

TENNECO INC  
Form 10-Q  
August 08, 2008

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

**FORM 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended June 30, 2008  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-12387

**TENNECO INC.**

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

**Delaware**

*(State or other jurisdiction of incorporation or  
organization)*

**76-0515284**

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

**500 North Field Drive, Lake Forest, Illinois**

*(Address of principal executive offices)*

**60045**

*(Zip Code)*

**Registrant's telephone number, including area code: (847) 482-5000**

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

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Yes  No

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

Common Stock, par value \$0.01 per share: 46,648,024 shares outstanding as of July 31, 2008.

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\* No response to this item is included herein for the reason that it is inapplicable or the answer to such item is negative.

### CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 concerning, among other things, our prospects and business strategies. These forward-looking statements are included in various sections of this report, including Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Part I, Item 2. The words may, will, believe, should, could, plans, expect, anticipated, estimates, and similar expressions (and variations thereof), identify forward-looking statements. Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, these expectations may not prove to be correct. Because these forward-looking statements are also subject to risks and uncertainties, actual results may differ materially from the expectations expressed in the forward-looking statements. Important factors that could cause actual results to differ materially from the expectations reflected in the forward-looking statements include:

changes in consumer demand, prices and our ability to have our products included on top selling vehicles, such as the recent significant shift in consumer preferences from light trucks and SUVs to other vehicles in light of higher fuel costs (because the percentage of our North American OE revenues related to light trucks and SUVs is greater than the percentage of the total North American light vehicle build rate represented by light trucks and SUVs, our North American OE business is sensitive to this change in consumer preferences), and other factors impacting the cyclical nature of automotive production and sales of automobiles which include our products, and the potential negative impact on our revenues and margins from such products;

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changes in automotive manufacturers' production rates and their actual and forecasted requirements for our products;

the overall highly competitive nature of the automotive parts industry, and our resultant inability to realize the sales represented by our awarded book of business (which is based on anticipated pricing for the applicable program over its life, and is subject to increases or decreases due to changes in customer requirements, customer and consumer preferences, and the number of vehicles actually produced by customers);

the loss of any of our large original equipment manufacturer ( OEM ) customers (on whom we depend for a substantial portion of our revenues), or the loss of market shares by these customers if we are unable to achieve increased sales to other OEMs;

general economic, business and market conditions, including without limitation the financial difficulties facing a number of companies in the automotive industry and the potential impact thereof on labor unrest, supply chain disruptions, weakness in demand and the collectibility of any accounts receivable due us from such companies;

labor disruptions at our facilities or any labor or other economic disruptions at any of our significant customers or suppliers or any of our customers' other suppliers (such as the recent strike at American Axle, which disrupted our supply of products for significant General Motors platforms);

increases in the costs of raw materials, including our ability to successfully reduce the impact of any such cost increases through materials substitutions, cost reduction initiatives, low cost country sourcing, and price recovery efforts with aftermarket and OE customers;

the cyclical nature of the global vehicle industry, including the performance of the global aftermarket sector and the longer product lives of automobile parts;

our continued success in cost reduction and cash management programs and our ability to execute restructuring and other cost reduction plans and to realize anticipated benefits from these plans;

costs related to product warranties;

the impact of consolidation among automotive parts suppliers and customers on our ability to compete;

operating hazards associated with our business;

changes in distribution channels or competitive conditions in the markets and countries where we operate, including the impact of changes in distribution channels for aftermarket products on our ability to increase or maintain aftermarket sales;

the negative impact of higher fuel prices on discretionary purchases of aftermarket products by consumers;

the cost and outcome of existing and any future legal proceedings;

economic, exchange rate and political conditions in the foreign countries where we operate or sell our products;

customer acceptance of new products;

new technologies that reduce the demand for certain of our products or otherwise render them obsolete;

our ability to realize our business strategy of improving operating performance;

capital availability or costs, including changes in interest rates, market perceptions of the industries in which we operate or ratings of securities;

our inability to successfully integrate any acquisitions that we complete;

changes by the Financial Accounting Standards Board or the Securities and Exchange Commission of authoritative generally accepted accounting principles or policies;

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potential legislation, regulatory changes and other governmental actions, including the ability to receive regulatory approvals and the timing of such approvals;

the impact of changes in and compliance with laws and regulations, including environmental laws and regulations, and environmental liabilities in excess of the amount reserved;

acts of war and/or terrorism, including, but not limited to, the events taking place in the Middle East, the current military action in Iraq and Afghanistan, the current situation in North Korea and the continuing war on terrorism, as well as actions taken or to be taken by the United States and other governments as a result of further acts or threats of terrorism, and the impact of these acts on economic, financial and social conditions in the countries where we operate; and

the timing and occurrence (or non-occurrence) of other transactions, events and circumstances which may be beyond our control.

The risks included here are not exhaustive. Refer to Part I, Item 1A Risk Factors in our annual report on Form 10-K for the year ended December 31, 2007, for further discussion regarding our exposure to risks. Additionally, new risk factors emerge from time to time and it is not possible for us to predict all such risk factors, nor to assess the impact such risk factors might have on our business or the extent to which any factor or combination of factors may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.



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**PART I.**

**FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of  
Tenneco Inc.**

We have reviewed the accompanying condensed consolidated balance sheet of Tenneco Inc. and consolidated subsidiaries (the Company) as of June 30, 2008, and the related condensed consolidated statements of income, cash flows, comprehensive income for the three-month and six-month periods ended June 30, 2008 and 2007, and of changes in shareholders' equity for the six-month periods ended June 30, 2008 and 2007. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews 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 (United States), 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 reviews, we are not aware of any material modifications that should be made to such 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 balance sheet of Tenneco Inc. and subsidiaries as of December 31, 2007, and the related consolidated statements of income (loss), cash flows, changes in shareholders' equity, and comprehensive income (loss) for the year then ended (not presented herein); and in our report dated February 29, 2008, we expressed an unqualified opinion on those consolidated financial statements and financial statement schedule and included an explanatory paragraph regarding the Company's adoption of the measurement date provisions of Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, as of January 1, 2007. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

**DELOITTE & TOUCHE LLP**

Chicago, Illinois  
August 7, 2008



Table of Contents**TENNECO INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

	<b>Three Months Ended June 30, 2008</b>	<b>Three Months Ended June 30, 2007</b>	<b>Six Months Ended June 30, 2008</b>	<b>Six Months Ended June 30, 2007</b>
	(Millions Except Share and Per Share Amounts)			
<b>Revenues</b>				
Net sales and operating revenues	\$ 1,651	\$ 1,663	\$ 3,211	\$ 3,063
<b>Costs and expenses</b>				
Cost of sales (exclusive of depreciation and amortization shown below)	1,383	1,377	2,709	2,556
Engineering, research, and development	34	29	70	56
Selling, general, and administrative	102	104	207	199
Depreciation and amortization of other intangibles	57	50	112	98
	1,576	1,560	3,098	2,909
<b>Other income (expense)</b>				
Loss on sale of receivables	(2)	(3)	(4)	(5)
Other income	2	3	5	3
			1	(2)
<b>Income before interest expense, income taxes, and minority interest</b>	<b>75</b>	<b>103</b>	<b>114</b>	<b>152</b>
Interest expense (net of interest capitalized of \$1 million and \$1 million for the three months ended June 30, 2008 and 2007, respectively, and \$3 million and \$2 million for the six months ended June 30, 2008 and 2007, respectively)	33	40	58	80
Income tax expense	27	20	32	22
Minority interest	2	2	5	4
<b>Net income</b>	<b>\$ 13</b>	<b>\$ 41</b>	<b>\$ 19</b>	<b>\$ 46</b>
<b>Earnings per share</b>				

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Weighted average shares of common stock  
outstanding

Basic	46,404,077	45,828,992	46,320,774	45,609,875
Diluted	47,729,214	47,680,883	47,719,218	47,415,922
Basic earnings per share of common stock	\$ 0.26	\$ 0.89	\$ 0.40	\$ 1.00
Diluted earnings per share of common stock	\$ 0.26	\$ 0.85	\$ 0.39	\$ 0.96

The accompanying notes to financial statements are an integral part of these statements of income.

**Table of Contents****TENNECO INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	<b>(Millions)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 164	\$ 188
Receivables		
Customer notes and accounts, net	907	732
Other	17	25
Inventories		
Finished goods	247	212
Work in process	198	175
Raw materials	128	111
Materials and supplies	48	41
Deferred income taxes	47	36
Prepayments and other	167	121
	1,923	1,641
Other assets:		
Long-term notes receivable, net	13	19
Goodwill	209	208
Intangibles, net	27	26
Deferred income taxes	336	370
Other	140	141
	725	764
Plant, property, and equipment, at cost	3,181	2,978
Less Accumulated depreciation and amortization	(1,937)	(1,793)
	1,244	1,185
	\$ 3,892	\$ 3,590
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Short-term debt (including current maturities of long-term debt)	\$ 46	\$ 46
Trade payables	1,074	987

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Accrued taxes	50	41
Accrued interest	21	22
Accrued liabilities	245	213
Other	39	49
	1,475	1,358
Long-term debt	1,446	1,328
Deferred income taxes	78	114
Postretirement benefits	285	288
Deferred credits and other liabilities	85	71
Commitments and contingencies		
Minority interest	33	31
Shareholders' equity:		
Common stock		
Premium on common stock and other capital surplus	2,805	2,800
Accumulated other comprehensive loss	(7)	(73)
Retained earnings (accumulated deficit)	(2,068)	(2,087)
	730	640
Less: Shares held as treasury stock, at cost	240	240
	490	400
	\$ 3,892	\$ 3,590

The accompanying notes to financial statements are an integral part of these balance sheets.

**Table of Contents****TENNECO INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>Three Months Ended June 30, 2008</b>	<b>Three Months Ended June 30, 2007</b>	<b>Six Months Ended June 30, 2008</b>	<b>Six Months Ended June 30, 2007</b>
	(Millions)			
<b>Operating Activities</b>				
Net income	\$ 13	\$ 41	\$ 19	\$ 46
Adjustments to reconcile net income to cash provided (used) by operating activities				
Depreciation and amortization of other intangibles	57	50	112	98
Deferred income taxes	(13)	(10)	(18)	(13)
Stock-based compensation	2	2	5	4
Loss on sale of assets	3	1	5	3
Changes in components of working capital				
(Increase) decrease in receivables	(61)	(111)	(148)	(312)
(Increase) decrease in inventories	(4)	3	(47)	(71)
(Increase) decrease in prepayments and other current assets	(22)	(13)	(40)	(24)
Increase (decrease) in payables	29	91	45	241
Increase (decrease) in accrued taxes	26		25	(4)
Increase (decrease) in accrued interest	(10)	2	(1)	(3)
Increase (decrease) in other current liabilities	26	13	11	19
Other	15	(2)	26	(10)
Net cash provided (used) by operating activities	61	67	(6)	(26)
<b>Investing Activities</b>				
Proceeds from the sale of assets	1	1	2	1
Cash payments for plant, property, and equipment	(64)	(36)	(127)	(75)
Acquisition of business	(19)		(19)	
Cash payments for software related intangible assets	(3)	(4)	(8)	(11)
Investments and other		1		2
Net cash used by investing activities	(85)	(38)	(152)	(83)
<b>Financing Activities</b>				
Issuance of common shares		2	1	4
Issuance of long-term debt				150
Debt issuance cost of long-term debt				(6)

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Retirement of long-term debt		(2)	(3)	(359)
Net increase (decrease) in revolver borrowings and short-term debt excluding current maturities of long-term debt	30	(7)	121	273
Distributions to minority interest partners	(2)		(4)	(1)
Other		(1)		
Net cash provided (used) by financing activities	28	(8)	115	61
Effect of foreign exchange rate changes on cash and cash equivalents	(1)	11	19	14
Increase (decrease) in cash and cash equivalents	3	32	(24)	(34)
Cash and cash equivalents, April 1 and January 1, respectively	161	136	188	202
Cash and cash equivalents, June 30 (Note)	\$ 164	\$ 168	\$ 164	\$ 168
<b>Supplemental Cash Flow Information</b>				
Cash paid during the period for interest	\$ 39	\$ 35	\$ 61	\$ 77
Cash paid during the period for income taxes (net of refunds)	\$ 12	\$ 20	\$ 24	\$ 28
<b>Non-cash Investing and Financing Activities</b>				
Period ended balance of payable for plant, property, and equipment	\$ 22	\$ 15	\$ 22	\$ 15

**Note:** Cash and cash equivalents include highly liquid investments with a maturity of three months or less at the date of purchase.

The accompanying notes to financial statements are an integral part of these statements of cash flows.



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## TENNECO INC.

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(Unaudited)

	Six Months Ended June 30,			
	2008		2007	
	Shares	Amount	Shares	Amount
	(Millions Except Share Amounts)			
<b>Common Stock</b>				
Balance January 1	47,892,532	\$	47,085,274	\$
Issued pursuant to benefit plans	233,315		228,036	
Stock options exercised	84,409		383,660	
Balance June 30	48,210,256		47,696,970	
<b>Premium on Common Stock and Other Capital Surplus</b>				
Balance January 1		2,800		2,790
Premium on common stock issued pursuant to benefit plans		5		5
Balance June 30		2,805		2,795
<b>Accumulated Other Comprehensive Loss</b>				
Balance January 1		(73)		(252)
Measurement date implementation of SFAS No. 158, net of tax of \$7 million				14
Other comprehensive income		66		41
Balance June 30		(7)		(197)
<b>Retained Earnings (Accumulated Deficit)</b>				
Balance January 1		(2,087)		(2,072)
Net income		19		46
Measurement date implementation of SFAS No. 158, net of tax				(5)
Other				(1)
Balance June 30		(2,068)		(2,032)
<b>Less Common Stock Held as Treasury Stock, at Cost</b>				
Balance January 1 and June 30	1,294,692	240	1,294,692	240

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Total	\$ 490	\$ 326
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The accompanying notes to financial statements are an integral part of these statements of changes in shareholders' equity.

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## TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)

	Three Months Ended June 30,			
	2008		2007	
	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
	(Millions)			
<b>Net Income</b>		\$ 13		\$ 41
<b>Accumulated Other Comprehensive Income (Loss)</b>				
<b>Cumulative Translation Adjustment</b>				
Balance April 1	\$ 139		\$ (41)	
Translation of foreign currency statements	12	12	29	29
Balance June 30	151		(12)	
<b>Additional Liability for Pension Benefits</b>				
Balance April 1 and June 30	(158)		(185)	
Balance June 30	\$ (7)		\$ (197)	
<b>Other comprehensive income</b>		12		29
<b>Comprehensive Income</b>		\$ 25		\$ 70

	Six Months Ended June 30,			
	2008		2007	
	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
	(Millions)			
<b>Net Income</b>		\$ 19		\$ 46

**Accumulated Other Comprehensive Income (Loss)**

**Cumulative Translation Adjustment**

Balance January 1	\$	85		\$	(53)	
Translation of foreign currency statements		66	66		41	41

Balance June 30		151			(12)	
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**Additional Liability for Pension Benefits**

Balance January 1		(158)			(199)	
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Measurement date implementation of SFAS No. 158, net of tax of \$7 million					14	
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Balance June 30		(158)			(185)	
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Balance June 30	\$	(7)		\$	(197)	
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<b>Other comprehensive income</b>			66			41
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<b>Comprehensive Income</b>			\$	85		\$	87
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The accompanying notes to financial statements are an integral part of these statements of comprehensive income.

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**TENNECO INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

(1) As you read the accompanying financial statements you should also read our Annual Report on Form 10-K for the year ended December 31, 2007.

In our opinion, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly Tenneco Inc.'s financial position, results of operations, cash flows, changes in shareholders' equity, and comprehensive income (loss) for the periods indicated. We have prepared the unaudited condensed consolidated financial statements pursuant to the rules and regulations of the U.S. Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for annual financial statements.

Our condensed consolidated financial statements include all majority-owned subsidiaries. We carry investments in 20 percent to 50 percent owned companies as an equity method investment, at cost plus equity in undistributed earnings since the date of acquisition and cumulative translation adjustments. We have eliminated intercompany transactions.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158 Employers' Accounting for Defined Benefit and Other Postretirement Plans. Effective January 1, 2007, Tenneco elected to early-adopt the measurement date provisions of SFAS No. 158. We previously presented the transition adjustment as part of other comprehensive income in our statement of comprehensive income and statement of changes in shareholders' equity for the six month period ended June 30, 2007. The transition adjustment should have been reported as a direct adjustment to the balance of accumulated other comprehensive income (loss) as of June 30, 2007. Comprehensive income for the six month period ended June 30, 2007 was previously reported as \$55 million. The amount of comprehensive income for the six month period should have been reported as \$41 million. The previously reported amount of other comprehensive income for the six month period ended June 30, 2007 was \$101 million and the amount that should have been reported is \$87 million. We have revised the presentation of comprehensive income and other comprehensive income for 2007 in the accompanying financial statements in this Form 10-Q. The statement of income, balance sheet and statement of cash flows were not affected.

(2) In September 2006, the FASB issued SFAS No. 157 Fair Value Measurement which is effective for financial statements issued for fiscal years beginning after November 15, 2007. We adopted SFAS No. 157 on January 1, 2008, with the exception of the application of this statement to non-recurring, nonfinancial assets and liabilities. The adoption of SFAS No. 157 did not have a material impact on our fair value measurements. SFAS No. 157 defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal most advantageous market for the asset or liability in an orderly transaction between market participants. SFAS No. 157 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into the following levels:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs, other than quoted prices in active markets, that are observable either directly or indirectly.

Level 3 Unobservable inputs based on our own assumptions.

The fair value of our recurring financial assets and liabilities at June 30, 2008 are as follows:

	<b>Level 1</b>	<b>Level 2 (Millions)</b>	<b>Level 3</b>
<b>Financial Liabilities:</b>			
Foreign exchange forward contracts	n/a	\$ 1	n/a
Interest rate swaps	n/a	\$	n/a
		\$ 1	

We did not have any financial assets requiring fair value measurements as of June 30, 2008.

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**TENNECO INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)

*Interest rate swaps* In April 2004, we entered into fixed-to-floating interest rate swaps covering \$150 million of our fixed interest rate debt. The fair value of our interest rate swap agreements are based on a model which incorporates observable inputs including LIBOR yield curves, the credit standing of the counterparties, nonperformance risk for similar cancelable forward option contracts, and discounted future expected cash flows utilizing market interest rates based on instruments with similar credit quality and maturities. The change in fair value of these swaps is recorded as part of interest expense and other long-term assets or liabilities.

*Foreign exchange forward contracts* We use foreign exchange forward purchase and sale contracts with terms of less than one year to hedge our exposure to changes in foreign currency exchange rates. The fair value of our foreign exchange forward contracts is based on a model which incorporates observable inputs including quoted spot rates, forward exchange rates and discounted future expected cash flows utilizing market interest rates with similar quality and maturity characteristics. The change in fair value of these foreign exchange forward contracts is recorded as part of currency gains (losses) and other current liabilities.

(3) Our financing arrangements are primarily provided by a committed senior secured financing arrangement with a syndicate of banks and other financial institutions. The arrangement is secured by substantially all our domestic assets and pledges of 66 percent of the stock of certain first-tier foreign subsidiaries, as well as guarantees by our material domestic subsidiaries.

On November 20, 2007, we issued \$250 million of 8 1/8 percent Senior Notes due November 15, 2015 through a private placement offering. The offering and related transactions were designed to (1) reduce our interest expense and extend the maturity of a portion of our debt (by using the proceeds of the offering to tender for \$230 million of our outstanding \$475 million 10 1/4 percent senior secured notes due 2013), (2) facilitate the realignment of the ownership structure of some of our foreign subsidiaries and (3) otherwise amend certain of the covenants in the indenture for the senior secured notes to be consistent with those contained in our 8 5/8 percent senior subordinated notes, including conforming the limitation on incurrence of indebtedness and the absence of a limitation on issuances or transfers of restricted subsidiary stock, and make other minor modifications.

In June 2008, we exchanged \$250 million principal amount of 8 1/8 percent Senior Notes due on 2015 which have been registered under the Securities Act of 1933, for and in replacement of all outstanding 8 1/8 percent Senior Notes due 2015 which we issued on November 20, 2007 in a private placement. The terms of the new notes are substantially identical to the terms of the notes for which they are being exchanged, except that the transfer restrictions and registration rights applicable to the original notes generally do not apply to the new notes.

The realignment was designed to allow us to more rapidly use our U.S. net operating losses and reduce our cash tax payments. The ownership structure realignment involved a new European holding company which owns some of our foreign entities. We may further alter the components of the realignment from time to time. If market conditions permit, we may offer debt issued by the new European holding company. This realignment utilized part of our U.S. net operating tax losses. Consequently, we recorded a non-cash charge of \$66 million in the fourth quarter of 2007.

In March 2007, we refinanced our \$831 million senior credit facility. This transaction reduced the interest rates we pay on all portions of the facility. While the total amount of the new senior credit facility is \$830 million,

approximately the same as the previous facility, we changed the components of the facility to enhance our financial flexibility. We increased the amount of commitments under our revolving loan facility from \$320 million to \$550 million, reduced the amount of commitments under our tranche B-1 letter of credit/revolving loan facility from \$155 million to \$130 million and replaced the \$356 million term loan B with a \$150 million term loan A. As of June 30, 2008, the senior credit facility consisted of a five-year, \$150 million term loan A maturing in March 2012, a five-year, \$550 million revolving credit facility maturing in March 2012, and a seven-year \$130 million tranche B-1 letter of credit/revolving loan facility maturing in March 2014.



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The refinancing of the prior facility allowed us to: (i) amend the consolidated net debt to EBITDA ratio, (ii) eliminate the fixed charge coverage ratio, (iii) eliminate the restriction on capital expenditures, (iv) increase the amount of acquisitions permitted to \$250 million, (v) improve the flexibility to repurchase and retire higher cost junior debt, (vi) increase our ability to enter into capital leases, (vii) increase the ability of our foreign subsidiaries to incur debt, (viii) increase our ability to pay dividends and repurchase common stock, (ix) increase our ability to invest in joint ventures, (x) allow for the increase in the existing tranche B-1 facility and/or the term loan A or the addition of a new term loan of up to \$275 million in order to reduce our 101/4 percent senior secured notes, and (xi) make other modifications.

Following the refinancing, the term loan A facility is payable in twelve consecutive quarterly installments, commencing June 30, 2009 as follows: \$6 million due each of June 30, September 30, December 31, 2009 and March 31, 2010, \$15 million due each of June 30, September 30, December 31, 2010 and March 31, 2011, and \$17 million due each of June 30, September 30, December 31, 2011 and March 16, 2012. The revolving credit facility requires that any amounts drawn be repaid by March 2012. Prior to that date, funds may be borrowed, repaid and reborrowed under the revolving credit facility without premium or penalty. Letters of credit may be issued under the revolving credit facility.

The tranche B-1 letter of credit/revolving loan facility requires that it be repaid by March 2014. We can borrow revolving loans and issue letters of credit under the \$130 million tranche B-1 letter of credit/revolving loan facility. The tranche B-1 letter of credit/revolving loan facility is reflected as debt on our balance sheet only if we borrow money under this facility or if we use the facility to make payments for letters of credit.

We have three fixed-to-floating interest rate swaps that effectively convert \$150 million of our 101/4 percent fixed interest rate senior secured notes into floating interest rate debt at an annual rate of LIBOR plus 5.68 percent. Based upon the current LIBOR rate of 4.08 percent (which was in effect until July 15, 2008) these swaps are expected to decrease our interest expense by \$1 million in 2008 excluding any impact from marking the swaps to market. Since entering into these swaps, we have realized a net cumulative benefit of \$3 million through June 30, 2008, in reduced interest payments. The change in the market value of these swaps is recorded as part of interest expense with an offset to other long-term assets or liabilities. As of June 30, 2008, the fair value of the interest rate swaps was a liability of less than \$1 million and has been recorded in other long-term liabilities.

(4) We have an agreement to sell an interest in some of our U.S. trade accounts receivable to a third party. Receivables become eligible for the program on a daily basis, at which time the receivables are sold to the third party without recourse, net of a discount, through a wholly-owned subsidiary. Under this agreement, as well as individual agreements with third parties in Europe, we have sold accounts receivable of \$216 million and \$148 million at June 30, 2008 and 2007, respectively. We recognized a loss of \$2 million and \$3 million for the three months ended June 30, 2008 and 2007, respectively, and \$4 million and \$5 million for the six months ended June 30, 2008 and 2007, respectively, on these sales of trade accounts, representing the discount from book values at which these receivables were sold to the third party. The discount rate varies based on funding cost incurred by the third party, which has averaged approximately five percent during 2008. We retain ownership of the remaining interest in the pool of receivables not sold to the third party. The retained interest represents a credit enhancement for the program. We value the retained interest based upon the amount we expect to collect from our customers, which approximates book value.

(5) Over the past several years we have adopted plans to restructure portions of our operations. These plans were approved by the Board of Directors and were designed to reduce operational and administrative overhead costs throughout the business. Prior to the change in accounting required for exit or disposal activities, we recorded charges to income related to these plans for costs that did not benefit future activities in the period in which the plans were finalized and approved, while actions necessary to affect these restructuring plans occurred over future periods in accordance with established plans.

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Our recent restructuring activities began in the fourth quarter of 2001, when our Board of Directors approved a restructuring plan, a project known as Project Genesis, which was designed to lower our fixed costs, relocate capacity, reduce our work force, improve efficiency and utilization, and better optimize our global footprint. We have subsequently engaged in various other restructuring projects related to Project Genesis. We incurred \$27 million in restructuring and restructuring-related costs during 2007, of which \$23 million was recorded in cost of sales and \$4 million was recorded in selling, general and administrative expense. In the second quarter of 2008, we incurred \$6 million in restructuring and restructuring-related costs, of which \$3 million was recorded in cost of sales and \$3 million was recorded in selling, general and administrative expense. For the first six months of 2008, we incurred \$10 million in restructuring and restructuring-related costs of which \$6 million was recorded in cost of sales and \$4 million in selling, general and administrative expense. Since Project Genesis was initiated, we have incurred costs of \$165 million through June 30, 2008.

Under the terms of our amended and restated senior credit agreement that took effect on March 16, 2007, we are allowed to exclude \$80 million of cash charges and expenses, before taxes, related to cost reduction initiatives incurred after March 16, 2007 from the calculation of the financial covenant ratios required under our senior credit facility. As of June 30, 2008, we have excluded \$33 million in allowable charges relating to restructuring initiatives against the \$80 million available under the terms of the March 2007 amended and restated senior credit facility.

In addition to the announced actions, we will continue to evaluate additional opportunities and expect that we will initiate actions that will reduce our costs through implementing the most appropriate and efficient logistics, distribution and manufacturing footprint for the future. We expect to continue to undertake additional restructuring actions as deemed necessary, however, there can be no assurances we will undertake such actions. Actions that we take, if any, will require the approval of our Board of Directors, or its authorized committee. We plan to conduct any workforce reductions that result in compliance with all legal and contractual requirements including obligations to consult with workers' councils, union representatives and others.

(6) We are subject to a variety of environmental and pollution control laws and regulations in all jurisdictions in which we operate. We expense or capitalize, as appropriate, expenditures for ongoing compliance with environmental regulations that relate to current operations. We expense costs related to an existing condition caused by past operations that do not contribute to current or future revenue generation. We record liabilities when environmental assessments indicate that remedial efforts are probable and the costs can be reasonably estimated. Estimates of the liability are based upon currently available facts, existing technology, and presently enacted laws and regulations taking into consideration the likely effects of inflation and other societal and economic factors. We consider all available evidence including prior experience in remediation of contaminated sites, other companies' cleanup experiences and data released by the United States Environmental Protection Agency or other organizations. These estimated liabilities are subject to revision in future periods based on actual costs or new information. Where future cash flows are fixed or reliably determinable, we have discounted the liabilities. All other environmental liabilities are recorded at their undiscounted amounts. We evaluate recoveries separately from the liability and, when they are assured, recoveries are recorded and reported separately from the associated liability in our condensed consolidated financial statements.

As of June 30, 2008, we are designated as a potentially responsible party in one Superfund site. Including the Superfund site, we may have the obligation to remediate current or former facilities, and we estimate our share of

environmental remediation costs at these facilities to be approximately \$11 million. For the Superfund site and the current and former facilities, we have established reserves that we believe are adequate for these costs. Although we believe our estimates of remediation costs are reasonable and are based on the latest available information, the cleanup costs are estimates and are subject to revision as more information becomes available about the extent of remediation required. At some sites, we expect that other parties will contribute to the remediation costs. In addition, at the Superfund site, the Comprehensive Environmental Response, Compensation and Liability Act provides that our liability could be joint and several, meaning that we could be required to pay in excess of our share

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of remediation costs. Our understanding of the financial strength of other potentially responsible parties at the Superfund site, and of other liable parties at our current and former facilities, has been considered, where appropriate, in our determination of our estimated liability. We believe that any potential costs associated with our current status as a potentially responsible party in the Superfund site, or as a liable party at our current or former facilities, will not be material to our consolidated results of operations, financial position or cash flows.

We also from time to time are involved in legal proceedings, claims or investigations that are incidental to the conduct of our business. Some of these proceedings allege damages against us relating to environmental liabilities (including toxic tort, property damage and remediation), intellectual property matters (including patent, trademark and copyright infringement, and licensing disputes), personal injury claims (including injuries due to product failure, design or warnings issues, and other product liability related matters), taxes, employment matters, and commercial or contractual disputes, sometimes related to acquisitions or divestitures. We vigorously defend ourselves against all of these claims. In future periods, we could be subjected to cash costs or non-cash charges to earnings if any of these matters is resolved on unfavorable terms. However, although the ultimate outcome of any legal matter cannot be predicted with certainty, based on current information, including our assessment of the merits of the particular claim, we do not expect that these legal proceedings or claims will have any material adverse impact on our future consolidated financial position, results of operations or cash flows.

In addition, we are subject to a number of lawsuits initiated by a significant number of claimants alleging health problems as a result of exposure to asbestos. A small percentage of claims have been asserted by railroad workers alleging exposure to asbestos products in railroad cars manufactured by The Pullman Company, one of our subsidiaries. Nearly all of the claims are related to alleged exposure to asbestos in our automotive emission control products. Only a small percentage of these claimants allege that they were automobile mechanics and a significant number appear to involve workers in other industries or otherwise do not include sufficient information to determine whether there is any basis for a claim against us. We believe, based on scientific and other evidence, it is unlikely that mechanics were exposed to asbestos by our former muffler products and that, in any event, they would not be at increased risk of asbestos-related disease based on their work with these products. Further, many of these cases involve numerous defendants, with the number of each in some cases exceeding 200 defendants from a variety of industries. Additionally, the plaintiffs either do not specify any, or specify the jurisdictional minimum, dollar amount for damages. As major asbestos manufacturers continue to go out of business or file for bankruptcy, we may experience an increased number of these claims. We vigorously defend ourselves against these claims as part of our ordinary course of business. In future periods, we could be subject to cash costs or non-cash charges to earnings if any of these matters is resolved unfavorably to us. To date, with respect to claims that have proceeded sufficiently through the judicial process, we have regularly achieved favorable resolution. During the first half of 2008, we were dismissed from over 635 of such cases. Accordingly, we presently believe that these asbestos-related claims will not have a material adverse impact on our future consolidated financial condition, results of operations or cash flows.

We provide warranties on some of our products. The warranty terms vary but range from one year up to limited lifetime warranties on some of our premium aftermarket products. Provisions for estimated expenses related to product warranty are made at the time products are sold or when specific warranty issues are identified on OE products. These estimates are established using historical information about the nature, frequency, and average cost of warranty claims. We actively study trends of our warranty claims and take action to improve product quality and minimize warranty claims. We believe that the warranty reserve is appropriate; however, actual claims incurred could

differ from the original estimates, requiring adjustments to the reserve. The reserve is included in both current and long-term liabilities on the balance sheet.

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Below is a table that shows the activity in the warranty accrual accounts:

	<b>Six Months Ended June 30, 2008      2007 (Millions)</b>	
Beginning Balance January 1,	\$ 25	\$ 25
Accruals related to product warranties	8	7
Reductions for payments made	(6)	(5)
Ending Balance June 30,	\$ 27	\$ 27

(7) Earnings per share of common stock outstanding were computed as follows:

	<b>Three Months Ended June 30, 2008</b>		<b>Three Months Ended June 30, 2007</b>		<b>Six Months Ended June 30, 2008</b>		<b>Six Months Ended June 30, 2007</b>	
	<b>(Millions Except Share and Per Share Amounts)</b>							
Basic earnings per share								
Net Income	\$	13	\$	41	\$	19	\$	46
Average shares of common stock outstanding		46,404,077		45,828,992		46,320,774		45,609,875
Earnings per average share of common stock	\$	0.26	\$	0.89	\$	0.40	\$	1.00
Diluted earnings per share								
Net Income	\$	13	\$	41	\$	19	\$	46
Average shares of common stock outstanding		46,404,077		45,828,992		46,320,774		45,609,875
Effect of dilutive securities:								
Restricted stock		42,862		139,897		93,229		203,090
Stock options		1,282,275		1,711,994		1,305,215		1,602,957
Average shares of common stock outstanding including dilutive securities		47,729,214		47,680,883		47,719,218		47,415,992

Earnings per average share of common stock	\$	0.26	\$	0.85	\$	0.39	\$	0.96
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Options to purchase 1,294,823 and 530,581 shares of common stock were outstanding at June 30, 2008 and 2007, respectively, but were not included in the computation of diluted EPS because the options were anti-dilutive for the quarters ended June 30, 2008 and 2007, respectively.

(8) *Equity Plans* In December 1996, we adopted the 1996 Stock Ownership Plan, which permitted the granting of a variety of awards, including common stock, restricted stock, performance units, stock equivalent units, stock appreciation rights ( SARs ), and stock options to our directors, officers, employees and consultants. The 1996 plan, which terminated as to new awards on December 31, 2001, was renamed the Stock Ownership Plan. In December 1999, we adopted the Supplemental Stock Ownership Plan, which permitted the granting of a variety of similar awards to our directors, officers, employees and consultants. We were authorized to deliver up to about 1.1 million treasury shares of common stock under the Supplemental Stock Ownership Plan, which also terminated as to new awards on December 31, 2001. In March 2002, we adopted the 2002 Long-Term Incentive Plan which permitted the granting of a variety of similar awards to our officers, directors, employees and consultants. Up to 4 million shares of our common stock were authorized for award under the 2002 Long-Term Incentive Plan. In March 2006, we adopted the 2006 Long-Term Incentive Plan which replaced the 2002 Long-Term Incentive Plan and permits the granting of a variety of similar awards to directors, officers, employees and consultants. As of



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June 30, 2008, up to 1,156,059 shares of our common stock remain authorized for award under the 2006 Long-Term Incentive Plan. Our nonqualified stock options have 7 to 20 year terms and vest equally over a three year service period from the date of the grant.

We have granted restricted common stock to our directors and certain key employees. These awards generally require, among other things, that the award holder remains in service to our company during the restriction period. We have also granted long-term performance units to certain key employees that are payable in cash. In 2008, the awards that are outstanding contain an annual stub-year grant payable in the first quarter of 2009, a three-year grant payable in the first quarter of 2010 and a second three year grant payable in the first quarter of 2011. Payment is based on the attainment of specified performance goals. The grant value is indexed to the stock price. Each employee granted long-term performance units will (based on the achievement of the applicable goals) receive a percentage of the total grant's value. In addition, we have granted SARs to certain key employees in our Asian operations that are payable in cash after a three year service period. The grant value is indexed to the stock price.

*Accounting Methods* Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment, using the modified prospective application method. Under this transition method, compensation cost recognized for the six months ended June 30, 2008 and 2007, respectively, includes the applicable amounts of: (1) compensation cost of all unvested stock-based awards granted prior to January 1, 2006, based upon the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and previously presented in pro-forma footnote disclosures, and (2) compensation cost for all stock-based awards granted on or after January 1, 2006, based upon the grant date fair value estimated in accordance with the new provisions of SFAS No. 123(R).

The impact of recognizing compensation expense related to nonqualified stock options is contained in the table below.

	<b>Six Months Ended June 30, 2008      2007 (Millions)</b>	
Selling, general and administrative	\$ 2	\$ 2
Loss before interest expense, income taxes and minority interest	(2)	(2)
Income tax benefit	1	1
Net loss	\$ (1)	\$ (1)
Decrease in basic earnings per share	\$ (0.03)	\$ (0.04)
Decrease in diluted earnings per share	\$ (0.03)	\$ (0.04)

For stock options awarded to retirement eligible employees we immediately accelerate the recognition of any outstanding compensation cost when employees become retiree eligible before the end of the explicit vesting period.

As of June 30, 2008, there was approximately \$4 million, net of tax, of total unrecognized compensation costs related to these stock-based awards that we expect to recognize over a weighted average period of 1.3 years.

Compensation expense for restricted stock, long-term performance units and SARs, net of tax, was approximately \$2 million for the six months ended June 30, 2008 and 2007, and was recorded in selling, general, and administrative expense on the statement of income.

SFAS No. 109, Accounting for Income Taxes, discusses the deductibility of transactions. We are allowed a tax deduction for compensation cost which is calculated as the difference between the value of the stock at the date of grant and the price upon exercise of a stock option. Under SFAS No. 123(R), excess tax benefits, which are tax benefits we may realize upon the exercise of stock options that are greater than the tax benefit recognized on the

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compensation cost recorded in our income statement, are recorded as an addition to paid-in capital. We would present cash retained as a result of excess tax benefits as financing cash flows. Any write-offs of deferred tax assets related to unrealized tax benefits associated with the recognized compensation cost would be reported as income tax expense.

Cash received from option exercises for the six months ended June 30, 2008, was \$1 million. Stock option exercises during the first six months of 2008 generated an excess tax benefit of approximately \$1 million. Pursuant to footnote 82 of SFAS No. 123(R), this benefit was not recorded as we have federal and state net operating losses which are not currently being utilized. As a result, the excess tax benefit had no impact on our financial position or statement of cash flows.

*Assumptions* We calculated the fair values of stock option awards using the Black-Scholes option pricing model with the weighted average assumptions listed below. The fair value of share-based awards is determined at the time the awards are granted which is generally in January of each year, and requires judgment in estimating employee and market behavior. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted.

	<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Stock Options		
Weighted average grant date fair value, per share	\$ 8.08	\$ 9.91
Weighted average assumptions used:		
Expected volatility	37.7%	38.4%
Expected lives	4.1	4.1
Risk-free interest rates	2.8%	4.7%
Dividend yields	0.0%	0.0%

Expected lives of options are based upon the historical and expected time to post-vesting forfeiture and exercise. We believe this method is the best estimate of the future exercise patterns currently available.

The risk-free interest rates are based upon the Constant Maturity Rates provided by the U.S. Treasury. For our valuations, we used the continuous rate with a term equal to the expected life of the options.

On January 10, 2001, we announced that our Board of Directors eliminated the quarterly dividend on our common stock. As a result, there is no dividend yield.

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*Stock Options* The following table reflects the status and activity for all options to purchase common stock for the period indicated:

	<b>Six Months Ended June 30, 2008</b>			
	<b>Shares Under Option</b>	<b>Weighted Avg. Exercise Prices</b>	<b>Weighted Avg. Remaining Life in Years</b>	<b>Aggregate Intrinsic Value (Millions)</b>
Outstanding Stock Options				
Outstanding, January 1, 2008	2,820,889	\$ 13.10	4.6	\$ 46
Granted	580,750	23.75		
Canceled				
Forfeited	(3,740)	22.50		
Exercised	(43,824)	4.64		\$ 1
Outstanding, March 31, 2008	3,354,075	\$ 15.05	5.0	\$ 37
Granted	3,306	25.26		
Canceled				
Forfeited	(14,528)	23.98		
Exercised	(40,585)	11.35		\$ 1
Outstanding, June 30, 2008	3,302,268	\$ 15.06	4.5	\$ 31

As previously disclosed, in certain years our administrative procedures for determining the final allocation of the options granted to middle management under our 2002 Long-Term Incentive Plan (the predecessor to our current equity incentive plan) were not finalized until after the Board approved the grants and set the exercise price. At the time the administrative procedures were completed, the market values of some of the options were greater than the grant prices. While these option-grant practices were not intended to avoid regulations or gain unfair financial advantage, they did result in monetary gains that current law (recently enacted Section 409A of the Internal Revenue Code) would subject to additional taxes and penalties.

*Restricted Stock* The following table reflects the status for all nonvested restricted shares for the period indicated:

**Six Months Ended  
June 30, 2008  
Weighted Avg.  
Grant Date**

	<b>Shares</b>		<b>Fair Value</b>
<b>Nonvested Restricted Shares</b>			
Nonvested balance at January 1, 2008	469,394	\$	24.91
Granted	227,830		23.75
Vested	(235,145)		24.10
Forfeited			
Nonvested balance at March 31, 2008	462,079	\$	24.75
Granted	1,653		25.26
Vested	(11,442)		23.80
Forfeited	(2,975)		24.48
Nonvested balance at June 30, 2008	449,315	\$	24.47

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The fair value of restricted stock grants is equal to the average market price of our stock at the date of grant. As of June 30, 2008, approximately \$9 million of total unrecognized compensation costs related to restricted stock awards is expected to be recognized over a weighted-average period of approximately 1.9 years.

*Long-Term Performance Units and SARs* Long-term performance units and SARs are paid in cash and recognized as a liability based upon their fair value. As of June 30, 2008, approximately \$1 million of total unrecognized compensation costs is expected to be recognized over the weighted-average period of approximately 2.0 years.

(9) Net periodic pension costs (income) and postretirement benefit costs (income) consist of the following components:

	<b>Three Months Ended June 30,</b>					
	<b>Pension</b>				<b>Postretirement</b>	
	<b>2008</b>		<b>2007</b>		<b>2008</b>	<b>2007</b>
	<b>US</b>	<b>Foreign</b>	<b>US</b>	<b>Foreign</b>	<b>US</b>	<b>US</b>
	<b>(Millions)</b>					
Service cost benefits earned during the period	\$ 1	\$ 2	\$ 1	\$ 2	\$	\$
Interest cost	5	4	5	5	3	3
Expected return on plan assets	(5)	(6)	(6)	(6)		
Net amortization:						
Actuarial loss		1		2	2	2
Prior service cost		1			(2)	(2)
Net pension and postretirement costs	\$ 1	\$ 2	\$	\$ 3	\$ 3	\$ 3

	<b>Six Months Ended June 30,</b>					
	<b>Pension</b>				<b>Postretirement</b>	
	<b>2008</b>		<b>2007</b>		<b>2008</b>	<b>2007</b>
	<b>US</b>	<b>Foreign</b>	<b>US</b>	<b>Foreign</b>	<b>US</b>	<b>US</b>
	<b>(Millions)</b>					
Service cost benefits earned during the period	\$ 1	\$ 4	\$ 1	\$ 4	\$ 1	\$ 1
Interest cost	10	8	10	9	5	5
Expected return on plan assets	(11)	(11)	(11)	(10)		
Net amortization:						
Actuarial loss	1	2	1	3	3	3
Prior service cost		1			(3)	(3)
Net pension and postretirement costs	\$ 1	\$ 4	\$ 1	\$ 6	\$ 6	\$ 6

Effective January 1, 2007, we froze our defined benefit plans and replaced them with additional contributions under defined contribution plans for nearly all U.S.-based salaried and non-union hourly employees.

In September 2006, the FASB issued Statement No. 158 Employers Accounting for Defined Benefit and Other Postretirement Plans. Effective January 1, 2007, Tenneco elected to early-adopt the measurement date provisions of SFAS No. 158. As a result, during the first quarter of 2007, the following adjustments were made to retained earnings (accumulated deficit) and accumulated other comprehensive income (both net of tax effects):

	<b>US</b>	<b>Foreign</b>
Retained earnings (accumulated deficit)	(3)	(2)
Accumulated other comprehensive income	8	6

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For the six months ended June 30, 2008, we made pension contributions of approximately \$3 million for our domestic pension plans and \$8 million for our foreign pension plans. Based on current actuarial estimates, we believe we will be required to make approximately \$18 million in contributions for the remainder of 2008.

We made postretirement contributions of approximately \$3 million during the first six months of 2008. Based on current actuarial estimates, we believe we will be required to make approximately \$7 million in contributions for the remainder of 2008.

(10) On July 9, 2008, we entered into a preliminary agreement to purchase the suspension business of Gruppo Marzocchi, an Italian based worldwide leader in supplying suspension technology in the two-wheeler market. If completed, the cost of this business acquisition would consist of the assumed debt of Marzocchi's suspension business, which was approximately \$15 million as of April 30, 2008, plus transaction costs. The final purchase agreement is dependent on a number of conditions including a legally-required consultation with the workers council representing Marzocchi's employees.

On May 30, 2008, we finalized the purchase agreement with Delphi Automotive Systems LLC to acquire certain ride control assets and inventory at Delphi's Kettering, Ohio facility which we will use to continue growing our OE ride control business globally. We paid approximately \$10 million for existing ride control components inventory and approximately \$9 million for certain machinery and equipment. In conjunction with the purchase agreement we have signed an agreement to lease a portion of the Kettering facility from Delphi and we have entered into a long-term supply agreement with General Motors Corporation to continue supplying passenger car shock and struts to General Motors from the Kettering facility. The final allocation of the purchase price for the assets will be completed within one year of acquisition.

In September 2007, we acquired Combustion Components Associates' ELIM-NO<sup>x</sup> technology for \$16 million. The acquisition included a complete reactant dosing system design and associated intellectual property including granted patents and patent applications yet to be granted for selective catalytic reduction emission control systems that reduce emissions of oxides of nitrogen from diesel powered vehicles. The technology can be used for both urea and hydrocarbon injection. We have recorded the acquisition as part of intangible assets on our balance sheet.

(11) In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities*. FSP EITF 03-6-1 requires that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating and shall be included in the computation of EPS pursuant to the two-class method. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. We are evaluating FSP EITF 03-6-1 to determine the effect on our condensed consolidated financial statements and related disclosures.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting principles to be used in the preparation and presentation of financial statements in accordance with generally accepted accounting principles. This statement will be effective 60 days after the Securities and Exchange Commission approves the Public Company Accounting Oversight Board's amendments to AU Section 411, *The Meaning of Present*



Fairly in Conformity with Generally Accepted Accounting Principles. We do not anticipate the adoption of SFAS No. 162 will have a material effect on our condensed consolidated financial statements.

In April 2008, the FASB issued FSP 142-3, Determination of Useful Life of Intangible Assets. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets, and requires additional disclosure relating to an entity's renewal or extension of recognized intangible assets. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and

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**TENNECO INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)

interim periods within those fiscal years. We do not expect the adoption of FSP 142-3 to have a material impact on our condensed consolidated financial statements.

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). SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities including how and why an entity uses derivative instruments, how an entity accounts for derivatives and hedges 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 financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are evaluating SFAS No. 161 to determine the effect on our condensed consolidated financial statement disclosures.

In February 2008, the FASB issued FSP 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. FSP 140-3 provides guidance on accounting for a transfer of a financial asset and a repurchase financing which is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties that is entered into contemporaneously with, or in contemplation of, the initial transfer. FSP 140-3 is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. We are evaluating FSP 140-3 to determine the effect on our condensed consolidated financial statements and related disclosures.

In February 2008, the FASB issued FSP 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13*. FSP 157-1 provides a scope exception to SFAS No. 157 which does not apply under Statement 13 and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. FSP 157-1 is effective upon the initial adoption of SFAS No. 157. FSP 157-1 did not have a material impact to our condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, contractual contingencies and any noncontrolling interest in the acquiree at the acquisition date at their fair values as of that date. SFAS No. 141(R) provides guidance on the accounting for acquisition-related costs, restructuring costs related to the acquisition and the measurement of goodwill and a bargain purchase. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after December 15, 2008. We do not expect the adoption of this statement to have a material impact to our condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*. SFAS No. 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. It clarified that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements, establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that does not result in deconsolidation and provides for expanded disclosure in the consolidated financial statements relating to the interests of the parent's owners and the interests of the noncontrolling owners of the subsidiary. SFAS No. 160 applies prospectively (except for the presentation and disclosure requirements) for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2008.

The presentation and disclosure requirements will be applied retrospectively for all periods presented. We are evaluating this statement to determine the effect on our condensed consolidated financial statements and related disclosures.

In December 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 110 (SAB 110). SAB 110 amends and replaces Question 6 of Section D.2 Topic 14, Share-Based Payment. Question 6 of Topic 14:D.2 (as amended) expresses the views of the staff regarding the use of a simplified method in developing an estimate of the expected term of plain vanilla share options in accordance with SFAS No. 123

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**TENNECO INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)

(revised 2004), Share-Based Payment (SFAS No. 123(R)). SAB 110 is effective January 1, 2008. The adoption of SAB 110 had no impact to our condensed consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurement. This statement defines fair value, establishes a fair value hierarchy for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. FSP 157-2 issued in February 2008 delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. We have adopted the measurement and disclosure impact of SFAS No. 157 relating to our financial assets and financial liabilities which are measured on a recurring basis (at least annually) effective January 1, 2008. See Note 2 to the condensed consolidated financial statements of Tenneco Inc. and Consolidated Subsidiaries. We do not expect the adoption of the nonfinancial assets and nonfinancial liabilities portion of SFAS No. 157 to have a material impact to our condensed consolidated financial statements.

In June 2007, the Emerging Issues Task Force (EITF) issued EITF 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 provides the final consensus on the application of paragraphs 62 and 63 of SFAS No. 123(R) on the accounting for income tax benefits relating to the payment of dividends on equity-classified employee share-based payment awards that are charged to retained earnings. EITF 06-11 affirms that the realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options should be recognized as an increase in additional paid-in-capital. Additionally, EITF 06-11 provides guidance on the amount of tax benefits from dividends that are reclassified from additional paid-in-capital to the income statement when an entity's estimate of forfeitures changes. EITF 06-11 is effective prospectively to the income tax benefits that result from dividends on equity-classified employee share-based payment awards that are declared in fiscal years beginning after December 15, 2007. The adoption of EITF 06-11, on January 1, 2008, did not have a material impact on our condensed consolidated financial statements.

In June 2007, the EITF issued EITF 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities. EITF 07-3 requires the deferral and capitalization of nonrefundable advance payments for goods or services that an entity will use in research and development activities pursuant to an executory contractual agreement. Expenditures which are capitalized under EITF 07-3 should be expensed as the goods are delivered or the related services are performed. EITF 07-3 is effective prospectively for fiscal years beginning after December 15, 2007 and interim periods within those fiscal years. EITF 07-3 is applicable to new contracts entered into after the effective date of this Issue. The adoption of EITF 07-3 on January 1, 2008, did not have a material impact on our condensed consolidated financial statements.

In April 2007, the FASB issued Interpretation No. 39-1, Amendment of FASB Interpretation No. 39 (FIN 39-1). This amendment allows a reporting entity to offset fair value amounts recognized for derivative instruments with fair value amounts recognized for the right to reclaim or realize cash collateral. Additionally, this amendment requires disclosure of the accounting policy on the reporting entity's election to offset or not offset amounts for derivative instruments. FIN 39-1 is effective for fiscal years beginning after November 15, 2007. The adoption of FIN 39-1 did not have a material impact on our condensed consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. This statement permits companies to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning on or after November 15, 2007. As we did not elect the fair value option, the adoption of SFAS 159 did not have a material effect on our condensed consolidated financial statements and related disclosures.

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**TENNECO INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 88, 106, and 132(R). Part of this Statement was effective as of December 31, 2006, and requires companies that have defined benefit pension plans and other postretirement benefit plans to recognize the funded status of those plans on the balance sheet on a prospective basis from the effective date. The funded status of these plans is determined as of the plans' measurement dates and represents the difference between the amount of the obligations owed to participants under each plan (including the effects of future salary increases for defined benefit plans) and the fair value of each plan's assets dedicated to paying those obligations. To record the funded status of those plans, unrecognized prior service costs and net actuarial losses experienced by the plans will be recorded in the Accumulated Other Comprehensive Loss section of shareholders' equity on the balance sheet. The initial adoption as of December 31, 2006 resulted in a reduction of Accumulated Other Comprehensive Loss in shareholders' equity of \$59 million.

In addition, SFAS No. 158 requires that companies using a measurement date for their defined benefit pension plans and other postretirement benefit plans other than their fiscal year end, change the measurement date effective for fiscal years ending after December 15, 2008. Effective January 1, 2007, we elected to early adopt the measurement date provision of SFAS No. 158. Adoption of this part of the statement was not material to our financial position and results of operations.

(12) We occasionally provide guarantees that could require us to make future payments in the event that the third party primary obligor does not make its required payments. We have not recorded a liability for any of these guarantees.

Additionally, we have from time to time issued guarantees for the performance of obligations by some of our subsidiaries, and some of our subsidiaries have guaranteed our debt. All of our existing and future material domestic wholly-owned subsidiaries fully and unconditionally guarantee our senior credit facility, our senior secured notes, our senior notes and our senior subordinated notes on a joint and several basis. The arrangement for the senior credit facility is also secured by first-priority liens on substantially all our domestic assets and pledges of 66 percent of the stock of certain first-tier foreign subsidiaries. The arrangement for the \$245 million senior secured notes is also secured by second-priority liens on substantially all our domestic assets, excluding some of the stock of our domestic subsidiaries. No assets or capital stock of our direct or indirect foreign subsidiaries secure these notes. You should also read Note 14 of the condensed consolidated financial statements of Tenneco Inc., where we present the Supplemental Guarantor Condensed Consolidating Financial Statements.

We have issued guarantees through letters of credit in connection with some obligations of our affiliates. As of June 30, 2008, we have guaranteed \$42 million in letters of credit to support some of our subsidiaries' insurance arrangements, foreign employee benefit programs, environmental remediation activities and cash management requirements.

*Negotiable Financial Instruments* One of our European subsidiaries receives payment from one of its OE customers whereby the accounts receivable are satisfied through the delivery of negotiable financial instruments. We may collect these financial instruments before their maturity date by either selling them at a discount or using them to satisfy accounts receivable that have previously been sold to a European bank. Any of these financial instruments which are not sold are classified as other current assets as they do not meet our definition of cash equivalents. The amount of

these financial instruments that was collected before their maturity date totaled \$10 million as of June 30, 2008, compared with \$21 million at the same date in 2007. No negotiable financial instruments were held by our European subsidiary as of June 30, 2008 or June 30, 2007.

In certain instances several of our Chinese subsidiaries receive payment from OE customers and satisfy vendor payments through the receipt and delivery of negotiable financial instruments. Financial instruments used to satisfy vendor payables and not redeemed totaled \$14 million and \$11 million at June 30, 2008 and 2007, respectively, and were classified as notes payable. Financial instruments received from OE customers and not redeemed totaled \$11 million and \$6 million at June 30, 2008 and 2007, respectively, and were classified as other current assets. One of our Chinese subsidiaries that issues its own negotiable financial instruments to pay its vendors is required to

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(Unaudited)

maintain a cash balance at a financial institution that guarantees those financial instruments. No financial instruments were outstanding at that Chinese subsidiary as of June 30, 2008. As of June 30, 2007 the required cash balance was less than \$1 million and was classified as cash and cash equivalents.

The negotiable financial instruments received by one of our European subsidiaries and some of our Chinese subsidiaries are checks drawn by our OE customers and guaranteed by their banks that are payable at a future date. The use of these instruments for payment follows local commercial practice. Because negotiable financial instruments are financial obligations of our customers and are guaranteed by our customers' banks, we believe they represent a lower financial risk than the outstanding accounts receivable that they satisfy which are not guaranteed by a bank.

(13) We are a global manufacturer with three geographic reportable segments: (1) North America, (2) Europe, South America and India ( Europe ), and (3) Asia Pacific. Each segment manufactures and distributes ride control and emission control products primarily for the automotive industry. We have not aggregated individual operating segments within these reportable segments. We evaluate segment performance based primarily on income before interest expense, income taxes, and minority interest. Products are transferred between segments and geographic areas on a basis intended to reflect as nearly as possible the market value of the products.

The following table summarizes certain Tenneco Inc. segment information:

	<b>North America</b>	<b>Europe</b>	<b>Segment Asia Pacific (Millions)</b>	<b>Reclass &amp; Elims</b>	<b>Consolidated</b>
<b>At June 30, 2008 and for the Three Months Then Ended</b>					
Revenues from external customers	\$ 674	\$ 815	\$ 162	\$	\$ 1,651
Intersegment revenues	3	38	5	(46)	
Income before interest expense, income taxes, and minority interest	17	48	10		75
<b>At June 30, 2007 and for the Three Months Then Ended</b>					
Revenues from external customers	\$ 810	\$ 718	\$ 135	\$	\$ 1,663
Intersegment revenues	2	93	4	(99)	
Income before interest expense, income taxes, and minority interest	50	45	8		103
<b>At June 30, 2008 and for the Six Months Then Ended</b>					
Revenues from external customers	\$ 1,357	\$ 1,551	\$ 303	\$	\$ 3,211
Intersegment revenues	5	105	9	(119)	
	26	73	15		114



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Income before interest expense, income taxes, and minority interest					
Total assets	1,655	1,806	414	17	3,892
<b>At June 30, 2007 and for the Six Months Then Ended</b>					
Revenues from external customers	\$ 1,453	\$ 1,362	\$ 248	\$	\$ 3,063
Intersegment revenues	4	192	7	(203)	
Income before interest expense, income taxes, and minority interest	80	58	14		152
Total assets	1,634	1,609	345	121	3,709
	24				

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**TENNECO INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)

(14) Supplemental guarantor condensed consolidating financial statements are presented below:

*Basis of Presentation*

Subject to limited exceptions, all of our existing and future material domestic 100% owned subsidiaries (which are referred to as the Guarantor Subsidiaries) fully and unconditionally guarantee our senior subordinated notes due in 2014, our senior notes due in 2015 and our senior secured notes due 2013 on a joint and several basis. We have not presented separate financial statements and other disclosures concerning each of the Guarantor Subsidiaries because management has determined that such information is not material to the holders of the notes. Therefore, the Guarantor Subsidiaries are combined in the presentation below.

These condensed consolidating financial statements are presented on the equity method. Under this method, our investments are recorded at cost and adjusted for our ownership share of a subsidiary's cumulative results of operations, capital contributions and distributions, and other equity changes. You should read the condensed consolidating financial information of the Guarantor Subsidiaries in connection with our condensed consolidated financial statements and related notes of which this note is an integral part.

*Distributions*

There are no significant restrictions on the ability of the Guarantor Subsidiaries to make distributions to us.

Table of Contents**TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**STATEMENT OF INCOME (LOSS)**

For the Three Months Ended June 30, 2008

	<b>Guarantor</b>	<b>Nonguarantor</b>	<b>Tenneco</b>	<b>Reclass</b>	
	<b>Subsidiaries</b>	<b>Subsidiaries</b>	<b>Inc.</b>	<b>&amp;</b>	<b>Consolidated</b>
			<b>(Parent</b>	<b>Elims</b>	
			<b>Company)</b>		
			<b>(Millions)</b>		
<b>Revenues</b>					
Net sales and operating revenues					
External	\$ 569	\$ 1,082	\$	\$	\$ 1,651
Affiliated companies	12	50		(62)	
	581	1,132		(62)	1,651
<b>Costs and expenses</b>					
Cost of sales (exclusive of depreciation shown below)	515	930		(62)	1,383
Engineering, research, and development	13	21			34
Selling, general, and administrative	35	66	1		102
Depreciation and amortization of other intangibles	20	37			57
	583	1,054	1	(62)	1,576
<b>Other income (expense)</b>					
Loss on sale of receivables		(2)			(2)
Other income (loss)	4	2	(1)	(3)	2
	4		(1)	(3)	
<b>Income (loss) before interest expense, income taxes, minority interest, and equity in net income from affiliated companies</b>					
	2	78	(2)	(3)	75
<b>Interest expense</b>					
External (net of interest capitalized)	(2)		35		33
Affiliated companies (net of interest income)	27	3	(30)		

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Income tax expense (benefit)	(4)	29	2		27
Minority interest		2			2
	(19)	44	(9)	(3)	13
Equity in net income (loss) from affiliated companies	40		22	(62)	
<b>Net income (loss)</b>	\$ 21	\$ 44	\$ 13	\$ (65)	\$ 13

Table of Contents**TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**STATEMENT OF INCOME (LOSS)**

For the Three Months Ended June 30, 2007

	<b>Tenneco Inc.</b>				
	<b>Guarantor Subsidiaries</b>	<b>Nonguarantor Subsidiaries</b>	<b>(Parent Company) (Millions)</b>	<b>Reclass &amp; Elims</b>	<b>Consolidated</b>
<b>Revenues</b>					
Net sales and operating revenues					
External	\$ 783	\$ 880	\$	\$	\$ 1,663
Affiliated companies	30	223		(253)	
	813	1,103		(253)	1,663
<b>Costs and expenses</b>					
Cost of sales (exclusive of depreciation shown below)	719	911		(253)	1,377
Engineering, research, and development	15	14			29
Selling, general, and administrative	39	63	2		104
Depreciation and amortization of other intangibles	19	31			50
	792	1,019	2	(253)	1,560
<b>Other income (expense)</b>					
Loss on sale of receivables		(3)			(3)
Other income (loss)	2	3	3	(5)	3
	2		3	(5)	
<b>Income (loss) before interest expense, income taxes, minority interest, and equity in net income from affiliated companies</b>					
	23	84	1	(5)	103
<b>Interest expense</b>					
External (net of interest capitalized)		2	38		40
Affiliated companies (net of interest income)	47	(5)	(42)		

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Income tax expense (benefit)	(12)	25	1	6	20
Minority interest		2			2
	(12)	60	4	(11)	41
Equity in net income (loss) from affiliated companies	60		37	(97)	
<b>Net income (loss)</b>	\$ 48	\$ 60	\$ 41	\$ (108)	\$ 41

Table of Contents**TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**STATEMENT OF INCOME (LOSS)**

For the Six Months Ended June 30, 2008

	<b>Tenneco Inc.</b>				
	<b>Guarantor Subsidiaries</b>	<b>Nonguarantor Subsidiaries</b>	<b>(Parent Company) (Millions)</b>	<b>Reclass &amp; Elims</b>	<b>Consolidated</b>
<b>Revenues</b>					
Net sales and operating revenues					
External	\$ 1,233	\$ 1,978	\$	\$	\$ 3,211
Affiliated companies	42	233		(275)	
	1,275	2,211		(275)	3,211
<b>Costs and expenses</b>					
Cost of sales (exclusive of depreciation shown below)	1,102	1,882		(275)	2,709
Engineering, research, and development	28	42			70
Selling, general, and administrative	72	133	2		207
Depreciation and amortization of other intangibles	41	71			112
	1,243	2,128	2	(275)	3,098
<b>Other income (expense)</b>					
Loss on sale of receivables		(4)			(4)
Other income (loss)	10	1	(2)	(4)	5
	10	(3)	(2)	(4)	1
<b>Income (loss) before interest expense, income taxes, minority interest, and equity in net income from affiliated companies</b>					
	42	80	(4)	(4)	114
<b>Interest expense</b>					
External (net of interest capitalized)	(2)		60		58
Affiliated companies (net of interest income)	65	(2)	(63)		

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Income tax expense (benefit)	(4)	31	5		32
Minority interest		5			5
	(17)	46	(6)	(4)	19
Equity in net income (loss) from affiliated companies	34		25	(59)	
<b>Net income (loss)</b>	\$ 17	\$ 46	\$ 19	\$ (63)	\$ 19



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## TENNECO INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(Unaudited)

## STATEMENT OF INCOME (LOSS)

For the Six Months Ended June 30, 2007

			<b>Tenneco Inc.</b>		
	<b>Guarantor Subsidiaries</b>	<b>Nonguarantor Subsidiaries</b>	<b>(Parent Company) (Millions)</b>	<b>Reclass &amp; Elims</b>	<b>Consolidated</b>
<b>Revenues</b>					
Net sales and operating revenues					
External	\$ 1,398	\$ 1,665	\$	\$	\$ 3,063
Affiliated companies	58	429		(487)	
	1,456	2,094		(487)	3,063
<b>Costs and expenses</b>					
Cost of sales (exclusive of depreciation shown below)	1,279	1,764		(487)	2,556
Engineering, research, and development	26	30			56
Selling, general, and administrative	76	121	2		199
Depreciation and amortization of other intangibles	37	61			98
	1,418	1,976	2	(487)	2,909
<b>Other income (expense)</b>					
Loss on sale of receivables		(5)			(5)
Other income (loss)	3	1	3	(4)	3
	3	(4)	3	(4)	(2)
<b>Income (loss) before interest expense, income taxes, minority interest, and equity in net income from affiliated companies</b>					
	41	114	1	(4)	152
<b>Interest expense</b>					
External (net of interest capitalized)	(1)	3	78		80
Affiliated companies (net of interest income)	92	(8)	(84)		

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Income tax expense (benefit)	(24)	34	1	11	22
Minority interest		4			4
	(26)	81	6	(15)	46
Equity in net income (loss) from affiliated companies	81		40	(121)	
<b>Net income (loss)</b>	\$ 55	\$ 81	\$ 46	\$ (136)	\$ 46

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(Unaudited)**BALANCE SHEET**

	<b>June 30, 2008</b>				
	<b>Tenneco</b>				
	<b>Inc.</b>				
	<b>Guarantor</b>	<b>Nonguarantor</b>	<b>(Parent</b>	<b>Reclass &amp;</b>	<b>Consolidated</b>
	<b>Subsidiaries</b>	<b>Subsidiaries</b>	<b>Company)</b>	<b>Elims</b>	
	<b>(Millions)</b>				
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 6	\$ 158	\$ 30	\$ (650)	\$ 164
Receivables, net	411	1,133	30	(650)	924
Inventories	224	397			621
Deferred income taxes	53		3	(9)	47
Prepayments and other	30	137			167
	724	1,825	33	(659)	1,923
Other assets:					
Investment in affiliated companies	620		1,145	(1,765)	
Notes and advances receivable from affiliates	3,530	227	5,534	(9,291)	
Long-term notes receivable, net		13			13
Goodwill	135	74			209
Intangibles, net	18	9			27
Deferred income taxes	291	45	239	(239)	336
Other	39	78	23		140
	4,633	446	6,941	(11,295)	725
Plant, property, and equipment, at cost	1,036	2,145			3,181
Less Accumulated depreciation and amortization	(685)	(1,252)			(1,937)
	351	893			1,244
	\$ 5,708	\$ 3,164	\$ 6,974	\$ (11,954)	\$ 3,892

**LIABILITIES AND  
SHAREHOLDERS EQUITY**

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Current liabilities:

Short-term debt (including current maturities of long-term debt)

Short-term debt non-affiliated	\$	\$	46	\$	\$	\$	46
Short-term debt affiliated	187	341	10	(538)			
Trade payables	321	847		(94)			1,074
Accrued taxes	4	37	11	(2)			50
Other	124	186	20	(25)			305
	636	1,457	41	(659)			1,475
Long-term debt non-affiliated		7	1,439				1,446
Long-term debt affiliated	4,171	116	5,004	(9,291)			
Deferred income taxes	256	61		(239)			78
Postretirement benefits and other liabilities	278	85		7			370
Commitments and contingencies							
Minority interest		33					33
Shareholders equity	367	1,405	490	(1,772)			490
	\$ 5,708	\$ 3,164	\$ 6,974	\$ (11,954)	\$	\$	3,892

**Table of Contents****TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**BALANCE SHEET**

	<b>December 31, 2007</b>				
	<b>Tenneco</b>				
	<b>Inc.</b>				
	<b>Guarantor</b>	<b>Nonguarantor</b>	<b>(Parent</b>	<b>Reclass &amp;</b>	<b>Consolidated</b>
	<b>Subsidiaries</b>	<b>Subsidiaries</b>	<b>Company)</b>	<b>Elims</b>	
	<b>(Millions)</b>				
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 6	\$ 182	\$	\$	\$ 188
Receivables, net	385	1,090	148	(866)	757
Inventories	198	341			539
Deferred income taxes	53		3	(20)	36
Prepayments and other	18	103			121
	660	1,716	151	(886)	1,641
Other assets:					
Investment in affiliated companies	628		1,083	(1,711)	
Notes and advances receivable from affiliates	3,607	232	5,383	(9,222)	
Long-term notes receivable, net		19			19
Goodwill	136	72			208
Intangibles, net	17	9			26
Deferred income taxes	310	60	180	(180)	370
Other	40	76	25		141
	4,738	468	6,671	(11,113)	764
Plant, property, and equipment, at cost	994	1,984			2,978
Less Accumulated depreciation and amortization	(658)	(1,135)			(1,793)
	336	849			1,185
	\$ 5,734	\$ 3,033	\$ 6,822	\$ (11,999)	\$ 3,590

**LIABILITIES AND  
SHAREHOLDERS EQUITY**

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Current liabilities:

Short-term debt (including current maturities of long-term debt)

Short-term debt non-affiliated	\$	\$	44	\$	2	\$	\$	46
Short-term debt affiliated			274		439			10 (723)
Trade payables			350		774			(137) 987
Accrued taxes			27		16			(2) 41
Other			118		169			21 (24) 284
			769		1,442			33 (886) 1,358
Long-term debt non-affiliated					7			1,321 1,328
Long-term debt affiliated			4,100		54			5,068 (9,222)
Deferred income taxes			213		81			(180) 114
Postretirement benefits and other liabilities			264		89			6 359
Commitments and contingencies								
Minority interest					31			31
Shareholders equity			388		1,329			400 (1,717) 400
	\$	\$	5,734	\$	3,033	\$	\$	6,822 (11,999) 3,590

**Table of Contents****TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**STATEMENT OF CASH FLOWS**

Three Months Ended June 30, 2008

			<b>Tenneco Inc.</b>			
	<b>Guarantor Subsidiaries</b>	<b>Nonguarantor Subsidiaries</b>	<b>(Parent Company)</b>	<b>Reclass &amp; Elims</b>	<b>Consolidated</b>	
			<b>(Millions)</b>			
<b>Operating Activities</b>						
Net cash provided (used) by operating activities	\$ 76	\$ 55	\$ (70)	\$	\$	61
<b>Investing Activities</b>						
Proceeds from the sale of assets		1				1
Cash payment for plant, property, and equipment	(20)	(44)				(64)
Acquisition of business	(19)					(19)
Cash payment for software related intangible assets	(2)	(1)				(3)
Investments and other						
Net cash used by investing activities	(41)	(44)				(85)
<b>Financing Activities</b>						
Net increase (decrease) in revolver borrowings and short-term debt excluding current maturities of long-term debt		2	28			30
Intercompany dividends and net increase (decrease) in intercompany obligations	(31)	(11)	42			
Distribution to minority interest partners		(2)				(2)
Other						
Net cash provided (used) by financing activities	(31)	(11)	70			28
Effect of foreign exchange rate changes on cash and cash equivalents		(1)				(1)
	4	(1)				3

Increase (decrease) in cash and cash equivalents

Cash and cash equivalents, April 1	2	159			161
Cash and cash equivalents, June 30 (Note)	\$ 6	\$ 158	\$	\$	\$ 164

**Note:** Cash and cash equivalents include highly liquid investments with a maturity of three months or less at the date of purchase.



Table of Contents**TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**STATEMENT OF CASH FLOWS**

Three Months Ended June 30, 2007

			<b>Tenneco Inc.</b>			
	<b>Guarantor Subsidiaries</b>	<b>Nonguarantor Subsidiaries</b>	<b>(Parent Company) (Millions)</b>	<b>Reclass &amp; Elims</b>	<b>Consolidated</b>	
<b>Operating Activities</b>						
Net cash provided (used) by operating activities	\$ 94	\$ 43	\$ (76)	\$ 6	\$ 67	
<b>Investing Activities</b>						
Proceeds from the sale of assets	1	1		(1)	1	
Cash payment for plant, property, and equipment	(11)	(21)		(4)	(36)	
Cash payment for software related intangible assets	(1)	(2)		(1)	(4)	
Investments and other		2		(1)	1	
Net cash used by investing activities	(11)	(20)		(7)	(38)	
<b>Financing Activities</b>						
Issuance of common shares			2		2	
Retirement of long-term debt		(2)	(113)	113	(2)	
Net increase (decrease) in revolver borrowings and short-term debt excluding current maturities of long-term debt		(104)	165	(68)	(7)	
Intercompany dividends and net increase (decrease) in intercompany obligations	(74)	95	23	(44)		
Other			(1)		(1)	
Net cash provided (used) by financing activities	(74)	(11)	76	1	(8)	
Effect of foreign exchange rate changes on cash and cash equivalents		11			11	
	9	23			32	

Increase (decrease) in cash and cash  
equivalents

Cash and cash equivalents, April 1			136				136
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Cash and cash equivalents, June 30 (Note)	\$	9	\$	159	\$		\$	168
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**Note:** Cash and cash equivalents include highly liquid investments with a maturity of three months or less at the date of purchase.

Table of Contents**TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**STATEMENT OF CASH FLOWS**

	<b>Six Months Ended June 30, 2008</b>				
	<b>Tenneco Inc.</b>			<b>Reclass &amp; Elims</b>	<b>Consolidated</b>
	<b>Guarantor Subsidiaries</b>	<b>Nonguarantor Subsidiaries</b>	<b>(Parent Company) (Millions)</b>		
<b>Operating Activities</b>					
Net cash provided (used) by operating activities	\$ (15)	\$ 42	\$ (33)	\$	\$ (6)
<b>Investing Activities</b>					
Proceeds from the sale of assets		2			2
Cash payment for plant, property, and equipment	(53)	(74)			(127)
Acquisition of business	(19)				(19)
Cash payment for software related intangible assets	(5)	(3)			(8)
Investments and other					
Net cash used by investing activities	(77)	(75)			(152)
<b>Financing Activities</b>					
Issuance of common stock			1		1
Retirement of long-term debt		(1)	(2)		(3)
Net increase (decrease) in revolver borrowings and short-term debt excluding current maturities of long-term debt		2	119		121
Intercompany dividends and net increase (decrease) in intercompany obligations	92	(7)	(85)		
Distribution to minority interest partners		(4)			(4)
Other					
Net cash provided (used) by financing activities	92	(10)	33		115
Effect of foreign exchange rate changes on cash and cash equivalents		19			19

Increase (decrease) in cash and cash equivalents			(24)			(24)
Cash and cash equivalents, January 1	6		182			188
Cash and cash equivalents, June 30 (Note)	\$ 6	\$	158	\$	\$	\$ 164

**Note:** Cash and cash equivalents include highly liquid investments with a maturity of three months or less at the date of purchase.

Table of Contents**TENNECO INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(Unaudited)**STATEMENT OF CASH FLOWS**

Six Months Ended June 30, 2007

			<b>Tenneco Inc.</b>			
	<b>Guarantor Subsidiaries</b>	<b>Nonguarantor Subsidiaries</b>	<b>(Parent Company) (Millions)</b>	<b>Reclass &amp; Elims</b>	<b>Consolidated</b>	
<b>Operating Activities</b>						
Net cash provided (used) by operating activities	\$ 118	\$ 10	\$ (158)	\$ 4	\$ (26)	
<b>Investing Activities</b>						
Proceeds from the sale of assets	1	1		(1)	1	
Cash payment for plant, property, and equipment	(27)	(45)		(3)	(75)	
Cash payment for software related intangible assets	(6)	(4)		(1)	(11)	
Investments and other		2			2	
Net cash used by investing activities	(32)	(46)		(5)	(83)	
<b>Financing Activities</b>						
Issuance of common stock			4		4	
Issuance of long-term debt			150		150	
Debt issuance cost of long-term debt			(6)		(6)	
Retirement of long-term debt		(2)	(470)	113	(359)	
Net increase (decrease) in revolver borrowings and short-term debt excluding current maturities of long-term debt		2	383	(112)	273	
Intercompany dividends and net increase (decrease) in intercompany obligations	(133)	36	97			
Distribution to minority interest partners		(1)			(1)	
Other						
Net cash provided (used) by financing activities	(133)	35	158	1	61	
		14			14	

Effect of foreign exchange rate changes on cash and cash equivalents

Increase (decrease) in cash and cash equivalents	(47)	13	(34)
Cash and cash equivalents, January 1	56	146	202
Cash and cash equivalents, June 30 (Note)	\$ 9	\$ 159	\$ 168

**Note:** Cash and cash equivalents include highly liquid investments with a maturity of three months or less at the date of purchase.

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

As you read the following review of our financial condition and results of operations, you should also read our condensed consolidated financial statements and related notes beginning on page 4.

**Executive Summary**

We are one of the world's leading manufacturers of automotive emission control and ride control products and systems. We serve both original equipment (OE) vehicle designers and manufacturers and the repair and replacement markets, or aftermarket, globally through leading brands, including Monroe®, Rancho®, Clevite® Elastomers and Fric Rot™ ride control products and Walker®, Fonos™, and Gillet™ emission control products. Worldwide we serve more than 39 different original equipment manufacturers, and our products or systems are included on eight of the top 10 passenger car models produced for sale in Europe and nine of the top 10 light truck and SUV models produced for sale in North America for 2007. Our aftermarket customers are comprised of full-line and specialty warehouse distributors, retailers, jobbers, installer chains and car dealers. We operate 80 manufacturing facilities worldwide and employ approximately 21,000 people to service our customers' demands.

Factors that are critical to our success include winning new business awards, managing our overall global manufacturing footprint to ensure proper placement and workforce levels in line with business needs, maintaining competitive wages and benefits, maximizing efficiencies in manufacturing processes, reducing overall costs and expanding our products into adjacent markets. In addition, our ability to adapt to key industry trends, such as the significant shift in consumer preferences from light trucks and SUVs to other vehicles in response to higher fuel costs and other economic and social factors, increasing technologically sophisticated content, changing aftermarket distribution channels, increasing environmental standards and extended product life of automotive parts, also play a critical role in our success. Other factors that are critical to our success include adjusting to industry and economic challenges such as increases in the cost of raw materials and our ability to successfully reduce the impact of any such cost increases through material substitutions, cost reduction initiatives and other methods.

We have a substantial amount of indebtedness. As such, our ability to generate cash both to fund operations and service our debt is also a significant area of focus for our company. See Results from Operations Cash Flows for the Three Months Ended June 30, 2008 and 2007, Results from Operations Cash Flows for the Six Months Ended June 30, 2008 and 2007 and Liquidity and Capital Resources below for further discussion of cash flows.

Total revenues for the second quarter of 2008 were \$1,651 million, compared to \$1,663 million in the second quarter of 2007. Excluding the impact of currency and substrate sales, revenue was down \$42 million, from \$1,203 million to \$1,161 million, driven by lower North American production volumes, which declined 15 percent during the second quarter, as well as the negative impact of several strikes in North America. Increased sales in Asia, Australia, South America and India helped partially offset the overall North American industry production decline.

Gross margin in the second quarter of 2008 was 16.2 percent, down 1.0 percentage points from 17.2 percent in 2007. Lower manufacturing cost absorption in North America resulting from lower production levels and a mix shift away from higher margin light trucks negatively impacted overall gross margin.

Selling, general and administrative was down \$2 million in the current quarter, at \$102 million, including \$7 million in aftermarket customer changeover costs and \$3 million in restructuring and restructuring-related expense, compared to \$104 million in the second quarter of 2007. Engineering expense was \$34 million and \$29 million in the second quarter of 2008 and 2007, respectively, as we continue to invest in engineering and technology development for OE emission control and ride control businesses globally. In total, we reported selling, general, administrative and

engineering expenses in the second quarter of 2008 at 8.2 percent of revenues, as compared to 8.0 percent of revenues for the second quarter of 2007.

Earnings before interest expense, taxes and minority interest ( EBIT ) was \$75 million for the second quarter of 2008, down \$28 million from the \$103 million reported in the second quarter of 2007. Improved earnings in our Europe and Asia Pacific segments partially offset higher restructuring charges, aftermarket customer changeover



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costs for new aftermarket business and reduced profitability in North America due to significant industry OE production cuts.

Total revenues for the first six months of 2008 were \$3,211 million, compared to \$3,063 million for the first six months of 2007. Excluding the impact of currency and substrate sales, revenue was down \$50 million, from \$2,260 million to \$2,210 million, driven by an \$83 million decline in North American OE revenues due to reduced light vehicle OE production volumes in North America in light of economic conditions, which were further impacted by several strikes including the American Axle strike. In addition, North American commercial vehicle (truck) production declined. Increased sales in South America, Asia and Australia helped partially offset the reduced North American OE production.

Gross margin in the first half of 2008 was 15.6 percent, down 1.0 percentage point from 16.6 percent in 2007. Lower North American OE production due in part to labor strikes, including the American Axle strike, and the mix shift away from the more profitable light trucks and SUVs more than accounted for the decline in gross margin. Lower manufacturing cost absorption in North America resulting from the lower production levels and higher restructuring charges negatively impacted overall gross margin.

We reported selling, general, administrative and engineering expenses in the first six months of 2008 at 8.6 percent of revenues, compared to 8.3 percent of revenues for the first six months of 2007. The increase was mainly due to \$6 million in higher restructuring costs, \$7 million in second quarter aftermarket customer changeover costs and our continued investment in engineering and technology development to prepare to meet customer needs for more stringent environmental regulations.

EBIT was \$114 million for the first half of 2008, down \$38 million from the \$152 million for 2007. Reduced North American OE production volumes, higher restructuring and aftermarket customer changeover costs, and increased spending on engineering more than accounted for the decline.

## **Results from Operations**

### ***Net Sales and Operating Revenues for the Three Months Ended June 30, 2008 and 2007***

The following tables reflect our revenues for the second quarter of 2008 and 2007. We present these reconciliations of revenues in order to reflect the trend in our sales in various product lines and geographic regions separately from the effects of doing business in currencies other than the U.S. dollar. We have not reflected any currency impact in the 2007 table since this is the base period for measuring the effects of currency during 2008 on our operations. We believe investors find this information useful in understanding period-to-period comparisons in our revenues.

Additionally, we show the component of our revenue represented by substrate sales in the following table. While we generally have primary design, engineering and manufacturing responsibility for OE emission control systems, we do not manufacture substrates. Substrates are porous ceramic filters coated with a catalyst precious metals such as platinum, palladium and rhodium. These are supplied to us by Tier 2 suppliers and directed by our OE customers. We generally earn a small margin on these components of the system. As the need for more sophisticated emission control solutions increases to meet more stringent environmental regulations, and as we capture more diesel aftertreatment business, these substrate components have been increasing as a percentage of our revenue. While these substrates dilute our gross margin percentage they are a necessary component of an emission control system.

Our value-add content in an emission control system includes designing the system to meet environmental regulations through integration of the substrates into the system, maximizing use of thermal energy to heat up the catalyst quickly, efficiently managing airflow to reduce back pressure as the exhaust stream moves past the catalyst, managing the

expansion and contraction of the emission control system components due to temperature extremes experienced by an emission control system, using advanced acoustic engineering tools to design the desired exhaust sound, minimizing the opportunity for the fragile components of the substrate to be damaged when we integrate it into the emission control system and reducing unwanted noise, vibration and harshness transmitted through the emission control system.

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We present these substrate sales separately in the following table because we believe investors utilize this information to understand the impact of this portion of our revenues on our overall business and because it removes the impact of potentially volatile precious metals pricing from our revenues. While, generally, our original equipment customers assume the risk of precious metals pricing volatility, it impacts our reported revenues. Excluding substrate catalytic converter and diesel particulate filters sales removes this impact.

	<b>Three Months Ended June 30, 2008</b>				
	<b>Revenues</b>	<b>Currency Impact</b>	<b>Revenues Excluding Currency (Millions)</b>	<b>Substrate Sales Excluding Currency Impact</b>	<b>Revenues Excluding Currency and Substrate Sales</b>
North America Original Equipment					
Ride Control	\$ 121	\$	\$ 121	\$	\$ 121
Emission Control	395		395	192	203
<b>Total North America Original Equipment</b>	<b>516</b>		<b>516</b>	<b>192</b>	<b>324</b>
North America Aftermarket					
Ride Control	114	1	113		113
Emission Control	44	1	43		43
<b>Total North America Aftermarket</b>	<b>158</b>	<b>2</b>	<b>156</b>		<b>156</b>
<b>Total North America</b>	<b>674</b>	<b>2</b>	<b>672</b>	<b>192</b>	<b>480</b>
Europe Original Equipment					
Ride Control	131	16	115		115
Emission Control	447	54	393	138	255
<b>Total Europe Original Equipment</b>	<b>578</b>	<b>70</b>	<b>508</b>	<b>138</b>	<b>370</b>
Europe Aftermarket					
Ride Control	69	8	61		61
Emission Control	60	7	53		53
<b>Total Europe Aftermarket</b>	<b>129</b>	<b>15</b>	<b>114</b>		<b>114</b>
South America & India	108	11	97	15	82
<b>Total Europe, South America &amp; India</b>	<b>815</b>	<b>96</b>	<b>719</b>	<b>153</b>	<b>566</b>
Asia	105	10	95	27	68
Australia	57	7	50	3	47
<b>Total Asia Pacific</b>	<b>162</b>	<b>17</b>	<b>145</b>	<b>30</b>	<b>115</b>
<b>Total Tenneco</b>	<b>\$ 1,651</b>	<b>\$ 115</b>	<b>\$ 1,536</b>	<b>\$ 375</b>	<b>\$ 1,161</b>



**Table of Contents****Three Months Ended June 30, 2007**

	<b>Revenues</b>	<b>Currency Impact</b>	<b>Revenues Excluding Currency (Millions)</b>	<b>Substrate Sales Excluding Currency Impact</b>	<b>Revenues Excluding Currency and Substrate Sales</b>
North America Original Equipment					
Ride Control	\$ 132	\$	\$ 132	\$	\$ 132
Emission Control	529		529	266	263
Total North America Original Equipment	661		661	266	395
North America Aftermarket					
Ride Control	110		110		110
Emission Control	39		39		39
Total North America Aftermarket	149		149		149
Total North America	810		810	266	544
Europe Original Equipment					
Ride Control	107		107		107
Emission Control	406		406	146	260
Total Europe Original Equipment	513		513	146	367
Europe Aftermarket					
Ride Control	61		61		61
Emission Control	63		63		63
Total Europe Aftermarket	124		124		124
South America & India	81		81	11	70
Total Europe, South America & India	718		718	157	561
Asia	85		85	30	55
Australia	50		50	7	43
Total Asia Pacific	135		135	37	98
Total Tenneco	\$ 1,663	\$	\$ 1,663	\$ 460	\$ 1,203

Revenues from our North American operations decreased \$136 million in the second quarter of 2008 compared to the same period last year. Higher aftermarket sales were more than offset by lower North American OE revenues. North American OE emission control revenues were down \$134 million in the second quarter of 2008. Excluding substrate sales, revenues were down \$60 million compared to last year. This decrease was primarily due to significant reduction in customer light truck production which included the Ford Super Duty gas and diesel pick up trucks, GM's three-quarter ton gasoline powered pick-up trucks, GM's light duty pick-up trucks and vans with the Duramax diesel engines and the Dodge Ram. North American OE ride control revenues for the second quarter of 2008 were down \$11 million from the prior year. Revenues from our recently acquired Kettering, Ohio ride-control operations helped

partially offset the significantly lower light truck and SUV production. Our total North American OE revenues, excluding substrate sales and currency, decreased 18 percent in the second quarter of 2008 compared to second quarter of 2007. The second quarter North American light truck production rate decreased 23 percent while production rates for passenger cars fell four percent. Aftermarket revenues for North America were \$158 million in the second quarter of 2008, an increase of \$9 million compared to the prior year, driven by higher volumes in both product lines due to sales to new customers. Aftermarket ride control revenues excluding currency increased four percent in the second quarter of 2008 while aftermarket emission control revenues excluding currency increased 10 percent in the second quarter of 2008.

Our geographic diversification benefitted us in the quarter as our European, South American and Indian segment s revenues increased \$97 million, or 14 percent, in the second quarter of 2008 compared to last year. The second quarter total European light vehicle industry production increased six percent from the second quarter of

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2007. Europe OE emission control revenues of \$447 million in the second quarter of 2008 were up 10 percent as compared to the second quarter of last year. Excluding substrate sales and a favorable impact of \$54 million due to currency, Europe OE emission control revenues decreased two percent over 2007, primarily due to less than prior year alloy surcharge recovery as nickel alloy costs were lower in the current year. Improved volumes on the BMW 1 and 3 series, Mini and VW Golf helped partially offset the emission control decrease. Europe OE ride control revenues of \$131 million in the second quarter of 2008 were up 23 percent year-over-year. Excluding currency, revenues increased by nine percent in the 2008 second quarter due to favorable volumes on the Suzuki Splash, VW Passat and Mercedes C-class. Lower volumes on the Audi A4 and A6 and the Renault Scenic partially offset the ride control increase. European aftermarket revenues increased \$5 million in the second quarter of 2008 compared to last year. When adjusted for currency, aftermarket revenues were down seven percent year over year. Excluding the \$8 million impact of currency, ride control aftermarket revenues were flat compared to prior year. Emission control aftermarket revenues were down \$10 million, excluding \$7 million in currency benefit, due to overall market declines. South American and Indian revenues were \$108 million during the second quarter of 2008, compared to \$81 million in the prior year. Stronger OE and aftermarket sales and currency appreciation drove this increase.

Our geographic diversification further benefitted us as revenues from our Asia Pacific segment increased \$27 million to \$162 million in the second quarter of 2008 compared to the same period last year. Excluding the impact of substrate sales and currency, revenues increased to \$115 million from \$98 million in the prior year. Asian revenues for the second quarter of 2008 were \$105 million, up 23 percent from last year. This increase was primarily due to higher OE sales in China. Second quarter revenues for Australia increased 13 percent to \$57 million. Excluding substrate sales and favorable currency of \$7 million, Australian revenue was up \$4 million.

**Table of Contents****Net Sales and Operating Revenues for the Six Months Ended June 30, 2008 and 2007**

	Six Months Ended June 30, 2008				Revenues Excluding Currency and Substrate Sales
	Revenues	Currency Impact	Revenues Excluding Currency Impact (Millions)	Substrate Sales	
North America Original Equipment					
Ride Control	\$ 233	\$	\$ 233	\$	\$ 233
Emission Control	833	2	831	409	422
Total North America Original Equipment	1,066	2	1,064	409	655
North America Aftermarket					
Ride Control	212	2	210		210
Emission Control	79	2	77		77
Total North America Aftermarket	291	4	287		287
Total North America	1,357	6	1,351	409	942
Europe Original Equipment					
Ride Control	260	33	227		227
Emission Control	873	109	764	272	492
Total Europe Original Equipment	1,133	142	991	272	719
Europe Aftermarket					
Ride Control	116	14	102		102
Emission Control	100	12	88		88
Total Europe Aftermarket	216	26	190		190
South America & India	202	22	180	28	152
Total Europe, South America & India	1,551	190	1,361	300	1,061
Asia	195	19	176	54	122
Australia	108	14	94	9	85
Total Asia Pacific	303	33	270	63	207
Total Tenneco	\$ 3,211	\$ 229	\$ 2,982	\$ 772	\$ 2,210



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	<b>Six Months Ended June 30, 2007</b>				<b>Revenues Excluding Currency and Substrate Sales</b>
	<b>Revenues</b>	<b>Currency Impact</b>	<b>Revenues Excluding Currency Impact (Millions)</b>	<b>Substrate Sales</b>	
North America Original Equipment					
Ride Control	\$ 265	\$	\$ 265	\$	\$ 265
Emission Control	905		905	432	473
Total North America Original Equipment	1,170		1,170	432	738
North America Aftermarket					
Ride Control	208		208		208
Emission Control	75		75		75
Total North America Aftermarket	283		283		283
Total North America	1,453		1,453	432	1,021
Europe Original Equipment					
Ride Control	214		214		214
Emission Control	793		793	284	509
Total Europe Original Equipment	1,007		1,007	284	723
Europe Aftermarket					
Ride Control	100		100		100
Emission Control	104		104		104
Total Europe Aftermarket	204		204		204
South America & India	151		151	19	132
Total Europe, South America & India	1,362		1,362	303	1,059
Asia	155		155	56	99
Australia	93		93	12	81
Total Asia Pacific	248		248	68	180
Total Tenneco	\$ 3,063	\$	\$ 3,063	\$ 803	\$ 2,260

Revenues from our North American operations decreased \$96 million in the first six months of 2008 compared to the same period last year. Higher aftermarket revenues were more than offset by lower OE revenues. North American OE emission control revenues were down \$72 million in the first six months of 2008. Excluding substrate sales and currency impact, revenues were down \$51 million compared to last year. This decrease was primarily due to significantly lower light vehicle OE production, as discussed in the three month discussion above. North American OE ride control revenues for the first six months of 2008 were down \$32 million from the prior year. The increase to ride control revenues from our recently acquired Kettering, Ohio ride-control operations was more than offset by the significantly lower customer production schedules. Our total North American OE revenues, excluding substrate sales

and currency, decreased 11 percent in the first six months of 2008 compared to the first six months of 2007, consistent with the North American light vehicle production rate decrease of 12 percent. Aftermarket revenues for North America were \$291 million in the first six months of 2008, an increase of \$8 million compared to the prior year, driven by higher sales in both product lines. Sales to new customers drove the increase. Excluding currency, aftermarket ride control revenues increased one percent in the first six months of 2008 while aftermarket emission control revenues increased three percent in the first six months of 2008.

Our geographic diversification benefitted us as our European, South American and Indian segment s revenues increased \$189 million, or 14 percent, in the first six months of 2008 compared to last year. The first six months total European light vehicle industry production increased five percent from the first six months of 2007. Europe OE emission control revenues of \$873 million in the first six months of 2008 were up 10 percent as compared to the first

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six months of last year. Excluding substrate sales and a favorable impact of \$109 million due to currency, Europe OE emission control revenues decreased four percent over 2007, primarily due to less than prior year alloy surcharge recovery as nickel alloy costs are lower in the current year. Europe OE ride control revenues of \$260 million in the first six months of 2008 were up 22 percent year-over-year. Excluding currency, revenues increased by six percent in the first six months of 2008 due to improved volumes on the VW Passat and Mercedes C-class both equipped with our electronic shocks. European aftermarket revenues increased \$12 million in the first six months of 2008 compared to last year. When adjusted for currency, aftermarket revenues were down six percent. Excluding the \$14 million impact of currency, ride control aftermarket revenues were up four percent due to strong volumes and improved pricing. Emission control aftermarket revenues were down 16 percent, excluding \$12 million in currency benefit, due to lower volumes which more than offset improved pricing. South American and Indian revenues were \$202 million during the first six months of 2008, compared to \$151 million in the prior year. Stronger OE and aftermarket sales and currency appreciation drove this increase.

Our geographic diversification further benefitted us as revenues from our Asia Pacific segment, increased \$55 million to \$303 million in the first six months of 2008 compared to the same period last year. Excluding the impact of substrate sales and currency, revenues increased to \$207 million from \$180 million in the prior year. Asian revenues for the first six months of 2008 were \$195 million, up 25 percent from last year. This increase was primarily due to higher OE sales in China driven by new launches and higher emission control volumes on existing platforms. Revenues for the first six months of 2008 for Australia increased 17 percent to \$108 million. Excluding substrate sales and favorable currency of \$14 million, Australian revenue was up \$4 million.

***EBIT for the three months ended June 30, 2008 and 2007***

	<b>Three Months Ended June 30, 2008</b>	<b>Three Months Ended June 30, 2007 (Millions)</b>	<b>Change</b>
North America	\$ 17	\$ 50	\$ (33)
Europe, South America & India	48	45	3
Asia Pacific	10	8	2
	\$ 75	\$ 103	\$ (28)

The EBIT results shown in the preceding table include the following items, certain of which are discussed below under Restructuring and Other Charges, which have an effect on the comparability of EBIT results between periods:

	<b>Three Months Ended June 30, 2008</b>	<b>2007 (Millions)</b>
North America		

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Restructuring and restructuring-related expenses	\$	1	\$
Changeover costs for new aftermarket customers(1)		7	
Europe, South America & India			
Restructuring and restructuring-related expenses		3	2
Asia Pacific			
Restructuring and restructuring-related expenses		2	

(1) Represents costs associated with changing new aftermarket customers from their prior suppliers to an inventory of our products. Although our aftermarket business regularly incurs changeover costs, we specifically identify in the table above those changeover costs that, based on the size or number of customers involved, we believe are of an unusual nature for the quarter in which they were incurred.

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EBIT for North American operations decreased to \$17 million in the second quarter of 2008, from \$50 million one year ago. OE industry production volume declines, including the industry's union labor strikes, and unfavorable vehicle mix shift negatively impacted EBIT by \$27 million. Lower manufacturing cost absorption driven by significant downward changes to customer production schedules reduced EBIT by an additional \$12 million. Higher depreciation expense of \$2 million related to capital expenditures to support our sizeable 2007 emission control platform launches further reduced EBIT. North America's second quarter 2008 EBIT was also negatively impacted by \$1 million in restructuring and restructuring-related costs and \$7 million of changeover costs for new aftermarket customers. Currency had a \$1 million unfavorable impact on North American EBIT. These decreases were partially offset by higher aftermarket volumes and new OE platform launches in both emission and ride control business which combined to impact EBIT favorably by \$9 million as well as focused spending reduction efforts to help counter the eroding North American industry environment, mainly in lower selling, general and administrative costs.

Our European, South American and Indian segment's EBIT was \$48 million for the second quarter of 2008 compared to \$45 million during the same period last year. Higher OE volumes, lower net alloy surcharges, manufacturing efficiencies, as well as favorable currency of \$2 million drove the increase. These increases were partially offset by lower European aftermarket sales. Restructuring and restructuring-related expenses of \$3 million were included in the second quarter of 2008 compared to \$2 million in the second quarter of 2007.

EBIT for our Asia Pacific segment in the second quarter of 2008 was \$10 million compared to \$8 million in the second quarter of 2007. Increased OE volumes impacted EBIT by \$2 million mainly in China, favorable currency of \$1 million and operational improvements drove the increase. Included in the second quarter of 2008's EBIT was \$2 million in restructuring and restructuring related expenses.

Currency had a \$2 million favorable impact on overall company EBIT for the three months ended June 30, 2008, as compared to the prior year.

***EBIT as a Percentage of Revenue***

	<b>Three Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
North America	3%	6%
Europe, South America & India	6%	6%
Asia Pacific	6%	6%
Total Tenneco	5%	6%

In North America, EBIT as a percentage of revenue for the second quarter of 2008 was three percentage points less than last year. Lower OE production of light trucks and SUVs, lower manufacturing cost absorption driven by the reduced OE production, higher spending on selling, general and administrative costs due to aftermarket changeover costs and increased depreciation expense were partially offset by the impact to EBIT margin due to increased aftermarket sales. During the second quarter of 2008, North American results also included higher restructuring and restructuring-related charges. In Europe, South America and India, EBIT margin for the second quarter of 2008 was even with prior year. Higher OE volumes, lower net alloy surcharges, favorable currency and manufacturing efficiencies were offset by higher restructuring costs. Restructuring and restructuring-related expenses were \$1 million more than the prior year. EBIT as a percentage of revenue for our Asia Pacific segment remained even versus prior

year. Volume increases in China, favorable currency and manufacturing efficiencies were offset by increased restructuring and restructuring-related expenses, which were \$2 million more than the prior year.

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	<b>Six Months Ended June 30, 2008</b>	<b>Six Months Ended June 30, 2007 (Millions)</b>	<b>Change</b>
North America	\$ 26	\$ 80	\$ (54)
Europe, South America & India	73	58	15
Asia Pacific	15	14	1
	<b>\$ 114</b>	<b>\$ 152</b>	<b>\$ (38)</b>

The EBIT results shown in the preceding table include the following items, certain of which are discussed below under Restructuring and Other Charges, which have an effect on the comparability of EBIT results between periods:

	<b>Six Months Ended June 30, 2008</b>	<b>2007 (Millions)</b>
North America		
Restructuring and restructuring-related expenses	\$ 2	\$ 1
Changeover costs for new aftermarket customers(1)	7	
Europe, South America & India		
Restructuring and restructuring-related expenses	6	3
Asia Pacific		
Restructuring and restructuring-related expenses	2	

- (1) Represents costs associated with changing new aftermarket customers from their prior suppliers to an inventory of our products. Although our aftermarket business regularly incurs changeover costs, we specifically identify in the table above those changeover costs that, based on the size or number of customers involved, we believe are of an unusual nature for the quarter in which they were incurred.

EBIT from North American operations decreased to \$26 million in the first six months of 2008, from \$80 million one year ago. The decline was primarily related to lower OE production volumes, including the industry union strikes, and a vehicle mix shift from light truck and SUVs to passenger cars. The OE production volume declines and the vehicle mix shift reduced EBIT by \$40 million for the first six months of 2008. Lower manufacturing cost absorption driven by the decline in overall OE production volumes reduced EBIT by \$12 million. Higher depreciation expense of \$5 million, resulting from capital expenditures to support our 2007 emission control platform launches, negatively impacted EBIT. In the first six months of 2008, North American EBIT was also negatively impacted by \$1 million of higher restructuring and restructuring-related expenses and \$7 million of new aftermarket customer changeover costs.

These decreases were partially offset by higher aftermarket volumes and new OE platform launches in both emission and ride control business which had a combined favorable EBIT impact of \$12 million.

Our European, South American and Indian segment's EBIT was \$73 million for the first six months of 2008 compared to \$58 million during the same period last year. The improvement was driven by significant manufacturing efficiencies which favorably impacted EBIT by \$16 million. Lower net alloy surcharges of \$5 million and reduced selling, general and administrative spending of \$8 million also benefited EBIT. These improvements were partially offset by increased spending of \$5 million on engineering as we invest in future programs and technologies and higher steel costs of \$8 million. Restructuring and restructuring-related expenses of \$6 million were included in first six months' EBIT of 2008, an increase of \$3 million from the same period last year. Currency had a \$2 million favorable impact on the first six months' EBIT of 2008.

EBIT for our Asia Pacific segment in the first six months of 2008 was \$15 million compared to \$14 million in the first six months of 2007. Increased volumes, mainly in China, increased EBIT by \$6 million while favorable



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currency had a \$2 million impact on EBIT. Those benefits were partially offset by increased selling, general and administrative expenses of \$2 million, higher steel costs of \$2 million and increased depreciation expense of \$1 million. Included in the first six months of 2008's EBIT was \$2 million of restructuring and restructuring-related expenses.

Currency had a \$4 million favorable impact on overall company EBIT for the six months ended June 30, 2008, as compared to the prior year.

***EBIT as a Percentage of Revenue***

	<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
North America	2%	6%
Europe, South America & India	5%	4%
Asia Pacific	5%	6%
Total Tenneco	4%	5%

In North America, EBIT as a percentage of revenue for the first six months of 2008 was four percentage points less than last year. The benefits from our higher aftermarket sales were more than offset by lower OE volumes, lower manufacturing cost absorption due to the reduced OE volumes, higher depreciation costs, and increased investments in engineering. During the first six months of 2008, North American results include higher restructuring and restructuring-related charges and aftermarket changeover costs. In Europe, South America and India, EBIT margin for the first six months of 2008 was one percentage point better than prior year. Reduced spending on selling, general and administrative costs, lower net alloy surcharges, favorable currency and manufacturing efficiencies were partially offset by higher engineering and depreciation costs. Restructuring and restructuring-related expenses were more than prior year. EBIT as a percentage of revenue for our Asia Pacific segment decreased one percentage point in the first six months of 2008 versus the prior year. OE production increases mainly in China and favorable currency were more than offset by higher restructuring and restructuring-related expenses and increased selling, general, and administrative costs.

***Interest Expense, Net of Interest Capitalized***

We reported interest expense of \$33 million (\$25 million in our U.S. operations and \$8 million in our foreign operations) in the second quarter of 2008 compared to \$40 million (\$39 million in the U.S. and \$1 million in our foreign operations) in the prior year. The requirement to mark to market the interest rate swaps described below increased interest expense by \$4 million in the second quarter 2008 and increased interest expense by \$3 million in the second quarter 2007. Interest expense decreased in the second quarter of 2008 compared to the prior year comparable period as a result of lower rates on both our variable debt and a portion of fixed rate debt.

We reported interest expense for the first half of 2008 of \$58 million (\$50 million in our U.S. operations and \$8 million in our foreign operations), down from \$80 million (\$78 million in our U.S. operations and \$2 million in our foreign operations) a year ago. The requirement to mark to market the interest rate swaps described below decreased interest expense by \$1 million for the first six months of 2008, versus an increase to expense of \$2 million in the first half of 2007. Included in the first six months of 2007 results was a \$5 million charge to expense the unamortized portion of debt issuance costs related to our previous senior credit facility due to our debt refinancing in the first

quarter of 2007.

We have three fixed-to-floating interest rate swaps that effectively convert \$150 million of our 101/4 percent fixed interest rate senior secured notes into floating interest rates at an annual rate of LIBOR plus 5.68 percent. Based upon the current LIBOR rate of 4.08 percent (which is in effect until July 15, 2008) these swaps are expected to decrease our interest expense by \$1 million in 2008 excluding any impact from marking the swaps to market. Since entering into these swaps, we have realized a net cumulative benefit of \$3 million through June 30, 2008, in reduced interest payments. On June 30, 2008, we had \$1.012 billion in long-term debt obligations that have fixed interest rates. Of that amount, \$245 million is fixed through July 2013, \$500 million is fixed through

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November 2014, \$250 million is fixed through November 2015, and the remainder is fixed from 2012 through 2025. Of the \$245 million, \$150 million has been swapped to floating and we also have \$438 million in long-term debt obligations outstanding under our senior secured credit facility that are subject to variable interest rates. See Note 3 to the condensed consolidated financial statements of Tenneco Inc. and Consolidated Subsidiaries.

***Income Taxes***

We reported income tax expense of \$27 million in the second quarter of 2008 which included a \$13 million non-cash charge for tax liabilities mostly related to changes in intercompany billing arrangements. The effective tax rate for the second quarter of 2008 was 64 percent. We reported income tax expense of \$20 million in the second quarter of 2007. The effective tax rate for the second quarter of 2007 was 32 percent.

Income tax expense was \$32 million for the first six months of 2008, compared to \$22 million for the first six months of 2007. The effective tax rate for the first half of 2008 was 57 percent as compared to 31 percent for the first six months of 2007.

***Restructuring and Other Charges***

Over the past several years we have adopted plans to restructure portions of our operations. These plans were approved by the Board of Directors and were designed to reduce operational and administrative overhead costs throughout the business. Prior to the change in accounting required for exit or disposal activities, we recorded charges to income related to these plans for costs that did not benefit future activities in the period in which the plans were finalized and approved, while actions necessary to affect these restructuring plans occurred over future periods in accordance with established plans.

Our recent restructuring activities began in the fourth quarter of 2001, when our Board of Directors approved a restructuring plan, a project known as Project Genesis, which was designed to lower our fixed costs, relocate capacity, reduce our work force, improve efficiency and utilization, and better optimize our global footprint. We have subsequently engaged in various other restructuring projects related to Project Genesis. We incurred \$27 million in restructuring and restructuring-related costs during 2007, of which \$23 million was recorded in cost of sales and \$4 million was recorded in selling, general and administrative expense. In the second quarter of 2008, we incurred \$6 million in restructuring and restructuring-related costs, of which \$3 million was recorded in cost of sales and \$3 million was recorded in selling, general and administrative expense. For the first six months of 2008, we incurred \$10 million in restructuring and restructuring-related costs of which \$6 million was recorded in cost of sales and \$4 million in selling, general and administrative expense. Since Project Genesis was initiated, we have incurred costs of \$165 million through June 30, 2008. We estimate that our current annual savings rate for completed projects is approximately \$102 million. When all actions are complete, we expect an additional \$11 million of annual savings.

Under the terms of our amended and restated senior credit agreement that took effect on March 16, 2007, we are allowed to exclude \$80 million of cash charges and expenses, before taxes, related to cost reduction initiatives incurred after March 16, 2007 from the calculation of the financial covenant ratios required under our senior credit facility. As of June 30, 2008, we have excluded \$33 million in allowable charges relating to restructuring initiatives against the \$80 million available under the terms of the March 2007 amended and restated to the senior credit facility.

In addition to the announced actions, we will continue to evaluate additional opportunities and expect that we will initiate actions that will reduce our costs through implementing the most appropriate and efficient logistics, distribution and manufacturing footprint for the future. We expect to continue to undertake additional restructuring actions as deemed necessary, however, there can be no assurances we will undertake such actions. Actions that we take, if any, will require the approval of our Board of Directors, or its authorized committee. We plan to conduct any

workforce reductions that result in compliance with all legal and contractual requirements including obligations to consult with workers' councils, union representatives and others.

**Table of Contents*****Earnings Per Share***

We reported net income of \$13 million or \$0.26 per diluted common share for the second quarter of 2008, as compared to net income of \$41 million or \$0.85 per diluted common share for the second quarter of 2007. Included in the results for the second quarter of 2008 were negative impacts from expenses related to our restructuring and restructuring related activities, the negative impact of new aftermarket customer changeovers and tax charges. The net impact of these items decreased earnings per diluted share by \$0.45. Included in the results for the second quarter of 2007 were negative impacts from expenses related to our restructuring activities which decreased earnings per diluted share by \$0.03. Please read the Notes to the consolidated financial statements for more detailed information on earnings per share.

We reported net income of \$19 million or \$0.39 per diluted common share for the first half of 2008, as compared to net income of \$46 million or \$0.96 per diluted common share for the first half of 2007. Included in the results for the first half of 2008 were negative impacts from expenses related to our restructuring activities, the negative impact of new aftermarket customer changeovers and tax charges. The net impact of these items decreased earnings per diluted share by \$0.52. Included in the results for the first half of 2007 were negative impacts from expenses related to our restructuring activities and charges relating to refinancing in the first quarter. The net impact of these items decreased earnings per diluted share by \$0.13.

***Cash Flows for the Three Months Ended June 30, 2008 and 2007***

	<b>Three Months Ended June 30, 2008</b>	<b>Three Months Ended June 30, 2007 (Millions)</b>
Cash provided (used) by:		
Operating activities	\$ 61	\$ 67
Investing activities	(85)	(38)
Financing activities	28	(8)

***Operating Activities***

For the three months ended June 30, 2008, operating activities provided \$61 million in cash compared to \$67 million in cash provided during the same period last year. For the three months ended June 30, 2008, cash used for working capital was \$16 million versus \$15 million for the three months ended June 30, 2007. Receivables were a use of cash of \$61 million compared to a use of cash of \$111 million in the prior year. The lower use of cash for receivables reflects the lower production activity in the U.S. as our OE customers reduced production in the quarter as well as an increase of \$45 million in securitized accounts receivable. Inventory cash flow changed only slightly, representing a cash outflow of \$4 million during the three months ended June 30, 2008 versus a cash inflow of \$3 million in the prior year. Accounts payable provided cash of \$29 million compared to last year's cash inflow of \$91 million driven by the lower level of U.S. production and lower days payable outstanding. The change in other operating cash flow is mostly related to a change in non-current liabilities driven by the tax liability recorded in the quarter as explained above. Cash taxes were \$12 million for the three months ended June 30, 2008, compared to \$20 million in the prior year.

One of our European subsidiaries receives payment from one of its OE customers whereby the accounts receivable are satisfied through the delivery of negotiable financial instruments. We may collect these financial instruments before their maturity date by either selling them at a discount or using them to satisfy accounts receivable that have previously been sold to a European bank. Any of these financial instruments which are not sold are classified as other current assets as they do not meet our definition of cash equivalents. The amount of these financial instruments that was collected before their maturity date totaled \$10 million as of June 30, 2008, compared with \$21 million at the same date in 2007. No negotiable financial instruments were held by our European subsidiary as of June 30, 2008 or June 30, 2007.

In certain instances several of our Chinese subsidiaries receive payment from OE customers and satisfy vendor payments through the receipt and delivery of negotiable financial instruments. Financial instruments used to satisfy

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vendor payables and not redeemed totaled \$14 million and \$11 million at June 30, 2008 and 2007, respectively, and were classified as notes payable. Financial instruments received from OE customers and not redeemed totaled \$11 million and \$6 million at June 30, 2008 and 2007, respectively, and were classified as other current assets. One of our Chinese subsidiaries that issues its own negotiable financial instruments to pay its vendors is required to maintain a cash balance at a financial institution that guarantees those financial instruments. No financial instruments were outstanding at that Chinese subsidiary as of June 30, 2008. As of June 30, 2007 the required cash balance was less than \$1 million and was classified as cash and cash equivalents.

The negotiable financial instruments received by one of our European subsidiaries and some of our Chinese subsidiaries are checks drawn by our OE customers and guaranteed by their banks that are payable at a future date. The use of these instruments for payment follows local commercial practice. Because negotiable financial instruments are financial obligations of our customers and are guaranteed by our customers' banks, we believe they represent a lower financial risk than the outstanding accounts receivable that they satisfy which are not guaranteed by a bank.

*Investing Activities*

Cash used for investing activities was \$47 million higher in the second quarter of 2008 compared to the same period a year ago. Cash payments for plant, property and equipment were \$64 million in the second quarter of 2008 versus payments of \$36 million in the second quarter of 2007. The increase of \$28 million in cash payments for plant, property and equipment was to support new business that has been awarded for 2010 and 2011. Cash of \$19 million was used to acquire the Kettering, Ohio ride control operations during the second quarter of 2008. Cash payments for software-related intangible assets were \$3 million in the second quarter of 2008 compared to \$4 million in the second quarter of 2007.

*Financing Activities*

Cash flow from financing activities was an \$28 million inflow in the second quarter of 2008 compared to an outflow of \$8 million in the same period of 2007. The increase was mainly due to borrowings against our revolver.

*Cash Flows for the Six Months Ended June 30, 2008 and 2007*

	<b>Six Months Ended June 30, 2008</b>	<b>Six Months Ended June 30, 2007</b>
	(Millions)	
Cash provided (used) by:		
Operating activities	\$ (6)	\$ (26)
Investing activities	(152)	(83)
Financing activities	115	61

*Operating Activities*

For the six months ended June 30, 2008, operating activities used \$6 million in cash compared to \$26 million in cash used during the same period last year. For the six months ended June 30, 2008, cash used for working capital was \$155 million versus \$154 million for the six months ended June 30, 2007. Receivables were a use of cash of

\$148 million compared to a cash use of \$312 million in the prior year. Inventory represented a cash outflow of \$47 million during the six months ended June 30, 2008, an improvement of \$24 million over the prior year. The year-over-year improvement in cash for both accounts receivable and inventory was primarily a result of higher working capital requirements for our new platform launches in North America in 2007. Accounts payable provided cash of \$45 million, a decrease from last year's cash inflow of \$241 million. This decrease also primarily resulted from the working capital activity in 2007 for our new platform launches in North America. The increase in other operating cash flow was primarily due to the non-cash tax liability charge referred to above and a decrease in long-term assets mainly related to engineering reimbursement arrangements with other customers. Cash taxes were \$24 million for the six months ended June 30, 2008, compared to \$28 million in the prior year.



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### *Investing Activities*

Cash used for investing activities was \$69 million higher in the first half of 2008 compared to the same period a year ago. Cash payments for plant, property and equipment were \$127 million in the first half of 2008 versus payments of \$75 million in the first six months of 2007. The increase of \$52 million in cash payments for plant, property and equipment was to support new programs launching in 2010 and 2011 to meet the stricter emission regulations. Cash of \$19 million was used to acquire ride control assets at Delphi's Kettering, Ohio location during the first half of 2008. Cash payments for software-related intangible assets were \$8 million in the first six months of 2008 compared to \$11 million in the first six months of 2007.

### *Financing Activities*

Cash flow from financing activities was a \$115 million inflow in the first six months of 2008 compared to an inflow of \$61 million in the same period of 2007. The primary reason for the change is attributable to an increase in borrowings to fund capital spending for future growth.

## **Outlook**

For the second half of the year, North American light vehicle production levels are expected to remain volatile due to overall weak vehicle sales and a continued mix shift away from light trucks and SUVs. We should benefit from our recent Kettering, Ohio acquisition, which produces ride control systems for passenger cars. We will continue to closely watch market conditions, specifically trends in light vehicle purchases by consumers and fuel prices in North America.

Although European economic indicators are weakening, Global Insight projects that production will be up 2 percent year-over-year for the second half of the year, with western Europe's estimated production decline of 1 percent more than offset by eastern Europe's estimated 9 percent production growth. Global Insight projects production to grow in the second half of the year in South America and India by 9 percent and 19 percent, respectively. Global Insight's second half of the year production estimate for China is a 16 percent increase. However, due to China's increasing fuel costs, rising inflation, and the recent earthquake, we expect this estimate to moderate. We anticipate that the global aftermarket will be relatively flat to slightly down. We will continue to support our strong brands and aggressively pursue new customers, actions that we hope will counter any continued softness in the aftermarket.

Global Insight projects that full year light vehicle production for North America will be down 11 percent, while total Europe industry production will increase 4 percent. In addition, Global Insight projects full year production will increase year-over-year in South America by 13 percent, in India by 11 percent and in China by 16 percent. We anticipate the growth in these regions will help mitigate the impact of the weak North American market.

Tenneco's guidance from the beginning of this year on its 2008 and 2009 global original equipment revenue is no longer applicable given the challenging economic conditions facing the automotive industry in North America and around the world. We are not providing a specific update to our 2008 and 2009 guidance due to the volatility of market conditions in North America and the uncertainties around customer restructurings and plant shut-downs. We will continue to focus globally on increasing productivity and cost improvements through Six Sigma, Lean manufacturing and restructuring activities. In North America, we may take additional restructuring actions as we adjust operations in the declining North American production environment, taking into account our capacity needs for future growth, particularly in the commercial vehicle segment. We have taken action to reduce salaried headcount in North America, and expect to record restructuring charges of \$5 million for these actions in the third quarter of 2008.

We continue to expect that we can achieve an average compounded annual OE revenue growth rate of 11% to 13% between 2008 and 2012. We expect half of this growth to be generated in the commercial vehicle market with significant new emission control business for on-road and off-road applications. We have been awarded 37 development or production contracts globally to supply diesel after-treatment technologies to meet stricter emissions regulations that take effect in various regions of the world starting in 2010. These include more than 20 commercial vehicle contracts for on-road and off-road (construction and agriculture) applications. We

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announced last month that we will be working with Caterpillar Inc. to develop and produce diesel engine after-treatment systems for Caterpillar engines to meet stricter diesel emissions regulations that phase in beginning in 2011.

Our guidance on steel cost increases from earlier this year has changed. Rising alloy surcharges for chrome in North America and soaring carbon steel prices worldwide are having a greater impact on costs than foreseen at the beginning of 2008. While we have substantial protection from much of the current steel inflation for 2008 due to our annual contracts, we do have some shorter term contracts and renewals that occur during the course of the year. As such we are now forecasting 2008 steel cost increases of \$50-\$60 million versus our earlier estimate of \$40 million. We believe we will offset these cost increases through our cost reduction efforts, aftermarket pricing and OE customer price recoveries. As current contracts expire, and we move into 2009, we are expecting an even more significant acceleration of these costs. Recovery discussions are already underway with our customers to pass these costs on to the market.

### ***Critical Accounting Policies***

We prepare our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Preparing our condensed consolidated financial statements in accordance with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The following paragraphs include a discussion of some critical areas where estimates are required.

#### ***Revenue Recognition***

We recognize revenue for sales to our original equipment and aftermarket customers when title and risk of loss pass to the customers under the terms of our arrangements with those customers, which is usually at the time of shipment from our plants or distribution centers. In connection with the sale of exhaust systems to certain original equipment manufacturers, we purchase catalytic converters and diesel particulate filters or components thereof including precious metals ( substrates ) on behalf of our customers which are used in the assembled system. These substrates are included in our inventory and passed through to the customer at our cost, plus a small margin, since we take title to the inventory and are responsible for both the delivery and quality of the finished product. Revenues recognized for substrate sales were \$822 million, and \$803 million for the first six months of 2008 and 2007, respectively. For our aftermarket customers, we provide for promotional incentives and returns at the time of sale. Estimates are based upon the terms of the incentives and historical experience with returns. Certain taxes assessed by governmental authorities on revenue producing transactions, such as value added taxes, are excluded from revenue and recorded on a net basis. Shipping and handling costs billed to customers are included in revenues and the related costs are included in cost of sales in our Statements of Income (Loss).

#### ***Warranty Reserves***

Where we have offered product warranty, we also provide for warranty costs. Those estimates are based upon historical experience and upon specific warranty issues as they arise. While we have not experienced any material differences between these estimates and our actual costs, it is reasonably possible that future warranty issues could arise that could have a significant impact on our consolidated financial statements.

#### ***Pre-production Design and Development and Tooling Assets***

We expense pre-production design and development costs as incurred unless we have a contractual guarantee for reimbursement from the original equipment customer. We had long-term receivables of \$18 million and \$20 million on the balance sheet at June 30, 2008 and December 31, 2007, respectively, for guaranteed pre-production design and development reimbursement arrangements with our customers. In addition, plant, property and equipment includes \$60 million and \$62 million at June 30, 2008 and December 31, 2007, respectively, for original equipment tools and dies that we own. Prepayments and other includes \$53 million and \$33 million at

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June 30, 2008 and December 31, 2007, respectively, for in-process tools and dies that we are building for our original equipment customers.

*Income Taxes*

We have a U.S. Federal tax net operating loss carryforward ( NOL ) at December 31, 2007, of \$518 million, which will expire in varying amounts from 2020 to 2027. The federal tax effect of that NOL is recorded as a deferred tax asset of \$181 million at December 31, 2007. In the first six months of 2008, we recorded an additional \$19 million in deferred tax assets. We also have state NOL carryforwards at December 31, 2007 of \$767 million, which will expire in various years through 2027. The tax effect of the state NOL, net of a valuation allowance, is recorded as a deferred tax asset of \$40 million at December 31, 2007 and \$39 million at June 30, 2008. We estimate, based on available evidence both positive and negative, that it is more likely than not that we will utilize these NOLs within the prescribed carryforward period. That estimate is based upon our expectations regarding taxable income of our U.S. operations and the implementation of available tax planning strategies that increase U.S. taxable income and accelerate usage of the NOL. Circumstances that could change that estimate include future U.S. earnings at lower than expected levels, resulting, for example, from a further deterioration in the production schedules and vehicle mix of our OE customers or significant additional increases in material costs that we are unable to recover from our customers, or a majority ownership change as defined in the rules of the U.S. tax law. If that estimate that it is more likely than not that we will utilize these NOLs changes, we would be required to cease recognizing an income tax benefit for any new NOL and could be required to record a reserve for some or all of the asset currently recorded on our balance sheet.

*Stock-Based Compensation*

Effective January 1, 2006, we began accounting for our stock-based compensation plans in accordance with SFAS No. 123(R), Share-Based Payment, which requires a fair value method of accounting for compensation costs related to our stock-based compensation plans. Under the fair value method recognition provision of the statement, a share-based payment is measured at the grant date based upon the value of the award and is recognized as expense over the vesting period. Determining the fair value of share-based awards requires judgment in estimating employee and market behavior. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted. As of June 30, 2008, there is approximately \$4 million, net of tax, of total unrecognized compensation costs related to these stock-based awards that is expected to be recognized over a weighted average period of 1.3 years as compared to \$5 million, net of tax, and a weighted average period of 1.2 years as of June 30, 2007.