

FINAL TRANSCRIPT

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TRW - Q3 2007 TRW Auto Earnings Conference Call

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Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

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PRESENTATION

Operator

Good morning and welcome to the TRW conference call. All lines have been placed on listen-only mode and, as a reminder; this conference call is being recorded. Presentation material for today's call was posted to the Company's website this morning at TRW.com/results. Please download the material now if you have not already done so. After the speakers' remarks there will be a question-and-answer period. (OPERATOR INSTRUCTIONS). I would now like to introduce your host for today's conference call, Mr. Patrick Stobb, Director of Investor Relations. Mr. Stobb, you may begin.

Patrick Stobb - TRW - IR Director

Thank you, Mandy, and I would like to welcome everyone to our third-quarter conference call. Joining me are John Plant, our President and Chief Executive Officer, and Joe Cantie, our Chief Financial Officer. On today's call John will provide an overview of the financial results and discuss other related business matters. After John's comments Joe will provide an expanded review of the financial information and then we'll open the call to your questions.

There are a few items I would like to cover before getting started. First, today's conference call will include forward-looking statements. These statements are based on the environment as we see it today and therefore involve risks and uncertainties. I would caution you that our actual results could differ materially from the forward-looking statements made on this call.

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Please refer to slide 3 of the presentation for our complete Safe Harbor statement. The risk factor section of our 2006 Form 10-K contains additional information about risks and uncertainties that could impact our business. You can access our 2006 10-K and other SEC filings by visiting the investor information section of our website at TRW.com or through the SEC's website at SEC.com. On a related matter, we expect to file our 10-Q within the next day or so.

The next item, in addition to our GAAP results we will be discussing non-GAAP information that we believe is useful in evaluating the Company's operating performance. Reconciliations for these non-GAAP measures to the closest GAAP equivalent can be found in the conference call materials posted to the investor information section of our website this morning.

And finally, we have not given our permission for any other recording of this call and do not approve or sanction any transcribing of the call. A replay can be accessed via dial in or through a webcast on our website; replay instructions were included in our release this morning. This concludes my comments; I'll now turn the call over to John Plant.

John Plant - TRW - CEO, President

Thanks, Pat, and good morning, everyone. I'm pleased that TRW's good performance continued during the quarter; we posted both sales and earnings growth compared to the previous year. We successfully completed a strenuous loan schedule and generated a good level of cost savings that helped offset the higher than expected commodity inflation.

With nine months of the results reported or the year we are focused on closing the year in a solid note. TRW's success, past and present, is in part attributable to the Company's unrivaled breadth of active and passive safety products, its leading industry, customer and geographic diversification and the ability to aggressively reduce costs through manufacturing efficiency programs, purchasing programs and the restructuring actions.

The Company's success can also be attributed to its ability to consistently deliver innovative technology to the market. We're at the forefront of active and passive safety and we believe our ability to design, develop and deliver advanced products is second to none.

In support of these efforts each year we invest over \$1 billion in capital and engineering. We are continuing to grow. For example, measuring from 2002 through to the end of 2006 our average content per vehicle in Europe, which is our European sales divided by total production in the region, increased by approximately \$100. Although partly fueled by currency this is an impressive result, especially considering the fact that the industry production in Western Europe, where most of our content is derived, was down nearly 5% during the period.

In 2007 total sales for Electronic Stability Control, Electrically Powered Steering, our Electric Park Brake, Tire Pressure Monitoring and Side and Curtain Airbag Systems have increased some 16%. Market penetration for many of these new control products are expected to increase over the next several years. One such product is Electrically Powered Steering, or EPS, which provides enhanced safety through greater integration with braking and also provides fuel efficiency improvements of some 3 to 4% compared to hydraulically powered steering.

We estimate market penetration for EPS systems in 2007 is approximately 40% in Europe compared to 10% in North America. With high fuel prices now in North America vehicle manufacturers are now more responsive to adopting this technology. We launch our first application in the U.S. region next year with a high-volume platform based on our good experience in the European markets.

Another example is TRW's Electric Park Brake, or EPB. We are the industry leader and first to market for this technology. The addition of EPB to a vehicle replaces the conventional brake pull mechanism with an electronic system that engages actuators on the rear calipers. EPB allows us to displace other supply content on the vehicle, frees up space in the vehicle cabin by

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

eliminating levers or pedals, requires less assembly time in the vehicle manufacturers' assembly plants. Currently market penetration for EPB is estimated at below 10% in Europe. We believe the opportunity for growth in EPB is substantial.

In summary, our present path of sustained growth is based on our ability to deliver affordable technology to our customers. We have a very active pipeline of product in the market and under development that we believe will help drive our future growth.

Turning now to vehicle production by market. Total volumes across the major markets increased during the third quarter. North America increased 4% which included a slight production increase for the Big 3 of 1%. Europe increased 4% and South America was up 15%. In Asia, China continued its substantial growth with a 22% increase in vehicle production.

The high production levels benefited the sales line for TRW. We reported third-quarter sales of \$3.5 billion, an increase of 16% compared to the prior year. Excluding the effects of currency our sales increased by more than 9% in Q3 which is a very solid outcome. We benefited from higher product volumes primarily due to new product introductions including above trend sales of the lower margin module products.

We posted sales growth across our major reporting regions; operations in China and South America, which are the primary locations in our rest of the world category, reported the most significant gains at 51% increase in sales in the quarter. Net earnings for Q3 were \$0.22 per share which compares to \$0.05 per share in the prior year. With respect to the year-to-date results we posted earnings after excluding debt retirement expenses of \$1.84 per share on sales of \$10.4 billion.

Turning now to third-quarter business developments beginning with a new business summary. We recorded steady business wins with a number of the world's leading vehicle manufacturers. The book of new business we have in place through 2010 provides a measure of confidence in our ability to grow revenue at a solid pace. We introduced a number of products during the quarter beginning with our Thin-Wide brake technology. The design of our calipers provided improved brake torque performance, longer life and weighed up to 20% less than our conventional brake which equates to increased fuel efficiency for our customers.

The second product introduced was our advanced 24 GHz midrange radar which is part of our expanding portfolio of active cruise control technologies. The new radar was designed to bring affordable all weather radar based systems to the mass vehicle market. We also introduced our latest regenerative electronic stability control system. The electronic brake system combines stability control with advanced regenerative braking to provide fuel efficiency and seamless brake blending performance for hybrid vehicles.

And finally, we introduced our efficient control system which uses sophisticated algorithms to monitor cabin comfort and helps minimize energy draw. And this provides, again, fuel efficiency for the air-conditioning system. These technologies underpin our success at winning new business and help ensure future growth.

As I mentioned previously, we had a very busy launch quarter, including 117 new programs which were successfully introduced. Our most significant launch was Chrysler's 2008 minivan platform where we have an extensive array of product on this vehicle. We also launched a host of products for the new VW Tiguan including our Electronic Park Brake and Electronic Stability Control System. Other launches included side and curtain airbags for the Fiat 500, corner modules and calipers for the Ford Econoline and Tire Pressure Monitoring Systems for Toyota and Hyundai.

Now for an update on commodity inflation which has represented significant challenges to our profitability in 2007. A majority of the inflationary pressures stem from the unpredictable nature of a weakened supply base in North America and sharp increases in the pricing curve for commodities such as nickel, zinc and magnesium. For the first nine months of the year the gross impact of commodity inflation was nearly \$[80] million.

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Based on year-end forecasts commodity inflation will now exceed \$100 million for the year which is above the level we indicated during our second-quarter conference call. Our sales growth together with improved cost performance and benefits derived from our restructuring programs have helped mitigate these heightened commodity inflationary pressures.

With respect to automotive components, the segment moved from a loss in 2006 to earning \$5 million in the third quarter of 2007. As I mentioned during our previous earnings call, the second half was going to be challenging for the segment. Although they have made headway in improving operations the segment was hit hard by commodity inflation. We do expect to show sequential improvement for the automotive components business and this will continue into the fourth quarter.

And the last item, the Big 3 North America are focused on inventory management which could lead to further production cuts. At this point we are monitoring production releases closely and are prepared to react quickly to minimize profit impact in the fourth quarter.

I'd now like to turn to our assumptions and outlook for the remainder of 2007. Persistent economic pressures continue in North America and heightened commodity inflation are presenting significant challenges. We have lowered our vehicle production estimate for North America to approximately 15 million units for the year and raised projections for Europe to 21.4 million units, primarily growth of small vehicles in Eastern Europe. Additionally, we expect volumes growth will continue in China and South America.

With nine months of results reported we find our expectations as follows -- we now expect sales for the year of approximately \$14.5 billion which assumes the strong Euro continues through the fourth quarter. We have narrowed our estimate for earnings, excluding debt retirement costs, to be in the range of \$2.10 to \$2.30 per share. Our estimate for pretax restructuring expenses holds at \$45 million for the year and we expect capital spending to be slightly less than 4% of sales. And finally, we adjusted the full-year effective tax rate excluding debt retirement costs to be in the range of 40 to 42%.

In closing, we are pleased with the results thus far this year and, per my earlier comments, we're looking to close the year out on a solid note with the midpoint of our guidance now the same as last time. We are optimistic about the future of TRW and we believe the Company is well-positioned to succeed in an ultra competitive global environment. With that I'll now hand over the call to Joe to discuss our financial results in further detail.

Joe Cantie - TRW - CFO, EVO, Treasurer

Thank you, John, and good morning to everyone. The third-quarter results we released this morning were, for the most part, pretty solid and in line with our expectations. With three quarters now behind us we're in a good position to finish out the year on a reasonable basis and believe our strength overseas will help us mitigate another difficult fourth-quarter operating environment primarily in North America.

I'll expand on our guidance for the remainder of 2007 in a few minutes, after I review our third-quarter and year-to-date results including some comments on our capital structure and cash flows. For the third quarter we reported sales of \$3.5 billion, an increase of \$480 million or 16% when compared to the previous year. Currency translation benefited the year-to-year sales comparison by \$201 million. The Euro, our most significant translation exposure, averaged 1.37 against the dollar which was about 8% higher than the average exchange rate we experienced in the prior year.

While our sales increased from currency translation the impact to operating income was not material after considering the net impact of both our translation and transaction exposures. If currency exchange rates hold as they are we expect currency will have a similar impact on our fourth-quarter results.

Excluding the effects of currency translation sales improved by about \$279 million or 9% compared to the previous year. Sales in the quarter benefited from increased customer production volumes, primarily in Europe and Asia, and from a higher penetration

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

of safety products in all markets. Big 3 production volumes in North America were essentially flat compared to last year, something I haven't been able to say for many quarters.

A higher level of module sales contributed about \$100 million of the increase. As a reminder, although the right decision from a return on capital standpoint, module sales provide a small amount to the operating line and therefore contributed to the decline in margin between the two periods. Our sales growth was well dispersed among our Chassis, Occupant Safety and Automotive Component segments. The only notable difference is that Chassis reported the highest level of growth, primarily due to the above trend module sales.

With respect to our regional sales mix, we experienced a measurable mix change away from North America primarily due to the impact of currency and increased product volumes in Asia and other parts of the world. During the quarter sales increased some 47% in our rest of world operations.

Moving down the income statement, operating income in the quarter was \$95 million which is \$13 million above the previous year. Excluding the impact of restructuring expenses from both years, the current year quarter was 27% above last year. Higher customer production volumes and new product growth were positive in the quarter. Net cost performance was also solid and together with other positives more than offset cost pressures related to customer pricing and to some extent commodity inflation.

Below operating income net interest and securitization expense was \$56 million which is below last year's level of \$62 million mainly due to the benefits derived from the debt refinancings we completed earlier in the year. Tax expense in both years was \$18 million. The effective tax rate in the 2007 quarter was 44% which compares favorably to 78% in the prior year primarily due to a different geographical mix of earnings and other factors between the two quarters.

At the bottom line we posted GAAP net earnings of \$0.22 per share which is good outcome for us and is improved from the prior year result of \$0.05 per share. And finally, for the quarter in terms of EBITDA we had \$237 million for the quarter compared to \$213 million last year.

Moving to a brief review of the year-to-date nine-month results, we reported sales of \$10.80 billion, which is an increase of \$944 million or 10% compared to the previous year. Currency translation accounted for \$528 million of the increase which primarily reflects the weakness of the U.S. dollar against the Euro and other major currencies. The remaining variance, \$416 million, can be attributed to increased vehicle production in Europe in China and continued growth of our safety products including above trend module sales that together offset pricing provided to our customers. Our operating income in the first nine months was \$475 million which compares to \$510 million in 2006.

Looking at the variance between the two periods, the lower 2007 result can be attributed to the first quarter in which operating income declined by \$52 million. If you recall, our Q1 results were negatively impacted by a weak production environment, a negative mix of products sold and other unfavorable items including lower profits in our automotive components group. Positive year-to-year operating results in both the second and third quarters helped to offset the decline.

Below operating income interest related expenses were \$177 million in 2007 compared to \$184 million last year. The decline is due to the refis earlier this year. Charges relating to the refinancing of our bonds and credit facilities in 2007 totaled \$155 million; the prior year had \$57 million associated with the Lucas Bond tender. And then tax expense for the nine-month period was \$116 million which compares to \$134 million in 2006. The effective tax rate after excluding debt retirement expenses from both years was 38% in 2007 which compares to 40% in 2006.

At the bottom line we reported GAAP net earnings of \$0.33 per share which compares to \$1.38 per share last year. However, net earnings excluding debt retirement expenses from both periods were \$1.84 this year compared to \$1.93 in 2006. And finally, in terms of EBITDA we had \$890 million this year compared to \$899 million in the prior year.

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Moving now to our capital structure -- third-quarter cash used by operations was \$158 million which included the repayment of \$127 million of outstanding borrowings under our U.S. securitization facility. If you recall, our second-quarter cash flow included proceeds from the receivable facility in the same amount. Cash flow was a use of \$31 million after excluding this debt repayment which compares to a source of \$1 million in 2006. For the third quarter CapEx was \$111 million this year compared to \$132 million last year.

So just looking at the quarter in isolation cash flow was comparable between the two years. However, on a year-to-date basis, cash used by operations was \$89 million or \$428 million after capital expenditures. We were hoping to catch up some of the cash used in the first half of the year during our third quarter. A few factors worked against us during the quarter.

First, our sales growth of 16% is great for the Company but from a cash flow standpoint required a higher level of working capital. Second, we had an invoicing issue with one of our businesses in Europe that caused a sizable portion of our receivables expected to be collected in September to arrive in October. And the third item, the higher level of business in Europe and Asia, where net payment terms are presently less favorable, has been increasing our working capital needs.

Our fourth quarter is always the strongest cash flow quarter. Based on our current forecast we expect to have a significant cash inflow which will allow us at a minimum to recover the cash outflow from operations after CapEx that we've experienced through the end of September.

Switching subjects now to our expectations for the fourth quarter. As our guidance indicates, our prospects remain positive although tempered by the difficult industry conditions that John and I have been discussing in our comments today, most notably in the North American market and on a wider scale persistent commodity inflation. Given the current vehicle inventory levels at the OEs we see only headwinds in terms of customer production schedules as we close out the year.

In North America production is expected to be down overall and 5% lower at the Big 3. For the fourth quarter, based on current forecasts, sales should be approximately \$3.7 billion, which is \$400 million plus compared to last year's fourth quarter. Currency and lower margin module sales will account for a substantial portion of the increase. The sales level is based on industry production of about 3.7 million units in North America and 5.5 million units in Europe including Eastern Europe. We expect pretax restructuring charges will be approximately \$13 million in the quarter.

In closing, we're pleased with the outcome of our year-to-date results and, as you would expect, we are focused on closing out the year as best we can and look forward to reporting our full-year results to you in February. We'll now move to the question-and-answer portion of the call.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). John Murphy, Merrill Lynch.

John Murphy - Merrill Lynch - Analyst

Good morning, guys. John, when we think about the growth in penetration of the Electronic Park Brake and Electronic Steering and other programs like that that you have, how invasive are those in the architecture of the vehicle and is it possible that there are shorter lead-times than typical systems because of their electronic nature?

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

John Plant - TRW - CEO, President

I wouldn't say that they are typically lower than any of our products. It's always on a normal brake system lead-time or electric steering system lead-time. So no difference in lead-times at all. What I would say is the penetration is increasing and so we will see additional high-volume platforms adopting those technologies over the next two to three years. And so we already have development contracts for some of those vehicles.

John Murphy - Merrill Lynch - Analyst

And then just a second question on -- as we see this safety -- the increased safety penetration lower down in the vehicle mix and we sort of see the democratization of the safety equipment, are you concerned or is it going to be tough to keep margins going, or are you going to be able to innovate quickly enough to support your current margin levels?

John Plant - TRW - CEO, President

I think our innovation has been an outstanding way of both margin maintenance, but also in particular sort of if anything you've seen from our third quarter, our growth rate was actually very commendable and substantially above vehicle production. So I think the amount of money that we're spending on innovation is playing towards us in terms of our ability to generate high revenues.

John Murphy - Merrill Lynch - Analyst

Then lastly, Joe, just looking at the fourth quarter the range looks like it's \$0.26 to \$0.46. Is that just sort of the typical uncertainty around the tax rate or is there something else going on in the fourth quarter?

Joe Cantie - TRW - CFO, EVO, Treasurer

No, if you look back we've always had like a \$0.20 range. When we get to the fourth quarter it's typically in the \$0.30 range when we do the year. It's just representative of all the different things that can happen in a global company like ours that includes tax rate, production schedules at the end of the year and a host of other things.

John Murphy - Merrill Lynch - Analyst

Okay. Thank you very much.

Operator

Rod Lache, Deutsche Bank. Chris Ceraso, Credit Suisse.

Chris Ceraso - Credit Suisse - Analyst

Good morning. A couple of things. On the module business, can you give us a little bit more detail here? What product areas is it in, which region of the world, which customers and just ballpark the margin, is it the kind of 1 to 2% area?

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Joe Cantie - TRW - CFO, EVO, Treasurer

Sure. No, our module business, as we said, we're about \$100 million up in the third quarter, for the year-to-date period it's closer to \$200 million, and we expect in the fourth quarter to have another \$100 million plus increase. Typically on the module side very little capital involved and on the pure module side of it it's about a 2% margin. There are certain module business that's higher, certain that's lower, but it averages out to be about 2%.

In terms of where it is, the biggest impact for us is in North America where we picked up some good module business. We also have modules in South America and Asia and it's all in the Chassis segment and you'll see that when we file our Q, you'll see the increase in the sales mostly being in the Chassis segment -- actually in the presentation that Pat had attached to this as well you can see that.

Chris Ceraso - Credit Suisse - Analyst

Okay. To go back to the cash flow, it sounds like you're saying breakeven plus for the full year. Normally you run in the neighborhood of \$100 million, maybe a little bit more, maybe a little bit less. What are the big deltas here? I know you've talked about the working capital and the increase in non-U.S. sales, but if you had to pick a couple of major buckets that are pushing your cash flow lower than your average what would those be?

Joe Cantie - TRW - CFO, EVO, Treasurer

Certainly the growth in our sales and the currency effect that's bearing into that is a component of it, but I would say that the biggest factor is the fact that we've been doing very well in Europe and Asia and North America has been a struggle of a market for us all year. And the terms on receivable days in those territories are longer than the terms in North America. And ideally we try to match our payable terms with our receivable terms, but in the world of our supply base it sometimes gets difficult to match that perfectly given the condition of some of our suppliers. So it's really down to the fact that we're doing much better in Europe and Asia at the expense of North America and our working capital terms aren't as positive for us out of those territories versus North America.

Chris Ceraso - Credit Suisse - Analyst

Okay. And then just last one, on the E Steering and the E Parking. John, you've often talked about the trade-off between price and volume and when you're kind of early in the stage of a new product the price is good but the volume is not quite there. Is that where you are on these products so the profitability isn't quite there yet, but as the adoption starts to pick up it will get better? Where are you on that curve for those products?

John Plant - TRW - CEO, President

Typically for most of the innovative products we tend to be I'd say at the higher end as we introduce. That's been except for one which is the Electric Steering where I think that that has come in. It's high volumes in the small car segment and so that's tending to be rather tougher, albeit we are looking at I'll say margins now which are -- we see a line of sight which margins on the Electric Steering will begin to improve.

Chris Ceraso - Credit Suisse - Analyst

So are these products not yet profitable yet or just below your corporate average?

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

John Plant - TRW - CEO, President

For things like I'm going to say Electronic Stability Control, Electric Park Brake, etc., those would be better. And for things like Electric Steering, that would be worse.

Chris Ceraso - Credit Suisse - Analyst

Okay, thanks a lot.

Operator

Patrick Archambault, Goldman Sachs.

Patrick Archambault - Goldman Sachs - Analyst

Just wanted to get a better sense of some of the gross margin deterioration that you saw year-on-year. It looks like for the first half of the year definitely you had volume as a huge headwind. All of a sudden in this quarter you have the wind at your back in terms of volume, but you see an increase in the year-on-year degradation in gross margin. And I was just wondering what sort of headwinds stepped up and offset that

Joe Cantie - TRW - CFO, EVO, Treasurer

Thanks for that question, Pat, because it gives me a chance to put some perspective on it. If you look at our quarter in the third quarter, last year we had a gross profit margin of 7.6%, this year we had a gross margin level of 6.7%, so it's 0.9% of a deterioration between two periods. To put that in perspective though, our sales improved by \$201 million for currency, pure translation. We get the benefit at the sales line, we do not get the benefit at the profit line -- it's close to breakeven.

Mainly because while we benefit from translation we lose in territories where, for example, Canada and Brazil where our sales are based in dollars but yet our cost base is in the Canadian dollar and the Brazil currency, so you have that offsetting effect going in there. So that accounts for about 0.4% between the two periods. If you just took the 3495 in sales, took out the translation benefit and then redid your margin you'd have 6.7 being 7.1.

Then the next item is our module sales where we increased over \$100 million in the quarter and, as I said previously, at about a 2% margin. If you were to normalize for that, that's another 0.2%. So that explains 0.6 of the 0.9.

The remaining 0.3 deterioration, which is approximately \$10 million, that's down to a number of different things going both ways, the most significant and most notable are the fact that we've had commodity inflation that we haven't been able to recover at the gross profit line; we do have cost savings down in our SG&A line below. You see the SG&A down between the two years, but at the gross profit margin level commodity inflation is a headwind there. And then just after that you have things like mix of what you sold last year versus this year, etc., etc.

But I do encourage people to consider the translation effect and the module sales. So when I look at those two there's not any operational concern with those, those are what they are. And after that you're talking about \$10 million that's down to a host of different things.

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Patrick Archambault - *Goldman Sachs - Analyst*

And on the module's front, is that going to increase as a percentage of sales on a go-forward basis or have you kind of ramped up to a level that we can kind of expect to hold steady?

Joe Cantie - *TRW - CFO, EVO, Treasurer*

No, I think in the fourth quarter we're going to see another increase above the \$100 million level between the first two quarters. And then as we exit the fourth quarter that will be the run rate going forward.

Patrick Archambault - *Goldman Sachs - Analyst*

Okay. And then on some of the raw material headwinds it sounds like that's probably mostly Tier II supply base which you mentioned before, right? I guess just is that something given some of the volume headwinds that you expect for the fourth quarter to actually get worse as we close out the year?

Joe Cantie - *TRW - CFO, EVO, Treasurer*

We think it will be a headwind for us again in the fourth quarter and, quite frankly, beyond that. I think in the third quarter most of our exposure is to Tier II's and Tier III's. But I'll also say that in the third quarter we took a good hit in areas -- mostly in our automotive components group -- for things like nickel and zinc. When you think of things like engine valves there's a lot of nickel that's involved in the plating. And so we had a little bit of an issue there. For the third quarter it's about a \$25 million to \$27 million commodity inflation hit this year versus last year and we would expect to have a similar kind of impact in the fourth quarter as well.

Patrick Archambault - *Goldman Sachs - Analyst*

I guess that's fully -- the inefficiencies related to Tier II, they are fully captured in the raw materials guidance that you provided?

Joe Cantie - *TRW - CFO, EVO, Treasurer*

Yes, as best as we can see it now.

Patrick Archambault - *Goldman Sachs - Analyst*

Okay, great. Thank you.

Operator

Nathan Jairam (sic), Banc of America Securities.

Jairam Nathan - *Banc of America Securities - Analyst*

This is Jairam here. You talked about the pension and (inaudible) expense, how much of that was -- did that help SG&A or was the cost (inaudible)?

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Joe Cantie - TRW - CFO, EVO, Treasurer

No, that definitely helped our SG&A line, the work that we've been doing to reduce our what we call legacy costs, pension and OPEB. And the comparison between the two years in SG&A pension and OPEB was about \$4 million to \$5 million of it.

Jairam Nathan - Banc of America Securities - Analyst

On the automotive components side, did you give a number for the EBIT, the operating profit for the segment?

Joe Cantie - TRW - CFO, EVO, Treasurer

Didn't do that, but I can do that for you. We had profits of \$5 million this year compared to a loss of close to \$5 million or \$6 million last year.

Jairam Nathan - Banc of America Securities - Analyst

Okay. And how should we think about that business? How patient should we think you would be on that business?

Joe Cantie - TRW - CFO, EVO, Treasurer

I think if you look at our third quarter they are about close to a 2% margin in the quarter for the automotive components group. And as I said earlier, they got hit very hard with commodity inflation in this quarter, primarily in the area of things like nickel and zinc. So the operational issues that we experienced a year ago are improving and have improved each quarter sequentially. We still have some work to do there, but that was not the major concern in the quarter, it was more the commodity inflation. And we do expect to show sequential improvement going into the fourth quarter -- very good improvement we're expecting in the fourth quarter of this year compared to close to the loss position we had last year.

Jairam Nathan - Banc of America Securities - Analyst

Okay, thanks. And lastly, did you say that you don't have a big increase on the module business for '08?

Joe Cantie - TRW - CFO, EVO, Treasurer

We're going to increase in the fourth quarter and that will be our run rate. So when you look at next year you'll still have a module increase when you have the full-year effect in '08 versus the ramp up that we experienced in '07.

Jairam Nathan - Banc of America Securities - Analyst

Okay. But nothing beyond that?

Joe Cantie - TRW - CFO, EVO, Treasurer

Nothing beyond that.

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Jairam Nathan - Banc of America Securities - Analyst

Okay, thanks.

Operator

Himanshu Patel, JPMorgan.

Himanshu Patel - JPMorgan - Analyst

Actually, Joe, just on that last number, just remind us again the full-year module sales for '07 versus what you guys are thinking for '08?

Joe Cantie - TRW - CFO, EVO, Treasurer

When I look through the first nine months, Himanshu, we had close to \$200 million in module sales. In the fourth quarter we're probably up another \$120 million. So you're looking at \$320 million of an increase this year versus the prior year. If the \$120 million in the fourth quarter turns out to be the run rate you're looking at \$480 million versus the \$320 million, so you're another \$160 million next year versus this year just based on full-year affect versus what we had this year.

Himanshu Patel - JPMorgan - Analyst

Okay. And then on the commodities cost front, have things gotten incrementally worse for you guys since last quarter or was this sort of back-end increase anticipated by you guys? And I guess I'm referring to commodity cost as well as the cost of assisting Tier II sub suppliers?

Joe Cantie - TRW - CFO, EVO, Treasurer

I would think on the margin maybe a little bit worse than we were expecting but not dramatically. We were expecting to have a difficult year in commodity inflation and as each quarter has gone by it's maybe marginally gotten a little bit worse. In the third quarter what happened to us was some of the specialty items -- again like zinc, magnesium, nickel -- maybe there was certain types of resins that spiked in the third quarter.

It seems like every quarter you have a spike in something and then that sort of improves itself in the next quarter, but yet there's always a new item that's spiking. So it's a very difficult thing to call, but on the margin I would say maybe we're slightly worse than we would have thought at the beginning of the year and as we rolled forward in each quarter.

Himanshu Patel - JPMorgan - Analyst

Okay. And then lastly, on the M&A front, are there any updates there in terms of the available list of properties and in terms of willingness for sellers to be selling right now or are you guys still sort of where you were maybe about a quarter ago in terms of opportunities?

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

John Plant - TRW - CEO, President

I think we're -- (inaudible) comment on this, Himanshu, so we're I would say no difference. We examine things which are relevant to us, but that nothing we're at this point to have any comments about or indeed announcing. We do scour the market to see if there's anything out there which is relevant to us and that's about it really.

Himanshu Patel - JPMorgan - Analyst

John, the product segment that you would look to expand into, should we think about the stuff that was within VDO as being sort of a comparable area of interest that you'd look for or are there other areas as well that we should think about?

John Plant - TRW - CEO, President

I think you should think about (inaudible) video in a different way. That really was at the time more of a departure from our normal I will say bolt-on acquisitive acquisition type of luck. That really was more I will say considered for I'll say initially a value prospect for something which is a property clearly on the market and maybe it's more of a transformational thing for it's to be taking us into segments which I'd like, characteristics in terms of growth and margins like I'll say the powertrain area.

But really when we think about our normal bolt-on acquisitions, these are things which would be relevant to let's say our breaking or to our occupant safety type of product and are really tending to look at increasing both customer and geographic diversity and that would be the nature of any bolt-on acquisition that I would expect to be able to announce in the future would be with regard to those principal areas of product. And my view is that it would increase our diversity rather than not.

Himanshu Patel - JPMorgan - Analyst

Two housekeeping questions, SG&A -- I'm sorry if you covered this earlier -- but the rate of improvement was impressive. Should we think about another step down in 2008 on that spending level, either an absolute or a relative to sales?

Joe Cantie - TRW - CFO, EVO, Treasurer

A couple comments there. First of all, when you look at the prior year, for the prior year we averaged about 4% for the whole year, the prior year 4.4% and for the third quarter was a bit high. I think somewhere in that 3.6 to 3.8% is a good planning level for you.

Himanshu Patel - JPMorgan - Analyst

Okay, great. Actually that's all I had. Thank you very much.

Operator

Jonathan Steinmetz, Morgan Stanley.

Jonathan Steinmetz - Morgan Stanley - Analyst

Good morning, everyone. Just a couple of follow-ups. On the commodity inflation, can you talk about maybe the cadence at which things flow through your income statement? Because it seems like nickel came down a lot during the quarter, I know it

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

was up a little bit year-on-year, and zinc similarly wasn't up that much year-on-year by the end. So will you get some sort of bounce back potentially in first '08? Is there just sort of a three- to six-month lag on these or am I not thinking about it correctly?

Joe Cantie - TRW - CFO, EVO, Treasurer

No, you are thinking about it correctly. There's always a lag on a lot of the things that we buy. So what you're quoting is spot rates and we have to -- a lot of our products and where we experience commodity inflation we're buying through Tier II's, so if you think of the supply chain, they're buying there, incorporating it into their products and then they're selling their products on to us. And where we do buy direct raw materials there's usually a lag period. So some of what we've experienced in the areas of nickel/zinc is because of where a lot of the spot rates have been in the earlier part of the year.

Jonathan Steinmetz - Morgan Stanley - Analyst

Okay, that makes sense. So we're sort of going up again some of the May, June type period highs?

Joe Cantie - TRW - CFO, EVO, Treasurer

Yes, and it varies by what you buy. So it varies between steel, chemicals, castings, etc., etc., but usually there's always a lag.

Jonathan Steinmetz - Morgan Stanley - Analyst

Okay. And similarly, did you mention the amount on the receivable item? You said there was an invoicing issue. If you're able to give the dollar amount then can you just explain what you meant when you said an invoicing issue?

Joe Cantie - TRW - CFO, EVO, Treasurer

Yes, one of our divisions in Europe miscoded VAT numbers on a bunch of invoices that caused -- by the time we straightened that out basically money that we thought we were going to get in September we wound up getting in the early days of October. It was as much as \$70 million.

Jonathan Steinmetz - Morgan Stanley - Analyst

Okay, thank you very much.

Operator

Rod Lache, Deutsche Bank.

Rod Lache - Deutsche Bank - Analyst

I'm sorry, I had to hop off earlier, but I just need a little bit of help understanding the year-over-year walk here. You had basically a \$279 million increase in sales excluding FX.

Joe Cantie - TRW - CFO, EVO, Treasurer

Right.

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Rod Lache - *Deutsche Bank - Analyst*

And your EBIT was up about \$13 million, but basically \$10 million of that was lower restructuring costs. So can you just help us understand in the quarter the raw material hit and how much of a contribution are you getting if any from the \$75 million of components? At least help us bridge the strong top-line growth versus what we're seeing on the EBIT line.

Joe Cantie - *TRW - CFO, EVO, Treasurer*

Okay. Let me try to take that in buckets, Rod. If you look at the increase in our sales between the two quarters, it's roughly about \$480 million. Of that \$201 million is translation for which we get relatively no income on, so you can adjust for that. Secondly we had an increase of over \$100 million in module sales which it carries about a 2% margin for us. So take that off the sales and take that off the profit and what you come down to at the gross profit level would be a 7.3% margin compared to a 7.6% margin. That 0.3% on those sales is about \$10 million.

There are a number of things going both ways as to why the \$10 million was lost between the two quarters, the most notable being what we were not able to recover at the gross profit line for commodity inflation. The commodity inflation hit for the quarter between this year and last year was about \$26 million, so that's at the gross profit line. As you see on the SG&A, we're down about \$8 million between the two quarters and that was due to a lot of cost reduction that we have on the SG&A side. And we focus our cost reduction to help us mitigate some of the commodity inflation that we're experiencing.

So while you don't see it at the gross profit level, when you consider the \$8 million pickup in SG&A that really helps us mitigate some of that. Then at the restructuring charges it's just the timing of when we planned our programs this year versus last year, so we're up \$10 million in restructuring expense between the two years. That really is just down to the timing of when we take our actions. The \$13 million in this quarter was primarily headcount actions in Europe where we continue to try to thrift and get more efficient. And again, that's just down to the timing. So hopefully if you piece those together it helps you understand the margin compression between the two quarters.

Rod Lache - *Deutsche Bank - Analyst*

So you'd have the \$279 million of revenue growth excluding FX, \$179 million of that is the excluding modules part, would you say that you're getting a 15 or 16% contribution margin on that excluding raw materials?

Joe Cantie - *TRW - CFO, EVO, Treasurer*

Yes, I mean, typically speaking we're somewhere in the 20 to 22% range in contribution margin. So if we do it your way -- let's see here -- we'd be somewhere around \$30 million of contribution margin on those increased sales. And then offsetting against that are things like the commodity hits and other things that we have going on in the business.

Rod Lache - *Deutsche Bank - Analyst*

Okay. And was the components business up on a year-over-year basis?

Joe Cantie - *TRW - CFO, EVO, Treasurer*

It was, but the components business in the third quarter was close to a 2% margin so it had a \$5 million income in the quarter compared to about a \$6 million loss the prior year. So there was about a \$10 million swing between the two quarters.

Oct. 30. 2007 / 9:00AM, TRW - Q3 2007 TRW Auto Earnings Conference Call

Rod Lache - *Deutsche Bank - Analyst*

Okay. All right, thank you.

Patrick Stobb - *TRW - IR Director*

Thanks, Rod. I guess that concludes today's call, this is Pat. If you have any further questions please give me a call this afternoon. Thank you. You can close the call, Mandy.

Operator

Thank you. This does conclude today's conference call. We appreciate your participation. You may disconnect at this time.

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