TRANE INC.
Form 10-K
February 20, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2007

¨ **Transition Report to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number 1-11415

TRANE INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-3465896**

(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
One Centennial Avenue, P.O. Box 6820,	**08855-6820**
Piscataway, New Jersey **(Address of principal executive office)**	**(Zip Code)**

Registrant s telephone number, including area code:

(732) 980-6000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $.01 par value	New York Stock Exchange
(and associated Common Stock Rights)	

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

x Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company

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

The aggregate market value of the voting stock (Common Stock) held by non-affiliates of the Registrant as of the close of business on June 30, 2007 was approximately $12.0 billion based on the closing sale price of the common stock on the New York Stock Exchange on that date. The company does not have any non-voting common equity.

Number of shares outstanding of each of the Registrant s classes of Common Stock, as of the close of business on February 13, 2008: Common Stock, $.01 par value, 195,263,968 shares.

Documents incorporated by reference: None

Table of Contents

TABLE OF CONTENTS

Table of Contents

Important Information Concerning Forward-Looking Statements

Certain of the statements contained in this report (other than the historical financial data and other statements of historical fact), including, without limitation, statements as to management s expectations and beliefs, are forward-looking statements. Forward-looking statements are made based upon management s good faith expectations and beliefs concerning future developments and their potential effect upon the Company. There can be no assurance that future developments will be in accordance with such expectations or that the effect of future developments on the Company will be those anticipated by management. Forward-looking statements can be identified by the use of words such as believe, expect, plans, strategy, prospects, estimate, project, anticipate, intends and other words of similar meaning in connect discussion of future operating or financial performance. For further information as to important risks and factors that could cause actual results to differ materially from management s expectations, see Item 1. Business, Item 1A. Risk Factors , Item 3. Legal Proceedings, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Information Concerning Forward-Looking Statements and Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Table of Contents

PART I

ITEM 1. BUSINESS

Trane Inc. (formerly known as American Standard Companies Inc.) (the Company) is a Delaware corporation incorporated in 1988. Trane or the Company refers to the Company, or to the Company and Trane U.S. Inc. (formerly known as American Standard Inc.) or Trane International Inc. (formerly known as American Standard International Inc.), each a wholly-owned subsidiary, including their subsidiaries, as the context requires.

Trane is a leading global manufacturer of commercial and residential heating, ventilation and air conditioning equipment (HVAC) and provides market-leading systems and services that enhance the quality and comfort of the air in homes and buildings around the world. The Company offers customers a broad range of energy-efficient HVAC systems; dehumidifying and air cleaning products; service and parts support and advanced building controls. The Company s systems and services have leading positions in premium commercial, residential, institutional and industrial markets; a reputation for reliability, high quality and product innovation; and a broad, well-established distribution network.

Trane through its predecessors has been in the HVAC business since 1864. The business strategy for the commercial market is to provide customers with integrated HVAC systems and solutions including equipment, controls, parts and services that make their buildings and therefore their businesses perform better. The business strategy for the residential market is to provide homeowners with total home comfort solutions including equipment and controls to create an ideal home environment.

For the year ended December 31, 2007, the Company had sales of $7,449.6 million and income from continuing operations of $400.2 million.

Customers and Key Markets

In 2007, the sale of commercial equipment accounted for approximately 47 percent of total revenue, the sale of residential equipment accounted for approximately 24 percent of total revenue and the remaining 29 percent of 2007 total revenue was derived from the sale of parts, services and solutions. Approximately 59 percent of the Company s revenue in 2007 was from sales of equipment, parts and services to the replacement, renovation and repair market segment, and the remainder from new construction. The Company derived 27 percent of its 2007 revenue from sales outside the U.S.

The business of the Company taken as a whole is not dependent upon any single customer or a few customers. No single customer accounted for 10 percent or more of the Company s sales for the years ended December 31, 2007, 2006 and 2005.

The Company has operations in North America, Europe, the Middle East, Asia and Central and South America. For sales by geographic region and end markets, see Management s Discussion and Analysis of Financial Condition and Results of Operations.

Products and Services

The Company manufactures and sells commercial and residential HVAC equipment and parts and provides HVAC services and solutions to its customers.

Products manufactured by the Company include:

- Large commercial applied systems consisting of chillers, air handlers and terminal devices such as variable air volume units, fan coils and controls.

- Light and large commercial unitary systems.

Table of Contents

- Split-system and packaged residential systems including condensing units, furnaces, air handlers, heat pumps, coils and air filtration devices.
- Thermostats that regulate room and building temperature.
- Controls that optimize and manage the performance of each unit or system.
- Integrated building automation systems that control, manage and report a building s performance including its energy consumption, air quality and comfort.

Trane offers high energy-efficiency system options for residential, commercial and industrial building types around the world. Energy efficiency means greater comfort for homeowners and building occupants, lower energy and raw material use, such as oil and natural gas, and less impact on the environment. Examples of Trane s energy efficient systems include:

- EarthWise CenTraVac chilled water system, which won the Best-of-the-Best Award in 2007 from the U.S. Environmental Protection Agency (EPA) for its contributions to strategic ozone protection. It is the most energy-efficient system available for large buildings.
- Energy recovery systems that use less energy to cool and heat during all seasons and provide free energy for the creation of hot water.
- The XL19i two-stage split-system air conditioner and heat pump that can save consumers more than 60 percent in operating costs compared with a 10-year-old existing unit.
- The XV95 is the market s most efficient gas furnace and the first to attain up to a 96.7 percent Annual Fuel Utilization Efficiency (AFUE) rating, exceeding the government s minimum AFUE rating for furnaces and boilers by nearly 20 percent.
- Variable speed indoor systems that are highly efficient to operate.
- Precedent 15 SEER (Seasonal Energy Efficiency Ratio) light commercial systems which was launched in the fourth quarter of 2006.
- Wireless Zone Sensors that help optimize overall building energy consumption.

The Company provides commercial service agreements covering both its own and its competitors equipment and systems and sells optional extended warranties to commercial and residential customers on its own equipment.

Marketing and Sales

The Company has a broad global network of company-owned sales offices and distribution centers, independent sales offices and independent wholesale distributors distributing its products.

The Company is served by a broad network of more than 170 company-owned and independent commercial sales offices (CSOs), 39 percent of which are located in the U.S. and Canada and the remainder throughout Europe, the Middle East, Latin America and Asia Pacific regions. CSOs work with building owners or their agents, such as architects and consulting engineers, to design and apply state-of-the-art HVAC systems to various buildings and sell equipment, systems and controls primarily to mechanical contractors.

A growing area is sales directed to building owners or sales directed by owners, primarily through national account relationships with owners or operators who manage a distributed network of facilities such as retail and hospitality chains, federal, state and local governments and agencies and process manufacturers such as pharmaceutical or electronics companies.

In addition to selling original equipment, Trane CSOs manage a network of more than 170 parts centers serving the needs of Company-owned and independent HVAC service companies. The parts centers sell both

2

Table of Contents

commercial and residential parts. The parts centers are either separate locations or part of the CSO locations. The CSOs also have an extensive network of service technicians and applications engineers who provide design, installation, consulting and maintenance services and controls contracting. Outside the U.S. and Canada, CSOs sell residential and commercial products to independent dealers and installers.

In addition to the CSOs, the Company is served by residential Company-owned sales offices and independent wholesale distributors in the U.S. and Canada. These sales offices and distributors have more than 500 stocking locations that sell Trane and American Standard residential and light commercial unitary products (up to 25 tons) to dealers and contractors who sell and install the equipment.

Additionally, TRANE® brand residential products are well positioned in the retail sales channel through a key sales lead program at The Home Depot, the top home improvement retailer in the U.S. This supports the marketing of TRANE® central heating and air conditioning systems to residential customers.

Competitors

The Company competes in all of its markets on the basis of the quality, reliability and breadth of its products and services; innovation and technological leadership; energy efficiency; price; and value. The Company s major competitors are:

Residential equipment systems in the U.S.: Carrier, Goodman Industries, Johnson Controls, Lennox and Rheem.

Commercial equipment systems globally: Carrier, Daikin and Johnson Controls.

Control products and systems globally: Honeywell International Inc., Johnson Controls and Siemens.

Services: in addition to the companies listed above, the Company competes with local independent service providers around the world.

Parts: in addition to the companies listed above, the Company competes with specialized parts distributors, such as Grainger and Johnstone Supply.

Organization

The Company s global headquarters is located in Piscataway, NJ. The Company s other main administrative offices are located in Brussels, Belgium; LaCrosse, WI; Shanghai, China; St. Paul, MN and Tyler, TX. The principal manufacturing operations are located in China, France, Mexico, Taiwan and the U.S. For additional information on the Company s facilities see Item 2. Properties. For additional information on employees see Other Matters Relating to Trane s Business as a Whole Employees.

Recent Developments

Company History American Standard Companies Inc. Separation

On February 1, 2007, Trane (then known as American Standard Companies Inc.) announced that its Board of Directors had completed a strategic review of the Company and unanimously approved a plan to separate its three businesses during 2007. The announced separation included a plan to spin off Trane s Vehicle Control Systems business and to sell its Bath and Kitchen business, with Trane retaining and focusing on its global HVAC business. The Board of Directors concluded that separating the three businesses would create greater shareholder value than the existing company structure and provide the separated companies with substantial opportunities and benefits allowing them to more effectively operate their respective businesses, including providing the separated companies with increased strategic focus, enhanced opportunities for growth, increased market recognition, improved capital flexibility and increased ability to attract, retain and motivate employees.

Table of Contents

On July 12, 2007, the Board of Directors of Trane approved the spinoff of the Vehicle Control Systems business into a new publicly traded company named WABCO Holdings Inc. (WABCO). The spinoff of WABCO was completed on July 31, 2007 and WABCO began trading thereafter as an independent company on the New York Stock Exchange (NYSE) under the ticker symbol WBC.

On July 23, 2007, the Company entered into an agreement to sell its Bath and Kitchen business to affiliates of Bain Capital Partners, LLC. The sale was completed on October 31, 2007 for approximately $1.745 billion, after closing adjustments but subject to certain post-closing adjustments. Combined with the proceeds received by Trane from the sale of its Venesta Washroom Systems business (which was formerly part of the Bath and Kitchen business) in March 2007, the Company s gross proceeds from the sale of the Bath and Kitchen business totaled approximately $1.91 billion. A portion of the proceeds from the sale of Bath and Kitchen, after expenses and taxes, was used to reduce debt.

Upon completion of the spinoff of the Vehicle Control Systems business and the sale of the Bath and Kitchen business, the Company s operations consist of its Air Conditioning Systems and Services business, which manufactures, sells and services commercial and residential HVAC equipment systems and controls. Following receipt of shareholder approval, American Standard Companies Inc. changed its name to Trane Inc. on November 28, 2007 and began trading on the NYSE under the ticker symbol TT.

Merger Agreement with Ingersoll Rand

On December 17, 2007, the Company announced that on December 15, 2007, it had entered into an agreement and plan of merger with Ingersoll-Rand Company Limited (Ingersoll Rand) and Indian Merger Sub, Inc., a wholly-owned subsidiary of Ingersoll Rand (Merger Sub), providing for the acquisition of the Company by Ingersoll Rand, a company publicly traded on the NYSE. Subject to the terms and conditions of the merger agreement, Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation and a wholly-owned subsidiary of Ingersoll Rand. At the effective time of the merger, each outstanding share of common stock of the Company, other than shares owned by the Company or Ingersoll Rand and any dissenting shares, will be converted into the right to receive a combination of (i) 0.23 (the Exchange Ratio) of an Ingersoll Rand Class A common share and (ii) $36.50 in cash (the Cash Consideration), without interest. Under the merger agreement, in the event that the Company or Ingersoll Rand reasonably determines in good faith that it is necessary to do so, in order to complete the merger without a vote of Ingersoll Rand s shareholders, the Cash Consideration may be increased by an amount up to $1.00 per share (with a corresponding reduction to the Exchange Ratio). The merger is subject to customary closing conditions, including the approval of the Company s shareholders and the receipt of certain required antitrust approvals and clearances. The Company received the necessary antitrust approvals under the Hart-Scott-Rodino Act on January 31, 2008. The Company currently anticipates that the merger will be completed in the second calendar quarter of 2008.

Business Data

Information related to the Income Statement, Balance Sheet and Cash Flow for the Company on a consolidated basis and by geographic area is set forth in Item 6, Selected Financial Data, in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and in Note 17 of Notes to Consolidated Financial Statements, all of which are incorporated herein by reference. Information on backlog and the seasonal aspects of the Company s business are set forth in Management s Discussion and Analysis of Financial Condition and Results of Operations, and under the caption Cyclical and Seasonal Nature of Business, respectively.

Company Goals

The Company has adopted the following performance goals:

- Sales growth, through:
  - Delivering premier customer service, building brand awareness and differentiation,

Table of Contents

- Technological leadership and product innovation based on knowledge to meet changing customer needs, and
- Geographic expansion.

Productivity improvement through:

- Materials management programs, and
- Quality and Six Sigma programs.

Financial goals including:

- Improving income from continuing operations and cash flow,
- Maintaining investment grade debt rating or equivalent rating,
- Maintaining or lowering the effective tax rate,
- Increasing the return of cash flow to shareholders, and
- Disciplined capital investment and improved asset utilization.

Materials Management

The Company s materials management initiative is centered on utilizing the Company s collective buying power on a global basis to improve purchasing efficiency, reduce the number of suppliers and improve the supply chain. Materials management also involves working with suppliers to develop effective components with lower part counts and easier assembly, resulting in improved quality and reduced costs. Materials management identifies opportunities to substitute lower-cost materials for higher-cost ones without compromising quality, durability and safety. Material costs represent a significant portion of total costs. Management believes that continued improvements realized through materials management could result in substantial savings.

Management continues to adopt challenging goals for continuous performance improvement. In 2007 improvements from materials management programs partially offset increasing commodity costs related to the purchase of steel, copper, aluminum, motors and electronics, which negatively impacted the Company by $186 million. Incremental benefits from this program were approximately $92 million in 2007, $84 million in 2006 and $30 million in 2005.

Six Sigma

Six Sigma is a structured approach to achieving significant productivity improvements in business and manufacturing processes through data-driven decisions. The Company originally introduced Six Sigma in 2000. In 2005, the Company incorporated Lean principles, which focus on speed and the reduction of waste in all processes, and now refers to the integration of Lean principles and tools within the framework of Six Sigma as Six Sigma Lean .

The Company continues to develop and deploy technical experts (referred to as Six Sigma Master Black Belts, Black Belts and Green Belts) through aggressive training and project deployment programs. At the end of 2007, the Company had 38 Master Black Belts, 566 Black Belts and 2,954 Green Belts who were certified or in training. To achieve such a designation, specific projects, timelines, milestones and savings must be achieved. Management is continually broadening the Six Sigma Lean approach to cover functions beyond manufacturing. In the past two years it has provided specific Six Sigma Lean training in safety, materials management, transactional analysis and design, deployment of new products, lean manufacturing, sales/marketing, maintenance and administrative processes.

Linkage of Goals with Incentive Compensation Plans

Management has adopted incentive compensation plans that are directly linked to achievement of the company-wide goals described above. Management believes the attainment of these goals will result in improved financial performance and enhanced shareholder value.

Table of Contents

Other Matters Relating to Trane s Business

Raw Materials and Purchased Components

The Company purchases a broad range of materials and components throughout the world in connection with its manufacturing activities. Major items include steel, copper, aluminum, motors and electronics. The ability of the Company s suppliers to meet performance and quality specifications and delivery schedules is important to the Company s operations. Material costs represent a significant portion of total costs. As a result, the Company has integrated much of its raw materials and components procurement efforts into its materials management initiative, which the Company believes results in significant savings. The energy and materials required for manufacturing operations have been readily available. The Company is not dependent on any single supplier or a few suppliers for the purchase of its raw materials and purchased components. Although the Company does not foresee any significant raw material shortages, it does expect to incur higher costs for certain commodity raw materials in 2008.

Patents, Licenses and Trademarks

The Company s operations are not dependent to any significant extent upon any single or related group of patents, licenses, franchises or concessions. The TRANE® and AMERICAN STANDARD® trademarks identified with the Company s products and services are important in the sale and marketing of such products and services.

The Company, from time to time, has granted patent licenses to, and has licensed technology from, other parties.

Research and Product Development

The Company made expenditures of $116 million in 2007, $101 million in 2006 and $87 million in 2005 for research and product development. The Company s research and development expenditures were primarily related to alternative refrigerants, compressors, heat transfer surfaces, airflow technology, acoustics, clean air products for residential air conditioning, micro-electronic controls and regulatory compliance. The Company has five research and development centers focusing on commercial and residential technologies. The centers are located in Shanghai, China; LaCrosse, WI; St. Paul, MN; Clarksville, TN and Tyler, TX.

Regulations and Environmental Matters

The Company s U.S. operations are subject to federal, state and local environmental laws and regulations. The Company has a number of proactive programs under way to minimize its impact on the environment and believes that it is in substantial compliance with environmental laws and regulations. A number of the Company s plants are undertaking responsive actions to address soil and groundwater issues. In addition, the Company is a party to a number of remedial actions under various federal and state environmental laws and regulations that impose liability on companies to clean up, or contribute to the cost of cleaning up, sites at which hazardous wastes or materials were disposed or released. Remedial actions to which the Company is a party include approximately 22 current proceedings under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) and similar state statutes in which the Company has potential liability based either on a past or current ownership interest in the site requiring remedial actions or based on disposal or alleged disposal of waste products at the site requiring remedial actions. Expenditures in 2007, 2006 and 2005 to evaluate and remediate such sites were not material.

Additional sites may be identified for environmental remediation in the future, including properties previously transferred by the Company and with respect to which the Company may have contractual indemnification obligations. The Company cannot estimate at this time the ultimate aggregate costs of all remedial actions because of uncertainties surrounding the nature and application of environmental regulations, the Company s lack of information about additional sites at which it may be listed as a potentially responsible party, the level of cleanup that may be required at specific sites and choices concerning the technologies to be applied in corrective actions, the number of contributors and the financial capacity of others to contribute to the cost of remediation at specific sites and the time periods over which remediation may occur. On the basis of the Company s historical experience and information currently available, these environmental actions should not have a material adverse effect on its financial condition, results of operations or liquidity.

The Company s international operations are also subject to various environmental statutes and regulations. Generally, these requirements tend to be no more restrictive than those in effect in the U.S. The Company believes it is in substantial compliance with existing domestic and foreign environmental statutes and regulations. As in the U.S., a number of the Company s international facilities are undertaking responsive actions to address groundwater and soil issues. Expenditures in 2007, 2006 and 2005 to evaluate and remediate these sites were not material. On the basis of the Company s historical experience and information currently available, these environmental actions should not have a material adverse effect on its financial condition, results of operations or liquidity.

The Company has derived significant revenues in recent years from sales of air conditioning equipment that uses refrigerants which contain chlorofluorocarbons (CFCs) and hydrochlorofluorocarbons (HCFCs). Production and use in new equipment of certain HCFCs and other chemicals with ozone-depletion potential are being phased out over various periods under laws and regulations that require use of substitute permitted refrigerants. The Company believes that these regulations will continue to have the effect of generating additional product sales and parts and service revenues, as existing air conditioning equipment utilizing CFCs and HCFCs, is converted to operate on other refrigerants or replaced. The Company is unable to estimate the magnitude or timing of these conversions or replacements. The Company has been working closely with refrigerant manufacturers that are developing refrigerant substitutes for CFCs and HCFCs, so the Company s products will be compatible with those substitutes. Although a significant percentage of the Company s commercial air conditioning products will require modification for refrigerant substitutes, the Company believes that it will remain competitive and does not expect any significant problems in complying with this changing regulatory environment. In addition, the Company is a leader in developing energy-efficient products that meet or exceed certain federal and state efficiency standards. However, providing more energy-efficient products will require additional research and development expense and capital expenditures to continue to offer energy-efficient product choices to the customer. The Company believes it will remain competitive and that it has adequate financial resources to fund these efforts.

Employees

The Company employed approximately 29,600 people as of December 31, 2007 (excluding employees of unconsolidated joint venture companies). The Company has eight major labor union contracts in North America covering approximately 6,750 employees. In North America, one contract expired and was successfully negotiated in 2007 covering approximately 920 employees. Three contracts will expire in 2008 covering approximately 2,140 employees, and two contracts will expire in 2009, covering approximately 2,470 employees. In addition, one contract in Mexico covering approximately 650 employees is negotiated on an annual basis. The Company also has four major labor contracts outside North America, covering approximately 1,120 employees. One contract in Chile covering 87 employees was successfully negotiated in 2007 after a four-day work stoppage. Another contract in Latin America, covering 54 employees, will be negotiated in 2008. Although the Company believes relations with its employees are good, there can be no assurance that the Company will not experience significant work stoppages in the future.

International Operations

The Company conducts operations through its subsidiaries in most of the countries of Western Europe, Brazil, Canada, the Middle East, Mexico, China, Thailand, Taiwan and other countries throughout the world. Because the Company has operations in foreign countries, fluctuations in currency exchange rates may have a significant impact on its consolidated financial statements. Such fluctuations have much less effect on local operating results because the Company, to a significant extent, sells its products within the countries in which they are manufactured. A portion of the Company s products are manufactured in lower-cost locations such as Mexico, Brazil and China and sold in various countries and are manufactured in the U.S. and sold abroad. This results in increased exposure to foreign exchange effects. The Company is also subject to political risks related to its foreign operations.

ITEM 1A. RISK FACTORS

The risks described below should be carefully considered before investing in the publicly traded securities of Trane. Any of the following factors could materially adversely affect the Company s future operating results, financial condition and/or stock price. The risks described below are not the only ones facing the Company. Other risk factors are included in Management s Discussion and Analysis of Financial Condition and Results of Operations Information Concerning Forward Looking Statements.

Risks Related to Current Operations

The Company s sales could decline due to macro-economic factors and other factors outside of the Company s control.

Changes in economic conditions and changes in the local economies of the countries or regions in which the Company sells its products and services, such as changes in consumer confidence, increases in interest rates and increases in unemployment, could affect consumer demand for the Company s products and services, which could negatively affect the Company s business and results of operations. In addition, as a result of the completion of its planned separation, the Company s operations are less diversified and therefore, subject, to a greater extent than previously, to the effects of changes to such factors on the commercial and residential construction markets in the geographic regions in which the Company operates.

In the U.S., much of the consumer demand for the Company s products has been driven by the replacement, repair, remodeling and new construction markets. The Company s business has benefited from the growth in the replacement, repair and remodeling and new construction markets in the U.S. As sales in the U.S. comprise approximately 73 percent of total sales in 2007, a significant decline in any of the replacement, repair, remodeling or new construction markets or a downturn in the U.S. economy, could negatively affect the Company s results of operations.

The Company s exposure to exchange rate fluctuations on cross border transactions and the translation of local currency results into U.S. dollars could negatively impact the Company s results of operations.

The Company conducts business through its subsidiaries in many different countries, and fluctuations in currency exchange rates could have a significant impact on the reported results of operations, which are presented in U.S. dollars. In 2007, approximately 27 percent of consolidated sales occurred outside of the U.S. A significant and growing portion of the Company s products are manufactured in lower-cost locations and sold in various countries. Cross border transactions, both with external parties and intercompany relationships, result in increased exposure to foreign exchange effects. Accordingly, significant changes in currency exchange rates, particularly the EURO, Pound Sterling, Chinese RMB (Yuan), Mexican Peso and the Canadian dollar, could cause fluctuations in the reported results of the Company s operations that could negatively affect its results of operations. Additionally, the strengthening of certain currencies such as the EURO and U.S. dollar potentially exposes the Company to competitive threats from lower cost producers in other countries such as China. Lastly, the Company s sales are translated into U.S. dollars for reporting purposes. The strengthening or weakening of the U.S. dollar could result in favorable or unfavorable translation effects as the results of foreign locations are translated into U.S. dollars. In 2007, the Company recorded $0.1 million of foreign exchange gains in its Income Statement. Foreign exchange translation effects benefited the Company s sales by $99.4 million and income from continuing operations by $8.4 million in 2007.

Table of Contents

The Company is subject to general risks associated with its foreign operations.

In addition to the currency exchange risks inherent in operating in many different foreign countries, there are other risks inherent in the Company s international operations. The risks related to the Company s foreign operations that are more often faced in the normal course of business include:

- Changes in tax law, increases in tax rates and the amount of foreign earnings relative to total consolidated earnings could change and impact the consolidated tax rate;
- Foreign earnings may be subject to withholding requirements or the imposition of tariffs, price or exchange controls, or other restrictions, including restrictions on repatriation of earnings;
- General economic and political conditions in countries where the Company operates may have an adverse effect on the Company s operations in those countries; and
- Changes in law could increase the cost of doing business in foreign jurisdictions, and the uncertainty of the legal environment in certain jurisdictions, especially in emerging markets, could limit the Company s ability to effectively enforce its rights in certain markets.

The ability to manage these risks could be difficult and may limit the Company s operations and make the manufacture and distribution of its products internationally more difficult, which could negatively affect the Company s business and results of operations.

If the Company is unable to obtain certain raw materials and component parts at reasonable price levels, its ability to maintain existing sales margins may be affected.

The Company purchases a broad range of materials and components throughout the world in connection with its manufacturing activities. Major items include steel, copper, aluminum, motors and electronics. The cost of raw materials represents a significant portion of total costs. In 2007 the Company incurred higher costs for certain raw materials, energy and transportation costs, which affected earnings. The Company s future results of operations and profitability could be negatively affected if it cannot obtain raw materials at a reasonable cost. While the Company was able to raise prices in 2007 to offset the impact of rising commodity costs, on a cumulative basis, commodity cost increases remain greater than price increases.

The Company may not be able to realize the estimated cost savings or productivity improvements from its materials management and Six Sigma Lean initiatives, respectively.

The Company s materials management initiative is centered on utilizing collective buying power on a global basis to improve purchasing efficiency, reduce the number of suppliers and improve the supply chain. Materials management also involves working with suppliers to develop effective components with lower part counts and easier assembly, resulting in improved quality and reduced costs. Material costs represent a significant portion of total costs. The Company s inability to successfully execute specific programs associated with the materials management initiative could negatively affect the Company s business and results of operations.

Similarly, the Company s Six Sigma Lean initiative is structured to achieve significant productivity improvements in business and manufacturing processes through data driven decisions. To the extent that the Company is not able to increase productivity at planned levels its results of operations could be adversely affected.

If there are changes in the environmental, health or other regulations that affect one or more of the Company s current products or future products, it could have a negative impact on the Company s business and results of operations.

The Company is currently governed by various environmental, health and other regulations in the U.S. and internationally. While there are a number of proactive programs underway to minimize the impact of the Company s products on the environment and the Company believes it is in substantial compliance with

Table of Contents

environmental laws and regulations, the Company cannot predict whether there will be changes in the environmental, health and other regulations affecting its products. Currently, there are regulations which require the phasing out of certain refrigerants such as CFCs and HCFCs, which are used in the products the Company manufactures and services. If the Company is unsuccessful in modifying certain of its products to be compatible with the substitute refrigerants, it could have a negative impact on its business and results of operations. There are also federal and state statutes which impose energy efficiency standards for certain of the Company s air conditioning systems. If the Company is unable to produce air conditioning systems that meet these statutory energy-efficiency requirements, it could have a negative impact on its ability to compete.

Any changes in the environmental, health or other regulations which affect the Company s current or future products could have a negative impact on its business if the Company were unable to adjust its product offering to comply with such regulatory changes. In addition, it is possible that the Company will incur increased costs as a result of complying with environmental, health and other regulations.

Changes to the Company s asbestos liability or insurance receivable could impact its results of operations.

In 2004, the Company recorded a liability for all pending and unasserted potential future asbestos indemnity claims. The Company also recorded a receivable with respect to expected insurance recoveries related to such liability. The amounts recorded for asbestos-related liability and insurance-related receivables rely on assumptions that are based on currently known facts and expected trends. The Company s actual expenses and insurance recoveries could be significantly higher or lower than those recorded if the assumptions used or relied upon vary significantly from actual results or if U.S. tort legislation governing asbestos claims is passed. The Company reviews these assumptions on a periodic basis to determine whether adjustments are required to its recorded asbestos-related liability and related insurance receivable. Adjustments, if any, to the estimate of the recorded asbestos-related liability and/or insurance receivable could negatively impact the results of operations for the period or periods in which such adjustments are made. See Note 15 of Notes to Consolidated Financial Statements for additional information regarding asbestos.

If the Company is not able to maintain good relations with its unionized employees, the Company could suffer work stoppages that could negatively affect its business and results of operations.

Approximately 27 percent of the Company s employees, as of December 31, 2007, are members of labor unions. The Company has eight major labor union contracts in North America. The Company also has four major labor contracts outside of North America. Five of the union contracts will expire in 2008, and the Company will be required to renegotiate them in the coming year. While the Company does not anticipate any problems in renegotiating the labor contracts that could negatively affect operational results, it cannot ensure that it will be able to reach an agreement with the unions. Any disputes with the labor unions could result in work stoppages or other labor protests which could disrupt its operations. Any such labor disputes could negatively affect the Company s business and results of operations. See Other Matters Relating to Trane s Business Employees for more information.

Changes in weather patterns and seasonal fluctuations may adversely affect the Company s business and results of operations.

Demand for the Company s products and services is influenced by weather conditions. Company sales tend to be seasonally higher in the second and third quarters of the year because, in the U.S. and other northern hemisphere markets, summer is the peak season for sales of air conditioning systems and services. Unexpected cool trends or unseasonably warm trends during the summer season could negatively or positively affect the Company s business and results of operations.

In addition, the Company s quarterly results may vary significantly. Although there is demand for the Company s products and services throughout the year, a significant percentage of total sales are related to U.S. residential and commercial construction activity, which is generally higher in the second and third quarters of the year. Therefore, results of any quarterly period may not be indicative of expected results for a full year.

Table of Contents

The Company may be subject to product liability and warranty and recall claims, which may increase the cost of doing business and adversely affect its business, financial condition and results of operations.

The Company is subject to a risk of product liability or warranty claims if its products actually or allegedly fail to perform as expected or the use of its products results, or is alleged to result, in bodily injury and/or property damage. While the Company maintains reasonable limits of insurance coverage to appropriately respond to such exposures, large product liability claims, if made, could exceed insurance coverage limits and insurance may not continue to be available on commercially acceptable terms, if at all. The Company cannot be assured that it will not incur significant costs to defend these claims or that it will not experience any product liability losses in the future. In addition, if any of the Company s designed products are or are alleged to be defective, the Company could be required to participate in recalls and exchanges of such products. In the past five years, the Company s warranty expense has fluctuated between 1.8 percent and 2.6 percent of sales on an annual basis. Individual quarters were above or below the annual averages. The future costs associated with providing product warranties and/or bearing the cost of repair or replacement of the Company s products could exceed historical experience and have a material adverse effect on the Company s business, financial condition and results of operations.

Risks Related to Separation Transactions

The Company may not be able to achieve some or all of the benefits it expects will result from the separation transactions.

The Company may not be able to achieve the full strategic and financial benefits it expects will result from the separation of two of the Company s three historical operating segments into independent companies or such benefits may be delayed or not occur at all. Additionally, the consolidated financial information included in this Annual Report on Form 10-K, does not reflect the financial condition, results of operations or cash flows that the Company would have achieved if the separation had been completed prior to, or during, the periods presented or those that the companies will achieve in the future.

If the distribution of WABCO s shares were to fail to qualify as tax-free for U.S. federal income tax purposes under Section 355 of the Internal Revenue Code (the Code), then the Company s shareholders or the Company may be required to pay U.S. federal income taxes.

The Company has received a private letter ruling from the Internal Revenue Service (IRS) substantially to the effect that the distribution qualifies as tax-free for U.S. federal income tax purposes under Section 355 of the Code. In addition, the Company has received an opinion of Skadden, Arps, Slate, Meagher & Flom LLP, tax counsel to Trane, substantially to the effect that the distribution will qualify as tax-free to Trane, WABCO and Trane shareholders under Section 355 and related provisions of the Code. The ruling and opinion are based on, among other things, certain assumptions as well as on the accuracy of certain factual representations and statements made by WABCO and the Company. In rendering its ruling, the IRS also relied on certain covenants that the Company and WABCO entered into, including the adherence to certain restrictions on WABCO s and the Company s future actions.

Notwithstanding receipt by Trane of the private letter ruling and the opinion of counsel, the IRS could assert that the distribution should be treated as a taxable transaction. If the distribution fails to qualify for tax-free treatment, then the Company would recognize a gain in an amount equal to the excess of (i) the fair market value of WABCO s common stock distributed to the Trane shareholders over (ii) Trane s tax basis in such common stock. Under the terms of the Tax Sharing Agreement, in the event the distribution were to fail to qualify as a tax-free reorganization and such failure was not the result of actions taken after the distribution by Trane or any of its subsidiaries or shareholders, WABCO would be responsible for all taxes imposed on Trane as a result thereof. In addition, each Trane shareholder who received WABCO common stock in the distribution generally would be treated as having received a taxable distribution in an amount equal to the fair market value of

Table of Contents

WABCO s common stock received (including any fractional share sold on behalf of the shareholder), which would be taxable as a dividend to the extent of the shareholder s ratable share of Trane s current and accumulated earnings and profits (as increased to reflect any current income including any gain recognized by Trane on the taxable distribution). The balance, if any, of the distribution would be treated as a nontaxable return of capital to the extent of the Trane shareholder s tax basis in its Trane stock, with any remaining amount being taxed as capital gain.

Risks Related to the Pending Acquisition by Ingersoll Rand

Failure to complete the merger will subject the Company to financial risks and could cause its stock price to decline.

On December 15, 2007, the Company entered into the merger agreement with Ingersoll-Rand Company Limited. The Company cannot be assured that the merger agreement will be adopted by its shareholders or that the other conditions to the completion of the merger will be satisfied. In connection with the merger, the Company is subject to several risks, including the following:

- the current market price of the Company s common stock may reflect a market assumption that the merger will occur, and a failure to complete the merger could result in a decline in the market price of the Company s common stock;
- the occurrence of any event, change or other circumstance that could give rise to a termination of the merger agreement;
- the inability to complete the merger due to the failure to obtain approval of the Company s shareholders or the failure to satisfy other conditions to consummation of the merger;
- the failure of the merger to close for any other reason;
- under the merger agreement, the Company could be required to pay Ingersoll Rand a termination fee of $315 million, if the merger agreement is terminated in certain circumstance involving a takeover proposal by a third party or a change in the Company s Board of Directors recommendation of the merger to its shareholders;
- the proposed transaction disrupts current plans and operations and the potential difficulties associated with employee retention as a result of the merger;
- the benefits the Company expects its shareholders would realize from the merger would not be realized, including as a result of the difficulties or delays in Ingersoll Rand s ability to successfully integrate its businesses with the Company s business following the merger;
- the effect of the announcement of the merger on the Company s operating results, business and relationships with customers, suppliers and other parties; and
- the amount of the costs, fees, expenses and charges the Company has and may incur related to the merger.

Because the market price of Ingersoll Rand common stock will fluctuate, shareholders of the Company cannot be sure of the market value of the shares of Ingersoll Rand common stock that they will receive upon completion of the merger until completion of the merger.

The number of shares of Ingersoll Rand common stock to be received by holders of the common stock of the Company in the merger as part of the merger consideration is fixed at 0.23 of an Ingersoll Rand Class A common share for each share of the Company s common stock. That number will not be adjusted in the event of any increase or decrease in the market price of either Ingersoll Rand Class A common shares or the Company s common stock. That number would be reduced, however, if Ingersoll Rand substitutes, under certain circumstances, up to $1.00 per share in cash for shares having an equivalent value (based on the average price of

Table of Contents

Ingersoll Rand common stock during a specified period prior to closing) as the amount of the increase in cash. The price of Ingersoll Rand common stock may vary at the closing of the merger from its price at the date of this Annual Report on Form 10-K and at the date of the special meeting of shareholders of the Company to be called to vote on adoption of the merger agreement. That variation may be the result of changes in the business, operations or prospects of Ingersoll Rand or the Company, market assessments of the likelihood that the merger will be completed and the timing of the merger, general market and economic conditions and other factors. In addition to the approval of the Company s shareholders, completion of the merger is subject to the receipt of required approvals under certain antitrust laws of foreign jurisdictions and the satisfaction or waiver of other conditions.

Failure to complete the merger could negatively impact the stock price and future business and financial results of Trane.

If the merger is not completed, the ongoing business of Trane may be adversely affected and will be subject to several risks, including the following: (i) Trane being required, under certain circumstances, to pay Ingersoll Rand a termination fee of $315 million under the merger agreement; (ii) Trane having to pay certain costs relating to the merger, such as legal, accounting, financial advisory and printing fees; and (iii) the focus of management of the Company on the merger instead of on pursuing other opportunities that could be beneficial to the Company, in each case, without realizing any of the benefits of having the transaction completed. In addition, if the merger is not consummated, Trane may experience negative reactions from the financial markets and Trane s customers and employees. If the merger is not completed, Trane cannot ensure its shareholders that the risks described above will not materialize and will not materially affect the business, financial results and stock price of Trane.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of February 14, 2008, the Company conducted its manufacturing activities through 35 plants in 10 countries of which the principal facilities are:

Location	Major Products Manufactured at Location
Clarksville, TN	Commercial unitary air conditioning
La Crosse, WI	Applied air conditioning systems
Lexington, KY	Air handling products
Macon, GA	Air handling products
Pueblo, CO	Applied air conditioning systems
Lynn Haven, FL	Commercial unitary air conditioning
Trenton, NJ	Residential gas furnaces and coils
Tyler, TX	Residential air conditioning
Vidalia, GA	Residential air handlers and whole house air cleaners
Ft. Smith, AR	Package air conditioners, heat pumps and gas electrics
Columbia, SC	Coils
Monterrey, Mexico	Reciprocating and scroll compressors
Charmes, France	Applied air conditioning systems
Golbey, France	Unitary air conditioning systems
Taicang, China	Applied and unitary air conditioning systems
GuangDong, China	Coils and air systems
Taipei, Taiwan	Coils and air systems

All of the plants described above are owned by the Company or a subsidiary except for the properties located in Taipei, Taiwan; Macon, GA; Vidalia, GA; and Monterrey, Mexico which are leased. The Company

Table of Contents

considers that its properties are generally in good condition, are well maintained, and are generally suitable and adequate to carry on the Company s business. In 2007, the Company s manufacturing plants, taken as a whole, operated moderately below capacity.

The Company also owns or leases warehouse and office space for administrative and sales staff. The Company headquarters, which is leased, is located in Piscataway, NJ.

ITEM 3. LEGAL PROCEEDINGS

The Haynes Litigation

In October 1999, in *Haynes Trane Service Agency, Inc. and Frederick M. Haynes v. American Standard, Inc., d/b/a The Trane Company,* in the United States District Court for the District of Colorado, verdicts were returned against the Company for a total of $18 million on the claim that it wrongfully terminated distribution agreements. On August 28, 2002, the appellate court ruled in favor of the Company and vacated the $18 million judgment. The appellate court also reinstated the Company s counterclaims, including fraud, and remanded to the trial court limited portions of Haynes initial claims. On December 7, 2005, a jury in the United States District Court in Colorado returned a favorable verdict for the Company in its lawsuit alleging fraud by Haynes Trane Service Agency, Inc. (HTSA), a former distributor of the Company s unitary air conditioning business. The jury also returned an advisory verdict recommending that the court award Fred Haynes $4.8 million, because the jurors concluded that the Company had wrongfully terminated an agency agreement with Mr. Haynes, the owner of HTSA, after discovering HTSA s fraudulent activities in 1995. On October 25, 2006, the trial judge ruled that pursuant to equitable principles Mr. Haynes was not entitled to any portion of the jury s advisory award and accordingly entered judgment in favor of the Company. On September 11, 2007, the trial court entered final judgment against Haynes and in favor of the Company on its fraud claim against HTSA in the amount of $4.75 million including pretrial interest. Haynes and HTSA filed notices of appeal on October 11, 2007, and the appeal is still pending.

The European Commission Investigation

In November 2004, the Company was contacted by the European Commission as part of a multi-company investigation into possible infringement of European Union competition law relating to the distribution of bathroom fixtures and fittings in certain European countries. On March 28, 2007, the Company, along with a number of other companies, received a Statement of Objections from the European Commission. The Statement of Objections, an administrative complaint, alleges infringements of European Union competition rules by numerous bathroom fixture and fittings companies, including the Company and certain of its European subsidiaries engaged in the Bath and Kitchen business. Certain of these legal entities were transferred to WABCO as part of a legal reorganization in connection with the spinoff of the Company s Vehicle Control Systems business that occurred on July 31, 2007. The Company and certain of its subsidiaries and, in light of that legal reorganization, certain of WABCO s subsidiaries will be jointly and severally liable for any fines that result from the investigation. However, pursuant to an Indemnification and Cooperation Agreement among the Company and certain other parties (the Indemnification Agreement), American Standard Europe BVBA (renamed WABCO Europe BVBA) (ASE), which is a subsidiary of WABCO following the reorganization, will be responsible for, and will indemnify the Company and its subsidiaries (including certain subsidiaries formerly engaged in the Bath and Kitchen business) and their respective affiliates against, any fines related to this investigation. The Company and the charged subsidiaries responded to the European Commission on August 1, 2007 and July 31, 2007, respectively. A hearing with the European Commission regarding the response to the Statement of Objections was conducted from November 12-14, 2007, in Brussels. ASE and other former Company subsidiaries participated in the hearing. The Company, however, did not participate in the hearing.

In 2006, the European Commission adopted new fining guidelines (the 2006 Guidelines) and stated its intention to apply these guidelines in all cases in which a Statement of Objections is issued after September 2006. In applying the 2006 Guidelines, the Commission retains considerable discretion in calculating the fine although the European Union regulations provide for a cap on the maximum fine equal to ten percent of the parent company s (*i.e*., the Company s) worldwide revenue attributable to all of its products for the fiscal year prior to the year in which the fine is imposed. If the maximum fine is levied in 2008, the total liability could be approximately $1.1 billion based on the Company s worldwide revenue in 2007, subject to a probable reduction for leniency of at least 20 percent provided ASE, as the leniency applicant, fulfilled all conditions set forth in the European Commission s leniency notice. The Company is confident in ASE s ability to satisfy its obligations under the Indemnification Agreement because WABCO s capital structure includes sufficient funds available under its existing credit facilities and only a minimal amount of debt at December 31, 2007.

Bath and Kitchen Fixtures Antitrust Litigation and U.S. Department of Justice Competition Investigations

On February 23, 2005, the Company received a grand jury subpoena from the Antitrust Division of the U.S. Department of Justice seeking information primarily related to the sale and marketing of bathroom fittings by its European affiliates from January 1997 to the present. Because the Company has not been accused of any wrong-doing in this investigation, which is ongoing, the Company is unable to reasonably estimate the loss or range of loss that may result from it. The Company has cooperated fully with this investigation which has been dormant for over two years.

Also, in February 2005, the Company was named as a defendant in several lawsuits filed in the United States District Court for the Eastern District of Pennsylvania alleging that the Company and certain of its competitors conspired to fix prices for fittings and fixtures in the U.S. The federal cases were subsequently consolidated, and in June 2005 the plaintiffs filed an amended complaint in the federal action alleging that the Company conspired to fix prices for fixtures in the U.S. The amended complaint deleted reference to fittings and identified a somewhat different group of alleged co-conspirators as co-defendants. On September 22, 2005, the Company filed a motion to dismiss the complaint in the federal action, which was argued before the trial court on January 26, 2006. The other defendants in the federal action also filed motions to dismiss. On January 24, 2007, the trial judge granted the defendants motion for entry of judgment in favor of the defendants, dismissing the consolidated amended complaint with prejudice, and on February 20, 2007, the plaintiffs filed a Notice of Appeal of the trial judge s order. Oral arguments in the appeal were held on January 28, 2008. While the Company cannot predict the outcome of this appeal with certainty, the Company believes that the plaintiffs underlying claims in this lawsuit were entirely without merit.

P.T. Tatasolusi Pratama Litigation

On or about June 5, 2007, the former distributor of Trane commercial products in Indonesia, PT Tatasolusi Pratama (TSP), filed suit in the South Jakarta District Court against the Company and four of the Company s subsidiaries. The complaint alleges that the Company and its affiliates wrongfully terminated TSP s alleged exclusive distributorship and appointed a subsidiary of the Company, defendant PT Trane Indonesia, as the new distributor. The complaint also alleges that the Company and its affiliates unlawfully acquired TSP s customers. Finally, the complaint alleges that the Company and one of its subsidiaries violated a 1990 shareholder agreement and supplemental documents with TSP and its Singapore parent, Solutions Pte., by failing to form a business entity in Indonesia to market Trane products. In total, the complaint seeks approximately $69 million in damages. The Company and its subsidiaries intend to vigorously contest the allegations raised in the Complaint, which it believes lack merit. On October 23, 2007, the Company and two affiliates filed a Statement of Claim in the High Court of the Republic of Singapore against TSP. The Statement of Claim seeks declarations that none of the defendants has an interest in the distribution of Trane products, or any rights of any kind, arising out of the 1990 shareholder agreement and related agreements, as well as injunctions restraining the defendants from commencing and/or maintaining lawsuits in Singapore and elsewhere in relation to an interest in the distribution of Trane products, or rights of any kind, allegedly arising out of the 1990 shareholder agreement and related agreements. The grant of such an injunction would effectively prohibit TSP and Solutions Pte. from continuing to prosecute the Indonesian litigation.

Table of Contents

The Company believes that the resolution of the litigation matters described above will not have a material adverse effect on the financial position, liquidity or results of operations of the Company. The Company has not recorded a liability related to these matters.

Asbestos Litigation

Over the years, the Company has been named as a defendant in numerous lawsuits alleging various asbestos-related personal injury claims arising primarily from its historical sales of boilers and railroad brake shoes.

In these asbestos-related lawsuits, the Company is usually named as one of a large group of defendants. Many of these lawsuits involve multiple claimants, do not specifically identify the injury or disease for which damages are sought and/or do not allege a connection between any Company product and a claimed injury or disease. As a result, numerous lawsuits have been placed, and may remain on, inactive or deferred dockets, which some jurisdictions have established.

Accounting for Asbestos Liability

The Company has retained an outside consultant to assist it in calculating an estimate of the Company s total liability for pending and unasserted potential future asbestos-related claims, through 2055, which is the consultant s reasonable best estimate of the time it will take to resolve all of the Company s asbestos-related claims. The liability estimate is calculated on a pre-tax basis, is not discounted for the time value of money, and excludes legal fees which continue to be expensed by the Company as incurred. The consultant has reviewed the Company s claims data through December 31, 2007. The Company s total accrual for asbestos-related liabilities at December 31, 2007 and 2006 is $641.2 million and $665.8 million, respectively. The decrease of $24.6 million in 2007 was due primarily to claims payments made by the Company during the year.

Asbestos Claims Activity

From receipt of the first asbestos claim more than twenty years ago through December 31, 2007, the Company has resolved (by settlement or dismissal) 61,002 claims. The Company and its insurance carriers have paid settlements of approximately $109.0 million, which represents an average payment per resolved claim of $1,786. During 2007, 3,019 new claims were filed against the Company; 1,826 claims were dismissed and 740 claims were settled. At December 31, 2007, there are 105,023 open claims pending against the Company. Because claims are frequently filed and settled in large groups, the amount and timing of settlements, as well as the number of open claims, can fluctuate significantly from period to period.

Asbestos Insurance Recovery

The Company is in litigation against certain insurance carriers whose policies it believes provide coverage for asbestos claims. The insurance carriers named in this suit are challenging the Company s right to recovery. The Company filed the action in April 1999 in the Superior Court of New Jersey, Middlesex County, against various primary and lower layer excess insurance carriers, seeking coverage for environmental claims (the NJ Litigation). The NJ Litigation was later expanded to also seek coverage for asbestos related liabilities from 21 primary and lower layer excess carriers and underwriting syndicates. On September 19, 2005, the court granted the Company s motion to add 16 additional insurers and 117 new insurance policies to the NJ Litigation. The court also required the parties to submit all contested matters to mediation. The Company engaged in its first mediation session with the NJ Litigation defendants on January 18, 2006 and has engaged in active discussions since that time. During the mediation, the parties agreed to extensions of discovery deadlines and stays of discovery except for discovery necessary to facilitate the mediation process. The continued stay of discovery was confirmed by agreement at the most recent status conference with the court and the mediator, which took place on November 26, 2007.

Table of Contents

The Company estimates and records a receivable for amounts recoverable from its insurance carriers for asbestos claims that have been settled and paid, the reimbursable portion of incurred legal expenses, and the probable reimbursements relating to its estimated liability for pending and future claims. The total asbestos receivable is $342.9 million and $385.8 million at December 31, 2007 and 2006, respectively. The receivable decreased in 2007 primarily as a result of cash payments received from insurance companies of $55.5 million, partially offset by the recoverable portion of incurred legal expenses of $3.5 million and favorable settlements not yet recovered of $9.1 million. Please see Note 15 of Notes to Consolidated Financial Statements for a discussion of the methodology used to calculate the receivable and the factors considered in concluding that the insurance receivable, including amounts in litigation, is probable of recovery.

With the addition of the parties and policies referred to above, the NJ Litigation would resolve the coverage issues with respect to approximately 94 percent of the recorded receivable. The remaining six percent of the recorded receivable relates to policies for which the Company has not sought resolution of coverage because such policies were issued by parties whose coverage obligations are triggered at higher excess layers that are not expected to be reached in the near future. At December 31, 2007, 92 percent of the insurance recovery receivable is with carriers rated A or better by AM Best. This percentage excludes amounts that have been settled but not yet collected.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of the Company s shareholders during the fourth quarter of 2007.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The common stock of the Company is listed on the NYSE under the symbol TT. Prior to the completion of the Company s separation plan, the common stock of the Company was listed on the NYSE under the symbol ASD. Following receipt of shareholder approval, American Standard Companies Inc. changed its name to Trane Inc. on November 28, 2007 and began trading on the NYSE under the symbol TT.

The Company s Restated Certificate of Incorporation, as amended, authorizes the Company to issue up to 560,000,000 shares of common stock, par value $.01 per share, and 2,000,000 shares of preferred stock, par value $.01 per share, of which the Board of Directors designated 900,000 shares as a new series of Junior Participating Cumulative Preferred Stock. The Company also has a Rights Agreement. Each outstanding share of common stock has associated with it one right to purchase a specified amount of Junior Participating Cumulative Preferred Stock at a stipulated price in certain circumstances relating to changes in ownership of the common stock of the Company.

As of January 25, 2008, there were 738 holders of record of the Company s common stock. A significant number of the outstanding shares of common stock which are beneficially owned by individuals or entities are registered in the name of a nominee of The Depository Trust Company, a securities depository for banks and brokerage firms. The Company believes that there are approximately 39,200 beneficial owners of its common stock as of January 25, 2008.

The Company paid its first dividend in March 2005. The Company declared dividends of $135.8 million and $144.8 million in 2007 and 2006, respectively, on its common stock. On February 7, 2008, the Board of Directors declared a first quarter 2008 dividend of $0.16 per common share. Under the merger agreement, Trane has agreed to coordinate with Ingersoll Rand regarding the declaration of any dividends with respect to Trane common stock to ensure that the Trane shareholders will not receive more than one dividend, or fail to receive a dividend, for any single calendar quarter on their shares of Trane common stock (or Ingersoll Rand Class A common shares received in exchange therefore in the merger).

Set forth below are the high and low sales prices for shares of the Company s common stock and dividends paid for each quarterly period in 2006 and 2007.

2006	**High**	**Low**	**Dividends**
First quarter	$ 43.70	$ 35.01	$ 0.18
Second quarter	$ 47.14	$ 38.57	$ 0.18
Third quarter	$ 44.14	$ 37.71	$ 0.18
Fourth quarter	$ 46.81	$ 41.59	$ 0.18
2007			
First quarter	$ 55.30	$ 45.21	$ 0.18
Second quarter	$ 61.23	$ 51.76	$ 0.18
Third quarter(1)	$ 63.74	$ 32.35	$ 0.16
Fourth quarter	$ 46.74	$ 32.09	$ 0.16

(1) As part of the planned separation announced on February 1, 2007, Trane entered into an agreement to sell its former Bath and Kitchen business on July 23, 2007 (which sale was subsequently completed on October 31, 2007) and completed the spinoff of its former Vehicle Controls Systems business, known as WABCO on July 31, 2007. The market prices for Trane s shares of common stock provided in the table above include the value of the Bath and Kitchen business and Vehicle Control Systems business through the date of the announced sale and spinoff. The spinoff of WABCO was effected through a dividend of all WABCO

Table of Contents

common stock to holders of Trane common stock, in which holders of Trane common stock received one share of WABCO common stock for every three shares of Trane common stock owned. On July 31, 2007, the last trading day prior to the completion of the spinoff of WABCO, the closing price per share of Trane common stock was $54.05. On August 1, 2007, the first trading day after the completion of the spinoff of WABCO, the closing price per share of Trane common stock was $37.99 and the closing price per share of WABCO common stock was $49.00. As a result of the one-for-three ratio used in the spinoff, on the close of business on August 1, 2007, the first trading day after the completion of the spinoff of WABCO, the per share combined value of Trane common stock and WABCO common stock was $54.32.

On October 31, 2007, the Company s Board of Directors approved an additional $750.0 million to purchase shares of the Company s common stock in the open market. As of December 31, 2007, the unexpended authorization on the current program totaled $750.0 million. As of December 31, 2007, the unexpended authorization on prior repurchase programs totaled $54.1 million. A summary of the repurchase activity for 2007 follows. Under the merger agreement with Ingersoll Rand, the Company is restricted from repurchasing shares. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources for a description of the Company s stock repurchase program.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	**Total Number of Shares Purchased**	**Average Price Paid per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**	**Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs**
Total first quarter				$ 512,453,645
Total second quarter				$ 512,453,645
July 1 July 31				$ 512,453,645
August 1 August 31	9,241,300	$ 36.16	9,241,300	$ 178,296,786
September 1 September 30	3,476,800	$ 35.71	3,476,800	$ 54,124,808
Total third quarter	12,718,100	$ 36.04	12,718,100	
Total fourth quarter				
Total through December 31	12,718,100[(a)]	$ 36.04	12,718,100	$ 804,124,808

(a) All share repurchases were effected in accordance with the Safe Harbor Provisions of Rule 10b-18 of the Securities Exchange Act of 1934, as amended.

Table of Contents

PERFORMANCE GRAPH

The following graph and table compare the cumulative total shareholder return on the Company s common stock from December 31, 2002 through December 31, 2007, with the Standard & Poor s 500 Index and the Standard & Poor s Building Products Index, both of which include the Company. On July 31, 2007, the Company completed the spinoff of its Vehicle Control Systems business into an independent publicly traded company called WABCO Holdings Inc. For purposes of calculating the cumulative total shareholder returns on the Company s common stock, the spinoff of the Vehicle Control Systems business has been treated as a dividend of $16.03 per share of the Company s common stock (representing the value paid to the Company s shareholders on the date of the spinoff). The table and graph use data supplied by the Compustat Services unit of Standard & Poor s Corporation. The comparisons reflected in the graph and table are not intended to forecast the future performance of the common stock and may not be indicative of such future performance. The graph and table assume an investment of $100 in the common stock and each index on December 31, 2002 and the reinvestment of all dividends.

Total Shareholder Returns

	Dec 02	Dec 03	Dec 04	Dec 05	Dec 06	Dec 07
Trane Inc.	100.00	141.55	174.25	170.84	199.45	295.69
S&P 500 Index	100.00	128.68	142.69	149.70	173.34	182.86
S&P Building Products	100.00	136.51	179.07	160.19	171.88	173.52

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

(In millions, except per share data)	Year Ended December 31, 2007	2006	2005	2004	2003
Income Statement Data:					
Sales	**$ 7,449.6**	$ 6,758.1	$ 6,014.7	$ 5,345.5	$ 4,974.6
Cost of sales	**5,331.9**	4,796.1	4,308.9	3,872.5	3,778.1
Selling and administrative expenses	**1,400.2**	1,312.0	1,191.2	1,070.8	791.9
Operating income	**717.5**	650.0	514.6	402.2	404.6
Other (income) expense[a]	**5.5**	(8.2)	(13.5)	(10.0)	10.6
Asbestos indemnity, net of recoveries [b]				320.2	10.0
Interest expense	**109.6**	114.6	113.3	106.2	108.1
Income (loss) from continuing operations before income taxes[c]	**602.4**	543.6	414.8	(14.2)	275.9
Income tax expense (benefit)[c]	**202.2**	157.7	95.6	(11.7)	62.3
Income (loss) from continuing operations[c]	**$ 400.2**	$ 385.9	$ 319.2	$ (2.5)	$ 213.6
Per Share Data:					
Income (loss) from continuing operations					
Basic	**$ 2.01**	$ 1.91	$ 1.51	$ (0.01)	$ 0.99
Diluted	**$ 1.96**	$ 1.87	$ 1.47	$ (0.01)	$ 0.97
Weighted-average common shares outstanding:					
Basic	**199.0**	201.7	211.3	214.8	216.8
Diluted	**204.5**	206.3	217.0	220.6	221.2
Balance Sheet Data (at end of period):					
Total assets	**$ 5,097.3**	$ 7,422.5	$ 6,867.8	$ 6,841.8	$ 5,878.7
Total debt	**$ 1,059.5**	$ 1,715.4	$ 1,696.2	$ 1,507.9	$ 1,679.1
Cash dividends per common share	**$ 0.68**	$ 0.72	$ 0.60	$	$

In 2007, the Company completed the spinoff of its Vehicle Control Systems business and sold its Bath and Kitchen business. Accordingly, the operating results of these two businesses are reported as discontinued operations for all periods.

(a) In 2007, other (income) expense includes separation and merger advisory fees of $10.0 million ($8.0 million after tax, or $0.04 per diluted share), primarily related to the planned merger with Ingersoll Rand. Other (income) expense from continuing operations in 2006 also included a gain of $15.4 million ($13.8 million, after tax, $.07 per diluted share) related to the sale of operations in Australia.

(b) In the fourth quarter of 2004, the Company recorded a $307 million ($188 million, net of tax benefit, or $0.85 per diluted share) charge covering estimated net payments for pending and future asbestos-related claims. For a detailed description of the asbestos indemnity matter, see Note 15 of Notes to Consolidated Financial Statements.

(c) In 2007, income from continuing operations includes $2.6 million ($2.0 million after tax, or $0.01 per diluted share) of expenses related to operational consolidation expenses, primarily for the elimination of 25 jobs and other charges associated with plans initiated throughout 2007 to streamline manufacturing and administrative processes. Income taxes include a tax benefit of $0.6 million related to those expenses. The income tax provision included net tax benefits of $4.5 million ($0.02 per diluted share), which includes benefits associated with foreign audit settlements, the expiration of statute of limitations and adjustments of the 2006 tax provision to the final filed tax returns. The combined effect of the net tax benefits that occurred in 2007, together with other ongoing tax planning activities, resulted in an effective income tax rate of 33.6 percent for the year. In 2006, income from continuing operations includes $2.1 million ($1.4 million after tax, or $0.01 per diluted share) of expenses related to operational consolidation expenses, primarily for the elimination of 42 jobs and other charges associated with plans initiated throughout 2006 to streamline manufacturing and administrative processes. Income taxes include a tax benefit of $0.7 million related to those expenses. The income tax provision included $19.9 million of benefits ($0.10 per diluted share) during 2006 primarily related to the reduction of a tax contingency as a result of an expiring statute of limitations in a jurisdiction outside the United States and amounts principally related to adjustments to the 2005 tax provision to agree to the final 2005 tax returns. The combined effect of the tax benefits that occurred in 2006, together with other ongoing tax planning activities, resulted in an effective income tax rate of 29.0 percent for the year. In 2005, income from continuing operations includes $25.8 million ($17.5 million after tax, or $.08 per diluted share) of expenses related to operational consolidation expenses, primarily for the elimination of 458 jobs and other charges associated with plans initiated throughout 2005 to streamline manufacturing and administrative processes as well as a facility shut down. Income taxes include a tax benefit of $8.3 million related to those expenses. The income tax provision for 2005 also included benefits of $53.1 million ($0.24 per diluted share) from the resolution of tax audits and adjustments of the 2004 tax provision to the final filed tax returns. The combined effect of the tax benefits that occurred in 2005, together with other ongoing tax planning activities, reduced the effective income tax rate to 23.0 percent for the year. In 2004, income from continuing operations includes $7.7 million ($4.9 million after tax, or $0.02 per diluted share) of expenses related to operational consolidation expenses, which included the elimination of 205 jobs during 2004. Income taxes include a tax benefit of $2.8 million related to those expenses. Income taxes in 2004 include a $6.4 million tax benefit ($0.03 per diluted share) from the resolution of tax audits, and a reduction in withholding tax liabilities resulting from the decision not to distribute earnings of certain foreign subsidiaries. In 2003 income from continuing operations include expenses of $8.4 million ($5.4 million after tax, or $0.02 per diluted share) that included the elimination of 234 jobs. Income taxes include a tax benefit of $3.0 million related to those expenses. Income taxes in 2003 include a $19.6 million tax benefit ($0.09 per diluted share) principally because of the resolution of audits and approval of claims for research and development tax credits. Please refer to the Overview section of Item 7.   Management s Discussion and Analysis of Financial Condition and Results of Operations for additional information.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Executive Overview

Separation

On February 1, 2007, Trane (then known as American Standard Companies Inc.) announced that its Board of Directors had completed a strategic review of the Company and unanimously approved a plan to separate its three businesses during 2007. The announced separation included a plan to spin off Trane s Vehicle Control Systems business and to sell its Bath and Kitchen business, with Trane retaining and focusing on its global HVAC business. The Board of Directors had concluded that separating the three businesses would create greater shareholder value than the existing company structure and provide the separated companies with substantial opportunities and benefits allowing them to more effectively operate their respective businesses, including providing the separated companies with increased strategic focus, enhanced opportunities for growth, increased market recognition, improved capital flexibility and increased ability to attract, retain and motivate employees.

On July 12, 2007, the Board of Directors of Trane approved the spinoff of the Vehicle Control Systems business into a new publicly traded company named WABCO. The spinoff of WABCO was completed on July 31, 2007 and WABCO began trading thereafter as an independent company on the NYSE under the ticker symbol WBC.

On July 23, 2007, the Company entered into an agreement to sell its Bath and Kitchen business to affiliates of Bain Capital Partners, LLC. The sale was completed on October 31, 2007 for approximately $1.745 billion, after closing adjustments but subject to certain post-closing adjustments. Combined with the proceeds received by Trane from the sale of its Venesta Washroom Systems business (which was formerly part of the Bath and Kitchen business) in March 2007, the Company s gross proceeds from the sale of the Bath and Kitchen business totaled approximately $1.91 billion. A portion of the proceeds from the sale of Bath and Kitchen, after expenses and taxes, was used to reduce debt.

In accordance with Statement of Financial Accounting Standard No. 144 (FAS 144), the Vehicle Control Systems and Bath and Kitchen businesses have been reported as discontinued operations for all periods presented.

Upon completion of the spinoff of the Vehicle Control Systems business and the sale of the Bath and Kitchen business, the Company s operations consist of its Air Conditioning Systems and Services business, which manufactures, sells and services commercial and residential HVAC equipment systems and controls. Following receipt of shareholder approval, American Standard Companies Inc. changed its name to Trane Inc. on November 28, 2007 and began trading on the NYSE under the ticker symbol TT.

Merger Agreement with Ingersoll Rand

On December 17, 2007, the Company announced that on December 15, 2007, it had entered into an agreement and plan of merger with Ingersoll-Rand Company Limited (Ingersoll Rand) and Indian Merger Sub, Inc., a wholly-owned subsidiary of Ingersoll Rand (Merger Sub), providing for the acquisition of the Company by Ingersoll Rand, a publicly traded company on the NYSE. Subject to the terms and conditions of the merger agreement, Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation and a wholly-owned subsidiary of Ingersoll Rand. At the effective time of the merger, each outstanding share of common stock of the Company, other than shares owned by the Company or Ingersoll Rand and any dissenting shares, will be converted into the right to receive a combination of (i) 0.23 (the Exchange Ratio) of a share of Ingersoll Rand Class A common stock and (ii) $36.50 in cash (the Cash Consideration), without interest. Under the merger agreement, in the event that the Company or Ingersoll Rand reasonably determines in good faith that it is necessary to do so, in order to complete the merger without a vote of Ingersoll Rand shareholders, the Cash Consideration may be increased by an amount up to $1.00 per share (with a corresponding reduction to the Exchange Ratio). The merger is subject to customary closing conditions, including the approval of the Company s shareholders and the receipt of certain required antitrust approvals and clearances. The Company received the necessary antitrust approvals under the Hart-Scott-Rodino Act on January 31, 2008. The Company currently anticipates that the merger will be completed in the second calendar quarter of 2008.

Table of Contents

Business

Trane provides systems and services that enhance the quality and comfort of the air in homes and buildings around the world. The Company offers customers a broad range of energy-efficient HVAC systems; dehumidifying and air cleaning products; service and parts support; advanced building controls and solutions. The Company s systems and services have strong market positions in premium commercial, residential, institutional and industrial markets; a reputation for reliability, high quality and product innovation; and a broad distribution network. Company management analyzes the performance of the business using the following general framework and describes the performance of the business in this context throughout the remainder of this discussion and analysis of financial condition and results of operations.

Sales The Company analyzes its sales activity based on the impacts of its pricing initiatives and the volume and mix of its products. The realization of price increases and the execution of the strategy to improve sales mix to more profitable new products are important to the Company in order to offset commodity and other cost escalations and grow profitability.

Productivity The Company identifies the impact of key productivity programs in the areas of materials procurement, Six Sigma Lean and labor.

Commodities The Company s business uses commodities such as steel, copper and aluminum in the manufacturing process. The Company seeks to understand the impact of changing costs for these commodities on its performance.

Investments The Company analyzes its ongoing costs for new products in its business and its investments in sales and marketing programs in support of sales growth. Investments in new products are important to sustaining organic growth and to improve the mix of products through innovation and new product launches.

Financial Performance Overview

Overview

Income from continuing operations increased by $14.3 million to $400.2 million for the year ended December 31, 2007 from $385.9 million for the year ended December 31, 2006 due to increased sales and income from commercial air conditioning equipment and services, which more than offset lower sales and income of residential air conditioning systems. The strength in performance of commercial air conditioning equipment and services lessened the impact of continued weakness in residential equipment sales and income performance, which has been impacted by weak residential home construction, lower replacement rates in the remodeling and renovation market and warranty costs including the recall of the Company s whole house air cleaning systems. Income from continuing operations per diluted share for the year ended December 31, 2007 was $1.96 as compared to $1.87 for the year ended December 31, 2006. Income from continuing operations in 2007 includes $10.0 million ($8.0 million after tax) of separation costs and merger advisory fees, primarily related to the planned merger with Ingersoll Rand; whereas 2006 includes a $15.4 million gain ($13.8 million after tax) associated with the sale of operations in Australia.

Income from continuing operations increased by $66.7 million to $385.9 million for the year ended December 2006 from $319.2 million for the year ended December 31, 2005 due to increased sales and income in both commercial air conditioning equipment and services and residential air conditioning. The Company s strength in performance was primarily driven by growth in the U.S. and global commercial equipment markets, which more than offset the decline in the residential unitary market. Despite the decline in the residential unitary market, residential sales and income increased due to favorable mix and price increases. In 2006, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004) (FAS123R), *Share Based payment Awards,* which required the Company to recognize as expense the fair value of share-based payment awards. The Company elected to prospectively recognize stock compensation expense and did not restate prior

Table of Contents

periods. As a result, income from continuing operations for 2006 includes expense of $25.8 million ($16.3 million net of tax). Income from continuing operations in 2006 also includes a $15.4 million gain ($13.8 million after taxes) associated with the sale of operations in Australia. Income from continuing operations per diluted share for the year ended December 31, 2006 was $1.87 as compared to $1.47 for the year ended December 31, 2005.

Following is a table showing the percentage of total sales for the Company by market and geographic distribution.

Distribution of Company Sales by Market and Geography

	2007	2006	2005
Commercial	**47%**	45%	44%
Parts, Services and Solutions	**29%**	28%	29%
Residential	**24%**	27%	27%
	100%	100%	100%
Replacement, Renovation and Repair	**59%**	59%	58%
Commercial New Construction	**34%**	32%	31%
Residential New Construction	**7%**	9%	11%
	100%	100%	100%
U.S.	**73%**	73%	74%
Asia	**9%**	10%	9%
Europe	**8%**	7%	7%
Other	**10%**	10%	10%
	100%	100%	100%

The following discussion and analysis of annual results of continuing operations for 2007 compared to 2006 and 2006 compared to 2005 addresses changes in sales, expenses, income from continuing operations before income taxes, income taxes and income from continuing operations. Approximately one-fourth of the Company s business is outside the U.S.; therefore, changes in exchange rates can have a significant impact on the reported results of operations when presented in U.S. dollars. Changes in sales, expenses and income from continuing operations excluding foreign exchange translation effects are calculated using current year sales, expenses and income from continuing operations translated at prior year exchange rates. Presenting changes in sales, expenses and income from continuing operations excluding the effects of foreign exchange translation is not in conformity with generally accepted accounting principles (GAAP), but management analyzes the data in this manner because it is useful to them for understanding operational performance of the business. Management also uses data adjusted in this manner for purposes of determining incentive compensation. Accordingly, management believes that presenting information in this manner is also useful to shareholders in understanding the performance of the business. The changes in sales, expenses and income from continuing operations excluding the effects of foreign exchange translation are not meant to be a substitute for measurements prepared in conformity with GAAP nor to be considered in isolation.

Table of Contents

Results of Continuing Operations for 2007 Compared with 2006

	Year Ended December 31,			Excluding Foreign Exchange Translation	
(Dollars in millions)	2007	2006	% Change Reported	2007 Adjusted Amount	% Change Adjusted
Sales	**$ 7,449.6**	$ 6,758.1	10.2%	$ 7,350.2	8.8%
Cost of sales	**5,331.9**	4,796.1	11.2%	5,260.8	9.7%
Gross profit	**2,117.7**	1,962.0	7.9%	2,089.4	6.5%
Selling and administrative expenses	**1,400.2**	1,312.0	6.7%	1,381.9	5.3%
Operating income	**717.5**	650.0	10.4%	707.5	8.8%
Other (income) expense	**5.5**	(8.2)		5.5	
Interest expense	**109.6**	114.6	(4.4)%	108.0	(5.8)%
Income from continuing operations before income taxes	**602.4**	543.6	10.8%	594.0	9.3%
Income taxes	**202.2**	157.7	28.2%	N/A	N/A
Income from continuing operations	**$ 400.2**	$ 385.9	3.7%	N/A	N/A

Sales

Sales from continuing operations increased 10.2 percent (8.8 percent excluding foreign exchange translation effects) to $7,449.6 million for the year ended December 31, 2007 from $6,758.1 million for the year ended December 31, 2006. Overall, sales benefited from price increases in both commercial and residential equipment and higher volumes in commercial systems equipment, parts, services and solutions, which offset lower volumes in residential equipment sales. Sales benefited during the year ended December 31, 2007 from price increases of approximately $229 million, volume and mix increases of approximately $364 million and favorable foreign exchange translation of approximately $99 million.

Commercial equipment sales, which represent 47 percent of total sales, increased 16.2 percent (14.0 percent excluding foreign exchange translation effects) on a global basis. Within commercial equipment, global unitary sales were up 13.6 percent (12.0 percent excluding foreign exchange translation effects), and global applied sales were up 19.1 percent (16.1 percent excluding foreign exchange translation effects). Sales increased 13.0 percent in 2007 (15.5 percent excluding foreign exchange translation effects and 2006 sales associated with operations in Australia, which were sold in the fourth quarter of 2006) in the parts, services and solutions part of the business.

The commercial equipment market in the U.S. was up an estimated 14 percent year-over-year. International markets increased in the mid to high single digits. Globally, the Company s orders were up 13 percent for the year ended December 31, 2007 as compared to December 31, 2006. In the Americas, total orders were up 16 percent, and internationally, total orders were up 6 percent for the year ended December 31, 2007. Backlog as of December 31, 2007 was $967 million, an increase of 8 percent from December 31, 2006. The increase reflected increases in commercial equipment markets in all regions. Order strength and backlog levels at the end of 2007 seem to indicate that the commercial markets will continue to support sales growth in 2008. All variances exclude the impact of foreign exchange and 2006 orders associated with operations in Australia, which was sold in the fourth quarter of 2006. The Company believes that lower residential construction will continue to adversely impact sales volumes in 2008. As a result, the Company continues to monitor its inventories in its distribution channels, which appear to have stabilized after declining during the year.

Sales of residential equipment declined 2.9 percent in 2007 when compared to the prior year. The decrease was driven by a decrease in volume, which was partially offset by mix gains and improved price. The Company

Table of Contents

experienced lower sales volumes of compressor bearing units, furnaces and air handlers. The lower volume was in line with the overall decrease in the residential market, which was impacted by a decline in new residential home construction and lower replacement rates in the remodeling and renovation market. The Company estimates that the motor bearing unit market, which includes compressor bearing units, furnaces and air handlers, declined approximately 13 percent in 2007 versus 2006. The Company also estimates that compressor bearing unit shipments for the total market were down 11 percent in 2007 versus 2006.

Gross Profit

Gross profit increased by $155.7 million (an increase of $127.4 million excluding foreign exchange translation effects) for the year ended December 31, 2007 as compared to the year ended December 31, 2006. Gross profit benefited approximately from price increases of $229 million, volume and mix increases of $114 million associated with the items mentioned in the sales discussion above and productivity improvements of $100 million, which include $92 million from material savings initiatives and $8 million from other productivity related initiatives. These improvements were partially offset by commodity and logistics cost increases of $194 million, increased warranty expenses of $48 million, which includes $16 million of warranty expense associated with the Company s whole- house air cleaning systems, labor cost escalations of $36 million and $9 million of investments in manufacturing operations.

Selling and Administrative Expenses

Operating expenses increased by $88.2 million ($69.9 million excluding foreign exchange translation effects) during the year ended December 31, 2007 as compared to 2006. The increase in operating expenses was primarily driven by incremental investments in new product development and new service offerings of $34 million, an increase of $33 million in sales related expenses due to higher sales volumes and labor cost inflation of $18 million.

Other (Income) Expense

Other expense was $5.5 million for the year ended December 31, 2007 compared to $8.2 million of income in 2006. During 2007, the company recognized $10.0 million of separation costs and merger advisory expenses primarily related to the planned merger with Ingersoll Rand. In addition, gains from the sale of assets were $11.5 million higher in 2006 primarily as a result of a $15.4 million gain recognized on the sale of the Company s operations in Australia in 2006. These items were partially offset by higher interest income of $5.5 million and higher foreign exchange gains of $3.8 million in 2007.

Interest Expense

Interest expense decreased $5.0 million to $109.6 million for the year ended December 31, 2007 as compared to $114.6 million for the year ended December 31, 2006, primarily due to lower average debt balances.

Income Taxes

The income tax provision for the year ended December 31, 2007 was $202.2 million, or 33.6 percent of pre-tax income, compared with a provision of $157.7 million, or 29.0 percent of pre-tax income for 2006. The 2007 income tax provision included net tax benefits of $4.5 million, comprised of benefits associated with foreign audit settlements, the expiration of statute of limitations and adjustments of the 2006 tax provision to the final filed tax returns, and interest. The 2006 tax provision reflected tax benefits of $19.9 million primarily related to the reduction of a tax contingency as a result of an expiring statute of limitations in a jurisdiction outside the U.S. and amounts principally related to adjustments to the 2005 tax provision to agree to the final filed tax returns.

Table of Contents

Results of Continuing Operations for 2006 Compared with 2005

	Year Ended December 31,			Excluding Foreign Exchange Translation	
(Dollars in millions)	**2006**	**2005**	**% Change Reported**	**2006 Adjusted Amount**	**% Change Adjusted**
Sales	$ 6,758.1	$ 6,014.7	12.4%	$ 6,724.9	11.8%
Cost of sales	4,796.1	4,308.9	11.3%	4,780.6	10.9%
Gross profit	1,962.0	1,705.8	15.0%	1,944.3	14.0%
Selling and administrative expenses	1,312.0	1,191.2	10.1%	1,307.8	9.8%
Operating income	650.0	514.6	26.3%	636.5	23.7%
Other income	(8.2)	(13.5)	(39.3)%	(8.2)	(39.3)%
Interest expense	114.6	113.3	1.1%	114.4	1.0%
Income from continuing operations before income taxes	543.6	414.8	31.1%	530.3	27.8%
Income taxes	157.7	95.6	65.0%	N/A	N/A
Income from continuing operations	$ 385.9	$ 319.2	20.9%	N/A	N/A

Sales

Sales from continuing operations increased 12.4 percent (11.8 percent excluding foreign exchange translation effects) to $6,758.1 million for the year ended December 31, 2006 from $6,014.7 million for the year ended December 31, 2005. Overall, sales benefited from growth in residential and commercial equipment sales and growing parts and services sales. Sales for the year benefited from price increases of $186 million and volume and mix increases of $524 million. Price increases were put in place during 2006 to offset the rising cost for commodities such as steel, copper and aluminum.

Commercial equipment sales, which represent 45 percent of total Company sales, increased 15 percent on a global basis. Within the commercial equipment segment, global unitary sales were up 15 percent and applied sales were up 16 percent. Sales increased 9 percent in the parts, services and solutions business.

The commercial equipment market in the U.S. was up an estimated 15 percent in 2006, following increases of 6 percent in 2005 and 6 percent in 2004. Globally, commercial orders were up 15 percent (excluding favorable foreign exchange translation effects) in 2006 as compared to 2005. In the U.S., total commercial orders were up 13 percent and international orders were up 19 percent.

Sales of the Company s U.S. residential products increased 11 percent in 2006 as compared with 2005. The Company estimates that the residential unitary market was down approximately 20 percent in 2006. The increase in sales was driven by improved mix and price increases (as discussed above). Favorable mix was driven by the continued increase in sales of higher efficiency 13 SEER and above models. The government mandated transition to higher efficiency technology, through its minimum 13 SEER requirement, became effective for the industry on January 23, 2006. Partially offsetting the favorable mix and price improvements was a volume decrease during 2006 from lower market unit volume. In addition, sales of furnaces were down in 2006 as compared to 2005 due to unseasonably warm weather in the U.S. The Company believes that the market decrease during 2006 was largely attributable to higher final buys of 10 SEER products in 2005 in advance of the 13 SEER transition in the first quarter of 2006 and the beginning of the residential new construction downturn.

Gross Profit

Gross profit increased by $256.2 million (an increase of $238.5 million excluding foreign exchange translation effects) for the year ended December 31, 2006 as compared to 2005. Gross profit benefited approximately from price increases of $186 million, volume and mix increases of $136 million primarily attributable to the items mentioned in the sales discussion above, productivity improvements of $78 million,

Table of Contents

$13 million less operational consolidation expenses, lower warranty expense of $11 million and $7 million of benefits from previously announced operational consolidation activities. These improvements were partially offset by commodity cost increases of $152 million and labor and other cost escalations of $29 million.

Selling and Administrative Expenses

Operating expenses for 2006 were $1,312.0 million up 10.1 percent (9.8 percent excluding unfavorable foreign exchange translation effects) as compared to $1,191.2 million for 2005. The increase in operating expense was primarily driven by incremental investments in new product development and new service offerings of $64 million, labor cost inflation of $25 million, and an increase of $9 million in sales related expenses due to higher sales volumes. In addition, selling and administrative expenses in 2006 include $32 million of compensation expense associated with expensing the fair value of share-based payment awards. Partially offsetting the 2006 cost increases were $6 million of benefits from previously announced operational consolidation activities.

Other Income

Other income for the year ended December 31, 2006 was $8.2 million compared to $13.5 million for 2005. The decrease in other income, was primarily attributable to higher foreign exchange losses of $7.3 million, higher minority interest expense of $2.9 million and higher receivable securitization losses of $3.1 million associated with the sale of more receivables. These costs were partially offset by higher gains on the sale of assets of $8.0 million. Other income in 2006 includes a $15.4 million gain from the sale of the Company s operations in Australia.

Interest Expense

Interest expense increased $1.3 million to $114.6 million in year 2006 compared with $113.3 million for 2005, primarily driven by increased average outstanding debt balances during 2006.

Income Taxes

The tax provision for the year ended December 31, 2006 was $157.7 million, or 29.0 percent of pre-tax income, compared with a provision of $95.6 million or 23.0 percent of pre-tax income for 2005. The 2006 income tax provision reflects tax benefits of $19.9 million primarily related to the reduction of a tax contingency as a result of an expiring statute of limitations in a jurisdiction outside the U.S. and amounts principally related to adjustments to the 2005 tax provision to agree to the final filed tax returns. The 2005 tax provision includes tax benefits of $53.1 million primarily related to the resolution of tax audits and amounts principally related to adjustments to the 2004 tax provision to agree to the final filed tax returns.

Financial Results Overview Discontinued Operations

During 2007, the Company completed its planned separation and, accordingly, has reported its Vehicle Control Systems and Bath and Kitchen businesses as discontinued operations for all periods presented. On March 30, 2007, the Company sold the Armitage Venesta business included in its Bath and Kitchen segment. Venesta is a leading supplier of commercial washroom solutions in both the United Kingdom and Ireland. The Company received proceeds of $165 million and recognized a pre-tax gain of $80.8 million, $56.8 million net of taxes. On October 31, 2007, the Company sold its Bath and Kitchen business to affiliates of Bain Capital Partners, LLC for $1.745 billion after closing adjustments, but subject to post-closing adjustments. The Company received proceeds of $1.693 billion which was net of a $25.7 million accelerated pension contribution and other closing payments of $26.8 million. The sale resulted in a pre-tax loss of $53.1 million, $190.1 million after taxes. The net pre-tax gain of $27.7 million resulting from these transactions has been reflected in pre-tax gain on sale of discontinued operations in the table below.

Table of Contents

The following is an analysis of changes in sales, pre-tax income and income from discontinued operations for the Bath and Kitchen and Vehicle Control Systems businesses for the years ended December 31, 2007, 2006 and 2005. The results presented below for the Vehicle Control Systems business and the Bath and Kitchen business for the year ended December 31, 2007 represent only seven and ten months, respectively, as the Company completed the spinoff of its Vehicle Controls Systems business on July 31, 2007 and the sale of its Bath and Kitchen business on October 31, 2007.

	Year Ended December 31,		
(dollars in millions)	**2007**	**2006**	**2005**
Sales:			
Bath and Kitchen	$ 2,136.7	$ 2,434.9	$ 2,418.7
Vehicle Control Systems	1,328.8	2,015.2	1,831.0
Total	$ 3,465.5	$ 4,450.1	$ 4,249.7
Pre-tax income (loss) :			
Bath and Kitchen:			
Pre-tax income (loss)	$ 18.0	$ (51.3)	$ 63.0
Pre-tax gain on sale	27.7		
Separation costs	(1.4)		
Total Bath and Kitchen	$ 44.3	$ (51.3)	$ 63.0
Vehicle Control Systems:			
Pre-tax income	$ 149.3	$ 253.9	$ 248.1
Separation costs	(45.6)		
Total Vehicle Control Systems	103.7	253.9	248.1
Total	$ 148.0	$ 202.6	$ 311.1
Income taxes:			
Bath and Kitchen	$ 185.6	$ (34.1)	$ 24.5
Vehicle Control Systems	76.3	81.6	49.5
Total	$ 261.9	$ 47.5	$ 74.0
Income (loss) discontinued operations:			
Bath and Kitchen	$ (141.3)	$ (17.2)	$ 38.5
Vehicle Control Systems	27.4	172.3	198.6
Total	$ (113.9)	$ 155.1	$ 237.1

Bath and Kitchen

Sales for 2007 were $2,136.7 million, down 12.3 percent from $2,434.9 in 2006. The Company s 2007 consolidated results of operations include only ten months of sales for Bath and Kitchen as the Company completed the sale of this business on October 31, 2007. Additionally, 2007 Bath and Kitchen sales reflect only three months of results for the Armitage Venesta business which was sold in March 2007. Sales for the Armitage Venesta business were $15.4 million in 2007 as compared to $62.6 million 2006.

Sales for the year ended December 31, 2006 were $2,434.9 million, up 0.7 percent when compared to sales for the year ended December 31, 2005. Sales remained relatively consistent year over year due to increased sales in Europe and Asia, which offset the decrease in sales in the Americas. Sales in the Americas were unfavorably impacted by inventory controls at major customers and lower fittings sales as the business continued its launch of new products in this category.

Table of Contents

Pre-tax income was $44.3 million for the year ended December 31, 2007 as compared to a loss of $51.3 million in 2006. Pre-tax income for 2007 includes a net gain of $27.7 million related to the sale of the Armitage Venesta and Bath and Kitchen businesses as well as a benefit of $65.9 million associated with ceasing to depreciate and amortize long-lived assets that were classified as held for sale beginning in the first quarter of 2007. Pre-tax income for 2006 includes approximately $21.3 million of income from the Armitage Venesta business. These amounts were partially offset by $25.2 million of additional operational consolidation expenses in 2007 as compared to 2006.

The 2007 income tax provision was $185.6 million as compared to a benefit of $34.1 million in 2006. The 2007 income tax provision reflects $161.0 million of tax expense associated with the sale of the Armitage Venesta and Bath and Kitchen businesses and $37.9 million of tax costs associated with the legal reorganization of the Company incurred in connection with its separation plan.

The Bath and Kitchen business recognized a pre-tax loss of $51.3 million for the year ended December 31, 2006 as compared to pre-tax income of $63.0 million in 2005. The decrease in pre-tax income during 2006 included unfavorable volume and mix of $50 million, $68 million of commodity and logistics cost increases primarily natural gas and fuel costs, net productivity decreases of $22 million, labor cost escalations and other operating cost increases of $33 million, increased operational consolidation expenses of $21.7 million and investments in marketing and new products of approximately $9.0 million. These items were partially offset by $58 million in price gains and the benefits of previously announced operational consolidation programs of $31 million.

The tax provision for the year ended December 31, 2006 was a benefit of $34.1 million as compared to expense of $24.5 million in 2005. The benefit of $34.1 million reflects the Bath and Kitchen business pre-tax loss of $51.3 million in 2006 as compared to pre-tax income of $63.0 million in 2005.

Vehicle Control Systems

Sales for 2007 were $1,328.8 million, down 34.1 percent from $2,015.2 million in 2006. The Company s 2007 consolidated results of operations include only seven months of sales for Vehicle Control Systems as the Company completed the spinoff of this business on July 31, 2007.

Sales for the year ended December 31, 2006 were $2,015.2 million, up 10.1 percent when compared to 2005. The increase was attributable primarily to increased bus and truck production in most markets, and expanded content per vehicle, including new applications. The growth was strong in the original equipment manufacturer (OEM) and aftermarket businesses. This increase was partially offset by approximately $41.0 million of price decreases during the year. The adverse impact from price decreases was more than offset by market growth and by improved aftermarket sales, which increased 12 percent. Sales in Europe, the largest market, increased 10.9 percent in 2006. Sales increased 2.7 percent in North America, underperforming a market that increased an estimated 9 percent due to the effects of discontinued passenger car platforms. In Asia and Latin America, Vehicle Control Systems sales increased 15.6 percent and 2.9 percent, respectively. Sales growth in Asia was consistent with market growth in that region, which was approximately 14 percent for the year and sales in Latin America were negatively impacted by the slowing of the markets in that region during 2006.

Pre-tax income was $103.7 million for 2007 as compared to $253.9 million for 2006. Pre-tax income for 2007 includes $45.6 million of separation costs.

The 2007 income tax provision was $76.3 million as compared to $81.6 million in 2006. The 2007 income tax provision includes $55.7 million of tax costs associated with the legal reorganization of the Company incurred in connection with its separation plan.

Pre-tax income was $253.9 million for the year ended December 31, 2006 as compared to $248.1 million in 2005. Pre-tax income for 2006 benefited from volume and mix increases of $48 million, productivity improvements of $57.0 million and benefits from previously announced operational consolidation programs of

Table of Contents

$7.0 million. These improvements were partially offset by price decreases of $41 million, commodity cost increases of $27.0 million, labor cost escalations of $13.0 million, unfavorable foreign exchange translation effects of $13.0 million and $10.0 million of increased warranty expenses.

The 2006 income tax provision was $81.6 million as compared to $49.5 million in 2005. The 2006 income tax provision was higher than 2005 primarily due to higher pre-tax income as discussed above.

Liquidity and Capital Resources

Net cash provided by operating activities was $669.2 million for 2007. This compared with net cash provided by operating activities of $442.9 million for 2006. Contributing to the improvement was the receipt of $64.9 million from an asbestos-related insurance settlement. In addition, the Company had higher net income as compared to 2006, better inventory management and improved accounts payable terms. Net cash provided by operating activities was $442.9 million for 2006 as compared to $488.5 million for 2005. Net income in 2006 increased as compared to 2005. This benefit was offset by increased working capital in 2006 as compared to 2005. Working capital increased $307.3 million as compared to $7.9 million in 2005. The working capital increases were impacted by the timing of receivable collections in 2006 and higher inventory balances in 2006 partially to meet commercial backlog levels and partially because residential equipment sales were lower than expected.

The Company generated free cash flow of $500.2 million during 2007 as compared to $283.2 million in 2006. The increase in free cash flow in 2007 was attributable principally to the reasons mentioned above. Management uses free cash flow when reviewing and assessing the performance of the business. Free cash flow is also one of several measures used to determine incentive compensation. The following table reconciles free cash flow to cash flows provided by operating activities.

	Year ended December 31,		
	2007	**2006**	**2005**
Net cash provided by operating activities	**$ 669.2**	$ 442.9	$ 488.5
Adjustments to reconcile to free cash flow:			
Purchases of property, plant, equipment and computer software	**(169.0)**	(159.7)	(182.8)
Proceeds from disposal of property			20.5
Free cash flow	**$ 500.2**	$ 283.2	$ 326.2

The presentation of free cash flow is not in conformity with GAAP. This measure may not be comparable to similar measures of other companies as not all companies calculate this measure in the same manner. In addition, the presentation of free cash flow is not meant to be a substitute for measurements prepared in conformity with GAAP, nor to be considered in isolation. Cash flow from operating activities is the most directly comparable GAAP measure to free cash flow. Free cash flow is also one of several measures used to determine incentive compensation.

In investing activities, the Company made capital expenditures of $169.0 million during 2007, including $142.8 million on plant and equipment and $26.2 million in computer software. This compared with capital expenditures of $159.7 million in 2006, including $134.4 million on plant and equipment and $25.3 million on computer software. The increase in capital expenditures is primarily related to increased investments associated with new products. Investing activities in 2007 included $11.8 million of investments in affiliated companies as compared to $0.2 million during 2006. Investing activities in 2007 include the proceeds from the sale of the Company s Bath and Kitchen business which was completed on October 31, 2007 for $1.745 billion, after closing adjustments but subject to post-closing adjustments. On October 31, 2007, the Company received proceeds of $1.693 billion which was net of a $25.7 million accelerated pension contribution and other closing payments of $26.8 million. In addition, subsidiaries of Bath and Kitchen retained $88.4 million of cash upon the sale. Combined with the proceeds received by Trane from the sale of the Venesta Washroom Systems business (which was formerly a part of the Bath and Kitchen business) in March 2007, Trane s net proceeds from the sale of the Bath and Kitchen business totaled approximately $1.86 billion. Investing activities in 2007 includes $6.8 million of additional proceeds associated with the 2006 sale of operations in Australia. In 2006, the Company made capital expenditures of $159.7 million, including $134.4 million on plant and equipment and $25.3 million on computer software. This compared with capital expenditures of $182.8 million in 2005, including $160.0 million on plant and equipment and $22.8 million in computer software. Capital expenditures in 2005 reflected expenditures to address the government mandated transition to 13 SEER minimum energy efficiency standards. Proceeds from disposals of property, plant and equipment in 2006 included $25.1 million of proceeds received from the sale of operations in Australia.

The excess of cash provided by operating and investing activities during 2007 totaled $2,264.7 million and financing activities used $1,605.2 million. The cash generated by operating and investing activities funded in part net debt repayments of $(627.3) million, dividend payments of $135.8 million and share repurchases of $458.2 million. The debt repayments reflected the deployment of a portion of the proceeds received during the year from the sale of the Bath and Kitchen and Venesta businesses. The net effect of all operating, investing and financing activities for 2007 was an increase in cash and cash equivalents of $669.6 million. The excess of cash provided by operating and investing activities during 2006 totaled $312.0 million and financing activities used $405.4 million. The cash generated by operating and investing activities funded in part dividend payments and share repurchases totaling $144.8 million and $450.0 million, respectively. Financing activities during 2006 included proceeds realized from the exercise of stock options of $45.7 million. The net effect of all operating, investing and financing activities for 2006 was a decrease in cash and cash equivalents of $85.9 million.

The Company expects to draw on its cash balances and use cash generated from operating activities to pay dividends to its shareholders and to meet its financing requirements, including the repayment of maturing debt. The Company believes that the combination of available cash, projected cash generation from operations and credit lines in place will be sufficient to meet operating needs and liquidity requirements. On February 1, 2008, the Company repaid the outstanding balance of $318.4 million on its 7 $^{3}/8$ percent senior notes. On February 7, 2008, the Company s Board of Directors approved a quarterly dividend of $0.16 per share of common stock. The dividend will be paid on March 20, 2008 to shareholders of record on March 3, 2008. Under the merger agreement, Trane has agreed to coordinate with Ingersoll Rand regarding the declaration of any dividends with respect to Trane common stock to ensure that the Trane shareholders will not receive more than one dividend, or fail to receive a dividend for any single calendar quarter on their shares of Trane common stock (or Ingersoll Rand Class A common shares received in exchange therefor in the merger).

On October 31, 2007, the Company s Board of Directors approved an additional $750 million to purchase shares of the Company s common stock in the open market. As of December 31, 2007, the unexpended authorization under the Company s current and prior share repurchase programs was $804.1 million. There have been no additional repurchases since September 28, 2007 and the Company is prohibited under the terms of the merger agreement with Ingersoll Rand from effecting further repurchases.

On May 31, 2007, the Company replaced its primary bank credit agreement and various other 364-day credit facilities with two new credit agreements that provide the Company and certain subsidiaries (the Borrowers) with senior unsecured revolving credit facilities, aggregating $1.5 billion, available to all Borrowers as follows: (a) a five year, $1 billion multi-currency revolving credit facility expiring in 2012 of which up to $250 million may be used for issuing letters of credit and up to $100 million for same-day, short-term borrowings, and (b) a 364-day, $500 million multi-currency revolving credit facility, of which up to $75 million can be used for same-day, short-term borrowings. The 364-day facility has an option to renew for an additional 364 days. In addition, the Company, through a foreign subsidiary, continues to maintain a $50.0 million 364-day facility to support operations in Canada (the Canadian Facility).

Under the five-year facility, the Company pays a facility fee of 0.125 percent per annum. Borrowings thereunder bear interest generally at the London Interbank Offered Rate (LIBOR) plus a spread of 0.425 percent for usage less than or at 50 percent and a spread of 0.475 percent for usage over 50 percent. The Company also pays a fee of 0.425 percent per annum plus issuance fees for letters of credit.

Table of Contents

Under the 364-day facility, the Company pays a facility fee of 0.10 percent per annum. Borrowings thereunder bear interest generally at the LIBOR plus a spread of 0.45 percent for usage less than or at 50 percent and a spread of 0.50 percent for usage over 50 percent.

The LIBOR spreads for both the five-year facility and the 364-day facility are subject to adjustments should the Company s debt ratings change. Under the primary credit agreements, the Company, Trane U.S. and Trane International Inc. guarantee the debt obligations.

The primary credit agreements contain various covenants that limit, among other things, liens, transactions, subsidiary indebtedness, and certain mergers and sales of assets. The covenants also require the Company to meet certain financial tests: ratio of consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA), the ratio of consolidated EBITDA to consolidated interest expense and a liquidity test. The Company is currently in compliance with the covenants contained in the credit agreements.

At December 31, 2007, the Company s total indebtedness was $1,059.5 million. Annual scheduled debt maturities of long-term debt were $343.8 million, $222.6 million, $263.0 million, $1.7 million and $0.3 million for the years 2008 through 2012, respectively and $199.6 million thereafter. The Company had remaining availability under its primary bank credit agreements at December 31, 2007, of $1,455.3 million after reduction of $44.7 million of outstanding letters of credit. In addition, the Company had available at December 31, 2007, $21.5 million under the Canadian facility, and $113.4 million under other facilities that can be withdrawn by the banks at any time and outstanding letters of credit issued by other banks of $109.7 million as of December 31, 2007. See Note 12 of Notes to Consolidated Financial Statements for further information.

Debt securities (Senior Notes) sold under the 1998 Shelf Registration are issued by Trane U.S. Inc. and unconditionally guaranteed by Trane Inc. and Trane International Inc. These Senior Notes cannot be redeemed prior to their maturity date.

Effective January 30, 2008, the Company terminated its 364-day $500 million multi-currency revolver and expects to terminate the Canadian facility by April 2008. The five-year facility will terminate upon completion of the Company s merger with Ingersoll Rand.

Off-Balance Sheet Arrangements

The Company employs several means to manage its liquidity and is not dependent upon any one source of funding. In addition to funds available from operating cash flows, bank credit agreements and the public debt and equity markets as described above, the Company uses two principal off-balance sheet techniques: operating leases and receivables financing arrangements. Operating leases are employed as an alternative to purchasing certain property, plant and equipment. Receivables financing arrangements are used to reduce borrowing costs. Future rental commitments under all non-cancelable operating leases in effect at December 31, 2007, totaled $444.2 million. That total represents the equivalent of approximately $372.9 million of off-balance sheet debt, discounted at an assumed rate of 5.5 percent. See the following table of aggregate contractual obligations for a summary of amounts due under operating leases.

Historically, the Company has entered into accounts receivable financing facilities (Facilities) to reduce its borrowing cost. The Company established these Facilities in Europe and the U.S. with major international banks. As part of these Facilities, the Company formed, special-purpose entities (in Europe, the ESPE; in the U.S., the USSPE; collectively, the SPEs) that are included in the consolidated financial statements of the Company for the sole purpose of buying and selling receivables generated by the Company. Under these facilities the Company irrevocably and without recourse, transfers all eligible accounts receivable to the SPEs, which in turn, sell them, or undivided ownership interests in them, to conduits administered by the banks. The assets of the SPEs are not available to pay the claims of the Company or any of its subsidiaries.

Table of Contents

The receivables sold are removed from the balance sheet since they meet the applicable criteria of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140). The Company s retained interest is recorded at fair value in the Company s Consolidated Balance Sheet. To the extent that the cash received and value of the retained interest is less than the net book value of the receivables sold, losses are recognized at the time of the sale. Those losses amounted to $9.7 million, $9.8 million and $6.7 million for the years ended December 31, 2007, 2006 and 2005, respectively, and are included in other expense. The receivables represented by the retained interest are exposed to the risk of loss for any uncollectible amounts in the pool of receivables sold under this arrangement.

The Company retains a subordinated interest in the receivables sold into the U.S. Facility of approximately 62 percent. As of September 15, 2007, the Company reduced the size of its U.S. Facility to $150 million from $200 million and due to the sale of the Bath and Kitchen business, the Company repurchased accounts receivables related to the Bath and Kitchen business that were previously sold into the U.S. asset securitization program (the U.S. Facility) for $7.7 million. The Company retains responsibilities for the collection and administration of receivables subject to this facility. The U.S. Facility is also subject to the maintenance of certain financial covenants and the Company is currently in compliance with such covenants. The U.S. Facility will require renewal in September 2008. The Company has the ability to renew this facility and expects to do so.

On August 31, 2007, the Company terminated its accounts receivable financing facility in Europe (the European Facility) due to the spinoff of the Vehicle Controls Systems business and the sale of the Bath and Kitchen business. Accounts receivables that related to the Company s Vehicle Control Systems business ceased to be sold into the European Facility as of May 31, 2007 and the Company repurchased Vehicle Control Systems accounts receivables previously sold into the European Facility for $197.2 million. On August 31, 2007, the Company repurchased the outstanding balances of Trane and Bath and Kitchen receivables sold into the European Facility for $203.5 million.

The Company has commitments and performance guarantees, including energy savings guarantees totaling $90.0 million extending from 2008 to 2027, under long-term service and maintenance contracts. Through 2007, the Company has only experienced one insignificant loss under such arrangements and considers the probability of any significant future losses to be unlikely.

Following is a summary of contractual obligations, both on and off the balance sheet as of December 31, 2007.

Aggregate Contractual Obligations

At December 31, 2007

(Millions of dollars)

		Payments Due by Period[1]			
Contractual Obligations	**Total**	**2008**	**2009 and 2010**	**2011 and 2012**	**Beyond 2012**
Long-term debt obligations (principal plus interest)[2],[3]	$ 1,188.4	$ 395.3	$ 533.2	$ 27.0	$ 232.9
Operating lease obligations[4]	444.2	108.5	152.5	102.7	80.5
Purchase obligations[5]					
Unfunded pension and post-retirement benefits[6]	362.0	42.6	66.2	68.2	185.0
Other long-term liabilities included on the balance sheet[7]	64.6	18.5	16.3	9.7	20.1
Income tax audit settlements[8]	5.3	5.3			
Total	$ 2,064.5	$ 570.2	$ 768.2	$ 207.6	$ 518.5

Table of Contents

(1) The amounts and timing of such obligations, as shown in the table may vary substantially from amounts that will actually be paid in future years. For example, the actual amount to be paid under long-term debt obligations under the Company s primary credit agreement will depend on the amount of debt outstanding under the agreement in each year.
(2) Amounts shown for long-term debt obligations include the associated interest calculated at the December 31, 2007 rates applicable to each type of debt.
(3) Obligations under capital leases are not material (approximately $2 million) and are included in long-term debt obligations.
(4) Amounts include future rental commitments under all non-cancelable operating leases in effect at December 31, 2007. The present value of the $444.2 million total is equivalent to approximately $372.9 million, discounted at an assumed rate of 5.5 percent.
(5) In the normal course of business the Company expects to purchase approximately $3.8 billion in 2008 of materials and services, and estimates that on average no more than approximately $435 million is outstanding at any one time in the form of legally binding commitments. The Company spent approximately $3.6 billion, $3.2 billion and $2.8 billion on materials and services in 2007, 2006 and 2005, respectively. The Company also expects to spend approximately $170 million on capital expenditures for plant and equipment and $35 million for purchased computer software during 2008, and estimates that no more than $50 million is committed under legally binding agreements at any one time.
(6) Amounts represent undiscounted projected benefit payments to the Company s unfunded plans over the next ten years, as well as expected contributions to funded pension plans for 2008. The expected benefit payments are estimated based on the same assumptions used to measure the Company s accumulated benefit obligation at the end of 2007 and include benefits attributable to estimated future employee service of current employees.
(7) Other long-term liabilities include amounts payable under workers compensation and general liability claims.
(8) The $5.3 million of income tax audit settlements are gross unrecognized tax benefits as determined under FASB Interpretation No. 48 (FIN 48) for which the statutes of limitations are expected to expire in 2008. Due to the uncertainty regarding the timing of future cash outflows associated with other noncurrent unrecognized tax benefits of $167.7 million, the Company is unable to make a reliable estimate of the periods of cash settlement with the respective tax authorities and have not included such amount in the above summary of commitments.

Capital Expenditures

The Company s capital expenditures for 2007 were $169.0 million (including $142.8 million on plant and equipment and $26.2 million on computer software), compared with $159.7 million for 2006 (including $134.4 million on plant and equipment and $25.3 million on computer software). Major expenditures in 2007 primarily related to increased investments associated with new products.

The Company believes capital spending in recent years has been sufficient to maintain efficient production capacity, to implement important product and process redesigns, to expand capacity to meet increased demand and to make strategic investments and acquisitions. Six Sigma projects have freed up capacity in the Company s manufacturing facilities and are expected to continue to do so. The Company expects to continue investing to expand and modernize its existing facilities and invest in its facilities to create capacity for new product development. The Company expects to make capital expenditures on plant and equipment in 2008 of approximately $170 million, excluding potential acquisitions and computer software.

Effect of Recently Issued Accounting Standards

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (FAS 141(R)), to replace FAS 141, *Business Combinations*. FAS 141(R) requires use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and broadens the scope to all transactions and other events in which one entity obtains control over one or more other businesses. This statement is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 with earlier adoption prohibited. While the Company does not expect that the adoption of FAS 141(R) to have a material impact to its consolidated financial statements for transactions completed prior to December 31, 2008, the impact of the accounting change could be material for business combinations which may be consummated subsequent thereto.

In December 2007, the FASB issued Statement of Financial Accounting Standard No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*, (FAS 160). FAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the retained interest and gain or loss when a subsidiary is deconsolidated. This statement is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 with earlier adoption prohibited. The Company is currently evaluating the impact of FAS 160 on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurement* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. FAS 157 also expands financial statement disclosures about fair value measurements. On February 12, 2008, the FASB issued FASB Staff Position (FSP) 157-b which delays the effective date of FAS 157 for one year, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FAS 157 and FSP 157-b are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has elected a partial deferral of FAS 157 under the provisions of FSP 157-b related to the measurement of fair value used when evaluating goodwill, other intangible assets and other long-lived assets for impairment and valuing asset retirement obligations and liabilities for exit or disposal activities. The impact of partially adopting FAS 157 effective January 1, 2008 is not expected to be material to the Company s consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115 (FAS 159), which permits but does not require the Company to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. As the Company has not elected to fair value any financial instruments under the provisions of FAS 159, the adoption of this statement will not have an impact on the Company s consolidated financial statements.

Critical Accounting Policies and Estimates

The Company s discussion and analysis of its financial condition and results of operations are based upon the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in conformity with those accounting principles requires management to make judgments and estimates that affect the amounts reported in the consolidated financial statements and accompanying notes. Those judgments and estimates have a significant effect on the financial statements because they result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Actual results could differ from those estimates. The Company frequently re-evaluates its judgments and estimates that are based upon historical experience and on various other assumptions that are believed to be reasonable under the circumstances.

The Company believes that of its significant accounting policies (see Note 2 of Notes to Consolidated Financial Statements), the ones that may involve a higher degree of uncertainty, judgment and complexity are revenue recognition, post-retirement benefits, warranties, income taxes, stock based compensation and commitments and contingencies. Management has reviewed the following disclosures with the Audit Committee of the Board of Directors.

Revenue Recognition Sales of manufactured products are recorded when shipment occurs and title passes to the customer. Service revenues are recorded as services are performed or over the life of the service agreement. No revenue, product or service, is recorded unless persuasive evidence of an arrangement exists with the customer, the sales price is fixed and determinable, and collectibility at the sales price is reasonably assured.

The Company derives a portion of its revenue streams from multiple-element arrangements and arrangements for the sale of air conditioning equipment and related services under construction-type contracts. Both of these sources of revenues require the application of judgment and estimates. Revenues from contracts with multiple-element arrangements, such as those that include Company products along with other third-party products, are recognized for each separate unit of accounting based on the relative fair value. Revenues associated with construction type contracts are recorded using the percentage-of-completion method. The Company recognizes revenue under percentage of completion accounting using the cost to cost method as the measure of progress. The application of percentage of completion accounting requires estimates of future revenues and contract costs over the full term of the contract. The nature of these contracts and complexity of the projects can affect the Company s ability to estimate revenues and costs expected from the project. Accordingly, the Company updates project cost estimates on a quarterly basis or more frequently, when changes in circumstances warrant. Revenues associated with contracts accounted for under the percentage of completion method of accounting amounted to approximately ten percent of total company sales in 2007 and nine percent of total company sales in 2006 and 2005.

The Company offers certain customers cooperative advertising allowances, rebates and other forms of sales incentives. The Company records cooperative advertising allowances, rebates and other forms of sales incentives as a reduction of revenue at the later of the date of the sale or the date the incentive is offered. However, where the Company receives an identifiable benefit for the consideration that is sufficiently separable from the associated sale and the Company can reasonably estimate the fair market value of the benefit received, the Company records these costs in selling and administrative expenses in its consolidated statement of income. The recognition of the cost of these forms of sales incentives requires the application of judgments and estimates. The Company analyzes its history of paying such incentives, the terms of current and past incentives, as well as management s assessment of current conditions and other facts and circumstances when recording an appropriate estimate for these items at the time of the related sale or date the incentive is offered.

Post-Retirement Benefits The Company has significant pension and post-retirement benefit costs and liabilities that are developed from actuarial valuations. Inherent in these valuations are key assumptions including discount rates, expected return on plan assets, mortality rates, merit and promotion increases and the health care cost trend rate. The Company is required to consider current market conditions, including changes in interest rates and health care costs, in making its assumptions. Changes in the related pension and post-retirement benefit costs or liabilities may occur in the future due to changes in the assumptions. The assumptions as to the expected long-term rates of return on plan assets are based upon the composition of plan assets, historical long-term rates of return on similar assets and current and expected market conditions. The discount rate used for U.S. plans reflects the market rate for high-quality fixed-income investments on the Company s annual measurement date (December 31) and is subject to change each year. The discount rate was determined by matching, on an approximate basis, the coupons and maturities for a portfolio of corporate bonds (rated Aa or better by Moody s Investor Services) to the expected plan benefit payments defined by the projected benefit obligation. The discount rates used for plans outside the U.S. are based on a combination of relevant indices regarding corporate and government securities, the duration of the liability and appropriate judgment. A decrease of one percentage point in the assumed rate of return on plan assets and a decrease of one percentage point in the discount rate applied to projected benefit obligations would increase annual pension expense by approximately $12.4 million and healthcare cost by $1.1 million. An increase of one percentage point in the assumed health care cost trend rate in each future year would increase annual health insurance costs by approximately $0.6 million. See the disclosures about pension and post-retirement obligations, the composition of plan assets, assumptions and other matters in Note 7 of Notes to Consolidated Financial Statements.

Warranties Products sold are generally covered by a warranty for periods ranging from one to ten years and for the lifetime of certain products. At the time of sale, the Company accrues a warranty reserve for estimated costs to provide equipment, parts or services to satisfy warranty obligations. The Company s estimate of costs to service its warranty obligations is based on historical experience and expectations of future conditions. To the extent the Company experiences changes in warranty claim activity or costs associated with servicing those claims, its warranty accrual is adjusted accordingly. The Company also sells extended warranty contracts for up to 10 years on some of its products. Revenues from the sale of extended warranties are deferred and amortized on a straight-line basis over the terms of the contracts or based upon historical experience. Costs to satisfy obligations under extended warranty contracts are charged to cost of sales as incurred. Warranty accrual estimates are updated based upon the most current warranty claims information available. Such changes in estimates, increased warranty expense by a net $14 million in 2007, decreased warranty expense by a net $2 million in 2006, and increased warranty expense by $3 million in 2005. See Note 15 of Notes to Consolidated Financial Statements for a three-year summary of warranty costs.

Income Taxes The Company records a valuation allowance to reduce its deferred tax assets to the amount that it believes is more likely than not to be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event the Company were to determine that it would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to decrease the net deferred tax assets would be charged to income in the period such determination was made. Likewise, should the Company determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to increase the net deferred tax assets would increase income in the period such determination was made. Deferred tax assets have been reduced by a valuation allowance of $39.1 million at December 31, 2007.

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. The first step is recognition: the Company determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the Company presumes that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company also estimates its effective income tax rate periodically, considering all known factors and the estimated effects of future events or tax planning strategies that can cause that rate to vary from the statutory rate. Estimating the outcome of future events is inherently uncertain and final resolution of those events can cause the effective rate to vary significantly. For example, income taxes in the first quarter included $1.2 million ($0.01 per diluted share) of tax expense primarily related to adjustments of tax provisions of prior years to the final filed returns; income taxes in the second quarter of 2007 included $1.7 million ($0.01 per diluted share) of tax benefits primarily associated with foreign audit settlements and the expiration of statute of limitations; income taxes in the third quarter of 2007 included tax costs of $1.9 million ($0.01 per diluted share), which included adjustments of the 2006 tax provision to the final filed tax return and income taxes in the fourth quarter included $5.9 million ($0.03 per diluted share) of tax benefits primarily related to foreign audit settlements.

Stock-Based Compensation The Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004) (FAS 123R), *Share Based Payments* on January 1, 2006. FAS 123R requires the Company to measure and recognize in its consolidated statement of income the expense associated with all share-based payment awards made to employees and directors, including stock options, restricted stock units, restricted stock grants and discounts on employee stock purchases associated with the Employee Stock Purchase Plan (ESPP) based on estimated fair values. The Company utilizes the Black-Scholes option

Table of Contents

valuation model to measure the amount of compensation expense to be recognized for each option award. There are several assumptions that must be made when using the Black-Scholes model such as the expected term of each option, the expected volatility of the stock price during the expected term of the option, the expected dividends to be paid and the risk free interest rate expected during the option term. The Company has reviewed each of these assumptions carefully and based on the analysis discussed in Note 13 of Notes to Consolidated Financial Statements determined its best estimate for these variables. Of these assumptions, the expected term of the option and expected volatility of the Company s common stock are the most difficult to estimate since they are based on the exercise behavior of employees and expected performance of the Company s stock. An increase in the volatility of the Company s stock will increase the amount of compensation expense on new awards. An increase in the holding period of options will also cause an increase in compensation expense. Dividend yields and risk-free interest rates are less difficult to estimate, but an increase in the dividend yield will cause a decrease in expense and an increase in the risk-free interest rate will increase compensation expense.

Commitments and Contingencies The Company is subject to proceedings, lawsuits and other claims related to environmental, asbestos, labor, product and other matters. The Company is required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of liability to be recorded, if any, for these contingencies is made after careful analysis of each individual issue. The liability recorded may change in the future, possibly by significant amounts, due to new developments in any of the matters.

Asbestos The Company records a liability for all asbestos claims incurred as well as claims incurred but not yet reported that are considered probable and reasonably estimable. The Company also records a receivable for probable asbestos-related insurance recoveries. Both the recorded asbestos liability and the related receivable are based upon the Company s assumptions in consultation with outside advisors. Consequently, both the recorded liability and the recorded receivable may change in the future, possibly by significant amounts, if new facts or developments require the Company to reassess such assumptions. These assumptions are described in greater detail below.

Accounting for Asbestos-related Contingencies

The Company has retained Dr. Francine F. Rabinovitz of Hamilton, Rabinovitz & Associates, Inc. (HR&A) to assist it in calculating an estimate of the Company s total liability for pending and unasserted potential future asbestos-related claims through 2055, which is the consultant s reasonable best estimate of the time it will take to resolve all of the Company s asbestos-related claims. The liability estimate is calculated on a pre-tax basis, is not discounted for the time value of money, and excludes legal fees. Dr. Rabinovitz is an expert in performing complex calculations such as this. She has been involved in a number of asbestos-relate valuations of current and future liabilities, and her valuation methodologies have been accepted by numerous courts.

The methodology used by HR&A to project the Company s total liability for pending and unasserted potential future asbestos-related claims relies upon and includes the following factors:

- HR&A s interpretation of a widely accepted forecast of the population likely to have been exposed to asbestos;
- epidemiological studies estimating the number of people likely to develop asbestos-related diseases;
- HR&A s analysis of the number of people likely to file an asbestos-related personal injury claim against the Company based on such epidemiological data and the Company s most recent five-year claims history;
- an analysis of the Company s pending cases, by type of injury claimed;
- an analysis of the Company s most recent five-year history to determine the average settlement value of claims, by type of injury claimed;

Table of Contents

- an adjustment for inflation in the future average settlement value of claims, at a 3 percent annual inflation rate; and

- an analysis of the period over which the Company has and is likely to resolve asbestos-related claims against it in the future.

The Company monitors the number and mix (disease type) of claims filed and paid each period against the estimates calculated by its asbestos liability model. The Company s liability for both pending and unasserted claims could change significantly if actual experience related to these variables and/or information from the Company s outside advisors indicate that a change in the long-term assumptions regarding future claims is appropriate. For example, certain claim disease types are more costly to settle, which could impact the amount of the asbestos liability if actual experience and information regarding the current asbestos environment indicates that a change in the expected mix of future claims is warranted. In addition, the Company uses a rolling five year average of claim settlement amounts by disease type as the basis for calculating the expected settlement amounts of future claims. The asbestos liability could change significantly as the claim settlement amounts continue to develop.

In addition to the abovementioned liability, the Company records a receivable for probable asbestos-related insurance recoveries. This receivable represents amounts due to the Company for previously settled and paid claims, the reimbursable portion of incurred legal expenses and the probable reimbursements relating to its estimated liability for pending and future claims. In calculating the receivable, the Company uses the estimated asbestos liability for pending and projected future claims calculated by HR&A. It also considers the amount of insurance available, gaps in coverage, applicable deductibles, allocation methodologies, solvency ratings and credit-worthiness of the insurers, the published dividend rates of insolvent insurers, amounts already recovered from and the potential for settlements with insurers, and estimated annual legal fees. In addition, the Company and its advisors continually monitor the status of pending litigation that could impact the allocation of claims against the Company s various insurance policies.

The Company is in litigation against certain insurance carriers whose policies the Company believes provide coverage for asbestos-related claims. The insurance carriers named in this suit are challenging the Company s right to recovery. The Company and the defendants in the NJ Litigation engaged in their first mediation session on January 18, 2006 and have engaged in active discussions since that time. During the mediation, the parties have agreed to extensions of discovery deadlines and stays of discovery except for discovery necessary to facilitate the mediation process. The continued stay of discovery was confirmed by agreement at the most recent status conference with the court and the mediator, which took place on November 26, 2007.

Notwithstanding the fact that a portion of the Company s insurance recovery receivable is the subject of litigation, the Company has concluded that its insurance receivable is probable of recovery because of the following factors:

- the success of other companies in collecting under their insurance policies in comparable circumstances. The Company has reviewed numerous situations involving other companies and concluded that the Company s facts and circumstances support collection;

- the Company s confidence in its right to recovery under the terms of its policies and pursuant to applicable law;

- the nature of the issues raised in the New Jersey coverage litigation, in which the insurer defenses have been primarily focused on which insurance company should pay, not whether the claims themselves are covered under the numerous policies. Disagreements among carriers concerning which one is responsible for which claim are not unique to the Company where, as here, the policy holder has multiple lines of coverage potentially available to it; and

- the Company s recent experience in managing asbestos-related claims and insurance recoveries and settlements of such claims. The Company continues to receive payments on its remaining primary coverage and has reached several settlements with excess carriers. The Company s settlements in the New Jersey litigation with various individual carriers and syndicates where the Company s claims were the subject of litigation to date have reached approximately $103 million.

The Company reviews its estimates of the recorded asbestos-related liability and the related insurance receivable on a periodic basis to determine whether any adjustments are required. The Company may also adjust these estimates based upon the outcome of the court-ordered mediation referenced above and/or expected settlement discussions. See Note 15 of Notes to Consolidated Financial Statements for additional disclosures on asbestos and other contingent liabilities and a description of the activity and related amounts that impacted the Company s asbestos liability and related receivable for probable asbestos-related insurance recoveries.

Cyclical and Seasonal Nature of Business

Approximately 59 percent of the Company s sales are to the replacement, remodeling and repair markets that tend to be less cyclical than other markets. The Company s geographic diversity mitigates the effects of fluctuations in individual new construction markets.

Total Company sales tend to be seasonally higher in the second and third quarters of the year because, in the U.S. and other northern hemisphere markets, summer is the peak season for sales of air conditioning systems and services. In addition, a significant percentage of the Company s sales are related to U.S. residential and commercial construction activity, which is generally higher in the second and third quarters of the year.

Information Concerning Forward-Looking Statements

Certain of the statements contained in this report (other than the historical financial data and other statements of historical fact), including, without limitation, statements as to management s expectations and beliefs, are forward-looking statements. Forward-looking statements are made based upon management s good faith expectations and beliefs concerning future developments and their potential effect upon the Company. There can be no assurance that future developments will be in accordance with such expectations or that the effect of future developments on the Company will be those anticipated by management. Forward-looking statements can be identified by the use of words such as believe, expect, plans, strategy, prospects, estimate, project, anticipate, intends and other words of similar meaning in connect discussion of future operating or financial performance. This Annual Report on Form 10-K includes important information as to risk factors in Item 1. Business, Item 1A. Risk Factors, and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. Many important factors could cause actual results to differ materially from management s expectations, including:

- the level of end market activity in the markets the Company operates;
- weather conditions as unexpected cool trends or unseasonably warm trends during the summer season could negatively or positively affect business and results of operations;
- the extent to which the Company will be able to realize the estimated savings from materials management and Six Sigma Lean initiatives;
- additional developments which may occur that could affect the Company s estimate of asbestos liabilities and insurance recoveries, such as the nature and number of future claims, the average cost of disposing of such claims, average annual defense costs, the amount of insurance recovery, legislation or legal decisions affecting claims criteria or payout;
- unpredictable difficulties or delays in the development of new product technology;
- changes in U.S. or international economic conditions, such as inflation, interest rate fluctuations, foreign exchange rate fluctuations or recessions in the Company s markets;

pricing changes to the Company s supplies or products or those of its competitors, and other competitive pressures on pricing and sales;

increased difficulties in obtaining a consistent supply of those basic materials at pricing levels which will not have an adverse effect on results of operations;

integration of acquired businesses;

labor relations;

difficulties in obtaining or retaining the management and other human resource competencies that the Company needs to achieve its business objectives;

the impact on the Company from the loss of a significant customer or a few customers;

risks generally relating to the Company s international operations, including governmental, regulatory or political changes;

changes in environmental, health or other regulations that may affect one or more of the Company s current products or future products;

assumptions made related to post-retirement benefits, including rate of return on plan assets, the discount rate applied to projected benefit obligations and the rate of increase in the health care cost trend rate;

changes in laws or different interpretations of laws that may affect the Company s expected effective tax rate for 2008;

periodic adjustments to litigation reserves;

the outcome of lawsuits and other contingencies;

transactions or other events affecting the need for, timing and extent of the Company s capital expenditures;

adoption of new accounting pronouncements promulgated by the FASB or other accounting standard setting agencies; and

risks associated with the ongoing obligations of the Company resulting from the completion of its separation plan, including potential post-closing purchase price adjustments and potential indemnification claims by the purchasers of the Bath and Kitchen business or by WABCO, and the ability of such parties to satisfy, when due, the obligations assumed by such parties in connection therewith, including, without limitation, the obligations of WABCO and its subsidiaries under the Indemnification Agreement relating to the potential fines imposed in connection with the European Commission Investigation described in further detail under Item 3. Legal Proceedings.

Table of Contents

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

The Company is exposed to fluctuations in the price of major raw material commodities used in the manufacturing process (such as copper, aluminum, steel, motors and electronics), foreign currency fluctuations and interest rate changes. From time to time the Company enters into hedge agreements to reduce its risks related to commodity price, foreign currency and interest rates. Such agreements hedge only specific transactions or commitments. To minimize the risk of counter-party nonperformance, such agreements are made only through major financial institutions with significant experience in such financial instruments.

The aggregate impact of a hypothetical ten percent increase in the price of the major raw material commodities used in the Company s manufacturing process (such as copper, aluminum, steel, motors and electronics) would be approximately $75 million.

The Company conducts operations in most of the major countries of Western Europe, Brazil, Canada, the Middle East, Mexico, China, Thailand, Taiwan and other countries throughout the world. In addition, the Company conducts business in some of these countries through affiliated companies and partnerships in which the Company owns 50 percent or less of the stock or partnership interest. Fluctuations in currency exchange rates could have a significant impact on the Company s reported results of operations, which are presented in U.S. dollars. The Company believes its primary exposure to changes in currency exchange rates are associated with translating the results of operations to the U.S. dollar at exchange rates that have fluctuated throughout the year. A hypothetical ten percent weakening of all other currencies in relation to the U.S. dollar would have resulted in an approximate $16 million reduction in the 2007 reported income from continuing operations. In addition, fluctuations in currency exchange rates could have an impact on certain of the Company s monetary assets and liabilities denominated in currencies other than the functional currency of the respective entity. As of December 31, 2007, the Company does not have any material foreign currency exposures associated with such assets and liabilities.

To manage the balance between floating interest rate debt and fixed interest rate debt, the Company has entered into interest rate swaps that effectively convert fixed-rate debt to variable-rate debt. The maturity date of these swap contracts coincides with the maturity date of the underlying debt. Under these swaps, the Company pays a specified variable interest rate and receives the fixed rate applicable to the underlying debt. The interest rate swaps are designated as fair value hedges of the underlying debt. The fair value of the hedges is recorded in other long-term assets or liabilities with a corresponding increase or decrease in the debt obligation. The change in fair values of the hedge instrument and the debt are recorded as equal and offsetting unrealized gains and losses. The existing fair value hedges are 100 percent effective and therefore there is no effect on current earnings from hedge ineffectiveness. The notional value (the value of the underlying debt) of interest rate swaps outstanding as of December 31, 2007, and December 31, 2006 was $225 million. At December 31, 2007, approximately $254 million of the Company s $1.060 billion total debt bore interest at variable rates based upon the LIBOR. A ten percent change in swap rates would change the fair value of the interest rate swaps by approximately $0.2 million and $0.8 million as of December 31, 2007 and 2006, respectively.

To manage certain exposure to changes in foreign currency exchange rates, the Company entered into a cross currency swap to fix the foreign currency cash flow on its £60.0 million ($119.5 million at December 31, 2007 exchange rates) 8.25 percent senior notes due June 1, 2009 into the functional currency of the Company. All cash flow dates, including the maturity date on the swap contract match those of the underlying debt. Under the cross currency swap, the Company pays a fixed rate of 7.3825 percent on a notional amount of $122.6 million and receives a fixed rate of 8.25 percent on a notional amount of £60.0 million. The cross currency swap is designated as a cash flow hedge of the changes in the cash flow of the underlying debt resulting from changes in foreign currency exchange rates. The Sterling interest received on the swap is accrued and recorded as an offset to the Sterling interest expense accrued and recorded on the underlying debt. The U.S. dollar interest paid on the swap is accrued and recorded as interest expense. The fair value of the swap is measured quarterly and recorded on the balance sheet with an offsetting entry to other comprehensive income.

Table of Contents

An equal amount of other comprehensive income is reclassified to income to offset the effect of changes in spot rates when translating the hedged debt into U.S. dollars, which is recorded in the income statement. The fair value of the swap is a $3.2 million liability as of December 31, 2007. A ten percent change in the currency exchange rate would change the fair value of the cross currency swap by approximately $12.5 million at December 31, 2007.

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Trane Inc.

We have audited the accompanying consolidated balance sheets of Trane Inc. as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedules listed in the Index at Item 15(a). These financial statements and schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 consolidated financial position of Trane Inc. at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, Trane Inc. changed its method of accounting for uncertainty in income taxes effective January 1, 2007, stock-based compensation effective January 1, 2006 and defined benefit pension and other post-retirement plan obligations effective December 31, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Trane Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 14, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

New York, New York

February 14, 2008

Table of Contents

TRANE INC.

CONSOLIDATED STATEMENT OF INCOME

(Amounts in millions, except per share data)	**Year Ended December 31, 2007**	**2006**	**2005**
Sales	**$ 7,449.6**	$ 6,758.1	$ 6,014.7
Cost of sales	**5,331.9**	4,796.1	4,308.9
Selling and administrative expenses	**1,400.2**	1,312.0	1,191.2
Operating income	**717.5**	650.0	514.6
Other (income) expense	**5.5**	(8.2)	(13.5)
Interest expense	**109.6**	114.6	113.3
Income from continuing operations before income taxes	**602.4**	543.6	414.8
Income taxes	**202.2**	157.7	95.6
Income from continuing operations	**400.2**	385.9	319.2
Income (loss) from discontinued operations, net of income taxes	**(113.9)**	155.1	237.1
Net income	**$ 286.3**	$ 541.0	$ 556.3
Earnings per share:			
Basic net income per common share:			
Income from continuing operations	**$ 2.01**	$ 1.91	$ 1.51
Income (loss) from discontinued operations	**(0.57)**	0.77	1.12
Net income	**$ 1.44**	$ 2.68	$ 2.63
Diluted net income per common share:			
Income from continuing operations	**$ 1.96**	$ 1.87	$ 1.47
Income (loss) from discontinued operations	**(0.56)**	0.75	1.09
Net income	**$ 1.40**	$ 2.62	$ 2.56
Weighted-average common shares outstanding:			
Basic	**199.0**	201.7	211.3
Diluted	**204.5**	206.3	217.0

See Notes to Consolidated Financial Statements.

Table of Contents

TRANE INC.

CONSOLIDATED BALANCE SHEET

(Amounts in millions, except share data)	December 31, 2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 902.5**	$ 232.9
Accounts receivable, less allowance for doubtful accounts $42.8 in 2007; $39.4 in 2006	**1,138.5**	930.3
Inventories	**697.3**	691.9
Future income tax benefits	**78.9**	70.2
Other current assets	**235.2**	319.7
Assets of discontinued operations		3,397.1
Total current assets	**3,052.4**	5,642.1
Facilities, at cost, net of accumulated depreciation	**833.0**	758.7
Goodwill	**318.5**	305.2
Long-term asbestos receivable	**336.9**	336.6
Long-term future income tax benefits	**224.5**	194.6
Investment in associated companies	**27.3**	30.5
Other assets	**304.7**	154.8
TOTAL ASSETS	**$ 5,097.3**	$ 7,422.5
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Loans payable to banks	**$ 28.5**	$ 77.5
Current maturities of long-term debt	**343.8**	23.1
Accounts payable	**484.6**	427.2
Accrued payrolls	**279.0**	244.6
Current portion of warranties	**155.6**	137.3
Taxes on income	**122.2**	48.8
Deferred revenue	**228.7**	172.5
Other accrued liabilities	**596.7**	497.0
Liabilities of discontinued operations		1,783.3
Total current liabilities	**2,239.1**	3,411.3
Long-term debt	**687.2**	1,543.4
Other long-term liabilities:		
Post-retirement benefits	**311.5**	334.8
Asbestos liability	**628.2**	652.8
Warranties	**311.9**	275.3
Deferred tax liabilities	**11.4**	70.6
Other long-term liabilities	**369.8**	210.8
Total liabilities	**4,559.1**	6,499.0
Commitments and contingencies		
Shareholders equity:		
Preferred stock, 2,000,000 shares authorized; none issued and outstanding		
Common stock, $0.01 par value, 560,000,000 shares authorized; shares issued: 251,776,794 in 2007; 251,773,228 in 2006; and shares outstanding: 194,464,230 in 2007; 199,891,689 in 2006	**2.5**	2.5
Capital surplus	**959.0**	897.0
Treasury stock, at cost: 57,312,564 shares in 2007; 51,881,539 shares in 2006	**(1,764.9)**	(1,523.3)
Retained earnings	**1,577.8**	1,972.4
Accumulated other comprehensive income:		

Deferred gain on hedge contracts	**1.4**	3.3
Foreign currency translation effects	**(127.8)**	(138.9)
Unrealized losses on benefit plans	**(109.8)**	(289.5)
Total shareholders equity	**538.2**	923.5
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 5,097.3**	$ 7,422.5

See Notes to Consolidated Financial Statements.

48

Table of Contents

TRANE INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Amounts in millions)	Year Ended December 31, 2007	2006	2005
Cash flows from operating activities:			
Net income	**$ 286.3**	$ 541.0	$ 556.3
Less: Income from discontinued operations, net of income taxes	**(113.9)**	155.1	237.1
Income from continuing operations	**400.2**	385.9	319.2
Adjustments to reconcile net cash provided by operating activities:			
Depreciation	**87.5**	76.6	70.7
Amortization of capitalized software and other intangibles	**27.8**	31.0	29.5
Equity in earnings of unconsolidated joint ventures, net of dividends received	**2.4**	(4.5)	(11.0)
Non-cash compensation expense	**99.0**	88.3	60.7
Deferred income taxes	**(75.8)**	(8.3)	22.5
Gain on sale of property, plant and equipment	**(0.1)**	(11.0)	(3.8)
Changes in assets and liabilities, net of the effects of divestitures:			
Accounts receivable	**(184.4)**	(83.2)	(45.7)
Inventories	**9.9**	(136.5)	2.3
Accounts payable	**38.3**	(87.6)	35.5
Other accrued liabilities and taxes	**176.0**	134.9	69.4
Post-retirement benefits	**(32.7)**	20.7	(16.1)
Net asbestos indemnity liability	**(24.9)**	27.2	5.2
Other current and long-term assets	**(31.7)**	(38.5)	(52.4)
Other long-term liabilities	**177.7**	47.9	2.5
Net cash provided by operating activities	**669.2**	442.9	488.5
Net cash provided by (used in) discontinued operating activities	**(389.5)**	263.4	331.9
Cash flows from investing activities:			
Proceeds from sale of Bath and Kitchen, net of retained cash	**1,769.5**		
Purchases of property, plant and equipment	**(142.8)**	(134.4)	(160.0)
Investments in affiliated companies and other businesses	**(11.8)**	(0.2)	(8.4)
Investments in computer software	**(26.2)**	(25.3)	(22.8)
Proceeds from joint venture, net		3.9	12.2
Proceeds from sale of other businesses and property, plant and equipment	**6.8**	25.1	20.5
Net cash provided by (used in) investing activities	**1,595.5**	(130.9)	(158.5)
Net cash used by discontinued investing activities	**(83.1)**	(104.8)	(164.8)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	**34.4**	16.9	214.1
Repayments of long-term debt	**(32.5)**	(311.3)	(211.1)
Net change in revolving credit facilities	**(554.0)**	285.2	189.2
Net change in other short-term debt	**(75.2)**	65.5	(54.5)
Purchases of treasury stock	**(458.2)**	(450.0)	(500.0)
Dividend payments	**(135.8)**	(144.8)	(126.4)
Proceeds from exercise of stock options	**101.4**	45.7	35.6
Proceeds from (payment of) foreign exchange forward contracts		1.4	(4.1)
Tax benefit from exercise of stock options	**61.3**	20.5	8.7
Transfer from (to) discontinued operations	**(445.3)**	65.5	293.4
Cash distributed to WABCO	**(101.3)**		

Net cash used by financing activities	**(1,605.2)**	(405.4)	(155.1)
Net cash provided by (used in) discontinued financing activities	**403.0**	(176.1)	(175.1)
Effect of exchange rate changes on cash and cash equivalents	**10.1**	7.5	(3.1)
Effect of exchange rate changes on cash related to discontinued operations	**8.7**	6.5	(2.5)
Net increase (decrease) in cash and cash equivalents	**608.7**	(96.9)	161.3
Less: Net decrease in cash related to discontinued operations	**(60.9)**	(11.0)	(10.5)
Cash and cash equivalents at beginning of year	**232.9**	318.8	147.0
Cash and cash equivalents at end of year	**$ 902.5**	**$ 232.9**	**$ 318.8**
Cash paid during the year for:			
Interest	**$ 112.4**	$ 117.7	$ 110.9
Taxes	**$ 220.3**	$ 191.6	$ 185.3

See Notes to Consolidated Financial Statements.

Table of Contents

TRANE INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME

					Accumulated Other Comprehensive Income				
(Amounts in millions)	**Common Stock**	**Capital Surplus**	**Treasury Stock**	**Retained Earnings**	**Deferred Gain on Hedge Contracts**	**Foreign Currency Translation Effects**	**Unrealized Gain (Loss) on Benefit Plans**	**Minimum Pension Liability Adjustment**	**Compre-hensive Income**
Balance at December 31, 2004	**$ 2.5**	**$ 794.5**	**$ (760.1)**	**$ 1,146.6**	**$ 9.3**	**$ (102.8)**	**$**	**$ (159.7)**	
Net income				556.3					$ 556.3
Foreign currency translation						(109.8)		9.5	(100.3)
Deferred gain on hedge contracts, net of taxes					11.6				11.6
Minimum pension liability adjustment, net of taxes								32.4	32.4
Total comprehensive income									**$ 500.0**
Dividends paid				(126.4)					
Treasury stock purchased			(500.0)						
Stock options exercised		(7.2)	42.9						
Stock options tax benefit		13.3							
Stock issued to Employee Stock Ownership Plan		29.1	35.3						
Stock issued to Employee Stock Purchase Plan		3.4	5.3						
Other common stock issued or reacquired		1.3	(4.8)						
Balance at December 31, 2005	**$ 2.5**	**$ 834.4**	**$ (1,181.4)**	**$ 1,576.5**	**$ 20.9**	**$ (212.6)**	**$**	**$ (117.8)**	
Net income				541.0					$ 541.0
Foreign currency translation						73.7		(6.2)	67.5
Deferred gain on hedge contracts, net of taxes					(17.6)				(17.6)
Minimum pension liability adjustment, net of taxes								79.3	79.3
Total comprehensive income									**$ 670.2**
Adoption of FAS 158, net of taxes							(289.5)	44.7	
Dividends paid				(145.1)					
Treasury stock purchased			(450.0)						
Stock options exercised		(8.2)	53.8						
Stock options tax benefit		15.6							
Stock issued to Employee Stock Ownership Plan		21.9	46.0						
Stock issued to Employee Stock Purchase Plan		2.1	7.4						
Stock-based compensation and other stock issued		31.2	0.9						
Balance at December 31, 2006	**$ 2.5**	**$ 897.0**	**$ (1,523.3)**	**$ 1,972.4**	**$ 3.3**	**$ (138.9)**	**$ (289.5)**	**$**	
Net income				286.3					$ 286.3
Foreign currency translation						102.3	(14.0)		88.3
Deferred gain on hedge contracts, net of taxes					(1.9)				(1.9)
Sale of Bath and Kitchen						0.1	85.3		85.4
Unrealized gain on benefit plans, net of taxes							30.2		30.2
Total comprehensive income									**$ 488.3**
Dividends paid				(135.8)					
Adoption of FIN 48				(19.1)					
Treasury stock purchased			(458.2)						
Stock options exercised		(59.8)	161.2						

Stock options tax benefit		60.8						
Stock issued to Employee Stock Ownership Plan		23.7	46.2					
Stock issued to Employee Stock Purchase Plan		2.5	7.3					
Stock-based compensation and other stock issued		34.8	1.9					
Distribution of WABCO				(526.0)		(91.3)	78.2	
Balance at December 31, 2007	**$ 2.5**	**$ 959.0**	**$ (1,764.9)**	**$ 1,577.8**	**$ 1.4**	**$ (127.8)**	**$ (109.8)**	**$**

See Notes to Consolidated Financial Statements.

50

Table of Contents

TRANE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Description of Company

Trane Inc. (formerly known as American Standard Companies Inc.) (the Company) is a Delaware corporation incorporated in 1988. Trane or the Company refers to the Company, or to the Company and Trane U.S. Inc. (formerly known as American Standard Inc.) or Trane International Inc. (formerly known as American Standard International Inc.), each a wholly-owned subsidiary, including their subsidiaries, as the context requires.

Trane is a leading global manufacturer of commercial and residential heating, ventilation and air conditioning equipment (HVAC) and provides market-leading systems and services that enhance the quality and comfort of the air in homes and buildings around the world. The Company offers customers a broad range of energy-efficient HVAC systems: dehumidifying and air cleaning products; service and parts support and advanced building controls. The Company s systems and services have leading positions in premium commercial, residential, institutional and industrial markets; a reputation for reliability, high quality and product innovation; and a broad, well-established distribution network.

Separation

On February 1, 2007, Trane (then known as American Standard Companies Inc.) announced that its Board of Directors had completed a strategic review of the Company and unanimously approved a plan to separate its three businesses during 2007. The announced separation included a plan to spin off Trane s Vehicle Control Systems business and to sell its Bath and Kitchen business, with Trane retaining and focusing on its global HVAC business. The Board of Directors concluded that separating the three businesses would create greater shareholder value than the existing company structure and provide the separated companies with substantial opportunities and benefits allowing them to more effectively operate their respective businesses, including providing the separated companies with increased strategic focus, enhanced opportunities for growth, increased market recognition, improved capital flexibility and increased ability to attract, retain and motivate employees.

On July 12, 2007, the Board of Directors of Trane approved the spinoff of the Vehicle Control Systems business into a new publicly traded company named WABCO Holdings Inc. (WABCO). The spinoff of WABCO was completed on July 31, 2007 and WABCO began trading thereafter as an independent company on the New York Stock Exchange (NYSE) under the ticker symbol WBC.

On July 23, 2007, the Company entered into an agreement to sell its Bath and Kitchen business to affiliates of Bain Capital Partners, LLC. The sale was completed on October 31, 2007 for approximately $1.745 billion, after closing adjustments but subject to certain post-closing adjustments. Combined with the proceeds received by the Company from the sale of its Venesta Washroom Systems business (which was formerly part of the Bath and Kitchen business) in March 2007, the Company s gross proceeds from the sale of the Bath and Kitchen business totaled approximately $1.91 billion. A portion of the proceeds from the sale of Bath and Kitchen, after expenses and taxes, was used to reduce debt.

Upon completion of the spinoff of the Vehicle Control Systems business and the sale of the Bath and Kitchen business, the Company s operations consist of its Air Conditioning Systems and Services business, which manufactures, sells and services HVAC equipment systems and controls. Following receipt of shareholder approval, American Standard Companies Inc. changed its name to Trane Inc. on November 28, 2007 and began trading on the NYSE under the ticker symbol TT.

Merger Agreement with Ingersoll Rand

On December 17, 2007, the Company announced that on December 15, 2007 it had entered into an agreement and plan of merger with Ingersoll-Rand Company Limited (Ingersoll Rand) and Indian Merger Sub,

Table of Contents

Inc., a wholly-owned subsidiary of Ingersoll Rand (Merger Sub), providing for the acquisition of the Company by Ingersoll Rand, a company publicly traded on the NYSE. Subject to the terms and conditions of the merger agreement, Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation and a wholly-owned subsidiary of Ingersoll Rand. At the effective time of the merger, each outstanding share of common stock of the Company, other than shares owned by the Company or Ingersoll Rand and any dissenting shares, will be converted into the right to receive a combination of (i) 0.23 (the Exchange Ratio) of a share of Ingersoll Rand Class A common share and (ii) $36.50 in cash (the Cash Consideration), without interest. Under the merger agreement, in the event that the Company or Ingersoll Rand reasonably determines in good faith that it is necessary to do so, in order to complete the merger without a vote of Ingersoll Rand shareholders, the Cash Consideration may be increased by an amount up to $1.00 per share (with a corresponding reduction to the Exchange Ratio). The merger is subject to customary closing conditions, including the approval of the Company s shareholders and the receipt of certain required antitrust approvals and clearances. The Company received the necessary antitrust approvals under the Hart-Scott-Rodino Act on January 31, 2008. The Company currently anticipates that the merger will be completed in the second calendar quarter of 2008.

NOTE 2. Accounting Policies

Financial Statement Presentation The financial statements include the accounts of majority-owned subsidiaries; intercompany transactions are eliminated. Investments in unconsolidated joint ventures (generally a 20 percent to 50 percent ownership interest) are included at cost plus the Company s equity in undistributed earnings in accordance with the equity method of accounting and reflected as investments in associated companies in the consolidated balance sheet. Certain reclassifications of amounts reported in prior years have been made to conform to the 2007 classifications.

The Vehicle Control Systems and Bath and Kitchen businesses have been reported as discontinued operations for all periods presented in the accompanying consolidated financial statements in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment of Long-Lived Assets*.

Use of Estimates The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Some of the most significant estimates included in the preparation of the consolidated financial statements are related to revenue recognition, post-retirement benefits, warranties, income taxes, insurance recoveries, asbestos indemnity liabilities, stock based compensation and commitments and contingencies.

Foreign Currency Translation In accordance with Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation,* adjustments resulting from translating foreign functional currency assets and liabilities into U.S. dollars are recorded in a separate component of shareholders equity. Gains or losses resulting from transactions in other than the functional currency are reflected in the Consolidated Statement of Income, except for transactions which hedge net investments in a foreign entity and intercompany transactions of a long-term investment nature. For operations in countries that have hyper-inflationary economies, net income includes gains and losses from translating assets and liabilities at year-end rates of exchange, except for inventories and facilities, which are translated at historical rates.

Revenue Recognition In accordance with Securities and Exchange Commission s Staff Accounting Bulletin No. 104, sales of manufactured products are principally recorded when shipment occurs and title passes to a customer, persuasive evidence of an arrangement exists with the customer, the sales price is fixed and determinable and the collectibility of the sales price is reasonably assured. A portion of the Company s revenue stream is derived from the sale of services. Revenue under long-term service contracts for the maintenance of air conditioning equipment is recorded over the term of the contract. The Company also sells extended warranty contracts on certain products, and the revenues from such contracts are deferred and amortized on a straight-line basis over the terms of the contracts or based upon historical experience. Other service revenues are recorded as the service is performed. Shipping and handling costs are generally billed to customers and are included in sales.

The Company derives a portion of its revenues from multiple element-arrangements. Revenues under multiple-element arrangements, such as those that include Company products along with other third party products, are recognized for each separate unit of accounting when delivered based on the relative fair value. The Company generally allocates total revenue under the arrangements to each of the elements based on the relative sale price of each element when sold separately.

Revenues from air conditioning equipment and the related installation sold under construction-type contracts are recorded using the percentage-of-completion method in accordance with Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* and related guidance. The Company recognizes revenue under percentage of completion accounting using the cost to cost method as the measure of progress. Revenues associated with contracts accounted for under the percentage of completion method of accounting amounted to approximately ten percent of total Company sales in 2007 and nine percent of total company sales in 2006 and 2005. The liability for billings in excess of costs associated with percentage of completion contracts was $41.0 million and $34.1 million at December 31, 2007 and 2006, respectively.

In accordance with EITF 01-9, *Accounting for Consideration Given By a Vendor to a Customer,* the Company typically records cooperative advertising allowances, rebates and other forms of sales incentives as a reduction of revenue at the later of the date of the sale or the date the incentive is offered. However, where the Company receives an identifiable benefit for the consideration that is sufficiently separable from the associated sale and the Company can reasonably estimate the fair market value of the benefit received, the Company records the costs in selling and administrative expenses. Sales incentives recognized in selling and administrative expenses in the accompanying consolidated statement of income were $36.8 million, $31.8 million and $37.0 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Shipping and Handling Costs Shipping, handling, purchasing, receiving, inspecting, warehousing, internal transfer and other costs of distribution are recorded as cost of sales.

Cash Equivalents The Company considers all highly liquid investments with maturities at the date of purchase of three months or less to be cash equivalents. The Company s investments consist primarily of U.S. Government money market funds and time deposits. The investments are carried at cost, which approximates fair value. Cash and cash equivalents included cash of $237.9 million and $188.1 million at December 31, 2007 and December 31, 2006, respectively. Investments at December 31, 2007 and December 31, 2006 were $664.6 and $44.8 million, respectively.

Allowance for Doubtful Accounts The Company analyzes the aging of accounts receivable, historical bad debts, customer creditworthiness and current economic trends in determining the allowance for doubtful accounts. The Company provides for estimates of product returns at the time of sale.

Transfers of Financial Instruments Sales and transfers of financial instruments are accounted for under Statement of Financial Accounting Standard No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140). The Company sells interests in accounts receivable to special purpose entities created as part of accounts receivable financing facilities established by the Company in the U.S. with major international banks (see Note 9 Accounts Receivable Securitization Agreements). Receivables sold under such arrangements are removed from the balance sheet at the time they are sold since the transactions meet the sale criteria of FAS 140. Specifically, the receivables are legally isolated from the Company, the purchasers have the right to pledge or exchange the receivables and the purchasers obtain effective control over the receivables. Any retained interests in receivables sold are carried at fair value in other current assets.

Inventories Inventories are recorded at the lower of cost or realizable value, cost being determined principally by the use of the last-in, first-out (LIFO) method.

Facilities Property plant and equipment balances are stated at cost less accumulated depreciation. The Company capitalizes costs, including interest during construction, of fixed asset additions, improvements, and betterments that add to productive capacity or extend the asset life. The Company assesses facilities for impairment when events or circumstances indicate that the carrying amount of these assets may not be recoverable. Maintenance and repair expenditures are expensed as incurred. The Company capitalized $2.2 million, $1.0 million and $0.5 million of interest related to construction of facilities for the years ended December 31, 2007, 2006 and 2005.

Depreciation Depreciation and amortization are computed on the straight-line method based on the estimated useful life of the asset or asset group, which is 40 years for buildings and 5 to 15 years for machinery and equipment.

Computer Software The Company capitalizes the costs of obtaining or developing internal-use computer software which is amortized ratably over periods of up to seven years, beginning when the software is ready for its intended use. At December 31, 2007 and 2006, the unamortized amount of internal-use computer software included in other assets is $87.9 million and $90.5 million, respectively.

Goodwill and Intangible Assets In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, goodwill is not amortized but is subject to impairment tests annually on October 1 or more often when events or circumstances indicate that the carrying amount of goodwill may not be recoverable. A goodwill impairment loss is recognized to the extent the carrying amount of goodwill exceeds the implied fair value of goodwill. In accordance with FAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* the Company assesses intangible assets subject to amortization, when events or circumstances indicate that the carrying amount of those assets may not be recoverable. Impairments of intangible assets are recognized when the carrying value of the assets are less than the expected cash flows of the assets on an undiscounted basis. All amortizable assets are amortized over their estimated useful lives.

Debt Issuance Costs The costs related to the issuance of debt are capitalized and amortized to interest expense using the effective interest method over the life of the related debt.

Warranties The Company provides for estimated warranty costs at the time of sale for products sold with a limited warranty. Costs to satisfy extended warranty obligations are charged to cost of sales as incurred.

Post-retirement Benefits Post-retirement benefits are provided for substantially all employees of the Company, both in the U.S. and abroad. In the U.S., the Company also provides various post-retirement health care and life insurance benefits for certain of its employees. Such benefits are accounted for on an accrual basis using actuarial assumptions in accordance with Statement of Financial Accounting Standards No. 87, *Employers Accounting for Pensions* and No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions* and related guidance. In December 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 158 (FAS 158), *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No, 87, 88, 106, and 132(R).* FAS 158 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan s overfunded status or a liability for a plan s underfunded status. FAS 158 also requires an entity to measure a defined benefit postretirement plan s assets and obligations that determine its funded status as of the end of the employer s fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in comprehensive income in the year in which the changes occur.

Asbestos Indemnity Liability and Related Insurance Recoveries The Company records a liability for all asbestos claims incurred as well as claims incurred but not yet reported that are considered probable and reasonably estimable. The Company engages an expert to assist it in calculating and evaluating the total amount of the asbestos indemnity liability. The Company also estimates and records a receivable for amounts recoverable from its insurance carrier for asbestos claims that have been settled and paid, the reimbursable portion of incurred legal expenses, and the probable reimbursements relating to its estimated liability for pending and future claims.

Research and Development Expenses Research and development costs are expensed as incurred. The Company incurred approximately $116 million in 2007, $101 million in 2006 and $87 million in 2005 for research activities and product development.

Income Taxes In accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes,* deferred income taxes are determined on the asset and liability method, and are recognized for all temporary differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. No provision is made for U.S. income taxes applicable to undistributed earnings of foreign subsidiaries that are indefinitely reinvested.

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 provides recognition criteria and a related measurement model for tax positions taken by companies. In accordance with FIN 48, a tax position is a position in a previously filed tax return or a position expected to be taken in a future tax filing that is reflected in measuring current or deferred income tax assets and liabilities. Tax positions are recognized only when it is more likely than not (likelihood greater than 50 percent), based on technical merits, that the position will be sustained upon examination. Tax positions that meet the more likely than not threshold are measured using a probability weighted approach as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement. As a result of the implementation of FIN 48, the Company recognized a $19.1 million increase in the liability for unrecognized tax benefits, which was accounted for as an increase to the non-current tax liability and a charge to retained earnings.

Advertising Expense The cost of advertising is expensed as incurred or in the case of sales literature as distributed. The Company incurred $94 million, $88 million and $74 million of advertising costs in 2007, 2006 and 2005, respectively.

Earnings per Share Basic earnings per share have been computed using the weighted-average number of common shares outstanding. The weighted-average number of outstanding common shares used in computing diluted earnings per share included weighted-average incremental shares of 5,511,333 in 2007, 4,608,073 in 2006, and 5,678,795 in 2005, primarily from the assumed exercise of stock options issued under the Company s stock option plans. The weighted-average number of outstanding antidilutive stock options excluded from the computation of diluted earnings per share in 2007, 2006 and 2005 was 1,589,861, 1,634,839, and 869,849, respectively.

Comprehensive Income Comprehensive income is presented in the Consolidated Statement of Shareholders Equity and Comprehensive Income and consists of net income, deferred gains or losses on hedge contracts, foreign currency translation adjustments, pension adjustments and unrecognized losses on post retirement benefit plans. The Company s investments in its foreign subsidiaries are considered to be permanently invested and no provision for income taxes on the related foreign exchange translation adjustments of those subsidiaries has been recorded.

Financial Instruments with Off Balance Sheet Risk The Company from time to time enters into agreements to reduce its risk related to foreign currency, commodity prices and interest rates. Gains and losses from underlying rate or price changes are included in income unless the contract hedges a net investment in a foreign entity, a firm commitment, or related debt instrument, in which case gains and losses are included as a component of foreign currency translation effects in shareholders equity or included as a component of the transaction.

Stock-Based Compensation The Company has three primary stock-based compensation plans the 2002 Omnibus Incentive Plan, the Stock Incentive Plan and the Employee Stock Purchase Plan (ESPP), which are described in Note 13 Capital Stock. Under the first two plans, the Company has granted options to employees and directors to acquire a fixed number of shares of the Company s common stock at a specified price, and also

Table of Contents

has made grants of restricted stock units and restricted shares. Under the ESPP, employees are entitled to purchase shares of the Company s common stock at a discount of 15 percent from the market price on the date of purchase. The Company also issues stock-based compensation under the Supplemental Compensation Plan for outside Directors, the Supplemental Savings Plan and the Deferred Compensation Plan. The Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004) (FAS 123R), *Share Based Payments* on January 1, 2006. FAS 123R requires the Company to measure and recognize in its consolidated statement of income, the expense associated with all share-based payment awards made to employees and directors including stock options, restricted stock units, restricted stock grants and discounts on employee stock purchases associated with the ESPP based on either estimated fair values or actual fair values in the case of restricted stock and restricted stock unit grants. The Company adopted FAS 123R using the modified prospective approach. Under the modified prospective approach, the Company began to recognize as expense the cost of unvested awards outstanding as of January 1, 2006 as well as the cost of awards granted after January 1, 2006. Prior to January 1, 2006, the Company accounted for share-based payments under APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). Under APB 25 compensation cost was not recognized for substantially all options granted because the exercise price of options granted was equal to the market value of the Company s common stock on the grant date and the ESPP plan was deemed noncompensatory. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to FAS 123R. The Company considered the provisions of SAB 107 when it adopted FAS 123R. SAB 107 provides guidance in the area of valuation techniques, expected volatility and expected term calculations and disclosure requirements.

The Company recognizes compensation cost for each share-based payment award over the requisite service period of the award. Compensation cost is measured on the grant date of the award, which is the date the Company s Board of Directors approves the granting of the award. Compensation cost on discounts associated with ESPP purchases is recognized on the date that shares are purchased. Income from continuing operations before income taxes included $23.4 million and $25.8 million of stock-based compensation expense for the years ended December 31, 2007 and 2006, respectively. The estimated tax benefit associated with this expense was $8.0 million and $9.5 million for the years ended December 31, 2007 and 2006, respectively. Prior period consolidated statements of income have not been restated. If the Company had applied the fair value recognition provisions of FAS 123R to stock-based employee compensation for the year ended December 31, 2005, net income would have been $536.3 million and basic and diluted net income per share would have been $2.54 and $2.48, respectively. To measure the fair value of stock option awards, the Company utilizes the Black-Scholes option valuation method. To measure the fair value of restricted stock unit grants, the Company uses the fair market value of the Company s stock on the grant date. The Black-Scholes option valuation method considers the following factors when calculating fair value the exercise price of the option, the stock price on the date of the grant, the expected term of the option, the expected volatility during the expected term of the option, the expected dividends to be paid and the risk free interest rate expected during the option term. The requisite service period for substantially all of the Company s stock options is the explicit vesting period included in the terms of the stock option award. Accordingly, the Company estimates compensation expense based on the number of awards it believes will ultimately vest, which includes an estimate of the number of awards expected to be forfeited. The estimated fair value of the award is recognized on a straight line basis over the requisite service period of the award. The Company periodically reviews its estimate of forfeitures and revises the estimate as facts and circumstances warrant.

In connection with the spinoff of its Vehicle Control Systems business, adjustments were made to outstanding options in accordance with the original terms of the plans under which the options were granted. These plans require that, in the event of a change in capitalization, outstanding equity awards be proportionally adjusted to reflect the change in capitalization in an equitable manner. All options granted prior to 2007, except for options qualified as incentive stock options (ISOs) under Section 422 of the Internal Revenue Code and certain options granted to employees in Italy and Canada, have been adjusted into two separate options based on the WABCO spinoff distribution ratio. The per share exercise price of the original option was proportionately allocated between the adjusted options based on the relative trading prices of the respective underlying stock

Table of Contents

immediately following the distribution. The options granted to WABCO employees in 2007 have been equitably adjusted so as to relate solely to shares of WABCO s common stock and the ISOs and certain options granted in Italy and Canada have been equitably adjusted to relate solely to shares of the Company s stock. Because these adjustments were required by the terms of the original award and the adjustment maintains the economic value before and after the equity restructuring, no compensation costs have been recognized as a result of these adjustments.

The Company options and the WABCO options issued as part of this adjustment will continue to be subject to the original vesting schedules. Further, for purposes of vesting and the post-termination exercise periods applicable to such stock options, continued employment with WABCO or the Company, as the case may be, will be viewed as continued employment with the issuer of the options.

Note 3. Discontinued Operations

As discussed above, the Company completed the spinoff of the Vehicle Control Systems business on July 31, 2007. The Company also finalized the sale of the Bath and Kitchen business to affiliates of Bain Capital Partners, LLC on October 31, 2007. Accordingly, the Vehicle Control Systems and Bath and Kitchen businesses have been reported as discontinued operations for all periods presented.

Summary income statement and condensed balance sheet information for Vehicle Control Systems and Bath and Kitchen are set forth below. The separation costs relate to investment banking, legal, tax and accounting fees, other professional advisory fees, employee costs and other costs and income taxes associated with executing the separation transactions.

Vehicle Control Systems

(Dollars in millions)	Seven Months Ended July 31, 2007 2007	Year Ended December 31, 2006	2005
Sales	$ 1,328.8	$ 2,015.2	$ 1,831.0
Pre-tax income from discontinued operations	$ 149.3	$ 253.9	$ 248.1
Separation costs	45.6		
Tax separation costs	55.7		
Income taxes	20.6	81.6	49.5
Income from discontinued operations, net of income taxes	$ 27.4	$ 172.3	$ 198.6

The results of Vehicle Control Systems are included in the table above through the date of the spinoff.

(Dollars in millions)	December 31, 2006
Cash	$ 35.2
Accounts receivable	187.7
Inventories	138.1
Other current assets	49.9
Property, plant and equipment	299.7
Goodwill	343.8
Other non-current assets	180.0
Total assets	$ 1,234.4
Loans payable to banks	$ 14.1
Accounts payable	147.5
Accrued and other current liabilities	242.3
Long-term debt	57.3
Post-retirement benefits	368.6
Other liabilities	97.6
Total liabilities	$ 927.4

The following table sets forth the net assets of Vehicle Control Systems distributed to shareholders on July 31, 2007.

(Dollars in millions)	July 31, 2007
Assets	$ 1,563.8
Liabilities	954.8
Net assets	609.0
Recognition of tax indemnity receivable from WABCO	(69.9)
Unrealized losses on benefit plans, net of tax	78.2
Foreign currency translation effect	(91.3)
Impact on retained earnings	$ 526.0

Bath and Kitchen

(Dollars in millions)	Ten Months Ended October 31, 2007	Year Ended December 31, 2006	2005
Sales	$ 2,136.7	$ 2,434.9	$ 2,418.7
Pre-tax income (loss) from discontinued operations	$ 18.0	$ (51.3)	$ 63.0
Pre-tax gain on sale of discontinued operations	27.7		
Separation costs	1.4		
Tax separation costs	37.9		
Income tax expense (benefit)	147.7	(34.1)	24.5
Income (loss) from discontinued operations, net of income taxes	$ (141.3)	$ (17.2)	$ 38.5

On March 30, 2007, the Company sold its Armitage Venesta business (Venesta) included within the Bath and Kitchen segment. Venesta is a leading supplier of commercial washroom solutions in both the United Kingdom and Ireland. The Company received proceeds of $165 million and recognized a pre-tax gain of $80.8 million, $56.8 million net of taxes. On October 31, 2007, the Company sold its Bath and Kitchen business to affiliates of Bain Capital Partners, LLC for $1.745 billion, after closing adjustments but subject to certain post-closing adjustments. The Company received proceeds of $1.693 billion which was net of a $25.7 million

Table of Contents

accelerated pension contribution and other closing payments of $26.8 million. The sale resulted in a pre-tax loss of $53.1 million, $190.1 million after taxes. The net pre-tax gain of $27.7 million resulting from these transactions has been reflected in pre-tax gain on sale of discontinued operations in the table above.

Bath and Kitchen incurred $78.5 million of operational consolidation expenses in 2007. The 2007 charges relate to its consolidation of operations and streamlining of commercial functions in Europe and the Americas. Bath and Kitchen is in the process of closing its Wolverhampton, UK, location and transferring its fittings assembly and logistics to more cost effective locations; Bath and Kitchen is also in the process of closing its Excelsior, United Kingdom facility, and has closed its Chiva, Spain and Queimados, Brazil facilities and transferred the ceramics manufacturing operations to more cost effective locations. Bath and Kitchen also streamlined and simplified its commercial organization in several European countries and discontinued the production of cast iron bathtubs at its Revin, France location. Bath and Kitchen also discontinued production of metal tubs and basins at a plant in Cambridge, Ontario Canada.

During 2006, Bath and Kitchen incurred $53.3 million of operational consolidation expenses before minority interest income of $1.2 million. The 2006 charges primarily related to severance associated with the consolidation of manufacturing and administrative processes, the consolidation of its ceramics manufacturing operations in the United Kingdom and the consolidation of some new product development, supply chain, finance and administrative activities in its European operations.

During 2005, Bath and Kitchen incurred $31.6 million of operational consolidation expenses before minority interest income of $1.9 million. The 2005 charges primarily related to severance and employee costs related to the reorganization of its fittings manufacturing plant in Europe and streamlining manufacturing and administrative processes.

(Dollars in millions)	**December 31, 2006**
Cash	$ 25.7
Accounts receivable	216.0
Inventories	461.9
Other current assets	77.2
Property, plant and equipment	667.4
Goodwill	582.7
Other non-current assets	131.8
Total assets	$ 2,162.7
Accounts payable	$ 223.2
Accrued and other current liabilities	323.6
Post-retirement benefits	168.9
Other liabilities	140.2
Total liabilities	$ 855.9

NOTE 4. Effect of Recently Issued Accounting Standards

In December 2007, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (FAS 141(R)), to replace Statement of Financial Accounting Standards No. 141, *Business Combinations*. FAS 141(R) requires use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and broadens the scope to all transactions and other events in which one entity obtains control over one or more other businesses. This statement is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 with earlier adoption prohibited. While the Company does not expect the adoption of FAS 141(R) to have a material impact to its consolidated financial statements for transactions completed prior to December 31, 2008, the impact of the accounting change could be material for business combinations which may be consummated subsequent thereto.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51*, (FAS 160). FAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the retained interest and gain or loss when a subsidiary is deconsolidated. This statement is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 with earlier adoption prohibited. The Company is currently evaluating the impact of FAS 160 on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurement* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. FAS 157 also expands financial statement disclosures about fair value measurements. On February 12, 2008, the FASB issued FASB Staff Position (FSP) 157-b which delays the effective date of FAS 157 for one year, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FAS 157 and FSP 157-b are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has elected a partial deferral of FAS 157 under the provisions of FSP 157-b related to the measurement of fair value used when evaluating goodwill, other intangible assets and other long-lived assets for impairment and valuing asset retirement obligations and liabilities for exit or disposal activities. The impact of partially adopting FAS 157 effective January 1, 2008 is not expected to be material to the Company s consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115* (FAS 159), which permits but does not require the Company to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. As the Company has not elected to fair value any financial instruments under the provisions of FAS 159, the adoption of this statement will not have an impact to its consolidated financial statements.

NOTE 5. Operational Consolidation Charges

During 2007, the Company incurred charges related to operational consolidation activities consisting principally of severance and related expenses as more fully described below.

In 2007, the Company recorded $2.6 million of operational consolidation expenses, which were included in selling and administrative expenses. Included in the $2.6 million was a reversal of $2.0 million related to a change in severance on prior period plans and $4.6 million of expense related to severance associated with the consolidation of administrative functions. These actions included the elimination of 25 jobs. The Company expended $1.5 million of cash on operational consolidation activities during 2007.

During 2006, the Company incurred $2.1 million of operational consolidation expenses of which $2.2 million was included in selling and administrative expenses and $0.1 million of income was included in cost of sales. This amount includes a reversal of $1.7 million related to a change in the estimated severance on prior period plans and $3.8 million of expense related to severance associated with the consolidation of administrative functions.

During 2005 the Company incurred $25.8 million of operational consolidation expenses of which $13.1 million was included in selling and administrative expenses and $12.7 million was included in cost of sales. The $25.8 million of operational consolidation expenses related to the following initiatives:

(i) $12.0 million of charges primarily related to severance and job elimination expenses associated with a plan designed to improve the effectiveness and efficiency of the business on a global basis that included the elimination of 340 jobs and the consolidation of administrative functions,

Table of Contents

(ii) $10.8 million of charges for the impairment of goodwill and other long-lived assets and $1.1 million of charges for severance, associated with the closure of its Rockingham, NC manufacturing facility that included the elimination of 118 jobs, and

(iii) $1.9 million of charges associated with a plan to transfer production to a lower cost production facility in North America and salaried severance.

NOTE 6. Other (Income) Expense

Other (income) expense was as follows:

	Year Ended December 31,		
(Dollars in millions)	**2007**	**2006**	**2005**
Equity in net income of unconsolidated joint ventures	**$ (10.1)**	$ (9.1)	$ (10.4)
Minority interest expense	**5.6**	5.3	2.4
Receivable discount fees	**9.7**	9.8	6.7
Foreign exchange (gain) loss	**(0.1)**	3.7	(3.6)
Interest income	**(7.3)**	(1.8)	(1.1)
(Gain) loss on sale of assets	**0.6**	(10.9)	(2.9)
Separation and merger related costs	**10.0**		
Other, net	**(2.9)**	(5.2)	(4.6)
	$ 5.5	$ (8.2)	$ (13.5)

The Company has investments in affiliates that are accounted for on the equity method. The Company holds a 24.5 percent ownership interest in Alliance Compressors, (Alliance) a joint venture that supplies the Company with air conditioning system compressors. The Company purchased $74.5 million, $75.0 million and $67.0 million of goods from Alliance during the years ended December 31, 2007, 2006 and 2005, respectively.

Other expense in 2007 includes $10.0 million of separation costs and merger advisory fees, primarily related to the planned merger with Ingersoll Rand.

NOTE 7. Post-Retirement Benefits

The Company sponsors post-retirement benefit plans covering substantially all U.S. employees, including an Employee Stock Ownership Plan (the ESOP) and a 401(k) savings plan (the Savings Plan) for the Company s U.S. salaried employees and certain U.S. hourly employees, a defined benefit plan for most U.S. employees covered by collective bargaining arrangements, and a pension plan established in 2003 as described below for certain U.S. salaried and non-union employees and certain collectively-bargained employees. The ESOP and Savings Plan are individual-account defined contribution plans. Shares of the Company s common stock held by the ESOP and Savings Plan are allocated to the accounts of eligible employees through basic allocations of 3 percent of covered compensation in the ESOP, and a matching Company contribution to the Savings Plan of up to 6 percent of covered compensation. The Company funds the ESOP and Savings Plan through contributions of either cash or shares of the Company s common stock. Shares of common stock accrued by employees under the ESOP and Savings Plan are credited to each employee s ESOP and Savings Plan accounts based on the fair value of shares on the date credited to their account. Cash dividends earned by shares held in the ESOP and Savings Plan are credited to each employee s account. During the year ended December 31, 2007, approximately 1.5 million shares of common stock had been allocated to employee accounts. Shares of common stock held by the ESOP and Savings Plan are included in the average number of shares outstanding for both basic and diluted earnings per share. Effective September 1, 2003, the Company established a pension plan for salaried and non-union U.S. employees (the Cash Balance Plan). Eligible employees may elect to participate in the pension plan and receive a credit equal to 3 percent of eligible pay. For these employees, the Company match in the Savings Plan is 50 percent of the employee contribution (up to a

Table of Contents

Company match of 3 percent). For employees who do not elect to participate in the pension plan, the Company match in the Savings Plan is 100 percent of the employee contribution (up to a Company match of 6 percent). Employees covered under certain collective bargaining agreements also participate in the Cash Balance plan and receive a 3 percent credit.

Benefits under defined benefit pension plans on a worldwide basis are generally based on years of service and either employee s compensation during the last years of employment or negotiated benefit levels. Participants under the Cash Balance Plan receive 3 percent of their eligible pay per year. This benefit earns an interest credit approximating five-year U.S. Treasury Securities and vests over a three-year period. In the U.S. the Company also provides various post-retirement health and life insurance benefits for certain of its employees. Certain of the pension plans are funded, depending on tax and statutory considerations in the country. Post-retirement health and life insurance benefits are funded as incurred.

Assets and vested accrued benefits for Bath and Kitchen employees in the Cash Balance Plan remained with Trane as part of the sale of the Bath and Kitchen business.

Table of Contents

The following table provides a reconciliation of the changes in pension and post-retirement health and life insurance benefit obligations and fair value of assets for the years ending December 31, 2007 and 2006, and a statement of the funded status at December 31, 2007 and 2006:

(Dollars in millions)	2007 Domestic Pension Benefits	2007 Domestic Health & Life Ins. Benefits	2007 Foreign Pension Benefits	2006 Domestic Pension Benefits	2006 Domestic Health & Life Ins. Benefits	2006 Foreign Pension Benefits
Reconciliation of benefit obligation:						
Obligation at beginning of year	**$ 725.5**	**$ 352.2**	**$ 24.1**	$ 711.9	$ 319.5	$ 23.0
Service cost	**21.0**	**12.6**	**2.4**	21.0	8.0	0.7
Interest cost	**42.4**	**18.4**	**1.2**	40.1	17.4	1.2
Participant contributions		**9.3**			8.6	
Plan amendments	**3.8**	**0.3**		10.9	0.1	
Actuarial (gain) loss	**(32.7)**	**(31.4)**	**(0.2)**	(22.2)	25.2	(0.6)
Curtailment related to sale of Bath and Kitchen	**(0.9)**	**(10.6)**				
Distribution of WABCO		**(19.1)**				
Benefit payments	**(41.2)**	**(29.0)**	**(0.8)**	(36.2)	(26.6)	(0.8)
Medicare Part D subsidy						
Foreign exchange effects			**0.9**			0.6
Obligation at end of year	**$ 717.9**	**$ 302.7**	**$ 27.6**	$ 725.5	$ 352.2	$ 24.1
Reconciliation of fair value of plan assets:						
Fair value of plan assets at beginning of year	**$ 709.1**	**$**	**$ 9.1**	$ 611.0	$	$ 8.8
Actual return on assets	**37.2**		**0.1**	78.7		0.9
Divestitures						
Employer contributions	**34.2**	**19.7**	**0.4**	55.6	18.0	0.3
Participant contributions		**9.3**			8.6	
Benefit payments	**(41.2)**	**(29.0)**	**(0.8)**	(36.2)	(26.6)	(0.8)
Foreign exchange effects			**1.9**			(0.1)
Fair value of plan assets at end of year	**$ 739.3**	**$**	**$ 10.7**	$ 709.1	$	$ 9.1
Funded Status at December 31:						
Funded status	**$ 21.4**	**$ (302.7)**	**$ (16.9)**	$ (16.4)	$ (352.2)	$ (15.0)
Unrecognized prior service cost (benefit)				59.2	(33.3)	
Unrecognized net actuarial (gain) loss				56.9	155.8	2.0
Unrecognized net initial obligation				0.5		
Net amount recognized	**$ 21.4**	**$ (302.7)**	**$ (16.9)**	$ 100.2	$ (229.7)	$ (13.0)
Amounts recognized on balance sheet						
After adoption of FAS 158						
Noncurrent assets	**$ 46.5**	**$**	**$ 4.2**	$ 6.6	$	$ 2.8
Current liabilities	**(11.3)**	**(26.1)**		(8.9)	(23.1)	
Noncurrent liabilities	**(13.8)**	**(276.6)**	**(21.1)**	(14.1)	(329.1)	(17.8)
Net amount recognized	**$ 21.4**	**$ (302.7)**	**$ (16.9)**	$ (16.4)	$ (352.2)	(15.0)
Amounts recognized in other comprehensive income consist of:						
Prior service cost	**$ 62.0**	**$ 5.8**	**$**	$ 59.2	$ (33.3)	$
Net actuarial (gain) loss	**43.7**	**71.0**	**(0.2)**	56.9	155.8	2.0

Unrecognized net initial obligation	**0.5**			0.5		
Total before tax effects	**$ 106.2**	**$ 76.8**	**$ (0.2)**	$ 116.6	$ 122.5	$ 2.0

A component of the 2006 post-retirement assets and liabilities presented above includes certain amounts that have been reflected in assets and liabilities of discontinued operations in the accompanying balance sheet.

Table of Contents

The following table provides a summary of pension plans with accumulated benefit obligations in excess of assets as of December 31:

(Dollars in millions)	2007 Domestic Plans	2007 Foreign Plans	2006 Domestic Plans	2006 Foreign Plans
For all plans:				
Accumulated benefit obligation	**$ 713.3**	**$ 23.9**	$ 718.0	$ 20.4
For pension plans with accumulated benefit obligations in excess of plan assets:				
Projected benefit obligation	**$ 37.5**	**$ 22.2**	$ 31.9	$ 18.4
Accumulated benefit obligation	**33.0**	**18.4**	26.3	14.7
Fair value of plan assets	**12.5**	**1.1**	9.0	0.6

Total post-retirement costs are shown below:

(Dollars in millions)	Year Ended December 31, 2007	2006	2005
Domestic plans	**$ 6.6**	$ 17.5	$ 24.0
Foreign plans	**3.2**	1.4	2.1
Health and life insurance benefits	**27.5**	27.1	26.6
Subtotal	**37.3**	46.0	52.7
Defined contribution plan cost, principally ESOP	**67.3**	64.0	60.2
Total post-retirement costs, including accretion expense	**$ 104.6**	$ 110.0	$ 112.9

Components of post-retirement costs are broken out in the tables below:

Pension Benefit Costs (Dollars in millions)	2007 Domestic Pensions	2007 Foreign Pensions	2006 Domestic Pensions	2006 Foreign Pensions	2005 Domestic Pensions	2005 Foreign Pensions
Service cost-benefits earned during period	**$ 21.0**	**$ 2.4**	$ 21.0	$ 0.7	$ 20.2	$ 1.2
Interest cost on projected benefit obligation	**42.4**	**1.2**	40.1	1.4	38.4	1.4
Less assumed return on plan assets	**(57.7)**	**(0.6)**	(53.0)	(0.7)	(45.1)	(0.4)
Amortization of prior service cost	**6.8**		6.4		5.7	
Amortization of actuarial net (gain) loss	**0.2**	**0.2**	3.2		3.6	(0.1)
Amortization of net initial obligation	**0.1**		0.1		0.1	
Curtailment (gain) loss	**(6.2)**		(0.3)		0.2	
Defined benefit plan cost	**6.6**	**3.2**	17.5	1.4	23.1	2.1
Additional SFAS 88 charge					0.9	
Net defined benefit plan cost after curtailments	**$ 6.6**	**$ 3.2**	$ 17.5	$ 1.4	$ 24.0	$ 2.1

Table of Contents

Other Post Retirement Benefit Costs **(Dollars in millions)**	**2007 Domestic Health & Life Ins. Benefits**	**2006 Domestic Health & Life Ins. Benefits**	**2005 Domestic Health & Life Ins. Benefits**
Service cost-benefits earned during period	**$ 12.6**	$ 8.0	$ 8.0
Interest cost on projected benefit obligation	**18.4**	17.4	16.9
Amortization of prior service cost	**(2.9)**	(4.8)	(4.5)
Amortization of net loss	**4.7**	6.5	6.3
Defined benefit plan cost	**32.8**	27.1	26.7
Curtailment gain recognized	**(5.3)**		(0.1)
Net defined benefit plan cost after curtailment	**$ 27.5**	$ 27.1	$ 26.6

As a result of the sale of the Bath and Kitchen business, and the resultant decrease in the active population, the Company recognized a curtailment gain of $11.5 million relating to prior unrecognized service costs. The curtailment gain is included in the loss from discontinued operations.

Amortization of prior service cost is computed on the straight-line method over the average remaining service period of active participants.

Major assumptions used in determining the benefit obligation and net cost for post-retirement plans are presented below as weighted averages:

Benefit Obligation at December 31,	**2007 Domestic Plans**	**2007 Life Ins. Benefits**	**2007 Foreign Plans**	**2006 Domestic Plans**	**2006 Life Ins. Benefits**	**2006 Foreign Plans**
Discount Rate	**6.23%**	**6.00%**	**4.84%**	6.00%	5.76%	4.58%
Salary Growth	**4.92%**	**4.13%**	**3.12%**	4.63%	4.63%	3.13%
			Net Periodic Pension Cost for the Year			
Discount Rate	**6.00%**	**5.75%**	**4.58%**	5.75%	5.75%	4.56%
Salary Growth	**4.63%**	**4.63%**	**3.13%**	4.34%	4.34%	3.12%
Expected Return on Plan Assets	**8.22%**	**N/A**	**6.77%**	8.23%	N/A	6.75%

The assumed rate of return is a long-term investment return that takes into account the types of assets held by the plan and expected returns for the asset class. Return expectations reflect forward-looking analysis as well as historical experience. The Company s asset management strategy focuses on maintaining a diversified portfolio using various asset classes to generate attractive returns while managing risk. In determining the target asset allocation for a given plan, consideration is given to the nature of its liabilities, and portfolios are periodically rebalanced with reference to the target level.

Asset Allocation	**2007 Domestic Plans**	**2007 Foreign Plans**	**2006 Domestic Plans**	**2006 Foreign Plans**	**Target Domestic Plans**	**Target Foreign Plans**
Equity Securities	**65%**	**48%**	67%	44%	64%	50%
Debt Securities	**33%**	**52%**	31%	56%	31%	50%
Other, including Real Estate	**2%**	**0%**	2%	0%	5%	0%

The Company makes contributions to pension plans that at a minimum meet all statutory funding requirements. Cash contributions to the U.S. plans totaled $34.2 million in 2007. The Company expects contributions will decrease in 2008 as a result of the fully funded status of the main defined benefit plan.

65

Table of Contents

Expected future benefit payments are shown in the table below:

(Dollars in millions)	2008	2009	2010	2011	2012	2013-2017
Domestic plans without subsidy	$ 80.5	$ 74.4	$ 80.6	$ 80.8	$ 82.8	$ 460.5
Medicare D subsidy reimbursements	$ 0.4	$ 0.4	$ 0.4	$ 0.4	$ 0.4	$ 2.0
Foreign plans	$ 0.9	$ 0.9	$ 0.9	$ 0.9	$ 0.8	$ 3.8

The weighted-average annual assumed rate of increase in the health care cost trend rate is 8.5 percent for 2008 and is assumed to decrease to 8.0 percent in 2009 and gradually decline to 4.75 percent by 2018. The health care cost trend rate assumption has a significant effect on the amounts reported. A change in the assumed rate of one percentage point for each future year would have the following effects:

(Dollars in millions)	1% Increase	1% Decrease
Effect on the health care component of accumulated post-retirement obligation	$ 0.6	$ (0.5)
Effect on total of service and interest cost components of net periodic post-retirement health care benefit costs	$ 8.1	$ (7.4)

NOTE 8. Income Taxes

Uncertain Tax Positions

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). In connection therewith, the Company recognized a $19.1 million increase in non-current tax liabilities for unrecognized tax benefits and recorded a corresponding charge to retained earnings. The total amount of unrecognized tax benefits on the date of adoption was $213.5 million. The unrecognized tax benefits attributabl