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### **C. McClure: “Steering Through Discontinuous Change”**

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*The following is a complete transcript of remarks delivered by Chip McClure, chairman, CEO and president of ArvinMeritor, Inc., at the Center for Automotive Research annual Management Briefing Seminars at the Grand Traverse Resort and Spa, Traverse City, Michigan, August 8, 2007.*

Good morning. Discontinuous Change – that’s something this industry has been steering through for a long time. I’ve been in this business for nearly 30 years. I’ve been involved with very challenging situations, handled lots of crises, and faced lots of unknowns.

But, I’ve never witnessed this much turmoil, especially on so many fronts at one time. Globalization has had an exponential affect on everything we do – we’re seeing similar problems across multiple industries, the presence of private-equity pulls competitors together, and the influence of financial markets around the world are affecting materials costs.

Throughout my experience, I’ve maintained that our most important objective should be to ensure that our business is flexible enough to adapt to these changes while maintaining our ability to provide strong value to our shareholders.

While this goal may seem simplistic, executing it can be more difficult than you might expect; we must look at the entire spectrum of the total cost model. Maintaining flexibility requires that we strengthen our balance sheet, grow globally, create and invest in viable core competencies, recruit and maintain a technically advanced workforce, and, of course, reduce costs.

Today’s requirements for running a successful Tier One auto supplier are no less than total transformation. Because of the demands on suppliers today, I believe that simply “steering” through change is no longer enough. “Steering” is avoidance...we react to the potholes, we steer around them, we get around the change to push ourselves a little further down the road.

Well, defensive driving only gets you so far. Reactive management only gets you so far. We must do more. We must get and stay ahead of the curve; we must anticipate change and plan accordingly. Jack Welch said “when the rate of change outside exceeds the rate of change inside, the end is in sight.” Our industry is past trying to adapt to change, or manage change.

What we need now is to master change –anticipating it, planning for it, and accepting it. We can get ahead of the curve on some of these enormous drivers of change, including in the areas of: Healthcare and Pension Costs. Innovation and Technology. Emerging Markets --which, frankly, have already emerged, and Capital Structure.

There’s a common resolution here – no matter what issues, concerns, problems and changes we’re facing. It’s innovation, on all fronts. Not just products. Not just processes. Innovation in *everything* we do. Innovation to force unconventional thinking in all the conventional places.

As we all know, healthcare is an area in the midst of great change. Healthcare is currently the centerpiece of the UAW contract negotiations. It’s being debated everywhere from corporate offices to kitchen tables to Capitol Hill. The reality today is that people can no longer depend on their companies to provide the same level of healthcare to which they’ve become accustomed. Companies can no longer afford it. To continue at the levels we are now, it will literally break the back of this industry.

In 2005, total national health expenditures rose by 6.9 percent – two times the rate of inflation – with a total spend of two trillion dollars. At this rate of growth, health care spending is expected to reach four trillion dollars by 2015. We must control these costs. It severely affects our bottom line as well as the consumers’ pocket books. This calls for drastic measures.

We’re talking about the need for a societal change, and, frankly, this industry has to drive it, because it affects much more than costs. For a lifetime, companies have been taking care of their employees’ healthcare and retirement needs. As that benefit erodes, we can expect that the employee commitment and loyalty to a company will also weaken. This is a crisis not only for Detroit, but for every industrialized industry in this country.

Saddled by the crushing weight of domestic legacy costs, we’re not competing on a level playing field against emerging markets and U.S. transplants. It’s our responsibility to make this a serious priority, and it’s up to us to take action. We can’t wait for government intervention. We can’t “steer through change,” we have to *drive* change.

The decisions we make today about how we’re going to handle runaway healthcare costs could make or break our industry tomorrow. And frankly, I’m not going to allow my business to get pushed to the brink over the cost of prescriptions.

Goodyear’s \$1 billion healthcare fund for retirees is a good example of a company stepping out of the box, taking action and driving its own destiny. I’m sure we’ll now see a lot of other company’s following Goodyear’s precedent.

ArvinMeritor got ahead of the curve two years ago when we introduced aggressive changes to our healthcare plans. We increased individual contributions and we

discontinued healthcare for retirees. We have moved our current plans to a consumer-driven initiative – shifting more of the responsibility to the employee so they can become an educated consumer on healthcare. We've put several tools in place to help and make it easier for our employees to take on more ownership and responsibility in driving down the cost and improving the quality of their care.

Not only is the employee taking on more responsibility in helping to drive cost down, but company leadership needs to take more responsibility in forcing actions that will make a difference in costs as well.

First we need to create an understanding of the true cost drivers in health care spending and identify practical and creative ways to contain these cost drivers. By looking at how the spending is distributed from HMOs, hospitals, pharmaceutical companies and others in the value chain, we can get at those processes that are the most inefficient and costly.

If we're going to make a difference, we need a voice at the table, and that means we need more people involved in the process. I, therefore, make sure I'm actively involved in organizations I can count on to tend to our interest in Washington and are helping support our efforts going forward.

I'm actively involved in: The Business Roundtable, and The National Association of Manufacturers, or NAM. As the Chairman of the HR Council for NAM, I've been primarily focused on driving technology solutions, such as the implementation and standardization of IT systems to improve the healthcare process and reduce costs.

It's estimated that Electronic Health Records alone would reduce health care spending by more than \$100 billion per year. And the Health IT bill introduced in June by Senator Kennedy, Enzi, Clinton, and Huch claims it could reduce the cost of a family's health insurance policy by more than \$700 a year.

I've personally visited hospitals and healthcare groups to get a first-hand look at some of the IT solutions that have been successfully implemented to reduce costs and improve efficiency.

I'm having meetings in Washington to talk with as many legislators as I can on this subject. I'm encouraging them to accelerate their debate on developing new policies that can affect the quality and cost of healthcare.

It's this kind of involvement from us that's going to help make the connections and push solutions.

On my most recent trip to Washington I met with two congressmen who both have experience in running healthcare-related businesses and have a tremendous understanding of the IT issues in that industry. I'm working to connect them with John Engler at NAM so they can work together on pioneering new IT initiatives that could significantly reduce healthcare cost.

Improving IT is a huge step. We know in our business – as in any business – that technology helps solve problems – and the healthcare industry is no exception. It all comes down to taking action that will put us ahead of the curve.

Frankly, it's time we stopped healthcare from destroying the health of our industry and our country.

Right up there with healthcare are other insidious legacy costs. Pension costs go hand-in-hand with health care costs and require the same attention and commitment. Two years ago, our pension obligations at ArvinMeritor were under-funded by \$659 million. And, of course, the rating agencies treated that the same way as they do debt, so it was putting us in a bad position.

We undertook several actions to improve the funding position of our pensions...first by making adjustments among different plans, which enabled us to increase earnings on the funds that were already there. Then, we revised the plan from a defined benefit program to a defined contribution plan.

All this action took us from \$659 million to right around \$165 million of unfunded pensions. At this point, we estimate that our U.S. – based ERISA plan is between 92 and 95 percent funded. In the U.S. we're well on our way to having a fully funded pension plan – and we expect to have it in the near future.

These are the kind of initiatives that I believe put us ahead of the curve when it comes to innovative strategies that will help set us up for growth down the road.

Again, we need to actively get involved and drive our own change. We need to move ahead of the curve and not just sit back and let things happen to us. We have to constantly watch, make adjustments to, and evolve our strategies so that we're in the best financial position possible. It's a very proactive approach. You can't afford to be passive here or you're likely to get rundown by runaway costs.

By reducing our costs in areas like healthcare and pensions, we're in better shape to invest in the new product areas that will generate revenue and growth.

The nature of innovation is changing tremendously. It's becoming much more open. It's becoming much more global. It's becoming much more collaborative. And its definition is becoming much broader. It's product innovation that is the lifeblood of this industry. Nowhere is vision more vital than in product innovation.

The Street forces us to evaluate the business on a quarter-to-quarter basis, but product innovation is not a short-term solution. It takes planning to identify the gaps between current products and customer needs and finding the new idea that fills that need.

Many of these new ideas are generated through engineering. We rely heavily on our engineers to develop truly innovative products that our customers "gotta have", and are willing to pay a premium for. We must constantly look for that product or process that will give us that next advantage. And we have to continuously seek out the growth opportunities.

Developing new technologies is going to demand a higher level of intimacy between the supplier and the customer. We're going to have to collaborate and work even harder together if we're ever going to have a chance to beat the tar out of the competition.

And it's not always going to be the big, disruptive breakthrough technology that will give us a competitive edge. Some of our best returns will come from incremental improvements in what has already been done before – in what we already know works.

This industry is not a sprint, it's a marathon, and we need to make smart investments in incremental innovations that will provide long-term gains.

We know that we have to create our own options for the future. We have to identify where we can create value and literally transform ourselves to get there. It sometimes requires us to rethink products from the ground up. Focusing on where the demand is going to be will be key to developing future technologies.

And, there's innovation in global product planning. Good global innovation means identifying – based on regulations, timing, and regional need -- where in the world your best opportunities exist.

Wal-Mart is a great example of how customers are creating the demand for environmentally responsible products. They have a fleet of about 7,200 heavy-duty trucks that drive about 900 million miles a year. It's among the top 10 private fleets in corporate America.

And they are seeking help from suppliers like ArvinMeritor, Cummins Engine and International Truck to develop new hybrid powertrains that will provide a 25 percent increase in fuel efficiency in three years and 100 percent by 2015.

It's huge. Considering that a MPG increase of just one gallon saves Wal-Mart between \$35 and \$50 million a year. Innovative, long-term plans are critical because we know what's just around the next curve – new, more intense competition from emerging players.

You all know, the competitive landscape is rapidly changing, and will continue to change at a much faster pace than we've ever experienced before. The new reality is that the market share battle field is changing, and more intense competition is coming from new emerging players.

It won't be the Americans, Europeans and Japanese fighting for a piece of the already crowded marketplace, it's the new players from China, India and Korea that are beginning to give us a run for our money. Some are here, some are coming, but they're all intending to be faster, cheaper and better.

Look at South Korean manufacturers, for example. Their auto production this year is expected to reach four million units. While they may be leading the pack of new entrants, we can expect other emerging markets to rise up quickly as well.

But the emerging market competitors aren't just vehicle manufacturers; they're parts manufacturers, too. There's an entire supply chain that will be forced to compete on a global scale.

It brings not only increased competition, but, to a greater extent, increased growth opportunities. Nowhere are those growth opportunities bigger than in China. China has been big news for a while now. And even though ArvinMeritor has been well established

in that region for more than a decade, we still continue to be excited about the ever-emerging opportunities.

In China alone – where the GDP grew more than 11 percent last year – we expect car and heavy truck sales to exceed the rest of the world in the next decade. We believe that by 2010, light vehicle sales could rise to 10 million.

In '07, we anticipate China will sell about 300,000 heavy-duty trucks. That means that in 2007 China could sell nearly 100,000 more trucks than we'll sell this year in North America, which has traditionally been our biggest market. We want to be in a good position to leverage those numbers, and that requires – again – that we get ahead of the curve.

The announcement we made a few weeks ago with Chery Motors is a great example of that. We entered into a joint venture partnership with Chery – one of China's fastest growing OEMs – to design and manufacture light vehicle chassis systems and components. As the majority partner in this 60/40 JV arrangement, we have the flexibility to grow and supply chassis systems to other OE customers in China.

Located in Wuhu, it's one of several China-based facilities we're planning to add to our network over the next 18 months in support of new business with customers in the region.

Our business with Chery will represent \$150 million in revenue to us by 2010. As part of our global growth strategy, we plan to triple our sales in Asia and with the Asian OEMs within the next five years. That's more than \$1 billion of added sales in Asia-Pacific, and it's more than \$1 billion in sourcing from existing and new suppliers in that region.

That also includes taking advantage of the phenomenal growth opportunities in India. This year, India is on track to sell about 200,000 heavy trucks. That will make India the fourth largest heavy truck market in the world. We've been establishing and growing our position in India for over 20 years. And we're growing so fast that this year alone we'll be doubling the number of engineers and technicians we have in our technical center in Bangalore.

We're leveraging our position in India as well as accelerating our opportunities in Korea, Australia, Thailand, Indonesia and other key growth areas where we believe we can get high-quality components at a very affordable price.

Our goal is to get ahead of the curve with a healthy mix of local OEMs in the Asia-Pacific region that we can grow with as they move forward on a global basis. We're pleased with the progress we're making.

We're growing our business with some of the leading Asian heavy-duty truck and Light Vehicle customers, including Hino, Hyundai, Kia, Chery, Daewoo Motors, First Auto Works and Tata Motors. Like us, these companies are spreading globally to make the most of international diversity. We plan to be their global partner and benefit from their growth.

We believe with the global strategies we're implementing we will be one of the most geographically diverse suppliers in the industry, realigning our customer base to

represent one-third in North America, one-third in Europe, and one-third with Asian customers around the world.

Just look at the commercial vehicle segment – while we've had a downturn in North America, sales in South America are soaring...Europe is robust and growing...and in Asia there has never been a higher demand.

Frankly, if you're not everywhere today, you're nowhere. It's transformation at a global level. No matter how daunting, this is where the opportunities are. This is where the customers are – current and future. This is where the U.S. automotive supply base needs to be.

The winners of the future are going to be organizations that can figure out how to tap into the fast-moving world marketplace. An innovative global plan and a commitment to all levels of product innovation are not only drivers of change; they are must-haves to stay ahead of the curve. They are the tools to create that mastery of change I mentioned earlier.

But those tools are impossible to obtain if you don't tackle the balance sheet. And that takes financial innovation to strengthen our capital structure. By that I mean having the courage to challenge the status quo in every area.

If we want the financial advantage of product R&D, we have to aggressively cut costs in other areas to fund it. It's why at ArvinMeritor we've been rationalizing and refocusing our company.

We're in the process of consolidating and closing 13 facilities by 2011 as we continue to optimize our manufacturing footprint and right size in the right areas. It's why we sold our light vehicle aftermarket Business. It's why we more recently sold off our emissions technologies business.

We're focusing our investment solely in core areas that offer us the best opportunities. It's all in the name of creating value. Of going where the profitable growth opportunities are. Of getting ahead of the curve. We're being very proactive in making the tough decisions and implementing actions that will support our efforts in staying ahead of the new financial realities we're facing in our industry.

We're now in the first phases of executing an aggressive program to fundamentally change the profitability of the business. Our new program, called Performance Plus, includes both operational and commercial elements to create long-term shareholder value.

This effort will take no less than a cultural transformation to focus the entire organization on profitability and growth targets for which they will be measured and held accountable. With Performance Plus, we're on track to achieve \$75 million of cost reductions in 2008 and \$150 million in 2009.

However, true financial innovation is about more than cost reduction. Cost reduction will help you steer through change, but it won't get you ahead of the curve. Suppliers with the strongest balance sheets, rather than those with just the lowest costs, are in the best position to grow their sales globally.

Frankly, automakers cannot afford failures in the supply chain, it's just too risky. There are many financial opportunities available to our industry that, for one reason or another, have not become the norm for automotive, yet provide a level of capital security.

We've made a concerted effort to bring innovation into our capital activities, and it's produced tremendous results. Instead of limiting ourselves to one or two major banks, we accessed a wider variety of banking contacts than we normally would and we asked them for ideas and suggestions.

We can't limit our financial creativity. We have seen, and benefited from, the insight that outside thinking can provide. Over a period of time we created a relationship with several of the major banks on Wall Street, laid out what our goals and major objectives were and solicited their thoughts and ideas on accomplishing those goals.

The result was a blend of ideas from Wall Street and our treasury staff that resulted in us exchanging bonds and extending the maturity of existing bondholders, as opposed to the standard approach which would be to sell new bonds, get the proceeds and then go into a different transaction and buy back existing bonds in the market.

We took care of all this with one fee instead of two – so we were able to accomplish our goal less expensively and do it with bondholders who already knew ArvinMeritor.

It was this same approach that brought the idea to issue convertible debt instead of regular debt. And we included a new feature in these bonds that allows us to minimize the dilution of the current shareholders.

It's a deal that is regularly done in the high-tech and biotech worlds, but not automotive. So we jumped on something unconventional for our industry, and planned a webcast for a bond offering of \$200 million. We were surprised and elated when the interest in our bonds reached over \$1 billion. Needless to say, financial innovation has pushed us ahead of the curve from a debt perspective.

Business is no longer linear or sequential. It can be spontaneous, contrary, unexpected and often ambiguous. And we have to deal with it. Answers are not often simple. It's all the outgrowth of change. Change forces us to question everything. To change our mind-set. To balance short-term demands with long-term persistence.

The key, the vehicle, to get ahead of change, ahead of the curve, is innovation. Innovation initiatives have to be multi-faceted. It's not just an attack on cost. It's not just a growth plan. It's not just balance sheet improvement. It's not just diversifying your customer base, and it's not just new product. It's an accumulation of all of these efforts. It's paying attention to the total business model.

Taking proactive measures to lift crushing healthcare and pension costs. Investing in game-changing technology while continually improving the existing technology. Creating a global footprint that opens the doors for global opportunity. Structuring financial deals that will allow us to cut cost and grow revenue simultaneously.

Getting ahead of the curve requires action. It requires involvement. It requires vision. This business is an exercise in foresight. It's about positioning yourself to capitalize on future investment opportunities.

Alfred P. Sloan said, "The circumstances of the ever-changing market and ever-changing product are capable of breaking any business organization if that organization is unprepared for change."

It happens all the time, businesses don't move fast enough, don't stay ahead of change. Britain used to have 80 percent of the international motorcycle market. Today, they have one percent. Triumph and BSA didn't change. The Japanese manufacturers did, and now Honda and Suzuki own the market, along with Harley Davidson.

There are new rules to succeeding in this business. You have a choice to write them, or follow them. Personally, I say, someone get me a pen.

Thank you.

#### **About ArvinMeritor**

*ArvinMeritor, Inc. is a premier global supplier of a broad range of integrated systems, modules and components to the motor vehicle industry. The company serves light vehicle, commercial truck, trailer and specialty original equipment manufacturers and certain aftermarkets. Headquartered in Troy, Mich., ArvinMeritor employs approximately 19,000 people in 25 countries. ArvinMeritor common stock is traded on the New York Stock Exchange under the ticker symbol ARM. For more information, visit the company's Web site at: <http://www.arvinmeritor.com/>.*

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