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[www.tenneco-automotive.com](http://www.tenneco-automotive.com)



1999 Annual Report

A large, circular, blurred image of a car wheel, likely a hubcap, with a reflection of the Earth (globe) on its surface. The wheel is centered in the frame, and the globe's colors (blue, green, brown) are visible in the reflection. The text "WHEREVER WHEELS TURN..." is overlaid on the wheel.

WHEREVER WHEELS TURN...

# TENNECO AUTOMOTIVE IS THERE.



## PASSENGER VEHICLES



Tenneco Automotive's revolutionary ASD struts with impact sensor damping provide a superior ride for the new Nissan Altima. A similar technology is found in our new Monroe Reflex™ ride control products for the aftermarket.



## LIGHT TRUCKS: PICKUP TRUCKS, SPORT-UTILITY VEHICLES AND MINIVANS



Growth in this vehicle segment has provided opportunities for the company's high-performance aftermarket products.



## TWO-WHEELERS



The BMW R1200 C motorcycle is equipped with a state-of-the-art Tenneco Automotive exhaust system.

# CORPORATE PROFILE

Tenneco Automotive is one of the world’s largest designers, manufacturers and marketers of emission control and ride control products and systems for the automotive original equipment market and aftermarket. The company’s new independent status allows it to focus more clearly on pursuing strategic partnerships and acquisitions to enhance its product portfolio and technology base.

## OUR VISION

Pioneering global ideas for cleaner, quieter and safer transportation.

## OUR MISSION

Tenneco Automotive’s mission is to delight our customers as the No. 1 technology-driven, global manufacturer and marketer of value-differentiated ride control, emission control and elastomer products and systems.

We will strengthen our leading position through a shared-value culture of employee involvement where an intense focus on continued improvement delivers shareholder value in everything we do.

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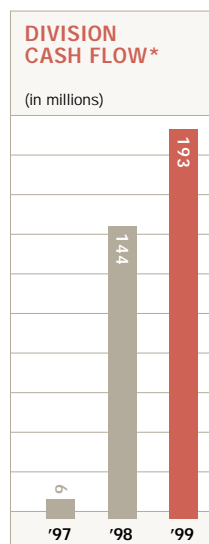
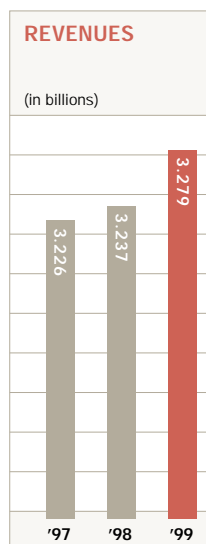
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## FINANCIAL HIGHLIGHTS

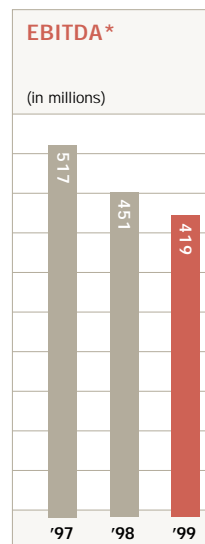
In millions except share and revenues per employee, years ended December 31,

|   | 1999              | 1998       |
|---|-------------------|------------|
| Net sales and operating revenues  | <b>\$3,279</b>    | \$3,237    |
| Division cash flow*   | <b>\$ 193</b>     | \$ 144     |
| Earnings before interest, taxes, depreciation, and amortization (EBITDA)* | <b>\$ 419</b>     | \$ 451     |
| Income from continuing operations*  | <b>\$ 89</b>      | \$ 163     |
| Capital expenditures  | <b>\$ 154</b>     | \$ 195     |
| Depreciation and amortization   | <b>\$ 144</b>     | \$ 150     |
| Average diluted shares outstanding  | <b>33,656,063</b> | 33,766,906 |
| Revenues per employee   | <b>137,216</b>    | 135,469    |
| Total assets – continuing operations                                      | <b>\$2,943</b>    | \$3,020    |

\* The information presented for 1999 is before a charge for restructuring, stand-alone company expenses, and transaction and other expenses, which reduced EBITDA by \$127 million, income from continuing operations by \$152 million, and division cash flow by \$4 million. The information presented for 1998 is before a charge for restructuring and previously unallocated Tenneco Inc. expenses, which reduced EBITDA by \$74 million and income from continuing operations by \$47 million. Additional information regarding these adjustments can be found in Management's Discussion and Analysis on page 23.



\* Before charges and transaction costs



\* Before charges and transaction costs

## TO OUR SHAREHOLDERS:

As the world was turning to a new millennium, Tenneco Automotive began a new existence as an independent company. On November 4, 1999, the final vestiges of the original Tenneco disappeared with the spin-off of the specialty packaging business, now called Pactiv. As a separate company, we are focused solely on designing, manufacturing and selling emission and ride control systems for the transportation industry.

Since becoming president of Tenneco Automotive in May of 1999, I have concentrated on the challenges of both launching this stand-alone business and redirecting an organization whose shortcomings stemmed mostly from an unclear strategic direction. Eighteen months before the separation, Tenneco Automotive had been positioned in multiple merger and acquisition scenarios, creating an atmosphere of uncertainty with our employees. For this reason, I established three key priorities for the new management team and communicated these priorities repeatedly to all employees:

- n customer satisfaction,
- n employee satisfaction, and
- n Economic Value Added (EVA®), an important component of which is cash management.

By immediately focusing the organization on improving our customer relationships, boosting our morale and teamwork, and emphasizing cash flow to pay down debt, I believe we can quickly begin delivering shareholder value.



**MARK P. FRISSORA**  
Chairman and Chief Executive Officer

My other top priorities included the assembly of a new management team and implementing robust planning processes. I needed a team that had the energy and relevant experience to accomplish the spin-off and run the business at much higher levels of performance. Accordingly, eight of my 14 direct reports are new.

We have adopted a grass-roots process orientation for running the business that carries with it the credo to consistently deliver on our promises. This does not mean we are setting low hurdle rates for ourselves so we can hit easy targets, but it does mean we understand our business at the granular level with every revenue and cost center being charted, benchmarked and reviewed

weekly to enable us to more tightly manage the business. Internally at Tenneco Automotive, we call this integrated business planning process our Business Operating System, and the process now touches every employee.

**Financial Review.** 1999 was a year of mixed results, ending with a fourth quarter the new management team was proud to call its own. As I mentioned earlier, cash is king and our fourth quarter cash results were nothing short of excellent. Operationally, we generated cash flow of \$99 million versus \$30 million a year earlier – a 230 percent improvement. This enabled us to reduce the debt level allocated in the spin-off by \$68 million. Normally we operated with \$25 million of cash balances around the world at year-end, but in 1999 we ended the year with a balance of \$84 million.

Operating income from operations for the fourth quarter, before the special charges and costs described below, increased significantly to \$52 million compared to a loss of \$4 million a year ago, and revenues rose to \$806 million, the most ever for a fourth quarter in Tenneco Automotive history.

Full-year results are clouded by pretax charges of \$137 million due to transaction costs associated with the separation of the automotive business from packaging, stand-alone company costs and restructuring

charges taken to right-size manufacturing and distribution footprints primarily in Europe and to a lesser extent in North America. Including these charges and costs, results from continuing operations for 1999 were a loss of \$63 million, or \$1.87 per diluted share. Before the charges and costs, income from continuing operations for the full year was \$89 million, or \$2.65 per diluted share, compared to \$163 million, or \$4.83 per diluted share, for full-year 1998. These numbers are clearly unacceptable. There were, however, some positive results that I'd like to highlight.

Full-year operating results for North American operations showed sales improvement of 5 percent year-over-year driven primarily by market share increases in our original equipment business. Operating profit improved 71 percent compared to 1998. Dramatic reduction in the aftermarket cost structure coupled with strong performance by our original equipment business made 1999 a great year for North America.

European results, however, reflected, among other things, an absence of strong leadership as the managing director position remained open for a full year, delaying the implementation of our new business planning processes. European revenues declined slightly while profitability dropped considerably as new OE business and improved aftermarket pricing were offset by unfavorable currency exchange rates and soft aftermarket ride control sales.



Difficult economic conditions and currency devaluation – particularly in Brazil – offset overall South America sales and market share gains. In Australia and Asia, we successfully weathered the regional economic crisis, recording revenue growth for the year.

**Strategy for Creating Value.** The new management team of Tenneco Automotive inherits a legacy of key strengths we will continue to focus on: leading global market share; a premier advanced technology position with original equipment manufacturers around the world; and, the blend of aftermarket and original equipment businesses enabling us to leverage product life cycle costs for our customers.

In addition to leveraging these key strengths, we are focusing the organization on the fundamentals of running a good business with strategies supporting customer satisfaction, employee satisfaction and Economic Value Added.



**Customer Satisfaction.** We have completed customer satisfaction surveys around the world and now have customer-specific improvement plans being driven through our integrated Business Operating System. By measuring our progress monthly against targets set by our customers, we enhance our ability to win new business.

Focusing on advanced technology is yet another way we look to improve customer satisfaction. Three years ago, we determined that to maintain our premier technology position, we had to invest more money in the business. After completing a benchmarking study, we invested heavily to strengthen our position by adding state-of-the-art testing labs and depth to our staff of highly trained engineers.

Moreover, to improve the link and flow of technology between our businesses, we formed cross-continent, cross-divisional product development teams that share engineering knowledge to develop new value-differentiated products and increase the speed at which we bring our products to market. This focus on technology should increase market share in both our product lines and improve our profitability as well as the profitability of our customers.



While we have implemented various lean technologies within our manufacturing base, we did not have a systematic approach to modern manufacturing principles. Accordingly, we have partnered with an outside manufacturing consultant to develop a comprehensive program that will be completed in 2001, all in the interest of reducing our cost to support our customers' continuous improvement programs.

**Employee Satisfaction.** After completing global employee surveys for the new Tenneco Automotive, we learned our employees wanted us to address three critical areas: improved communication from management, enhanced rewards and recognition programs, and more and better training and development initiatives. We again integrated measurements on these three areas into our Business Operating System and have begun driving initiatives to improve significantly these three critical areas for our employees. Ultimately, our goal is to become the employer of choice in our industry.

**Economic Value Added.** To help us motivate the organization to drive shareholder value, we recently partnered with Stern Stewart & Co. to assist with the implementation of the EVA® Management System. The EVA® system helps measure a company's value with a goal toward

driving sustainable shareholder wealth. We began deploying this management system in January and by mid-2001 we expect every employee in the company will be trained, measured and compensated on EVA®.

Critical to our success of improving EVA® performance is increasing our cash flow. We spent much of the last half of 1999 analyzing benchmarking data on all aspects of cash flow. The results were broken down into two large areas of opportunity: (1) working capital as a percent of sales, and (2) selling, general, and administrative (SG&A) costs. Our internal goals are to drive out \$250 million of inventory and accounts receivables, along with \$100 million in SG&A costs by year-end 2001.

**Aftermarket Revitalization.** Finally, revitalizing our global aftermarket business is an important strategic opportunity for us going forward. In 1998, we began an initiative to reduce headcount, close manufacturing facilities and realign the distribution operations of our North American aftermarket business. We expect this initiative to provide us with \$25 million in savings by the end of 2000, and it has already lowered our monthly breakeven point from \$57 million in 1998 to \$44 million today.

Resizing the footprint, however, was just half of the answer to turning this business around. In 1999, we changed our marketing focus, moving away from push

marketing to pull marketing techniques to sell our products. The push marketing techniques used in the past provided our customers promotional terms in return for taking more inventory at the end of each quarter. The result for us: higher, but less profitable, sales at the end of every quarter.

Now, instead of loading our products into the warehouse distributors at the end of the quarters, we offer installers incentives to actually pull our products through the channel by making the installation to the end consumer. The more shocks or exhaust systems installed, the greater opportunity for installers to win awards or co-op advertising. We believe this will be a winning strategy for both us and our customers, and will allow us to regain market share in North America over the next year.

The European aftermarket is beginning to see market pressures similar to those we faced in the North American aftermarket over the past two years. For this reason, much of the restructuring charge we took in the fourth quarter is being applied to right-size our manufacturing footprint, moving to lower cost labor markets in Eastern Europe. Additionally, we are employing in the European aftermarket the same changes in marketing strategy and new product differentiation we utilized in North America.

**Conclusion.** In the final analysis, I believe Tenneco Automotive has significant opportunities to generate shareholder wealth by introducing new and exciting products and deploying lean thinking throughout the organization. To accomplish this, we must maintain a balance between excellent customer relationships, employee satisfaction and Economic Value Added. Armed with improved business processes, our new capable team of senior managers is positioned to focus on these areas while delivering on our commitment of creating shareholder value.



**MARK P. FRISSORA**  
Chairman and Chief Executive Officer  
February 24, 2000

A woman's profile is shown in a dark setting, illuminated from the side. Inside her head, several different types of wheels are visible, symbolizing the connection between human thought and automotive technology. The wheels include a modern alloy wheel, a classic spoked wheel, and a smaller hubcap-like wheel.

## WHEREVER WHEELS TURN...

human ingenuity sets them in motion. Tenneco Automotive has a well-earned reputation for developing and applying technology that makes wheels turn more safely, more quietly, more smoothly. As a result, our products are recognized throughout the world.

But we know that even the most advanced technology begins with a person having an idea and turning that idea into a product.

Today, we are renewing efforts to enlist the ingenuity of all our people to continue creating new and improved ways to keep wheels turning, to make our plants run more efficiently, to recognize opportunities for acquiring knowledge, to enhance our financial performance.





W H E R E V E R



W H E E L S T U R N . . .

# TECHNOLOGY IS SPINNING AHEAD

With our highly engineered ride control and exhaust systems, Tenneco Automotive is a pioneer in providing cleaner, quieter and safer transportation. Three years ago, we determined that our company had to invest more to maintain our premier technology position. Today, after investing \$56 million, we have strengthened our R&D capabilities by adding state-of-the-art testing labs and highly trained engineers.

Our 15 engineering and design facilities located across the globe can work in concert literally around the clock to meet our customers' needs in a cost-effective manner. We have also built our portfolio of patented technologies – which currently exceeds 645 – to provide our customers

**Tenneco Automotive's technology centers feature state-of-the-art labs and equipment such as this 4-poster semi-anechoic testing lab in St. Truiden, Belgium. In this lab, we are able to simulate real driving conditions to attain a superior combination of noise, vibration and harshness levels for our customers.**

with products that can differentiate their vehicles. As a result of this, we have won a number of awards from customers around the world.

As we go forward, consumers, manufacturers and regulators are demanding safer vehicles that operate with less impact on the environment. To meet

these requirements, innovative products currently under development include: the titanium exhaust system for the Ford Prodigy hybrid family car prototype; an advanced suspension system on GM's Precept technology vehicle; and a lightweight, elastomeric rear suspension system for the DaimlerChrysler ESX3 concept car.

Finally, we are now focusing on improving the sharing of technology between our original equipment and aftermarket businesses. We have formed global product development teams to jointly develop new products and bring them to market faster. This newly created "product machine" is designed to increase product introductions from one every three years to five new products per year in each of our product lines. We expect this intense technology focus to increase market share and profitability.

**Testing facilities, including equipment to measure noise, ensure that the sound qualities of our engineered systems complement the image of the vehicle.**



**Tenneco Automotive's new Semi-Active Muffler (SAM) adapts easily to more powerful engines or stricter noise regulations without changing muffler volume. At the same time, SAM offers lower exhaust backpressure.**





# WE KEEP CUSTOMERS MOVING

Over the past five years, Tenneco Automotive has truly become a global company. Today more than 45 percent of our revenues come from outside of North America. More than half of our employees are located outside of the United States. We produce in 21 countries and sell our products in over 100 countries.

Our substantial engineering and manufacturing infrastructure enables us to service our customers from nearly anywhere in the world. Our engineering centers on five continents allow us to link the design and development of our products and systems globally. This is extremely important as original equipment manufacturers consolidate their vehicle offerings into "global platforms" where the same basic vehicle is produced on two or more continents. Because of our ability to manufacture high-quality products worldwide, Tenneco Automotive has been awarded the business for more than 30 global platforms.



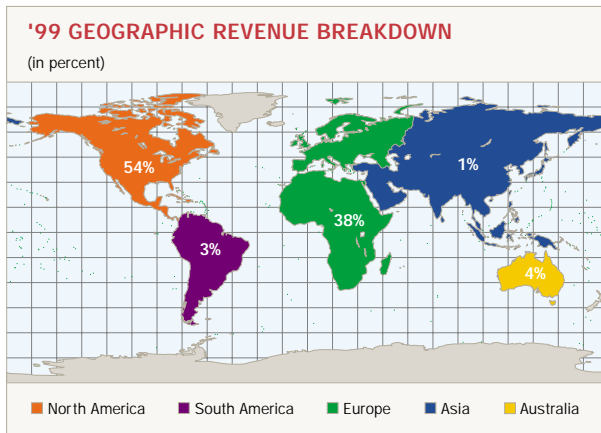
**Tenneco Automotive supplies the catalytic converter for the new Ford Focus, one of the top-selling passenger cars in the world.**

With growth slowing in the mature markets of North America and Western Europe, sales and manufacturing are shifting to emerging markets. Tenneco Automotive continues to strengthen its position in these areas through the use of strategic alliances and joint ventures.

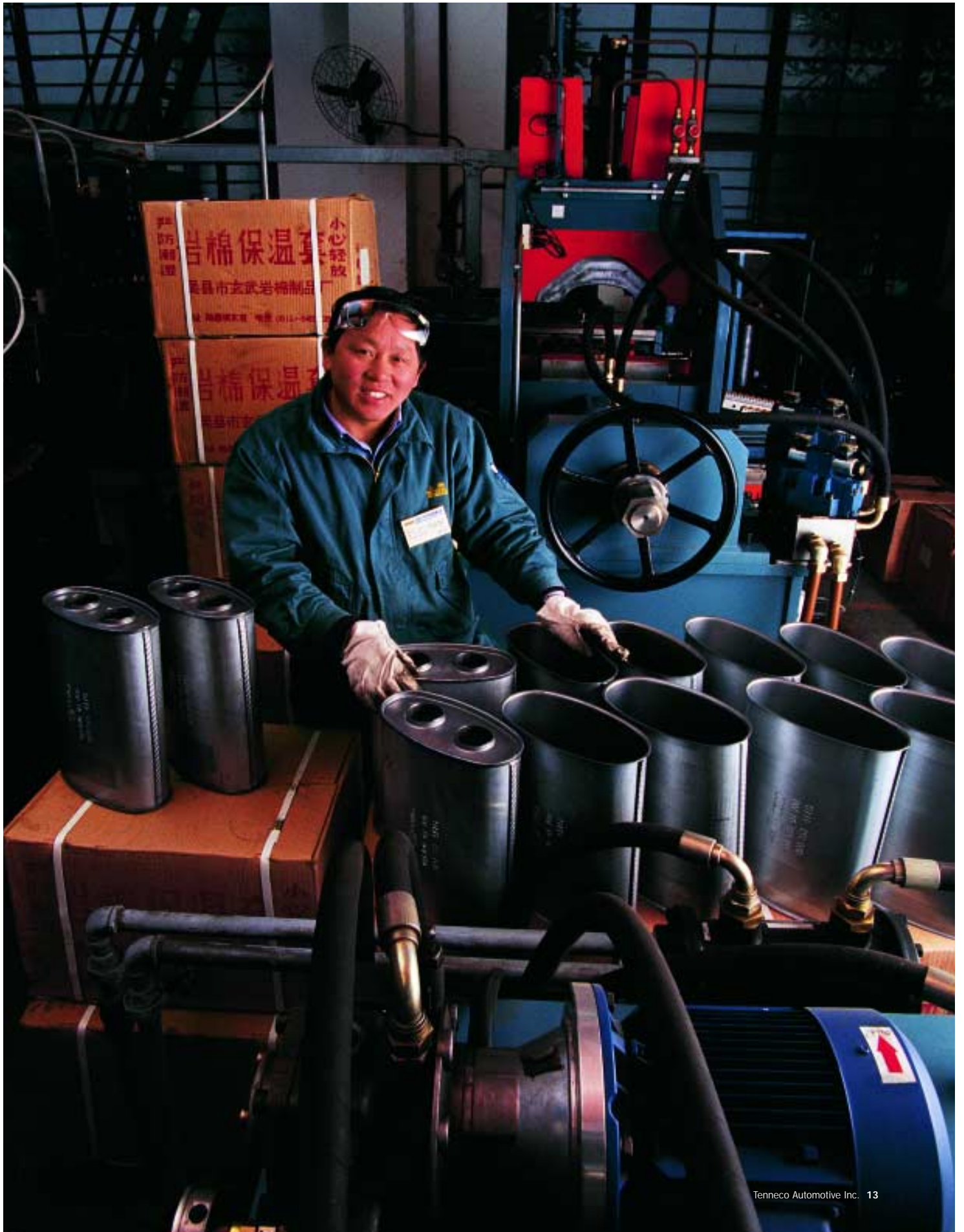
In 1999, we established the newest of our three Chinese joint ventures, Shanghai Walker Exhaust Systems Co. Ltd. This facility is currently gearing up to begin production of the exhaust system for the new Volkswagen B-5 Passat global platform. In India, our efforts to begin selling locally manufactured Monroe® branded products paid off as we increased our aftermarket ride control revenue by over 20 percent compared to 1998. In Japan, our aftermarket sales rose 15 percent in 1999, improving our market share in that country. In addition, we substantially increased ride control volumes in South

America and are examining opportunities in Eastern Europe.

**In 2000, our new China joint venture, Shanghai Walker Exhaust Systems Co. Ltd., will begin supplying Shanghai Volkswagen with the exhaust system for its new B-5 Passat, the successor to the popular Santana.**













# OUR BRANDS LEAD THE WAY

In 1999, Tenneco Automotive ride control and exhaust products were the choice of 25 different original equipment manufacturers worldwide. We provided products or systems for six of the top 10 passenger car models and eight of the top 10 light truck models produced worldwide in 1998. In the aftermarket,



Monroe® ride control products have a high brand recognition in targeted consumer markets, and Walker® emission control products have a strong trade awareness – making them two of the best-known branded auto parts in the world.

Our original equipment exhaust products and ride control systems hold top positions in North America, Europe, Australia and South America. As a Tier I systems integrator and supplier for more than 10 years, we work closely with original equipment manufacturers and are currently involved in designing,

NAPA, our largest aftermarket customer, began selling the new Monroe Reflex™ shock absorber late in 1999. Monroe Reflex™ maximizes tire to road contact, providing superior handling and safety on any surface without sacrificing comfort.

manufacturing and/or engineering ride control or emission control products and systems for 33 global platforms. Over the last two years, one or more of our products was included on more than 100 vehicle launches around the world.

**With the 1999 introduction of the new premium Monroe Reflex™ shock absorber, Tenneco Automotive has rounded out its product slate. In addition to Monroe Reflex™, we now offer the economy Gas Matic®, as well as the mid-range Sensa-Trac®, still one of the best-selling shocks in the world.**

In the aftermarket, Tenneco Automotive is a leading supplier for exhaust products in North America, Europe and Australia, and we are also a top supplier of ride control products in these areas and South America. We serve more than 500 customers worldwide in the aftermarket, with sales volumes widely distributed over our entire customer base.

We are capitalizing on our brand strength by applying the design, manufacturing and technical expertise incorporated into our original equipment products to increase maintenance and repair sales. In addition, the excellent brand reputation achieved by Walker® and Monroe® provides a foundation for introducing additional branded products into other specialty markets such as heavy-duty trucks, construction equipment, two-wheelers and recreational vehicles.





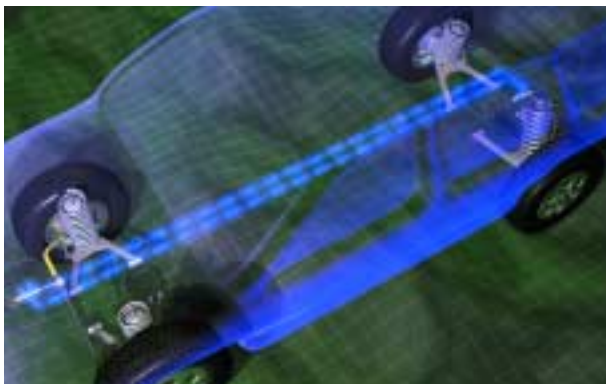
# WE'RE ENCIRCLING OPPORTUNITY

Always alert to excellent opportunities, Tenneco Automotive's aggressive global acquisition strategy over the past five years has added significant revenue growth. These transactions have provided entry into new regions, enhanced our product and system offerings and supplemented our growing portfolio of advanced technology.

We are now focusing on smaller acquisitions or strategic alliances to fill certain product niches or to gain additional proven proprietary technology. Our 1999 purchase of Kinetic Ltd.

**Already a leading supplier of shocks, struts and elastomers, the acquisition of Kinetic® roll control technology gives Tenneco Automotive the ability to supply fully integrated systems that optimize and revolutionize ride control.**

illustrates this approach. Rather than bricks and mortar, we acquired intellectual property – a revolutionary roll control system – to add to our advanced suspension technology. Combined with our manufacturing, marketing and distribution expertise, we believe Kinetic® has great potential.



**Tenneco Automotive recently entered into agreements with Draftex S.A. France to jointly develop and market elastomeric products in Europe, South America and Mexico, positioning our company for the global expansion of this product line.**

Kinetic® reduces the possibility of roll-over accidents and fills the need for improved safety in sport-utility vehicles and minivans that may be required by legislation in the United States.

We are also integrating Kinetic® technology into our ride control systems to create a complete suspension system that provides a significant opportunity to increase our market share and raise our potential vehicle content.

Kinetic® technology has already generated development contracts for nine different vehicles around the world, and will be incorporated in a 2002 mid-sized SUV platform. In 2000, we hope to announce that more vehicle manufacturers will place firm orders for this revolutionary technology.

We have also made significant progress in developing Kinetic® retrofit kits for installation on vehicles already on the road, and expect to introduce this technology in the aftermarket in 2000.

**Kinetic® ride control technology, acquired in 1999, significantly reduces vehicle roll potential, enhances handling and improves off-road performance. An engineer at our Monroe, Michigan, engineering center tests Kinetic® technology that has been retrofitted on a Lincoln Navigator.**











# OUR PEOPLE PROVIDE THE PUSH

We look on the people in our organization as a key competitive advantage and continue seeking ways to fully utilize our human resources. Several initiatives are under way to harness the ideas and creative efforts of all Tenneco Automotive people.

The Business Operating System is our umbrella approach for engaging everyone in the task of continuous improvement. It links our business strategy with results by focusing attention on three critical areas: customer satisfaction, employee satisfaction and Economic Value Added.

We are motivating all employees to pursue lean manufacturing techniques that reduce or eliminate waste, enhance

**Involving employees to continuously improve the design, manufacture and marketing of our products is a key to future success. A ride control team participates in Eureka Ranch, a brainstorming center, to exchange ideas in an atmosphere that encourages nontraditional thinking.**

efficiency and ensure our products reach customers as specified and on time. Our company is also initiating process reengineering in three key process areas: order fulfillment, program management/product development and pricing. Employee teams are training with Hammer & Co. to provide focus and structure to this initiative.



**Every Tenneco Automotive employee is being trained to use the Economic Value Added financial tool through such devices as the Zodiak board game that gives players the feel of running a business.**

Employee surveys have pinpointed areas for special focus, such as employee recognition, development and continuing education. In the next year, we expect to double our annual training hours to an average of 40 hours per employee.

To help focus on cash management and asset leverage, we recently partnered with Stern Stewart, the preeminent advisory firm on increasing shareholder wealth through Economic Value Added (EVA®). EVA® is a financial tool that more effectively measures how well we employ our capital resources. Everyone at Tenneco Automotive will be encouraged to think and behave as owners by using EVA® techniques daily.

We also recognize outstanding individual efforts through the companywide President's Circle Award. Each year these award winners become role models and ambassadors for how innovation, hard work and outstanding individual efforts can contribute to the ultimate performance of the company.

**Good ideas can come from the shop floor as well as the design laboratory. We encourage all employees to think like owners and make sure we are investing resources to achieve the best results.**

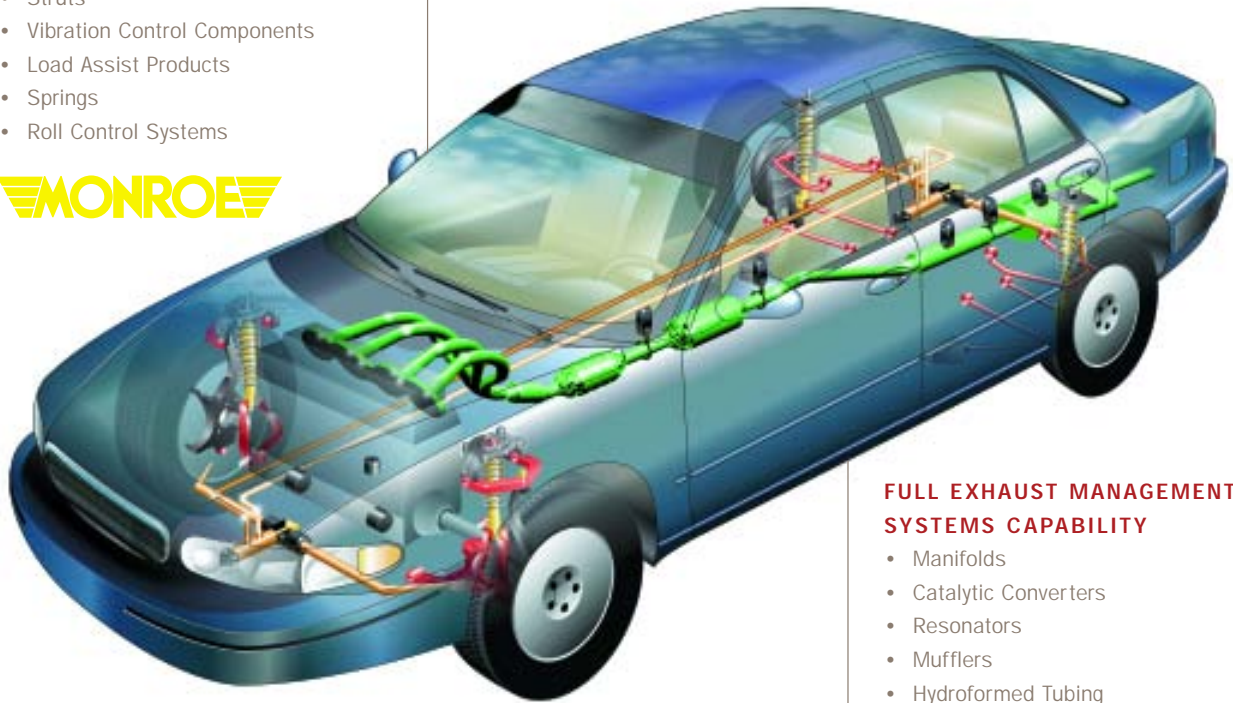




# TENNECO AUTOMOTIVE AT A GLANCE

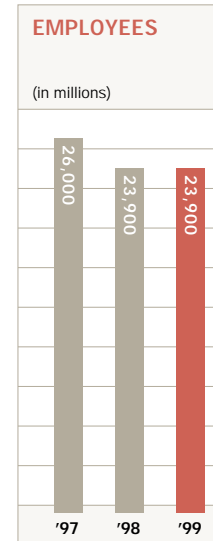
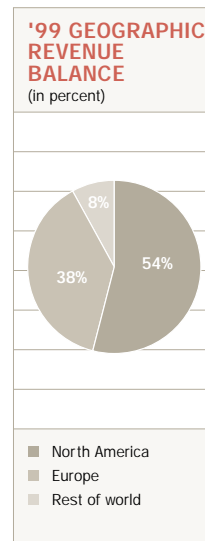
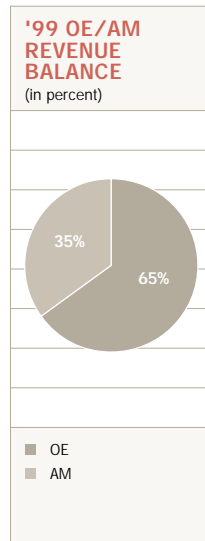
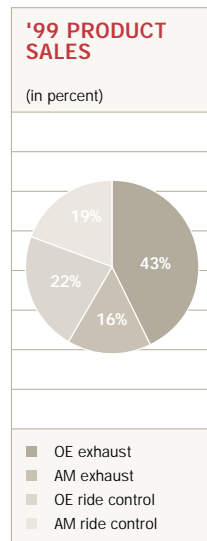
## FULL SUSPENSION MANAGEMENT SYSTEMS CAPABILITY

- Shock Absorbers
- Struts
- Vibration Control Components
- Load Assist Products
- Springs
- Roll Control Systems



## FULL EXHAUST MANAGEMENT SYSTEMS CAPABILITY

- Manifolds
- Catalytic Converters
- Resonators
- Mufflers
- Hydroformed Tubing





**Manufacturing Locations**

**NORTH AMERICA**

- Paragould, Arkansas
- Long Beach, California
- Hartwell, Georgia
- Angola, Indiana
- Elkhart, Indiana
- Ligonier, Indiana
- Litchfield, Michigan
- Marshall, Michigan
- Sterling Heights, Michigan
- Fenton, Missouri
- Kansas City, Missouri
- Cozad, Nebraska
- Seward, Nebraska
- Milan, Ohio
- Napoleon, Ohio
- Smithville, Tennessee
- Harrisonburg, Virginia
- Virginia Beach, Virginia
- Cambridge, Ontario
- Owen Sound, Ontario
- Windsor, Ontario
- Celaya, Mexico
- Puebla, Mexico
- Queretaro, Mexico
- Reynosa, Mexico

**EUROPE**

- Gent, Belgium
- St. Truiden, Belgium
- Hodkovice, Czech Republic
- Middelfart, Denmark
- Ernée, France
- Etain, France
- Iwuy, France
- Laval, France
- St. Jacques de la Lande, France
- Sandouville, France
- Wissembourg, France
- Edenkoben, Germany
- Emden, Germany
- Rastatt, Germany
- Saarlouis, Germany
- Zwickau, Germany
- Rybnik, Poland
- Palmela, Portugal
- Ermua, Spain
- Gijon, Spain
- Martorell, Spain
- Valencia, Spain
- Göteborg, Sweden
- Trollhattan, Sweden
- Vittaryd, Sweden
- Corlu, Turkey
- Burnley, U.K.
- Birmingham, U.K.
- Tredegar, U.K.
- York, U.K.

**ASIA**

- Beijing, China
- Dalian, China
- Shanghai, China
- Chennai, India
- Gurgaon, India
- Hosur, India
- Pondicherry, India
- Pune, India



**SOUTH AMERICA**

- Buenos Aires, Argentina
- Rosario, Argentina
- Cotia, Brazil
- Curitiba, Brazil
- Mogi-Mirim, Brazil

**SOUTH AFRICA**

- Port Elizabeth (2)

**AUSTRALIA**

- Clovelly Park, South Australia
- O'Sullivan Beach, South Australia
- Lower Hutt, New Zealand
- Alexandria, New South Wales

- **Corporate Headquarters** (Lake Forest, Illinois)
- ▲ **Technical Centers**

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements regarding, among other things, our prospects and business strategies. The words “will,” “may,” “hope to,” “designed to,” “believes,” “goals,” “should,” “potential,” “plans,” “expects,” “scheduled” and “estimates,” and similar expressions (and variations thereof), identify these 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:

- general economic, business and market conditions;
- the impact of consolidation among automotive parts suppliers and customers on our ability to compete;
- operating hazards associated with our business;
- changes in consumer demand and preferences for automobiles and automotive parts, as well as changes in automobile manufacturers’ actual and forecasted requirements for our products;
- changes in distribution channels or competitive conditions in the markets and countries where we operate, including the impact of changes in distribution channels for after-market products on our ability to increase or maintain aftermarket sales;
- cyclicalities of automotive production and sales;
- material substitution;
- labor disruptions at our facilities or at any of our significant customers or suppliers;
- 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 integrate operations of acquired businesses quickly and in a cost effective manner;
- our ability to successfully transition as a stand-alone company;
- 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;
- changes by the Financial Accounting Standards Board or the Securities and Exchange Commission of authoritative generally accepted accounting principles or policies;
- 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; and
- the occurrence or non-occurrence of circumstances beyond our control.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

On November 4, 1999, Tenneco Inc. completed the spin-off of its packaging business to shareholders, leaving the automotive business as the sole remaining operating segment. Following the spin-off, Tenneco Inc. changed its name to Tenneco Automotive Inc. In this Management's Discussion and Analysis, when we discuss Tenneco we mean Tenneco Inc. and its consolidated subsidiaries before the spin-off and Tenneco Automotive Inc. and its consolidated subsidiaries after the spin-off.

As you read the following review of our financial condition and results of operations, you should also read our financial statements and related notes beginning on page 37.

### BACKGROUND OF THE SPIN-OFF TRANSACTION

In July 1998, the Board of Directors authorized management to develop a broad range of strategic alternatives to separate the automotive, paperboard packaging, and specialty packaging businesses. Subsequently, we completed the following actions:

- In January 1999, we announced an agreement to contribute the containerboard business to a new joint venture with an affiliate of Madison Dearborn Partners. The proceeds from the transaction, including debt assumed by the new joint venture, were approximately \$2 billion. The transaction closed in April 1999. We retained a 43 percent interest in the joint venture.
- In April 1999, we announced an agreement to sell our folding carton operations to Carastar Industries. This transaction closed in June 1999. The folding carton operations and the containerboard business together represented our paperboard packaging operating segment.

- On November 4, 1999, we completed the spin-off of the common stock of Tenneco Packaging Inc., now known as Pactiv Corporation, to our shareholders. Pactiv included all of the businesses that made up our specialty packaging segment as well as our remaining interest in the containerboard joint venture and our administrative services operations.

As a result of this series of transactions, our former specialty and paperboard packaging operating segments are presented as discontinued operations in the accompanying financial statements. You should read Note 2 to the financial statements for more information about our discontinued operations.

The morning following the spin-off, we completed a reverse stock split that had been approved by our shareholders in a special meeting held in October 1999. As a result, every five shares of our common stock were converted into one share of our new common stock.

Before the spin-off, we realigned substantially all of our existing debt through a combination of tender offers, exchange offers, and other refinancings. To finance the debt realignment, we borrowed under new credit facilities and issued subordinated debt. Pactiv also borrowed under new credit facilities and issued new publicly traded Pactiv debt in exchange for certain series of our publicly traded debt that was outstanding before the debt realignment. Note 4 to the financial statements and the section – "Liquidity and Capital Resources" have more information about our debt and the debt realignment.

### YEARS 1999 AND 1998

#### Results from Continuing Operations

The following tables aggregate and summarize our results from continuing operations:

| <i>In millions</i>                            | Revenue | EBIT  | Interest | Taxes  | Minority Interest | Income from Continuing Operations |
|---|---------|-------|----------|--------|-------------------|-----------------------------------|
| <b>1999</b>                                   |         |       |          |        |                   |                                   |
| Operating units results                       | \$3,279 | \$275 | \$ (96)  | \$(67) | \$(23)            | \$ 89                             |
| Restructuring charges                         | -       | (55)  | -        | 5      | -                 | (50)                              |
| Spin-off transaction costs and other expenses | -       | (59)  | (10)     | (25)   | -                 | (94)                              |
| "Stand-alone" company expenses                | -       | (9)   | -        | 3      | -                 | (6)                               |
| Previously unallocated Tenneco Inc. expenses  | -       | (4)   | -        | 2      | -                 | (2)                               |
| Reported results                              | \$3,279 | \$148 | \$(106)  | \$(82) | \$(23)            | \$ (63)                           |
| <b>1998</b>                                   |         |       |          |        |                   |                                   |
| Operating units results                       | \$3,237 | \$301 | \$ (69)  | \$(40) | \$(29)            | \$163                             |
| Restructuring charges                         | -       | (53)  | -        | 19     | -                 | (34)                              |
| Previously unallocated Tenneco Inc. expenses  | -       | (21)  | -        | 8      | -                 | (13)                              |
| Reported results                              | \$3,237 | \$227 | \$ (69)  | \$(13) | \$(29)            | \$116                             |

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Earnings from continuing operations per diluted common share were \$3.44 in 1998 compared to a loss of \$1.87 in 1999. The following table shows the impact on earnings per diluted common share of the costs and charges reflected in the tables above:

|   | 1999      | 1998    |
|---|-----------|---------|
| Operating units results   | \$ 2.65   | \$ 4.83 |
| Restructuring charges   | (1.50)    | (1.02)  |
| Spin-off transaction costs and other expenses                         | (2.80)    | —       |
| "Stand-alone" company expenses  | (.17)     | —       |
| Previously unallocated Tenneco Inc. expenses                          | (.05)     | (.37)   |
| Reported earnings per diluted common share from continuing operations | \$ (1.87) | \$ 3.44 |

The reverse stock split we completed on the morning following the spin-off is reflected for all periods in this Management's Discussion and Analysis. You should read Note 7 to the financial statements for more information.

### Operating Units Results

#### Net Sales and Operating Revenues

| <i>In millions</i> | 1999    | 1998    | %<br>Change |
|--------------------|---------|---------|-------------|
| North America      | \$1,760 | \$1,679 | 5           |
| Europe             | 1,235   | 1,252   | (1)         |
| Rest of World      | 284     | 306     | (7)         |
|                    | \$3,279 | \$3,237 | 1           |

Revenues from our North American original equipment market increased by 15 percent due primarily to higher volumes. Record-breaking light vehicle production in North America, which increased from about 15.6 million units in 1998 to about 17.0 million units in 1999, or 9 percent, combined with our solid position on many top-selling light truck platforms, were primarily responsible for our North American revenue growth. Revenues from our North American aftermarket business decreased by \$70 million in 1999 from 1998. Lower aftermarket exhaust product volumes represented \$59 million of the decrease, primarily due to increased price competition and increasing average exhaust system product lives arising from the use of stainless steel by original equipment manufacturers.

European revenues were essentially unchanged from 1998. Revenues from our European original equipment exhaust operations increased by \$59 million due primarily to higher

volumes from new original equipment exhaust program launches. The impact of currency devaluation in Europe on both original equipment and aftermarket operations reduced our revenues in Europe by \$56 million. Increased price competition and private branded sales, as well as generally weaker aftermarket industry conditions, also contributed to the year-over-year change in revenues.

Revenues from our operations in the rest of the world decreased 7 percent to \$284 million compared to \$306 million in the prior year. Difficult economic conditions in South America and currency devaluation in Brazil led to a \$37 million decrease in revenues. This was partially offset by a 49 percent increase in Asian revenues due primarily to higher volumes.

### Income Before Interest Expense, Income Taxes, and Minority Interest ("EBIT")

We reported EBIT of \$148 million in 1999, compared to \$227 million in 1998. Each year included costs and charges, shown in the table in the above section – "Results from Continuing Operations," that have an effect on comparability of the results. These costs and charges are explained in more detail following the discussion of our automotive operating units' results. Before considering these costs and charges, our automotive operating units reported EBIT of \$275 million in 1999 compared to \$301 million in 1998. Those results are shown by segment in the following table:

| <i>In millions</i> | 1999  | 1998  |
|--------------------|-------|-------|
| North America      | \$181 | \$106 |
| Europe             | 82    | 159   |
| Rest of World      | 12    | 36    |
|                    | \$275 | \$301 |

The increase in our North American EBIT was driven by improvements in both our original equipment market and our aftermarket. The North American aftermarket improved due to significantly reduced marketing and promotional expenses, lower operational costs due to our restructuring initiatives, and lower customer changeover expenses. These improvements were partially offset by the impact of lower sales. Our North American original equipment market improved due to the increase in sales volumes as well as realized operational cost savings initiatives. These improvements in our original equipment business were partially offset by the launch of some lower margin exhaust platforms.

While European original equipment volumes were up in 1999, the EBIT impact of this revenue improvement was offset by lower profit margins from the new business and price reductions to original equipment manufacturers on existing exhaust programs. Lower sales of our premium ride control products in the aftermarket, combined with the introduction of private branded ride control products, caused a change in our product mix toward lower margin products. This, combined with higher product sales to original equipment dealer service departments rather than sales through our traditional aftermarket channels, accounted for most of the EBIT decrease in our European aftermarket. Finally, the required change in our accounting for start-up expenses and the impact of European currency devaluation were the other major factors causing the decline in EBIT from our European operations during 1999.

EBIT from our operations in the rest of the world fell \$24 million in 1999, primarily resulting from the currency devaluation and resulting economic instability in South America which reduced EBIT by \$28 million. This was partially offset by stronger operating results in Australia from operational cost-saving activities and improved original equipment exhaust product mix.

#### EBIT as a Percentage of Revenue

The following table shows EBIT as a percentage of revenue by segment before the costs and charges described above:

|                          | 1999  | 1998 |
|--------------------------|-------|------|
| North America            | 10.3% | 6.3% |
| Europe                   | 6.6   | 12.7 |
| Rest of World            | 4.2   | 11.8 |
| Total Tenneco Automotive | 8.4%  | 9.3% |

In North America, operating income as a percentage of revenue increased significantly due to proportionately lower aftermarket selling, general, and administrative expenses relative to the change in sales and improved overhead absorption due to higher original equipment volumes. European operating income as a percentage of revenue decreased primarily due to lower aftermarket sales and product mix changes from higher margin to lower margin business in both market channels. The decrease in EBIT margin in the rest of the world was caused primarily by difficult economic conditions and currency devaluation in Brazil, which was partially offset by increased margins in Australia.

#### Restructuring Charges

We adopted plans to restructure portions of our operations in both 1998 and 1999. In the fourth quarter of 1998, our Board of Directors approved an extensive restructuring plan designed to reduce administrative and operational overhead costs. We recorded a pre-tax charge to income from continuing operations of \$53 million, \$34 million after-tax, or \$1.02 per diluted common share. Of the pre-tax charge, for operational restructuring plans, \$36 million related to the consolidation of the manufacturing and distribution operations of our North American aftermarket business. A staff and related cost-reduction plan, which covered employees in both the operating units and corporate operations, cost \$17 million.

Our aftermarket restructuring involved closing two plant locations and five distribution centers, resulting in eliminating 302 positions. Our staff and related cost-reduction plan involved eliminating 454 administrative positions. We wrote down the fixed assets at the locations to be closed to their fair value, less costs to sell, in the fourth quarter of 1998. As a result of the single-purpose nature of the assets, we estimated fair value at scrap value less cost to dispose. We do not expect to receive any significant net cash proceeds from our ultimate disposal of these assets, which should be complete by the fourth quarter of 2000. The effect of suspending depreciation for these impaired assets is a reduction in depreciation and amortization of about \$2 million on an annual basis.

As of December 31, 1999, we have terminated approximately 670 employees and our North American aftermarket business has closed one plant location and four distribution centers under the 1998 plan. To address customer service and production transfer issues, we have delayed closing one plant location and one distribution center until the first quarter of 2000. We have executed all other restructuring actions, with the exception of the final disposal of certain assets, according to our initial plan, and these actions were completed by year-end 1999.

In the fourth quarter of 1999, our Board of Directors approved a second restructuring plan designed to further reduce operational overhead costs. We recorded a pre-tax charge to income from continuing operations of \$55 million, \$50 million after-tax, or \$1.50 per diluted common share.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The charge includes \$37 million recorded in Europe to close a ride control manufacturing facility and an exhaust just-in-time plant, close or downsize four aftermarket distribution centers, and reduce administrative overhead by reducing management employment; \$15 million to close a North American exhaust manufacturing facility; and \$3 million for employment reductions in South America and Asia. In total, the plan involves eliminating approximately 780 positions. We wrote down the fixed assets at the locations to be closed to their fair value, less costs to sell, in the fourth quarter of 1999. We estimated the fair value for buildings using external real estate valuations or a review of recent sales prices for like buildings in the area surrounding

the plant to be closed. As a result of the single-purpose nature of the machinery and equipment to be disposed of, fair value was estimated at scrap value less cost to dispose in most cases. For certain machines that have value in the used equipment market, engineers estimated value based on recent sales of like machines. We expect to receive net cash proceeds of about \$11 million when we dispose of these assets. The effect of suspending depreciation for these impaired assets is a reduction in depreciation and amortization expense of about \$3 million on an annual basis. We expect to complete all restructuring activities by the middle of 2001.

Amounts related to the restructuring plans are shown in the following table:

| <i>In millions</i>  | Dec. 31, 1998<br>Restructuring<br>Reserve | 1999<br>Restructuring<br>Charge | 1999<br>Cash<br>Payments | Charged<br>to Asset<br>Accounts | Dec. 31, 1999<br>Restructuring<br>Reserve |
|---------------------|---|---------------------------------|--------------------------|---------------------------------|---|
| Severance           | \$15                                      | \$21                            | \$10                     | \$ –                            | \$26                                      |
| Asset impairments   | –   | 31                              | –                        | 31                              | –   |
| Facility exit costs | 1   | 3                               | 2                        | –                               | 2   |
|                     | \$16                                      | \$55                            | \$12                     | \$31                            | \$28                                      |

We continue to evaluate our cost structure and manufacturing footprint in an effort to identify and evaluate other opportunities to improve our results. These efforts could result in developing further restructuring plans that would involve additional restructuring charges.

### Spin-off Transaction Costs and Other Expenses

In the fourth quarter of 1999, we recorded costs and expenses to complete the series of actions necessary to separate Pactiv from the automotive business. These costs included fees for advisors, costs for accelerated vesting of restricted and performance shares of common stock granted to key employees by Tenneco since 1996, and other fees and expenses directly associated with the spin-off transaction. Also included in the total of \$59 million in spin-off transaction costs and other expenses in the table presented earlier in the section "Results from Continuing Operations" is a \$12 million charge to write down the value of a receivable from a former business that we sold in 1994. Deteriorating performance by that business, as well as a consolidation in its primary industry, has caused us to revise our estimate of the proceeds we will ultimately collect on the receivable.

### "Stand-Alone" Company Expenses

These costs were incurred after the November 4 spin-off transaction date and include the addition of functions necessary for us to operate as a public company as well as administrative costs for information technology and payroll and accounts payable services. We receive these information technology and payroll and accounts payable services from Pactiv under a contractual agreement entered into in connection with the spin-off of Pactiv. We have identified and explained these costs separately to improve comparability since they did not exist in 1998. These costs will, however, continue in future periods.

We currently estimate these stand-alone company expenses will be approximately \$54 million annually. Of that amount, approximately \$40 million relates to the services received under the contract with Pactiv. The contract extends for 24 months from the date of the spin-off. Subsequent to year-end, Pactiv sold the payroll and accounts payable functions to a third party who will continue to provide those services under terms similar to the Pactiv arrangements, except that the term has been extended for an additional year for a total of three years from the date of the spin-off.

### Previously Unallocated Tenneco Inc. Expenses

Tenneco Inc. incurred costs at the corporate level that were not allocated to the business units. Some of those historical costs remained in our results due to the manner in which our former corporate operations were split between Pactiv and us. These costs related primarily to a receivables sale program operated by Tenneco Inc. prior to the spin-off. Tenneco Inc.'s receivables sale program was discontinued at the end of the third quarter of 1999. The total amount of expenses previously unallocated by Tenneco Inc. were \$21 million in 1998 and \$4 million in 1999. All of the 1999 previously unallocated Tenneco Inc. expenses were incurred in the first nine months of 1999.

### Interest Expense, Net of Interest Capitalized

We reported interest expense for our continuing operations of \$106 million in 1999, compared to \$69 million in 1998. Interest expense allocated to discontinued operations was \$118 million in 1999 and \$171 million in 1998. The decrease in our total interest expense is due primarily to our lower debt levels as a result of using the proceeds from the containerboard sale to pay down debt. This was partially offset by higher interest expense after the spin-off due to our higher cost of financing.

As a result of the realignment of our debt before the spin-off, we borrowed approximately \$1.7 billion under our new debt arrangements. The new debt structure is explained in more detail in "Liquidity and Capital Resources" later in this Management's Discussion and Analysis and in Note 4 to our financial statements.

We allocate interest expense to our discontinued operations based generally on the ratio of net assets of discontinued operations to our total net assets plus debt. We began taking certain debt and balance sheet realignment actions in October of 1999, before the spin-off. As a result of these actions, the ratio for allocating interest changed in October, requiring a reduction in interest allocated to discontinued operations. This adjustment was \$10 million, which we have attributed to part of the cost of the spin-off and debt realignment transactions.

### Income Taxes

Our effective tax rate for 1999 was 195 percent. This high effective tax rate relates primarily to the spin-off transaction. In connection with the spin-off, we repatriated earnings from some foreign tax jurisdictions. Since our policy is to reinvest earnings from foreign operations rather than repatriate them

to the U.S., this one-time action resulted in a charge to recognize the taxes due on the repatriation. Additionally, some tax benefits previously shared between the automotive and packaging businesses are no longer available to us following the spin-off and this resulted in a tax charge in the fourth quarter. Finally, the 1999 restructuring involves significant activity in Europe where many of the costs of restructuring will not be deductible for tax purposes. Consequently, we recognized no tax benefit for these non-deductible costs.

Our effective tax rate for 1998 was 8 percent. This rate was lower than the statutory rate as a result of certain non-recurring foreign and state tax benefits, lower foreign tax rates, and a reduction in our estimated tax liabilities related to certain global tax audits.

### Minority Interest

Minority interest is related primarily to dividends on the preferred stock of a U.S. subsidiary. We repurchased the preferred stock before the spin-off as part of the debt realignment.

### Discontinued Operations and Extraordinary Loss

Revenues and income for the paperboard packaging discontinued operations are shown in the following table:

| <i>In millions, year ended December 31</i>                | 1999    | 1998    |
|---|---------|---------|
| Net sales and operating revenues                          | \$ 445  | \$1,570 |
| Income (loss) before income taxes and interest allocation |         |         |
| Operations  | \$ 32   | \$ 99   |
| Loss on containerboard sale                               | (343)   | —       |
| Gain on sale of folding carton                            | 11      | —       |
| Gain on sale of joint venture with Caraustar              | —       | 15      |
| Gain on sale of non-strategic timberland                  | —       | 17      |
|   | (300)   | 131     |
| Income tax (expense) benefit                              | 120     | (48)    |
| Income (loss) before interest allocation                  | (180)   | 83      |
| Allocated interest expense, net of income tax             | (5)     | (26)    |
| Income (loss) from discontinued operations                | \$(185) | \$ 57   |

Fourth quarter 1998 results from discontinued operations for the paperboard packaging segment include a pretax charge of \$14 million related to a restructuring plan to reduce administrative and operational overhead costs. The paperboard packaging restructuring plan involved closing four box plants and eliminating 78 manufacturing and 198 administrative positions.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

Revenues and income for the discontinued specialty packaging business and administrative services operations are shown in the following table:

| <i>In millions, year ended December 31</i>         | <b>1999</b>    | 1998    |
|--|----------------|---------|
| Net sales and operating revenues                   | <b>\$2,419</b> | \$2,791 |
| Income before income taxes and interest allocation | <b>87</b>      | 280     |
| Income tax (expense) benefit                       | <b>(29)</b>    | (113)   |
| Income before interest allocation                  | <b>58</b>      | 167     |
| Allocated interest expense, net of income tax      | <b>(81)</b>    | (85)    |
| Income (loss) from discontinued operations         | <b>\$ (23)</b> | \$ 82   |

Results from discontinued operations for the specialty packaging segment in 1999 include a pre-tax charge of \$29 million relating to a plan to realign the headquarters functions. This plan involved severing approximately 40 employees and closing the Greenwich, Connecticut, headquarters facility.

Our loss from discontinued operations in 1999 was \$208 million, comprised principally of an after-tax loss on sale of the paperboard packaging business of \$207 million. This loss on sale includes a \$54 million net loss in the fourth quarter, reflecting events that occurred subsequent to the April 1999 sale related to the final settlement of working capital amounts, revisions to actuarially determined estimates of pension plan effects, and changes in estimates regarding liabilities retained by Pactiv.

Earnings per common diluted share from discontinued operations were \$4.12 in 1998 compared to a loss per common diluted share of \$6.23 in 1999.

We recognized extraordinary losses related to the early retirement of debt during 1999. In the first quarter, we recognized an extraordinary loss of \$7 million net of income tax, or \$.21 per common diluted share, related to debt retired in connection with the containerboard sale. In the fourth quarter, we recognized an extraordinary loss of \$11 million net of income tax, or \$.34 per common diluted share, for the cost of debt retired in connection with the debt realignment necessary to accomplish the spin-off. This extraordinary loss related to the debt securities that were retired in the cash tender offer. We did not recognize any gain or loss on the debt securities retired in the offer to exchange Pactiv debt securities for our debt securities since the terms of the Pactiv debt securities were not "substantially different" from the terms of our debt securities.

### Changes in Accounting Principles

In March 1998, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," which establishes new accounting and reporting standards for the costs of computer software developed or obtained for internal use. This statement required prospective application for fiscal years beginning after December 15, 1998. We adopted SOP 98-1 on January 1, 1999. The impact of this new standard did not have a significant effect on our financial position or results of operations.

In April 1998, the AICPA issued SOP 98-5, "Reporting on the Costs of Start-up Activities," which requires costs of start-up activities to be expensed as incurred. This statement was effective for fiscal years beginning after December 15, 1998. The statement requires previously capitalized costs related to start-up activities to be expensed as a cumulative effect of a change in accounting principle when the statement is adopted. Prior to January 1, 1999, we capitalized some costs related to start-up activities, primarily pre-production design and development costs for new automobile original equipment platforms. We adopted SOP 98-5 on January 1, 1999, and recorded an after-tax charge for the cumulative effect of this change in accounting principle of \$102 million (net of a \$50 million tax benefit), or \$3.04 per diluted common share. The change in accounting principle decreased income from continuing operations by \$19 million (net of a \$11 million tax benefit), or \$.56 per diluted common share, for the year ended December 31, 1999. If the new accounting method had been applied retroactively, income from continuing operations for the years ended December 31, 1998 and 1997, would have been lower by \$19 million (net of a \$12 million tax benefit), or \$.57 per diluted common share, and \$18 million (net of a \$12 million tax benefit), or \$.54 per diluted common share, respectively.

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes new accounting and reporting standards requiring that all derivative instruments, including derivative instruments embedded in other contracts, be recorded in the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special

accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting treatment. This statement cannot be applied retroactively and is effective for all fiscal years beginning after June 15, 2000. We are currently evaluating the new standard and have not yet determined the impact it will have on our financial position or results of operations.

Effective January 1, 1999, we changed our method of accounting for customer acquisition costs from a deferral method to an expense-as-incurred method. In connection with the decision to separate the automotive and specialty packaging businesses into independent public companies, we determined that a change to an expense-as-incurred method of accounting for automotive aftermarket customer acquisition costs was preferable in order to permit improved comparability of stand-alone financial results with our aftermarket industry competitors. We recorded an after-tax charge for the cumulative effect of this change in accounting principle of \$32 million (net of a \$22 million tax benefit), or \$.95 per diluted common share. The change in accounting principle increased income from continuing operations by \$10 million (net of \$6 million in income tax expense), or \$.30 per diluted common share, for the year ended December 31, 1999. If the new accounting principle had been applied retroactively, income from continuing operations for the years ended December 31, 1998 and 1997, would have been lower by \$4 million (net of a \$3 million income tax benefit), or \$.11 per diluted common share, and \$12 million (net of a \$8 million income tax benefit), or \$.35 per diluted common share, respectively.

## Liquidity and Capital Resources

### Capitalization

| <i>In millions, December 31,</i>                       | 1999           | 1998           |
|--|----------------|----------------|
| Short-term debt and current maturities                 | \$ 56          | \$ 304         |
| Long-term debt   | 1,578          | 671            |
| Debt allocated to discontinued operations              | -              | 2,456          |
| <b>Total debt</b>                                      | <b>1,634</b>   | <b>3,431</b>   |
| Minority interest of continuing operations             | 16             | 407            |
| Minority interest allocated to discontinued operations | -              | 14             |
| <b>Total minority interest</b>                         | <b>16</b>      | <b>421</b>     |
| Common shareholders' equity                            | 422            | 2,504          |
| <b>Total capitalization</b>                            | <b>\$2,072</b> | <b>\$6,356</b> |

Our debt and equity balances at December 31, 1999, reflect the impact of the debt realignment and spin-off transactions. At December 31, 1999, we had no borrowings under our revolving credit facility. Our short-term debt relates primarily to borrowings by foreign subsidiaries. Our long-term debt balance consists of borrowings made under new credit agreements described below to facilitate the debt realignment, as well as approximately \$21 million of public debt that was not retired in the cash tender and exchange offers.

Our equity at December 31, 1999, reflects the effect of the spin-off of Pactiv to our shareholders. This transaction resulted in a \$1,448 million reduction to common equity. Equity was also reduced during 1999 by cumulative translation adjustments resulting from the strong U.S. dollar, by the loss recognized primarily as a result of the spin-off transaction, and dividends of \$151 million issued for the first three quarters of 1999.

Prior to the spin-off, we realigned substantially all of our existing debt. To accomplish this, we initiated an offer to exchange Pactiv debt securities for some of our debt securities having a book value of \$1,166 million. We also initiated a cash tender offer to purchase debt securities having a book value of \$1,374 million and repaid substantially all of our short-term borrowings. Finally, we retired approximately \$400 million of subsidiary preferred stock. These transactions were financed by borrowings under our new credit facility, senior subordinated debt that we issued, and borrowings by Pactiv under new credit facilities. The debt of Pactiv was rated investment grade and our debt was rated noninvestment grade by debt rating agencies.

As part of the debt realignment, on September 30, 1999, we entered into a \$1.55 billion committed senior secured financing arrangement with a syndicate of banks and other financial institutions consisting of: (i) a \$500 million, six-year revolving credit facility; (ii) a \$450 million six-year term loan; (iii) a \$300 million eight-year term loan and; (iv) a \$300 million eight-and-one-half-year term loan. This financing is secured by substantially all of our tangible and intangible U.S. assets, the capital stock of our material U.S. subsidiaries and up to 66 percent of the capital stock of our first-tier foreign subsidiaries. It is also guaranteed by our material U.S. subsidiaries.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

We will pay a portion of each term loan in quarterly installments beginning September 30, 2001. Borrowings under this facility bear interest at an annual rate equal to, at our option, either (i) the London Interbank Offering Rate plus a margin of 275 basis points for the six-year revolving credit facility and the six-year term loan, 325 basis points for the eight-year term loan and 350 basis points for the eight-and-one-half-year term loan; or (ii) a rate consisting of the greater of The Chase Manhattan Bank's prime rate or the Federal Funds rate plus 50 basis points, plus a margin of 175 basis points for the six-year revolving credit facility and the six-year term loan, 225 basis points for the eight-year term loan and 250 basis points for the eight-and-one-half-year term loan. Under the provisions of the senior credit facility agreement, the interest margins for borrowings under the revolving credit facility and the six-year term loan may be adjusted based on our consolidated leverage ratio (total debt divided by consolidated earnings before interest, taxes, depreciation, and amortization ("EBITDA") as defined in the senior credit facility agreement) measured at the end of each quarter starting with the fiscal quarter ending December 31, 2000.

The senior credit facility agreement requires that we initially maintain: (i) a consolidated leverage ratio (consolidated indebtedness divided by consolidated EBITDA) not greater than 4.75; (ii) a consolidated interest coverage ratio (consolidated EBITDA divided by consolidated interest expense) not less than 2.00; and (iii) a consolidated fixed charge coverage ratio (consolidated EBITDA less consolidated capital expenditures, divided by consolidated interest expense) not less than 1.00. Under the terms of the senior credit facility agreement, the maximum permitted consolidated leverage ratio will decrease beginning in the year 2001, the minimum permitted consolidated interest coverage ratio will increase beginning in the year 2001, and the minimum permitted consolidated fixed charge coverage ratio will increase beginning in the year 2002. The senior credit facility agreement also contains restrictions on our operations that are customary for similar facilities, including limitations on: (a) incurring additional liens; (b) sale and lease-back transactions; (c) liquidations and dissolutions; (d) incurring additional indebtedness or guarantees; (e) capital expenditures;

(f) dividends; (g) mergers and consolidations; and (h) prepayments and modifications of subordinated and other debt instruments. Compliance with these requirements and restrictions is a condition for any incremental borrowings under the senior credit facility agreement and failure to meet these requirements enables the lenders to require us to repay any outstanding loans.

On October 14, 1999, we issued \$500 million of 11½ percent senior subordinated notes due in 2009. The senior subordinated debt indenture requires that we, as a condition to incurring certain types of indebtedness not otherwise permitted, initially maintain an interest coverage ratio of not less than 2.00. Under the terms of the indenture, the minimum interest coverage ratio will increase beginning in 2001. The indenture also contains restrictions on our operations, including limitations on: (1) incurring additional indebtedness or liens; (2) dividends; (3) distributions and stock repurchases; (4) investments; and (5) mergers and consolidations.

### Capital Commitments

We estimate that expenditures of approximately \$81 million will be required after December 31, 1999, to complete facilities and projects authorized at that date, and we have made substantial commitments in connection with these facilities and projects.

### Dividends on Common Stock

In October 1999, our shareholders approved an amendment to the Certificate of Incorporation providing for a one-for-five reverse stock split of Tenneco's common stock. As a result, the reverse stock split is reflected in the historical dividends declared on our common shares. We declared dividends on our common shares of \$1.50 per share for each quarter in 1998 and the first three quarters of 1999. During the fourth quarter of 1999, no cash dividends were paid.

Now that the spin-off of Pactiv is complete, we are highly leveraged and restricted with respect to paying dividends by the terms of our financing arrangements. On January 12, 2000, we announced that our board of directors declared a first quarter dividend of 5 cents per share payable on March 14, 2000, to shareholders of record at the close of business on February 25, 2000.

## Cash Flows

| <i>In millions</i>                           | 1999   | 1998  |
|--|--------|-------|
| <b>Cash provided (used) by:</b>              |        |       |
| Operating activities – continuing operations | \$ (1) | \$ 63 |
| Investing activities – continuing operations | (227)  | (278) |
| Financing activities                         | 1,495  | 216   |

## Operating Activities

Cash provided by continuing operating activities, including cash transaction related and stand-alone expenses, declined by \$64 million for 1999 compared to 1998. Income from continuing operations, inclusive of transaction and stand-alone expenses, and restructuring and other charges, was \$179 million lower, and investments in working capital were \$70 million more in 1999 compared to 1998. The increase in working capital was primarily attributable to the \$112 million increase in accounts receivable arising primarily from the termination of the domestic accounts receivable factoring program operated by Tenneco Inc. Net deferred income tax liabilities increased by \$97 million in 1999. The majority of this increase is related to the spin-off transaction and reallocation of tax assets between us and our discontinued operations.

Cash provided by our discontinued operations declined by \$722 million in 1999 compared to 1998. The paperboard operations were responsible for \$213 million, which is attributable primarily to the purchase of containerboard business accounts receivable in contemplation of the sale of the containerboard business in April. Transaction expenses related to the spin-off reduced discontinued operations cash flow by an additional \$164 million. Additionally, containerboard results are reflected for the first four months in 1999 and for the full year in 1998 due to the sale of this business, and the specialty business results are reflected for the first 10 months in 1999 and for the full year in 1998 due to the spin-off.

## Investing Activities

Cash used by investing activities for continuing operations was \$51 million higher in 1999 compared to 1998. Capital expenditures were \$41 million lower in 1999 compared to 1998 due to more effective capital management. This was offset by the acquisition of Kinetic Ltd., an Australian suspension engineering company, for \$36 million in May 1999. Cash used by other investing activities was \$45 million. Discontinued operations

and adjustments related to the spin-off accounted for \$24 million of this total and investments in other intangible assets accounted for most of the balance in other investing activities.

Cash used by investments in discontinued operations increased by \$476 million in 1999 compared to 1998. During the second quarter of 1999, Pactiv acquired for approximately \$1.1 billion certain assets previously used by the containerboard business under operating leases and timber cutting rights. This was required in order to complete the April containerboard sale. The source of the funds for these capital expenditures was borrowings by Pactiv prior to the containerboard sale. See “Financing Activities” below. We also received approximately \$300 million in proceeds related to the containerboard and folding carton sale transactions.

## Financing Activities

Excluding financing activities required to complete the containerboard sale transaction and the spin-off of Pactiv, cash provided by financing activities was \$545 million in 1999. This reflected primarily the impact of our debt realignment discussed earlier in the section – “Liquidity and Capital Resources.” You should also read Note 1, “Summary of Accounting Policies – Allocation of Corporate Debt and Interest Expense,” for more information.

Before the containerboard sale transaction, Pactiv borrowed approximately \$1.8 billion. Pactiv used these borrowings to acquire the assets used under operating leases and timber cutting rights described under “Investing Activities” above, and to purchase the containerboard business accounts receivable described under “Operating Activities” above. Pactiv remitted the balance of the borrowings to us to retire short-term debt. Pactiv contributed the containerboard business to the new joint venture, including approximately \$1.8 billion in new debt. The debt reduction that resulted from this contribution is shown on the Statements of Cash Flows as a non-cash financing activity.

## YEAR 2000

We completed all Year 2000 remediation efforts by December 31, 1999. No material Year 2000 issues were identified at significant vendors, at customers or at any of our locations. Our total cost to address the Year 2000 issues was about \$16 million.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### EURO CONVERSION

The European Monetary Union resulted in the adoption of a common currency, the "euro," among eleven European nations. The euro is being adopted over a three-year transition period beginning January 1, 1999. In October 1997, we established a cross-functional euro committee, comprised of representatives of our operational divisions as well as our corporate offices. That committee had two principal objectives: (1) to determine the impact of the euro on our business operations, and (2) to recommend and facilitate implementation of those steps necessary to ensure that we would be fully prepared for the euro's introduction. As of January 1, 1999, we implemented those euro conversion procedures that we determined were necessary and prudent to adopt by that date, and we are on track to becoming fully "euro ready" on or before the conclusion of the three-year euro transition period. We believe that the costs associated with transitioning to the euro will not be material to our consolidated financial position or results of operations.

### ENVIRONMENTAL AND OTHER MATTERS

We and certain of our subsidiaries and affiliates are parties to environmental proceedings. We expense or capitalize, as appropriate, expenditures for ongoing compliance with environmental regulations that relate to current operations. We expense expenditures that relate to an existing condition caused by past operations and 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 experience 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. We report these liabilities in the balance sheet 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 financial statements.

At December 31, 1999, we had been designated as a potentially responsible party in four Superfund sites. We have estimated our share of the remediation costs for these sites to be approximately \$1 million in the aggregate. In addition to the Superfund sites, we may have the obligation to remediate current or former facilities, and we estimate our share of remediation costs at these facilities to be approximately \$15 million. For both the Superfund sites 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 sites, 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 of remediation costs. Our understanding of the financial strength of other potentially responsible parties has been considered, where appropriate, in our determination of our estimated liability. We believe that the costs associated with our current status as a potentially responsible party in the Superfund sites, or as a liable party at our current or former facilities, will not be material to our consolidated financial position or results of operations.

We estimate that our capital expenditures for environmental matters will be \$3 million and \$4 million for 2000 and 2001, respectively.

We are a party to various other legal proceedings arising from our operations. We believe that the outcome of these other proceedings, individually and in the aggregate, will not have a material adverse effect on our financial position or results of operations.

### DERIVATIVE FINANCIAL INSTRUMENTS

#### Foreign Currency Exchange Rate Risk

We use derivative financial instruments, principally foreign currency forward purchase and sale contracts with terms of less than one year, to hedge our exposure to changes in foreign currency exchange rates. Our primary exposure to changes in foreign currency rates results from intercompany

loans made between affiliates to minimize the need for borrowings from third parties. Additionally, we enter into foreign currency forward purchase and sale contracts to mitigate our exposure to changes in exchange rates on certain intercompany and third-party trade receivables and payables. We have from time to time also entered into forward contracts to hedge our net investment in foreign subsidiaries. We do not currently enter into derivative financial instruments for speculative purposes.

In managing our foreign currency exposures, we identify and aggregate existing offsetting positions and then hedge residual exposures through third-party derivative contracts. The following table summarizes by major currency the notional amounts, weighted average settlement rates, and fair value for foreign currency forward purchase and sale contracts as of December 31, 1999. All contracts in the following table mature in 2000.

| In millions except settlement rates, December 31, 1999 |            | Notional Amount in Foreign Currency | Weighted Average Settlement Rates | Fair Value in U.S. Dollars |
|--|------------|-------------------------------------|-----------------------------------|----------------------------|
| Australian dollars                                     | - Purchase | 8                                   | 0.656                             | \$ 5                       |
|  | - Sell     | (61)                                | 0.656                             | (40)                       |
| British pounds   | - Purchase | 108                                 | 1.615                             | 175                        |
|  | - Sell     | (92)                                | 1.615                             | (149)                      |
| Canadian dollars                                       | - Purchase | 18                                  | 0.692                             | 12                         |
|  | - Sell     | (97)                                | 0.692                             | (67)                       |
| Czech Republic koruna                                  | - Purchase | 32                                  | 0.028                             | 1                          |
|  | - Sell     | (551)                               | 0.028                             | (15)                       |
| Danish kroner  | - Purchase | -                                   | 0.135                             | -                          |
|  | - Sell     | (340)                               | 0.135                             | (46)                       |
| European euro  | - Purchase | 38                                  | 1.007                             | 38                         |
|  | - Sell     | (26)                                | 1.007                             | (26)                       |
| U.S. dollars   | - Purchase | 153                                 | 1.000                             | 153                        |
|  | - Sell     | (35)                                | 1.000                             | (35)                       |
| Other  | - Purchase | 43                                  | 0.143                             | 6                          |
|  | - Sell     | (150)                               | 0.079                             | (12)                       |
|  |            |                                     |                                   | \$ -                       |

### Interest Rate Risk

Following the realignment of our debt in connection with the spin-off of Pactiv, our financial instruments that are sensitive to market risk for changes in interest rates are our debt securities. We primarily use a revolving credit facility to finance our short-term capital requirements. We pay a current market rate of interest on these borrowings. We financed our long-term capital requirements with long-term debt with original maturity dates ranging from six to 10 years. We have \$500 million of

long-term debt obligations that have fixed interest rates and \$1.05 billion of long-term debt obligations that have variable interest rates based on a current market rate of interest. If we were to redeem our fixed rate, long-term debt securities prior to their stated maturity, we would generally incur costs based on the fair value of the debt at that time plus any applicable early payment premiums.

Under the terms of our senior credit facility agreement, we are required to hedge our exposure to floating interest rates within 180 days following the spin-off so that at least 50 percent of our long-term debt is fixed for a period of at least three years. In February 2000, we hedged \$250 million of our floating rate long-term debt with three-year, floating to fixed interest rate swaps. We must hedge about \$50 million more of our long-term, floating rate debt to satisfy the interest rate hedging requirement of the senior credit facility agreement.

We estimate that the fair value of our long-term debt at December 31, 1999, was about the same as its book value. The fair value of the floating rate portion of our long-term debt does not change as interest rates change. A one percent increase or decrease in interest rates would increase or decrease the interest expense we recognize in the income statement and the cash we pay for interest expense by about \$6 million after tax. The interest rate swaps we entered into after the end of the year would have reduced the effect of a one percent change in interest rates by about \$1 million after tax.

The statements and other information (including the tables) in this "Derivative Financial Instruments" section constitute "forward-looking statements."

### YEARS 1998 AND 1997

#### Results of Continuing Operations

We reported income from continuing operations of \$116 million for the year ended December 31, 1998, compared to \$234 million for the same period in 1997. The 1998 figure includes a \$34 million after tax charge to restructure the automotive aftermarket business and to reduce overhead and manufacturing costs throughout every part of the business. Excluding the restructuring charge, our income from continuing operations for the 1998 period was \$150 million compared to \$234 million for the year ended December 31, 1997. While our operating income declined, we also experienced higher interest expense and minority interest.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Net Sales and Operating Revenues

| <i>In millions</i> | 1998           | 1997           | %<br>Change |
|--------------------|----------------|----------------|-------------|
| North America      | \$1,679        | \$1,719        | (2)         |
| Europe             | 1,252          | 1,173          | 7           |
| Rest of World      | 306            | 334            | (8)         |
|                    | <b>\$3,237</b> | <b>\$3,226</b> | —           |

Our revenue for 1998 was essentially flat with 1997 as increases in original equipment revenue in North America and Europe of \$215 million were offset by a \$165 million decline in aftermarket revenues throughout the world and a \$54 million reduction due to the adverse impact of a strong U.S. dollar, with the remaining change due to the mix of products sold. Original equipment revenue increased as we continued to place our ride control and exhaust products on many of the world's best selling vehicles. Lower aftermarket demand was driven by customer consolidations that temporarily increased field inventory levels in North America and Europe; milder than normal winter weather; and continuing soft Asian and South American replacement markets. Additionally, we began reducing our quarterly promotional programs in an effort to better balance supply and demand going into 1999.

### Income Before Interest Expense, Income Taxes, and Minority Interest ("EBIT")

The following table presents EBIT for the years 1998 and 1997:

| <i>In millions</i>                           | 1998         | 1997         | %<br>Change |
|--|--------------|--------------|-------------|
| North America                                | \$ 58        | \$216        | (73)        |
| Europe                                       | 155          | 153          | 1           |
| Rest of World                                | 35           | 38           | (8)         |
| Automotive                                   | 248          | 407          | (39)        |
| Previously unallocated Tenneco Inc. expenses | (21)         | (12)         | NM          |
|  | <b>\$227</b> | <b>\$395</b> | (43)        |

Excluding restructuring charges, a comparison of our 1998 and 1997 EBIT is as follows:

| <i>In millions</i>                           | 1998         | 1997         | %<br>Change |
|--|--------------|--------------|-------------|
| North America                                | \$106        | \$216        | (51)        |
| Europe                                       | 159          | 153          | 4           |
| Rest of World                                | 36           | 38           | (5)         |
| Automotive                                   | 301          | 407          | (26)        |
| Previously unallocated Tenneco Inc. expenses | (21)         | (12)         | NM          |
|  | <b>\$280</b> | <b>\$395</b> | (29)        |

Our EBIT in 1998 reflected strong volume growth in the original equipment business that was more than offset by lower volumes in the aftermarket. The net impact of volume was a decline in EBIT of \$43 million. Adverse currency movements caused a further deterioration of \$14 million. The 1997 EBIT included \$10 million related to the favorable resolution of a legal action and a net reduction of \$4 million in certain reserves, related primarily to ongoing reorganization initiatives that had proceeded more rapidly and efficiently than planned, allowing us to adjust our cost estimate for completing the initiatives. Charges in 1998 for bad debts, a higher level of costs related to customer acquisition activity and marketing, and pricing adjustments in the original equipment business produced the balance of the earnings decline.

The previously unallocated Tenneco Inc. expenses in both 1998 and 1997 related primarily to the loss from the sale of accounts receivable.

### EBIT as a Percentage of Revenue

Excluding the fourth quarter 1998 restructuring charge described previously, EBIT as a percentage of revenue for 1998 and 1997 was as follows:

|               | 1998  | 1997  |
|---------------|-------|-------|
| North America | 6.3%  | 12.6% |
| Europe        | 12.7% | 13.0% |
| Rest of World | 11.8% | 11.4% |
| Automotive    | 9.3%  | 12.6% |
| Total         | 8.7%  | 12.2% |

### Interest Expense, net of interest capitalized

We incurred interest expense of \$69 million, a \$11 million increase over 1997. For the year 1998, we allocated \$171 million of interest expense to discontinued operations compared with \$158 million during 1997. Adjusting for the allocation, interest expense increased by \$24 million. This increase was attributable to higher average debt levels in 1998 resulting from our acquisition of the protective and flexible packaging business of KNP BT in late April 1997 for the specialty packaging segment, a higher level of working capital to support higher revenue levels, and common share repurchase activity.

### Income Taxes

Our effective tax rate for 1998 was 8 percent, compared to 24 percent for 1997. The 1998 effective tax rate was lower than the statutory rate as a result of certain nonrecurring foreign and state tax benefits, lower foreign tax rates, and



a reduction in our estimated tax liabilities related to certain global tax audits. The 1997 effective tax rate benefitted from the nonrecurring impact of certain foreign tax benefits and the benefit of previously unrecognized deferred tax assets.

### Minority Interest

Minority interest was \$29 million in 1998, compared to \$23 million in 1997. This represents primarily dividends on the preferred stock of a U.S. subsidiary. In December 1997, this subsidiary issued additional preferred stock. You should read Note 10 to the financial statements for additional information.

### DISCONTINUED OPERATIONS

Read Note 2 to the financial statements for information regarding the results of our discontinued operations.

### CHANGE IN ACCOUNTING PRINCIPLE

As required by the FASB's Emerging Issues Task Force Issue 97-13, "Accounting for Costs Incurred in Connection with a Consulting Contract that Combines Business Process Reengineering and Information Technology Transformation," we recorded an aftertax charge of \$46 million, or \$1.35 per diluted common share, in the fourth quarter of 1997, which was reported as a cumulative effect of a change in accounting principle.

### EARNINGS PER SHARE

Income from continuing operations was \$3.44 per diluted common share for 1998, compared to \$6.85 per diluted common share in 1997. Discontinued operations contributed \$4.12 per diluted common share for 1998 compared to \$3.72 per diluted common share for 1997. For 1997, we also recorded a charge for the cumulative effect of a change in accounting principle noted above of \$1.35 per diluted common share, resulting in net income of \$9.22 per diluted common share compared to \$7.56 per diluted common share for 1998.

### CASH FLOWS

| <i>In millions</i>                           | 1998  | 1997   |
|--|-------|--------|
| <b>Cash provided (used) by:</b>              |       |        |
| Operating activities – continuing operations | \$ 63 | \$ 211 |
| Investing activities – continuing operations | (278) | (289)  |
| Financing activities                         | 216   | 354    |

### Operating Activities

Cash flow provided by operating activities was \$148 million lower in 1998 than in 1997. Income from continuing operations was \$118 million lower than in 1997, largely as a result of higher interest expense and the restructuring charge taken during the fourth quarter of 1998, for which the bulk of the cash outflows occurred during 1999. Noncash charges for deferred income taxes were higher in 1997 than in 1998, primarily as a result of tax benefits derived from the 1996 reorganization and debt realignment and a 1996 tax net operating loss that was carried back to earlier years.

### Investing Activities

Investing activities used \$11 million less cash in 1998 than in 1997. Capital expenditures for continuing operations declined by \$26 million in 1998. Cash used for acquisitions decreased by \$26 million in 1998 compared to 1997. In 1998, we acquired the minority interest of a Brazilian subsidiary for \$3 million.

Capital expenditures and acquisitions for discontinued operations decreased in 1998 by \$124 million, as lower acquisitions in 1998 were partially offset by higher capital spending. During 1998, the most significant acquisitions were Richter Manufacturing, a North American protective packaging business, and the Belvidere, Illinois, dual ovenable paperboard tray manufacturing facility of Champion International. Acquisition activity in 1997 related primarily to the purchase of KNP BT's protective and flexible packaging business. The higher capital expenditures were primarily a result of \$84 million spent to acquire certain leased timberlands in contemplation of the separation of the containerboard assets from our other businesses.

### Financing Activities

Financing activities in 1998 generated \$138 million less cash than in 1997. During 1997, a subsidiary issued preferred stock for net proceeds of \$99 million. During 1998, we repurchased \$22 million more of our common stock than in 1997. During 1997, we refinanced a portion of our short-term debt by issuing \$600 million of long-term debt. The net proceeds of these debt offerings was \$593 million. During 1998, our short-term debt (excluding current maturities on long-term debt) increased by \$540 million.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

### To Tenneco Automotive Inc.:

We have audited the accompanying balance sheets of Tenneco Automotive Inc. (a Delaware corporation) and consolidated subsidiaries (see Note 1) as of December 31, 1999 and 1998, and the related statements of income, cash flows, changes in shareholders' equity and comprehensive income for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of Tenneco Automotive Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tenneco Automotive Inc. and consolidated subsidiaries as of December 31, 1999 and 1998, and the results of their operations and cash flows for each of the three years in the period ended December 31, 1999, in conformity with generally accepted accounting principles.

As discussed in Note 1 to the financial statements, in 1999 Tenneco Automotive Inc. changed its methods of accounting for the costs of start-up activities and for customer acquisition costs, and in 1997 changed its method of accounting for certain costs incurred in connection with information technology transformation projects.

Arthur Andersen LLP  
Chicago, Illinois  
January 24, 2000

## STATEMENTS OF INCOME

| <i>In millions except share and per share amounts, years ended December 31,</i> | 1999              | 1998       | 1997       |
|---|-------------------|------------|------------|
| <b>Revenues</b>   |                   |            |            |
| Net sales and operating revenues  | <b>\$ 3,279</b>   | \$3,237    | \$3,226    |
| Other income, net   | <b>13</b>         | (25)       | 37         |
|   | <b>3,292</b>      | 3,212      | 3,263      |
| <b>Costs and expenses</b>   |                   |            |            |
| Cost of sales (exclusive of depreciation shown below)                           | <b>2,427</b>      | 2,332      | 2,303      |
| Engineering, research, and development  | <b>52</b>         | 31         | 34         |
| Selling, general, and administrative  | <b>521</b>        | 472        | 421        |
| Depreciation and amortization   | <b>144</b>        | 150        | 110        |
|   | <b>3,144</b>      | 2,985      | 2,868      |
| <b>Income before interest expense, income taxes, and minority interest</b>      | <b>148</b>        | 227        | 395        |
| Interest expense (net of interest capitalized)                                  | <b>106</b>        | 69         | 58         |
| Income tax expense  | <b>82</b>         | 13         | 80         |
| Minority interest   | <b>23</b>         | 29         | 23         |
| <b>Income (loss) from continuing operations</b>                                 | <b>(63)</b>       | 116        | 234        |
| Income (loss) from discontinued operations, net of income tax                   | <b>(208)</b>      | 139        | 127        |
| Income (loss) before extraordinary loss   | <b>(271)</b>      | 255        | 361        |
| Extraordinary loss, net of income tax   | <b>(18)</b>       | –          | –          |
| Income (loss) before cumulative effect of change in accounting principles       | <b>(289)</b>      | 255        | 361        |
| Cumulative effect of change in accounting principles, net of income tax         | <b>(134)</b>      | –          | (46)       |
| <b>Net income (loss)</b>  | <b>\$ (423)</b>   | \$ 255     | \$ 315     |
| <b>Earnings (loss) per share</b>  |                   |            |            |
| Average shares of common stock outstanding –                                    |                   |            |            |
| Basic   | <b>33,480,686</b> | 33,701,115 | 34,052,946 |
| Diluted   | <b>33,656,063</b> | 33,766,906 | 34,160,327 |
| Basic earnings (loss) per share of common stock –                               |                   |            |            |
| Continuing operations   | <b>\$ (1.87)</b>  | \$ 3.45    | \$ 6.87    |
| Discontinued operations   | <b>(6.23)</b>     | 4.13       | 3.73       |
| Extraordinary loss  | <b>(.55)</b>      | –          | –          |
| Cumulative effect of changes in accounting principles                           | <b>(3.99)</b>     | –          | (1.35)     |
|   | <b>\$(12.64)</b>  | \$ 7.58    | \$ 9.25    |
| Diluted earnings (loss) per share of common stock –                             |                   |            |            |
| Continuing operations   | <b>\$ (1.87)</b>  | \$ 3.44    | \$ 6.85    |
| Discontinued operations   | <b>(6.23)</b>     | 4.12       | 3.72       |
| Extraordinary loss  | <b>(.55)</b>      | –          | –          |
| Cumulative effect of changes in accounting principles                           | <b>(3.99)</b>     | –          | (1.35)     |
|   | <b>\$(12.64)</b>  | \$ 7.56    | \$ 9.22    |
| Cash dividends per share of common stock  | <b>\$ 4.50</b>    | \$ 6.00    | \$ 6.00    |

*The accompanying notes to financial statements are an integral part of these statements of income (loss).*

## BALANCE SHEETS

In millions, as of December 31,

|  | 1999           | 1998           |
|--|----------------|----------------|
| <b>Assets</b>  |                |                |
| Current assets:  |                |                |
| Cash and temporary cash investments                              | \$ 84          | \$ 29          |
| Receivables –  |                |                |
| Customer notes and accounts, net                                 | 557            | 430            |
| Other  | 14             | 13             |
| Inventories  | 412            | 414            |
| Deferred income taxes  | 59             | 39             |
| Prepayments and other  | 75             | 139            |
|  | <b>1,201</b>   | <b>1,064</b>   |
| Other assets:  |                |                |
| Long-term notes receivable, net                                  | 20             | 23             |
| Goodwill and intangibles, net                                    | 495            | 499            |
| Deferred income taxes  | 13             | 39             |
| Pension assets   | 31             | 101            |
| Other  | 146            | 201            |
|  | <b>705</b>     | <b>863</b>     |
| Plant, property, and equipment, at cost                          | 1,923          | 1,944          |
| Less – Reserves for depreciation and amortization                | 886            | 851            |
|  | <b>1,037</b>   | <b>1,093</b>   |
| Net assets of discontinued operations                            | –              | 1,739          |
|  | <b>\$2,943</b> | <b>\$4,759</b> |
| <b>Liabilities and shareholders' equity</b>                      |                |                |
| Current liabilities:   |                |                |
| Short-term debt (including current maturities on long-term debt) | \$ 56          | \$ 304         |
| Trade payables   | 348            | 337            |
| Accrued taxes  | 20             | 31             |
| Accrued interest   | 29             | 37             |
| Accrued liabilities  | 149            | 124            |
| Other  | 61             | 76             |
|  | <b>663</b>     | <b>909</b>     |
| Long-term debt   | 1,578          | 671            |
| Deferred income taxes  | 108            | 98             |
| Postretirement benefits  | 125            | 139            |
| Deferred credits and other liabilities                           | 31             | 31             |
| Commitments and contingencies                                    |                |                |
| Minority interest  | 16             | 407            |
| Shareholders' equity:  |                |                |
| Common stock   | –              | –              |
| Premium on common stock and other capital surplus                | 2,721          | 2,712          |
| Accumulated other comprehensive income (loss)                    | (179)          | (91)           |
| Retained earnings (accumulated deficit)                          | (1,880)        | 142            |
|  | <b>662</b>     | <b>2,763</b>   |
| Less – Shares held as treasury stock, at cost                    | 240            | 259            |
|  | <b>422</b>     | <b>2,504</b>   |
|  | <b>\$2,943</b> | <b>\$4,759</b> |

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

## STATEMENTS OF CASH FLOWS

| <i>In millions, years ended December 31,</i>   | 1999    | 1998   | 1997    |
|--|---------|--------|---------|
| <b>Operating activities</b>  |         |        |         |
| Income (loss) from continuing operations   | \$ (63) | \$ 116 | \$ 234  |
| Adjustments to reconcile income (loss) from continuing operations to cash provided (used) by continuing operations – |         |        |         |
| Depreciation and amortization  | 144     | 150    | 110     |
| Deferred income taxes  | 97      | (76)   | 31      |
| (Gain) loss on sale of businesses and assets, net  | 6       | 20     | 20      |
| Changes in components of working capital –   |         |        |         |
| (Increase) decrease in receivables   | (151)   | (88)   | (25)    |
| (Increase) decrease in inventories   | (23)    | (32)   | (12)    |
| (Increase) decrease in prepayments and other current assets  | 14      | 26     | (79)    |
| Increase (decrease) in payables  | 46      | (12)   | 107     |
| Increase (decrease) in accrued taxes   | (43)    | (9)    | (8)     |
| Increase (decrease) in accrued interest  | (7)     | –      | 30      |
| Increase (decrease) in other current liabilities   | (11)    | 10     | (108)   |
| Other  | (10)    | (42)   | (89)    |
| Cash provided (used) by continuing operations  | (1)     | 63     | 211     |
| Cash provided (used) by discontinued operations  | (253)   | 469    | 308     |
| Net cash provided (used) by operating activities   | (254)   | 532    | 519     |
| <b>Investing activities</b>  |         |        |         |
| Net proceeds related to the sale of discontinued operations  | 303     | 22     | 24      |
| Net proceeds from sale of businesses and assets  | 8       | 10     | 5       |
| Expenditures for plant, property, and equipment  | (154)   | (195)  | (221)   |
| Acquisitions of businesses   | (36)    | (3)    | (29)    |
| Expenditures for plant, property, and equipment and business acquisitions – discontinued operations                  | (1,264) | (498)  | (622)   |
| Investments and other  | (45)    | (90)   | (44)    |
| Net cash provided (used) by investing activities   | (1,188) | (754)  | (887)   |
| <b>Financing activities</b>  |         |        |         |
| Issuance of common and treasury shares   | 41      | 50     | 48      |
| Purchase of common stock   | (4)     | (154)  | (132)   |
| Issuance of equity securities by a subsidiary  | –       | –      | 99      |
| Redemption of equity securities by a subsidiary  | (408)   | –      | –       |
| Issuance of long-term debt   | 3,721   | 4      | 597     |
| Retirement of long-term debt   | (1,410) | (21)   | (23)    |
| Net increase (decrease) in short-term debt excluding current maturities on long-term debt                            | (294)   | 540    | (31)    |
| Dividends (common)   | (151)   | (203)  | (204)   |
| Net cash provided (used) by financing activities   | 1,495   | 216    | 354     |
| Effect of foreign exchange rate changes on cash and temporary cash investments                                       | 2       | 6      | 3       |
| Increase (decrease) in cash and temporary cash investments   | 55      | –      | (11)    |
| Cash and temporary cash investments, January 1   | 29      | 29     | 40      |
| Cash and temporary cash investments, December 31 (Note)  | \$ 84   | \$ 29  | \$ 29   |
| Cash paid during the year for interest   | \$ 260  | \$ 259 | \$ 206  |
| Cash paid during the year for income taxes (net of refunds)  | \$ 137  | \$ 80  | \$(145) |
| <b>Non-cash investing and financing activities</b>   |         |        |         |
| Common equity interest received related to the sale of containerboard operations                                     | 194     | –      | –       |
| Principle amount of long-term debt assumed by buyers of containerboard operations                                    | (1,760) | –      | –       |
| Principal amount of long-term and short-term debt assumed by specialty packaging                                     | (2,118) | –      | –       |
| Distribution of specialty packaging business   | (1,448) | –      | –       |

*Note: Cash and temporary cash investments 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.*

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| <i>In millions, except share amounts,<br/>years ended December 31,</i> | 1999              |                | 1998              |                | 1997              |                |
|--|-------------------|----------------|-------------------|----------------|-------------------|----------------|
|  | Shares            | Amount         | Shares            | Amount         | Shares            | Amount         |
| <b>Common stock</b>  |                   |                |                   |                |                   |                |
| Balance January 1  | 34,734,039        | \$ -           | 34,513,977        | \$ -           | 34,313,531        | \$ -           |
| Issued pursuant to benefit plans                                       | 236,446           | -              | 220,062           | -              | 200,446           | -              |
| <b>Balance December 31</b>   | <b>34,970,485</b> | <b>-</b>       | <b>34,734,039</b> | <b>-</b>       | <b>34,513,977</b> | <b>-</b>       |
| <b>Premium on common stock and other capital surplus</b>               |                   |                |                   |                |                   |                |
| Balance January 1  |                   | 2,712          |                   | 2,681          |                   | 2,644          |
| Premium on common stock issued pursuant to benefit plans               |                   | 22             |                   | 31             |                   | 37             |
| Redemption of equity securities by a subsidiary                        |                   | (13)           |                   | -              |                   | -              |
| <b>Balance December 31</b>   |                   | <b>2,721</b>   |                   | <b>2,712</b>   |                   | <b>2,681</b>   |
| <b>Accumulated other comprehensive income (loss)</b>                   |                   |                |                   |                |                   |                |
| Balance January 1  |                   | (91)           |                   | (122)          |                   | 23             |
| Other comprehensive income (loss)                                      |                   | (110)          |                   | 31             |                   | (145)          |
| Reclassification adjustment for disposition of investments             |                   | 22             |                   | -              |                   | -              |
| <b>Balance December 31</b>   |                   | <b>(179)</b>   |                   | <b>(91)</b>    |                   | <b>(122)</b>   |
| <b>Retained earnings (accumulated deficit)</b>                         |                   |                |                   |                |                   |                |
| Balance January 1  |                   | 142            |                   | 89             |                   | (21)           |
| Net income (loss)  |                   | (423)          |                   | 255            |                   | 315            |
| Dividends -  |                   |                |                   |                |                   |                |
| Common stock   |                   | (151)          |                   | (202)          |                   | (205)          |
| Distribution of Specialty Packaging Business                           |                   | (1,448)        |                   | -              |                   | -              |
| <b>Balance December 31</b>   |                   | <b>(1,880)</b> |                   | <b>142</b>     |                   | <b>89</b>      |
| <b>Less - Common stock held as treasury stock, at cost</b>             |                   |                |                   |                |                   |                |
| Balance January 1  | 1,351,535         | 259            | 585,637           | 120            | -                 | -              |
| Shares acquired  | 93,553            | 9              | 876,076           | 161            | 656,151           | 134            |
| Shares issued pursuant to benefit and dividend reinvestment plans      | (146,715)         | (28)           | (110,178)         | (22)           | (70,514)          | (14)           |
| <b>Balance December 31</b>   | <b>1,298,373</b>  | <b>240</b>     | <b>1,351,535</b>  | <b>259</b>     | <b>585,637</b>    | <b>120</b>     |
| <b>Total</b>   |                   | <b>\$ 422</b>  |                   | <b>\$2,504</b> |                   | <b>\$2,528</b> |

*The accompanying notes to financial statements are an integral part of these statements of changes in shareholders' equity.*

## STATEMENTS OF COMPREHENSIVE INCOME

|  | 1999  |                              | 1998  |                         | 1997  |                         |
|--|---|------------------------------|---|-------------------------|---|-------------------------|
|  | Accumulated<br>other com-<br>prehensive<br>income | Compre-<br>hensive<br>income | Accumulated<br>other<br>comprehensive<br>income | Comprehensive<br>income | Accumulated<br>other<br>comprehensive<br>income | Comprehensive<br>income |
| <i>In millions, years ended December 31,</i>                                       |   |                              |   |                         |   |                         |
| <b>Net income (loss)</b>   |   | <b>\$(423)</b>               |   | <b>\$255</b>            |   | <b>\$ 315</b>           |
| <b>Accumulated other comprehensive income (loss)</b>                               |   |                              |   |                         |   |                         |
| <b>Cumulative translation adjustment</b>   |   |                              |   |                         |   |                         |
| Balance January 1  | <b>\$ (82)</b>                                    |                              | <b>\$(122)</b>                                  |                         | <b>\$ 23</b>                                    |                         |
| Translation of foreign currency statements   | <b>(114)</b>                                      | <b>(114)</b>                 | <b>40</b>                                       | <b>40</b>               | <b>(160)</b>                                    | <b>(160)</b>            |
| Hedges of net investment in foreign subsidiaries                                   | -   | -                            | -   | -                       | <b>23</b>                                       | <b>23</b>               |
| Income tax benefit (expense)   | -   | -                            | -   | -                       | <b>(8)</b>                                      | <b>(8)</b>              |
| Reclassification adjustment for disposition of investments in foreign subsidiaries | <b>20</b>   | -                            | -   | -                       | -   | -                       |
| Balance December 31  | <b>(176)</b>                                      |                              | <b>(82)</b>                                     |                         | <b>(122)</b>                                    |                         |
| <b>Additional minimum pension liability adjustment</b>                             |   |                              |   |                         |   |                         |
| Balance January 1  | <b>(9)</b>  | -                            | -   |                         |   |                         |
| Additional minimum pension liability adjustment                                    | <b>6</b>  | <b>6</b>                     | <b>(15)</b>                                     | <b>(15)</b>             | -   | -                       |
| Income tax benefit (expense)   | <b>(2)</b>  | <b>(2)</b>                   | <b>6</b>  | <b>6</b>                | -   | -                       |
| Reclassification adjustment for disposition of investments in subsidiaries         | <b>2</b>  | -                            | -   | -                       | -   | -                       |
| Balance December 31  | <b>(3)</b>  |                              | <b>(9)</b>                                      |                         | -   |                         |
| Balance December 31  | <b>\$(179)</b>                                    |                              | <b>\$(91)</b>                                   |                         | <b>\$(122)</b>                                  |                         |
| Other comprehensive income (loss)  |   | <b>(110)</b>                 |   | <b>31</b>               |   | <b>(145)</b>            |
| <b>Comprehensive income (loss)</b>   |   | <b>\$(533)</b>               |   | <b>\$286</b>            |   | <b>\$ 170</b>           |

*The accompanying notes to financial statements are an integral part of these statements of comprehensive income (loss).*

# NOTES TO FINANCIAL STATEMENTS

## 1. SUMMARY OF ACCOUNTING POLICIES

### Consolidation and Presentation

Tenneco Automotive Inc. was known as Tenneco Inc. before the spin-off on November 4, 1999, of our packaging business to our shareholders, as described in Note 2. In these notes, when we discuss Tenneco we mean Tenneco Inc. and its subsidiaries before the spin-off and Tenneco Automotive Inc. and its subsidiaries after the spin-off.

Our financial statements include all majority-owned subsidiaries. We carry investments in 20% to 50% owned companies at cost plus equity in undistributed earnings since the date of acquisition and cumulative translation adjustments. We have eliminated all significant intercompany transactions.

### Inventories

At December 31, 1999 and 1998, inventory by major classification was as follows:

| <i>In millions</i>     | 1999         | 1998         |
|------------------------|--------------|--------------|
| Finished goods         | \$215        | \$221        |
| Work in process        | 86           | 79           |
| Raw materials          | 73           | 73           |
| Materials and supplies | 38           | 41           |
|                        | <b>\$412</b> | <b>\$414</b> |

Our inventories are stated at the lower of cost or market. A portion of total inventories (30% and 28% at December 31, 1999 and 1998, respectively) is valued using the last-in, first-out method. If we had used the first-in, first-out ("FIFO") method of accounting for these inventories, they would have been \$21 million and \$15 million higher at December 31, 1999 and 1998, respectively. We value all other inventories using the FIFO or average cost methods at the lower of cost or market value.

### Goodwill and Intangibles, net

At December 31, 1999 and 1998, goodwill and intangibles, net of amortization, by major category were as follows:

| <i>In millions</i>      | 1999         | 1998         |
|-------------------------|--------------|--------------|
| Goodwill                | \$485        | \$487        |
| Other intangible assets | 10           | 12           |
|                         | <b>\$495</b> | <b>\$499</b> |

Goodwill is being amortized on a straight-line basis over periods ranging from 15 to 40 years. Goodwill amortization amounted to \$17 million, \$16 million, and \$14 million for 1999, 1998, and 1997, respectively, and is included in the statements of income caption "Depreciation and amortization."

We have capitalized certain intangible assets, primarily trademarks and patents, based on their estimated fair value at the date we acquired them. We amortize these intangible assets on a straight-line basis over periods ranging from five to 30 years. Amortization of intangibles amounted to \$3 million, \$2 million, and \$6 million in 1999, 1998, and 1997, respectively, and is included in the statements of income caption "Depreciation and amortization."

### Plant, Property, and Equipment, at Cost

At December 31, 1999 and 1998, plant, property, and equipment, at cost, by major category were as follows:

| <i>In millions</i>                        | 1999           | 1998           |
|---|----------------|----------------|
| Land, buildings, and improvements         | \$ 365         | \$ 341         |
| Machinery and equipment                   | 1,339          | 1,395          |
| Other, including construction in progress | 219            | 208            |
|   | <b>\$1,923</b> | <b>\$1,944</b> |

We depreciate these properties on a straight-line basis over the estimated useful lives of the assets. Useful lives range from 10 to 40 years for buildings and improvements and from three to 25 years for machinery and equipment.

### Notes Receivable and Allowance for Doubtful Accounts

Short and long-term notes receivable outstanding were \$26 million and \$36 million at December 31, 1999 and 1998, respectively.

At December 31, 1999 and 1998, the allowance for doubtful accounts on short and long-term accounts and notes receivable was \$29 million and \$39 million, respectively.

### Other Long-Term Assets

Prior to January 1, 1999, we capitalized certain costs we incurred in connection with the acquisition of new customer contracts to sell our aftermarket products. These new customer acquisition costs were incurred in exchange for contracts in which the aftermarket customer agreed to purchase our aftermarket products exclusively for periods of time ranging up to three years. We amortized these costs over the initial contract period. At December 31, 1998, the net capitalized costs related to these activities were \$54 million. You should also read "Changes in Accounting Principles" later in this note for more information.

Before January 1, 1999, we capitalized certain costs related to start-up activities, primarily pre-production design and development costs for new automobile original equipment platforms, which are included in the 1998 balance sheet caption "Other assets - Other." We amortized the pre-production design and development costs over the life of the underlying supply



agreements and other start-up costs over the periods benefited, generally two years. Start-up costs capitalized, net of amortization, at December 31, 1998, were \$111 million for continuing operations and \$41 million for discontinued operations. You should also read "Changes in Accounting Principles" later in this note for more information.

Beginning on January 1, 1999, we began expensing pre-production design and development costs as incurred unless we have a contractual guarantee for reimbursement from the original equipment customer. At December 31, 1999, we had long-term receivables of \$10 million on the balance sheet for guaranteed pre-production design and development reimbursement arrangements with our customers. In addition, property, plant and equipment includes \$56 million and \$63 million at December 31, 1999 and 1998, respectively, for original equipment tools and dies that we own, and prepayments and other includes \$25 million and \$24 million at December 31, 1999 and 1998, respectively, for in-process tools and dies that we are building for our original equipment customers.

We capitalize certain costs related to the purchase and development of software that we use in our business operations. We amortize the costs attributable to these software systems over their estimated useful lives, ranging from three to 12 years, based on various factors such as the effects of obsolescence, technology and other economic factors. Capitalized software development costs, net of amortization, were \$73 million at December 31, 1999 and were \$67 million for continuing operations and \$140 million for discontinued operations at December 31, 1998. You should also read "Changes in Accounting Principles" later in this note for more information.

#### **Income Taxes**

We utilize the liability method of accounting for income taxes whereby we recognize deferred tax assets and liabilities for the future tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in our financial statements. We reduce deferred tax assets by a valuation allowance when, based upon our estimates, it is more likely than not that we will not realize a portion of the deferred tax assets in a future period. The estimates utilized in the recognition of deferred tax assets are subject to revision in future periods based on new facts or circumstances.

We do not provide for U.S. income taxes on unremitted earnings of foreign subsidiaries as our present intention is to reinvest the unremitted earnings in our foreign operations. Unremitted earnings of foreign subsidiaries are approximately \$410 million at December 31, 1999. It is not practicable to determine the amount of U.S. income taxes that would be payable upon remittance of the assets that represent those earnings.

#### **Earnings Per Share**

We compute basic earnings per share by dividing income available to common shareholders by the weighted-average number of common shares outstanding. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the weighted-average number of shares outstanding is adjusted to include estimates of additional shares that would be issued if potentially dilutive common shares had been issued. In addition, income available to common shareholders is adjusted to include any changes in income or loss that would result from the assumed issuance of the dilutive common shares.

#### **Allocation of Corporate Debt and Interest Expense**

Our practice is to incur indebtedness for our consolidated group at the parent company level or at a limited number of subsidiaries, rather than at the operating company level, and to centrally manage various cash functions. Consequently, our corporate debt has been allocated to discontinued operations based upon the ratio of the discontinued operations' net assets to our consolidated net assets plus debt. We have allocated interest expense, net of tax, to our discontinued operations based on the same allocation methodology. You should also read Note 2, "Discontinued Operations and Extraordinary Loss," for more information.

#### **Research and Development**

We expense research and development costs as they are incurred. Research and development expenses were \$32 million, \$30 million, and \$19 million for 1999, 1998, and 1997, respectively, and are included in the income statement caption "Engineering, research, and development expenses."

#### **Foreign Currency Translation**

Financial statements of international operations are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities and the weighted average exchange rate for each applicable period for revenues, expenses, and gains and losses. Translation adjustments are reflected in the balance sheet caption "Accumulated other comprehensive income (loss)."

#### **Risk Management Activities**

We use derivative financial instruments, principally foreign currency forward purchase and sale contracts with terms of less than one year, to hedge our exposure to changes in foreign currency exchange rates, and interest rate swaps to hedge our exposure to changes in interest rates. Our primary exposure to changes in foreign currency rates results from intercompany loans made between affiliates to minimize the

## NOTES TO FINANCIAL STATEMENTS

need for borrowings from third parties. Net gains or losses on these foreign currency exchange contracts that are designated as hedges are recognized in the income statement to offset the foreign currency gain or loss on the underlying transaction. Additionally, we enter into foreign currency forward purchase and sale contracts to mitigate our exposure to changes in exchange rates on some intercompany and third party trade receivables and payables. Since these anticipated transactions are not firm commitments, we mark these forward contracts to market each period and record any gain or loss in the income statement. From time to time we have also entered into forward contracts to hedge our net investment in foreign subsidiaries. We recognize the after-tax net gains or losses on these contracts on the accrual basis in the balance sheet caption "Accumulated other comprehensive income (loss)." In the statement of cash flows, cash receipts or payments related to these exchange contracts are classified consistent with the cash flows from the transaction being hedged.

We do not currently enter into derivative financial instruments for speculative purposes.

### Changes in Accounting Principles

In March 1998, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," which establishes new accounting and reporting standards for the costs of computer software developed or obtained for internal use. This statement required prospective application for fiscal years beginning after December 15, 1998. We adopted SOP 98-1 on January 1, 1999. The impact of this new standard did not have a significant effect on our financial position or results of operations.

In April 1998, the AICPA issued SOP 98-5, "Reporting on the Costs of Start-up Activities," which requires costs of start-up activities to be expensed as incurred. This statement was effective for fiscal years beginning after December 15, 1998. The statement requires previously capitalized costs related to start-up activities to be expensed as a cumulative effect of a change in accounting principle when the statement is adopted. Prior to January 1, 1999, we capitalized certain costs related to start-up activities, primarily pre-production design and development costs for new automobile original equipment platforms. We adopted SOP 98-5 on January 1, 1999, and recorded an after-tax charge for the cumulative effect of this change in accounting principle of \$102 million (net of a \$50 million tax benefit), or \$3.04 per diluted common share. The change in accounting principle decreased income from continuing

operations by \$19 million (net of an \$11 million tax benefit), or \$.56 per diluted common share, for the year ended December 31, 1999. If the new accounting method had been applied retroactively, income from continuing operations for the years ended December 31, 1998 and 1997, would have been lower by \$19 million (net of a \$12 million tax benefit), or \$.57 per diluted common share, and \$18 million (net of a \$12 million tax benefit), or \$.54 per diluted common share, respectively.

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes new accounting and reporting standards requiring that all derivative instruments, including derivative instruments embedded in other contracts, be recorded in the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting treatment. This statement cannot be applied retroactively and is effective for all fiscal years beginning after June 15, 2000. We are currently evaluating the new standard and have not yet determined the impact it will have on our financial position or results of operations.

Effective January 1, 1999, we changed our method of accounting for customer acquisition costs from a deferral method to an expense-as-incurred method. In connection with the decision to separate the automotive and specialty packaging businesses into independent public companies, we determined that a change to an expense-as-incurred method of accounting for automotive aftermarket customer acquisition costs was preferable in order to permit improved comparability of stand-alone financial results with our aftermarket industry competitors. We recorded an after-tax charge for the cumulative effect of this change in accounting principle of \$32 million (net of a \$22 million tax benefit), or \$.95 per diluted common share. The change in accounting principle increased income from continuing operations by \$10 million (net of \$6 million in income tax expense), or \$.30 per diluted common share, for the year ended December 31, 1999. If the new accounting principle had been applied retroactively, income from continuing operations for the years ended December 31, 1998 and 1997, would have been lower by \$4 million (net of a \$3 million income tax benefit), or \$.11 per diluted common share, and \$12 million (net of a \$8 million income tax benefit), or \$.35 per diluted common share, respectively.

As required by the FASB's Emerging Issues Task Force ("EITF") Issue 97-13, "Accounting for Costs Incurred in Connection with a Consulting Contract that Combines Business Process Reengineering and Information Technology Transformation," we recorded an after-tax charge of \$46 million (\$1.35 per diluted common share), net of a tax benefit of \$28 million, in the fourth quarter of 1997. EITF 97-13 establishes the accounting treatment and an allocation methodology for certain consulting and other costs incurred in connection with information technology transformation efforts. This charge was reported as a cumulative effect of a change in accounting principle.

#### Use of Estimates

The preparation of financial statements in conformity 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Reclassifications

Prior years' financial statements have been reclassified where appropriate to conform to 1999 presentations.

## 2. DISCONTINUED OPERATIONS AND EXTRAORDINARY LOSS

#### Background of the Spin-off Transaction

In July 1998, the Board of Directors authorized management to develop a broad range of strategic alternatives to separate the automotive, paperboard packaging, and specialty packaging businesses. Subsequently, we completed the following actions:

- In January 1999, we announced an agreement to contribute the containerboard business to a new joint venture with an affiliate of Madison Dearborn Partners. The proceeds from the transaction, including debt assumed by the new joint venture, were approximately \$2 billion. The transaction closed in April 1999. We retained a 43 percent interest in the joint venture.
- In April 1999, we announced an agreement to sell our folding carton operations to Caraustar Industries. This transaction closed in June 1999. The folding carton operations and the containerboard business together represented our paperboard packaging operating segment.
- On November 4, 1999, we completed the spin-off of the common stock of Tenneco Packaging Inc., now known as Pactiv Corporation, to our shareholders. Pactiv included all

of the businesses that made up our specialty packaging segment, as well as our remaining interest in the containerboard joint venture and our administrative services operations.

As a result of this series of transactions, our former specialty and paperboard packaging operating segments are presented as discontinued operations in the accompanying financial statements.

The morning following the spin-off, we completed a reverse stock split that had been approved by our shareholders in a special meeting held in October 1999. As a result, every five shares of our common stock were converted into one share of our new common stock.

Before the spin-off, we realigned substantially all of our existing debt through a combination of tender offers, exchange offers, and other refinancings. You should also read Note 4, "Long-Term Debt, Short-Term Debt, and Financing Arrangements" for more information.

#### Discontinued Operations

Our loss from discontinued operations in 1999 was \$208 million, comprised principally of an after-tax loss on sale of the paperboard packaging business of \$207 million. This loss on sale includes a \$54 million net loss in the fourth quarter, reflecting events that occurred subsequent to the April 1999 sale related to the final settlement of working capital amounts, revisions to actuarially-determined estimates of pension plan effects, and changes in estimates regarding liabilities retained by Pactiv.

#### The Specialty Packaging Business

Net assets as of December 31, 1998 and 1997, and results of operations for the years ended December 31, 1999, 1998, and 1997, for the specialty packaging business were as follows:

| <i>In millions</i>                                   | 1999     | 1998     | 1997     |
|--|----------|----------|----------|
| Net assets at December 31                            | \$ -     | \$ 1,373 | \$ 1,348 |
| Net sales and operating revenues                     | \$ 2,419 | \$ 2,791 | \$ 2,563 |
| Income before income taxes and interest allocation   | \$ 87    | \$ 280   | \$ 302   |
| Income tax (expense) benefit                         | (29)     | (113)    | (118)    |
| Income before interest allocation                    | 58       | 167      | 184      |
| Allocated interest expense, net of income tax (Note) | (81)     | (85)     | (78)     |
| Income (loss) from discontinued operations           | \$ (23)  | \$ 82    | \$ 106   |

Note: Reference is made to Note 1, "Summary of Accounting Policies - Allocation of Corporate Debt and Interest Expense," for a discussion of the allocation of corporate debt and interest expense to discontinued operations.

## NOTES TO FINANCIAL STATEMENTS

### *The Paperboard Packaging Business*

Net assets as of December 31, 1998 and 1997, and results of operations for the years ended 1999, 1998, and 1997, for the paperboard packaging business were as follows:

| <i>In millions</i>  | 1999    | 1998    | 1997    |
|---|---------|---------|---------|
| Net assets at December 31                                 | \$ -    | \$ 366  | \$ 423  |
| Net sales and operating revenues                          | \$ 445  | \$1,570 | \$1,431 |
| Income (loss) before income taxes and interest allocation |         |         |         |
| Operation   | \$ 32   | \$ 99   | \$ 63   |
| Loss on containerboard sale                               | (343)   | -       | -       |
| Gain on sale of folding carton                            | 11      | -       | -       |
| Gain on sale of joint venture with Carastar               | -       | 15      | -       |
| Gain on sale of non-strategic timberland                  | -       | 17      | -       |
|   | (300)   | 131     | 63      |
| Income tax (expense) benefit                              | 120     | (48)    | (19)    |
| Income (loss) before interest allocation                  | (180)   | 83      | 44      |
| Allocated interest expense, net of income tax (Note)      | (5)     | (26)    | (23)    |
| Income (loss) from discontinued operations                | \$(185) | \$ 57   | \$ 21   |

*Note: Reference is made to Note 1, "Summary of Accounting Policies – Allocation of Corporate Debt and Interest Expense," for a discussion of the allocation of corporate debt and interest expense to discontinued operations.*

### Extraordinary Loss

In connection with the sale of the containerboard assets, an extraordinary loss of approximately \$7 million, net of an income tax benefit of \$3 million, was recognized due to the early retirement of debt. As a result of the debt realignment prior to the spin-off, we recognized an extraordinary loss of approximately \$11 million, net of an income tax benefit of \$7 million. This extraordinary loss consists principally of the fair value paid in the cash tender offers in excess of the historical carrying value for the debt tendered.

### 3. RESTRUCTURING CHARGES

We adopted plans to restructure portions of our operations in both 1998 and 1999. In the fourth quarter of 1998, our Board of Directors approved an extensive restructuring plan designed to reduce administrative and operational overhead costs. We recorded a pre-tax charge to income from continuing operations of \$53 million, \$34 million after-tax, or \$1.02 per diluted common share. Of the pre-tax charge, for operational restructuring plans, \$36 million related to the consolidation

of the manufacturing and distribution operations of our North American aftermarket business. A staff and related cost-reduction plan, which covered employees in both the operating units and corporate operations, cost \$17 million.

Our aftermarket restructuring involved closing two plant locations and five distribution centers, resulting in eliminating 302 positions. Our staff and related cost-reduction plan involved eliminating 454 administrative positions. We wrote down the fixed assets at the locations to be closed to their fair value, less costs to sell, in the fourth quarter of 1998. As a result of the single-purpose nature of the assets, we estimated fair value at scrap value less cost to dispose. We do not expect to receive any significant net cash proceeds from the ultimate disposal of these assets, which should be complete by the fourth quarter of 2000. The effect of suspending depreciation for these impaired assets is a reduction in depreciation and amortization of approximately \$2 million on an annual basis.

As of December 31, 1999, we have terminated approximately 670 employees and our North American aftermarket business has closed one plant location and four distribution centers under the 1998 plan. To address customer service and production transfer issues, we have delayed closing one plant location and one distribution center until the first quarter of 2000. We have executed all other restructuring actions, with the exception of the final disposal of certain assets, according to our initial plan, and those actions were completed by year-end 1999.

In the fourth quarter of 1999, our Board of Directors approved a second restructuring plan designed to further reduce operational overhead costs. We recorded a pre-tax charge to income from continuing operations of \$55 million, \$50 million after-tax, or \$1.50 per diluted common share.

The charge includes \$37 million recorded in Europe to close a ride control manufacturing facility and an exhaust just-in-time plant, close or downsize four aftermarket distribution centers, and reduce administrative overhead by reducing management employment; \$15 million to close a North American exhaust manufacturing facility; and \$3 million for employment reductions in South America and Asia. In total, the plan involves eliminating approximately 780 positions. We wrote down the fixed assets at the locations to be closed to their fair value, less costs to sell, in the fourth quarter of 1999. We estimated the fair value for buildings using external real estate valuations or a review of recent sales prices for like buildings in the area surrounding the plant to be closed. As a result of the single-purpose nature of the machinery and equipment to be disposed of, fair value was estimated at scrap value less cost to dispose in most cases. For certain machines that have value in the

used equipment market, engineers estimated value based on recent sales of like machines. We expect to receive net cash proceeds of approximately \$11 million when we dispose of these assets. The effect of suspending depreciation for these impaired assets is a reduction in depreciation and amortization expense of approximately \$3 million on an annual basis. We expect to complete all restructuring activities by the middle of 2001.

Amounts related to the restructuring plans are shown in the following table:

| <i>In millions</i>  | Dec. 31,<br>1998<br>restruc-<br>turing<br>reserve | 1999<br>restruc-<br>turing<br>charge | 1999<br>cash<br>pay-<br>ments | Charged<br>to asset<br>accounts | Dec. 31,<br>1999<br>restruc-<br>turing<br>reserve |
|---------------------|---|--------------------------------------|-------------------------------|---------------------------------|---|
| Severance           | \$15  | \$21                                 | \$10                          | \$ -                            | \$26  |
| Asset impairments   | -   | 31                                   | -                             | 31                              | -   |
| Facility exit costs | 1   | 3                                    | 2                             | -                               | 2   |
|                     | \$16  | \$55                                 | \$12                          | \$31                            | \$28  |

#### 4. LONG-TERM DEBT, SHORT-TERM DEBT, AND FINANCING ARRANGEMENTS

##### Long-Term Debt

A summary of our long-term debt obligations at December 31, 1999 and 1998, is set forth in the following table:

| <i>In millions</i>  | 1999           | 1998   |
|---|----------------|--------|
| <b>Tenneco Automotive Inc.</b>  |                |        |
| Senior Term Loans due 2001 through 2008, average effective interest rate 9.3% in 1999   | \$1,050        | \$ -   |
| 11½% Senior Subordinated Notes due 2009   | 500            | -      |
| Debentures due 2008 through 2025, average effective interest rate 9.3% in 1999 and 7.5% in 1998 (net of none in 1999 and \$64 million in 1998 of unamortized premium) | 3              | 1,213  |
| Notes due 2001 through 2007, average effective interest rate 8.9% in 1999 and 6.7% in 1998 (net of none in 1999 and \$33 million in 1998 of unamortized premium)      | 17             | 1,344  |
| <b>Other subsidiaries</b>   |                |        |
| Notes due 2000 through 2005, average effective interest rate 10.8% in 1999 and 10.7% in 1998 (net of none in 1999 and \$22 million in 1998 of unamortized discount)   | 9              | 53     |
|   | <b>1,579</b>   | 2,610  |
| Less – current maturities   | 1              | 250    |
| Total long-term debt  | <b>1,578</b>   | 2,360  |
| Less – long-term corporate debt allocated to net assets of discontinued operations  | -              | 1,689  |
| Total long-term debt, net of allocation to net assets of discontinued operations  | <b>\$1,578</b> | \$ 671 |

The aggregate maturities and sinking fund requirements applicable to the issues outstanding at December 31, 1999, are \$1 million, \$61 million, \$118 million, \$108 million, and \$106 million for 2000, 2001, 2002, 2003, and 2004, respectively.

##### Short-Term Debt

We principally use a revolving credit facility to finance our short-term capital requirements. Information regarding our short-term debt as of and for the years ended December 31, 1999 and 1998, is as follows:

| <i>In millions</i>   | 1999                     |                   | 1998                     |                   |
|--|--------------------------|-------------------|--------------------------|-------------------|
|  | Com-<br>mercial<br>paper | Notes<br>payable* | Com-<br>mercial<br>paper | Notes<br>payable* |
| Outstanding borrowings at end of year  | \$ -                     | \$ 55             | \$576                    | \$245             |
| Weighted average interest rate on outstanding borrowings at end of year                            | -%                       | 17.7%             | 5.8%                     | 6.3%              |
| Approximate maximum month-end outstanding borrowings during year                                   | \$822                    | \$287             | \$576                    | \$245             |
| Approximate average month-end outstanding borrowings during year                                   | \$280                    | \$143             | \$447                    | \$157             |
| Weighted average interest rate on approximate average month-end outstanding borrowings during year | 5.3%                     | 9.1%              | 5.8%                     | 6.9%              |

\* Includes borrowings under both committed credit facilities and uncommitted lines of credit and similar arrangements.

##### Short-Term Corporate Debt Allocation

| <i>In millions</i>  | 1999 | 1998   |
|---|------|--------|
| Current maturities on long-term debt  | \$ 1 | \$ 250 |
| Commercial paper  | -    | 576    |
| Notes payable   | 55   | 245    |
| Total short-term debt   | 56   | 1,071  |
| Less – short-term corporate debt allocated to net assets of discontinued operations | -    | 767    |
| Total short-term debt, net of allocation to discontinued operations                 | \$56 | \$ 304 |

## NOTES TO FINANCIAL STATEMENTS

### Financing Arrangements

| In millions                     | Term    | Committed credit facilities <sup>(a)</sup> |          |           |
|---------------------------------|---------|--|----------|-----------|
|                                 |         | Commitments                                | Utilized | Available |
| Tenneco Automotive Inc.         |         |  |          |           |
| revolving credit agreement      | 2005    | \$500                                      | \$ –     | \$500     |
| Subsidiaries' credit agreements | Various | 12   | 12       | –         |
|                                 |         | \$512                                      | \$12     | \$500     |

<sup>(a)</sup> We generally are required to pay commitment fees on the unused portion of the total commitment and facility fees on the total commitment.

Prior to the spin-off, we realigned substantially all of our existing debt. To accomplish this, we initiated an offer to exchange Pactiv debt securities for some of our debt securities having a book value of \$1,166 million. We also initiated a cash tender offer to purchase debt securities having a book value of \$1,374 million and repaid substantially all of our short-term borrowings. Finally, we retired approximately \$400 million of subsidiary preferred stock. These transactions were financed by borrowings under our new credit facility, senior subordinated debt that we issued, and borrowings by Pactiv under new credit facilities. The debt of Pactiv was rated investment grade and our debt was rated non-investment grade by debt rating agencies.

As part of the debt realignment, on September 30, 1999, we entered into a \$1.55 billion committed senior secured financing arrangement with a syndicate of banks and other financial institutions consisting of: (i) a \$500 million, six-year revolving credit facility; (ii) a \$450 million six-year term loan; (iii) a \$300 million eight-year term loan and; (iv) a \$300 million eight-and-one-half-year term loan. The financing is secured by substantially all of our tangible and intangible U.S. assets, the capital stock of our material U.S. subsidiaries, and up to 66 percent of the capital stock of our first-tier foreign subsidiaries. It is also guaranteed by our material U.S. subsidiaries. We will pay a portion of each term loan in quarterly installments beginning September 30, 2001. Borrowings under this facility bear interest at an annual rate equal to, at our option, either (i) the London Interbank Offering Rate plus a margin of 275 basis points for the six-year revolving credit facility and the six-year term loan, 325 basis points for the eight-year term loan and 350 basis points for the eight-and-one-half year term loan; or (ii) a rate consisting of the greater of The Chase Manhattan Bank's prime rate or the Federal Funds rate plus 50 basis points, plus a margin of 175 basis points for the six-year

revolving credit facility and the six-year term loan, 225 basis points for the eight-year-term loan and 250 basis points for the eight-and-one-half-year term loan. Under the provisions of the senior credit facility agreement, the interest margins for borrowings under the revolving credit facility and the six-year term loan may be adjusted based on the consolidated leverage ratio (total debt divided by consolidated earnings before interest, taxes, depreciation, and amortization ("EBITDA") as defined in the senior credit facility agreement) measured at the end of each quarter starting with the fiscal quarter ending December 31, 2000.

The senior credit facility agreement requires that we initially maintain: (i) a consolidated leverage ratio (consolidated indebtedness divided by consolidated EBITDA) not greater than 4.75; (ii) a consolidated interest coverage ratio (consolidated EBITDA divided by consolidated interest expense) not less than 2.00; and (iii) a consolidated fixed charge coverage ratio (consolidated EBITDA less consolidated capital expenditures, divided by consolidated interest expense) not less than 1.00. Under the terms of the senior credit facility agreement, the maximum permitted consolidated leverage ratio will decrease beginning in the year 2001, the minimum permitted consolidated interest coverage ratio will increase beginning in the year 2001, and the minimum permitted consolidated fixed charge coverage ratio will increase beginning in the year 2002. The senior credit facility agreement also contains restrictions on our operations that are customary for similar facilities, including limitations on: (a) incurring additional liens; (b) sale and leaseback transactions; (c) liquidations and dissolutions; (d) incurring additional indebtedness or guarantees; (e) capital expenditures; (f) dividends; (g) mergers and consolidations; and (h) prepayments and modifications of subordinated and other debt instruments. Compliance with these requirements and restrictions is a condition for any incremental borrowings under the senior credit facility agreement and failure to meet these requirements enables the lenders to require us to repay any outstanding loans.

On October 14, 1999, we issued \$500 million of 11½ percent senior subordinated notes due in 2009. The senior subordinated debt indenture requires that we, as a condition to incurring certain types of indebtedness not otherwise permitted, initially maintain an interest coverage ratio of not less than 2.00. Under the terms of the indenture, the minimum interest coverage ratio will increase beginning in 2001. The indenture also contains restrictions on our operations, including limitations on: (1) incurring additional indebtedness or liens; (2) dividends; (3) distributions and stock repurchases; (4) investments; and (5) mergers and consolidations.



## 5. FINANCIAL INSTRUMENTS

The carrying and estimated fair values of our financial instruments by class at December 31, 1999 and 1998, were as follows:

| In millions  | 1999                 |                  | 1998            |            |
|--|----------------------|------------------|-----------------|------------|
|  | Carrying amount      | Fair value       | Carrying amount | Fair value |
|  | Assets (Liabilities) |                  |                 |            |
| Long-term debt (including current maturities) (Note) | <b>\$(1,579)</b>     | <b>\$(1,588)</b> | \$(2,610)       | \$(2,606)  |
| Instruments with off-balance-sheet risk              |                      |                  |                 |            |
| Foreign currency contracts                           | -                    | -                | 1               | 1          |
| Financial guarantees                                 | -                    | <b>(38)</b>      | -               | (13)       |

*Note: The carrying amounts and estimated fair value of long-term debt are before allocation of corporate debt to discontinued operations. Reference is made to Note 1 for information concerning corporate debt allocated to discontinued operations.*

Under the terms of our senior credit facility agreement, we are required to hedge our exposure to floating interest rates within 180 days following the date of the spin-off so that at least 50 percent of our long-term debt is fixed for a period of at least three years. In February 2000, we hedged \$250 million of our long-term, floating rate debt with three-year, floating to fixed interest rate swaps. We must hedge approximately \$50 million more of our long-term, floating rate debt to satisfy the interest rate hedging requirement of the senior credit facility agreement.

### Asset and Liability Instruments

The fair value of cash and temporary cash investments, short and long-term receivables, accounts payable, and short-term debt was considered to be the same as or was not determined to be materially different from the carrying amount.

Long-term debt – The fair value of fixed rate long-term debt was based on the market value of debt with similar maturities and interest rates.

### Instruments With Off-Balance-Sheet Risk

Foreign Currency Contracts – Note 1, “Summary of Accounting Policies – Risk Management Activities,” describes our use of and accounting for foreign currency exchange contracts. The following table summarizes by major currency the contractual amounts of foreign currency contracts we utilize:

| In millions                                    | Notional Amount |              |               |       |
|--|-----------------|--------------|---------------|-------|
|  | Dec. 31, 1999   |              | Dec. 31, 1998 |       |
|  | Purchase        | Sell         | Purchase      | Sell  |
| <b>Foreign currency contracts (in U.S.\$):</b> |                 |              |               |       |
| Australian dollars                             | \$ 5            | \$ 40        | \$ 3          | \$ 2  |
| Belgian francs                                 | -               | -            | 17            | 19    |
| British pounds                                 | 175             | 149          | 163           | 252   |
| Canadian dollars                               | 12              | 67           | 73            | 115   |
| Czech Republic koruna                          | 1               | 15           | -             | 19    |
| Danish kroner                                  | -               | 46           | 12            | -     |
| European euro                                  | 38              | 26           | -             | -     |
| French francs                                  | -               | -            | 89            | 17    |
| German marks                                   | -               | -            | 2             | 33    |
| Spanish pesetas                                | -               | -            | 32            | 2     |
| U.S. dollars                                   | 153             | 35           | 105           | 33    |
| Other  | 6               | 12           | 25            | 28    |
|  | <b>\$390</b>    | <b>\$390</b> | \$521         | \$520 |

Based on exchange rates at December 31, 1999 and 1998, the cost of replacing these contracts in the event of non-performance by the counterparties would not have been material.

Guarantees – We had guaranteed payment and performance of approximately \$38 million and \$13 million at December 31, 1999 and 1998, respectively, primarily with respect to letters of credit and other guarantees supporting various financing and operating activities.

As of the spin-off, all of our then existing and future material domestic wholly owned subsidiaries fully and unconditionally guaranteed the senior secured credit facility and the senior subordinated notes on a joint and several basis.



## NOTES TO FINANCIAL STATEMENTS

### 6. INCOME TAXES

The domestic and foreign components of our income from continuing operations before income taxes are as follows:

| <i>In millions, years ended December 31,</i> | 1999          | 1998    | 1997  |
|--|---------------|---------|-------|
| U.S. income (loss) before income taxes       | <b>\$(42)</b> | \$ (65) | \$ 91 |
| Foreign income before income taxes           | <b>84</b>     | 223     | 246   |
| Income before income taxes                   | <b>\$ 42</b>  | \$158   | \$337 |

Following is a comparative analysis of the components of income tax expense applicable to continuing operations:

| <i>In millions, years ended December 31,</i> | 1999          | 1998  | 1997   |
|--|---------------|-------|--------|
| <b>Current</b>                               |               |       |        |
| U.S.   | <b>\$(44)</b> | \$ 72 | \$ (5) |
| State and local                              | <b>(4)</b>    | (21)  | —      |
| Foreign                                      | <b>33</b>     | 38    | 54     |
|  | <b>(15)</b>   | 89    | 49     |
| <b>Deferred</b>                              |               |       |        |
| U.S.   | <b>62</b>     | (109) | 13     |
| Foreign, state, and other                    | <b>35</b>     | 33    | 18     |
|  | <b>97</b>     | (76)  | 31     |
| Income tax expense                           | <b>\$ 82</b>  | \$ 13 | \$ 80  |

Following is a reconciliation of income taxes computed at the statutory U.S. federal income tax rate (35% for all years presented) to the income tax expense reflected in the statements of income:

| <i>In millions, years ended December 31,</i>                                   | 1999        | 1998  | 1997  |
|--|-------------|-------|-------|
| Tax expense computed at the statutory U.S. federal income tax rate             | <b>\$15</b> | \$ 55 | \$118 |
| Increases (reductions) in income tax expense resulting from:                   |             |       |       |
| Foreign income taxed at different rates and foreign losses with no tax benefit | <b>(2)</b>  | (12)  | (25)  |
| Taxes on repatriation dividends  | <b>33</b>   | —     | —     |
| State and local taxes on income, net of U.S. federal income tax benefit        | <b>(2)</b>  | (8)   | 4     |
| Recognition of previously unbenefited loss carryforwards                       | <b>(4)</b>  | (5)   | (11)  |
| Amortization of nondeductible goodwill   | <b>3</b>    | 3     | 2     |
| Tax effect of intercompany allocation  | <b>18</b>   | —     | —     |
| Nondeductible restructuring expenses   | <b>15</b>   | —     | —     |
| Other  | <b>6</b>    | (20)  | (8)   |
| Income tax expense   | <b>\$82</b> | \$ 13 | \$ 80 |

The components of our net deferred tax liability were as follows:

| <i>In millions, December 31,</i>            | 1999         | 1998  |
|---|--------------|-------|
| <b>Deferred tax assets</b>                  |              |       |
| Tax loss carryforwards:                     |              |       |
| U.S.  | <b>\$ 78</b> | \$104 |
| State                                       | <b>2</b>     | 7     |
| Foreign                                     | <b>49</b>    | 58    |
| Postretirement benefits other than pensions | <b>31</b>    | 32    |
| Other                                       | <b>28</b>    | 26    |
| Valuation allowance                         | <b>(25)</b>  | (30)  |
| Net deferred tax asset                      | <b>163</b>   | 197   |
| <b>Deferred tax liabilities</b>             |              |       |
| Tax over book depreciation                  | <b>132</b>   | 113   |
| Pensions                                    | <b>13</b>    | 27    |
| Other                                       | <b>54</b>    | 77    |
| Total deferred tax liability                | <b>199</b>   | 217   |
| Net deferred tax liability                  | <b>\$ 36</b> | \$ 20 |

As shown by the valuation allowance in the table above, we had potential tax benefits of \$25 million and \$30 million at December 31, 1999 and 1998, respectively, that we did not recognize in the statements of income when they were generated. These unrecognized tax benefits resulted primarily from foreign tax loss carryforwards that are available to reduce future foreign tax liabilities.

The \$223 million of U.S. tax loss carryforwards that exist at December 31, 1999, expire in 2018. The \$29 million of state tax loss carryforwards that exist at December 31, 1999, will expire in varying amounts over the period from 2000 to 2012. Of the \$165 million of foreign tax loss carryforwards that exist at December 31, 1999, \$145 million do not expire and the remainder expire in varying amounts over the period from 2000 to 2009.

We have tax sharing agreements with our former affiliates that allocate tax liabilities for prior periods.

### 7. COMMON STOCK

On October 25, 1999, our shareholders approved a reverse stock split whereby every five shares of our common stock were converted into one share of our new common stock on the day following the spin-off of Pactiv. In addition, the stock options outstanding on the date of the spin-off were adjusted such that employees received options only in the company for which they worked. The number of shares subject to these options, as well as their exercise prices, were adjusted so that the options immediately after the spin-off had equivalent economic terms to the options immediately before the spin-off.

Also, on the date of the spin-off, all restricted stock and units and all performance shares then outstanding were fully vested. All share prices and amounts, prior to November 5, 1999, in this note, with the exception of the earnings per share table, are presented before the effect of the spin-off and reverse stock split. We have authorized 350 million shares (\$.01 par value) of common stock, of which 34,970,485 shares and 173,670,197 shares were issued at December 31, 1999 and 1998, respectively. We held 1,298,373 shares and 6,757,678 shares of treasury stock at December 31, 1999 and 1998, respectively.

### Stock Repurchase Plans

During 1997, we initiated a common stock repurchase program to acquire up to 8.5 million shares. Approximately 7.5 million shares have been acquired under this program at a total cost of approximately \$289 million. All purchases that we executed through this program were in the open market or negotiated purchases.

### Reserved

The total number of shares of our common stock reserved at December 31, 1999 and 1998, were as follows:

| <i>December 31,</i>          | <b>1999</b>      | 1998       |
|------------------------------|------------------|------------|
| <b>Original issue shares</b> |                  |            |
| Thrift Plan                  | <b>380,000</b>   | 74,576     |
| Stock Ownership Plan         | <b>8,603,344</b> | 16,199,114 |
| Employee Stock Purchase Plan | <b>232,052</b>   | 1,642,037  |
|                              | <b>9,215,396</b> | 17,915,727 |
| <b>Treasury stock</b>        |                  |            |
| Employee Stock Award Plan    | <b>1,119,500</b> | —          |
| Thrift Plan                  | —                | 201,541    |
|                              | <b>1,119,500</b> | 201,541    |

### Stock Plans

#### Tenneco Automotive Inc. Stock Ownership Plan

In December 1996, we adopted the 1996 Stock Ownership Plan, which permits the granting of a variety of awards, including common stock, restricted stock, performance units, stock appreciation rights ("SARs"), and stock options to our directors, officers, and employees. The plan, which will terminate December 31, 2001, was renamed the "Tenneco Automotive Inc. Stock Ownership Plan" in connection with the spin-off. We can issue up to 9.4 million shares of common stock under the Stock Ownership Plan after adjusting for the spin-off and reverse stock split.

### Restricted Stock/Units, Performance Units, and Stock Equivalent Units

We have granted restricted stock and restricted units under the Stock Ownership Plan to certain key employees. These awards generally require, among other things, that the employee remains our employee during the restriction period. We have also granted performance units to certain key employees that will vest over three years from the date of grant based on the attainment of specified performance goals in each of the three years. During 1999, 1998, and 1997, we granted 2,705,107, 640,810, and 494,350 shares and units, respectively, with a weighted average fair value based on the price of our stock on the grant date of \$8.56, \$38.03, and \$43.08 per share, respectively. At December 31, 1999, 263,770 restricted shares at an average price of \$8.40 per share, 465,000 performance units at an average price of \$8.56 per share, 39,076 restricted units at an average price of \$8.56 per unit, and 1,935,261 stock equivalent units at an average price of \$8.56 per unit were outstanding under this plan.

In December 1996, we adopted a restricted stock and unit plan and performance unit plan for each member of the Board of Directors who is not also an officer. During 1999, 6,000 performance units were issued under this plan at the weighted average fair value of our stock on the grant date of \$8.56 per share. During 1998 and 1997, 1,700 and 5,040 restricted shares and units, respectively, were issued under this plan at the weighted average fair value of our stock on the grant date of \$37.31, and \$45.19 per share, respectively. At December 31, 1999, no restricted shares or restricted units and 6,000 performance units at an average price of \$8.56 per unit were outstanding under the plan.

### Employee Stock Purchase Plan

Effective April 1, 1997, we adopted an Employee Stock Purchase Plan ("ESPP") that allows U.S. and Canadian employees to purchase our common stock at a 15% discount. Each year employees participating in the ESPP may purchase shares with a discounted value not to exceed \$21,250. Under the ESPP, we sold 281,056, 613,195, and 244,768 shares to employees in 1999, 1998, and 1997, respectively. The weighted average fair value of the employee purchase right, which was estimated using the Black-Scholes option pricing model and the assumptions described below except that the average life of each purchase right was assumed to be 90 days, was \$4.29, \$6.31, and \$11.16 in 1999, 1998, and 1997, respectively. The ESPP was suspended in June 1999, in connection with the reorganization transactions.

## NOTES TO FINANCIAL STATEMENTS

### Stock Options

The following table reflects the status and activity for all stock options we have issued, including those outside the option plans discussed above, for the periods indicated:

|  | 1999                |                                  | 1998                |                                  | 1997                |                                  |
|--|---------------------|----------------------------------|---------------------|----------------------------------|---------------------|----------------------------------|
|  | Shares under option | Weighted average exercise prices | Shares under option | Weighted average exercise prices | Shares under option | Weighted average exercise prices |
| <b>Stock options</b>   |                     |                                  |                     |                                  |                     |                                  |
| Outstanding, beginning of year                                 | 12,423,304          | \$42.58                          | 11,924,072          | \$43.42                          | 10,877,758          | \$43.41                          |
| Granted before the reverse stock split                         | 1,763,700           | 39.04                            | 1,745,480           | 37.30                            | 2,928,669           | 42.91                            |
| Cancelled before the reverse stock split                       | (9,968,074)         | 41.86                            | (1,123,639)         | 43.53                            | (1,569,376)         | 43.19                            |
| Adjustment for reverse stock split and spin-off                | 3,702,596           | 20.04                            | —                   | —                                | —                   | —                                |
| Granted after the reverse stock split                          | 2,047,500           | 8.56                             | —                   | —                                | —                   | —                                |
| Cancelled after the reverse stock split                        | (2,879)             | 20.32                            | —                   | —                                | —                   | —                                |
| Exercised  | —                   | —                                | (122,609)           | 38.58                            | (312,979)           | 39.64                            |
| Outstanding, end of year                                       | 9,966,147           | 19.83                            | 12,423,304          | 42.58                            | 11,924,072          | 43.42                            |
| Options exercisable at end of year                             | 5,574,049           | 23.15                            | 7,522,654           | 42.84                            | 2,703,948           | 40.84                            |
| Weighted average fair value of options granted during the year |                     | \$ 3.03                          |                     | \$10.82                          |                     | \$12.62                          |

The fair value of each option granted during 1999, 1998, and 1997 is estimated on the date of grant using the Black-Scholes option pricing model using the following weighted-average assumptions for grants in 1999, 1998, and 1997, respectively: (i) risk-free interest rates of 5.9%, 5.7%, and 6.6%;

(ii) expected lives of 5.7, 9.9, and 7.5 years; (iii) expected volatility 26.9%, 25.6%, and 25.6%; and (iv) dividend yield of 2.6%, 3.2%, and 2.8%.

The following table reflects summarized information about stock options outstanding at December 31, 1999:

| Range of Exercise Price | Options Outstanding            |   |                                 | Options Exercisable            |                                 |
|-------------------------|--------------------------------|---|---------------------------------|--------------------------------|---------------------------------|
|                         | Number outstanding at 12/31/99 | Weighted average remaining contractual life | Weighted average exercise price | Number exercisable at 12/31/99 | Weighted average exercise price |
| \$ 8.00 – \$14.00       | 2,047,500                      | 9.8 years                                   | \$ 8.56                         | —                              | \$ —                            |
| \$14.00 – \$21.00       | 1,682,212                      | 15.4 years                                  | 19.49                           | 664,521                        | 19.64                           |
| \$21.00 – \$27.00       | 6,236,435                      | 9.8 years                                   | 23.62                           | 4,909,528                      | 23.63                           |
|                         | 9,966,147                      |   |                                 | 5,574,049                      |                                 |

We apply Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," to account for our stock-based compensation plans. We recognized after-tax stock-based compensation expense in 1999 of \$11 million, in 1998 of \$3 million, and in 1997 of \$5 million, of which \$8 million, \$3 million, and \$4 million, respectively, related to

restricted stock and performance shares awarded to employees of our discontinued operations. Had compensation costs for our stock-based compensation plans been determined in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," based on the fair value at the grant dates for the awards under those plans, our pro forma net income and

earnings per diluted share of common stock for the years ended December 31, 1999, 1998, and 1997, would have been lower by \$13 million or \$.39 per diluted common share, \$33 million or \$.19 per diluted common share, and \$34 million or \$.20 per diluted common share, respectively of which \$8 million, \$20 million, and \$22 million related to employees of our discontinued operations, respectively.

#### Grantor Trust

In August 1998, we established a grantor trust and issued approximately 1.9 million shares of common stock to the trust. This grantor trust was a so-called "rabbi trust" designed to assure the payment of deferred compensation and supplemental pension benefits. The trust was consolidated in our financial statements and the shares were reflected in our financial statements as treasury stock. Consequently, the shares of common stock issued to the trust were not considered to be outstanding in the computation of earnings per share.

The grantor trust was terminated at the time of the spin-off.

#### Rights Plan

On September 9, 1998, we adopted a Rights Plan and established an independent Board committee to review it every three years. The Rights Plan was adopted to deter coercive takeover tactics and to prevent a potential acquiror from gaining control of us in a transaction that is not in the best interests of our shareholders. Generally, under the Rights Plan, as it has been amended, if a person becomes the beneficial owner of 15 percent or more of our outstanding common stock, each right will entitle its holder to purchase, at the right's exercise price, a number of shares of our common stock or, under certain circumstances, of the acquiring person's common stock, having a market value of twice the right's exercise price. Rights held by the 15 percent or more holder will become void and will not be exercisable.

In March 2000, we amended the Rights Plan to (1) reduce from 20 percent to 15 percent the level of beneficial ownership at which the rights become exercisable, as described above, and (2) eliminate the "qualified offer" terms of the plan. These terms provided that the rights would not become exercisable in connection with a "qualified offer," which was defined as an all-cash tender offer for all outstanding common stock that was fully financed, remained open for a period of at least 60 business days, results in the offeror owning at least 85% of our common stock after consummation of the offer, assured a prompt second-step acquisition of shares not purchased in the initial offer, at the same price as the initial offer, and met certain other requirements.

In connection with the adoption of the Rights Plan, our Board of Directors also adopted a three-year independent director evaluation ("TIDE") mechanism. Under the TIDE mechanism, an independent Board committee will review, on an ongoing basis, the Rights Plan and developments in rights plans generally, and, if it deems appropriate, recommend modification or termination of the Rights Plan. The independent committee will report to our Board at least every three years as to whether the Rights Plan continues to be in the best interests of our shareholders.

#### Dividend Reinvestment and Stock Purchase Plan

Under the Tenneco Automotive Inc. Dividend Reinvestment and Stock Purchase Plan, holders of our common stock may apply their cash dividends and optional cash investments to the purchase of additional shares of our common stock.

#### Earnings Per Share

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

| <i>In millions except share and per share amounts, years ended December 31,</i> | 1999       | 1998       | 1997       |
|---|------------|------------|------------|
| <b>Basic earnings (loss) per share</b>  |            |            |            |
| Income (loss) from continuing operations  | \$ (63)    | \$ 116     | \$ 234     |
| Average shares of common stock outstanding                                      | 33,480,686 | 33,701,115 | 34,052,946 |
| Earnings (loss) from continuing operations per average share of common stock    | \$(1.87)   | \$3.45     | \$6.87     |
| <b>Diluted earnings (loss) per share</b>  |            |            |            |
| Income (loss) from continuing operations  | \$ (63)    | \$ 116     | \$ 234     |
| Average shares of common stock outstanding                                      | 33,480,686 | 33,701,115 | 34,052,946 |
| Effect of dilutive securities:  |            |            |            |
| Restricted stock  | 18,545     | 10,586     | —          |
| Stock options   | 8,055      | 17,647     | 90,573     |
| Performance shares  | 148,777    | 37,558     | 16,808     |
| Average shares of common stock outstanding including dilutive securities        | 33,656,063 | 33,766,906 | 34,160,327 |
| Earnings (loss) from continuing operations per average share of common stock    | \$(1.87)   | \$3.44     | \$6.85     |

## NOTES TO FINANCIAL STATEMENTS

### 8. PREFERRED STOCK

We had 50 million shares of preferred stock (\$.01 par value) authorized at December 31, 1999 and 1998. No shares of preferred stock were outstanding at those dates. We have designated and reserved 2 million shares of the preferred stock as junior preferred stock for the Qualified Offer Rights Plan.

### 9. MINORITY INTEREST

At December 31, 1998, we reported minority interest in the balance sheet of \$407 million, of which \$394 million resulted from the December 1994 and December 1997 sales of preferred stock (\$300 million and \$100 million, respectively) of Tenneco International Holding Corp. ("TIHC") to a financial investor. Subsequent to each sale, the investor had approximately a 25% interest in TIHC, consisting of 100% of the issued and outstanding variable rate voting preferred stock of TIHC. We and some of our subsidiaries held 100% of the issued and outstanding \$8.00 junior preferred stock and common stock of TIHC. For financial reporting purposes, the assets, liabilities, and earnings of TIHC and its subsidiaries are consolidated in our financial statements, and the investor's preferred stock interest was recorded as "Minority interest" in the 1998 balance sheet. In connection with the spin-off, we purchased the preferred stock from the investor and the related minority interest was eliminated from our balance sheet.

At December 31, 1998, there is \$14 million of minority interest included as part of the net assets of discontinued operations.

### 10. PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

We have various defined benefit pension plans that cover substantially all of our employees. Benefits are based on years of service and, for most salaried employees, on final average compensation. Our funding policy is to contribute to the plans amounts necessary to satisfy the funding requirement of applicable federal or foreign laws and regulations. Plan assets consist principally of listed equity and fixed income securities. Some of our employees participated in the Tenneco Retirement Plan ("TRP"). For information regarding the TRP, see the notes to the table below.

We have postretirement health care and life insurance plans that cover a majority of our domestic employees. For salaried employees, the plans cover our employees retiring on or after attaining age 55 who have had at least 10 years of service with us after attaining age 45. For hourly employees, the postretirement benefit plans generally cover employees who retire according to one of our hourly employee retirement plans. All of these benefits may be subject to deductibles, copayment provisions, and other limitations, and we have reserved the right to change these benefits. Our postretirement benefit plans are not funded.

A summary of the change in benefit obligation, the change in plan assets, the development of net amount recognized, and the amounts recognized in the balance sheets for the pension plans and postretirement benefit plans follows:

|   | Pension |        | Postretirement |          |
|---|---------|--------|----------------|----------|
| <i>In millions</i>                                      | 1999    | 1998   | 1999           | 1998     |
| <b>Change in benefit obligation:</b>                    |         |        |                |          |
| Benefit obligation at September 30 of the previous year | \$ 552  | \$ 491 | \$ 115         | \$ 105   |
| Spin-off of Pactiv                                      | (285)   | —      | —              | —        |
| Currency rate conversion                                | (4)     | —      | —              | —        |
| Service cost  | 8       | 13     | 4              | 3        |
| Interest cost   | 17      | 36     | 8              | 8        |
| Plan amendments   | 5       | 1      | —              | —        |
| Actuarial loss (gain)                                   | 4       | 41     | 4              | 7        |
| Benefits paid   | (15)    | (30)   | (9)            | (8)      |
| Benefit obligation at September 30                      | \$ 282  | \$ 552 | \$ 122         | \$ 115   |
| <b>Change in plan assets:</b>                           |         |        |                |          |
| Fair value at September 30 of the previous year         | \$ 583  | \$ 593 | \$ —           | \$ —     |
| Spin-off of Pactiv                                      | (338)   | —      | —              | —        |
| Currency rate conversion                                | —       | (1)    | —              | —        |
| Actual return on plan assets                            | 35      | 13     | —              | —        |
| Employer contributions                                  | 8       | 7      | 9              | 8        |
| Participants' contributions                             | 1       | 1      | —              | —        |
| Benefits paid   | (15)    | (30)   | (9)            | (8)      |
| Fair value at September 30                              | \$ 274  | \$ 583 | \$ —           | \$ —     |
| <b>Development of net amount recognized:</b>            |         |        |                |          |
| Funded status at September 30                           | \$ (8)  | \$ 31  | \$ (122)       | \$ (115) |
| Contributions during the fourth quarter                 | 2       | 1      | 2              | 2        |
| Unrecognized cost:                                      |         |        |                |          |
| Actuarial loss (gain)                                   | 5       | 20     | 30             | 27       |
| Prior service cost                                      | 15      | 12     | (1)            | (1)      |
| Transition liability (asset)                            | (3)     | (7)    | —              | —        |
| Net amount recognized at December 31                    | \$ 11   | \$ 57  | \$ (91)        | \$ (87)  |

| In millions                                      | Pension |       | Postretirement |        |
|--|---------|-------|----------------|--------|
|  | 1999    | 1998  | 1999           | 1998   |
| <b>Amounts recognized in the balance sheets:</b> |         |       |                |        |
| Prepaid benefit cost                             | \$ 37   | \$ 81 | \$ -           | \$ -   |
| Accrued benefit cost                             | (35)    | (39)  | (91)           | (87)   |
| Intangible asset                                 | 4       | 4     | -              | -      |
| Accumulated other comprehensive income           | 5       | 11    | -              | -      |
| Net amount recognized                            | \$ 11   | \$ 57 | \$(91)         | \$(87) |

Notes: Assets of one plan may not be utilized to pay benefits of other plans. Additionally, the prepaid (accrued) benefit cost has been recorded based upon certain actuarial estimates as described below. Those estimates are subject to revision in future periods given new facts or circumstances.

Amounts included in the above table for 1998 reflect the participation of our employees in the TRP; however, our employees will not accrue additional benefits under the TRP following the spin-off. The sponsorship and the prepaid pension costs related to the TRP were transferred to Pactiv in connection with the corporate restructuring transactions. We have established a new defined benefit plan for our employees called the Tenneco Automotive Retirement Plan with provisions similar to the TRP.

Amounts in the table are for continuing operations only. Amounts recognized in the balance sheets for discontinued operations include the following:

| In millions                            | Pension |       | Postretirement |        |
|--|---------|-------|----------------|--------|
|  | 1999    | 1998  | 1999           | 1998   |
| Net assets of discontinued operations  | \$ -    | \$630 | \$ -           | \$(61) |
| Accumulated other comprehensive income | -       | 4     | -              | -      |
|  | \$ -    | \$634 | \$ -           | \$(61) |

Net periodic pension costs (income) from continuing operations for the years 1999, 1998, and 1997, consist of the following components:

| In millions   | 1999 | 1998  | 1997   |
|---|------|-------|--------|
| Service cost – benefits earned during the year        | \$ 8 | \$ 13 | \$ 12  |
| Interest on prior year's projected benefit obligation | 17   | 36    | 33     |
| Expected return on plan assets                        | (22) | (48)  | (45)   |
| Net amortization:                                     |      |       |        |
| Actuarial loss  | -    | 1     | -      |
| Prior service cost                                    | 1    | 1     | 1      |
| Transition asset                                      | -    | (2)   | (2)    |
| Net pension costs (income)                            | \$ 4 | \$ 1  | \$ (1) |

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for all pension plans with accumulated benefit obligations in excess of plan assets were \$50 million, \$48 million, and \$13 million, respectively, as of September 30, 1999, and \$114 million, \$108 million, and \$68 million, respectively, as of September 30, 1998. An additional expense of \$1 million was recorded in 1999 related to our December adoption of the Tenneco Automotive Retirement Plan.

The weighted average discount rates (which are based on long-term market rates) used in determining the 1999, 1998, and 1997 actuarial present value of the benefit obligations were 6.9%, 6.9%, and 7.6%, respectively. The rate of increase in future compensation was 4.3%, 4.7%, and 5.0%, for 1999, 1998, and 1997, respectively. The weighted average expected long-term rate of return on plan assets for 1999, 1998, and 1997 was 9.4%, 9.8%, and 9.9%, respectively.

Net periodic postretirement benefit cost from continuing operations for the years 1999, 1998, and 1997 consist of the following components:

| In millions   | 1999 | 1998 | 1997 |
|---|------|------|------|
| Service cost – benefits earned during the year            | \$4  | \$2  | \$4  |
| Interest on accumulated postretirement benefit obligation | 8    | 8    | 7    |
| Net amortization of actuarial loss                        | 1    | 1    | -    |
| Net periodic postretirement benefit cost                  | \$13 | \$11 | \$11 |

The weighted average assumed health care cost trend rate used in determining the accumulated postretirement benefit obligation was 5% for all periods.

Increasing the assumed health care cost trend rate by one percentage point in each year would increase the 1999, 1998, and 1997 accumulated postretirement benefit obligations by approximately \$13 million, \$13 million, and \$12 million, respectively, and would increase the aggregate of the service cost and interest cost components of the net periodic postretirement benefit cost by approximately \$2 million each year for 1999, 1998, and 1997.

Decreasing the assumed health care cost trend rate by one percentage point in each year would decrease the 1999 accumulated postretirement benefit obligation by approximately \$11 million and would decrease the aggregate of service cost and interest cost components of the net periodic postretirement benefit cost by \$2 million.

The discount rates (which are based on long-term market rates) used in determining the 1999, 1998, and 1997 accumulated postretirement benefit obligations were 7.50%, 7.00%, and 7.75%, respectively.



## NOTES TO FINANCIAL STATEMENTS

### 11. SEGMENT AND GEOGRAPHIC AREA INFORMATION

We are a global manufacturer with two geographic reportable segments: North America and Europe. 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.

The accounting policies of the segments are the same as described in Note 1, "Summary of Accounting Policies." 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. Segment results for 1999, 1998, and 1997 are as follows:

| <i>In millions</i>  | Segment       |         |        |                     | Consolidated |
|---|---------------|---------|--------|---------------------|--------------|
|   | North America | Europe  | Other  | Reclass. and Elims. |              |
| <b>At December 31, 1999, and for the year then ended</b>    |               |         |        |                     |              |
| Revenues from external customers                            | \$1,760       | \$1,235 | \$ 284 | \$ –                | \$3,279      |
| Intersegment revenues                                       | 8             | 38      | 13     | (59)                | –            |
| Interest income   | –             | –       | 7      | –                   | 7            |
| Depreciation and amortization                               | 69            | 44      | 31     | –                   | 144          |
| Income before interest, income taxes, and minority interest | 166           | 44      | (62)   | –                   | 148          |
| Income (loss) from discontinued operations                  | –             | –       | (208)  | –                   | (208)        |
| Extraordinary loss  | –             | –       | (18)   | –                   | (18)         |
| Cumulative effect of change in accounting principle         | (65)          | (32)    | (37)   | –                   | (134)        |
| Total assets  | 1,193         | 944     | 840    | (34)                | 2,943        |
| Investment in affiliated companies                          | –             | 1       | –      | –                   | 1            |
| Capital expenditures for continuing operations              | 71            | 65      | 18     | –                   | 154          |
| Noncash items other than depreciation and amortization      | 8             | 23      | (4)    | –                   | 27           |
| <b>At December 31, 1998, and for the year then ended</b>    |               |         |        |                     |              |
| Revenues from external customers                            | \$1,679       | \$1,252 | \$ 306 | \$ –                | \$3,237      |
| Intersegment revenues                                       | 9             | 26      | 10     | (45)                | –            |
| Interest income   | –             | –       | 6      | –                   | 6            |
| Depreciation and amortization                               | 72            | 51      | 27     | –                   | 150          |
| Income before interest, income taxes, and minority interest | 58            | 155     | 14     | –                   | 227          |
| Income (loss) from discontinued operations                  | –             | –       | 139    | –                   | 139          |
| Total assets (Note)   | 1,062         | 1,046   | 2,703  | (52)                | 4,759        |
| Net assets of discontinued operations                       | –             | –       | 1,739  | –                   | 1,739        |
| Investment in affiliated companies                          | –             | 1       | –      | –                   | 1            |
| Capital expenditures for continuing operations              | 96            | 67      | 32     | –                   | 195          |
| Noncash items other than depreciation and amortization      | 3             | 5       | (1)    | –                   | 7            |
| <b>At December 31, 1997, and for the year then ended</b>    |               |         |        |                     |              |
| Revenues from external customers                            | \$1,719       | \$1,173 | \$ 334 | \$ –                | \$3,226      |
| Intersegment revenues                                       | 7             | 31      | 17     | (55)                | –            |
| Interest income   | –             | 1       | 3      | –                   | 4            |
| Depreciation and amortization                               | 59            | 28      | 23     | –                   | 110          |
| Income before interest, income taxes, and minority interest | 216           | 153     | 26     | –                   | 395          |
| Income (loss) from discontinued operations                  | –             | –       | 127    | –                   | 127          |
| Cumulative effect of change in accounting principle         | –             | (3)     | (43)   | –                   | (46)         |
| Total assets (Note)   | 1,096         | 946     | 2,718  | (78)                | 4,682        |
| Net assets of discontinued operations                       | –             | –       | 1,771  | –                   | 1,771        |
| Investment in affiliated companies                          | –             | 2       | –      | –                   | 2            |
| Capital expenditures for continuing operations              | 95            | 84      | 42     | –                   | 221          |
| Noncash items other than depreciation and amortization      | (5)           | (5)     | 4      | –                   | (6)          |

*Note: The Other segment's total assets include the net assets of discontinued operations.*

The following table shows information relating to our external customer revenues for each product or each group of similar products:

| <i>In millions, years ended December 31,</i>    | Net Sales and Operating Revenues |                |                |
|---|----------------------------------|----------------|----------------|
|   | 1999                             | 1998           | 1997           |
| <b>Emissions Control Systems &amp; Products</b> |                                  |                |                |
| Aftermarket                                     | \$ 514                           | \$ 590         | \$ 686         |
| Original equipment market                       | 1,401                            | 1,224          | 1,067          |
|   | <b>1,915</b>                     | <b>1,814</b>   | <b>1,753</b>   |
| <b>Ride Control Systems &amp; Products</b>      |                                  |                |                |
| Aftermarket                                     | \$ 634                           | \$ 685         | \$ 782         |
| Original equipment market                       | 730                              | 738            | 691            |
|   | <b>1,364</b>                     | <b>1,423</b>   | <b>1,473</b>   |
| <b>Total</b>                                    | <b>\$3,279</b>                   | <b>\$3,237</b> | <b>\$3,226</b> |

During 1999, sales to three major customers comprised approximately 13.8%, 13.6%, and 10.3% of consolidated net sales and operating revenues. During 1998, sales to two major customers comprised 12.8% and 13.7% of consolidated net sales and operating revenues. During 1997, sales to one major customer comprised approximately 13.2% of consolidated net sales and operating revenues.

| <i>In millions</i>                                       | Geographic Area |         |                              |      | Reclass. and Elims. | Consolidated |
|--|-----------------|---------|------------------------------|------|---------------------|--------------|
|  | United States   | Germany | Other Foreign <sup>(a)</sup> |      |                     |              |
| <b>At December 31, 1999, and for the year then ended</b> |                 |         |                              |      |                     |              |
| Revenues from external customers <sup>(b)</sup>          | \$1,460         | \$355   | \$1,464                      | \$ - |                     | \$3,279      |
| Long-lived assets <sup>(c)</sup>                         | 578             | 88      | 568                          | -    |                     | 1,234        |
| Total assets   | 1,497           | 205     | 1,309                        | (68) |                     | 2,943        |
| <b>At December 31, 1998, and for the year then ended</b> |                 |         |                              |      |                     |              |
| Revenues from external customers <sup>(b)</sup>          | \$1,432         | \$321   | \$1,484                      | \$ - |                     | \$3,237      |
| Long-lived assets <sup>(c)</sup>                         | 648             | 116     | 654                          | -    |                     | 1,418        |
| Total assets <sup>(d)</sup>                              | 2,733           | 444     | 1,646                        | (64) |                     | 4,759        |
| <b>At December 31, 1997, and for the year then ended</b> |                 |         |                              |      |                     |              |
| Revenues from external customers <sup>(b)</sup>          | \$1,502         | \$273   | \$1,451                      | \$ - |                     | \$3,226      |
| Long-lived assets <sup>(c)</sup>                         | 634             | 99      | 568                          | -    |                     | 1,301        |
| Total assets <sup>(d)</sup>                              | 2,982           | 242     | 1,512                        | (54) |                     | 4,682        |

Notes:

<sup>(a)</sup> Revenues from external customers and long-lived assets for individual foreign countries other than Germany are not material.

<sup>(b)</sup> Revenues are attributed to countries based on location of the seller.

<sup>(c)</sup> Long-lived assets include all long-term assets except net assets from discontinued operations, goodwill, intangibles, and deferred tax assets.

<sup>(d)</sup> Total assets include net assets from discontinued operations.

## NOTES TO FINANCIAL STATEMENTS

### 12. COMMITMENTS AND CONTINGENCIES

#### Capital Commitments

We estimate that expenditures aggregating approximately \$81 million will be required after December 31, 1999, to complete facilities and projects authorized at such date, and we have made substantial commitments in connection with these facilities and projects.

#### Lease Commitments

We have long-term leases for certain facilities, equipment, and other assets. The minimum lease payments under non-cancelable operating leases with lease terms in excess of one year are \$16 million, \$15 million, \$12 million, \$11 million, and \$11 million for the years 2000, 2001, 2002, 2003, and 2004, respectively, and \$25 million for subsequent years.

Our commitments under capital leases were not significant to the accompanying financial statements. Total rental expense for continuing operations for the years 1999, 1998, and 1997 was \$34 million, \$31 million, and \$30 million, respectively, including minimum rentals under non-cancelable operating leases of \$18 million, \$16 million, and \$29 million for the corresponding periods.

#### Litigation

We are party to various legal proceedings arising from our operations. We believe that the outcome of these proceedings, individually and in the aggregate, will have no material effect on our financial position or results of operations.

#### Environmental Matters

We are subject to a variety of environmental and pollution control laws and regulations in all jurisdictions in which we operate. We have provided reserves for compliance with these laws and regulations where it is probable that a liability exists and where we can make a reasonable estimate of the liability. The estimated liabilities recorded are subject to change as more information becomes available regarding the magnitude of possible costs and the timing, varying costs, and effectiveness of alternative technologies. However, we believe that any additional costs that may arise as more information becomes available will not have a material effect on our financial condition or results of operations.

### 13. QUARTERLY FINANCIAL DATA (UNAUDITED)

In millions except per share amounts

| Quarter  | Net sales and operating revenues | Income (loss) before interest expense income taxes, and minority interest | Income (loss) from continuing operations | Income (loss) from discontinued operations | Income (loss) before extraordinary loss | Extraordinary loss | Income (loss) before cumulative effect of change in accounting principle | Cumulative effect of change in accounting principle | Net income (loss) |
|--|----------------------------------|---|--|--|---|--------------------|--|---|-------------------|
| <b>1999</b>  |                                  |   |  |  |   |                    |  |   |                   |
| 1st  | \$ 789                           | \$ 55   | \$ 16                                    | \$ (166)                                   | \$ (150)                                | \$ (7)             | \$ (157)   | \$ (134)  | \$ (291)          |
| 2nd  | 868                              | 97  | 37                                       | 55   | 92                                      | -                  | 92   | -   | 92                |
| 3rd  | 816                              | 67  | 27                                       | 12   | 39                                      | -                  | 39   | -   | 39                |
| 4th  | 806                              | (71)  | (143)                                    | (109)                                      | (252)                                   | (11)               | (263)  | -   | (263)             |
|  | \$3,279                          | \$148   | \$ (63)                                  | \$ (208)                                   | \$ (271)                                | \$ (18)            | \$ (289)   | \$ (134)  | \$ (423)          |
| <b>1998</b>  |                                  |   |  |  |   |                    |  |   |                   |
| 1st  | \$ 800                           | \$ 83   | \$ 43                                    | \$ 32                                      | \$ 75                                   | \$ -               | \$ 75  | \$ -  | \$ 75             |
| 2nd  | 864                              | 124   | 63                                       | 74   | 137                                     | -                  | 137  | -   | 137               |
| 3rd  | 804                              | 81  | 63                                       | 40   | 103                                     | -                  | 103  | -   | 103               |
| 4th  | 769                              | (61)  | (53)                                     | (7)  | (60)                                    | -                  | (60)   | -   | (60)              |
|  | \$3,237                          | \$227   | \$ 116                                   | \$ 139                                     | \$ 255                                  | \$ -               | \$ 255   | \$ -  | \$ 255            |
| Quarter  |                                  |   | From continuing operations               | From discontinued operations               | Before extraordinary loss               | Extraordinary loss | Before cumulative effect of change in accounting principle               | Cumulative effect of change in accounting principle | Net income (loss) |
| <b>Basic earnings (loss) per share of common stock</b>   |                                  |   |  |  |   |                    |  |   |                   |
| <b>1999</b>  |                                  |   |  |  |   |                    |  |   |                   |
| 1st  |                                  |   | \$ .47                                   | \$(4.99)                                   | \$(4.52)                                | \$(.20)            | \$(4.72)   | \$(4.00)  | \$ (8.72)         |
| 2nd  |                                  |   | 1.07                                     | 1.67                                       | 2.74                                    | -                  | 2.74   | -   | 2.74              |
| 3rd  |                                  |   | .86                                      | .32  | 1.18                                    | -                  | 1.18   | -   | 1.18              |
| 4th  |                                  |   | (4.25)                                   | (3.24)                                     | (7.49)                                  | (.34)              | (7.83)   | -   | (7.83)            |
|  |                                  |   | \$(1.87)                                 | \$ (6.23)                                  | \$ (8.10)                               | \$(.55)            | \$(8.65)   | \$(3.99)  | \$(12.64)         |
| <b>1998</b>  |                                  |   |  |  |   |                    |  |   |                   |
| 1st  |                                  |   | \$ 1.26                                  | \$ .95                                     | \$ 2.21                                 | \$ -               | \$ 2.21  | \$ -  | \$ 2.21           |
| 2nd  |                                  |   | 1.88                                     | 2.16                                       | 4.04                                    | -                  | 4.04   | -   | 4.04              |
| 3rd  |                                  |   | 1.85                                     | 1.24                                       | 3.09                                    | -                  | 3.09   | -   | 3.09              |
| 4th  |                                  |   | (1.57)                                   | (.23)                                      | (1.80)                                  | -                  | (1.80)   | -   | (1.80)            |
|  |                                  |   | \$ 3.45                                  | \$ 4.13                                    | \$ 7.58                                 | \$ -               | \$ 7.58  | \$ -  | \$ 7.58           |
| <b>Diluted earnings (loss) per share of common stock</b> |                                  |   |  |  |   |                    |  |   |                   |
| <b>1999</b>  |                                  |   |  |  |   |                    |  |   |                   |
| 1st  |                                  |   | \$ .47                                   | \$(4.99)                                   | \$(4.52)                                | \$(.20)            | \$(4.72)   | \$(4.00)  | \$ (8.72)         |
| 2nd  |                                  |   | 1.06                                     | 1.67                                       | 2.73                                    | -                  | 2.73   | -   | 2.73              |
| 3rd  |                                  |   | .86                                      | .32  | 1.18                                    | -                  | 1.18   | -   | 1.18              |
| 4th  |                                  |   | (4.25)                                   | (3.24)                                     | (7.49)                                  | (.34)              | (7.83)   | -   | (7.83)            |
|  |                                  |   | \$(1.87)                                 | \$ (6.23)                                  | \$ (8.10)                               | \$(.55)            | \$(8.65)   | \$(3.99)  | \$(12.64)         |
| <b>1998</b>  |                                  |   |  |  |   |                    |  |   |                   |
| 1st  |                                  |   | \$ 1.26                                  | \$ .94                                     | \$ 2.20                                 | \$ -               | \$ 2.20  | \$ -  | \$ 2.20           |
| 2nd  |                                  |   | 1.88                                     | 2.15                                       | 4.03                                    | -                  | 4.03   | -   | 4.03              |
| 3rd  |                                  |   | 1.84                                     | 1.24                                       | 3.08                                    | -                  | 3.08   | -   | 3.08              |
| 4th  |                                  |   | (1.57)                                   | (.23)                                      | (1.80)                                  | -                  | (1.80)   | -   | (1.80)            |
|  |                                  |   | \$ 3.44                                  | \$ 4.12                                    | \$ 7.56                                 | \$ -               | \$ 7.56  | \$ -  | \$ 7.56           |

Note: You should read Notes 1, 2, 3 and 7 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for items affecting quarterly results. The sum of the quarters may not equal the total of the respective year's earnings per share on either a basic or diluted basis due to changes in the weighted average shares outstanding throughout the year.



## SELECTED CONSOLIDATED FINANCIAL DATA

In millions except share and per share amounts, years ended December 31,

|  | 1999 <sup>(a)</sup> | 1998 <sup>(a)</sup> | 1997 <sup>(a)</sup> | 1996           | 1995           |
|--|---------------------|---------------------|---------------------|----------------|----------------|
| <b>Statements of income data:</b> <sup>(b)</sup>   |                     |                     |                     |                |                |
| Net sales and operating revenues from continuing operations –                                    |                     |                     |                     |                |                |
| North America  | \$ 1,768            | \$1,688             | \$1,726             | \$1,550        | \$1,270        |
| Europe   | 1,273               | 1,278               | 1,204               | 1,201          | 1,050          |
| Other  | 297                 | 316                 | 351                 | 279            | 214            |
| Intergroup sales   | (59)                | (45)                | (55)                | (50)           | (55)           |
|  | <b>\$ 3,279</b>     | <b>\$3,237</b>      | <b>\$3,226</b>      | <b>\$2,980</b> | <b>\$2,479</b> |
| Income from continuing operations before interest expense, income taxes, and minority interest – |                     |                     |                     |                |                |
| North America  | \$ 166              | \$ 58               | \$ 216              | \$ 128         | \$ 133         |
| Europe   | 44                  | 155                 | 153                 | 94             | 81             |
| Other  | (62)                | 14                  | 26                  | 20             | 34             |
| Total  | <b>148</b>          | <b>227</b>          | <b>395</b>          | <b>242</b>     | <b>248</b>     |
| Interest expense (net of interest capitalized) <sup>(c)</sup>                                    | 106                 | 69                  | 58                  | 60             | 44             |
| Income tax expense   | 82                  | 13                  | 80                  | 79             | 91             |
| Minority interest  | 23                  | 29                  | 23                  | 21             | 23             |
| Income (loss) from continuing operations   | (63)                | 116                 | 234                 | 82             | 90             |
| Income (loss) from discontinued operations, net of income tax <sup>(d)</sup>                     | (208)               | 139                 | 127                 | 564            | 645            |
| Extraordinary loss, net of income tax <sup>(e)</sup>   | (18)                | –                   | –                   | (236)          | –              |
| Cumulative effect of changes in accounting principles, net of income tax <sup>(f)</sup>          | (134)               | –                   | (46)                | –              | –              |
| Net income (loss)  | (423)               | 255                 | 315                 | 410            | 735            |
| Preferred stock dividends  | –                   | –                   | –                   | 12             | 12             |
| Net income (loss) to common stock  | <b>\$ (423)</b>     | <b>\$ 255</b>       | <b>\$ 315</b>       | <b>\$ 398</b>  | <b>\$ 723</b>  |
| Average number of shares of common stock outstanding   |                     |                     |                     |                |                |
| Basic  | 33,480,686          | 33,701,115          | 34,052,946          | 33,921,875     | 34,552,840     |
| Diluted  | 33,656,063          | 33,766,906          | 34,160,327          | 34,105,223     | 34,702,331     |
| Earnings (loss) per average share of common stock –  |                     |                     |                     |                |                |
| Basic:   |                     |                     |                     |                |                |
| Continuing operations  | \$ (1.87)           | \$ 3.45             | \$ 6.87             | \$ 2.45        | \$ 2.60        |
| Discontinued operations <sup>(d)</sup>   | (6.23)              | 4.13                | 3.73                | 16.27          | 18.32          |
| Extraordinary loss <sup>(e)</sup>  | (.55)               | –                   | –                   | (6.96)         | –              |
| Cumulative effect of changes in accounting principles <sup>(f)</sup>                             | (3.99)              | –                   | (1.35)              | –              | –              |
|  | <b>\$(12.64)</b>    | <b>\$ 7.58</b>      | <b>\$ 9.25</b>      | <b>\$11.76</b> | <b>\$20.92</b> |
| Diluted:   |                     |                     |                     |                |                |
| Continuing operations  | \$ (1.87)           | \$ 3.44             | \$ 6.85             | \$ 2.43        | \$ 2.59        |
| Discontinued operations <sup>(d)</sup>   | (6.23)              | 4.12                | 3.72                | 16.18          | 18.24          |
| Extraordinary loss <sup>(e)</sup>  | (.55)               | –                   | –                   | (6.96)         | –              |
| Cumulative effect of changes in accounting principles <sup>(f)</sup>                             | (3.99)              | –                   | (1.35)              | –              | –              |
|  | <b>\$(12.64)</b>    | <b>\$ 7.56</b>      | <b>\$ 9.22</b>      | <b>\$11.65</b> | <b>\$20.83</b> |
| Cash dividends per common share  | \$ 4.50             | \$ 6.00             | \$ 6.00             | \$ 9.00        | \$ 8.00        |
| <b>Balance sheet data:</b> <sup>(b)</sup>  |                     |                     |                     |                |                |
| Net assets of discontinued operations <sup>(d)</sup>   | \$ –                | \$1,739             | \$1,771             | \$1,883        | \$1,469        |
| Total assets   | 2,943               | 4,759               | 4,682               | 4,653          | 3,635          |
| Short-term debt <sup>(c)</sup>   | 56                  | 304                 | 75                  | 74             | 109            |
| Long-term debt <sup>(c)</sup>  | 1,578               | 671                 | 713                 | 639            | 469            |
| Debt allocated to discontinued operations <sup>(c)</sup>   | –                   | 2,456               | 2,123               | 1,590          | 1,454          |
| Minority interest  | 16                  | 407                 | 408                 | 304            | 301            |
| Shareowners' equity  | 422                 | 2,504               | 2,528               | 2,646          | 3,148          |

In millions except share and per share amounts, years ended December 31,

|   | 1999 <sup>(a)</sup> | 1998 <sup>(a)</sup> | 1997 <sup>(a)</sup> | 1996   | 1995     |
|---|---------------------|---------------------|---------------------|--------|----------|
| <b>Statement of cash flows data:</b> <sup>(b)</sup> |                     |                     |                     |        |          |
| Net cash provided (used) by operating activities    | \$ (254)            | \$ 532              | \$ 519              | \$ 253 | \$ 1,443 |
| Net cash (used) by investing activities             | (1,188)             | (754)               | (887)               | (685)  | (1,162)  |
| Net cash provided (used) by financing activities    | 1,495               | 216                 | 354                 | 147    | (356)    |
| Capital expenditures for continuing operations      | 154                 | 195                 | 221                 | 188    | 208      |
| <b>Other data:</b>                                  |                     |                     |                     |        |          |
| EBITDA <sup>(g)</sup>                               | \$ 292              | \$ 377              | \$ 505              | \$ 336 | \$ 331   |
| Ratio of earnings to fixed charges <sup>(h)</sup>   | 1.0                 | 2.2                 | 4.8                 | 2.3    | 2.6      |

**Notes:**

Our financial statements which are discussed in the following notes are included in this Form 10-K. They cover the three years ended December 31, 1999.

(a) For a discussion of the significant items affecting comparability of the financial information for the years ended 1999, 1998 and 1997, see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(b) During the periods presented, we completed numerous acquisitions. The most significant acquisition was our acquisition of Clevite for \$328 million in July 1996. You should also read "Item 1. Business" included elsewhere in this Annual Report on Form 10-K.

(c) Debt amounts for 1998, 1997 and 1996, and for 1999 through November 4, 1999, are net of allocations of corporate debt to the net assets of our discontinued specialty packaging and paperboard packaging segments. Debt amounts for 1995 are net of allocations of corporate debt to the net assets of our discontinued specialty packaging, paperboard packaging, energy, and shipbuilding segments. Interest expense for periods presented is net of interest expense allocated to income from discontinued operations. These allocations of debt and related interest expense are based on the ratio of our investment in the specialty packaging, paperboard packaging, energy, and shipbuilding segments' respective net assets to our consolidated net assets plus debt. You should also read Notes to the Financial Statements of Tenneco Automotive Inc. and Consolidated Subsidiaries for more information.

(d) Discontinued operations reflected in the above periods consist of our (1) specialty packaging segment, which was discontinued in August 1999, (2) paperboard packaging segment, which was discontinued in June 1999, (3) energy and shipbuilding segments, which were discontinued in December 1996, and (4) farm and construction equipment segment, which was discontinued in March 1996. You should also read Notes to the Financial Statements of Tenneco Automotive Inc. and Consolidated Subsidiaries for more information.

(e) Represents our costs related to prepayment of debt, including the 1996 loss recognized in the realignment of our debt preceding the 1996 corporate reorganization, the 1999 loss recognized in connection with the contribution of the containerboard assets to a new joint venture, and the 1999 loss recognized in the spin-off of Tenneco Packaging Inc. You should also read Notes to the Financial Statements of Tenneco Automotive Inc. and Consolidated Subsidiaries for more information.

(f) In 1999, we implemented the American Institute of Certified Public Accountants Statement of Position 98-5, "Reporting on the Costs of Start-up Activities." In addition, effective January 1, 1999, we changed its method of accounting for customer acquisition costs from a deferred method to an expense-as-incurred method. In 1997, we implemented the Financial Accounting Standards Board's Emerging Issues Task Force Issue 97-13, "Accounting for Costs Incurred in Connection with a Consulting Contract that Combines Business Process Reengineering and Information Technology Transformation." In 1994, we adopted Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Postemployment Benefits." You should also read Notes to the Financial Statements of Tenneco Automotive Inc. and Consolidated Subsidiaries for additional information.

(g) EBITDA represents income from continuing operations before interest expense, income taxes, minority interest and depreciation and amortization. EBITDA is not a calculation based upon generally accepted accounting principles. The amounts included in the EBITDA calculation, however, are derived from amounts included in the historical statements of income data. In addition, EBITDA should not be considered as an alternative to net income or operating income as an indicator of our operating performance, or as an alternative to operating cash flows as a measure of liquidity. We have reported EBITDA because we believe EBITDA is a measure commonly reported and widely used by investors and other interested parties as an indicator of a company's ability to incur and service debt. We believe EBITDA assists investors in comparing a company's performance on a consistent basis without regard to depreciation and amortization, which can vary significantly depending upon accounting methods, particularly when acquisitions are involved, or nonoperating factors. However, the EBITDA measure presented in this document may not always be comparable to similarly titled measures reported by other companies due to differences in the components of the calculation.

(h) For purposes of computing this ratio, earnings generally consist of income from continuing operations before income taxes and fixed charges excluding capitalized interest. Fixed charges consist of interest expense, the portion of rental expense considered representative of the interest factor and capitalized interest. For purposes of computing these ratios, preferred stock dividends have been included in the calculations on a pre-tax basis.

## DIRECTORS AND OFFICERS

### BOARD OF DIRECTORS

**Mark Andrews** ■ ●

Chairman  
Andrews Associates, Inc.,  
a government consulting firm

**M. Kathryn Eickhoff** ■

President  
Eickhoff Economics, Inc.,  
a consulting firm

**Mark P. Frissora**

Chairman and  
Chief Executive Officer  
Tenneco Automotive

**Dana G. Mead**

Retired Chairman  
Tenneco Inc.

**Sir David Plastow** ●

Retired Chairman  
The Medical Research Council  
in London

**Roger B. Porter** ●

IBM Professor of Business and  
Government and Director of  
The Center for Business and  
Government at Harvard University

**David B. Price, Jr.** ●

Executive Vice President  
BF Goodrich Company and  
President and Chief Operating Officer  
BF Goodrich Performance Materials

**Paul T. Stecko** ■

Chief Executive Officer  
Packaging Corporation of America

■ Audit Committee

● Compensation/Nominating/  
Governance Committee

Red symbol indicates committee chair

### CORPORATE OFFICERS

**Mark P. Frissora**

Chairman and  
Chief Executive Officer

**Ronald G. Berlin**

Vice President  
Global Supply Chain Management

**William M. Churchill**

Vice President  
Global Ride Control Engineering

**Timothy R. Donovan**

Senior Vice President and  
General Counsel

**Alex Drysdale**

Vice President and  
Managing Director  
Australia/New Zealand

**David G. Gabriel**

Senior Vice President and  
General Manager  
North American Aftermarket

**H. William Haser**

Vice President and  
Chief Information Officer, Americas

**Timothy E. Jackson**

Senior Vice President and  
General Manager  
North American Original Equipment and  
Worldwide Program Management

**Mark A. McCollum**

Senior Vice President and  
Chief Financial Officer

**Hari N. Nair**

Vice President and  
Managing Director  
South America/Asia

**Paul D. Novas**

Vice President and  
Treasurer

**Richard P. Schneider**

Senior Vice President  
Global Administration

**Richard J. Sloan**

Executive Vice President and  
Managing Director  
Europe

**James K. Spangler**

Vice President  
Global Communications

**Kenneth R. Trammell**

Vice President and  
Controller

**Dr. Herman Weltens**

Vice President  
Global Emission Control Engineering

## INVESTOR INFORMATION

### CORPORATE HEADQUARTERS

Tenneco Automotive Inc.  
500 North Field Drive  
Lake Forest, Illinois 60045  
847/482-5000

### WEB SITE

[www.tenneco-automotive.com](http://www.tenneco-automotive.com)

### CORPORATE INFORMATION

Individuals interested in receiving the Form 10-K or other corporate literature, as well as our latest quarterly earnings should write the Investor Relations Department at the corporate headquarters address or call 847/482-5058.

Information about Tenneco Automotive is also available on the company's Web site.

### STOCK LISTINGS

Tenneco Automotive's common stock is listed under the ticker symbol TEN.

TEN is traded primarily on the New York Stock Exchange and also on the following exchanges: Chicago, Pacific and London.

### INVESTOR INQUIRIES

Securities analysts, portfolio managers and representatives of financial institutions seeking information about the company should contact the Investor Relations department: 847/482-5042 or 847/482-5015.

### STOCKHOLDER INQUIRIES

For shareholder services such as change of address, lost certificates, dividend checks or change in registered ownership, write, call or e-mail:

First Chicago Trust  
Company of New York  
c/o EquiServe  
P.O. Box 2500  
Jersey City, New Jersey  
07303-2500  
800/519-3111  
E-mail: [fctc@em.fcnbd.com](mailto:fctc@em.fcnbd.com)  
Internet: [www.equiserve@equiserve.com](http://www.equiserve@equiserve.com)  
TDD/TYY for the hearing impaired:  
201/222-4955

### DIVIDENDS

The current practice established by the directors is to declare quarterly dividends. The last such dividend of 5 cents per share of common stock was declared on January 12, 2000, payable March 14, 2000, to stockholders of record on February 25, 2000. The current practice is subject to review and change at the discretion of the Board of Directors.

### STOCK PRICE DATA

|                          | Sale Prices                      |                                  | Dividends Paid |
|--------------------------|----------------------------------|----------------------------------|----------------|
|                          | High                             | Low                              |                |
| <b>1999</b>              |                                  |                                  |                |
| 1st quarter              | \$37 <sup>1</sup> / <sub>4</sub> | \$27 <sup>1</sup> / <sub>2</sub> | \$.30          |
| 2nd quarter              | 31 <sup>3</sup> / <sub>8</sub>   | 22 <sup>11</sup> / <sub>16</sub> | .30            |
| 3rd quarter              | 25 <sup>5</sup> / <sub>8</sub>   | 15 <sup>5</sup> / <sub>16</sub>  | .30            |
| 4th quarter through 11/4 | 17 <sup>9</sup> / <sub>16</sub>  | 13 <sup>13</sup> / <sub>16</sub> | —              |
| 4th quarter after 11/4*  | 9 <sup>1</sup> / <sub>2</sub>    | 7                                | —              |
| <b>1998</b>              |                                  |                                  |                |
| 1st quarter              | \$45                             | \$36                             | \$.30          |
| 2nd quarter              | 47 <sup>1</sup> / <sub>2</sub>   | 37                               | .30            |
| 3rd quarter              | 38 <sup>7</sup> / <sub>8</sub>   | 30 <sup>7</sup> / <sub>8</sub>   | .30            |
| 4th quarter              | 37 <sup>7</sup> / <sub>16</sub>  | 29 <sup>1</sup> / <sub>2</sub>   | .30            |

\* On November 4, 1999, Tenneco Automotive completed the spin-off of Pactiv and the following morning effected a one-for-five reverse stock split. Accordingly, the high and low sales prices for periods following this date give effect to these transactions.

### DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

The Tenneco Automotive DirectSERVICE™ Investment Program has been established so that individuals can make direct purchases of Tenneco Automotive common stock and reinvest dividends. To receive a prospectus and enrollment package, contact:

The DirectSERVICE  
Investment Program  
c/o EquiServe  
P.O. Box 2598  
Jersey City, New Jersey  
07303-2598  
or call 800/519-3111

Enrollment material is also available on the Internet at: [www.netstockdirect.com](http://www.netstockdirect.com).

### ANNUAL MEETING

The 2000 Annual Meeting of Shareholders will be held at 10:30 a.m. on Tuesday, May 9, 2000, at The Chicago Botanical Gardens, 1000 Lake Cook Road, Glencoe, Illinois.