

JOHNSON CONTROLS INC

Form 10-Q

May 06, 2008

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

**Form 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2008
- OR**
- 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  No

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

<b>Class</b>	<b>Shares Outstanding at March 31, 2008</b>
Common Stock: \$0.017/18 par value per share	593,417,685

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ITEM 1. FINANCIAL STATEMENTS****Johnson Controls, Inc.  
Condensed Consolidated Statements of Financial Position**  
(in millions; unaudited)

	March 31, 2008	September 30, 2007	March 31, 2007
<b>Assets</b>			
Cash and cash equivalents	\$ 233	\$ 674	\$ 172
Accounts receivable net	6,451	6,600	5,933
Inventories	2,209	1,968	1,847
Other current assets	1,716	1,630	1,491
Current assets	10,609	10,872	9,443
Property, plant and equipment net	4,324	4,208	4,056
Goodwill	6,401	6,131	6,019
Other intangible assets net	793	773	783
Investments in partially-owned affiliates	854	795	600
Other noncurrent assets	1,638	1,326	1,586
Total assets	\$ 24,619	\$ 24,105	\$ 22,487
<b>Liabilities and Shareholders Equity</b>			
Short-term debt	\$ 574	\$ 264	\$ 361
Current portion of long-term debt	443	899	696
Accounts payable	5,238	5,365	4,555
Accrued compensation and benefits	914	978	817
Accrued income taxes	90	97	128
Other current liabilities	2,254	2,317	2,220
Current liabilities	9,513	9,920	8,777
Commitments and contingencies (Note 16)			
Long-term debt	3,301	3,255	3,564
Postretirement health and other benefits	260	256	327
Minority interests in equity of subsidiaries	150	128	142
Other noncurrent liabilities	1,800	1,639	1,862
Shareholders equity	9,595	8,907	7,815
Total liabilities and shareholders equity	\$ 24,619	\$ 24,105	\$ 22,487

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 Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
Net sales				
Products and systems*	\$ 7,593	\$ 6,841	\$ 15,302	\$ 13,533
Services*	1,813	1,651	3,588	3,169
	9,406	8,492	18,890	16,702
Cost of sales				
Products and systems	6,725	6,034	13,467	11,944
Services	1,371	1,265	2,806	2,491
	8,096	7,299	16,273	14,435
Gross profit	1,310	1,193	2,617	2,267
Selling, general and administrative expenses	(888)	(861)	(1,838)	(1,664)
Net financing charges	(66)	(69)	(135)	(138)
Equity income	31	19	48	48
Income from continuing operations before income taxes and minority interests	387	282	692	513
Provision for income taxes	81	17	145	70
Minority interests in net earnings of subsidiaries	17	3	23	13
Income from continuing operations	289	262	524	430
Loss from discontinued operations, net of income taxes		(4)		(10)
Loss on sale of discontinued operations, net of income taxes		(30)		(30)
Net income	\$ 289	\$ 228	\$ 524	\$ 390
Earnings per share from continuing operations				
Basic	\$ 0.49	\$ 0.44	\$ 0.88	\$ 0.73
Diluted	\$ 0.48	\$ 0.44	\$ 0.87	\$ 0.72
Earnings per share				
Basic	\$ 0.49	\$ 0.39	\$ 0.88	\$ 0.66

Diluted

\$ 0.48 \$ 0.38 \$ 0.87 \$ 0.65

\* 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 Ended March 31, 2008		Six Months Ended March 31, 2007	
	\$	\$	\$	\$
<b>Operating Activities</b>				
Net income	\$ 289	\$ 228	\$ 524	\$ 390
Adjustments to reconcile net income to cash provided by operating activities				
Depreciation	185	176	366	350
Amortization of intangibles	9	12	19	24
Equity in earnings of partially-owned affiliates, net of dividends received	(22)	(15)		(32)
Minority interests in net earnings of subsidiaries	17	3	23	13
Deferred income taxes	(29)	(54)	(20)	(49)
Loss on sale of discontinued operations		30		30
Equity-based compensation	13	10	33	25
Other		18	19	21
Changes in working capital, excluding acquisitions and divestitures of businesses				
Accounts receivable	(57)	(277)	429	(128)
Inventories	(68)	(43)	(150)	(90)
Other current assets	(57)	44	39	43
Restructuring reserves	(18)	(30)	(32)	(63)
Accounts payable and accrued liabilities	75	395	(760)	121
Accrued income taxes	(39)	(42)	(14)	(48)
Cash provided by operating activities	298	455	476	607
<b>Investing Activities</b>				
Capital expenditures	(174)	(211)	(361)	(441)
Sale of property, plant and equipment	17	9	32	17
Acquisition of businesses, net of cash acquired	(43)		(69)	
Business divestitures		35		35
Recoverable customer engineering expenditures	19		15	
Settlement of cross-currency interest rate swaps	(61)		(93)	(57)
Changes in long-term investments		2	(12)	3
Cash used by investing activities	(242)	(165)	(488)	(443)
<b>Financing Activities</b>				
Increase (decrease) in short-term debt net	370	(254)	283	68
Increase in long-term debt	232		233	105
Repayment of long-term debt	(691)	(16)	(712)	(382)
Payment of cash dividends	(78)	(126)	(143)	(130)
Stock repurchases	(38)	(16)	(73)	(23)

Other	(25)	42	(17)	77
Cash used by financing activities	(230)	(370)	(429)	(285)
<b>Decrease in cash and cash equivalents</b>	<b>\$ (174)</b>	<b>\$ (80)</b>	<b>\$ (441)</b>	<b>\$ (121)</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**  
**March 31, 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 six month periods ended March 31, 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.

**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 first quarter of fiscal 2010 (October 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 the first quarter of fiscal 2008, the Company completed three acquisitions for a combined purchase price of \$75 million, of which \$43 million was paid in the three months ended March 31, 2008. None of the acquisitions were material to the Company's consolidated financial statements. In connection with these acquisitions, the Company recorded goodwill of \$36 million.

In September 2007, the Company recorded a \$200 million equity investment in a joint venture with U.S. Airconditioning Distributors, Inc., a California based, privately-owned 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 \$618 million, \$633 million and \$525 million at March 31, 2008, September 30, 2007, and March 31, 2007, respectively. Amounts included within other current liabilities were \$544 million, \$538 million and \$430 million at March 31, 2008, September 30, 2007, and March 31, 2007, respectively.

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

**6. Inventories**

Inventories consisted of the following (in millions):

	March 31, 2008	September 30, 2007	March 31, 2007
Raw materials and supplies	\$ 923	\$ 774	\$ 730
Work-in-process	359	329	284
Finished goods	989	930	885
FIFO inventories	2,271	2,033	1,899
LIFO reserve	(62)	(65)	(52)
Inventories	\$ 2,209	\$ 1,968	\$ 1,847

**7. Goodwill and Other Intangible Assets**

The changes in the carrying amount of goodwill in each of the Company's reporting segments for the six month period ended September 30, 2007 and the six month period ended March 31, 2008 were as follows (in millions):

	March 31, 2007	Business Acquisitions	Currency Translation and Other	September 30, 2007
Building efficiency				
North America systems	\$ 502	\$	\$ (5)	\$ 497
North America service	620		2	622
North America unitary products	480		1	481
Global workplace solutions	168		13	181
Europe	387		5	392
Rest of world	508		20	528
Automotive experience				
North America	1,180		(3)	1,177
Europe	1,109		58	1,167
Asia	193		12	205
Power solutions	872		9	881
Total	\$ 6,019	\$	\$ 112	\$ 6,131

	September 30, 2007	Business Acquisitions	Currency Translation and Other	March 31, 2008
Building efficiency				

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North America systems	\$	497	\$	8	\$	1	\$	506
North America service		622		28		3		653
North America unitary products		481						481
Global workplace solutions		181						181
Europe		392				19		411
Rest of world		528				59		587
Automotive experience								
North America		1,177						1,177
Europe		1,167				102		1,269
Asia		205				12		217
Power solutions		881				38		919
Total	\$	6,131	\$	36	\$	234	\$	6,401

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

The Company's other intangible assets, primarily from business acquisitions, are valued based on independent appraisals and consisted of (in millions):

	March 31, 2008			September 30, 2007			March 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Amortized intangible assets									
Patented technology	\$ 309	\$ (161)	\$ 148	\$ 315	\$ (147)	\$ 168	\$ 298	\$ (133)	\$ 165
Unpatented technology	25	(10)	15	21	(8)	13	33	(11)	22
Customer relationships	347	(36)	311	306	(24)	282	311	(22)	289
Miscellaneous	35	(13)	22	47	(32)	15	29	(23)	6
Total amortized intangible assets	716	(220)	496	689	(211)	478	671	(189)	482
Unamortized intangible assets									
Trademarks	297		297	295		295	295		295
Pension asset							6		6
Total unamortized intangible assets	297		297	295		295	301		301
Total intangible assets	\$ 1,013	\$ (220)	\$ 793	\$ 984	\$ (211)	\$ 773	\$ 972	\$ (189)	\$ 783

Amortization of other intangible assets for the six month periods ended March 31, 2008 and 2007 was \$19 million and \$24 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 six months ended March 31, 2008 and March 31, 2007 was as follows (in millions):

	2008	2007
Balance as of September 30	\$ 150	\$ 189

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Accruals for warranties issued during the period	76	61
Accruals from acquisitions	1	
Accruals related to pre-existing warranties (including changes in estimates)		2
Settlements made (in cash or in kind) during the period	(80)	(71)
Currency translation	5	3
Balance as of March 31	\$ 152	\$ 184

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

**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 fiscal 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 March 31, 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 March 31, 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 Severance and Termination Benefits	Other	Currency 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

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

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. 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 fiscal 2008.

As of March 31, 2008, approximately 2,185 employees have been separated from the Company pursuant to the York restructuring, including 295 for North America systems, 50 for North America unitary products, 1,095 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 Severance and Termination Benefits	Other	Currency 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 adjustment	(17)	(4)	4	(17)
Balance at March 31, 2008	\$ 8	\$ 13	\$ 7	\$ 28

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 \$104 million and \$129 million for the three months ended March 31, 2008 and 2007, respectively, and \$227 million and \$270 million for the six months ended March 31, 2008 and 2007. These expenditures are net of customer reimbursements of \$99 million and \$63 million for the three months ended March 31, 2008 and 2007, respectively, and \$176 million and \$113 million for the six months ended March 31, 2008 and 2007, respectively.

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

**11. Income Taxes**

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

	Three Months		Six Months	
	Ended March 31,		Ended March 31,	
	2008	2007	2008	2007
Federal, state and foreign income tax expense	\$ 81	\$ 59	\$ 145	\$ 107
Effective tax rate adjustment		(5)		
Change in tax status of foreign subsidiary		(22)		(22)
Audit resolutions		(15)		(15)
Provision for income taxes	\$ 81	\$ 17	\$ 145	\$ 70

***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 six months ended March 31, 2008 and 2007, the Company's estimated annual effective income tax rate for continuing operations was 21.0%. In the three months ended March 31, 2007, the Company reduced its estimated annual effective income tax rate for continuing operations from 23.0% to 21.0%.

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

For the three and six months ended March 31, 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 \$8 million of additional interest and penalties during the six months ended March 31, 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., fiscal 2004 through fiscal 2006 are currently under exam by the Internal Revenue Service (IRS) and fiscal 1999 through fiscal 2003 are currently under IRS Appeals. Additionally, the Company is 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

Tax years covered represent updates for the activities arising during the three months ended March 31, 2008, including additional years and removal of years under tax exam. In the three months ended March 31, 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 2001 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 three and

six months ended March 31, 2008. In the three months ended March 31, 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 in 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		Six Months	
	Ended March 31,		Ended March 31,	
	2008	2007	2008	2007
Service cost	\$ 20	\$ 18	\$ 40	\$ 37
Interest cost	35	32	70	64
Expected return on plan assets	(41)	(38)	(83)	(76)
Amortization of transitional obligation				(1)
Amortization of net actuarial loss	1	3	3	6
Amortization of prior service cost	1		1	1
Net periodic benefit cost	\$ 16	\$ 15	\$ 31	\$ 31

	Non-U.S. Pension Plans			
	Three Months		Six Months	
	Ended March 31,		Ended March 31,	
	2008	2007	2008	2007
Service cost	\$ 9	\$ 10	\$ 19	\$ 19
Interest cost	18	15	36	30
Expected return on plan assets	(16)	(14)	(33)	(27)
Amortization of net actuarial loss	2	2	4	4
Net periodic benefit cost	\$ 13	\$ 13	\$ 26	\$ 26



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	Postretirement Health and Other Benefits			
	Three Months		Six Months	
	Ended March 31,		Ended March 31,	
	2008	2007	2008	2007
Service cost	\$ 1	\$ 2	\$ 2	\$ 3
Interest cost	5	4	9	9
Amortization of net actuarial gain	(1)		(1)	
Amortization of prior service cost	(2)	(2)	(4)	(3)
Net postretirement benefit expense	\$ 3	\$ 4	\$ 6	\$ 9

**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		Six Months	
	Ended March 31,		Ended March 31,	
	2008	2007	2008	2007
<b>Weighted Average Shares Outstanding</b>				
Basic weighted average shares outstanding	592.8	590.1	593.0	588.9
Effect of dilutive securities:				
Stock options	7.9	7.8	9.1	7.2
Diluted weighted average shares outstanding	600.7	597.9	602.1	596.1
<b>Antidilutive Securities</b>				
Options to purchase common shares	1.0		0.8	0.3

**14. Comprehensive Income**

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

	Three Months		Six Months	
	Ended March 31,		Ended March 31,	
	2008	2007	2008	2007
Net income	\$ 289	\$ 228	\$ 524	\$ 390
Realized and unrealized losses on derivatives	(1)	(3)	(52)	(21)

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Foreign currency translation adjustments	324	32	448	139
Other comprehensive income	323	29	396	118
Comprehensive income	\$ 612	\$ 257	\$ 920	\$ 508

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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 six months ended March 31, 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 \$81 million and \$8 million was recorded for the three month periods ending March 31, 2008 and 2007, respectively, and a net loss of approximately \$107 million and \$34 million was recorded for the six month periods ended March 31, 2008 and 2007, respectively. These losses were more than offset by gains on the underlying foreign currency-denominated assets.

**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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**Johnson Controls, Inc.**  
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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. Unallocated assets are corporate cash and cash equivalents, investments in partially-owned affiliates and other non-segment assets. Financial information relating to the Company's reportable segments is as follows (in millions):

	Net Sales			
	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
Building efficiency				
North America systems	\$ 563	\$ 484	\$ 1,075	\$ 928
North America service	582	536	1,123	1,007
North America unitary products	153	187	315	392
Global workplace solutions	781	670	1,562	1,316
Europe	616	553	1,281	1,165
Rest of world	604	533	1,187	1,077
	3,299	2,963	6,543	5,885
Automotive experience				
North America	1,699	1,825	3,518	3,561
Europe	2,551	2,347	4,952	4,455
Asia	400	369	769	745
	4,650	4,541	9,239	8,761
Power solutions	1,457	988	3,108	2,056
Total net sales	\$ 9,406	\$ 8,492	\$ 18,890	\$ 16,702



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**Johnson Controls, Inc.**  
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	Segment Income			
	Three Months		Six Months	
	Ended March		Ended March	
	31,		31,	
	2008	2007	2008	2007
Building efficiency				
North America systems	\$ 63	\$ 40	\$ 112	\$ 72
North America service	42	38	68	48
North America unitary products	(14)	6	(23)	14
Global workplace solutions	11	15	29	32
Europe	14	1	40	20
Rest of world	61	37	114	74
	177	137	340	260
Automotive experience				
North America	25	(1)	35	(53)
Europe	120	120	195	200
Asia	10	2	3	9
	155	121	233	156
Power solutions	121	93	254	235
Total segment income	\$ 453	\$ 351	\$ 827	\$ 651
Net financing charges	66	69	135	138
Income from continuing operations before income taxes and minority interests	\$ 387	\$ 282	\$ 692	\$ 513

**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.

The Company has entered into supply contracts with certain vendors that include minimum volume requirements which, if not met, could subject the Company to potential liabilities. At the end of the second quarter of fiscal 2008, there were no known volume shortfalls for which the Company was contractually obligated. These supply contracts include cancellation penalties in the event that either party elects to terminate the agreement prior to its expiration. Such penalties, if incurred, could be material to the Company's consolidated financial condition, results of operations or cash flows.

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**Johnson Controls, Inc.**  
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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 to the Company, or investments by the Company, to ensure uninterrupted supply to its customers. For example, Plastech Engineered Products, Inc. (Plastech), a major supplier of certain injection molded and other molded plastic component parts to the Company and the North American automotive industry, filed for protection under Chapter 11 of the U.S. Bankruptcy Code. The Company and Plastech's term lenders have proposed to establish a joint venture that would acquire the interiors and underhood business of Plastech, subject to certain activities, including approval by the Bankruptcy Court and approval by the Company's Board of Directors.

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**PricewaterhouseCoopers LLP**

100 E. Wisconsin Ave., Suite 1800

Milwaukee WI 53202

Telephone (414) 212 1600

**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 March 31, 2008 and 2007, and the related consolidated statements of income and the condensed consolidated statements of cash flows for the three-month and six-month periods ended March 31, 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.

PricewaterhouseCoopers LLP

Milwaukee, Wisconsin

May 6, 2008

**Table of Contents****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, or 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 of our Annual Report on Form 10-K for the year ended September 30, 2007. 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 March 31, 2008 compared to the three months ended March 31, 2007, while references to Year-to-Date refer to the six months ended March 31, 2008 compared to the six months ended March 31, 2007.

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

(In millions)	Three Months Ended			Six Months Ended		
	March 31,		Change	March 31,		Change
	2008	2007		2008	2007	
Net sales	\$9,406	\$8,492	11%	\$18,890	\$16,702	13%
Income from continuing operations before income taxes and minority interests	387	282	37%	692	513	35%

**Three Months:**

The \$914 million increase in consolidated net sales was primarily due to higher revenues in the power solutions segment (\$390 million) mainly from pass-through pricing of higher lead costs, the favorable effects of foreign currency translation (approximately \$590 million) and growth in the building efficiency business (\$190 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 building efficiency unitary products group (\$35 million) from a decline in the U.S. residential market and lower net volumes in the North American (\$125 million) and European (\$95 million) automotive markets.

The \$105 million increase in consolidated income from continuing operations before income taxes and minority interests was primarily due to higher sales volume and margin expansion in the building efficiency business (\$50 million) despite higher selling, general and administrative (SG&A) expenses to support growth, cost savings measures in the automotive experience North America segment (\$25 million), improved price/mix in the power solutions segment (\$15 million) and the favorable effects of foreign currency translation (approximately \$40 million). These increases were partially offset by unfavorable performance in the building efficiency unitary products group (\$20 million) related to a decline in the U.S. residential market.

**Year-to-Date:**

The \$2.2 billion increase in consolidated net sales was primarily due to pass-through pricing of higher lead costs in the power solutions segment (\$900 million), higher sales volumes in the building efficiency business (\$350 million) mainly from increased global demand for the Company's offerings for nonresidential buildings and the favorable impact of foreign currency translation (approximately \$1.0 billion), partially offset by lower sales in the automotive experience business (\$100 million) reflecting the weaker North American automotive market.

The \$179 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 (\$110 million) despite higher SG&A expenses to support growth, operational efficiencies in the automotive experience North America segment (\$90 million) and improved price/product mix in the power solutions segment (\$20 million). These increases were partially offset by unfavorable performance in the building efficiency unitary products group (\$37 million) related to a decline in the U.S. residential market.

**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 Three Months Ended March 31,			Net Sales Six Months Ended March 31,		
	2008	2007	Change	2008	2007	Change
North America systems	\$ 563	\$ 484	16%	\$ 1,075	\$ 928	16%
North America service	582	536	9%	1,123	1,007	12%
North America unitary products	153	187	-18%	315	392	-20%
Global workplace solutions	781	670	17%	1,562	1,316	19%
Europe	616	553	11%	1,281	1,165	10%
Rest of world	604	533	13%	1,187	1,077	10%
	\$ 3,299	\$ 2,963	11%	\$ 6,543	\$ 5,885	11%

**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 (\$34 million) and the impact of first quarter fiscal 2008 acquisitions (\$12 million).

The decrease in North American unitary products was primarily due to a depressed U.S. residential market which impacted new construction and housing starts.

The increase in global workplace solutions primarily reflects a higher volume of global pass-through contracts (\$10 million), a net increase and expansion in existing contracts (\$45 million) and new business volumes (\$6 million), and the favorable impact of foreign currency translation (approximately \$50 million).

The increase in Europe reflects the favorable impact of foreign currency translation (approximately \$75 million), partially offset by a reduction in systems and product volumes (\$12 million).

The increase in rest of world is due to volume increases mainly in Latin America, Asia and the Middle East (\$31 million) and the favorable impact of foreign currency translation (approximately \$40 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 (\$99 million) and the impact of first quarter fiscal 2008 acquisitions (\$17 million).

The decrease in North American unitary products was primarily due to a depressed U.S. residential market which impacted new construction and housing starts.

The increase in global workplace solutions primarily reflects a higher volume of global pass-through contracts (\$35 million), a net increase and expansion in existing customers (\$104 million) and new business volumes (\$7 million), and the favorable impact of foreign currency translation (approximately \$100 million).

The increase in Europe reflects the favorable impact of foreign currency translation (approximately \$135 million), partially offset by a reduction in systems and product volumes (\$19 million).

The increase in rest of world is due to volume increases (\$50 million) in Asia, Latin America and the Middle East and the favorable impact of foreign currency translation (approximately \$60 million).

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

(In millions)	Segment Income Three Months Ended March 31,			Segment Income Six Months Ended March 31,		
	2008	2007	Change	2008	2007	Change
North America systems	\$ 63	\$ 40	58%	\$ 112	\$ 72	56%
North America service	42	38	11%	68	48	42%
North America unitary products	(14)	6	*	(23)	14	*
Global workplace solutions	11	15	-27%	29	32	-9%
Europe	14	1	*	40	20	*
Rest of world	61	37	65%	114	74	54%
	\$ 177	\$ 137	29%	\$ 340	\$ 260	31%

\* Measure not meaningful.

**Three Months:**

The increases in North America systems and North America service were primarily due to higher sales volumes and operational efficiencies (\$33 million), partially offset by additional SG&A expenses to support business growth initiatives (\$10 million).

The decrease in North America unitary products was primarily due to the decline in sales volumes from a depressed U.S. residential market which impacted new construction and housing starts.

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 (approximately \$3 million) and continuing benefit from prior year restructuring plans, branch office redesign and manufacturing footprint changes (\$19 million), partially offset by increased SG&A expenses to support business growth and system implementations (\$9 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 (\$19 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 (\$77 million), partially offset by additional SG&A expenses to support business growth initiatives (\$17 million).

The decrease in North America unitary products was primarily due to the decline in sales volumes from a depressed U.S. residential market which impacted new construction and housing starts (\$33 million), and purchase accounting adjustments related to the September 2007 equity investment in a joint venture with U.S. Airconditioning Distributors, Inc (\$4 million).

The slight decrease in global workplace solutions was primarily due to less favorable margins and mix in North American contracts, partially offset by higher volumes (\$5 million).

The increase in Europe was primarily due to the favorable impact of foreign currency translation (approximately \$8 million) and continuing benefit from prior year restructuring plans, branch office redesign and manufacturing footprint changes (\$30 million), partially offset by increased SG&A expenses to support business growth and system implementations (\$18 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 (\$38 million).

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

(In millions)	Net Sales Three Months Ended March 31,			Net Sales Six Months Ended March 31,		
	2008	2007	Change	2008	2007	Change
North America	\$ 1,699	\$ 1,825	-7%	\$ 3,518	\$ 3,561	-1%
Europe	2,551	2,347	9%	4,952	4,455	11%
Asia	400	369	8%	769	745	3%
	\$ 4,650	\$ 4,541	2%	\$ 9,239	\$ 8,761	5%

**Three Months:**

The decrease in North America was primarily due to volume reductions at Ford Motor Company, Chrysler LLC and Nissan Motor Company. The decrease in net sales of 7% was slightly better than the estimated industry's production decrease of 8% for the quarter. A worker's strike at a U.S. supplier to one of our major customers also unfavorably impacted net sales by \$24 million in the second quarter of fiscal 2008.

The increase in Europe was primarily due to the favorable impact of foreign currency translation (approximately \$300 million) and increased volumes at Kia Motors Corporation and Volkswagen AG, partially offset by decreased business with Daimler AG, General Motors Corporation, The Volvo Group and BMW AG.

The increase in Asia was primarily due to the favorable impact of foreign currency translation (approximately \$27 million) and higher volumes with Nissan Motor Company in Japan.

**Year-to-Date:**

The decrease in North America was primarily due to a decline in volumes on sport utility vehicle programs with Ford Motor Company and Chrysler LLC, partially offset by higher sales volumes with Honda Motor Company.

The increase in Europe was primarily due to the favorable impact of foreign currency translation (approximately \$540 million) and increased volumes at Kia Motors Corporation, Fiat Automobiles SpA and Volkswagen AG, partially offset by lower volumes and discontinued programs with Daimler AG and BMW AG.

The increase in Asia was primarily due to the favorable impact of foreign currency translation (approximately \$40 million), partially offset by lower sales volumes mainly in Korea and Japan.

**Automotive Experience Segment Income**

(In millions)	Segment Income Three Months Ended March 31,			Segment Income Six Months Ended March 31,		
	2008	2007	Change	2008	2007	Change
North America	\$ 25	\$ (1)	*	\$ 35	\$ (53)	*
Europe	120	120	0%	195	200	-3%
Asia	10	2	*	3	9	*
	\$ 155	\$ 121	28%	\$ 233	\$ 156	49%

\*

Measure not  
meaningful.

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

The increase in North America was primarily due to favorable gross margins from purchasing savings (\$12 million) and operational efficiencies (\$39 million), partially offset by lower production volumes (\$16 million) and the unfavorable impact of a worker's strike at a U.S. supplier to one of our major customers (\$8 million).

European segment income was consistent with the prior year primarily due the favorable impact of foreign currency translation (approximately \$25 million), purchasing savings (\$25 million) and favorable net engineering costs (\$12 million), partially offset by the lower sales volumes (\$23 million) and lower economic recoveries (\$39 million).

The increase in Asia was primarily due to higher volumes (\$4 million), operating efficiencies (\$3 million), higher equity income from China joint ventures (\$2 million) and the favorable impact of foreign currency translation (\$2 million), partially offset by higher employee expenses to support market expansion (\$4 million).

**Year-to-Date:**

The increase in North America was primarily due to pricing improvements (\$12 million), favorable gross margins from purchasing savings (\$19 million) and operational efficiencies (\$82 million), partially offset by higher SG&A expenses (\$23 million) and a worker's strike at a U.S. supplier to one of our major customers (\$8 million).

The decrease in Europe was primarily due to the timing of platform pricing adjustments and lower economic recoveries (\$42 million), partially offset by the favorable impact of foreign currency translation (\$37 million).

The decrease in Asia is primarily due to higher employee expenses to support market expansion (\$13 million), partially offset by the favorable impact of foreign currency translation (\$4 million) and higher equity income from China joint ventures (\$2 million).

**Power Solutions**

(In millions)	Three Months Ended March 31,			Six Months Ended March 31,		
	2008	2007	Change	2008	2007	Change
Net sales	\$1,457	\$988	47%	\$3,108	\$2,056	51%
Segment income	121	93	30%	254	235	8%

**Three Months:**

Net sales increased primarily due to the pass-through pricing of higher lead costs (\$310 million), the favorable impact of foreign currency translation (approximately \$75 million) and improved price/product mix (\$80 million).

Segment income increased primarily due to improved price/product mix (\$15 million), the favorable impact of foreign currency translation (\$6 million) and higher equity income from Asia joint ventures (\$6 million).

**Year-to-Date:**

Net sales increased primarily due to the impact of higher lead costs on pricing (\$675 million), improved price/product mix (\$197 million), the favorable impact of foreign currency translation (approximately \$145 million) and higher sales volumes (\$25 million).

Segment income increased due to improved price/product mix (\$30 million) and operational efficiencies (\$5 million), partially offset by higher SG&A costs (\$15 million) mainly to support global business growth.

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

(In millions)	Three Months Ended March 31,			Six Months Ended March 31,		
	2008	2007	Change	2008	2007	Change
Net financing charges	\$66	\$69	-4%	\$135	\$138	-2%

The decrease in net financing charges in the three and six month periods is due to lower borrowing levels compared to the prior period, as well as lower short-term interest rates.

**Provision for Income Taxes**

(In millions)	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
Tax provision	\$ 81	\$ 17	\$ 145	\$ 70
Effective tax rate	21.0%	6.0%	21.0%	13.6%
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 three and six months ended March 31, 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 in fiscal 2007. This effective tax rate approximated the local statutory rate adjusted for permanent differences.

**Net Income**

(In millions)	Three Months Ended March 31,			Six Months Ended March 31,		
	2008	2007	Change	2008	2007	Change
Income from continuing operations	\$ 289	\$ 262	10%	\$ 524	\$ 430	22%
Loss from discontinued operations		(4)	*		(10)	*
Loss on sale of discontinued operations		(30)	*		(30)	*
Net income	\$ 289	\$ 228	27%	\$ 524	\$ 390	34%

\*



Measure not  
meaningful.

The increase in income from continuing operations for the three month period ended March 31, 2008 was primarily due to higher sales volume and margin expansion in the building efficiency business (\$50 million) despite higher SG&A expenses to support growth, cost savings measures in the automotive experience North America segment (\$25 million), improved price/product mix in the power solutions segment (\$15 million) and the favorable effects of foreign currency translation (approximately \$40 million). These increases were partially offset by unfavorable performance in the building efficiency

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unitary products group (\$20 million) related to a decline in the U.S. residential market and an increase in the provision for income taxes (\$64 million) related to non-recurring adjustments in the prior year.

The increase in income from continuing operations for the six month period ended March 31, 2008 was primarily due to higher sales volume and improving gross margins through pricing and operational efficiencies in the building efficiency business (\$110 million) despite higher SG&A expenses to support growth, cost savings measures in the automotive experience North America segment (\$90 million) and improved price/product mix in the power solutions segment (\$20 million). These increases were partially offset by unfavorable performance in the building efficiency unitary products group (\$37 million) related to a decline in the U.S. residential market and an increase in the provision for income taxes (\$75 million) related to non-recurring adjustments in the prior year.

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. 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 April 16, 2008, the Company announced an increase in its previously issued fiscal 2008 guidance for net sales of approximately \$38 billion to approximately \$39 billion, an increase of 13% from prior year net sales, and reaffirmed its previously issued guidance that diluted earnings per share from continuing operations will increase 18% to approximately \$2.45 to \$2.50 per share.

**Backlog**

Building efficiency's backlog relates to its control systems and service activity. At March 31, 2008, the unearned backlog was \$4.5 billion, compared to \$3.9 billion at March 31, 2007, a 15% increase.

**Financial Condition***Working Capital*

(In millions)	March 31, 2008	September 30, 2007	Change	March 31, 2007	Change
Working capital	\$ 1,880	\$ 1,441	30%	\$ 1,551	21%
Accounts receivable	6,451	6,600	-2%	5,933	9%
Inventories	2,209	1,968	12%	1,847	20%
Accounts payable	5,238	5,365	-2%	4,555	15%

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.

The increase in working capital at March 31, 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 lead costs and some seasonality in the building efficiency business and lower accounts payable from timing of payments, partially offset by lower accounts receivable from improved collections and seasonality. Compared to March 31, 2007, the increase is primarily due to higher accounts receivable from increased sales and higher inventories from the impact of higher lead costs, partially offset by higher accounts payable from the higher cost of inventories.



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The Company's days sales in accounts receivable for the three months ended March 31, 2008 were 57, slightly lower than 58 in the comparable period ended September 30, 2007 and higher than 55 for the comparable period ended March 31, 2007. There has been no significant deterioration in the credit quality of the Company's receivables or changes in revenue recognition policies. The decrease in accounts receivable compared to September 30, 2007 is due to the seasonality of net sales between the two periods, as well as the timing of unbilled revenues on long-term contracts. The increase in accounts receivable compared to March 31, 2007 is consistent with higher sales volume.

The Company's inventory turns for the three months ended March 31, 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 residential housing market. Inventory turns were higher compared to March 31, 2007 due to improvements in inventory management.

Days payable at March 31, 2008 decreased to 67 days from 71 days at September 30, 2007 and increased from 63 days at March 31, 2007 mainly due to the timing of payments.

*Cash Flows*

(In millions)	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2008	2007	2008	2007
Net cash provided by operating activities	\$298	\$455	\$476	\$607
Net cash used by investing activities	242	165	488	443
Net cash used by financing activities	230	370	429	285
Capital expenditures	174	211	361	441

The decrease in net cash provided by operating activities in the three months ended March 31, 2008 was primarily due to timing differences in accounts payable and accrued liabilities, partially offset by higher accounts receivable due to the timing of unbilled revenues on long-term contracts and higher net income. For the six months ended March 31, 2008, the decrease in net cash provided by operating activities was due to higher inventory and lower accounts payable as compared to the prior fiscal year end, partially offset by higher net income and lower accounts receivable as compared to the prior fiscal year end.

The increase in net cash used in investing activities for the three and six months ended March 31, 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 decrease in net cash used by financing activities for the three months ended March 31, 2008 was primarily the result of a slight decrease in debt repayments and the timing of dividend payments. For the six months ended March 31, 2008, the increase was due to higher debt repayments.

The majority of the capital spending for property, plant and equipment in the three and six months ended March 31, 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 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.

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

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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 March 31, 2008, the Company has concluded that it does not have any material assets whose recovery is at risk.

*Capitalization*

(In millions)	March 31 2008	September 30, 2007	Change	March 31, 2007	Change
Short-term debt	\$ 574	\$ 264	117%	\$ 361	59%
Long-term debt	3,744	4,154	-10%	4,260	-12%
Shareholders equity	9,595	8,907	8%	7,815	23%
Total capitalization	\$ 13,913	\$ 13,325	4%	\$ 12,436	12%
Total debt as a % of total capitalization	31.0%	33.2%		37.2%	

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, commercial paper and the new three year, floating rate yen loan to repay the notes.

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 March 31, 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 money market loans in both U.S. dollars and Euros. The Company estimates that, as of March 31, 2008, it could borrow up to \$1 billion at its current debt ratings in money market loans.

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 March 31, 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.

**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 first quarter of fiscal 2010 (October 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.

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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.

**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.



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

At March 31, 2008, the Company did not experience 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 March 31, 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 March 31, 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 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

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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**

There are no material changes to the disclosure regarding risk factors presented in Item 1A to the Company's Annual Report on Form 10-K for the year ended September 30, 2007.

**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 March 31, 2008. There were no purchases by Citibank in the three or six months ended March 31, 2008.

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 March 31, 2008.

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Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of the Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased under the Programs
1/1/08 1/31/08 Purchases by Company (1)	423,089	\$ 33.40	279,600	\$ 107,300,792
2/1/08 2/29/08 Purchases by Company (1)				\$ 107,300,792
3/1/08 3/31/08 Purchases by Company (1)	307,000	\$ 32.27	307,000	\$ 102,394,713
1/1/08 1/31/08 Purchases by Citibank (2)				\$ 48,382,000
2/1/08 2/29/08 Purchases by Citibank (2)				\$ 58,702,000
3/1/08 3/31/08 Purchases by Citibank (2)				\$ 54,660,000

(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 36 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: May 6, 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
15	Letter of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm, dated May 6, 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.