

NAVISTAR INTERNATIONAL CORP  
Form 10-K  
December 30, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended October 31, 2008

OR

“ **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 1-9618

**NAVISTAR INTERNATIONAL CORPORATION**

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

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

**36-3359573**  
*(I.R.S. Employer Identification No.)*

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4201 Winfield Road, P.O. Box 1488,

Warrenville, Illinois  
(Address of principal executive offices)

60555  
(Zip Code)

Registrant's telephone number, including area code (630) 753-5000

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

**Common stock, par value \$0.10 per share**

**Cumulative convertible junior preference stock, Series D (with \$1.00 par value per share)**

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

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  No

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 and (2) has been subject to such filing requirements for the past 90 days. Yes  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.

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

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

As of April 30, 2008, the aggregate market value of common stock held by non-affiliates of the registrant was \$4.1 billion. For purposes of the foregoing calculation only, executive officers and directors of the registrant, and pension and 401(k) plans of the registrant, have been deemed to be affiliates.

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

As of November 30, 2008, the number of shares outstanding of the registrant's common stock was 71,228,856, net of treasury shares.

Documents incorporated by reference: Portions of the Company's Proxy Statement for the Annual Meeting of Shareowners to be held on February 17, 2009, are incorporated by reference in Part III.

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**Disclosure Regarding Forward-Looking Statements**

Information provided and statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended ( Securities Act ), Section 21E of the Securities Exchange Act of 1934, as amended ( Exchange Act ), and the Private Securities Litigation Reform Act of 1995. Such forward-looking statements only speak as of the date of this report and the Company assumes no obligation to update the information included in this report. Such forward-looking statements include information concerning our possible or assumed future results of operations, including descriptions of our business strategy. These statements often include words such as believe, expect, anticipate, intend, plan, estimate, or similar expressions. These statements are not guarantees of performance or results and they involve risks, uncertainties, and assumptions. Although we believe that these forward-looking statements are based on reasonable assumptions, there are many factors that could affect our actual financial results or results of operations and could cause actual results to differ materially from those in the forward-looking statements. All future written and oral forward-looking statements by us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to above. Except for our ongoing obligations to disclose material information as required by the federal securities laws, we do not have any obligations or intention to release publicly any revisions to any forward-looking statements to reflect events or circumstances in the future or to reflect the occurrence of unanticipated events.

**Available Information**

We are subject to the reporting and information requirements of the Exchange Act and as a result, are obligated to file periodic reports, proxy statements, and other information with the United States Securities and Exchange Commission ( SEC ). We make these filings available free of charge on our website (<http://www.navistar.com>) as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC. The SEC maintains a website (<http://www.sec.gov>) that contains our annual, quarterly, and current reports, proxy and information statements, and other information we file electronically with the SEC. You can read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Room 1850, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Information on our website does not constitute part of this Annual Report on Form 10-K.

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**PART I**

**Item 1. Business**

Navistar International Corporation ( *NIC* ), incorporated under the laws of the state of Delaware in 1993, is a holding company whose principal operating subsidiaries are Navistar, Inc. and Navistar Financial Corporation ( *NFC* ). Both *NIC* and *NFC* file periodic reports with the SEC. References herein to the Company, we, our, or us refer to *NIC* and its subsidiaries, and certain variable interest entities of which we are the primary beneficiary. We report our annual results for our fiscal year, which ends October 31. As such, all references to 2008, 2007, and 2006 contained within this Annual Report on Form 10-K relate to the fiscal year unless otherwise indicated.

**Overview**

We are an international manufacturer of International brand commercial trucks, IC Bus, LLC ( *IC* ) brand buses, MaxxForce brand diesel engines, Workhorse Custom Chassis, LLC ( *WCC* ) brand chassis for motor homes and step vans, Navistar Defense, LLC military vehicles, and a provider of service parts for all makes of trucks and trailers. Additionally, we are a private-label designer and manufacturer of diesel engines for the pickup truck, van, and sport utility vehicles ( *SUV* ) markets. We also provide retail, wholesale, and lease financing of our trucks, and financing for our wholesale and retail accounts.

**Our Strategy**

Our long term strategy is focused on three pillars:

Great Products

Growing our Class 8 tractor line, including an expanded line of ProStar and LoneStar® trucks

Focusing engine research and development in order to have a competitive advantage for the 2010 emissions standards

Introducing our advanced engine technology in new markets

Competitive Cost Structure

Increasing our seamless integration of MaxxForce branded engine lines in our products, including the establishment of our new MaxxForce 11 and 13 engines

Reducing materials cost by increasing global sourcing, leveraging scale benefits, and finding synergies among strategic partnerships

Profitable Growth

Working in cooperation with the U.S. military to provide an extensive line of defense vehicles and product support, including but not limited to, Mine Resistant Ambush Protected ( *MRAP* ) vehicles and other vehicles derived from our existing truck platforms

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Minimizing the impact of our traditional markets cyclical by growing the Parts segment and expansion markets sales, such as Mexico, international export, military export, recreational vehicle, commercial bus, and commercial step van

Broadening our Engine segment customer base

The two key enablers to the above strategy are as follows:

Leverage the resources we have and those of our partners

Grow in our traditional markets and globally through partnerships and joint ventures to reduce investment, increase speed to market, and reduce risk

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Maintain product and plant flexibility to fully utilize our existing facilities, people, and technologies

Combine global purchasing relationships to achieve scale and sourcing anywhere in the world to contain costs

Control our destiny

Control the development process and associated intellectual property of our products

Leverage key supplier competencies to reduce costs of components and improve quality

Ensure the health and growth of our distribution network to provide our products to key markets

## **Our Operating Segments**

We operate in four industry segments: Truck, Engine, Parts (collectively called *manufacturing operations* ), and Financial Services, which consists of NFC and our foreign finance operations (collectively called *financial services operations* ). Corporate contains those items that do not fit into our four segments. Selected financial data for each segment can be found in Note 17, *Segment reporting*, to the accompanying consolidated financial statements.

### ***Truck Segment***

The Truck segment manufactures and distributes a full line of class 4 through 8 trucks and buses in the common carrier, private carrier, government/service, leasing, construction, energy/petroleum, military vehicles, and student and commercial transportation markets under the International, Navistar Defense, LLC, and IC brands. This segment also produces chassis for motor homes and commercial step-van vehicles under the WCC brand. Additionally, we design, produce, and market a brand of light commercial vehicles for the truck market in India under the Mahindra International, Ltd. ( *Mahindra* ) brand.

The Truck segment's manufacturing operations in the United States ( *U.S.* ), Canada, Mexico (collectively called *North America* ), and South Africa consist principally of the assembly of components manufactured by our suppliers, although this segment also produces some sheet metal components, including truck cabs.

We compete primarily in the class 6 through 8 school bus, medium and heavy truck markets within the U.S. and Canada, which we consider our *traditional* markets. We have successfully expanded our traditional market by increasing our sales to the U.S. military. The products we sell to the U.S. military are derivatives of our commercial vehicles and allow us to leverage our manufacturing and engineering expertise, utilize existing plants, and seamless integration of our engines. We continue to grow in *expansion* markets, which include Mexico, international export, non-U.S. military, recreational vehicle ( *RV* ), commercial step-van, and other class 4 through 8 truck and bus markets. We market our commercial products through our extensive independent dealer network in North America, which offers a comprehensive range of services and other support functions to our customers. Our commercial trucks are distributed in virtually all key markets in North America through our distribution and service network, comprised of 820 U.S. and Canadian dealer and retail outlets and 85 Mexican dealer locations as of October 31, 2008. We occasionally acquire and operate dealer locations ( *Dealcor* ) for the purpose of transitioning ownership or providing temporary operational assistance. In addition, our network of used truck centers and International certified used truck dealers in the U.S. and Canada provides trade-in support to our dealers and national accounts group, and markets all makes and models of reconditioned used trucks to owner-operators and fleet buyers. The Truck segment is our largest operating segment, accounting for the majority of our total external sales and revenues.

The markets in which the Truck segment competes are subject to considerable volatility and move in response to cycles in the overall business environment. These markets are particularly sensitive to the industrial sector, which generates a significant portion of the freight tonnage hauled. Government regulation has impacted, and will continue to impact, trucking operations and the efficiency and specifications of equipment.





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The class 4 through 8 truck and bus markets in North America are highly competitive. Major U.S. domestic competitors include: PACCAR Inc. ( PACCAR ), Ford Motor Company ( Ford ), and General Motors Corporation ( GM ). Competing foreign-controlled domestic manufacturers include: Freightliner and Western Star (both subsidiaries of Daimler-Benz AG ( Mercedes Benz )), and Volvo and Mack (both subsidiaries of Volvo Global Trucks). Major U.S. military vehicle competitors include: BAE systems, Force Protection Inc, General Dynamics Land Systems, General Purpose Vehicles, Oshkosk Truck, and Protected Vehicles Incorporated. In addition, smaller, foreign-controlled market participants such as Isuzu Motors America, Inc. ( Isuzu ), Nissan North America, Inc. ( Nissan ), Hino (a subsidiary of Toyota Motor Corporation ( Toyota )), and Mitsubishi Motors North America, Inc. ( Mitsubishi ) are competing in the U.S. and Canadian markets with primarily imported products. In Mexico, the major domestic competitors are Kenmex (a subsidiary of PACCAR) and Mercedes Benz.

***Engine Segment***

The Engine segment designs and manufactures diesel engines across the 50 through 475 horsepower range for use primarily in our class 6 and 7 medium trucks, military vehicles, buses, and selected class 8 heavy truck models, and for sale to original equipment manufacturers ( OEMs ) in North and South America for SUVs and pick-ups. This segment also sells engines for industrial and agricultural applications, and supplies engines for WCC, Low-Cab Forward ( LCF ), class 5 vehicles, and began production of our new MaxxFORCE 11 and 13 Big-Bore engines. The engine segment has made a substantial investment, together with Ford, in the Blue Diamond Parts ( BDP ) joint venture, which is responsible for the sale of service parts to Ford. The Engine segment is our second largest operating segment based on total external sales and revenues.

The Engine segment has manufacturing operations in the U.S., Brazil, and Argentina. The operations at these facilities consist principally of the assembly of components manufactured by our suppliers, as well as machining operations relating to steel and grey iron components.

Our diesel engines are sold under the MaxxFORCE brand as well as produced for other OEMs, principally Ford. We supply our V-8 diesel engine to Ford for use in all of Ford's diesel-powered super-duty trucks and vans over 8,500 lbs. gross vehicle weight in North America. Shipments to Ford during the year ended October 31, 2008 account for 90% of our V-8 shipments and 44% of total shipments (including intercompany transactions). We are currently involved in litigation with Ford. For more information regarding our litigation with Ford, see Item 3, *Legal Proceedings*. There has been a decrease in Ford shipments due to a reduction in the production of heavy-duty pickup trucks built by Ford that contain diesel engines. We believe there is a high probability that this decrease in Ford engine volumes is permanent and will not return to historical volumes. As a result of our expectations related to future Ford engine volumes, we have taken an asset impairment charge and accrued other related costs in 2008.

In the U.S. and Canada mid-range commercial truck diesel engine market, there are six major players: Navistar, Inc., Cummins Inc. ( Cummins ), Mercedes Benz, Caterpillar Inc. ( Caterpillar ), Isuzu, and Hino. In the heavy pickup truck markets, Navistar, Inc. (Power Stroke) in the Ford Super Duty, competes with Cummins in Dodge, and GM/Isuzu (Duramax) in Chevrolet and GMC.

In South America, we have a substantial share of the diesel engine market in the mid-sized pickup and SUV markets as well as the mid-range diesel engines produced in that market. Our South American subsidiary MWM International Industria De Motores Da America Do Sul Ltda. ( MWM ) is a leader in the South American mid-range diesel engine market. MWM sells products in more than 35 countries on five continents and provides customers with additional engine offerings in the agriculture, marine, and light truck markets. MWM competes with Mitsubishi and Toyota in the Mercosul pickup and SUV markets; Cummins, Mercedes Benz, and Fiat Powertrain ( FPT ) in the Light and Medium truck markets; Mercedes Benz, Cummins, Scania, Volvo, and FPT in the heavy truck market; Mercedes Benz in the bus market; New Holland (a subsidiary of CNH Global N.V.), Sisu Diesel (a subsidiary of AGCO Corporation), and John Deere in the agricultural market; and Scania and Cummins in the stationary market.

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In Mexico, we compete in classes 4 through 8 with MaxxForce 5, 7, DT, and 9 engines, facing competition from Cummins, Caterpillar, Isuzu, Hino, Mercedes Benz, and Ford. The application of the new MaxxForce 11 and 13 Big-Bore engines in Mexico will depend on the availability of low sulfur diesel fuel throughout the country. In buses, we compete in classes 6 through 8 with I-6 MaxxForce DT and 9 engines and I-4 MWM engines branded MaxxForce 4.8, having as a main competitor Mercedes Benz with 904 and 906 series engines.

### ***Parts Segment***

The Parts segment supports our brands of International trucks, IC buses, WCC chassis, Navistar Defense, LLC vehicles, and MaxxForce engines by providing customers with proprietary products together with a wide selection of other standard truck, trailer, and engine service parts. We distribute service parts in North America and the rest of the world through the dealer network that supports our Truck and Engine segments.

Our extensive dealer channels provide us with an advantage in serving our customers. Goods are delivered to our customers either through one of our 11 regional parts distribution centers in North America or through direct shipment from our suppliers for parts not generally stocked at our distribution centers. We have a dedicated parts sales team within North America, as well as three national account teams focused on large fleet customers, a global sales team, and a government and military team. In conjunction with the Truck sales and technical service group, we provide an integrated support team that works to find solutions to support our customers.

### ***Financial Services Segment***

The Financial Services segment provides retail, wholesale, and lease financing of products sold by the Truck segment and its dealers within the U.S. and Mexico. We also finance wholesale and retail accounts receivable. Sales of new products (including trailers) of other manufacturers are also financed regardless of whether designed or customarily sold for use with our truck products. Our Mexican financial services operations primary business is to provide wholesale, retail, and lease financing to the Mexican operations' dealers and retail customers.

In 2008, retail, wholesale, and lease financing of products manufactured by others approximated 14% of the financial services segment's total originations. This segment provided wholesale financing in 2008 and 2007 for 96% and 94%, respectively, of our new truck inventory sold by us to our dealers and distributors in the U.S. and provided retail and lease financing of 11% and 12% of all new truck units sold or leased by us to retail customers for 2008 and 2007, respectively.

### **Government Contracts**

Since 2006, orders from the U.S. military for our vehicles, services, technical expertise, and related service parts have become increasingly significant. As a U.S. government contractor, we are subject to specific regulations and requirements as mandated by our contracts. These regulations include Federal Acquisition Regulations, Defense Federal Acquisition Regulations, and the Code of Federal Regulations. We are also subject to routine audits and investigations by U.S. government agencies such as the Defense Contract Management Agency and Defense Contract Audit Agency. These agencies review and assess compliance with contractual requirements, cost structure, and applicable laws, regulations, and standards.

### **Engineering and Product Development**

Our engineering and product development programs are focused on product improvements, innovations, and cost reductions. As a truck manufacturer, costs have been focused on further development of our existing products such as the Prostar and LoneStar trucks as well as modifications of our trucks to accommodate 2010 emission compliant engines. As a diesel engine manufacturer, we have incurred research, development, and tooling costs

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to design our engine product lines to meet United States Environmental Protection Agency ( U.S. EPA ), California Air Resources Board ( CARB ), and other applicable foreign government emission requirements. Our engineering and product development expenditures were \$380 million in 2008 compared to \$382 million in 2007.

**Acquisitions, Strategic Agreements, and Joint Ventures**

We continuously seek and evaluate opportunities in the marketplace that provide us with the ability to leverage new technology, expand our engineering expertise, provide access to expansion markets, and identify component and material sourcing alternatives. During the recent past, we have entered into a number of collaborative strategic relationships and have acquired businesses that allowed us to generate manufacturing efficiencies, economies of scale, and market growth opportunities. We also routinely re-evaluate our existing relationships to determine whether they continue to provide the benefits we originally envisioned as well as review potential partners for new opportunities.

In November 2007, we signed a second joint venture with Mahindra & Mahindra, Ltd. to produce diesel engines for medium and heavy commercial trucks and buses in India. This joint venture affords us the opportunity to enter a market in India that has significant growth potential for commercial vehicles and diesel power. We maintain a 49% ownership in this joint venture.

In December 2007, we sold our interests in a heavy-duty trucks parts remanufacturing business. In connection with this sale, we received gross proceeds of \$22 million.

**Backlog**

Our worldwide backlog of unfilled truck orders (subject to cancellation or return in certain events) at October 31, 2008 and 2007 was 21,400 and 18,900 units, respectively. Although the backlog of unfilled orders is one of many indicators of market demand, other factors such as changes in production rates, internal and supplier available capacity, new product introductions, and competitive pricing actions may affect point-in-time comparisons.

**Employees**

As our business requirements change, fluctuations may occur within our workforce from year to year. The following tables summarize the number of employees worldwide as of the dates indicated and an additional subset of active union employees represented by the United Automobile, Aerospace and Agricultural Implement Workers of America ( UAW ), the National Automobile, Aerospace and Agricultural Implement Workers of Canada ( CAW ), and other unions, for the periods as indicated:

|                                     | As of October 31, |                     |        |
|-------------------------------------|-------------------|---------------------|--------|
|                                     | 2008              | 2007 <sup>(A)</sup> | 2006   |
| <b>Employees worldwide</b>          |                   |                     |        |
| Total active employees              | 15,900            | 13,300              | 17,500 |
| Total inactive employees            | 1,900             | 3,900               | 700    |
| Total employees worldwide           | 17,800            | 17,200              | 18,200 |
|                                     |                   |                     |        |
|                                     | As of October 31, |                     |        |
|                                     | 2008              | 2007 <sup>(A)</sup> | 2006   |
| <b>Total active union employees</b> |                   |                     |        |
| Total UAW                           | 3,300             | 2,000               | 4,800  |
| Total CAW                           | 1,000             | 600                 | 1,400  |
| Total other unions                  | 2,800             | 2,100               | 16,200 |

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Employees are considered inactive in certain situations including disability leave, leave of absence, layoffs, and work stoppages. Inactive employees as of October 31, 2007 included approximately 2,500 UAW workers who had commenced a work stoppage that began on October 23, 2007 and ended on December 16, 2007.

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Our existing labor contract with the UAW runs through September 30, 2010. Our existing labor contract with the CAW runs through June 30, 2009. See Item 1A, *Risk Factors*, for further discussion related to the risk associated with labor and work stoppages.

### **Patents and Trademarks**

We continuously obtain patents on our inventions and own a significant patent portfolio. Additionally, many of the components we purchase for our products are protected by patents that are owned or controlled by the component manufacturer. We have licenses under third-party patents relating to our products and their manufacture and grant licenses under our patents. The monetary royalties paid or received under these licenses are not material.

Our primary trademarks are an important part of our worldwide sales and marketing efforts and provide instant identification of our products and services in the marketplace. To support these efforts, we maintain, or have pending, registrations of our primary trademarks in those countries in which we do business or expect to do business. We grant licenses under our trademarks for consumer-oriented goods, such as toy trucks and apparel, outside the product lines that we manufacture. The monetary royalties received under these licenses are not material.

### **Supply**

We purchase raw materials, parts, and components from numerous outside suppliers. To avoid duplicate tooling expenses and to maximize volume benefits, single-source suppliers fill a majority of our requirements for parts and components.

The impact of an interruption in supply will vary by commodity and type of part. Some parts are generic to the industry while others are of a proprietary design requiring unique tooling, which require additional effort to relocate. However, we believe our exposure to a disruption in production as a result of an interruption of raw materials and supplies is no greater than the industry as a whole. In order to alleviate losses resulting from an interruption in supply, we maintain contingent business interruption insurance for loss of earnings and/or extra expense directly resulting from physical loss or damage at a direct supplier location.

While we believe we have adequate assurances of continued supply, the inability of a supplier to deliver could have an adverse effect on production at certain of our manufacturing locations.

### **Impact of Government Regulation**

Truck and engine manufacturers continue to face significant governmental regulation of their products, especially in the areas of environment and safety. New on-highway emissions standards came into effect in the U.S. on January 1, 2007, which reduced allowable particulate matter and allowable nitrogen oxide. This change in emissions standards resulted in a significant increase in the cost of our products to meet these emissions levels.

We have incurred research, development, and tooling costs to design and produce our engine product lines to meet U.S. EPA and CARB emission requirements. The 2007 emission compliance standards required a more stringent reduction of nitrogen oxide and particulate matter with an additional reduction scheduled for January 1, 2010. We are developing products to meet the requirements of the 2010 emissions standards. The 2010 CARB emission regulations will begin the initial phase-in of on-board diagnostics for truck engines and are a part of our product plans.

Canadian heavy-duty engine emission regulations essentially mirror those of the U.S. EPA. Beginning in July 2008, heavy-duty engine emission requirements reflect Euro IV standards with which we are compliant. More stringent reductions of nitrogen oxide are required by 2010; however, compliance in Mexico is conditioned on availability of low sulfur diesel fuel that may not be available at that time.

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Truck manufacturers are also subject to various noise standards imposed by federal, state, and local regulations. The engine is one of a truck's primary sources of noise, and we therefore work closely with OEMs to develop strategies to reduce engine noise. We are also subject to the National Traffic and Motor Vehicle Safety Act ( Safety Act ) and Federal Motor Vehicle Safety Standards ( Safety Standards ) promulgated by the National Highway Traffic Safety Administration. We believe we are in substantial compliance with the requirements of the Safety Act and the Safety Standards.

The Energy Independence and Security Act of 2007 ( EISA07 ) was signed into law in December 2007. EISA07 requires the Department of Transportation ( DOT ) to determine in a rulemaking proceeding how to implement fuel efficiency standards for trucks with gross vehicle weights of 8,500 pounds and above. It is presently estimated that EISA07 will result in fuel efficiency standards being implemented for trucks in the 2016 - 2017 timeframe. EISA07 requires studies on truck fuel efficiency by the National Academy of Sciences and the DOT, in advance of the DOT rulemaking process. We are actively engaged in providing information on vehicle fuel efficiency for the studies and we expect to participate in the rulemaking process.

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**EXECUTIVE OFFICERS OF NIC**

The following selected information for each of our current executive officers (as defined by regulations of the SEC) was prepared as of November 30, 2008.

**William A. Caton**, 57, Executive Vice President and Chief Risk Officer of NIC since 2008. He is also Executive Vice President and Chief Risk Officer of Navistar, Inc. since 2008. Prior to these positions, he served as a director and Executive Vice President and Chief Financial Officer of both NIC and Navistar, Inc. from 2006 to 2008 and Executive Vice President and Vice President, Finance of both NIC and Navistar, Inc. from 2005 to 2006. Prior to these positions, he was employed by various subsidiaries of Dover Corporation from 1989 to 2005, most recently serving as Vice President and Chief Financial Officer of Dover Diversified, Inc., a diversified manufacturing company with over 7,000 employees, from 2002 to 2005; Chief Financial Officer of Waukesha Bearings, a leading supplier of fluid film and active magnetic bearings for turbo machinery, from 2001 to 2002; and Executive Vice President of DovaTech, Ltd., a manufacturer of welding equipment from 2000 to 2001.

**Phyllis E. Cochran**, 56, Senior Vice President and General Manager of the Parts Group of Navistar, Inc. since 2007. Prior to this position, Ms. Cochran served as Vice President and General Manager of the Parts Group of Navistar, Inc. from 2004 to 2007. Ms. Cochran was also Chief Executive Officer and General Manager of Navistar Financial Corporation from 2003 to 2004. Ms. Cochran was Executive Vice President and General Manager of Navistar Financial Corporation from 2002 to 2003. Ms. Cochran also served as Vice President of Operations for Navistar Financial Corporation from 2000 to 2002; and Vice President and Controller for Navistar Financial Corporation from 1994 to 2000. She is a director of The Mosaic Company, a world leading producer and marketer of concentrated phosphate and potash crop nutrients.

**Steven K. Covey**, 57, Senior Vice President and General Counsel of NIC since 2004 and Chief Ethics Officer since 2008. Mr. Covey also is Senior Vice President and General Counsel of Navistar, Inc. since 2004 and Chief Ethics Officer since 2008. Prior to these positions, Mr. Covey served as Deputy General Counsel of Navistar, Inc. from April 2004 to September 2004 and as Vice President and General Counsel of Navistar Financial Corporation from 2000 to 2004. Mr. Covey also served as Corporate Secretary for NIC from 1990 to 2000; and Associate General Counsel of Navistar, Inc. from 1992 to 2000.

**Gregory W. Elliott**, 47, Senior Vice President, Human Resources and Administration of Navistar, Inc. since 2008. Prior to this position, Mr. Elliott served as Vice President, Corporate Human Resources and Administration of Navistar, Inc. from 2004 to 2008 and as Vice President, Corporate Communications of Navistar, Inc., from 2000 to 2004. Prior to joining Navistar, Inc., Mr. Elliott served as Director of Executive Communications of General Motors Corporation from 1997 to 1999.

**Terry M. Endsley**, 53, Executive Vice President, Chief Financial Officer and a directors of NIC since 2008. He is also a director and Executive Vice President and Chief Financial Officer of Navistar, Inc. since 2008. Prior to these positions, he served as Senior Vice President and Treasurer of NIC since 2006 and Vice President and Treasurer of NIC since 2003. Mr. Endsley also served as Senior Vice President and Treasurer of Navistar, Inc. since 2006 and Vice President and Treasurer of Navistar, Inc. since 2003. Prior to that, Mr. Endsley served as Assistant Treasurer of NIC from 1997 to 2003 and as Assistant Treasurer of Navistar, Inc. from 1997 to 2003.

**D.T. (Dee) Kapur**, 56, President of the Truck Group of Navistar, Inc. since 2003. Prior to joining Navistar, Inc., Mr. Kapur was employed by Ford Motor Company, a leading worldwide automobile manufacturer, from 1976 to 2003, most recently serving as Executive Director of North American Business Revitalization, Value Engineering from 2002 to 2003; Executive Director of Ford Outfitters, North American Truck, from 2001 to 2002; and Vehicle Line Director, Full Size Pick-ups and Utilities from 1997 to 2001.

**Curt A. Kramer**, 40, Corporate Secretary of NIC since 2007. Mr. Kramer also is Associate General Counsel and Corporate Secretary of Navistar, Inc. since 2007. Prior to these positions, Mr. Kramer served as General Attorney

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of Navistar, Inc. from April 2007 to October 2007, Senior Counsel of Navistar, Inc. from 2004 to 2007, Senior Attorney of Navistar, Inc. from 2003 to 2004 and Attorney of Navistar, Inc. from 2002 to 2003. Prior to joining Navistar, Inc., Mr. Kramer was in private practice.

**James M. Moran**, 43, Vice President and Treasurer of NIC since 2008. Mr. Moran is also Vice President and Treasurer of Navistar, Inc. since 2008. Prior to these positions, Mr. Moran served as Vice President and Assistant Treasurer of both NIC and Navistar, Inc. from 2007 to 2008 and Director of Corporate Finance of Navistar, Inc. from 2005 to 2007. Prior to joining NIC, Mr. Moran served as Vice President and Treasurer of R.R. Donnelley & Sons Company from 2003 to 2004 and Assistant Treasurer of R.R. Donnelley & Sons Company from 2002 to 2003. Prior to that, Mr. Moran held various positions in corporate finance, strategic planning, and credit and collections at R.R. Donnelley & Sons Company.

**Daniel C. Ustian**, 58, President and Chief Executive Officer of NIC since 2003 and Chairman of the Board of Directors of NIC since 2004. He is also Chairman of Navistar, Inc. since 2004 and President and Chief Executive Officer of Navistar, Inc. since 2003 and a director since 2002. Prior to these positions, he was President and Chief Operating Officer from 2002 to 2003, and President of the Engine Group of Navistar, Inc. from 1999 to 2002, and he served as Group Vice President and General Manager of Engine & Foundry from 1993 to 1999. He is a director of Monaco Coach Corporation and a member of the Business Roundtable, Society of Automotive Engineers and the American Foundry Association.

**John P. Waldron**, 44, Vice President and Controller (Principal Accounting Officer) of NIC since 2006. Prior to this position, Mr. Waldron was employed from 2005 to 2006 as Vice President, Assistant Corporate Controller of R.R. Donnelley & Sons Company, an international provider of print and print related services. Prior to that, Mr. Waldron was employed from 1999 to 2005 as Corporate Controller of Follett Corporation, a provider of education-related products and services.

### **Item 1A. Risk Factors**

The Company's financial condition, results of operations, and cash flows are subject to various risks, many of which are not exclusively within the Company's control that may cause actual performance to differ materially from historical or projected future performance. The risks described below could materially and adversely affect our business, financial condition, results of operations, or cash flows. These risks are not the only risks that we face. Our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations.

*Our technology solution to meet U.S. federal 2010 emissions standards may not be successful or may be more costly than planned.* Most truck and engine manufacturers have chosen selective catalytic reduction (SCR) systems to address the 2010 emission standards. We intend to address the 2010 emissions requirements for our core applications through advances in fuel systems, air management, combustion, and engine controls.

*The markets in which we compete are subject to considerable cyclicity.* Our ability to be profitable depends in part on the varying conditions in the truck, bus, mid-range diesel engine, and service parts markets, which are subject to cycles in the overall business environment and are particularly sensitive to the industrial sector, which generates a significant portion of the freight tonnage hauled. Truck and engine demand is also dependent on general economic conditions, interest rate levels, and fuel costs, among other external factors.

*We operate in the highly competitive North American truck market.* The North American truck market in which we operate is highly competitive. This competition results in price discounting and margin pressures throughout the industry and adversely affects our ability to increase or maintain vehicle prices.

*Our business may be adversely impacted by work stoppages and other labor relations matters.* We are subject to risk of work stoppages and other labor relations matters because a significant portion of our workforce is unionized. As of October 31, 2008, approximately 64% of our hourly workers and 9% of





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our salaried workers are represented by labor unions and are covered by collective bargaining agreements. Many of these agreements include provisions that limit our ability to realize cost savings from restructuring initiatives such as plant closings and reductions in workforce. Our current collective bargaining agreement with the UAW will expire in October 2010. Any UAW strikes, threats of strikes, or other resistance in connection with the negotiation of a new agreement or otherwise could materially adversely affect our business as well as impair our ability to implement further measures to reduce structural costs and improve production efficiencies. A lengthy strike by the UAW that involves a significant portion of our manufacturing facilities could have a material adverse effect on our financial condition, results of operations, and cash flows. See Item 1, *Business*, Employees.

*Current credit market conditions may impair our access to sufficient capital to engage in financing activities.* The U.S. and global economies are currently undergoing a period of economic uncertainty, and the related financial markets are experiencing unprecedented volatility. The current financial turmoil affecting the banking system and financial markets and the possibility that financial institutions may consolidate or go out of business have resulted in a tightening in the credit markets, a low level of liquidity in many financial markets, and extreme volatility in fixed income, credit, currency, and equity markets. Our financial services segment supports our manufacturing operations by providing financing to a significant portion of our dealers and retail customers. Our Financial Services segment traditionally obtains the funds to provide such financing from sales of receivables, medium and long-term debt, and equity capital and from short and long-term bank borrowings. If cash provided by operations, bank borrowings, continued sales and securitizations of receivables, and the placement of term debt does not provide the necessary liquidity, our Financial Services segment may restrict its financing of our products both at the wholesale and retail level, which may have a significant negative effect on our liquidity and results of operations.

*Our liquidity position may be adversely affected by a continued downturn in our industry.* Any downturn in our industry can adversely affect our operating results. In the event that industry conditions remain weak for any significant period of time, our liquidity position may be adversely affected, which may limit our ability to complete product development programs, capital expenditure programs, or other strategic initiatives at currently anticipated levels.

*The loss of business from Ford could have a negative impact on our business, financial condition, and results of operations.* Ford accounted for approximately 7% of our revenues for 2008, 14% of our revenues for 2007, and 12% of our revenues for 2006. In addition, Ford accounted for approximately 44%, 58%, and 61% of our diesel engine unit volume (including intercompany transactions) in 2008, 2007, and 2006, respectively, primarily relating to the sale of our V-8 diesel engines. See Item 3, *Legal Proceedings*, and Note 16, *Commitments and contingencies*, to the accompanying consolidated financial statements, for information related to our pending litigation with Ford. The loss of business or further reductions in business from Ford or the early termination or non-renewal of our agreement with Ford may potentially subject us to other costs that may be material. See Note 7, *Impairment of property and equipment and related charges*, to the accompanying consolidated financial statements, for additional information.

*We may not achieve all of the expected benefits from our current business strategies and initiatives.* We have recently completed acquisitions and joint ventures. No assurance can be given that our previous or future acquisitions or joint ventures will be successful and will not materially adversely affect our business, financial condition, or results of operations. Failure to successfully manage and integrate these and potential future acquisitions and joint ventures could materially harm our financial condition, results of operations, and cash flows.

*Our manufacturing operations are dependent upon third-party suppliers, making us vulnerable to supply shortages.* We obtain materials and manufactured components from third-party suppliers. Some of our suppliers are the sole source for a particular supply item. Any delay in receiving supplies could impair our ability to deliver products to our customers and, accordingly, could have a material adverse effect on our business, financial condition, results of operations, and cash flows. The volatility in the financial markets and uncertainty in the automotive sector could result in exposure related to the financial viability of certain of our key third-party suppliers.

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*Our business may be adversely affected by government contracting risks.* We derived approximately 27% of our revenues for 2008, 4% of our revenues for 2007, and 2% of our revenues for 2006 from the U.S. government. Our existing U.S. government contracts could extend over multiple years and are conditioned upon the continuing availability of congressional appropriations. Congress usually appropriates funds on a fiscal-year basis and if the congressional appropriations for a program under which we are contractors are not made, or are reduced or delayed, our contract could be cancelled or government purchases under the contract could be reduced or delayed, which could adversely affect our financial condition, results of operations, or cash flows. Although we have multiple bids and quotes, there are no guarantees that they will be awarded to us in the future or that volumes will be similar to volumes under previously awarded contracts. In addition, U.S. government contracts generally permit the contracting government agency to terminate the contract, in whole or in part, either for the convenience of the government or for default based on our failure to perform under the contract. If a contract is terminated for convenience, we would generally be entitled to the payment of our allowable costs and an allowance for profit on the work performed. If one of our government contracts were to be terminated for default, we could be exposed to liability and our ability to obtain future contracts could be adversely affected.

*We are the subject of various lawsuits and governmental investigations alleging violations of federal securities laws and Delaware state law in relation to the restatement of certain previously issued financial statements.* The restatement of our financial results has led to lawsuits and governmental investigations. For additional information regarding this matter, see Item 3, *Legal Proceedings*.

*Failure to properly identify and correct material weaknesses or comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002.* Section 404 of the Sarbanes-Oxley Act requires that we evaluate and determine the effectiveness of our internal control over financial reporting. As described in Item 9A, *Controls and Procedures*, of this Annual Report on Form 10-K, we concluded that there are material weaknesses in our internal control over financial reporting. If we do not correct these material weaknesses, or we or our independent registered public accounting firm determines that we have additional material weaknesses in our internal control over financial reporting, we may be unable to provide financial information in a timely and reliable manner. Although we consistently review and evaluate our internal control systems to allow management to report on, and our independent auditors to attest to, the sufficiency of our internal control, we cannot assure you that we will not discover additional material weaknesses in our internal control over financial reporting. Any such additional material weaknesses or failure to correct existing material weaknesses could adversely affect investor confidence in the Company.

*We have significant under-funded postretirement obligations.* The under-funded portion of our projected benefit obligation was \$763 million and \$197 million for pension benefits at October 31, 2008 and 2007, respectively, and \$979 million and \$1.1 billion for postretirement healthcare benefits at October 31, 2008 and 2007, respectively. Moreover, we have assumed expected rates of return on plan assets and growth rates of retiree medical costs and the failure to achieve the expected rates of return and growth rates could have an adverse impact on our under-funded postretirement obligations, financial condition, results of operations, and cash flows. The volatility in the financial markets affects the valuation of our pension assets and liabilities, resulting in potentially higher pension costs and higher levels of under-funding in future periods.

*Our substantial debt could require us to use a significant portion of our cash flows to satisfy our debt obligations and may limit our operating flexibility.* We have a substantial amount of outstanding indebtedness which could:

Increase our vulnerability to general adverse economic and industry conditions;

Limit our ability to use operating cash flows in other areas of our business because we must dedicate a portion of these funds to make significantly higher interest payments on our indebtedness;

Limit our ability to obtain additional financing to fund future working capital, acquisitions, capital expenditures, engineering and product development costs, and other general corporate requirements;

Limit our ability to take advantage of business opportunities as a result of various restrictive covenants in our indebtedness; and

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Place us at a competitive disadvantage compared to our competitors that have less debt.

*The costs associated with complying with environmental and safety regulations could lower our margins.* We, like other truck and engine manufacturers, continue to face heavy governmental regulation of our products, especially in the areas of environment and safety. We have incurred engineering and product development costs and tooling costs to design our engine product lines to meet new U.S. EPA and CARB and other applicable foreign government emission standards. Complying with environmental and safety requirements adds to the cost of our products and increases the capital-intensive nature of our business.

*We are exposed to political, economic, and other risks that arise from operating a multinational business.* We have significant operations in foreign countries, primarily in Canada, Mexico, Brazil, Argentina, and India. Accordingly, our business is subject to the political, economic, and other risks that are inherent in operating in those countries and internationally. These risks include, among others:

Trade protection measures and import or export licensing requirements;

Tax rates in certain foreign countries that exceed those in the U.S. and the imposition of withholding requirements for taxes on foreign earnings;

Difficulty in staffing and managing international operations and the application of foreign labor regulations;

Currency exchange rate risk; and

Changes in general economic and political conditions in countries where we operate, particularly in emerging markets.

*Our ability to use net operating loss ( NOL ) carryovers to reduce future tax payments could be negatively impacted if there is a change in our ownership or a failure to generate sufficient taxable income.* Presently, there is no annual limitation on our ability to use NOLs to reduce future income taxes. However, if an ownership change as defined in Section 382 of the Internal Revenue Code of 1986, as amended, occurs with respect to our capital stock, our ability to use NOLs would be limited to specific annual amounts. Generally, an ownership change occurs if certain persons or groups increase their aggregate ownership by more than 50 percentage points of our total capital stock in a three-year period. If an ownership change occurs, our ability to use domestic NOLs to reduce taxable income is generally limited to an annual amount based on the fair market value of our stock immediately prior to the ownership change multiplied by the long-term tax-exempt interest rate. NOLs that exceed the Section 382 limitation in any year continue to be allowed as carryforwards for the remainder of the 20-year carryforward period and can be used to offset taxable income for years within the carryover period subject to the limitation in each year. Our use of new NOLs arising after the date of an ownership change would not be affected. If more than a 50% ownership change were to occur, use of our NOLs to reduce payments of federal taxable income may be deferred to later years within the 20-year carryover period; however, if the carryover period for any loss year expires, the use of the remaining NOLs for the loss year will be prohibited. If we should fail to generate a sufficient level of taxable income prior to the expiration of the NOL carryforward periods, then we will lose the ability to apply the NOLs as offsets to future taxable income.

*Adverse resolution of litigation may adversely affect our financial condition, results of operations, or cash flows.* Litigation can be expensive, lengthy, and disruptive to normal business operations. The results of complex legal proceedings are often uncertain and difficult to predict. An unfavorable outcome of a particular matter could have a material adverse effect on our business, financial condition, results of operations, or cash flows. For additional information regarding certain lawsuits in which we are involved, see Item 3, *Legal Proceedings*, and Note 16, *Commitments and contingencies*, to the accompanying consolidated financial statements.



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### **Item 1B. *Unresolved Staff Comments***

We have received no written comments regarding our periodic or current reports from the staff of the SEC that were issued 180 days or more preceding the end of 2008 that remain unresolved.

### **Item 2. *Properties***

In North America, we operate fourteen manufacturing and assembly facilities, which contain in the aggregate approximately 12 million square feet of floor space. Of these fourteen facilities, eleven are owned and three are subject to leases. Eight plants manufacture and assemble trucks, buses, and chassis, while six plants are used to build engines. Of these six plants, four manufacture diesel engines, one manufactures grey iron castings, and one manufactures ductile iron castings. In addition, we own or lease other significant properties in the U.S. and Canada including vehicle and parts distribution centers, sales offices, two engineering centers (which serve our Truck and Engine segments), and our headquarters which is located in Warrenville, Illinois. In addition, we own and operate manufacturing plants in both Brazil and Argentina, which contain a total of 1 million square feet of floor space for use by our South American engine subsidiaries.

The principal product development and engineering facility for our Truck segment is located in Fort Wayne, Indiana, and for our Engine segment is located in Melrose Park, Illinois. The Parts segment has eight distribution centers in the U.S., two in Canada, and one in Mexico.

A majority of the activity of the Financial Services segment is conducted from leased headquarters in Schaumburg, Illinois. The Financial Services segment also leases an office in Mexico.

All of our facilities are being utilized with the exception of the Indianapolis, Indiana engine plant, which stopped producing finished goods effective May 23, 2008 due to low order volumes for our V-8 engine. Resumption of production at this facility is dependent upon the receipt of additional engine orders. We believe that all of our facilities have been adequately maintained, are in good operating condition, and are suitable for our current needs. These facilities, together with planned capital expenditures, are expected to meet our needs in the foreseeable future.

### **Item 3. *Legal Proceedings***

#### *Overview*

We are subject to various claims arising in the ordinary course of business, and are party to various legal proceedings that constitute ordinary routine litigation incidental to our business. The majority of these claims and proceedings relate to commercial, product liability, and warranty matters. In our opinion, apart from the actions set forth below, the disposition of these proceedings and claims, after taking into account recorded accruals and the availability and limits of our insurance coverage, will not have a material adverse effect on our business or our financial condition, results of operations, or cash flows.

#### *Ford Litigation*

In January 2007, a complaint was filed against us in Oakland County Circuit Court in Michigan by Ford claiming damages relating to warranty and pricing disputes with respect to certain engines purchased by Ford from us. While Ford's complaint did not quantify its alleged damages, we estimate that Ford may be seeking in excess of \$500 million, and that this amount may increase (i) as we continue to sell engines to Ford at a price that Ford alleges is too high and (ii) as Ford pays its customers' warranty claims, which Ford alleges are attributable to us. We disagree with Ford's position and are defending ourselves vigorously in this litigation. We have filed an answer to the complaint denying Ford's allegations in all material respects. We have also asserted affirmative defenses to Ford's claims, as well as counterclaims alleging that, among other things, Ford has materially breached contracts between it and us in several different respects. Based on our investigation to date, we believe

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we have meritorious defenses to this matter. There can be no assurance, however, that we will be successful in our defense. In June 2007, we filed a separate lawsuit against Ford in the Circuit Court of Cook County, Illinois, for breach of contract relating to the manufacture of new diesel engines for Ford for use in vehicles including the F-150 pickup truck. In that case we are seeking unspecified damages. In September 2007, the judge dismissed our lawsuit against Ford, directing us to proceed with mediation. In February 2008, we re-filed the lawsuit against Ford because the parties were unable to resolve the dispute through mediation.

### *Securities and Exchange Commission Investigations*

In October 2004, we received a request from the staff of the SEC to voluntarily produce certain documents and information related to our accounting practices with respect to defined benefit pension plans and other postretirement benefits. We fully cooperated with this request. Based on the status of the inquiry, we are not able to predict the final outcome.

In January 2005, we announced that we would restate our financial results for 2002 and 2003 and the first three quarters of 2004. Our restated Annual Report on Form 10-K was filed in February 2005. The SEC notified us on February 9, 2005 that it was conducting an informal inquiry into our restatement. On March 17, 2005, we were advised by the SEC that the status of the inquiry had been changed to a formal investigation. On April 7, 2006, we announced that we would restate our financial results for 2002 through 2004 and for the first three quarters of 2005. We were subsequently informed by the SEC that it was expanding the investigation to include this restatement. Our 2005 Annual Report on Form 10-K, which included the restated financial statements, was filed in December 2007. We have been providing information to and fully cooperating with the SEC on this investigation. Based on the status of the investigation, we are not able to predict its final outcome.

### *Litigation Relating to Accounting Controls and Financial Restatement*

In December 2007, a complaint was filed against us by Norfolk County Retirement System and Brockton Contributory Retirement System (collectively Norfolk ). In March 2008, an additional complaint was filed by Richard Garza. Each of these matters is pending in the United States District Court, Northern District of Illinois.

The plaintiffs in the Norfolk case allege they are shareholders suing on behalf of themselves and a class of other shareholders who purchased shares of the Company's common stock between February 14, 2003 and July 17, 2006. The complaint alleges that the defendants, which include the Company, one of its executive officers, two of its former executive officers, and the Company's former independent accountants, Deloitte & Touche LLP, violated federal securities laws by making false and misleading statements about the Company's financial condition during that period. In March 2008, the court appointed Norfolk County Retirement System and the Plumbers Local Union 519 Pension Trust as joint lead plaintiffs. The plaintiffs in this matter seek compensatory damages and attorneys' fees among other relief. We are currently awaiting the Court's decision on a motion to dismiss that we originally filed on July 7, 2008.

The plaintiff in the Garza case brought a derivative claim on behalf of the Company against one of the Company's executive officers, two of its former executive officers, and certain of its directors, alleging that (i) all of the defendants violated their fiduciary obligations under Delaware law by willfully ignoring certain accounting and financial reporting problems at the Company, thereby knowingly disseminating false and misleading financial information about the Company, (ii) certain of the defendants were unjustly enriched in connection with their sale of Company stock during the December 2002 to January 2006 period, and (iii) defendants violated Delaware law by failing to hold an annual meeting of shareholders. In connection with this last allegation, the plaintiff seeks an order requiring defendants to schedule an annual meeting of shareholders. Otherwise, the plaintiffs in this matter seek compensatory damages, disgorgement of the proceeds of defendants' profits from the sale of Company stock, attorneys' fees, and other equitable relief.

We strongly dispute the allegations in these complaints and will vigorously defend ourselves.



**Table of Contents***Environmental Matters*

Along with other vehicle manufacturers, we have been subject to an increase in the number of asbestos-related claims in recent years. In general, these claims relate to illnesses alleged to have resulted from asbestos exposure from component parts found in older vehicles, although some cases relate to the alleged presence of asbestos in our facilities. In these claims we are not the sole defendant, and the claims name as defendants numerous manufacturers and suppliers of a wide variety of products allegedly containing asbestos. We have strongly disputed these claims, and it has been our policy to defend against them vigorously. Historically, the actual damages paid out to claimants have not been material in any year to our financial condition, results of operations, or cash flows. It is possible that the number of these claims will continue to grow, and that the costs for resolving asbestos related claims could become significant in the future.

**Item 4. Submission of Matters to a Vote of Security Holders**

At our Annual Meeting of Stockholders held on September 5, 2008, the following nominees were elected to the Board of Directors to serve in the class and for the term as set forth below and until their successors are duly elected and qualified. There were no broker non-votes or abstentions with respect to this matter. The results of the voting for the election of directors were as follows:

| Nominee   | Votes For  | Withheld  |
|---|------------|-----------|
| <b><u>Class I Directors Whose Term Expires 2009</u></b>   |            |           |
| Y. Marc Belton  | 58,275,917 | 5,601,430 |
| Dr. Abbie Griffin   | 58,271,115 | 5,606,232 |
| Terry M. Endsely  | 62,502,498 | 1,374,849 |
| <b><u>Class II Directors Whose Term Expires 2010</u></b>  |            |           |
| Eugenio Clariond  | 59,521,668 | 4,355,679 |
| David D. Harrison   | 59,519,475 | 4,357,872 |
| Steven J. Klinger   | 63,782,191 | 95,156    |
| <b><u>Class III Directors Whose Term Expires 2010</u></b> |            |           |
| James H. Keyes  | 58,271,265 | 5,606,082 |
| John D. Correnti  | 58,254,838 | 5,622,509 |
| Michael N. Hammes   | 59,497,292 | 4,380,055 |
| Daniel C. Ustian  | 59,498,402 | 4,378,945 |

Accordingly, the nominees received a plurality of the votes cast in the election of directors at the meeting and were elected. The name of the remaining director who did not stand for election at the Annual Meeting and who is elected in accordance with our certificate of incorporation is Dennis D. Williams.

A second proposal put before the stockholders at the Annual Meeting was the ratification of the selection of KPMG LLP as the Company's independent auditors for the fiscal year ending October 31, 2008. The results of voting for the ratification of KPMG LLP as the Company's independent auditors for the fiscal year ending October 31, 2008 were as follows:

|                  |                      |                        |
|------------------|----------------------|------------------------|
| <b>Votes For</b> | <b>Votes Against</b> | <b>Votes Abstained</b> |
| 63,820,121       | 36,958               | 20,268                 |

Accordingly, the number of affirmative votes cast on the proposal constituted more than a majority of the votes cast on the proposal at the Annual Meeting and the proposal was approved.

**Table of Contents****PART II****Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities**

Prior to February 14, 2007, our common stock was listed on the New York Stock Exchange ( NYSE ), the Chicago Stock Exchange, and the Pacific Stock Exchange under the abbreviated stock symbol NAV. Effective February 14, 2007, our common stock was de-listed from the aforementioned exchanges and then traded on the Over-the-Counter ( OTC ) market under the symbol NAVZ until June 30, 2008, at which time our common stock was re-listed on the NYSE. As of November 30, 2008, there were approximately 13,615 holders of record of our common stock.

The following is the high and low market price per share of our common stock from NYSE and OTC for each quarter of 2007 and 2008. Our stock was traded on the OTC market for part of the second quarter of 2007, the third and fourth quarters of 2007, the first and second quarters of 2008, and for part of the third quarter of 2008. The OTC market quotations in the table below reflect inter-dealer prices, without retail mark-up, mark-down, or commissions and may not represent actual transactions.

| 2008                | High     | Low      | 2007                | High     | Low      |
|---------------------|----------|----------|---------------------|----------|----------|
| 1 <sup>st</sup> Qtr | \$ 64.45 | \$ 43.75 | 1 <sup>st</sup> Qtr | \$ 44.56 | \$ 26.89 |
| 2 <sup>nd</sup> Qtr | \$ 66.05 | \$ 48.00 | 2 <sup>nd</sup> Qtr | \$ 59.50 | \$ 39.35 |
| 3 <sup>rd</sup> Qtr | \$ 79.05 | \$ 50.29 | 3 <sup>rd</sup> Qtr | \$ 74.60 | \$ 53.10 |
| 4 <sup>th</sup> Qtr | \$ 63.50 | \$ 21.95 | 4 <sup>th</sup> Qtr | \$ 72.00 | \$ 46.00 |

Holders of our common stock are entitled to receive dividends when and as declared by the Board of Directors out of funds legally available therefor, provided that, so long as any shares of our preferred stock and preference stock are outstanding, no dividends (other than dividends payable in common stock) or other distributions (including purchases) may be made with respect to the common stock unless full cumulative dividends, if any, on our shares of preferred stock and preference stock have been paid. Under the General Corporation Law of the State of Delaware, dividends may only be paid out of surplus or out of net profits for the year in which the dividend is declared or the preceding year, and no dividend may be paid on common stock at any time during which the capital of outstanding preferred stock or preference stock exceeds our net assets.

Payments of cash dividends and the repurchase of common stock are currently limited due to restrictions contained in our \$1.5 billion loan facilities dated January 19, 2007. We have not paid dividends on our common stock since 1980 and do not expect to pay cash dividends on our common stock in the foreseeable future.

There were no sales of unregistered equity securities during the fourth quarter ended October 31, 2008 nor were there purchases by us or our affiliates of our equity securities during the fourth quarter ended October 31, 2008.

**Table of Contents****Item 6. Selected Financial Data**

Refer to Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and the notes to the accompanying consolidated financial statements for additional information regarding the financial data presented below, including matters that might cause this data not to be indicative of our future financial condition or results of operations.

We operate in four industry segments: Truck, Engine, Parts, and Financial Services. A detailed description of our segments, products, and services, as well as additional selected financial data is included in *Our Operating Segments* in Item 1, *Business*, and in Note 17, *Segment reporting*, to the accompanying consolidated financial statements.

**Five-Year Summary of Selected Financial and Statistical Data**

| As of and for the Years Ended October 31,<br>(in millions, except per share data, units shipped, and percentages) | 2008      | 2007      | 2006      | 2005      | 2004     |
|---|-----------|-----------|-----------|-----------|----------|
| <b>RESULTS OF OPERATIONS DATA</b>   |           |           |           |           |          |
| Sales and revenues, net   | \$ 14,724 | \$ 12,295 | \$ 14,200 | \$ 12,124 | \$ 9,678 |
| Net income (loss)   | 134       | (120)     | 301       | 139       | (44)     |
| Depreciation and amortization   | 393       | 371       | 364       | 322       | 288      |
| Basic earnings (loss) per share   | 1.89      | (1.70)    | 4.29      | 1.98      | (0.64)   |
| Diluted earnings (loss) per share   | 1.82      | (1.70)    | 4.12      | 1.90      | (0.64)   |
| Average number of shares outstanding:   |           |           |           |           |          |
| Basic   | 70.7      | 70.3      | 70.3      | 70.1      | 69.7     |
| Diluted   | 73.2      | 70.3      | 74.5      | 76.3      | 69.7     |
| <b>BALANCE SHEET DATA</b>   |           |           |           |           |          |
| Total assets  | \$ 10,390 | \$ 11,448 | \$ 12,830 | \$ 10,786 | \$ 8,750 |
| Long-term debt: <sup>(A)</sup>  |           |           |           |           |          |
| Manufacturing operations  | 1,639     | 1,665     | 1,946     | 1,476     | 1,514    |
| Financial services operations   | 3,770     | 4,418     | 4,809     | 3,933     | 2,106    |
| Total long-term debt  | \$ 5,409  | \$ 6,083  | \$ 6,755  | \$ 5,409  | \$ 3,620 |
| Redeemable equity securities  | \$ 143    | \$ 140    | \$        | \$        | \$       |
| Stockholders' deficit   | (1,495)   | (874)     | (1,114)   | (1,699)   | (1,852)  |
| <b>SUPPLEMENTAL DATA</b>  |           |           |           |           |          |
| Capital expenditures <sup>(B)</sup>   | \$ 176    | \$ 312    | \$ 230    | \$ 295    | \$ 244   |
| Engineering and product development costs   | 380       | 382       | 453       | 413       | 287      |
| <b>OPERATING DATA</b>   |           |           |           |           |          |
| Manufacturing gross margin <sup>(C)</sup>   | 17.1%     | 14.9%     | 15.7%     | 13.3%     | 11.9%    |
| U.S. and Canadian market share <sup>(D)</sup>   | 30.8%     | 26.6%     | 26.7%     | 27.0%     | 28.1%    |
| Unit shipments worldwide:   |           |           |           |           |          |
| Truck chargeouts <sup>(E)</sup>   | 102,200   | 113,600   | 155,400   | 131,700   | 108,800  |
| Total engine shipments <sup>(F)</sup>   | 345,500   | 404,700   | 519,700   | 522,600   | 432,200  |

(A) Exclusive of current portion of long-term debt.

(B) Exclusive of purchases of equipment leased to others.

(C) Manufacturing gross margin is calculated by subtracting *Costs of products sold* from *Sales of manufactured products, net* and dividing that amount by *Sales of manufactured products, net*.

(D) Based on market-wide information from Wards Communications and R.L. Polk & Co.

(E) Truck chargeouts are defined by management as trucks that have been invoiced.

(F) Includes engine shipments to OEMs and to our Truck segment.

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### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is designed to provide information that is supplemental to, and should be read together with, our consolidated financial statements and the accompanying notes. Information in this Item is intended to assist the reader in obtaining an understanding of our consolidated financial statements, the changes in certain key items in those financial statements from year-to-year, the primary factors that accounted for those changes, any known trends or uncertainties that we are aware of that may have a material affect on our future performance, as well as how certain accounting principles affect the Company's consolidated financial statements. In addition, this Item provides information about our business segments and how the results of those segments impact our financial condition and results of operations as a whole. Our MD&A includes the following sections:

Executive Summary

Key Trends and Business Outlook

Results of Operations and Segment Review

Liquidity and Capital Resources

Off-Balance Sheet Arrangements

Contractual Obligations

Other Information

Income Taxes

Environmental Matters

Securitization Transactions

Critical Accounting Policies and Estimates

New Accounting Pronouncements

### **Executive Summary**

In 2008, we continued the execution of our long term strategies which has resulted in a fundamental shift in our profitability. For the year ended October 31, 2008, we recorded net income of \$134 million or diluted earnings per share of \$1.82 during a year when we experienced declining unit volume shipments in our two largest segments: Truck and Engine. Our Truck segment's traditional shipments declined by over 43% from a high of 127,100 units in 2006 compared to a low of 72,900 units in 2008. Our Engine segment's shipments declined by over 33% from a high of 519,700 units in 2006 as compared to a low of 345,500 units in 2008. Our profitability was driven by tremendous growth in our Navistar Defense, LLC subsidiary in 2008, offsetting sales declines in our traditional truck markets. Our U.S. military sales increased to \$3.9 billion in

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2008 from \$368 million in 2007 and \$238 million in 2006 primarily due to an increase in our MRAP volumes and to a lesser extent parts procurement. The impact of unit declines in our Engine segment related to Ford in the U.S. were mitigated by an 18% increase in our unit sales in South America. In addition to our improved sales, our profitability was favorably affected by actions we initiated to control our overall costs by idling plants with low volumes and containing our legacy costs by actively managing our health care costs.

We encountered a severe downturn in the markets of our two largest segments: Truck and Engine. The unit delivery declines in these two segments significantly curtailed our net sales but were more than offset by year over year growth of \$3.5 billion in our sales to the U.S. military through our Navistar Defense, LLC subsidiary as compared to 2007. Excluding the growth in U.S. military sales, the declines in our Truck segment were heavily influenced by the overall performance of the traditional truck markets. Our traditional truck market shipments experienced a decline of 3,900 units or 5% in 2008 versus the prior year. The first half declines in 2008 in our traditional truck shipments were primarily attributable to unfavorable comparisons to the prior year, when

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customers increased their purchases of 2006 engines ahead of the implementation of the 2007 emissions standards. In addition, retail customer demand for new trucks was further reduced as a result of increasing diesel fuel prices through most of 2008 and declining economic conditions in the U.S. during the second half of 2008. Our worldwide sales of diesel engines experienced declines of 59,200 units or 15% in 2008 versus prior year. The primary reason for this decline was decreased purchase requirements from Ford. We believe our sales to Ford are unlikely to return to historical volumes and have idled operations to mitigate this impact. We have also increased our sales to diversify our portfolio of customers primarily through our Brazilian engine subsidiary, MWM.

Excluding the \$42 million net gain in 2008 primarily due to modifications to our UAW master contract, we incurred postretirement benefits expense of \$25 million and \$145 million in 2008 and 2007, respectively. Primary drivers of the lower postretirement benefits expense in 2008 versus 2007 included higher expected returns on plan assets in 2008 (due to a larger asset base at the beginning of 2008). Expected returns on plan assets are a favorable offset to net postretirement benefits expense. We also benefited from lower cumulative loss amortization in 2008 versus 2007, which is another component of net postretirement benefits expense.

We expect to incur significantly higher net postretirement benefits expense during 2009. This results largely from the decline in the asset base during 2008 (which will lower the value of expected returns for 2009) and increased amortization of cumulative losses.

Our total costs and expenses in 2008 were significantly higher compared to 2007 primarily due to *Impairment of property and equipment* and other costs of \$395 million related to our expectations of permanently lower Ford diesel volumes in our Engine segment. The majority of the costs related to the lower Ford volumes resulted in the impairment of property and equipment. We recorded \$358 million of impairment charges because we believe there is a high probability that the diesel engines we will sell to Ford in the U.S. will remain significantly lower than past levels and can no longer support the asset carrying values.

Included in the change in our results were the following significant items in 2008: *Impairment of property and equipment* and other costs of \$395 million described above, derivative expense due to a non-cash mark to market charge on our interest rate swap agreements of \$25 million in 2008 compared to \$14 million in 2007, foreign exchange loss of \$19 million in 2008 compared to a foreign exchange gain of \$12 million in 2007, a \$42 million reduction in postretirement expense primarily due to modifications to our UAW master contract exclusive to 2008, professional, consulting, and auditing expenses of \$165 million in 2008 as compared to expenses of \$234 million in 2007, and debt refinancing and restructuring costs of \$31 million in 2007 that did not recur in 2008.

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Our consolidated results of operations, including diluted earnings (loss) per share, for the years ended October 31, are as follows:

| <b>(in millions, except per share data)</b>     | <b>2008</b>      | <b>2007</b> | <b>2006</b> |
|---|------------------|-------------|-------------|
| Sales and revenues, net                         | <b>\$ 14,724</b> | \$ 12,295   | \$ 14,200   |
| Costs of products sold                          | <b>11,930</b>    | 10,131      | 11,703      |
| Impairment of property and equipment            | <b>358</b>       |             |             |
| Selling, general and administrative expenses    | <b>1,453</b>     | 1,461       | 1,332       |
| Engineering and product development costs       | <b>380</b>       | 382         | 453         |
| Interest expense                                | <b>469</b>       | 502         | 431         |
| Other (income) expenses, net                    | <b>14</b>        | (34)        | (15)        |
| Total costs and expenses                        | <b>14,604</b>    | 12,442      | 13,904      |
| Equity in income of non-consolidated affiliates | <b>71</b>        | 74          | 99          |
| Income (loss) before income tax                 | <b>191</b>       | (73)        | 395         |
| Income tax expense                              | <b>57</b>        | 47          | 94          |
| Net income (loss)                               | <b>\$ 134</b>    | \$ (120)    | \$ 301      |
| Diluted earnings (loss) per share               | <b>\$ 1.82</b>   | \$ (1.70)   | \$ 4.12     |

**Key Trends and Business Outlook**

Certain factors have affected our results of operations for 2008 as compared to 2007 and 2006. Some of these factors are as follows:

*Global Economy* The global economies, and in particular the U.S., are currently undergoing a period of economic uncertainty, and the related financial markets are experiencing unprecedented volatility. The current financial turmoil is adversely affecting the banking system and financial markets. The possibility that financial institutions may consolidate or fail has resulted in a tightening in the credit markets, a low level of liquidity in many financial markets, and extreme volatility in fixed income, credit, currency, and equity markets. Uncertainty about current global economic conditions poses a risk as customers may postpone spending in response to tighter credit, negative financial news and/or declines in income or asset values, or lower demand for their products or services which could have a material negative effect on the demand for our products. If the future economic environment continues to be less favorable than it has been in recent years, we could experience difficulties in our ability to provide retail, wholesale, and lease financing of our products. In addition, there could be exposure related to the financial viability of certain of our key third-party suppliers, some of which are our sole source for a particular supply item. The volatility in the financial markets will also affect the valuation of our pension assets and postretirement liabilities, resulting in potentially higher postretirement costs in future periods. Lower expectations of growth and profitability have resulted in impairments of certain goodwill and other long-lived assets and we could continue to experience pressure on the carrying values if these conditions persist for an extended period of time.

*Military Sales* Our Navistar Defense, LLC subsidiary experienced tremendous growth in 2008 due to our ability to leverage existing products and plants to meet the urgent demand of the U.S. military for MRAP vehicles. Our U.S. military sales increased to \$3.9 billion in 2008 from \$368 million in 2007 and \$238 million in 2006 primarily due to increases in MRAP vehicle volumes. Over the long term, we expect this business to generate approximately \$2 billion in annual sales. In 2009, we do not expect U.S. military sales to continue at the 2008 levels as a result of volume declines in MRAP vehicles partially offset by increases in other military applications.

*Traditional Truck Market* The traditional truck markets in which we compete are typically cyclical in nature due to the strong influence of macro-economic factors such as industrial production, demand for





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durable goods, capital spending, oil prices, and consumer confidence. The traditional truck industry retail deliveries were 244,100 in 2008, 319,000 in 2007, and 454,700 in 2006. We believe 2008 appears to be a low point in the cycle, but we are uncertain whether 2009 will recover from this level and, if so, to what extent.

*Worldwide Engine Unit Sales* Our worldwide engine unit sales are primarily impacted by sales to Ford and sales in South America, our largest engine market outside of the North American market. These markets are impacted by consumer demand for products that use our engines as well as macro-economic factors such as oil prices and construction activity. Our worldwide engine unit sales were 345,500 in 2008, 404,700 in 2007, and 519,700 in 2006. We believe that the Ford engine unit sales in the North American market will continue at lower levels and will not revert to historical levels. We expect 2009 worldwide unit sales to be similar to 2008.

*Capital Markets* The overall decline in the fair values of securities in the capital markets has lowered the asset values of our postretirement plans. In 2008, our actual returns experience was a loss of approximately 30% on our U.S. pension plan assets. The follow on effect is significantly higher projected post retirement expense for 2009.

*Changes in Credit Markets* Beginning in the late summer and early fall of 2007, the financial markets experienced a major correction linked primarily to the sub-prime mortgage lending market. The asset-backed securitization markets used by us and our lending conduit banks were affected by this correction. As a result, recent borrowings have been and future borrowings could continue to be more costly than in the past. Our recent securitizations in 2008 have been priced at 60 to 175 basis points over London Interbank Offered Rate (LIBOR) or U.S. Treasuries, compared to a historical spread of 50 to 60 basis points.

*Provision for Doubtful Accounts* Our portfolio quality continues to show signs of weakness. Increases in delinquencies and default rates impact charge-offs and our provision for doubtful accounts, suggesting increased credit exposure. Our provision for doubtful accounts was \$65 million or 1% of total finance and other receivables, \$52 million or 1% of total finance and other receivables, and \$28 million or 1% of total finance and other receivables in 2008, 2007, and 2006, respectively.

*Emissions Standards Change Impact and Pre-Buy* In 2010, the new emissions standards will be stricter than in 2007, although it is unknown whether or not there will be a material impact on overall truck industry cyclicality. The traditional truck markets cycle has historically spanned roughly 5 to 10 years peak-to-peak; however, in 2006 and early 2007 we had observed a significant industry-wide increase in demand for vehicles and engines ahead of the implementation of stricter 2007 engine emissions standards.

*2010 Emissions Standards Technology* In the North American markets, most truck and engine manufacturers have chosen SCR as the solution to meet 2010 emissions standards. We have chosen a non-SCR, in-cylinder, solution to meet the 2010 emissions standards and believe it will provide us with a competitive advantage.

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*Certain Professional Fees* The process of restating our previously issued consolidated financial statements for fiscal years 2003 through 2005 required considerable efforts at a significant financial cost, which has been expensed as incurred. In addition, we incurred elevated levels of professional fees in 2008, 2007, and 2006 related to assistance in preparing our consolidated financial statements, as well as documenting and performing an assessment of our internal control over financial reporting, as required by the Sarbanes-Oxley Act of 2002. The table below summarizes the costs incurred for each year in the three year period ended October 31, 2008.

| (in millions)   | 2008          | 2007          | 2006         | Total         |
|---|---------------|---------------|--------------|---------------|
| Professional fees associated with the 2005 audit and the re-audit of periods prior to 2005                  | \$ 14         | \$ 69         | \$ 23        | \$ 106        |
| Professional fees associated with the 2008, 2007, and 2006 audits   | 57            | 16            |              | 73            |
| Professional, consulting, and legal fees related to preparation of our public filing documents              | 77            | 130           | 38           | 245           |
| Professional fees associated with documentation and assessment of internal control over financial reporting | 17            | 19            | 10           | 46            |
| <b>Total</b>  | <b>\$ 165</b> | <b>\$ 234</b> | <b>\$ 71</b> | <b>\$ 470</b> |

*Customer and Transportation Industry Consolidations* Beginning in 2007 and continuing throughout the first half of 2008, various transportation companies have either been acquired or merged to form combined operating entities. Although we are unable to determine what the impact of these industry consolidations will be with regard to future purchases of our trucks, engines, and parts, we have experienced that some of these newly combined entities may not require the same number of vehicles as was previously required by the individual entities.

*Derivative Financial Instruments* Derivative financial instruments are primarily used by our financial services operations. Our financial services operations manage exposure to fluctuations in interest rates by limiting the amount of fixed rate assets funded with variable rate debt. This is accomplished by funding fixed rate receivables utilizing a combination of fixed rate and variable rate debt and derivative financial instruments to convert variable rate debt to fixed. None of our derivatives qualified for hedge accounting treatment in 2008, 2007, or 2006, accordingly we apply mark to market accounting and recognize the resulting non-cash charges as an element of interest expense. The fair value of these instruments is estimated based on quoted market prices and is subject to market risk, as the instruments may become less valuable due to changes in market conditions or interest rates. We have recognized derivative interest expenses of \$57 million in 2008, \$8 million in 2007, and \$8 million in 2006, including non-cash mark to market related expense of \$25 million in 2008, \$14 million in 2007, and \$4 million in 2006. The increase in derivative interest expense over this time period is generally a consequence of falling interest rates. For additional information, see Note 15, *Financial instruments and commodity contracts*, to the accompanying consolidated financial statements.

*Steel and Other Commodities* Generally, we have been able to mitigate the effects of steel and other commodity cost increases via a combination of design changes, material substitution, resourcing, global sourcing efforts, and pricing performance. In addition, although the terms of supplier contracts and special pricing arrangements can vary, generally a time lag exists between when our suppliers incur increased costs and when these costs are passed on to us as well as when we might recover them through increased pricing. This time lag can span several quarters or years, depending on the specific situation. More recent trends indicate the cost pressures from the majority of our steel and commodity inputs have not only ceased, but reversed somewhat. Commodity price increases, particularly for aluminum, copper, precious metals, resins, and steel have contributed to substantial cost pressures in the industry as well as from our suppliers. Cost increases related to steel, precious metals, resins, and petroleum products totaled approximately \$97 million, \$86 million, and \$178 million, for 2008, 2007, and 2006, respectively, as compared to the corresponding prior year period.

**Table of Contents****Results of Operations and Segment Review**

The following table summarizes our consolidated statements of operations and illustrates the key financial indicators used to assess the consolidated financial results. Financial information is presented for the years ended October 31, 2008, 2007, and 2006, as prepared in accordance with U.S. generally accepted accounting principles ( GAAP ). Throughout our MD&A, percentage changes that are deemed to be not meaningful are designated as N.M.

**Results of Operations for 2008 as Compared to 2007**

|   | 2008      | 2007      | Change   | Percentage Change |
|---|-----------|-----------|----------|-------------------|
| <b>(in millions, except per share data and percentage change)</b> |           |           |          |                   |
| Sales and revenues, net   | \$ 14,724 | \$ 12,295 | \$ 2,429 | 20                |
| Costs of products sold  | 11,930    | 10,131    | 1,799    | 18                |
| Impairment of property and equipment                              | 358       |           | 358      | N.M.              |
| Selling, general and administrative expenses                      | 1,453     | 1,461     | (8)      | (1)               |
| Engineering and product development costs                         | 380       | 382       | (2)      | (1)               |
| Interest expense  | 469       | 502       | (33)     | (7)               |
| Other (income) expenses, net                                      | 14        | (34)      | 48       | N.M.              |
| Total costs and expenses  | 14,604    | 12,442    | 2,162    | 17                |
| Equity in income of non-consolidated affiliates                   | 71        | 74        | (3)      | (4)               |
| Income (loss) before income tax                                   | 191       | (73)      | 264      | N.M.              |
| Income tax expense  | 57        | 47        | 10       | 21                |
| Net income (loss)   | \$ 134    | \$ (120)  | \$ 254   | N.M.              |
| Diluted earnings (loss) per share                                 | \$ 1.82   | \$ (1.70) | \$ 3.52  | N.M.              |
| <i>Sales and Revenues, net</i>                                    |           |           |          |                   |

|   | 2008      | 2007      | Change   | Percentage Change |
|---|-----------|-----------|----------|-------------------|
| <b>(in millions, except percentage change)</b>            |           |           |          |                   |
| Sales of manufactured products, net U.S. and Canada       | \$ 11,930 | \$ 9,806  | \$ 2,124 | 22                |
| Sales of manufactured products, net Rest of world ( ROW ) | 2,469     | 2,104     | 365      | 17                |
| Total sales of manufactured products, net                 | 14,399    | 11,910    | 2,489    | 21                |
| Finance revenues  | 325       | 385       | (60)     | (16)              |
| Sales and revenues, net                                   | \$ 14,724 | \$ 12,295 | \$ 2,429 | 20                |

In 2008, net sales and revenues increased by 20% as compared to 2007. This increase was attributed primarily to our Truck segment, which increased net sales and revenues by \$2.5 billion as compared to 2007 driven by higher U.S. military sales.

Our Truck segment was our largest segment as measured in net sales and revenues, representing 70% and 64% of total consolidated net sales and revenues for 2008 and 2007, respectively. Net sales and revenues increased within this segment by 32% in 2008 as compared to 2007. The primary driver of the increase in net sales and revenues was growth in our U.S. military sales of \$3.5 billion. The success of our ProStar products and ROW sales contributed to this increase but was more than offset by weakness in our traditional markets in School Bus, Class 6 and 7 medium truck ( Medium Truck ), and Class 8 heavy truck ( Heavy Truck ). Our share of retail deliveries by traditional truck class increased in 2008

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by 4% versus 2007 primarily due to the Truck segment's School Bus, Medium Truck, and Class 8 severe service ( Severe Service Truck ) classes, which all led

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their markets with the greatest relative retail market share in each of their classes by brand. We have also made significant market share gains in combined Heavy Trucks and Severe Service Trucks due to the introduction of our ProStar trucks and new military vehicles.

Our Engine segment was our second largest segment in net sales and revenues with \$3.3 billion in 2008 and \$3.5 billion in 2007. Units shipped to Ford in North America significantly decreased by 85,500 units or 40% compared to the prior year due to a reduction in Ford's purchasing requirements. There was a decrease in the relative ratio of diesel to gas trucks produced in the heavy-duty pickup truck market to 59% in 2008 from 71% in 2007, which contributed to the lowered Ford demand for our engines. We expect our sales to Ford are unlikely to return to historical volumes. The decline in units shipped to Ford in North America was partially offset by increases in non-Ford OEM sales and intersegment sales to the Truck segment for sales to the U.S. military.

Our Parts segment recorded net sales of \$1.8 billion in 2008 and \$1.6 billion in 2007 for growth of 17%. This growth was primarily due to our expansion into the military business, as well as our continued focus on expansion outside of our commercial traditional markets. In the traditional markets, we were able to realize slight growth despite the challenging economy and we continue to successfully maintain our presence through expansion into additional product lines and enhancement of our relationship with new and current fleets.

Our Financial Services segment net revenues declined 22% in 2008 as compared to 2007. There were reduced financing opportunities resulting from fewer purchases of vehicles and components due to reduced customer demand as a result of deteriorating credit market and weakening economic conditions. During 2008, proceeds from the sale of receivables, net of issuance costs, amounted to \$1.1 billion compared to \$887 million in 2007.

*Costs and Expenses*

| (in millions, except percentage change)                            | 2008             | 2007             | Change          | Percentage Change |
|--|------------------|------------------|-----------------|-------------------|
| Costs of products sold, excluding items presented separately below | \$ 11,655        | \$ 9,880         | \$ 1,775        | 18                |
| Postretirement benefits expense allocated to cost of products sold | 18               | 47               | (29)            | (62)              |
| Product warranty costs   | 257              | 204              | 53              | 26                |
| <b>Total costs of products sold</b>                                | <b>\$ 11,930</b> | <b>\$ 10,131</b> | <b>\$ 1,799</b> | <b>18</b>         |

*Costs of products sold* increased 18% for 2008 as compared to 2007. As a percentage of net sales of manufactured products, *Costs of products sold* decreased to 83% in 2008 from 85% in 2007. Included in *Costs of products sold* are product warranty costs and an allocated portion of our postretirement benefits expense. Product warranty costs, including extended warranty program costs and net of vendor recoveries (product warranty costs), were \$257 million in 2008 and \$204 million in 2007. Postretirement expense included in *Costs of products sold*, inclusive of Company 401(k) contributions, were \$18 million in 2008 and \$47 million in 2007. Apart from product warranty costs and postretirement benefits expense, *Costs of products sold* as a percentage of net sales of manufactured products decreased to 81% in 2008 from 83% in 2007. The decrease in costs of products sold as a percentage of net sales of manufactured products between 2008 and 2007 is largely attributable to increased U.S. military and ROW sales offsetting higher steel and other commodity prices (for more information regarding steel and other commodity prices, see *Key Trends and Business Outlook*, Steel and Other Commodities) and declining manufacturing efficiencies due to lower volumes as a result of weakness in our traditional markets.

The increase of \$53 million in product warranty costs in 2008 as compared to 2007 was primarily the result of adjustments to warranty accruals for changes in our estimates of warranty costs for products sold in prior years (pre-existing warranty) at the Truck and Engine segments and were partially offset by a combination of

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reduced volumes and improved per unit warranty expense. In 2008, we incurred \$76 million of product warranty costs associated with adjustments to pre-existing warranties compared to \$22 million incurred in 2007.

In 2008, product warranty costs at the Truck segment were \$152 million compared to \$138 million in 2007. We accrue warranty related costs under standard warranty terms and for claims that we may choose to pay as an accommodation to our customers even though we are not contractually obligated to do so ( out-of-policy ). The Truck segment incurred an expense for pre-existing warranty costs of \$29 million in 2008 as compared to \$14 million in 2007. Quality improvements and a 10% decline in truck shipments as compared to 2007 allowed us to mitigate our warranty costs in 2008 excluding the year-over-year increase of \$15 million for pre-existing warranty costs. Product warranty costs at the Engine segment were \$100 million (3% of Engine segment net sales of manufactured products) compared to \$64 million (2% of Engine segment net sales of manufactured products) in 2007. The increase in product warranty costs at the Engine segment was attributable to adjustments to pre-existing warranties and higher engine volumes delivered to other OEMs. We continue to work on progressive improvements in product warranty costs by focusing on controlling the reliability and quality of our emissions-compliant engines. For more information regarding product warranty costs, see Note 1, *Summary of significant accounting policies*, to the accompanying consolidated financial statements.

*Selling, general and administrative expenses*

|  | 2008     | 2007     | Change | Percentage Change |
|--|----------|----------|--------|-------------------|
| <b>(in millions, except percentage change)</b>   |          |          |        |                   |
| Selling, general and administrative expenses, excluding items presented separately below           | \$ 951   | \$ 793   | \$ 158 | 20                |
| Professional consulting, legal, and auditing fees  | 165      | 234      | (69)   | (29)              |
| Postretirement benefits expense (income) allocated to selling, general and administrative expenses | (38)     | 85       | (123)  | N.M.              |
| Dealcor expenses   | 218      | 289      | (71)   | (25)              |
| Incentive compensation and profit-sharing  | 78       |          | 78     | N.M.              |
| Provision for doubtful accounts  | 65       | 52       | 13     | 25                |
| Stock-based compensation expense   | 14       | 8        | 6      | 75                |
| Total selling, general and administrative expenses   | \$ 1,453 | \$ 1,461 | \$ (8) | (1)               |

The primary drivers of the \$158 million increase in *Selling, general and administrative expenses* as compared to the prior year was caused primarily by increases in salaries and related benefits, new business development expenses and legal expenses. Professional consulting, legal, and auditing fees have declined significantly as a result of becoming current with our SEC filings and eliminating a majority of the consultant expenses by transferring activities back to company employees. The decrease in professional consulting, legal, and auditing fees were partially offset by an increase in the number of accounting and finance personnel. Postretirement benefits expense have improved due to several factors discussed more completely in the postretirement benefits section. Dealcor expenses declined primarily due to a decrease in related sales activity and the sale of Company owned dealerships. The increases in compensation and profit-sharing expenses are due to the improvement in our financial results, primarily meeting established net income goals. The increase in provision for doubtful accounts is due to an increase in repossessions and delinquencies coupled with continued weakness in our receivables portfolio. We provide for certain losses related to the potential repossession and liquidation of collateral underlying finance receivables with dealers and retail customers. Finally, increases in stock-based compensation expense versus prior year resulted from the issuance of restricted stock during the fourth quarter of 2008. A significant portion of the awards were granted to retirement eligible employees resulting in immediate recognition of a substantial portion of those costs consistent with relevant accounting literature.

*Engineering and product development costs* declined slightly in 2008 as compared to 2007. *Engineering and product development costs* were primarily incurred by our Truck and Engine segments for innovation and cost

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reduction, and to provide our customers with product and fuel efficiencies. *Engineering and product development costs* incurred at the Truck segment were \$179 million in 2008, which compares to the \$173 million incurred in 2007, and relates primarily to the further development of our ProStar class 8 long-haul truck. In addition, the Truck segment also incurred costs in 2008 and 2007 related to the development and roll-out of our 2010 emissions-compliant products and to a lesser extent the development of the LoneStar class 8 truck. *Engineering and product development costs* incurred at our Engine segment increased \$3 million or 2% in 2008 as compared to the prior year. This increase is a result of the efforts to develop 2010 emissions-compliant engines, new engine products, and MWM-International Euro IV emission-compliant engines.

The following table presents the amounts of postretirement benefits (income) expenses, for defined benefit and defined contribution plans, as allocated among *Costs of products sold, Selling, general and administrative expenses, and Engineering and product development costs*:

|   | 2008           | 2007          | Change          | Percentage Change |
|---|----------------|---------------|-----------------|-------------------|
| <b>(in millions, except percentage change)</b>            |                |               |                 |                   |
| Net postretirement benefits expense (income) included in: |                |               |                 |                   |
| Costs of products sold                                    | \$ 18          | \$ 47         | \$ (29)         | (62)              |
| Selling, general and administrative expenses              | (38)           | 85            | (123)           | N.M.              |
| Engineering and product development costs                 | 3              | 13            | (10)            | (77)              |
| <b>Total postretirement benefits expense (income)</b>     | <b>\$ (17)</b> | <b>\$ 145</b> | <b>\$ (162)</b> | <b>N.M.</b>       |

Total postretirement benefits expense (income) includes defined benefit plans (pensions and post-employment benefits primarily health and life insurance) and defined contribution plans (401(k) contributions for active employees) as described in Note 11, *Postretirement benefits*, to the accompanying consolidated financial statements.

We recognized income related to our postretirement benefits from defined benefit plans of \$42 million for the year ended October 31, 2008 compared to an expense of \$122 million for the same period in 2007. On December 16, 2007, the majority of Company employees represented by the UAW voted to ratify a new contract that will run through September 30, 2010. Among the changes from the prior contract was the cessation of annual lump sum payments that had been made to certain retirees. We previously accounted for these payments as a defined benefit plan based on the historical substance of the underlying arrangement. The elimination of these payments and other changes resulted in a net settlement and curtailment of the plan resulting in income of \$42 million during 2008.

During the third quarter of 2008, the Engine segment's Indianapolis plant laid off over 400 employees. That layoff was driven by a reduction in Ford's production schedules that management believed, at that time, to be temporary. Based on recent developments in economic conditions and the Company's current outlook regarding its Ford contract, it is probable that those employees, as well as other employees from the facility laid off prior to the third quarter, may not return to work. As such, net charges of \$5 million representing curtailments and contractual termination benefits were recognized for the Company's pension and postretirement benefit plans in the fourth quarter of 2008.

Excluding the effects of the two events described above, postretirement benefits income from defined benefit plans was \$5 million for the year ended October 31, 2008. The \$126 million reduction in defined benefit plan expense resulted from better than expected returns and a significant reduction in the projected benefit obligation resulting from fully insuring our Medicare eligible population in our largest postretirement medical plan. Each of these actions took place in 2007 and represent variances from prior actuarial estimates. These variances significantly reduced the cumulative loss pool during 2007. Such costs amortize into income in the subsequent years as a component of postretirement benefits (income) expense. Amortization of the loss pool for pension and health and welfare plans was \$13 million for the year ended October 31, 2008 compared to \$81 million for the

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same period in 2007. Additionally, the growth in the asset base during 2007 had the effect of increasing the expected return on plan assets in 2008 (another component of postretirement benefits (income) expense). The expected return on plan assets for pension and health and welfare plans for the year ended October 31, 2008 was \$386 million compared to \$334 million for the same period in 2007. See Note 11, *Postretirement benefits*, to the accompanying consolidated financial statements for further information on postretirement benefits.

Postretirement benefits expense resulting from the defined contribution plans was \$25 million and \$23 million for the years ended October 31, 2008 and 2007, respectively.

The following table presents the components of *Interest expense*:

| <b>(in millions, except percentage change)</b> | <b>2008</b> | <b>2007</b> | <b>Change</b> | <b>Percentage Change</b> |
|--|-------------|-------------|---------------|--------------------------|
| Interest on manufacturing operations debt      | \$ 154      | \$ 197      | \$ (43)       | (22)                     |
| Interest on financial services operations debt | 258         | 297         | (39)          | (13)                     |
| Derivative interest expense                    | 57          | 8           | 49            | 613                      |
| Total interest expense                         | \$ 469      | \$ 502      | \$ (33)       | (7)                      |

*Interest expense* decreased 7% in 2008 as compared to 2007. This decrease was primarily due to a decrease in interest rates and lower debt balances partially offset by the derivative interest expense of \$57 million in 2008 and \$8 million in 2007. The derivative interest expense arising from non-cash mark to market accounting was \$25 million in 2008 and \$14 million in 2007. For more information, see Note 10, *Debt*, to the accompanying consolidated financial statements.

*Other (income) expenses, net* was \$14 million of other expense and \$34 million of other income in 2008 and 2007, respectively. The primary drivers in *Other (income) expenses, net* were foreign exchange losses, other impairment charges, interest income, and early extinguishment of debt. Foreign exchange loss increased by \$31 million, other impairment charges increased by \$24 million, and interest income decreased by \$12 million as compared to the prior year. *Other (income) expenses, net* includes \$31 million of expenses related to the early extinguishment of debt in 2007 that did not recur in 2008.

*Total costs and expenses* in 2008 were significantly higher due to \$395 million of *Impairment of property and equipment* and other costs related to our expectations of permanently lower Ford volumes in our Engine segment. *Impairment of property and equipment* charges amounted to \$358 million. For additional information about these items, see Note 7, *Impairment of property and equipment and related charges*, to the accompanying consolidated financial statements. Other related charges of \$37 million were primarily expensed in *Costs of products sold* and *Selling, general and administrative expenses*.

*Equity in income of non-consolidated affiliates*

Our *Equity in income of non-consolidated affiliates* is primarily derived from our ownership interests in BDP, BDT, and to a lesser extent other partially-owned affiliates. We reported \$71 million of income in 2008 as compared to \$74 million in 2007 with a majority of the income in both years being derived from BDP. For more information, see Note 9, *Investments in and advances to non-consolidated affiliates*, to the accompanying consolidated financial statements.

*Income tax expense*

*Income tax expense* was \$57 million in 2008 as compared to \$47 million in 2007. Our *Income tax expense* in each year is affected by various factors, including adjustments to deferred tax asset valuation accounts, research and development credits, Medicare reimbursements, and other items. Due to the rapid deterioration of our Canadian



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business and the uncertainty of its future profitability, we established a valuation allowance against the full balance of Canadian net deferred tax assets. For additional information about these items, see Note 13, *Income taxes*, to the accompanying consolidated financial statements.

*Net income (loss) and Diluted earnings (loss) per share*

As a result of the above items, we recorded net income of \$134 million, an increase of \$254 million as compared to a prior year net loss of \$120 million. Included in our increase of \$254 million was growth in our U.S. military sales and the following significant items: impairment of property and equipment and other costs of \$395 million related to our expectations of permanently lower Ford diesel volumes exclusive to 2008, derivative expense due to a non-cash mark to market charge on our interest rate swap agreements of \$25 million in 2008 compared to \$14 million in 2007, foreign exchange loss of \$19 million in 2008 compared to a foreign exchange gain of \$12 million in 2007, a \$42 million reduction in postretirement expense primarily due to modifications to our UAW master contract exclusive to 2008, professional, consulting, and auditing expenses of \$165 million in 2008 as compared to expenses of \$234 million in 2007, and debt refinancing and restructuring costs of \$31 million in 2007 that did not recur in 2008.

Our diluted earnings per share for 2008 were \$1.82, calculated on 73.2 million shares. For 2007, our diluted loss per share was \$1.70, calculated on 70.3 million shares. Diluted shares reflect the impact of our convertible securities including common stock options in accordance with the treasury stock and if-converted methods. For further detail on the calculation of diluted earnings per share, see Note 19, *Earnings (loss) per share*, to the accompanying consolidated financial statements.

**Results of Operations for 2007 as Compared to 2006**

|   | 2007      | 2006      | Change     | Percentage Change |
|---|-----------|-----------|------------|-------------------|
| <b>(in millions, except per share data)</b>     |           |           |            |                   |
| Sales and revenues, net                         | \$ 12,295 | \$ 14,200 | \$ (1,905) | (13)              |
| Costs of products sold                          | 10,131    | 11,703    | (1,572)    | (13)              |
| Selling, general and administrative expenses    | 1,461     | 1,332     | 129        | 10                |
| Engineering and product development costs       | 382       | 453       | (71)       | (16)              |
| Interest expense                                | 502       | 431       | 71         | 17                |
| Other (income) expenses, net                    | (34)      | (15)      | (19)       | 127               |
| Total costs and expenses                        | 12,442    | 13,904    | (1,462)    | (11)              |
| Equity in income of non-consolidated affiliates | 74        | 99        | (25)       | (25)              |
| Income (loss) before income tax                 | (73)      | 395       | (468)      | N.M.              |
| Income tax expense                              | 47        | 94        | (47)       | (50)              |
| Net income (loss)                               | \$ (120)  | \$ 301    | \$ (421)   | N.M.              |
| Diluted earnings (loss) per share               | \$ (1.70) | \$ 4.12   | \$ (5.82)  | N.M.              |
| <i>Sales and Revenues, net</i>                  |           |           |            |                   |

|  |                 | 2007     | 2006      | Change     | Percentage Change |
|--|-----------------|----------|-----------|------------|-------------------|
| <b>(in millions, except percentage change)</b> |                 |          |           |            |                   |
| Sales of manufactured products, net            | U.S. and Canada | \$ 9,806 | \$ 12,273 | \$ (2,467) | (20)              |
| Sales of manufactured products, net            | ROW             | 2,104    | 1,605     | 499        | 31                |