | 88                                               | 64     | 38%    | 202                                             | 138    | 46%    |
|                                | \$ 301                                           | \$ 274 | 10%    | \$ 641                                          | \$ 534 | 20%    |

\* Measure not meaningful.

**Three Months:**

The increases in North America systems and North America service were primarily due to higher margins due to process and manufacturing improvements (\$35 million), partially offset by additional SG&A expenses to support business growth initiatives (\$5 million) and a nonrecurring contract benefit received in the prior year (\$6 million).

The decrease in North America unitary products was primarily due to the decline in sales volumes.

Despite higher sales volumes, global workplace solutions decreased slightly due to less favorable margins and mix in North America.

The increase in Europe was primarily due to the favorable impact of foreign currency translation (\$6 million) and continuing benefit from prior year restructuring plans, branch office redesign and manufacturing footprint changes (\$14 million), partially offset by increased SG&A expenses to support business growth and system implementations (\$15 million).

The increase in rest of world was primarily due to higher sales volumes and margin improvements in Latin America, Asia and the Middle East (\$18 million) and the favorable impact of foreign currency translation (\$6 million).

**Year-to-Date:**

The increases in North America systems and North America service were primarily due to higher sales volumes and improving gross margins through pricing and operational efficiencies (\$112 million), partially offset by additional SG&A expenses to support business growth initiatives (\$22 million) and a nonrecurring contract benefit received in the prior year (\$6 million).

The decrease in North America unitary products was primarily due to the decline in sales volumes (\$59 million) and purchase accounting adjustments related to the September 2007 equity investment in a joint venture with U.S. Airconditioning Distributors, Inc (\$3 million).

The slight decrease in global workplace solutions was primarily due to less favorable margins and mix in North American contracts.

The increase in Europe was primarily due to the favorable impact of foreign currency translation (\$14 million) and continuing benefit from prior year restructuring plans, branch office redesign and manufacturing footprint changes (\$44 million), partially offset by increased SG&A expenses to support business growth and system implementations (\$33 million).

The increase in rest of world was primarily due to higher sales volumes and margin improvements in Asia, Latin America and the Middle East (\$56 million) and the favorable impact of foreign currency translation (\$8 million).

**Table of Contents****Automotive Experience    Net Sales**

| (in millions) | Net Sales<br>Three Months<br>Ended June 30, |          |        | Net Sales<br>Nine Months<br>Ended June 30, |           |        |
|---------------|---------------------------------------------|----------|--------|--------------------------------------------|-----------|--------|
|               | 2008                                        | 2007     | Change | 2008                                       | 2007      | Change |
| North America | \$ 1,681                                    | \$ 1,988 | -15%   | \$ 5,199                                   | \$ 5,549  | -6%    |
| Europe        | 2,705                                       | 2,312    | 17%    | 7,657                                      | 6,767     | 13%    |
| Asia          | 402                                         | 335      | 20%    | 1,171                                      | 1,080     | 8%     |
|               | \$ 4,788                                    | \$ 4,635 | 3%     | \$ 14,027                                  | \$ 13,396 | 5%     |

**Three Months:**

The decrease in North America was primarily due to volume reductions with Ford Motor Company, General Motors Corporation and Chrysler LLP (the Detroit 3) and Toyota Motor Corporation. The decrease in net sales of 15% was consistent with the North American industry's production decrease for the quarter. A strike at a U.S. supplier to one of our major customers also unfavorably impacted net sales by \$79 million in the third quarter of fiscal 2008.

The increase in Europe was primarily due to the favorable impact of foreign currency translation (\$338 million) and increased volumes at General Motors Corporation, Fiat Automobiles SpA and The Volvo Group.

The increase in Asia was primarily due to the favorable impact of foreign currency translation (\$12 million) and higher volumes with Nissan Motor Company in Japan and joint ventures in China.

**Year-to-Date:**

The decrease in North America was primarily due to volume reductions with the Detroit 3 and Toyota Motor Corporation. Additionally, a strike at a U.S. supplier to one of our major customers had an unfavorable impact on net sales of \$103 million.

The increase in Europe was primarily due to the favorable impact of foreign currency translation (\$878 million) and increased volumes at Kia Motors Corporation and Fiat Automobiles SpA, partially offset by decreased business with Daimler AG and BMW AG.

The increase in Asia was primarily due to the favorable impact of foreign currency translation (\$52 million) and higher volumes with Nissan Motor Company in Japan, partially offset by lower sales volumes mainly in Korea.

**Automotive Experience    Segment Income**

| (in millions) | Segment Income<br>Three Months<br>Ended June 30, |        |        | Segment Income<br>Nine Months<br>Ended June 30, |        |        |
|---------------|--------------------------------------------------|--------|--------|-------------------------------------------------|--------|--------|
|               | 2008                                             | 2007   | Change | 2008                                            | 2007   | Change |
| North America | \$ 47                                            | \$ 52  | -10%   | \$ 82                                           | \$ (1) | *      |
| Europe        | 139                                              | 139    | 0%     | 334                                             | 339    | -1%    |
| Asia          | 13                                               | (11)   | *      | 16                                              | (2)    | *      |
|               | \$ 199                                           | \$ 180 | 11%    | \$ 432                                          | \$ 336 | 29%    |

\* Measure not  
meaningful.

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**Table of Contents****Three Months:**

The decrease in North America was primarily due to lower production volumes (\$45 million) and the unfavorable impact of a strike at a U.S. supplier to one of our major customers (\$23 million), partially offset by favorable gross margins from purchasing savings (\$21 million), favorable net engineering costs (\$17 million) and operational efficiencies (\$22 million).

European segment income was consistent with the prior year primarily due the favorable impact of foreign currency translation (\$29 million), purchasing savings (\$30 million) and favorable net engineering costs (\$10 million), partially offset by price reductions to our customers (\$59 million) and the cost of downsizing a facility due to changes in a customer's production plan (\$10 million).

The increase in Asia was primarily due to higher volumes (\$7 million), operating efficiencies (\$12 million), higher equity income from China joint ventures (\$7 million) and the favorable impact of foreign currency translation (\$2 million), partially offset by higher employee expenses to support market expansion (\$5 million).

**Year-to-Date:**

The increase in North America was primarily due to pricing improvements (\$12 million), favorable gross margins from purchasing savings (\$39 million) and operational efficiencies (\$104 million), partially offset by lower production volumes (\$45 million) and a strike at a U.S. supplier to one of our major customers (\$31 million).

The decrease in Europe was primarily due to the timing of platform pricing adjustments and lower economic recoveries of material cost increases (\$131 million) and lower sales volumes (\$23 million), partially offset by the favorable impact of foreign currency translation (\$66 million) and purchasing savings (\$83 million).

The increase in Asia is primarily due to higher volumes (\$7 million), the favorable impact of foreign currency translation (\$6 million), operational efficiencies (\$14 million) and higher equity income from China joint ventures (\$9 million), partially offset by higher employee expenses to support market expansion (\$18 million).

***Power Solutions***

| (in millions)  | Three Months<br>Ended June 30, |         |        | Nine Months<br>Ended June 30, |         |        |
|----------------|--------------------------------|---------|--------|-------------------------------|---------|--------|
|                | 2008                           | 2007    | Change | 2008                          | 2007    | Change |
| Net sales      | \$1,400                        | \$1,029 | 36%    | \$4,508                       | \$3,085 | 46%    |
| Segment income | 145                            | 119     | 22%    | 399                           | 354     | 13%    |

**Three Months:**

Net sales increased primarily due to the pass-through pricing of higher lead costs (\$201 million), the favorable impact of foreign currency translation (\$74 million), higher volumes in Europe and Asia (\$21 million) and improved price/product mix (\$75 million).

Segment income increased primarily due to improved price/product mix (\$26 million), higher volumes (\$5 million) and the favorable impact of foreign currency translation (\$4 million), partially offset by higher SG&A costs (\$9 million) mainly to support global business growth.

**Year-to-Date:**

Net sales increased primarily due to the impact of higher lead costs on pricing (\$886 million), improved price/product mix (\$273 million), the favorable impact of foreign currency translation (\$219 million) and higher sales volumes (\$45 million).

Segment income increased due to improved price/product mix (\$56 million) and the favorable impact of foreign currency translation (\$13 million), partially offset by higher SG&A costs (\$24 million) mainly to

support global business growth.

**Table of Contents****Net Financing Charges**

| (in millions)         | Three Months Ended<br>June 30, |      |        | Nine Months Ended<br>June 30, |       |        |
|-----------------------|--------------------------------|------|--------|-------------------------------|-------|--------|
|                       | 2008                           | 2007 | Change | 2008                          | 2007  | Change |
| Net financing charges | \$69                           | \$71 | -3%    | \$204                         | \$209 | -2%    |

The decrease in net financing charges in the three and nine month periods is due to lower borrowing levels and lower short-term interest rates, partially offset by costs to convert certain fixed-rate debt to floating rate debt.

**Provision for Income Taxes**

| (in millions)                       | Three Months Ended<br>June 30, |        | Nine Months Ended<br>June 30, |        |
|-------------------------------------|--------------------------------|--------|-------------------------------|--------|
|                                     | 2008                           | 2007   | 2008                          | 2007   |
| Tax provision                       | \$ 121                         | \$ 106 | \$ 266                        | \$ 176 |
| Effective tax rate                  | 21.0%                          | 21.0%  | 21.0%                         | 17.4%  |
| Estimated annual effective tax rate | 21.0%                          | 21.0%  | 21.0%                         | 21.0%  |

In calculating the provision for income taxes, the Company uses an estimate of the annual effective tax rate based upon the facts and circumstances known at each interim period. On a quarterly basis, the actual effective tax rate is adjusted, as appropriate, based upon changed facts and circumstances, if any, as compared to those forecasted at the beginning of the fiscal year and each interim period thereafter.

The tax provision for the nine months ended June 30, 2007 reflects a \$22 million tax benefit realized by a change in tax status of an automotive experience subsidiary in the Netherlands. This change in tax status resulted from a voluntary tax election that produced a deemed liquidation for U.S. federal income tax purposes.

In the second quarter of fiscal 2007, the Company reduced its income tax liability by \$15 million due to the favorable resolution of certain income tax audits.

In the second quarter of fiscal 2007, the Company reduced its estimated annual effective income tax rate for continuing operations from 23.0% to 21.0%.

The Company utilized an effective tax rate for discontinued operations of approximately 38% for Bristol Compressors and 35% for its engine electronics business in fiscal 2007. This effective tax rate approximated the local statutory rate adjusted for permanent differences.

**Net Income**

| (in millions)                           | Three Months Ended<br>June 30, |        |        | Nine Months Ended<br>June 30, |        |        |
|-----------------------------------------|--------------------------------|--------|--------|-------------------------------|--------|--------|
|                                         | 2008                           | 2007   | Change | 2008                          | 2007   | Change |
| Income from continuing operations       | \$ 439                         | \$ 396 | 11%    | \$ 963                        | \$ 826 | 17%    |
| Loss from discontinued operations       |                                |        | *      |                               | (10)   | *      |
| Loss on sale of discontinued operations |                                |        | *      |                               | (30)   | *      |
| Net income                              | \$ 439                         | \$ 396 | 11%    | \$ 963                        | \$ 786 | 23%    |

\*

Measure not  
meaningful.

The increase in income from continuing operations for the three month period ended June 30, 2008 was primarily due to higher sales volume and margin expansion in the building efficiency business (\$41 million) due to process and manufacturing improvements, higher volumes and improved performance mainly in Europe and Asia in the power solutions segment (\$20 million) and the favorable effects of foreign currency translation (\$50 million). These increases were partially offset by lower North America

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volumes in automotive experience (\$12 million) and lower volumes in the North America unitary products group (\$25 million) related to a decline in the U.S. residential market, an increase in the provision for income taxes (\$15 million) and higher minority interests in net earnings of subsidiaries (\$16 million).

The increase in income from continuing operations for the nine month period ended June 30, 2008 was primarily due to higher sales volume and improving gross margins through pricing and cost savings measures in the building efficiency business (\$146 million) despite higher SG&A expenses to support growth, operational efficiencies in the automotive experience North America segment (\$75 million) despite lower volumes, higher volumes and improved price/product mix in the power solutions segment (\$35 million) and the favorable impact of foreign currency translation (\$109 million). These increases were partially offset by lower volumes in the North America unitary products group (\$65 million) related to a decline in the U.S. residential market, the timing of platform pricing adjustments and lower economic recoveries of material costs in automotive experience Europe (\$17 million), higher SG&A costs in automotive experience Asia and power solutions mainly to support growth (\$30 million), an increase in the provision for income taxes (\$90 million) and higher minority interests in net earnings of subsidiaries (\$26 million).

Discontinued operations primarily relate to the Bristol Compressor business, which was acquired as part of the December 2005 York International Corporation acquisition and was sold in March 2007 resulting in an after tax loss of \$27 million for the nine months ended June 30, 2007 and \$30 million after final purchase price adjustments. Additionally, the Company settled a claim in the prior year related to the February 2005 sale of the engine electronics business that resulted in an after tax loss of \$3 million.

**Outlook**

On July 17, 2008, the Company announced a revision in its previously issued fiscal 2008 guidance for net sales from approximately \$39 billion down to approximately \$38 billion, which would represent an increase of 11% from prior year net sales. On the same date, the Company also lowered its guidance for diluted earnings per share from continuing operations to an 11% increase or approximately \$2.32 to \$2.34 per share, down from its previously issued guidance of an 18% increase to approximately \$2.45 to \$2.50 per share. These decreases were due to expected costs associated with the acquisition of Plastech Engineered Products, Inc. during the fourth quarter of fiscal 2008, net unrecovered material economics, lower production volumes in the North American automotive marketplace, and the general weakness in the North American economy.

**Backlog**

Building efficiency's backlog relates to its control systems and service activity. At June 30, 2008, the unearned backlog was \$4.8 billion, compared to \$4.3 billion at June 30, 2007, a 15% increase due to strong orders for systems and services in all geographic regions.

**Financial Condition***Working Capital*

|                     | June 30, | September |        | June 30, |        |
|---------------------|----------|-----------|--------|----------|--------|
| (in millions)       | 2008     | 30,       | Change | 2007     | Change |
|                     |          | 2007      |        |          |        |
| Working capital     | \$1,983  | \$ 1,441  | 38%    | \$1,937  | 2%     |
| Accounts receivable | 6,647    | 6,600     | 1%     | 6,352    | 5%     |
| Inventories         | 2,292    | 1,968     | 16%    | 1,968    | 16%    |
| Accounts payable    | 5,179    | 5,365     | -3%    | 4,760    | 9%     |

The Company defines working capital as current assets less current liabilities, excluding cash, short-term debt, the current portion of long-term debt and net assets of discontinued operations. Management believes that this measure of working capital, which excludes financing-related items and discontinued activities, provides a more useful measurement of the Company's operating performance.



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The increase in working capital at June 30, 2008 as compared to September 30, 2007 is primarily due to the net impact of strengthening foreign currencies against the U.S. dollar, higher inventories resulting mainly from higher commodity costs and some seasonality in the building efficiency business and lower accounts payable from timing of payments. Compared to June 30, 2007, the increase is primarily due to higher accounts receivable from increased sales and higher inventories from the impact of higher commodity costs, partially offset by higher accounts payable from the higher cost of inventories.

The Company's days sales in accounts receivable (DSO) for the three months ended June 30, 2008 were 58, consistent with the DSO at September 30, 2007 and slightly higher than 57 for the comparable period ended June 30, 2007. There has been no significant deterioration in the credit quality of the Company's receivables or changes in revenue recognition policies. The increase in accounts receivable compared to September 30, 2007 is mainly due to higher sales in the power solutions and automotive experience Europe segments. The increase in accounts receivable compared to June 30, 2007 is consistent with higher revenues.

The Company's inventory turns for the three months ended June 30, 2008 were lower than those for the period ended September 30, 2007 mainly due to seasonality and higher inventory levels in the building efficiency business from slower moving inventory because of the decline in the U.S. residential housing market. Inventory turns were comparable compared to the three months ended June 30, 2007.

Days payable at June 30, 2008 decreased to 65 days from 71 days at September 30, 2007 and increased from 63 days at June 30, 2007 mainly due to the timing of supplier payments.

***Cash Flows***

| (in millions)                             | Three Months Ended<br>June 30, |       | Nine Months Ended<br>June 30, |       |
|-------------------------------------------|--------------------------------|-------|-------------------------------|-------|
|                                           | 2008                           | 2007  | 2008                          | 2007  |
| Net cash provided by operating activities | \$552                          | \$240 | \$1,028                       | \$847 |
| Net cash used by investing activities     | 288                            | 194   | 776                           | 637   |
| Net cash used by financing activities     | 241                            | 29    | 670                           | 314   |
| Capital expenditures                      | 190                            | 141   | 551                           | 582   |

The increase in net cash provided by operating activities in the three months ended June 30, 2008 was primarily due to higher net income and less cash used in working capital, primarily accounts receivable and inventory. For the nine months ended June 30, 2008, the increase in net cash provided by operating activities was due to higher net income.

The increase in net cash used by investing activities for the three months ended June 30, 2008 was due to higher capital expenditures and the timing of customer engineering recoveries. The increase for the nine months ended June 30, 2008 was due to the acquisitions of businesses in fiscal 2008 and impact of the settlement of cross-currency interest rate swaps, partially offset by lower capital expenditures.

The increase in net cash used by financing activities for the three and nine months ended June 30, 2008 was primarily due to higher debt repayments.

The majority of the capital spending for property, plant and equipment in the three and nine months ended June 30, 2008 was for investments within the automotive experience business.

***Long-Lived Assets***

The Company has certain subsidiaries, mainly located in Germany, Italy, the Netherlands, United Kingdom and the United States, which have generated operating and/or capital losses and, in certain circumstances, have limited loss carryforward periods. As a result, the Company has recorded valuation allowances against tax assets for certain of

these subsidiaries in accordance with Statement of Financial Accounting Standards (SFAS) No. 109. SFAS No. 109 requires the Company to record a valuation allowance for each legal entity or consolidated group when realization is not likely and evaluate both positive and negative historical evidences as well as expected future events.

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The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The Company's long-lived asset impairment analyses indicate that assets are not impaired based on SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires the Company to group assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities and evaluate the asset group against the sum of the undiscounted future cash flows. At June 30, 2008, the Company has concluded that it does not have any material assets whose recovery is at risk.

*Capitalization*

| (in millions)                             | June 30,<br>2008 | September<br>30,<br>2007 | Change | June 30,<br>2007 | Change |
|-------------------------------------------|------------------|--------------------------|--------|------------------|--------|
| Short-term debt                           | \$ 641           | \$ 264                   | 143%   | \$ 462           | 39%    |
| Long-term debt                            | 3,488            | 4,154                    | -16%   | 4,155            | -16%   |
| Shareholders' equity                      | 9,996            | 8,907                    | 12%    | 8,309            | 20%    |
| Total capitalization                      | \$ 14,125        | \$ 13,325                | 6%     | \$ 12,926        | 9%     |
| Total debt as a % of total capitalization | 29.2%            | 33.2%                    |        | 35.7%            |        |

On June 1, 2008, the Company retired \$200 million of York International Corporation fixed rate bonds at maturity. The Company used proceeds from commercial paper issuances to repay the bonds.

In December 2007, the Company entered into a 25 billion yen (\$220 million), three year, floating rate loan agreement. The agreement gave the Company the right to borrow the loan proceeds through January 15, 2008. The Company borrowed the 25 billion yen on January 15, 2008.

On January 17, 2008 and February 1, 2008, the Company retired \$500 million and \$175 million, respectively, in floating rate notes and fixed rate bonds at maturity. The Company used a combination of cash, proceeds from commercial paper issuances and proceeds under the new three year, floating rate yen loan to repay the notes and bonds.

In December 2006, the Company entered into a five-year, \$2.0 billion revolving credit facility which expires in December 2011. This facility replaced a five-year \$1.6 billion revolving credit facility that would have expired in October 2010 and serves as the commercial paper backup facility. There were no draws on the committed credit line during the three months ended June 30, 2008.

In December 2006, the Company entered into a 12 billion yen (\$104 million), three year, floating rate loan. The net proceeds of the bank loan were used to repay unsecured commercial paper obligations.

In November 2006, the Company issued commercial paper to repay a \$350 million note that matured.

The Company also selectively makes use of short-term credit lines in both U.S. dollars and Euros. The Company estimates that, as of June 30, 2008, it could borrow up to \$1 billion at its current debt ratings on committed and uncommitted credit lines.

As of June 30, 2008, the Company is in compliance with all covenants and other requirements set forth in its credit agreements and indentures. None of the Company's debt agreements requires accelerated repayment in the event of a decrease in credit ratings. Currently, the Company believes it has ample liquidity and full access to the capital markets to support business growth and future acquisitions. The Company believes its capital resources and liquidity position at June 30, 2008 are adequate to meet projected needs. The Company believes requirements for working capital, capital expenditures, dividends, debt maturities and any potential acquisitions in fiscal 2008 will continue to be funded from operations, supplemented by short- and long-term borrowings, if required.

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### **New Accounting Standards**

In March 2008, the Financial Accounting Standards Board (FASB) issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*—an amendment of FASB Statement No. 133. SFAS No. 161 enhances required disclosures regarding derivatives and hedging activities, including how an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for the Company beginning in the second quarter of fiscal 2009 (January 1, 2009). The Company is assessing the potential impact that the adoption of SFAS No. 161 will have on its consolidated financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*. SFAS No. 141(R) changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, preacquisition contingencies, transaction costs, in-process research and development and restructuring costs. In addition, under SFAS No. 141(R), changes in an acquired entity's deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS No. 141(R) will be effective for the Company beginning in the first quarter of fiscal 2010 (October 1, 2009). This standard, when adopted, will change the Company's accounting treatment for business combinations on a prospective basis.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51. SFAS No. 160 changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method changes the accounting for transactions with minority interest holders. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. SFAS No. 160 will be effective for the Company beginning in the first quarter of fiscal 2010 (October 1, 2009). The Company is assessing the potential impact that the adoption of SFAS No. 160 will have on its consolidated financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*—including an amendment to FASB Statement No. 115. SFAS No. 159 permits entities to measure certain financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 will be effective for the Company beginning in the first quarter of fiscal 2009 (October 1, 2008). The Company is assessing the potential impact that the adoption of SFAS No. 159 will have on its consolidated financial condition and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 also establishes a fair value hierarchy that prioritizes information used in developing assumptions when pricing an asset or liability. SFAS No. 157 will be effective for the Company beginning in the first quarter of fiscal 2009 (October 1, 2008). The Company is assessing the potential impact that the adoption of SFAS No. 157 will have on its consolidated financial condition and results of operations.

In June 2006, the FASB issued FASB Interpretation Number (FIN) 48, *Accounting for Uncertainty in Income Taxes*—an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 allows recognition of only those tax benefits that satisfy a greater than 50% probability threshold. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. See Note 11 for the impact of the Company's adoption of FIN 48 as of October 1, 2007.

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### **Other Financial Information**

The interim financial information included in this Quarterly Report on Form 10-Q has not been audited by PricewaterhouseCoopers LLP (PwC). PwC has, however applied limited review procedures in accordance with professional standards for reviews of interim financial information. Accordingly, you should restrict your reliance on their reports on such information. PwC is not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their reports on the interim financial information because such reports do not constitute reports or parts of the registration statements prepared or certified by PwC within the meaning of Sections 7 and 11 of the Securities Act of 1933.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

At June 30, 2008, the Company had not experienced any adverse changes in market risk exposures that materially affect the quantitative and qualitative disclosures presented in the Company's Annual Report on Form 10-K for the year ended September 30, 2007.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the principal executive officer and principal financial officer concluded that the disclosure controls and procedures were effective as of June 30, 2008 to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time period specified in the SEC rules and forms, and to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding disclosure.

#### **Changes in Internal Control Over Financial Reporting**

There have been no significant changes in the Company's internal control over financial reporting during the three months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

As noted in Item 1 to the Company's Annual Report on Form 10-K for the year ended September 30, 2007, liabilities potentially arise globally under various Environmental Laws and Worker Safety Laws for activities that are not in compliance with such laws and for the cleanup of sites where Company-related substances have been released into the environment.

Currently, the Company is responding to allegations that it is responsible for performing environmental remediation, or for the repayment of costs spent by governmental entities or others performing remediation, at approximately 60 sites in the United States. Many of these sites are landfills used by the Company in the past for the disposal of waste materials; others are secondary lead smelters and lead recycling sites where the Company

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returned lead-containing materials for recycling; a few involve the cleanup of Company manufacturing facilities; and the remaining fall into miscellaneous categories. The Company may face similar claims of liability at additional sites in the future. Where potential liabilities are alleged, the Company pursues a course of action intended to mitigate them.

The Company accrues for potential environmental losses in a manner consistent with accounting principles generally accepted in the United States; that is, when it is probable a loss has been incurred and the amount of the loss is reasonably estimable. The Company reviews the status of its environmental sites on a quarterly basis and adjusts its reserves accordingly. Such potential liabilities accrued by the Company do not take into consideration possible recoveries of future insurance proceeds. They do, however, take into account the likely share other parties will bear at remediation sites. It is difficult to estimate the Company's ultimate level of liability at many remediation sites due to the large number of other parties that may be involved, the complexity of determining the relative liability among those parties, the uncertainty as to the nature and scope of the investigations and remediation to be conducted, the uncertainty in the application of law and risk assessment, the various choices and costs associated with diverse technologies that may be used in corrective actions at the sites, and the often quite lengthy periods over which eventual remediation may occur. Nevertheless, the Company has no reason to believe at the present time that any claims, penalties or costs in connection with known environmental matters will have a material adverse effect on the Company's financial position, results of operations or cash flows.

The Company is involved in a number of product liability and various other lawsuits incident to the operation of its businesses. Insurance coverages are maintained and estimated costs are recorded for claims and lawsuits of this nature. It is management's opinion that none of these will have a material adverse effect on the Company's financial position, results of operations or cash flows. Costs related to such matters were not material to the periods presented.

### **ITEM 1A. RISK FACTORS**

The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in Part I, Item 1A. Risk Factors of our Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

#### **General Risks**

##### **We are subject to pricing pressure from our larger customers.**

We face significant competitive pressures in all of our business segments. Because of their purchasing size, our larger customers can influence market participants to compete on price terms. If we are not able to offset pricing reductions resulting from these pressures by improved operating efficiencies and reduced expenditures, those pricing reductions may have an adverse impact on our business.

##### **We are subject to risks associated with our non-U.S. operations which could adversely affect our results of operations.**

We have significant operations in a number of countries outside the U.S., some of which are located in emerging markets. Long-term economic uncertainty in some of the regions of the world in which we operate, such as Asia, South America, the Middle East, Central Europe and other emerging markets, could result in the disruption of markets and negatively affect cash flows from our operations to cover our capital needs and debt service.

In addition, as a result of our global presence, a significant portion of our revenues and expenses are denominated in currencies other than the U.S. dollar. We are therefore subject to foreign currency risks and foreign exchange exposure. Our primary exposures are to the Euro, British pound, Japanese yen, Czech koruna, Mexican peso, Swiss franc and Chinese yuan. While we employ financial instruments to hedge transactional and foreign exchange exposure, these activities do not insulate us completely from those exposures.

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There are other risks that are inherent in our non-U.S. operations, including the potential for changes in socio-economic conditions, laws and regulations, including import, export, labor and environmental laws and monetary and fiscal policies, protectionist measures that may prohibit acquisitions or joint ventures, unsettled political conditions and possible terrorist attacks against American interests.

These and other factors may have a material adverse effect on our non-U.S. operations and therefore on our business and results of operations.

**We are subject to regulation of our international operations that could adversely affect our business and results of operations.**

Due to our global operations, we are subject to many laws governing international relations, including those that prohibit improper payments to government officials and restrict where we can do business, what information or products we can supply to certain countries and what information we can provide to a non-U.S. government, including but not limited to the Foreign Corrupt Practices Act and the U.S. Export Administration Act. Violations of these laws, which are complex and often times difficult to interpret and apply, may result in severe criminal penalties or sanctions that could have a material adverse effect on our business, financial condition and results of operations.

**We are subject to costly requirements relating to environmental regulation and environmental remediation matters, which could adversely affect our business and results of operations.**

Because of uncertainties associated with environmental regulation and environmental remediation activities at sites where we may be liable, future expenses that we may incur to remediate identified sites could be considerably higher than the current accrued liability on our balance sheet, which could have a material adverse effect on our business and results of operations. As of September 30, 2007, we recorded \$27 million for environmental liabilities and \$81 million in related conditional asset retirement obligations.

**Negative or unexpected tax consequences could adversely affect our results of operations.**

Adverse changes in the underlying profitability and financial outlook of our operations in several jurisdictions could lead to changes in our valuation allowances against deferred tax assets and other tax reserves on our statement of financial position that could materially and adversely affect our results of operations. Additionally, changes in statutory tax rates in the U.S. or in other countries where the Company has significant operations could materially affect deferred tax assets and liabilities on our balance sheet.

We are also subject to tax audits by governmental authorities in the U.S. and in non-U.S. jurisdictions. Negative unexpected results from one or more such tax audits could adversely affect our results of operations.

**Legal proceedings in which we are, or may be, a party may adversely affect us.**

We are currently and may in the future become subject to legal proceedings and commercial or contractual disputes. These are typically claims that arise in the normal course of business including, without limitation, commercial or contractual disputes with our suppliers, intellectual property matters and employment claims. There exists the possibility that such claims may have an adverse impact on our results of operations that is greater than we anticipate.

**An increase in our level of indebtedness could lead to a downgrade in the ratings of our debt and, in turn, restrict our ability to access the debt capital markets.**

Changes in the ratings that rating agencies assign to our debt may ultimately impact our access to the debt capital markets. An increase in the level of our indebtedness in the future, to the extent that we finance future acquisitions with debt, for example, may result in a downgrade in the ratings that are assigned to our debt. If ratings for our debt fall below investment grade, our access to the debt capital markets would become restricted.

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Additionally, several of our credit agreements generally include an increase in interest rates if the ratings for our debt are downgraded. Further, an increase in the level of our indebtedness may increase our vulnerability to adverse general economic and industry conditions and may affect our ability to obtain additional financing.

### **We may be unable to complete or integrate acquisitions effectively, which may adversely affect our growth, profitability and results of operations.**

We expect acquisitions of businesses and assets to play a role in our company's future growth. We cannot be certain that we will be able to identify attractive acquisition targets, obtain financing for acquisitions on satisfactory terms or successfully acquire identified targets. Additionally, we may not be successful in integrating acquired businesses into our existing operations and achieving projected synergies. Competition for acquisition opportunities in the various industries in which we operate may rise, thereby increasing our costs of making acquisitions or causing us to refrain from making further acquisitions. These and other acquisition-related factors may negatively and adversely impact our growth, profitability and results of operations.

### **Building Efficiency Risks**

#### **Our building efficiency business relies to a great extent on contracts and business with U.S. government entities, the loss of which may adversely affect our results of operations.**

Our building efficiency business contracts with government entities and is subject to specific rules, regulations and approvals applicable to government contractors. We are subject to routine audits by the Defense Contract Audit Agency to assure our compliance with these requirements. Our failure to comply with these or other laws and regulations could result in contract terminations, suspension or debarment from contracting with the U.S. federal government, civil fines and damages and criminal prosecution. In addition, changes in procurement policies, budget considerations, unexpected U.S. developments, such as terrorist attacks, or similar political developments or events abroad that may change the U.S. federal government's national security defense posture may affect sales to government entities.

#### **Increases in commodity prices may adversely affect our results of operations.**

Commodity prices have continued to increase rapidly in the past year, primarily steel, aluminum, copper, and fuel costs. If commodity prices continue to rise, and if we are not able to recover these cost increases through price increases to our customers, then such increases will have an adverse effect on our results of operations.

#### **Decline in the residential and commercial new construction markets may adversely affect our results of operations.**

HVAC equipment sales in the residential and commercial new construction markets correlate to the number of new homes and buildings that are built. A significant decline in the construction of new commercial buildings requiring interior control systems or residential housing may have an adverse effect on our results of operations and such events could result in potential liabilities or additional costs, including impairment charges, to the Company.

#### **A variety of other factors could adversely affect the results of operations of our building efficiency business.**

Any of the following could materially and adversely impact the results of operations of our building efficiency business: loss of, or changes in, building automation or facility management supply contracts with our major customers; delays or difficulties in new product development; the potential introduction of similar or superior technologies; financial instability or market declines of our major or component suppliers; the unavailability of raw materials, primarily steel, copper and electronic components, necessary for production of HVAC equipment; unseasonable weather conditions in various parts of the world; changes in energy costs or governmental regulations that would decrease the incentive for customers to update or improve their interior control systems; increased energy efficiency legislation requirements worldwide; a decline in the outsourcing of facility management services; and availability of labor to support growth of our service businesses.

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**Automotive Experience Risks**

**Decreased demand from our customers in the automotive industry may adversely affect our results of operations.**

In fiscal 2007, our three largest customers were automobile manufacturers Ford Motor Company (Ford), General Motors Corporation (GM) and DaimlerChrysler AG (now Daimler AG and Chrysler LLP), with consolidated global net sales to these customers representing approximately 28% of total Company net sales. Sales to these customers originating in the U.S. represented approximately 10% of our consolidated net sales in fiscal 2007. Our financial performance depends, in part, on conditions in the automotive industry. Ford, GM and Chrysler LLP (the Detroit 3) have experienced declining market shares in North America and have announced significant restructuring actions in an effort to improve profitability. The North American automotive manufacturers are also burdened with substantial structural costs, such as pension and healthcare costs, that have impacted their profitability and labor relations and may ultimately result in severe financial difficulty, including bankruptcy. If our customers reduce their orders to us, it would adversely impact our results of operations. A prolonged downturn in the North American automotive industry or a significant change in product mix due to consumer demand could require us to shut down plants or incur impairment charges. Additionally, we have significant component production for manufacturers of motor vehicles in the U.S., Europe, South America, Japan and other Asia/Pacific Rim countries. Continued uncertainty relating to the financial condition of the Detroit 3 and others in the automotive industry may have a negative impact on our business.

**The financial distress of our suppliers could harm our results of operations.**

Automotive industry conditions have adversely affected our supplier base. Lower production levels for some of our key customers and increases in certain raw material, commodity and energy costs have resulted in severe financial distress among many companies within the automotive supply base. Several large suppliers have filed for bankruptcy protection or ceased operations. The continuation of financial distress within the supplier base may lead to increased commercial disputes and possible supply chain interruptions. In addition, the adverse industry environment has required us to provide financial support to distressed suppliers or take other measures to ensure uninterrupted production. The continuation or worsening of these industry conditions may have a negative impact on our business.

**Change in consumer demand may adversely affect our results of operations.**

Recent and any future increases in energy costs that consumers incur is resulting in shifts in consumer demand away from motor vehicles that typically have higher amounts of content that we supply, such as light trucks, cross-over vehicles, minivans and SUVs, to smaller vehicles that have lower amounts of content that we supply. The loss of business with respect to, or a lack of commercial success of, one or more particular vehicle models for which we are a significant supplier could reduce our sales and harm our profitability, thereby adversely affecting our results of operations.

**We may not be able to successfully negotiate pricing terms with our customers in the automotive experience business, which may adversely affect our results of operations.**

We negotiate sales prices annually with our automotive seating and interiors customers. Cost-cutting initiatives that our customers have adopted generally result in increased downward pressure on pricing. Our customer supply agreements generally require reductions in component pricing over the period of production. Pricing pressures may further intensify, particularly in North America, as the Detroit 3 pursue restructuring and cost cutting initiatives to better compete with their non-U.S. competitors. If we are unable to generate sufficient production cost savings in the future to offset price reductions, our results of operations may be adversely affected.

**Increases in commodity prices may adversely affect our results of operations.**

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Commodity prices have continued to increase rapidly in the past year. In our two largest markets, North America and Europe, the cost of commodities, primarily steel, fuel, resin and chemicals, has increased (net of recoveries through price increases to customers). If commodity prices continue to rise, and if we are not able to recover these cost increases through price increases to our customers, then such increases will have an adverse effect on our results of operations.

### **The cyclical nature of original equipment automobile production rates may adversely affect the results of operations in our automotive experience business.**

Our automotive experience business is directly related to automotive sales and automotive production by our customers. Automotive production and sales are highly cyclical and depend on general economic conditions and other factors, including consumer spending and preferences. Any significant economic decline that results in a reduction in automotive production and sales by our automotive experience customers may have a material adverse impact on our results of operations.

### **A variety of other factors could adversely affect the results of operations of our automotive experience business.**

Any of the following could materially and adversely impact the results of operations of our automotive experience business: the loss of, or changes in, automobile seating and interiors supply contracts or sourcing strategies with our major customers or suppliers; start-up expenses associated with new vehicle programs or delays or cancellations of such programs; underutilization of our manufacturing facilities, which are generally located near, and devoted to, a particular customer's facility; inability to recover engineering and tooling costs; market and financial consequences of any recalls that may be required on products that we have supplied; delays or difficulties in new product development; the potential introduction of similar or superior technologies; and global overcapacity and vehicle platform proliferation.

## **Power Solutions Risks**

### **We face increasing competition and pricing pressure from other companies in the power solutions business.**

The power solutions business competes with a number of major domestic and international manufacturers and distributors of lead-acid batteries, as well as a large number of smaller, regional competitors. The North American, European and Asian lead-acid battery markets are highly competitive. The manufacturers in these markets compete on price, quality, technical innovation, service and warranty. If we are unable to remain competitive and maintain market share in the regions and markets we serve, our results of operations may be adversely affected.

### **Increases in commodity prices may adversely affect our results of operations.**

Lead is a major component of our lead acid batteries. The cost of lead has been volatile. As the price of lead rises, if we are not able to recover these cost increases through price increases to our customers or with commodity hedging strategies, then such increases may have an adverse effect on our results of operations. Additionally, other commodity prices have continued to increase rapidly in the past year, primarily fuel, acid and resin. If other commodity prices continue to rise, and if we are not able to recover these cost increases through price increases to our customers, then such increases will have an adverse effect on our results of operations.

### **A variety of other factors could adversely affect the results of operations of our power solutions business.**

Any of the following could materially and adversely impact the results of operations of our power solutions business: loss of or changes in automobile battery supply contracts with our large original equipment and aftermarket customers; the increasing quality and useful life of batteries or use of alternative battery technologies, both of which may contribute to a growth slowdown in the lead-acid battery market; delays or cancellations of new vehicle programs; market and financial consequences of any recalls that may be required on

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our products; delays or difficulties in new product development, including nickel-metal-hydride/lithium-ion technology; financial instability or market declines of our customers or suppliers; the increasing global environmental regulation related to the manufacture of lead-acid batteries; and the lack of the development of a market for hybrid vehicles.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

In September 2006, the Company's Board of Directors authorized a stock repurchase program to acquire up to \$200 million of the Company's outstanding common stock. Stock repurchases under this program may be made through open market, privately negotiated transactions or otherwise at times and in such amounts as Company management deems appropriate. The stock repurchase program does not have an expiration date and may be amended or terminated by the Board of Directors at any time without prior notice.

The Company entered into an Equity Swap Agreement, dated March 18, 2004 and amended March 3, 2006 and May 16, 2006 (Swap Agreement), with Citibank, N.A. (Citibank). The Company selectively uses equity swaps to reduce market risk associated with its stock-based compensation plans, such as its deferred compensation plans and stock appreciation rights. These equity compensation liabilities increase as the Company's stock price increases and decrease as the Company's stock price decreases. In contrast, the value of the Swap Agreement moves in the opposite direction of these liabilities, allowing the Company to fix a portion of the liabilities at a stated amount.

Citibank has advised the Company that, in connection with the Swap Agreement, Citibank may purchase shares of the Company's stock in the market or in privately negotiated transactions up to an amount equal to \$200 million in aggregate market value at any given time. The Company disclaims that Citibank is an affiliated purchaser of the Company as such term is defined in Rule 10b-18(a)(3) under the Securities Exchange Act or that Citibank is purchasing any shares for the Company. Although the Swap Agreement has a stated expiration date, the Company's intention is to continually renew the Swap Agreement with Citibank's consent. The net effect of the change in fair value of the Swap Agreement and the change in equity compensation liabilities was not material to the Company's earnings for the three months ended June 30, 2008. Citibank reduced its holdings of Company stock by 500,000 shares in the quarter ended December 31, 2007 and 200,000 shares in the quarter ended June 30, 2008 in connection with the Swap Agreement.

The following table presents information regarding the repurchase of the Company's common stock by the Company and purchases of the Company's common stock by Citibank in connection with the Swap Agreement during the three months ended June 30, 2008.

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| Period                                      | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total Number<br>of<br>Shares<br>Purchased as<br>Part of the<br>Publicly<br>Announced<br>Program | Approximate<br>Dollar<br>Value of Shares<br>that May Yet be<br>Purchased under<br>the<br>Programs |
|---------------------------------------------|-------------------------------------------|---------------------------------------|-------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|
| 4/1/08 4/30/08<br>Purchases by Company (1)  | 1,942                                     | \$ 35.85                              |                                                                                                 | \$ 102,394,713                                                                                    |
| 5/1/08 5/31/08<br>Purchases by Company (1)  |                                           |                                       |                                                                                                 | \$ 102,394,713                                                                                    |
| 6/1/08 6/30/08<br>Purchases by Company (1)  | 996                                       | \$ 33.90                              |                                                                                                 | \$ 102,394,713                                                                                    |
| 4/1/08 4/30/08<br>Purchases by Citibank (2) |                                           |                                       |                                                                                                 | \$ 48,382,000                                                                                     |
| 5/1/08 5/31/08<br>Purchases by Citibank (2) |                                           |                                       |                                                                                                 | \$ 53,542,000                                                                                     |
| 6/1/08 6/30/08<br>Purchases by Citibank (2) |                                           |                                       |                                                                                                 | \$ 82,412,000                                                                                     |

(1) The repurchases of the Company's common stock by the Company are intended to partially offset dilution related to our stock option and restricted stock equity compensation plans and are treated as repurchases of Company common stock for purposes of this disclosure.

(2) Citibank may purchase shares of the

Company's stock up to an amount equal to \$200 million. The approximate dollar value of shares that may yet be purchased under the Citibank program fluctuates based on the market value of the Company's stock and/or sales by Citibank of the Company's stock.

**ITEM 6. EXHIBITS**

Reference is made to the separate exhibit index contained on page 41 filed herewith.

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**SIGNATURES**

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

JOHNSON CONTROLS, INC.

Date: August 8, 2008

By: */s/ R. Bruce McDonald*  
R. Bruce McDonald  
Executive Vice President and  
Chief Financial Officer

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**JOHNSON CONTROLS, INC.**  
**Form 10-Q**  
**INDEX TO EXHIBITS**

| Exhibit No. | Description                                                                                                                                                      |
|-------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.X        | Johnson Controls, Inc. Retirement Restoration Plan, amended and restated effective January 1, 2009, filed herewith. **                                           |
| 15          | Letter of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm, dated August 5, 2008, relating to Financial Information.                    |
| 31.1        | Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                          |
| 31.2        | Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                          |
| 32          | Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

\*\* Denotes a management contract or compensation plan.