JOHNSON CONTROLS INC
Form 10-Q
February 05, 2009

Table of Contents

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended December 31, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number: 1-5097

JOHNSON CONTROLS, INC.
(Exact name of registrant as specified in its charter)

Wisconsin	**39-0380010**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
5757 North Green Bay Avenue Milwaukee, Wisconsin	**53209**
(Address of principal executive offices)	*(Zip Code)*

(414) 524-1200
(Registrant s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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 þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

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

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

Class	**Shares Outstanding at December 31, 2008**
Common Stock: $0.017/18 par value per share	594,215,653

JOHNSON CONTROLS, INC.
Form 10-Q
Report Index

	Page
Part I. Financial Information	
Item 1. Financial Statements (unaudited)	
Condensed Consolidated Statements of Financial Position at December 31, 2008, September 30, 2008 and December 31, 2007	3
Consolidated Statements of Income for the Three Month Periods Ended December 31, 2008 and 2007	4
Condensed Consolidated Statements of Cash Flows for the Three Month Periods Ended December 31, 2008 and 2007	5
Notes to Condensed Consolidated Financial Statements	6
Report of Independent Registered Public Accounting Firm	20
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	21
Item 3. Quantitative and Qualitative Disclosures About Market Risk	31
Item 4. Controls and Procedures	31
Part II. Other Information	
Item 1. Legal Proceedings	32
Item 1A. Risk Factors	33
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	33
Item 4. Submission of Matters to a Vote of Security Holders	34
Item 6. Exhibits	34
Signatures	35

EX-15
EX-31.1
EX-31.2
EX-32

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	December 31, 2008	September 30, 2008	December 31, 2007
Assets			
Cash and cash equivalents	$ 202	$ 384	$ 407
Accounts receivable net	5,063	6,472	6,180
Inventories	1,935	2,099	2,070
Other current assets	1,517	1,721	1,572
Current assets	8,717	10,676	10,229
Property, plant and equipment net	4,115	4,389	4,214
Goodwill	6,392	6,513	6,251
Other intangible assets net	757	769	775
Investments in partially-owned affiliates	703	863	812
Other noncurrent assets	1,620	1,777	1,522
Total assets	$ 22,304	$ 24,987	$ 23,803
Liabilities and Shareholders Equity			
Short-term debt	$ 985	$ 456	$ 179
Current portion of long-term debt	452	287	896
Accounts payable	3,779	5,225	4,933
Accrued compensation and benefits	804	1,024	853
Accrued income taxes	59	117	108
Other current liabilities	2,462	2,701	2,283
Current liabilities	8,541	9,810	9,252
Long-term debt	3,176	3,201	3,249
Postretirement health and other benefits	228	236	297
Other noncurrent liabilities	1,817	2,080	1,802
Long-term liabilities	5,221	5,517	5,348
Commitments and contingencies (Note 17)			
Minority interests in equity of subsidiaries	229	236	133

Shareholders equity	8,313	9,424	9,070
Total liabilities and shareholders equity	$ 22,304	$ 24,987	$ 23,803

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

3

Table of Contents

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

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
Net sales		
Products and systems*	$ 5,647	$ 7,709
Services*	1,689	1,775
	7,336	9,484
Cost of sales		
Products and systems	5,273	6,742
Services	1,378	1,435
	6,651	8,177
Gross profit	685	1,307
Selling, general and administrative expenses	(859)	(950)
Net financing charges	(56)	(69)
Equity income (loss)	(136)	17
Income (loss) before income taxes and minority interests	(366)	305
Provision for income taxes	242	64
Minority interests in net earnings of subsidiaries		6
Net income (loss)	$ (608)	$ 235
Earnings (loss) per share		
Basic	$ (1.02)	$ 0.40
Diluted	$ (1.02)	$ 0.39

* Products and systems consist of automotive experience and power solutions products and systems and building efficiency

installed
systems.
Services are
building
efficiency
technical and
global
workplace
solutions.

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

4

Table of Contents

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

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
Operating Activities		
Net income (loss)	$ (608)	$ 235
Adjustments to reconcile net income (loss) to cash provided (used) by operating activities:		
Depreciation	181	181
Amortization of intangibles	9	10
Equity in earnings of partially-owned affiliates, net of dividends received	184	22
Minority interests in net earnings of subsidiaries		6
Deferred income taxes	300	9
Impairment charges	110	
Equity-based compensation	20	20
Other	15	19
Changes in working capital, excluding acquisitions:		
Accounts receivable	1,128	486
Inventories	78	(82)
Other current assets	85	96
Restructuring reserves	(52)	(14)
Accounts payable and accrued liabilities	(1,656)	(835)
Accrued income taxes	(111)	25
Cash provided (used) by operating activities	(317)	178
Investing Activities		
Capital expenditures	(268)	(187)
Sale of property, plant and equipment	3	15
Acquisition of businesses, net of cash acquired	(22)	(26)
Recoverable customer engineering expenditures	(22)	(4)
Settlement of cross-currency interest rate swaps		(32)
Changes in long-term investments	(48)	(12)
Cash used by investing activities	(357)	(246)
Financing Activities		
Increase (decrease) in short-term debt net	549	(87)
Increase in long-term debt		1
Repayment of long-term debt	(9)	(21)
Payment of cash dividends	(77)	(65)
Stock repurchases		(35)
Other	29	8

Cash provided (used) by financing activities	492	(199)
Decrease in cash and cash equivalents	$ (182)	$ (267)

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

Johnson Controls, Inc.
Notes to Condensed Consolidated Financial Statements
December 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) necessary to present fairly the financial position, results of operations and cash flows for the periods presented. Certain information and footnote disclosures included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted pursuant to the rules and regulations of the United States 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, 2008. The results of operations for the three month period ended December 31, 2008 are not necessarily indicative of results for the Company s 2009 fiscal year because of seasonal and other factors.

The consolidated financial statements include the accounts of Johnson Controls, Inc. and its domestic and non-U.S. subsidiaries that are consolidated in conformity with U.S. GAAP. All significant intercompany transactions have been eliminated. Investments in partially-owned affiliates are accounted for by the equity method when the Company s interest exceeds 20% and the company does not have a controlling interest.

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

Under certain criteria as provided for in Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 46(R), Consolidation of Variable Interest Entities an Interpretation of ARB No. 51, the Company may consolidate a partially-owned affiliate when it has less than a 50% ownership. In order to determine whether to consolidate a partially-owned affiliate when the Company has less than a 50% ownership, we first determine if the entity is a variable interest entity (VIE). An entity is considered to be a VIE if it has one of the following characteristics: 1) the entity is thinly capitalized; 2) residual equity holders do not control the entity; 3) equity holders are shielded from economic losses or do not participate fully in the entity s residual economics; or 4) the entity was established with non-substantive voting. If the entity meets one of these characteristics, we then determine if the Company is the primary beneficiary of the VIE. Under FIN 46(R), the party exposed to the majority of the risks and rewards associated with the VIE is the VIE s primary beneficiary and must consolidate the entity.

Based upon the criteria set forth in FIN 46(R), the Company has determined that at December 31, 2008, it was the primary beneficiary in two VIE s in which it holds less than 50% ownership as the Company funds the entities short-term liquidity needs. Both entities are consolidated within the automotive experience North America segment. The carrying amounts and classification of assets and liabilities included in our consolidated statements of financial position for these two consolidated entities are as follows (in millions):

	December 31, 2008	December 31, 2007
Current assets	$ 125	$ 15
Noncurrent assets	118	135
Total assets	$ 243	$ 150

Current liabilities	$	93	$	113
Noncurrent liabilities				
Total liabilities	$	93	$	113

As of December 31, 2008, the Company did not have a significant variable interest in any unconsolidated VIE s.

6

Table of Contents

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

2. New Accounting Standards

In May 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the accounting principles to be used in the preparation of the financial statements presented in conformity with U.S. GAAP. This statement is effective sixty days after approval by the SEC. The Company does not expect the effects of adopting SFAS No. 162 to be significant.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. SFAS No. 161 enhances required disclosures regarding derivatives and hedging activities, including how an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. SFAS No. 161 is effective for the Company beginning in the second quarter of fiscal 2009 (January 1, 2009). The Company has determined that the adoption of SFAS No. 161 will not be material to its consolidated financial condition and results of operation.

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 statement, 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. The Company adopted this statement effective October 1, 2008 and has not elected to measure any financial assets and financial liabilities at fair value which were not previously required to be measured at fair value. The adoption of this statement has had no impact on our 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. The Company adopted this statement effective October 1, 2008. The adoption of this

statement did not have a material impact on our consolidated financial condition and results of operation. See Note 14 for more information regarding the impact of the Company s adoption of SFAS No. 157. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed in the financial statements on a nonrecurring basis to fiscal years beginning after November 15, 2008. The Company has not applied the provisions of SFAS No. 157 to its nonfinancial assets and nonfinancial liabilities in accordance with FSP FAS 157-2 as of December 31, 2008. The provisions of SFAS No. 157 for

Table of Contents

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

nonfinancial assets and nonfinancial liabilities will be effective for the Company beginning in the first quarter of fiscal 2010 (October 1, 2009).

3. Acquisition of Businesses

During the first quarter of fiscal 2009, the Company completed one acquisition for a purchase price of $27 million, of which $22 million has been paid as of December 31, 2008. The acquisition is not material to the Company s consolidated financial statements. In connection with this acquisition, the Company recorded goodwill of $24 million. The purchase price allocation may be subsequently adjusted to reflect final valuation studies.

In the first quarter of fiscal 2008, the Company completed three acquisitions for a combined purchase price of $71 million, which were not material, individually or in aggregate, to the Company s consolidated financial statements. In connection with these acquisitions, the Company recorded goodwill of $45 million.

4. 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 $613 million, $670 million and $629 million at December 31, 2008, September 30, 2008, and December 31, 2007, respectively. Amounts included within other current liabilities were $625 million, $654 million and $555 million at December 31, 2008, September 30, 2008, and December 31, 2007, respectively.

5. Inventories

Inventories consisted of the following (in millions):

	December 31, 2008	September 30, 2008	December 31, 2007
Raw materials and supplies	$ 846	$ 902	$ 878
Work-in-process	284	324	323
Finished goods	917	985	931
FIFO inventories	2,047	2,211	2,132
LIFO reserve	(112)	(112)	(62)
Inventories	$ 1,935	$ 2,099	$ 2,070

6. Goodwill and Other Intangible Assets

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

Table of Contents

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

	December 31, 2007	Business Acquisitions	Currency Translation and Other	September 30, 2008
Building efficiency				
North America systems	$ 505	$ 10	$	$ 515
North America service	659	(2)		657
North America unitary products	481			481
Global workplace solutions	181	6	(9)	178
Europe	401		27	428
Rest of world	563		11	574
Automotive experience				
North America	1,182	178	(4)	1,356
Europe	1,191	7	21	1,219
Asia	198		2	200
Power solutions	890		15	905
Total	$ 6,251	$ 199	$ 63	$ 6,513

	September 30, 2008	Business Acquisitions	Currency Translation and Other	December 31, 2008
Building efficiency				
North America systems	$ 515	$	$	$ 515
North America service	657			657
North America unitary products	481			481
Global workplace solutions	178			178
Europe	428		(10)	418
Rest of world	574	24	(66)	532
Automotive experience				
North America	1,356		(2)	1,354
Europe	1,219		(64)	1,155
Asia	200		14	214
Power solutions	905		(17)	888
Total	$ 6,513	$ 24	$ (145)	$ 6,392

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

December 31, 2008		September 30, 2008		December 31, 2007	
Gross Carrying	Accumulated	Gross Carrying	Accumulated	Gross Carrying	Accumulated

	Amount	Amortization	Net	Amount	Amortization	Net	Amount	Amortization	Net
Amortized intangible assets									
Patented technology	$298	$ (170)	$128	$ 302	$ (168)	$134	$317	$ (153)	$164
Unpatented technology	23	(10)	13	25	(11)	14	24	(9)	15
Customer relationships	343	(45)	298	344	(42)	302	327	(31)	296
Miscellaneous	33	(12)	21	35	(13)	22	15	(10)	5
Total amortized intangible assets	697	(237)	460	706	(234)	472	683	(203)	480
Unamortized intangible assets									
Trademarks	297		297	297		297	295		295
Total intangible assets	$994	$ (237)	$757	$1,003	$ (234)	$769	$978	$ (203)	$775

Amortization of other intangible assets for each of the three months ended December 31, 2008 and 2007 was $9 million. Excluding the impact of any future acquisitions, the Company anticipates amortization of other intangible assets will average approximately $33 million per year over the next five years.

7. 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

Table of Contents

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

factors, the adequacy of the Company s warranty provisions are adjusted as necessary. While the Company s warranty costs have historically been within its calculated estimates, 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 three months ended December 31, 2008 and 2007 was as follows (in millions):

	2008	2007
Balance as of September 30	$ 204	$ 186
Accruals for warranties issued during the period	47	39
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	(55)	(26)
Currency translation	(5)	1
Balance as of December 31	$ 191	$ 199

8. Restructuring Costs

To better align the Company s resources with its growth strategies while reducing the cost structure of its global operations, the Company committed to a restructuring plan (2008 Plan) in the fourth quarter of fiscal 2008 and recorded a $495 million restructuring charge. The restructuring charge relates to cost reduction initiatives in its automotive experience, building efficiency and power solutions businesses and includes workforce reductions and plant consolidations. The Company expects to substantially complete the initiative by early 2010. The automotive-related restructuring is in response to the fundamentals of the European and North American automotive markets. The actions target reductions in the Company s cost base by decreasing excess manufacturing capacity due to lower industry production and the continued movement of vehicle production to low-cost countries, especially in Europe. The restructuring actions in building efficiency are primarily in Europe where the Company is centralizing certain functions and rebalancing its resources to target the geographic markets with the greatest potential growth. Power solutions actions are focused on optimizing its regional manufacturing capacity.

The 2008 Plan includes workforce reductions of approximately 9,400 employees (3,700 for automotive experience North America, 3,400 for automotive experience Europe, 300 for building efficiency North America, 900 for building efficiency Europe, 600 for building efficiency rest of world, and 500 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 December 31, 2008, approximately 3,700 of the employees have been separated from the Company pursuant to the 2008 Plan. In addition, the 2008 Plan includes 21 plant closures (9 for automotive experience North America, 9 for automotive experience Europe, 1 for building efficiency North America, and 2 for power solutions). As of December 31, 2008, 4 of the 21 plants have been closed. The restructuring charge for the impairment of 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 2008 Plan reserve, included within other current liabilities in the consolidated statements of financial position (in millions):

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

	Employee Severance and Termination Benefits	Other	Currency Translation	Total
Balance at September 30, 2008	$ 435	$ 9	$	$ 444
Utilized Cash	(47)			(47)
Utilized Noncash			(17)	(17)
Balance at December 31, 2008	$ 388	$ 9	$ (17)	$ 380

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, lead to additional impairment charges and/or require additional restructuring of its operations.

9. 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 in the consolidated statements of income. A portion of the costs associated with these activities is reimbursed by customers. Such expenditures amounted to $105 million and $123 million for the three months ended December 31, 2008 and 2007, respectively, net of customer reimbursements of $87 million and $77 million for the three months ended December 31, 2008 and 2007, respectively.

10. Income Taxes

The more significant discrete period items affecting the Company s income tax provision for the three months ended December 31, 2008 and 2007 are as follows (in millions):

	Three months ended December 31,			
	2008	Tax rate	2007	Tax rate
Income taxes at annual effective rate	$ (88)	24.0%	$ 64	21.0%
Discrete period items:				
Valuation allowance adjustments	300			
Impairment charges	30			
Provision for income taxes	$ 242	-66.1%	$ 64	21.0%

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 annual 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. In the current fiscal quarter, the Company s estimated annual effective income tax rate of 24% is greater than the prior year rate of 21%, primarily due to losses in jurisdictions for which no tax benefit is recognized.

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

Valuation Allowance

The Company reviews its deferred tax asset valuation allowances on a quarterly basis. In determining the potential need for a valuation allowance, the historical and projected financial results of the legal entity or consolidated group recording the net deferred tax asset are 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.

In the first quarter of fiscal 2009, the Company performed an analysis of its worldwide deferred tax assets. As a result of the rapid deterioration in the economic environment, several jurisdictions incurred unexpected losses in the first quarter that resulted in cumulative losses over the prior three years. As a result, and after considering tax planning initiatives and other positive and negative evidence, the Company determined that it was more likely than not that the deferred tax assets would not be utilized in several jurisdictions including France, Mexico, Spain and the United Kingdom. Therefore, the Company recorded $300 million of valuation allowances as income tax expense. To the extent the Company improves its underlying operating results in these jurisdictions, these valuation allowances, or a portion thereof, could be reversed in future periods.

Impairment Charges

In the first quarter of fiscal 2009, the Company recorded a $30 million discrete period tax adjustment related to first quarter 2009 impairment costs using a blended statutory tax rate of 12.6%.

Uncertain Tax Positions

In June 2006, FASB issued FIN 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 prior year business combinations. 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 net change in interest and penalties during the three months ended December 31, 2008 was not material. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense or goodwill, when applicable.

The Company is subject to income taxes in the United States 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 the major jurisdictions noted below:

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
Spain	4 years
United Kingdom	6 years
U.S. Federal	3 years
U.S. State	3 to 5 years

Table of Contents

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

In the United States, the 2004 through 2006 fiscal years are currently under exam by the Internal Revenue Service (IRS) and the fiscal years 1999 to 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	2004	2005
Belgium	2006	2007
Canada	2004	2006
France	2005	2007
Germany	2001	2003
Italy	2004	2005
Spain	2003	2005

It is reasonably possible that certain tax examinations, appellate proceedings and/or tax litigation will conclude within the next 12 months, which may result in favorable tax reserve adjustments in an amount not to exceed $100 million.

11. 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 (in millions):

	Pension Plans			
	U.S. Plans Three Months Ended December 31,		Non -U.S. Plans Three Months Ended December 31,	
	2008	2007	2008	2007
Service cost	$ 17	$ 20	$ 8	$ 10
Interest cost	40	35	16	18
Expected return on plan assets	(45)	(42)	(13)	(17)
Amortization of net actuarial loss	1	2	1	2
Net periodic benefit cost	$ 13	$ 15	$ 12	$ 13

	Postretirement Health and Other Benefits Three Months Ended December 31,	
	2008	2007
Service cost	$ 1	$ 1
Interest cost	5	4
Amortization of net actuarial gain	(1)	
Amortization of prior service cost	(2)	(2)
Net periodic benefit cost	$ 3	$ 3

12. Earnings Per Share

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

13

Table of Contents

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

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
Income Available to Common Shareholders		
Basic and diluted income (loss) available to common shareholders	$ (608)	$ 235
Weighted Average Shares Outstanding		
Basic weighted average shares outstanding	593.5	593.3
Effect of dilutive securities:		
Stock options		9.6
Diluted weighted average shares outstanding	593.5	602.9
Antidilutive Securities		
Options to purchase common shares		0.6

For the three months ended December 31, 2008, the total number of potential dilutive options was 1.5 million. However, these options were not included in the computation of diluted net loss per common share for the quarter since to do so would decrease the loss per share.

On November 19, 2008, the Company declared a quarterly dividend of $0.13 per common share payable January 5, 2009, to shareholders of record on December 12, 2008. On November 14, 2007, the Company declared a quarterly dividend of $0.13 per common share payable January 3, 2008, to shareholders of record on December 14, 2007.

13. Comprehensive Income

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

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
Net income (loss)	$ (608)	$ 235
Realized and unrealized losses on derivatives	(38)	(51)
Foreign currency translation adjustments	(398)	124
Other comprehensive income (loss)	(436)	73
Comprehensive income (loss)	$ (1,044)	$ 308

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 statement 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 accumulated 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 unfavorable foreign currency translation adjustments (CTA) for the three months ended December 31, 2008 were primarily due to the weakening of the euro 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 the sale or liquidation of the related foreign subsidiary. The outstanding net investment

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

hedges had an unfavorable impact of $42 million and $26 million to the accumulated other comprehensive income account for the quarters ending December 31, 2008 and 2007, respectively.

14. Fair Value Measurements

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. In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed in the financial statements on a nonrecurring basis to fiscal years beginning after November 15, 2008. The Company has not applied the provisions of SFAS No. 157 to its nonfinancial assets and nonfinancial liabilities in accordance with FSP FAS 157-2 as of December 31, 2008.

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 also establishes a three-level fair value hierarchy that prioritizes information used in developing assumptions when pricing an asset or liability as follows:

Level 1: Observable inputs such as quoted prices in active markets;
Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
Level 3: Unobservable inputs where there is little or no market data, which requires the reporting entity to develop its own assumptions.

SFAS No. 157 requires the use of observable market data, when available, in making fair value measurements. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

Recurring Fair Value Measurements

The following table presents the Company s fair value hierarchy for those assets and liabilities measured at fair value on a quarterly basis as of December 31, 2008 (in millions):

		Fair Value Measurements Using:		
	Total as of December 31, 2008	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cross-currency interest rate swap	$ 31	$	$ 31	$
Equity swap	1	1		
Total	$ 32	$ 1	$ 31	$
Liabilities				
Foreign currency exchange derivatives	$ 19	$ 19	$	$

Commodity derivatives	84		84	
Interest rate swaps and related debt	495		495	
Foreign currency denominated debt	1,165	1,165		
Total	$ 1,763	$ 1,184	$ 579	$

Valuation Methods

Cross-currency interest rate swap The Company selectively uses cross-currency interest rate swaps to hedge the foreign currency exposure associated with its foreign currency denominated debt obligations. The cross-currency interest rate swap is valued using market assumptions. The currency effects of the swap and related debt obligation are reflected in the consolidated statement of income and the change in value of the swap and debt obligation offset. The Company settled its cross-currency interest rate swap in the second quarter of fiscal 2009.

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

Equity swap The Company selectively uses equity swaps to reduce market risk associated with certain of its stock-based compensation plans, such as its deferred compensation plans and stock appreciation rights. The equity swaps are valued under a market approach as the fair value of the swaps is equal to the Company s stock price at the reporting period date. Changes in fair value on the equity swaps are reflected in the consolidated statement of income. The Company settled its equity swap in the second quarter of fiscal 2009.

Foreign currency exchange derivatives The Company selectively hedges anticipated transactions that are subject to foreign exchange exposure primarily using foreign currency exchange hedge contracts. The foreign currency exchange derivatives are valued under a market approach using publicized spot and forward prices. As cash flow hedges, the effective portion of the hedge gains or losses due to changes in fair value are initially recorded as a component of accumulated other comprehensive income and are subsequently reclassified into earnings when the hedged transactions occur and affect earnings. Any ineffective portion of the hedge is reflected in the consolidated statement of income. These contracts are highly effective in hedging the variability in future cash flows attributable to changes in currency exchange rates at December 31, 2008.

Commodity derivatives The Company selectively hedges anticipated transactions that are subject to commodity price exposure primarily using commodity hedge contracts. The commodity derivatives are valued under a market approach using publicized prices, where available, or dealer quotes. As cash flow hedges, the effective portion of the hedge gains or losses due to changes in fair value are initially recorded as a component of accumulated other comprehensive income and are subsequently reclassified into earnings when the hedged transactions, typically sales or cost related to sales, occur and affect earnings. Any ineffective portion of the hedge is reflected in the consolidated statement of income. These contracts are highly effective in hedging the variability in future cash flows attributable to changes in commodity price changes at December 31, 2008.

Interest rate swaps and related debt The Company selectively uses interest rate swaps to reduce market risk associated with changes in interest rates for its fixed-rate bonds (fair value hedges). The interest rate swaps and related debt balances are valued under a market approach using publicized swap curves. Changes in the fair value of the swap and hedged portion of the debt are recorded in the consolidated statement of income. The Company settled all of its interest rate swaps in the second quarter of fiscal 2009.

Foreign currency denominated debt The Company has entered into certain foreign currency denominated debt obligations to selectively hedge portions of its net investment in Japan. The currency effects of the debt obligations are reflected in the foreign currency translation adjustments component of accumulated other comprehensive income where they offset gains and losses recorded on the Company s net investment in Japan. The Company also has certain foreign currency denominated debt obligations not designated as net investment hedges, and the currency effects of the related debt obligations are reflected in the consolidated statement of income. The Company s foreign denominated debt obligations are valued under a market approach using publicized spot prices. On January 17, 2009, the Company retired its 24 billion yen, three year, floating rate loan agreement that matured.

15. Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the asset s carrying amount may not be recoverable. The Company conducts its long-lived asset impairment analyses in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires the Company to group assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities and evaluate the asset group against the sum of the undiscounted future cash flows. If the undiscounted cash flows do not indicate the carrying amount of the asset group is recoverable, an

impairment charge is measured as the amount by which the carrying amount of the asset group exceeds its fair value. At December 31, 2008, in conjunction with the preparation of its financial statements, the Company concluded it had a triggering event requiring assessment of impairment of its long-lived assets due to the significant declines in the North American and European automotive sales volumes. As a result, the Company reviewed its long-lived assets for impairment and recorded a $110 million impairment charge

Table of Contents

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

in the first quarter of fiscal 2009, of which $77 million related to the North American automotive experience segment and $33 million related to the European automotive experience segment.

The Company reviews its equity investments for impairment whenever there is a loss in value of an investment which is other than a temporary decline. The Company conducts its equity investment impairment analyses in accordance with the Accounting Principles Board (APB) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. APB Opinion No. 18 requires the Company to record an impairment charge for a decrease in value of an investment when the decline in the investment is considered to be other than temporary. At December 31, 2008, in conjunction with the preparation of its financial statements, the Company concluded it had a triggering event requiring assessment of impairment of its equity investment in a 48%-owned joint venture with U.S. Airconditioning Distributors, Inc. (U.S. Air) due to the significant decline in North American residential housing construction starts, which has significantly impacted the financial results of the equity investment. The Company reviewed its equity investment in U.S. Air for impairment and as a result, recorded a $152 million impairment charge within its North American unitary products segment in the first quarter of fiscal 2009.

The Company concluded there were no other impairments at December 31, 2008. The Company will continue to monitor developments in the automotive and North American residential heating, ventilating and air conditioning (HVAC) industries as future adverse developments in these industries could lead to additional impairment charges.

16. 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

Building efficiency designs, produces, markets and installs HVAC and control systems that monitor, automate and integrate critical building segment equipment and conditions including HVAC, fire-safety and security in commercial buildings and in various industrial applications.

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.

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

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

Automotive experience

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

Power solutions

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

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

	Net Sales Three Months Ended December 31,	
	2008	2007
Building efficiency		
North America systems	$ 537	$ 512
North America service	532	541
North America unitary products	133	162
Global workplace solutions	728	781
Europe	572	665
Rest of world	585	583
	3,087	3,244
Automotive experience		
North America	1,403	1,819
Europe	1,439	2,401
Asia	289	369
	3,131	4,589
Power solutions	1,118	1,651

Total net sales	$ 7,336	$ 9,484

Table of Contents

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

	Segment Income Three Months Ended December 31,	
	2008	2007
Building efficiency		
North America systems	$ 55	$ 49
North America service	34	26
North America unitary products	(176)	(9)
Global workplace solutions	6	18
Europe	12	26
Rest of world	48	53
	(21)	163
Automotive experience		
North America	(170)	10
Europe	(147)	75
Asia	(12)	(7)