LEAR CORP
Form 10-K
February 27, 2007

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

Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006.

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

Commission file number: 1-11311

LEAR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**13-3386776**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
21557 Telegraph Road, Southfield, MI	**48033**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code:
(248) 447-1500

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, par value $0.01 per share	New York Stock Exchange

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 þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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

Indicate by check mark 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. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

As of June 30, 2006, the aggregate market value of the registrant s Common Stock, par value $0.01 per share, held by non-affiliates of the registrant was $1,491,485,965. The closing price of the Common Stock on June 30, 2006, as reported on the New York Stock Exchange, was $22.21 per share.

As of February 16, 2007, the number of shares outstanding of the registrant s Common Stock was 76,387,448 shares.

DOCUMENTS INCORPORATED BY REFERENCE

None.

LEAR CORPORATION AND SUBSIDIARIES

CROSS REFERENCE SHEET AND TABLE OF CONTENTS

First Amendment to Pension Equalizatin Program
Form of Amended & Restated Indemnity Agreement
Computation of Net Income Per Share
Computation of Ratios of Earnings to Fixed Charges
List of Subsidiaries
Consent of Ernst & Young LLP
Rule 13A-14(A)/15D-14(A) Certification of Principal Executive Officer
Rule 13A-14(A)/15D-14(A) Certification of Principal Financial Officer
Section 906 Certification of Chief Executive Officer
Section 906 Certification of Chief Financial Officer

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PART I

ITEM 1 *BUSINESS*

In this Report, when we use the terms the Company, Lear, we, us and our, unless otherwise indicated or the con otherwise requires, we are referring to Lear Corporation and its consolidated subsidiaries. A substantial portion of the Company s operations are conducted through subsidiaries controlled by Lear Corporation. The Company is also a party to various joint venture arrangements. Certain disclosures included in this Report constitute forward-looking statements that are subject to risks and uncertainties. See Item 1A, Risk Factors, and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Statements.

BUSINESS OF THE COMPANY

General

Our company was founded in 1917 as American Metal Products Corporation. Through a management-led buyout in 1988, Lear established itself as a private seat assembly operation for the North American automobile market with annual sales of approximately $900 million. We completed our initial public offering in 1994, at a time when customers increasingly were seeking suppliers that could provide complete automotive interior systems on a global basis. Between 1993 and 2000, there was significant consolidation in the automotive supplier industry, and during that time, we made 17 strategic acquisitions. These acquisitions assisted in transforming Lear from primarily a North American automotive seat assembly operation into a global tier 1 supplier of complete automotive interior systems, with capacity for full design, engineering, manufacture and delivery of the automotive interior.

Today, we have operations in 33 countries and rank #127 among the Fortune 500 list of publicly traded U.S. companies. We are a leading global automotive supplier with 2006 net sales of $17.8 billion. Our business is focused on providing complete seat and electrical distribution systems and select electronic products, and we supply every major automotive manufacturer in the world. In seat systems, we believe we hold a #2 position globally based on seat units sold, in a market we estimate at $45 to $50 billion. In electrical distribution systems, we believe we hold a #3 position in North America and a #4 position in Europe based on units sold, in a global market we estimate at $15 to $20 billion.

We have pursued a global strategy, aggressively expanding our operations in Europe, Central America, Africa and Asia. Since 2001, we have realized an 11% compound annual growth rate in net sales outside of North America, with 45% of our 2006 sales coming from outside of North America. Our Asian-related sales (on an aggregate basis, including both consolidated and unconsolidated sales) have grown from $800 million in 2002 to $2.6 billion in 2006. We expect additional Asian-related sales growth in 2007, led by expanding relationships with Hyundai, Nissan and Toyota.

In 2006, our sales were comprised of the following vehicle categories: 55% cars, including 22% mid-size, 16% compact, 13% luxury/sport and 4% full-size, and 45% light truck, including 26% sport utility and 19% pickup and other light truck. We have expertise in all platform segments of the automotive market and expect to continue to win new business in line with market trends. As an example, in North America, our revenues in the fast growing crossover segment, as a percentage of our total revenues, are in-line with the crossovers total share of the market.

Since early 2005, the North American automotive market has become increasingly challenging. Higher fuel prices have led to a shift in consumer preferences away from SUVs, and our North American customers have faced

increasing competition from foreign competitors. In addition, higher commodity costs (principally, steel, copper, resins and other oil-based commodities) have caused margin pressure in the sector. In response, our North American customers have reduced production levels on several of our key platforms and have taken aggressive actions to reduce costs. As a result, we experienced a significant decrease in our operating earnings in 2005 in each of our product segments. Although production volumes remained lower in 2006 on many of our key platforms, production schedules were less volatile. Our seating business demonstrated improved operating performance in 2006.

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The negative impact of the recent industry environment has been more pronounced in our interior business. This business, which includes instrument panels and cockpit systems, headliners and overhead systems, door panels, flooring and acoustic systems and interior trim, represented $3.2 billion of net sales in 2006. The interior segment is more capital intensive and sensitive to fluctuations in commodity prices, particularly resins. It is also characterized by overcapacity and a relatively fragmented supplier base. Further consolidation and restructuring is required to return this market segment to an appropriate profit level. When our major customers indicated an intent to focus on interior component purchases rather than total interior integration, we decided to exit this segment of the interior market and focus on the product lines for which we can provide more value. In October 2006, we completed the contribution of substantially all of our European interior business to International Automotive Components Group, LLC (IAC Europe), a joint venture with WL Ross & Co. LLC (WL Ross) and Franklin Mutual Advisers, LLC (Franklin), in exchange for a one-third equity interest in IAC Europe. In addition, on November 30, 2006, we entered into an Asset Purchase Agreement with International Automotive Components Group North America, Inc. and International Automotive Components Group North America, LLC (together, IAC North America), WL Ross and Franklin under which we agreed to transfer substantially all of the assets of our North American interior business segment (as well as our interests in two China joint ventures) and $25 million of cash to IAC North America. Under the terms of the agreement, we will receive a 25% equity interest in the IAC North America joint venture and warrants to purchase an additional 7% equity interest. We expect this transaction to close in the first quarter of 2007. We believe that with a strong presence in major markets, IAC Europe and IAC North America will be well positioned to participate in a consolidation of this market segment and become a strong global interior supplier.

Within our core product segments, seating and electronic and electrical, we believe we can provide more value for our customers and that there is significant opportunity for continued growth. We are pursuing a more product line focused strategy, investing in consumer driven products and selective vertical integration. In 2005, we initiated a comprehensive restructuring strategy to align capacity with our customers as they rationalize their operations and to more aggressively expand our low cost country manufacturing and purchasing initiatives to improve our overall cost structure. We believe our commitment to customer service and quality will result in a global leadership position in each of our core product segments. We are targeting 5% annual growth in global sales, while growing our annual sales in Asia and with Asian customers by 25%. We believe these recent business improvements and initiatives, coupled with our strong platform for growth in our core seating and electronic and electrical businesses, will drive our profit margins back to historical levels.

In 2006, we increased our financial flexibility by completing a new primary credit facility and refinancing our near-term debt maturities. As a result of these financing transactions, we have no significant debt maturities until 2010.

Merger Agreement

On February 9, 2007, we entered into an Agreement and Plan of Merger (the Merger Agreement) with AREP Car Holdings Corp., a Delaware corporation (Parent), and AREP Car Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Parent (Merger Sub). Under the terms of the Merger Agreement, Merger Sub would be merged with and into Lear, and as a result, Lear would continue as the surviving corporation and a wholly owned subsidiary of Parent. Parent and Merger Sub are affiliates of Carl C. Icahn.

Pursuant to the Merger Agreement, as of the effective time of the merger, each issued and outstanding share of common stock of Lear, other than shares (i) owned by Parent, Merger Sub or any subsidiary of Parent and (ii) owned by any shareholders who are entitled to and who properly exercise appraisal rights under Delaware law, will be canceled and automatically converted into the right to receive $36.00 in cash, without interest.

The Merger Agreement contains provisions pursuant to which we may solicit alternative acquisition proposals for forty-five days after the date of the Merger Agreement (the Solicitation Period) and receive unsolicited proposals thereafter. We may terminate the Merger Agreement under certain circumstances, including if our board of directors determines in good faith that it has received a Superior Proposal (as defined in the Merger Agreement) and otherwise complies with certain terms of the Merger Agreement. In connection with such termination, and in certain other limited circumstances, we would be required to pay a fee of $85 million to Parent plus up to $15 million

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of Parent s out-of-pocket expenses (including fees and expenses of financing sources, counsel, accountants, investment bankers, experts and consultants) relating to the Merger Agreement. If such termination is to accept a Superior Proposal prior to the end of the Solicitation Period, we would be required to pay a fee of $74 million to Parent plus up to $6 million of Parent s out-of-pocket expenses.

Parent has obtained debt financing commitments for the transaction contemplated by the Merger Agreement. Consummation of the merger is not subject to a financing condition, but is subject to other conditions, including receipt of the affirmative vote of the holders of a majority of the outstanding shares of Lear, antitrust approvals and other customary closing conditions.

In connection with the execution of the Merger Agreement, we entered into a voting agreement with Icahn Partners LP, Icahn Partners Master Fund LP, Koala Holding LLC and High River Limited Partnership. In the aggregate, such holders beneficially own approximately 15% of Lear s outstanding common stock. Pursuant to the voting agreement, such holders agreed to vote in favor of the merger and, subject to certain exceptions, not to dispose of any shares of common stock prior to consummation of the merger. Such holders have also agreed to vote in favor of a Superior Proposal under certain circumstances. In addition, American Real Estate Partners, L.P. has provided a limited guaranty in favor of Lear with respect to the performance by Parent and Merger Sub of certain payment obligations under the Merger Agreement.

For further information regarding the Merger Agreement, please refer to the Merger Agreement and certain related documents which are incorporated by reference as exhibits to this Report.

Strategy

Our principal objective is to strengthen and expand our position as a leading automotive supplier to the global automotive industry by focusing on the needs of our customers. We believe that the criteria for selection of automotive suppliers are not only cost, quality, delivery and service, but also, increasingly, worldwide presence and the ability to work collaboratively to reduce cost throughout the entire system, increase functionality and bring new consumer driven products to market.

Specific elements of our strategy include:

Leverage Core Product Lines. In response to the recent industry trend away from total interior integration, we are taking a more product-focused approach to managing our business. We have taken steps to exit the more commodity-like components segment of the interior business and focus on the seating and electronic and electrical segments where we can provide greater value to our customers. The opportunity to strengthen our global leadership position in these segments exists as we develop new products, continue to expand our relationships with global automakers and grow with our customers as they enter new markets globally. In addition, we see an opportunity to offer increased value to our customers and improve our product line profitability through selective vertical integration. In our seating segment, we are focused on increasing our capabilities in structural components and selected trim and foam products. In our electronic and electrical segment, we believe that building upon our junction box and terminals and connectors capabilities will allow us to provide electrical distribution systems at a lower cost.

Invest in New Technology. Automotive manufacturers view the vehicle interior as a major selling point and are increasingly responding to the consumer demands for more interior features. Our Core Dimension Strategy focuses our research and development efforts on innovative product solutions for the seven attributes our research indicates that consumers most value: safety, comfort and convenience, environmental, craftsmanship, commonization, infotainment and flexibility. Within seating, we provide industry-leading safety features such

as ProTec[tm] PLuS, our second generation of self-aligning head restraints that significantly reduce whiplash injuries, and we offer numerous flexible seating configurations that meet a wide range of customer requirements. Within our electronic and electrical segment, our proprietary electrical distribution and Radio Frequency (RF) technology provides several opportunities to provide value. We participate in the wireless control systems market with products such as our Car2UTM two-way keyless fobs that embed features such as remote-controlled engine start, door locks, climate controls, vehicle status and location. We also offer the Intellitire® Tire Pressure Monitoring System, an industry leading safety

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feature, and infotainment features such as integrated family entertainment systems. To further these efforts, we maintain five advanced technology centers and several customer-focused product engineering centers where we design, develop and test new products and analyze consumer responses to automotive interior styling and innovations.

Enhance Strong Customer Relationships. We believe that the long-standing and strong relationships we have built with our customers allow us to act as partners in identifying business opportunities and anticipating the needs of our customers in the early stages of vehicle design. Quality continues to be a differentiating factor in the eyes of the consumer and a competitive cost factor for our customers. We are dedicated to providing superior customer service and maintaining an excellent reputation for providing world-class quality at competitive prices. According to the 2006 J.D. Power and Associates Seat Quality Report[tm], we have ranked as the highest-quality major seat manufacturer in the United States for the last six years. In recognition of our efforts, our facilities continue to receive awards from our customers. Recently, Toyota honored us for Superior Supplier Diversity and Excellence in Quality for 2006, and GM awarded us the Best-In Class Launch Execution award for the GMT900 program. We intend to maintain and improve the quality of our products and services through our ongoing Quality First initiatives.

Maintain Operational Excellence. To withstand fluctuations in industry demand, we continue to be proactive by maintaining an intense focus on the efficiency of our manufacturing operations and identifying opportunities to reduce our cost structure. We manage our cost structure, in part, through ongoing continuous improvement and productivity initiatives throughout the organization, as well as initiatives to promote and enhance the sharing of technology, engineering, purchasing and capital investments across customer platforms. Our current initiatives include:

Restructuring Program: We initiated a $250 million restructuring program in 2005 intended to (1) better align our manufacturing capacity with the changing needs of our customers, (2) eliminate excess capacity and lower our operating costs and (3) streamline our organization structure and reposition our business for improved long- term profitability. Since undertaking the restructuring program, we have initiated the closure of 14 manufacturing facilities and six administrative/engineering facilities, with a cumulative headcount reduction of approximately 6,000 employees. In light of the continuation of challenging industry conditions, we have recently expanded the restructuring program to include additional facility actions and census reductions. We expect the full cost of the restructuring program to be $300 million through 2007.

Common Architecture: We are taking actions to leverage our scale and expertise to develop common product architecture. Common architecture allows us to leverage our design, engineering and development costs and deliver an enhanced end product with improved quality and craftsmanship.

Low-Cost Country Footprint: Our low-cost country strategy is designed to increase our global competitiveness from both a manufacturing and sourcing standpoint. We currently support our global operations through more than 80 manufacturing and engineering facilities located in 20 low-cost countries. We plan to continue to aggressively pursue this strategy by establishing expanded vertical integration capabilities in Mexico, Central America, Eastern Europe, Africa and Asia and leveraging our low-cost engineering capabilities with engineering centers in China, India and the Philippines. Excluding our interior business, approximately 30% of our components currently come from low-cost countries, and our target is to increase this percentage to 45% by 2010.

Expand in Asia and with Asian Automotive Manufacturers Worldwide. We believe that it is important to have a manufacturing footprint that aligns with our customers global presence. The Asian markets present significant growth opportunities, as all major global automotive manufacturers are expanding production in this

region to meet increasing demand. We believe we are well-positioned to take advantage of China s emerging growth as we have an extensive network of high-quality manufacturing facilities across China providing seating and electronic and electrical products to a variety of global customers for local production. We also have operations in Korea, India, Thailand and the Philippines, where we also see opportunities for significant growth. This growth has been accomplished, in part, through a series of joint ventures with our customers and/or local suppliers. We currently have 16 joint ventures throughout Asia. Additionally, we plan

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to continue to support the Asian automotive manufacturers as they invest and expand beyond Asia, into North America and Europe. We have recently increased our Asian related business in the United States through seating and electrical business with Hyundai and seating and flooring business with Nissan. We have also entered into strategic alliances to support future programs with both Nissan and Hyundai globally. We intend to continue pursuing joint ventures and other alliances in order to expand our geographic and customer diversity.

Products

We currently conduct our business in two core product operating segments: seating and electronic and electrical. The seating segment includes seat systems and the components thereof. The electronic and electrical segment includes electronic products and electrical distribution systems, primarily wire harnesses and junction boxes; interior control and entertainment systems; and wireless systems. In the second half of 2006, we entered into two transactions to transfer substantially all of the assets of our European and North American interior business to separate joint ventures. The interior segment, a third product operating segment in which we historically operated, includes instrument panels and cockpit systems, headliners and overhead systems, door panels, flooring and acoustic systems and other interior products. Net sales by product segment as a percentage of total net sales is shown below:

For the Year Ended December 31,	**2006**	**2005**	**2004**
Seating	65%	65%	67%
Electronic and electrical	17	17	16
Interior	18	18	17

For further information related to our reportable operating segments, see Note 13, Segment Reporting, to the consolidated financial statements included in this Report.

Seating. The seating segment consists of the manufacture, assembly and supply of vehicle seating requirements. Seat systems typically represent 30% to 40% of the total cost of an automotive interior. We produce seat systems for automobiles and light trucks that are fully assembled and ready for installation. In most cases, seat systems are designed and engineered for specific vehicle models or platforms. We have recently developed Lear Flexible Seat Architecture, whereby we can assist our customers in achieving a faster time-to-market by building a program-specific seat incorporating the latest performance requirements and safety technology in a shorter period of time. Seat systems are designed to achieve maximum passenger comfort by adding a wide range of manual and power features, such as lumbar supports, cushion and back bolsters and leg supports.

As a result of our strong product design and product technology, we are a leader in designing seats with enhanced safety and convenience features. For example, our ProTec^{tm} PLuS Self-Aligning Head Restraint is an advancement in seat passive safety features. By integrating the head restraint with the lumbar support, the occupant s head is provided support earlier and for a longer period of time in a rear-impact collision, potentially reducing the risk of injury. We also supply a patented integrated restraint seat system that uses an ultra high-strength steel tower and a split-frame design to improve occupant comfort and convenience, as well as a high-performance climate system for seat cooling and moisture removal. To address the increasing focus on craftsmanship, we have developed concave seat contours that eliminate wrinkles and provide improved styling. We are also satisfying the growing customer demand for reconfigurable seats with our thin profile rear seat and our stadium slide seat system. For example, General Motors full-size sport utility vehicles and full-size pickups, as well as the Ford Freestyle, Cadillac SRX, and Dodge Durango, use our reconfigurable seating technology, and General Motors full-size sport utility vehicles, as well as the Ford Explorer and Dodge Durango, use our thin profile seating technology for their third row seats.

Electronic and Electrical. The migration from conventional electrical distribution systems to electronic products and electrical distribution systems is facilitating the integration of wiring and electronic products within the overall electrical architecture of a vehicle. This migration can reduce the overall system cost and weight and improve reliability and packaging by optimizing the overall system architecture and eliminating a portion of the terminals, connectors and wires normally required for a conventional electrical distribution

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system. Our umbrella technology, Intertronics®, reflects our ability to integrate electronic products with automotive interior systems. This technology is already having an impact on a number of new and next generation products. For example, our integrated seat adjuster module has two dozen fewer cut circuits and five fewer connectors, weighs a half of a pound less and costs twenty percent less than a traditional separated electronic control unit and seat wiring system. In addition, our smart junction box expands the traditional junction box functionality by utilizing printed circuit board technologies.

Our electronic and electrical products can be grouped into three categories:

Electrical Distribution Systems. Wire harness assemblies are a collection of terminals, connectors and wires that connect all of the various electronic/electrical devices in the vehicle to each other and/or to a power source. Terminals and connectors are components of wire harnesses and other electronic/electrical devices that connect wire harnesses and electronic/electrical devices. Fuse boxes are centrally located boxes in the vehicle that contain fuses and/or relays for circuit and device protection, as well as power distribution. Junction boxes serve as a connection point for multiple wire harnesses. They may also contain fuses and relays for circuit and device protection. Smart junction boxes are junction boxes with integrated electronic functions, which eliminate interconnections and increase overall system reliability. Certain vehicles may have two or three smart junction boxes linked as a multiplexed buss line.

Interior Control and Entertainment Systems. The instrument panel center console module provides a control panel for the entertainment system, accessory switch functions, heating, ventilation and air conditioning. The integrated seat adjuster module combines seat adjustment, power lumbar support, memory function and seat heating into one package. The integrated door module consolidates the controls for window lift, door lock, power mirror and seat heating and ventilation. Our Mechatronic™ lighting control module integrates electronic control logic and diagnostics with the headlamp switch. Entertainment products include sound systems, television modules and the floor-, seat- or center console-mounted MediaConsole with a flip-up screen that provides DVD and video game viewing for back-seat passengers.

Wireless systems. Wireless products send and receive signals using radio frequency technology. Our wireless systems include passive entry systems, dual range/dual function remote keyless entry systems and tire pressure monitoring systems. Passive entry systems allow the vehicle operator to unlock the door without using a key or physically activating a remote keyless fob. Dual range/dual function remote keyless entry systems allow a single transmitter to perform multiple functions. For example, our Car2U™ remote keyless entry system can control and display the status of the vehicle, such as starting the engine, locking and unlocking the doors, opening the trunk and setting the cabin temperature. In addition, dual range/dual function remote keyless entry systems combine remote keyless operations with vehicle immobilizer capability. Our tire pressure monitoring system, known as the Lear Intellitire® Tire Pressure Monitoring System, alerts drivers when a tire has low pressure. We have received production awards for Intellitire® from Ford for many of their North American vehicles and from Hyundai for several models beginning in 2005. Automotive manufacturers are required to have tire pressure monitoring systems on a portion of new vehicles sold in the United States beginning with model year 2006 and on all new vehicles sold in the United States by model year 2008.

Interior. The interior segment consists of the manufacture, assembly and supply of interior systems and components. Interior products are designed to provide a harmonious and comfortable interior for vehicle occupants, as well as a variety of functional and safety features. Set forth below is a description of our principal interior products:

Instrument Panels and Cockpit Systems. The instrument panel is a complex system of coverings and foam, as well as plastic and metal sub-structure designed to house various components and to act as a safety device for the vehicle occupant. The cockpit system consists of, among other things, the instrument panel trim/pad, structural subsystem, electrical distribution system, climate control, driver control pedals, steering controls and driver and passenger safety systems. Specific components of the cockpit system include the instrument cluster/gauges, cross car structure, electronic and electrical components, wire harness, audio system, heating, ventilation and air conditioning module, air distribution ducts, air vents, steering column and wheel and glove compartment assemblies. Airbag technologies also continue to be an

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important component of cockpit systems. As a result of our research and development efforts, we have introduced cost-effective, integrated, seamless airbag covers, which provide greater styling flexibility for the automotive manufacturer. We believe that future trends in instrument panels and cockpit systems will focus on safety-related features. We have also developed Spray PUR™, a seamless polyurethane coating for instrument panels, which eliminates visual seams. This process is currently being used on several vehicle models, including the Cadillac DTS and Buick Lucerne.

Headliners and Overhead Systems. Overhead systems consist of a headliner, lighting, visors, consoles, wiring and electronics, as well as all other products located in the interior of the vehicle roof. Headliners consist of a substrate, as well as a finished interior layer made of a variety of fabrics and materials. While headliners are an important contributor to interior aesthetics, they also provide insulation from road noise and can serve as carriers for a variety of other components, such as visors, overhead consoles, grab handles, coat hooks, electrical wiring, speakers, lighting and other electronic and electrical products. As the amount of electronic and electrical content available in vehicles has increased, headliners have emerged as an important carrier of technology since electronic features ranging from garage door openers to lighting systems are often optimally situated in the headliner. In addition, headliners provide an important safety function by mitigating the effects of head impact. We have developed a system that molds the protective foam directly onto the back of the headliner. This system is being used on several vehicle models that were launched in 2006.

Door Panels. Door panels consist of several component parts, which are attached to a substrate by various methods. Specific components include vinyl or cloth-covered appliqués, armrests, radio speaker grilles, map pocket compartments, carpet and sound-reducing insulation. In addition, door systems often incorporate electronic products and electrical distribution systems, including lock and latch, window glass, window regulators and audio systems, as well as wire harnesses for the control of power seats, windows, mirrors and door locks. We have recently introduced a two-shot molding process that allows a door panel with multiple materials to be produced in a single injection molding machine. This technology, which results in improved craftsmanship and lower costs, is being used on several vehicle models that were launched in 2006.

Flooring and Acoustic Systems. We have an extensive and comprehensive portfolio of SonoTec® acoustic products, including flooring systems and dash insulators. These acoustic products provide noise, vibration and harshness resistance. Carpet flooring systems generally consist of tufted or non-woven carpet with a thermoplastic backcoating, which when heated, allows the carpet to be fitted precisely to the interior or trunk compartment of the vehicle. Non-carpeted flooring systems, used primarily in commercial and fleet vehicles, offer improved wear and maintenance characteristics. The dash insulator, mounted onto the firewall, separates the passenger compartment from the engine compartment and is the primary component for preventing engine noise from entering the passenger compartment.

On October 16, 2006, we completed the contribution of substantially all of our European interior business to IAC Europe, our joint venture with WL Ross and Franklin, in exchange for a one-third equity interest in IAC Europe. In connection with the transaction, we entered into various ancillary agreements providing us with customary minority shareholder rights and registration rights with respect to our equity interest in IAC Europe. Our European interior business included substantially all of our interior components business in Europe (other than Italy and one facility in France), consisting of nine manufacturing facilities in five countries supplying door panels, overhead systems, instrument panels, cockpits and interior trim to various original equipment manufacturers. IAC Europe also owns the European interior business formerly held by Collins & Aikman Corporation. In connection with the transaction, we recognized a pretax loss of approximately $29 million in the third quarter of 2006. For pro forma unaudited condensed consolidated financial statements which take into account the effect of this transaction, among other things, please see our Current Report on Form 8-K filed with the Securities and Exchange Commission (the SEC) on December 8, 2006.

On November 30, 2006, we entered into an Asset Purchase Agreement with IAC North America, WL Ross and Franklin under which we agreed to transfer substantially all of the assets of our North American interior business segment (as well as our interests in two China joint ventures) and $25 million of cash to IAC North America. Under

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the terms of the agreement, we will receive a 25% equity interest in the IAC North America joint venture and warrants to purchase an additional 7% equity interest. WL Ross and Franklin will make aggregate cash contributions of $75 million to the joint venture in exchange for the remaining equity and extend a $50 million term loan to IAC North America. IAC North America will assume the ordinary course liabilities of our North American interior business and we will retain certain pre-closing liabilities, including pension and post-retirement healthcare liabilities incurred through the closing date of the transaction. After closing, we will account for our investment in IAC North America under the equity method of accounting. In the event that IAC North America does not meet certain financial targets in 2007, we will fund up to an additional $40 million, and WL Ross and Franklin will contribute up to an additional $45 million. In connection with the transaction, we have entered into various ancillary agreements providing for customary minority shareholder rights and registration rights with respect to our equity interest in the joint venture.

The closing of the transaction for our North American interior business is subject to various conditions, including the receipt of required third-party consents, as well as other closing conditions customary for transactions of this type. In connection with the transaction, we recognized a pretax loss of approximately $607 million in the fourth quarter of 2006. We expect the transaction to close in the first quarter of 2007, and certain additional losses will be recognized at that time. No assurances can be given that the IAC North America transaction will be consummated on the terms contemplated or at all. For pro forma unaudited condensed consolidated financial statements which take into account the effect of this transaction, among other things, please see our Current Report on Form 8-K filed with the SEC on December 8, 2006.

Manufacturing

A description of the manufacturing processes for each of our two core operating segments, as well as our interior segment, is set forth below.

Seating. Our seating facilities generally use just-in-time manufacturing techniques, and products are delivered to the automotive manufacturers on a just-in-time basis. These facilities are typically located near our customers manufacturing and assembly sites. Our seating facilities utilize a variety of methods whereby foam and fabric are affixed to an underlying seat frame. Raw materials used in our seat systems, including steel, aluminum and foam chemicals, are generally available and obtained from multiple suppliers under various types of supply agreements. Leather, fabric and certain components are also purchased from multiple suppliers under various types of supply agreements. The majority of our steel purchases are comprised of engineered parts that are integrated into a seat system, such as seat frames, mechanisms and mechanical components. Therefore, our exposure to changes in steel prices is primarily indirect, through the supply base. We are increasingly using long-term, fixed-price supply agreements to purchase key components. We generally retain the right to terminate these agreements if our supplier does not remain competitive in terms of cost, quality, delivery, technology or customer support.

Electronic and Electrical. Electrical distribution systems are networks of wiring and associated control devices that route electrical power and signals throughout the vehicle. Wire harness assemblies consist of raw, coiled wire, which is automatically cut to length and terminated. Individual circuits are assembled together on a jig or table, inserted into connectors and wrapped or taped to form wire harness assemblies. All materials are purchased from suppliers, with the exception of a portion of the terminals and connectors that are produced internally. Certain materials are available from a limited number of suppliers. Supply agreements typically last for up to one year. The assembly process is labor intensive, and as a result, production is generally performed in low-cost labor sites in Mexico, Honduras, the Philippines, Eastern Europe and Northern Africa.

Some of the principal components attached to the wire harness assemblies that we manufacture include junction boxes and electronic control modules. Junction boxes are manufactured in both North America and Europe with a

proprietary, capital-intensive assembly process, using printed circuit boards, a portion of which are purchased from third-party suppliers. Proprietary processes have been developed to improve the function of these junction boxes in harsh environments, including high temperatures and humidity.

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Electronic control modules are assembled using high-speed surface mount placement equipment in both North America and Europe.

Interior. Our interior systems process capabilities include injection molding, low-pressure injection molding, blow molding, compression molding, rotational molding, urethane foaming and vacuum forming, as well as various trimming and finishing methods. Raw materials, including resin and chemical products, and finished components are assembled into end products and are obtained from multiple suppliers, under supply agreements which typically last for up to one year. In addition, we produce carpet at one North American plant.

While we internally manufacture many of the components that are described above, a substantial portion of these components are furnished by independent, tier II automotive suppliers and other vendors throughout the world. In certain instances, it would be difficult and expensive for us to change suppliers of products and services that are critical to our business. With the recent decline in the automotive production of our key customers and substantial and continuing pressures to reduce costs, certain of our suppliers have experienced, or may experience, financial difficulties. We seek to carefully manage our supplier relationships to minimize any significant disruptions of our operations. However, adverse developments affecting one or more of our major suppliers, including certain sole-source suppliers, could negatively impact our operating results. See Item 1A, Risk Factors Adverse developments affecting one or more of our major suppliers could harm our profitability.

Customers

We serve the worldwide automotive and light truck market, which produced over 65 million vehicles in 2006. We have automotive interior content on over 300 vehicle nameplates worldwide, and our major automotive manufacturing customers (including customers of our non-consolidated joint ventures) currently include:

BMW	DaimlerChrysler	Dongfeng	Fiat
First Autoworks	Ford	GAZ	General Motors
Honda	Hyundai	Isuzu	Mahindra & Mahindra
Mazda	Mitsubishi	Porsche	PSA
Renault	Nissan	Subaru	Suzuki
Toyota	Volkswagen		

During the year ended December 31, 2006, General Motors and Ford, two of the largest automotive and light truck manufacturers in the world, together accounted for approximately 47% of our net sales, excluding net sales to Saab, Volvo, Jaguar and Land Rover, which are affiliates of General Motors or Ford. Inclusive of their respective affiliates, General Motors and Ford accounted for approximately 32% and 23%, respectively, of our net sales in 2006. In addition, DaimlerChrysler accounted for approximately 10% of our net sales in 2006. For further information related to our customers and domestic and foreign sales and operations, see Note 13, Segment Reporting, to the consolidated financial statements included in this Report.

We receive blanket purchase orders from our customers. These purchase orders generally provide for the supply of a customer s annual requirements for a particular vehicle model, rather than for the purchase of a specified quantity of products. Although purchase orders may be terminated at any time by our customers, such terminations have been minimal and have not had a material impact on our operating results. Our primary risks are that an automotive manufacturer will produce fewer units of a vehicle model than anticipated or that an automotive manufacturer will not award us a replacement program following the life of a vehicle model. In order to reduce our reliance on any one vehicle model, we produce automotive interior systems and components for a broad cross-section of both new and established models. However, larger passenger cars and light trucks typically have more interior content and therefore,

tend to have a more significant impact on our operating performance. Our net sales for the year ended December 31, 2006, were comprised of the following vehicle categories: 55% cars, including 22% mid-size, 16% compact, 13% luxury/sport and 4% full-size, and 45% light truck, including 26% sport utility and 19% pickup and other light truck.

Our agreements with our major customers generally provide for an annual productivity cost reduction. Historically, cost reductions through product design changes, increased productivity and similar programs with our

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suppliers have generally offset these customer-imposed productivity cost reduction requirements. However, in the latter part of 2004 and in 2005, unprecedented increases in certain raw material and commodity costs (principally steel, resins and other oil-based commodities), as well as increases in energy costs had a material adverse impact on our operating results. Raw material, energy and commodity costs have remained high and continued to have an adverse impact on our operating results throughout 2006. While we have been able to offset a portion of the adverse impact through aggressive cost reduction actions, relatively high raw material, energy and commodity costs are expected to continue, and no assurances can be given that we will be able to achieve such customer cost reduction targets in the future.

Technology

We have the ability to integrate the engineering, research, design, development and validation testing of all automotive interior systems. Advanced technology development is conducted at our five advanced technology centers and at our product engineering centers worldwide. At these centers, we engineer our products to comply with applicable safety standards, meet quality and durability standards, respond to environmental conditions and conform to customer and consumer requirements. Our global innovation and technology center located in Southfield, Michigan, develops and integrates new concepts and is our central location for consumer research, benchmarking, craftsmanship and industrial design activity.

We also have state-of-the-art acoustic testing and instrumentation and data analysis capabilities. We own an industry-leading validation test center featuring acoustic and sound quality testing, including a dual-surface, four-wheel chassis dynamometer acoustical chamber and reverberant sound room, capable of precision acoustic testing of front, rear and four-wheel drive vehicles. Together with computer-controlled data acquisition and analysis capabilities, the reverberant sound room provides precisely controlled laboratory conditions for sophisticated interior and exterior noise, vibration and harshness testing of parts, materials and systems, including powertrain, exhaust and suspension components. We also maintain electromagnetic compatibility labs at several of our electronic and electrical facilities, where we develop and test electronic products for compliance with governmental requirements and customer specifications.

We have developed a number of designs for innovative interior features focused on increasing value to our customers. Our umbrella technology, Intertronics®, reflects our ability to integrate electronic products with automotive interior systems. Intertronics products and technologies are grouped into three categories: integrated electronic control units; interior control and entertainment systems, which include sound systems and family entertainment systems, as well as switches; and wireless systems, which include remote keyless entry. In addition, we incorporate many convenience, comfort and safety features into our interior designs, including advanced whiplash concepts, lifestyle vehicle interior storage systems, overhead integrated modules, integrated restraint seat systems (3-point and 4-point belt systems integrated into seats), side impact airbags, integrated child restraint seats and integrated instrument panel airbag systems. We also invest in our computer-aided engineering design and computer-aided manufacturing systems. Recent enhancements to these systems include advanced acoustic modeling and analysis capabilities and the enhancement of our research and design website. Our research and design website is a tool used for global customer telecommunications, technology communications, collaboration and direct exchange of digital assets.

We continue to develop new products and technologies, including solid state smart junction boxes and new radio-frequency products like our Car2U™ Home Automation System. We have created certain brand identities, which identify products for our customers. The ProTec™ brand products are optimized for interior safety; the SonoTec® brand products are optimized for interior acoustics; and the EnviroTec™ brand products are environmentally friendly.

We hold many patents and patent applications pending worldwide. While we believe that our patent portfolio is a valuable asset, no individual patent or group of patents is critical to the success of our business. We also license

selected technologies to automotive manufacturers and to other automotive suppliers. We continually strive to identify and implement new technologies for use in the design and development of our products.

We have numerous registered trademarks in the United States and in many foreign countries. The most important of these marks include LEAR CORPORATION (including a stylized version thereof) and LEAR.

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These marks are widely used in connection with our product lines and services. The trademarks and service marks ADVANCE RELENTLESSLY, CAR2U, INTELLITIRE, PROTEC, PROTEC PLUS and others are used in connection with certain of our product lines and services.

We have dedicated, and will continue to dedicate, resources to research and development. Research and development costs incurred in connection with the development of new products and manufacturing methods, to the extent not recoverable from our customers, are charged to selling, general and administrative expenses as incurred. These costs amounted to approximately $170 million, $174 million and $198 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Joint Ventures and Minority Interests

We form joint ventures in order to gain entry into new markets, facilitate the exchange of technical information, expand our product offerings and broaden our customer base. In particular, we believe that certain joint ventures have provided us, and will continue to provide us, with the opportunity to expand our business relationships with Asian automotive manufacturers. In 2006, our joint ventures continued to be awarded new business with Asian automotive manufacturers both in Asia (including seating business with Chang an Ford, Beijing Hyundai Motor Co. and BMW Brilliance Automotive Co. in China, seating business with General Motors/Daewoo in Korea and seating business with Nissan in China, India and Thailand) and elsewhere (including seating and flooring business with Nissan in the United States and flooring and interior trim business with Toyota in the United States). In addition, we have a joint venture that produces flooring and carpet products for Honda in the United States.

We recently entered into agreements to transfer the assets of our European and North American interior businesses to separate joint ventures. On October 16, 2006, we completed the contribution of substantially all of our European interior business to IAC Europe, our joint venture with WL Ross and Franklin, in exchange for a one-third equity interest in IAC Europe. Our European interior business included substantially all of our interior components business in Europe (other than Italy and one facility in France), consisting of nine manufacturing facilities in five countries supplying door panels, overhead systems, instrument panels, cockpits and interior trim to various original equipment manufacturers. In addition, on November 30, 2006, we entered into an Asset Purchase Agreement with IAC North America, WL Ross and Franklin under which we agreed to transfer substantially all of the assets of our North American interior business segment (as well as our interests in two China joint ventures) and $25 million of cash to IAC North America. The closing of the transaction for our North American interior business is subject to various conditions, including the receipt of required third-party consents and other closing conditions customary for transactions of this type. We expect the transaction to close in the first quarter of 2007, although no assurances can be given that the IAC North America transaction will be consummated on the terms contemplated or at all.

We currently have thirty-three strategic joint ventures located in sixteen countries. Of these joint ventures, eighteen are consolidated and fifteen are accounted for using the equity method of accounting; sixteen operate in Asia, thirteen operate in North America (including eight that are dedicated to serving Asian automotive manufacturers) and four operate in Europe and Africa. Net sales of our consolidated joint ventures accounted for less than 5% of our consolidated net sales for the year ended December 31, 2006. As of December 31, 2006, our investments in non-consolidated joint ventures totaled $141 million and support nineteen customers. For further information related to our joint ventures, see Note 6, Investments in Affiliates and Other Related Party Transactions, to the consolidated financial statements included in this Report.

Competition

Within each of our operating segments, we compete with a variety of independent suppliers and automotive manufacturer in-house operations, primarily on the basis of cost, quality, technology, delivery and service. A

summary of our primary independent competitors is set forth below.

Seating. We are one of two primary independent suppliers in the outsourced North American seat systems market. Our primary independent competitor in this market is Johnson Controls. Magna International Inc. and Faurecia also have a presence in this market. Our major independent competitors are Johnson Controls and Faurecia in Europe and Johnson Controls, TS Tech Co., Ltd. and Toyota Boshoku in Asia.

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Electronic and Electrical. We are one of the leading independent suppliers of automotive electrical distribution systems in North Amer