

NAVISTAR INTERNATIONAL CORP

Form 10-Q

June 09, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 30, 2010

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)

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Delaware
(State or other jurisdiction of

36-3359573
(I.R.S. Employer

incorporation or organization)

Identification No.)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

As of May 31, 2010, the number of shares outstanding of the registrant's common stock was 71,593,171, net of treasury shares.

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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 Navistar International Corporation 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 do not constitute guarantees of performance or results and they involve risks, uncertainties, and assumptions. For a further description of these factors, see Item 1A, *Risk Factors*, included within our Annual Report on Form 10-K for the year ended October 31, 2009, which was filed on December 21, 2009. 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.

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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 Quarterly Report on Form 10-Q.

Table of Contents**PART I****Item 1. Condensed Consolidated Financial Statements
Navistar International Corporation and Subsidiaries****Consolidated Statements of Operations****(Unaudited)**

	Three Months Ended April 30,		Six Months Ended April 30,	
	2010	2009	2010	2009
(in millions, except per share data)				
Sales and revenues				
Sales of manufactured products, net	\$ 2,690	\$ 2,741	\$ 5,448	\$ 5,636
Finance revenues	53	67	104	142
Sales and revenues, net	2,743	2,808	5,552	5,778
Costs and expenses				
Costs of products sold	2,189	2,295	4,451	4,618
Restructuring charges	3	(3)	(14)	55
Selling, general and administrative expenses	372	300	710	676
Engineering and product development costs	116	130	225	238
Interest expense	64	57	131	150
Other (income) expense, net	(47)	22	(41)	(176)
Total costs and expenses	2,697	2,801	5,462	5,561
Equity in (loss) income of non-consolidated affiliates	(13)	14	(19)	31
Income before income tax benefit (expense)	33	21	71	248
Income tax benefit (expense)	10	(9)	2	(2)
Net income	43	12	73	246
Net income attributable to non-controlling interests	(13)		(26)	
Net income attributable to Navistar International Corporation	\$ 30	\$ 12	\$ 47	\$ 246
Earnings per share attributable to Navistar International Corporation:				
Basic	\$ 0.43	\$ 0.16	\$ 0.66	\$ 3.45
Diluted	0.42	0.16	0.65	3.44
Weighted average shares outstanding:				
Basic	71.4	70.8	71.3	71.2
Diluted	72.8	71.3	72.4	71.5

See Notes to Condensed Consolidated Financial Statements

Table of Contents**Navistar International Corporation and Subsidiaries****Consolidated Balance Sheets**

(in millions, except per share data)	April 30, 2010 (Unaudited)	October 31, 2009 (Revised) ^(A)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 508	\$ 1,212
Marketable securities	175	
Trade and other receivables, net	754	855
Finance receivables, net	1,420	1,706
Inventories	1,719	1,666
Deferred taxes, net	106	107
Other current assets	240	202
Total current assets	4,922	5,748
Restricted cash and cash equivalents	284	485
Trade and other receivables, net	38	26
Finance receivables, net	1,400	1,498
Investments in non-consolidated affiliates	97	62
Property and equipment (net of accumulated depreciation and amortization of \$1,850 and \$1,765, at the respective dates)	1,439	1,467
Goodwill	324	318
Intangible assets (net of accumulated amortization of \$112 and \$101, at the respective dates)	272	264
Deferred taxes, net	44	52
Other noncurrent assets	120	103
Total assets	\$ 8,940	\$ 10,023
LIABILITIES, REDEEMABLE EQUITY SECURITIES AND STOCKHOLDERS DEFICIT		
Liabilities		
Current liabilities		
Notes payable and current maturities of long-term debt	\$ 1,006	\$ 1,136
Accounts payable	1,600	1,872
Other current liabilities	1,065	1,177
Total current liabilities	3,671	4,185
Long-term debt	3,539	4,156
Postretirement benefits liabilities	2,203	2,570
Deferred taxes, net	170	142
Other noncurrent liabilities	555	599
Total liabilities	10,138	11,652
Redeemable equity securities	11	13
Stockholders deficit		
Series D convertible junior preference stock	4	4
Common stock (\$0.10 par value per share, 110.0 shares authorized, 71.2 and 75.4 shares issued at the respective dates)	7	7
Additional paid in capital	2,195	2,181
Accumulated deficit	(2,025)	(2,072)
Accumulated other comprehensive loss	(1,311)	(1,674)
Common stock held in treasury, at cost (4.1 and 4.7 shares, at the respective dates)	(135)	(149)

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Total stockholders' deficit attributable to Navistar International Corporation	(1,265)	(1,703)
Stockholders' equity attributable to non-controlling interests	56	61
Total stockholders' deficit	(1,209)	(1,642)
Total liabilities, redeemable equity securities, and stockholders' deficit	\$ 8,940	\$ 10,023

(A) Revised; See Note 1, *Summary of significant accounting policies*.

See Notes to Condensed Consolidated Financial Statements

Table of Contents**Navistar International Corporation and Subsidiaries****Condensed Consolidated Statements of Cash Flows****(Unaudited)**

(in millions)	Six Months Ended April 30,	
	2010	2009
Cash flows from operating activities		
Net income	\$ 73	\$ 246
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	132	140
Depreciation of equipment leased to others	26	27
Deferred taxes	11	(2)
Amortization of debt issuance costs and discount	20	8
Stock-based compensation	16	11
Provision for doubtful accounts	34	28
Impairment of goodwill and intangibles		7
Equity in loss of non-consolidated affiliates, net of dividends	22	16
Other non-cash operating activities	34	44
Changes in other assets and liabilities, exclusive of the effects of businesses acquired and disposed	(102)	(38)
Net cash provided by operating activities	266	487
Cash flows from investing activities		
Purchases of marketable securities	(663)	(354)
Sales or maturities of marketable securities	488	356
Net change in restricted cash and cash equivalents	201	(96)
Capital expenditures	(78)	(77)
Purchase of equipment leased to others	(25)	(18)
Proceeds from sales of property and equipment	6	4
Investments in non-consolidated affiliates	(59)	(14)
Proceeds from sales of affiliates	3	3
Acquisition of intangibles	(11)	
Business acquisitions, net of cash received	(2)	
Net cash used in investing activities	(140)	(196)
Cash flows from financing activities		
Proceeds from issuance of securitized debt	245	321
Principal payments on securitized debt	(536)	(658)
Proceeds from issuance of non-securitized debt	557	259
Principal payments on non-securitized debt	(728)	(362)
Net increase (decrease) in notes and debt outstanding under revolving credit facilities	(281)	71
Principal payments under financing arrangements and capital lease obligations	(43)	(24)
Debt issuance costs	(22)	(2)
Proceeds from exercise of stock options	14	
Dividends paid by subsidiaries to non-controlling interest	(33)	
Stock repurchases		(29)
Net cash used in financing activities	(827)	(424)

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Effect of exchange rate changes on cash and cash equivalents	(3)	(10)
Decrease in cash and cash equivalents	(704)	(143)
Cash and cash equivalents at beginning of period	1,212	861
Cash and cash equivalents at end of the period	\$ 508	\$ 718

See Notes to Condensed Consolidated Financial Statements

Table of Contents**Navistar International Corporation and Subsidiaries****Consolidated Statements of Stockholders Deficit****(Unaudited)**

(in millions)	Series D Convertible Junior Preference Stock	Common Stock	Additional Paid in Capital	Compre- hensive Income (Loss)	Accumulated Deficit	Accumulated Other Compre- hensive Loss	Common Stock Held in Treasury, at Cost	Stock- holders Equity attributable to Non- controlling interests	Total
Balance as of October 31, 2009^(A)	\$ 4	\$ 7	\$ 2,181		\$ (2,072)	\$ (1,674)	\$ (149)	\$ 61	\$ (1,642)
Net income				\$ 47	47			26	73
Other comprehensive loss:									
Foreign currency translation adjustments				8					8
U.S. OPEB re-measurement				309					309
Other post-employment benefits				46					46
Total other comprehensive income				363		363			
Total comprehensive income				\$ 410					
Transfer from redeemable equity securities upon exercise or expiration of stock options			3						3
Stock-based compensation			12						12
Stock ownership programs			(1)				14		13
Cash dividends paid to non-controlling interest								(33)	(33)
Investment from non-controlling interest								2	2
Balance as of April 30, 2010	\$ 4	\$ 7	\$ 2,195		\$ (2,025)	\$ (1,311)	\$ (135)	\$ 56	\$ (1,209)
Balance as of October 31, 2008	\$ 4	\$ 7	\$ 1,966		\$ (2,392)	\$ (943)	\$ (137)	\$ 6	\$ (1,489)
Net income				\$ 246	246				246
Other comprehensive loss:									
Foreign currency translation adjustments				(19)					(19)
Other post-employment benefits				31					31
Pension re-measurement				(321)					(321)
Total other comprehensive loss				(309)		(309)			
Total comprehensive loss				\$ (63)					
Stock options recorded as redeemable equity securities			(5)						(5)
Redeemable equity securities modification			130						130
Transfer from redeemable equity securities upon exercise or expiration of stock options			4						4

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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of significant accounting policies

Organization and Description of the 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). References herein to the Company, we, our, or us refer collectively to NIC, its subsidiaries, and certain variable interest entities (VIEs) of which we are the primary beneficiary. We operate in four principal industry segments: Truck, Engine, Parts (collectively called manufacturing operations), and Financial Services. The Financial Services segment consists of NFC and our foreign finance operations (collectively called financial services operations).

Basis of Presentation and Consolidation

The accompanying unaudited consolidated financial statements include the assets, liabilities, and results of operations of our manufacturing operations, majority-owned dealers (Dealcors), wholly-owned financial services subsidiaries, and VIEs of which we are the primary beneficiary. The effects of transactions among consolidated entities have been eliminated to arrive at the consolidated amounts. Certain reclassifications were made to prior year s amounts to conform to the 2010 presentation.

We prepared the accompanying unaudited consolidated financial statements in accordance with United States (U.S.) generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X issued by the SEC. Accordingly, they do not include all of the information and notes required by U.S. GAAP for comprehensive annual financial statements.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting policies described in our Annual Report on Form 10-K for the year ended October 31, 2009 and should be read in conjunction with the disclosures therein. In our opinion, these interim financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial condition, results of operations, and cash flows for the periods presented. Operating results for interim periods are not necessarily indicative of annual operating results.

Variable Interest Entities

We are the primary beneficiary of several VIEs, primarily joint ventures, established to manufacture or distribute products and enhance our operational capabilities. We are the primary beneficiary because our variable interests absorb the majority of the VIE s expected gains and losses. Accordingly, we include in our consolidated financial statements the assets and liabilities and results of operations of those entities, even though we may not own a majority voting interest. The liabilities recognized as a result of consolidating these VIEs do not represent additional claims on our general assets; rather they represent claims against the specific assets of the consolidated entities. Assets of these entities are not available to satisfy claims against our general assets.

In January 2009, we reached a settlement agreement with Ford Motor Company (Ford) where we agreed to settle our respective lawsuits against each other (the Ford Settlement). As a part of the Ford Settlement, on June 1, 2009, our equity interest in our Blue Diamond Parts (BDP) and Blue Diamond Truck (BDT) joint ventures with Ford were increased to 75%. With the increase in our equity interest, we determined that we were the primary beneficiary of these two VIE s and have consolidated them since June 1, 2009. As a result, our Consolidated Balance Sheets includes assets of \$258 million and \$297 million and liabilities of \$77 million and

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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

\$122 million as of April 30, 2010 and October 31, 2009, respectively, from BDP and BDT, including \$42 million and \$52 million of cash and cash equivalents, at the respective dates, which are not readily available to satisfy our other obligations. Their creditors do not have recourse to our general credit.

Our Financial Services segment consolidates several VIEs. As a result, our Consolidated Balance Sheets include assets of \$962 million and \$1.5 billion and liabilities of \$753 million and \$1.2 billion as of April 30, 2010 and October 31, 2009, respectively, all of which are involved in securitizations that are treated as borrowings. In addition, our Consolidated Balance Sheets include assets of \$971 million and \$782 million and related liabilities of \$815 million and \$634 million as of April 30, 2010 and October 31, 2009, respectively, all of which are involved in structures in which we transferred assets to special purpose entities (SPEs) that are not VIEs, which in turn arranged securitizations that are treated as borrowings. Investors that hold securitization debt have a priority claim on the cash flows generated by their respective securitized assets to the extent they are entitled to pay principal and interest payments. Investors in securitizations of these VIEs and SPEs have no recourse to the general credit of NIC or any other consolidated entity.

Our Financial Services segment does not consolidate a qualifying special purpose entity (QSPE) that is outside the scope of the accounting standard on consolidation of VIEs, and a conduit since we are not its primary beneficiary. Our consolidated SPE s obtain funds from the QSPE and conduit, which securitize the related assets. Portions of the assets of the QSPE and conduit are accounted for as sales when securitized and accordingly those portions are not carried on our Consolidated Balance Sheets. Our consolidated SPEs retain residual economic interests in the future cash flows of the securitized assets that are owned by the QSPE and conduit. We carry these retained interests as an asset, included in *Finance receivables, net* on our Consolidated Balance Sheets. Retained interests are subordinated to the priority claims of investors in each respective securitization; our maximum loss exposure to the activities of the QSPE and conduit is limited to our retained interests. See Note 5, *Finance receivables*, for further discussion.

We are also involved with other VIEs, which we do not consolidate because we are not the primary beneficiary. Our determination that we are not the primary beneficiary of these entities is based upon the characteristics of our variable interests, which do not absorb the majority of the VIE s expected gains and losses. Our financial support and maximum loss exposure relating to these non-consolidated VIEs is not material to our financial condition, results of operations, or cash flows.

We use the equity method to account for our investments in entities that we do not control under the voting interest or variable interest models, but where we have the ability to exercise significant influence over operating and financial policies. Net income includes our share of the net earnings (loss) of these entities. As of April 30, 2010, we use the equity method to account for investments in thirteen active, partially-owned affiliates, in which the Company or one of its subsidiaries is a shareholder, general or limited partner, or venturer, as applicable.

Recently Adopted Accounting Standards

As of April 30, 2010, we adopted new guidance regarding disclosures about fair value measurements. The guidance requires new disclosures related to transfers in and out of Level 1 and Level 2 fair value measurements. The guidance also provides clarification to existing disclosures. The disclosures required by this guidance are included in Note 8, *Fair value measurements*.

As of February 1, 2010, we adopted new guidance regarding revenue arrangements with multiple deliverables. This guidance requires companies to allocate revenue in arrangements involving multiple deliverables based on the estimated selling price of each deliverable, even though such deliverables are not sold separately either by the

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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

company or by other vendors. The Company elected to early adopt this guidance at the beginning of our second quarter of fiscal 2010 on a prospective basis. As required by the guidance, as the period of adoption was not the beginning of our fiscal year, we applied the adoption retrospectively from November 1, 2009. There was no impact on our Consolidated Statement of Operations related to the adoption of this guidance.

As of November 1, 2009, we adopted new guidance on the accounting for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement), which requires issuers of convertible debt securities within its scope to separate these securities into a debt component and an equity component, resulting in the debt component being recorded at estimated fair value without consideration given to the conversion feature. Issuance costs are also allocated between the debt and equity components. The guidance requires that convertible debt within its scope reflect a company's nonconvertible debt borrowing rate when interest expense is recognized. The provisions of the guidance are retrospective upon adoption. The adoption of the guidance on November 1, 2009 impacted the accounting treatment of the Company's \$570 million, 3% convertible senior subordinated notes due 2014 (the Convertible Notes) by reclassifying a portion of the original principal amount of the Convertible Notes balance to additional paid in capital, resulting in a discount on the Convertible Notes that will be amortized through interest expense over the life of the notes. We estimated the fair value of the liability component at \$456 million with a discount on the Convertible Notes of \$114 million at the date of issuance. Of the \$18 million of debt issuance costs, we allocated \$14 million and \$4 million to the liability component and equity component, respectively. Our Consolidated Balance Sheet as of October 31, 2009 was retroactively restated to reflect the increase to *Additional paid in capital* of \$110 million, the reduction in *Long-term debt* for the debt discount of \$114 million, and the reduction in *Other noncurrent assets* for the equity component of debt issuance costs of \$4 million. The resulting debt discount is amortized as interest expense and therefore reduces net income and basic and diluted earnings per share. The effective interest rate on the Convertible Notes will be 8.42% with the amortization of debt discount and debt issuance costs. As a result of the short period the debt was outstanding, adoption of the guidance did not have a material impact on our Consolidated Statement of Operations for the year ended October 31, 2009.

As of November 1, 2009, we adopted new guidance on non-controlling interests that clarifies that non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity. As required, this guidance was adopted through retrospective application, and all prior period information has been revised accordingly.

As of November 1, 2009, we adopted new guidance on the determination of the useful life of intangible assets. This guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The guidance also requires expanded disclosure related to the determination of useful lives for intangible assets and should be applied to all intangible assets recognized as of, and subsequent to, the effective date. The adoption did not have a material impact on our consolidated financial statements.

As of November 1, 2009, we adopted new guidance on fair value measurements for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in our consolidated financial statements on a nonrecurring basis. The adoption did not have a material impact on our consolidated financial statements.

As of November 1, 2009, we adopted new guidance that substantially changes the accounting for and reporting of business combinations including (i) expanding the definition of a business and a business combination, (ii) requiring all assets and liabilities of the acquired business, including goodwill and contingent consideration to be recorded at fair value on the acquisition date, (iii) requiring acquisition-related transaction and restructuring costs to be expensed rather than accounted for as acquisition costs, and (iv) requiring reversals of valuation

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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

allowances related to acquired deferred tax assets and changes to acquired income tax uncertainties to be recognized in earnings. The adoption did not have a material impact on our consolidated financial statements.

Recently Issued Accounting Standards

Accounting pronouncements issued by various standard setting and governmental authorities that have not yet become effective with respect to our consolidated financial statements are described below, together with our assessment of the potential impact they may have on our consolidated financial statements:

In January 2010, the Financial Accounting Standards Board (FASB) issued new guidance regarding disclosures about fair value measurements. The guidance requires new disclosures related to activity in Level 3 fair value measurements. This guidance requires purchases, sales, issuances, and settlements to be presented separately in the rollforward of activity in Level 3 fair value measurements and is effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Our effective date is November 1, 2011. When effective, we will comply with the disclosure provisions of this guidance.

In June 2009, the FASB issued new guidance on accounting for transfers of financial assets. The guidance eliminates the concept of a QSPE, changes the requirements for derecognizing financial assets, and requires additional disclosures in order to enhance information reported to users of financial statements by providing greater transparency about transfers of financial assets, including securitization transactions, and an entity's continuing involvement in and exposure to the risks related to transferred financial assets. This guidance is effective for fiscal years beginning after November 15, 2009. Our effective date is November 1, 2010. We are evaluating the potential impact on our consolidated financial statements.

In June 2009, the FASB issued new guidance regarding the consolidation of VIEs. The guidance also amends the determination of whether an enterprise is the primary beneficiary of a VIE, and is, therefore, required to consolidate an entity, by requiring a qualitative analysis rather than a quantitative analysis. The qualitative analysis will include, among other things, consideration of who has the power to direct the activities of the entity that most significantly impact the entity's economic performance and who has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. This guidance also requires continuous reassessments of whether an enterprise is the primary beneficiary of a VIE. Prior guidance required reconsideration of whether an enterprise was the primary beneficiary of a VIE only when specific events had occurred. QSPEs, which were previously exempt from the application of this guidance, will be subject to the provisions of this guidance when it becomes effective. The guidance also requires enhanced disclosures about an enterprise's involvement with a VIE. This guidance is effective for the first annual reporting period beginning after November 15, 2009 and for interim periods within that first annual reporting period. Our effective date is November 1, 2010. We are evaluating the potential impact on our consolidated financial statements.

In December 2008, the FASB issued new guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. Our effective date is October 31, 2010. When effective, we will comply with the disclosure provisions of this guidance.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses. Significant estimates and assumptions are used for, but are not limited to, pension and other postretirement benefits,

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

allowance for doubtful accounts, sales of receivables, income tax contingency accruals and valuation allowances, product warranty accruals, asbestos accruals, asset impairment, and litigation-related accruals. Actual results could differ from our estimates.

Reversal of tax reserve for change in estimate

Under the Brazilian tax system, the state government levies a tax on the incremental value added to goods or service (commonly known as value added tax or VAT). The VAT is computed based on the value added to the taxed item which is then included in the price of products sold and purchased. We periodically review our VAT credit balances for recovery based primarily on projected sales and purchases. In the past, we determined that a portion of our VAT credits were not recoverable and accordingly provided an allowance against the balance not expected to be recovered. In the second quarter of 2010, we reevaluated our VAT credit balance and reserve and concluded that based on actions taken to facilitate changes in sales mix between domestic and export and production locations, it was probable that previously reserved VAT credits will be utilized. As a result, we recognized a material adjustment for this change in estimate in *Other (income) expense, net* of \$42 million, or \$0.58 per diluted share for the three and six months ended April 30, 2010.

Concentration Risks

Our financial condition, results of operations, and cash flows are subject to concentration risks related to concentrations of union employees and two customers. As of April 30, 2010, approximately 6,040, or 58%, of our hourly workers and approximately 706, or 9%, of our salaried workers are represented by labor unions and are covered by collective bargaining agreements. Our collective bargaining agreement with the National Automobile, Aerospace and Agricultural Implement Workers of Canada, covering approximately 1,030 or 10% of our hourly workers as of April 30, 2010, expired on June 30, 2009. As a result, we have temporarily ceased production at our Chatham, Canada facility. Negotiations for a new collective bargaining agreement are ongoing. Our collective bargaining agreements with the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) will expire on October 1, 2010. As of April 30, 2010, approximately 1,790 or 17% of our hourly workers were covered by these collective bargaining agreements. See Note 14, *Segment reporting*, for discussion of customer concentrations. Additionally, our future operations may be affected by changes in governmental procurement policies, budget considerations, changing national defense requirements, and global, political, and economic developments in the U.S. and certain foreign countries (primarily Canada, Mexico, and Brazil).

Product Warranty Liability

Accrued product warranty and deferred warranty revenue activity is as follows:

	Six Months Ended	
	April 30,	
	2010	2009
(in millions)		
Accrued product warranty and deferred warranty revenue, at beginning of period	\$ 492	\$ 602
Costs accrued and revenues deferred	117	102
Adjustments to pre-existing warranties ^(A)	9	78
Payments and revenues recognized	(146)	(180)
Warranty adjustment related to legal settlement ^(B)		(75)
Accrued product warranty and deferred warranty revenue, at end of period	472	527
Less: Current portion	228	256

Noncurrent accrued product warranty and deferred warranty revenue

\$ 244

\$ 271

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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(A) Adjustments to pre-existing warranties reflect changes in our estimate of warranty costs for products sold in prior periods. Such adjustments typically occur when claims experience deviates from historic and expected trends. We recognized material adjustments for changes in estimates of \$61 million and \$78 million, or \$0.86 and \$1.09 per diluted share, for the three and six months ended April 30, 2009, respectively.

(B) See Note 2, *Ford settlement and related charges*, for discussion regarding warranty adjustments related to the Ford Settlement.

The amount of deferred revenue related to extended warranty programs was \$146 million and \$139 million at April 30, 2010 and October 31, 2009, respectively. Revenue recognized under our extended warranty programs was \$11 million and \$23 million for the three and six months ended April 30, 2010, respectively and \$10 million and \$20 million for the three and six months ended April 30, 2009, respectively.

2. Ford settlement and related charges

In 2008, the Engine segment recognized \$358 million of charges for impairments of property and equipment associated with its asset groups in the VEE Business Unit. The impairment charges were the result of a reduction in demand from Ford for diesel engines produced by the VEE Business Unit and the expectation that Ford's demand for diesel engines would continue to be below previously anticipated levels. Also in 2008, the VEE Business Unit recorded \$37 million of other charges related to the significant reduction in demand from Ford.

In the first quarter of 2009, we reached a settlement agreement with Ford where we agreed to settle our respective lawsuits against each other. The result of the Ford Settlement resolved all prior warranty claims, resolved the selling price for our engines going forward, and allowed Ford to pursue a separate strategy related to diesel engines in its products. Additionally, both companies agreed to end their current North America supply agreement for diesel engines as of December 31, 2009 (the agreement was otherwise set to expire July 2012). In the first quarter of 2009, we received a \$200 million cash payment from Ford, which was recorded as a gain in *Other (expense) income, net*, and we reversed our previously recorded warranty liability of \$75 million, which was recorded as a reduction of *Costs of products sold*. In the third quarter of 2009, we increased our interest in our BDP and BDT joint ventures with Ford to 75% and recognized a gain of \$23 million in *Other (expense) income, net* in connection with the increased equity interests in BDP. The increased equity interest in BDT did not result in a gain or loss.

Also in the first quarter of 2009, with the changes in Ford's strategy, we announced our intention to close our Indianapolis Engine Plant (IEP) and our Indianapolis Casting Corporation foundry (ICC) and the Engine segment recognized \$58 million of restructuring charges. The restructuring charges consisted of \$21 million in personnel costs for employee termination and related benefits, \$16 million of charges for pension and other postretirement contractual termination benefits and a pension curtailment, and \$21 million of other contractual costs. In the fourth quarter of 2009, the Engine segment recognized an additional \$4 million of charges for benefits to terminated employees. Net of first quarter adjustments of \$3 million reducing personnel costs for employee termination, the Engine segment recognized \$59 million of restructuring charges for the year ended October 31, 2009. In the third quarter of 2009, we made the decision that at IEP we will continue certain quality control and manufacturing engineering activities and there will be no other business activities aside from these after July 31, 2009. We have delayed the closure of ICC to July 16, 2010 due to supply and other customer needs.

In the first quarter of 2010, we settled a portion of our other contractual costs and recognized a \$16 million benefit. We expect the majority of the remaining restructuring and other costs, excluding pension and other postretirement related costs, will be paid in 2010.

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The following table summarizes the activity in the restructuring liability related to Ford, which excludes \$16 million of charges for pension and other postretirement contractual termination benefits, and the pension curtailment for 2010:

(in millions)	Balance at October 31, 2009	Additions	Payments	Adjustments	Balance at April 30, 2010
Employee termination charges	\$ 20	\$	\$ (10)	\$ (1)	\$ 9
Other contractual costs	21		(5)	(16)	
Restructuring liability	\$ 41	\$	\$ (15)	\$ (17)	\$ 9

In addition to the restructuring charges, in the second through fourth quarters of 2009 the Engine segment recognized other related charges for inventory valuation and low volume adjustments of \$105 million, of which \$81 million and \$24 million were recognized in *Costs of products sold* and *Other (expense) income, net*, respectively. Offsetting the charges were warranty recoveries of \$29 million, of which \$26 million and \$3 million were recognized in *Other (expense) income, net* and *Costs of products sold*, respectively. Included in these charges and offsetting recoveries was the impact of our settlement with Continental Automotive Systems US, Inc. (Continental).

In the fourth quarter of 2009, we agreed to settle our commercial dispute related to Continental's low volume damages claim and our counter claim related to quality issues for products primarily sold to Ford. Through this settlement, our ongoing business relationships were restructured and all existing claims between the Company and Continental were settled. The settlement agreement with Continental was a multiple element arrangement which, among other things, included an agreement for the Company to acquire all membership interests, certain assets, and assume certain liabilities of Continental Diesel Systems US, LLC (CDS), a wholly owned subsidiary of Continental. In addition to a cash payment of \$18 million to Continental, we determined the fair value of consideration exchanged included \$29 million of warranty recoveries offset by \$27 million of low volume adjustments. Net of the reversal of existing balances, we recognized a net charge of \$2 million related to the settlement.

3. Business combinations and consolidation of variable interest entities*Blue Diamond Parts*

BDP was formed in August 2001 as a joint venture between Ford and Navistar (collectively, the Members), with Ford owning 51% and Navistar owning 49%. BDP manages the sourcing, merchandising, and distribution of various spare parts for vehicles the Members sell in North America. These spare parts are primarily for Navistar diesel engines in Ford trucks, commercial truck parts, and certain parts for F650/750 and Low-Cab Forward trucks produced for Ford by BDT. Substantially all of BDP's transactions are between BDP and its Members.

On June 9, 2009, pursuant to the provisions of the Ford Settlement, we increased our equity interest in BDP from 49% to 75%, effective June 1, 2009. Our voting interest in BDP remains 50%. The receipt of additional equity interest from Ford was among the various components of the Ford Settlement, and no additional consideration was paid to Ford in connection with the increase in equity interest in BDP. We determined the fair value of the increased interest in BDP based on a discounted cash flow model utilizing BDP's estimated future cash flows. The fair value of the increased interest, net of settlement of an executory contract, was \$23 million and we recognized a gain of this amount in *Other (expense) income, net* in our Engine segment in the third quarter of 2009.

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

With the increase in our equity interest, we determined that we are now the primary beneficiary of BDP and have consolidated the operating results of BDP since June 1, 2009. As a result of the BDP acquisition, we recognized an intangible asset for customer relationships of \$45 million and have assigned a useful life of nine years. For additional information on the Ford Settlement, see Note 2, *Ford settlement and related charges*.

The unaudited pro forma financial information in the table below summarizes the combined results of operations of Navistar and BDP as though BDP had been combined as of the beginning of the period presented. The unaudited pro forma financial information is presented for information purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of the period, or that may result in the future.

(in millions, except per share data)	Three Months Ended April 30, 2009	Six Months Ended April 30, 2009
Sales and revenue, net	\$ 2,866	\$ 5,892
Net income	33	289
Net income attributable to non-controlling interests	(11)	(22)
Net income attributable to Navistar International Corporation	\$ 22	\$ 267
Earnings per share attributable to Navistar International Corporation:		
Pro forma basic earnings per share	\$ 0.32	\$ 3.75
Pro forma diluted earnings per share	\$ 0.32	\$ 3.73

The table above includes BDP net service revenue of \$52 million and \$101 million, net expenses of \$7 million and \$10 million, income before tax expense of \$45 million and \$91 million, and net income of \$47 million and \$92 million for the three and six months ended April 30, 2009, respectively.

4. Allowance for doubtful accounts

The activity related to our allowance for doubtful accounts for trade and other receivables and finance receivables is summarized as follows:

(in millions)	Three Months Ended April 30,		Six Months Ended April 30,	
	2010	2009	2010	2009
Allowance for doubtful accounts, at beginning of period	\$ 110	\$ 109	\$ 104	\$ 113
Provision for doubtful accounts, net of recoveries	20	26	34	28
Charge-off of accounts	(11)	(13)	(19)	(19)
Allowance for doubtful accounts, at end of period	\$ 119	\$ 122	\$ 119	\$ 122

5. Finance receivables

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Finance receivables are receivables of our financial services operations, which generally can be repaid without penalty prior to contractual maturity. Total finance receivables reported on the Consolidated Balance Sheets are net of an allowance for doubtful accounts.

The primary business of our financial services operations is to provide wholesale, retail, and lease financing for new and used trucks sold by us and our dealers and, as a result, our finance receivables and leases are concentrated in the trucking industry. On a geographic basis, there is not a disproportionate concentration of credit risk in any area of the U.S. or other countries where we have financial service operations. We retain as collateral an ownership interest in the equipment associated with leases and, on our behalf and the behalf of the various trusts, we maintain a security interest in equipment associated with generally all finance receivables. All

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

of the assets of our financial services operations are restricted through security agreements to benefit the creditors of the respective finance subsidiary. Total on-balance sheet assets of our financial services operations net of intercompany balances are \$3.4 billion and \$3.9 billion, at April 30, 2010 and October 31, 2009, respectively. Included in total assets are on-balance sheet finance receivables of \$2.8 billion and \$3.2 billion at April 30, 2010 and October 31, 2009, respectively.

In March 2010, we entered into a three-year Operating Agreement (with one-year automatic extensions and subject to early termination provisions) with GE Capital Corporation and GE Capital Commercial, Inc. (collectively "GE"). Under the terms of the agreement, GE becomes our preferred source of retail customer financing for equipment offered by us and our dealers in the U.S. We will provide GE a loss sharing arrangement for certain credit losses. While under limited circumstances NFC retains the rights to originate retail customer financing, we expect retail finance receivables and retail finance revenues will decline over the next five years as our retail portfolio pays down.

Securitizations

Our financial services operations transfer wholesale notes, accounts receivable, retail notes, finance leases, and operating leases through SPEs, which generally are only permitted to purchase these assets, issue asset-backed securities, and make payments on the securities. In addition to servicing receivables, our continued involvement in the SPEs includes an economic interest in the transferred receivables and managing exposure to interest rates using interest rate swaps, interest rate caps, and forward contracts. Certain sales of wholesale notes and accounts receivables are considered to be sales in accordance with guidance on accounting for transfers and servicing of financial assets and extinguishment of liabilities, and are accounted for off-balance sheet. For sales that do qualify for off-balance sheet treatment, an initial gain (loss) is recorded at the time of the sale while servicing fees and excess spread income are recorded as revenue when earned over the life of the finance receivables.

We received net proceeds of \$6 million and \$245 million from securitizations of finance receivables and investments in operating leases accounted for as secured borrowings for the three and six months ended April 30, 2010, and \$309 million and \$321 million for the three and six months ended April 30, 2009, respectively.

Off-Balance Sheet Securitizations

We use an SPE that has in place a revolving wholesale note trust, which is a QSPE, which provides for the funding of eligible wholesale notes through an investor certificate and variable funding notes ("VFN"). The QSPE owned \$691 million of wholesale notes and \$45 million of cash equivalents as of April 30, 2010 and \$763 million of wholesale notes as of October 31, 2009. The QSPE held \$100 million and \$96 million of wholesale notes with our Dealcors as of April 30, 2010 and October 31, 2009, respectively.

Components of available wholesale note trust funding facilities were as follows:

		As of April 30, 2010	As of October 31, 2009
(in millions)	Maturity		
Investor notes		\$	\$ 212
Variable funding certificate			650
Variable funding notes	August 2010	500	
Investor notes	October 2012	350	
Investor notes	January 2012	250	

Total wholesale note funding

\$ 1,100 \$ 862

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

In November 2009, we completed the sale of \$350 million of three-year investor notes within the wholesale note trust funding facility. This sale was eligible for funding under the U.S. Federal Reserve Term Asset-Backed Securities Loan Facility (TALF) program.

In February 2010, we completed the sale of \$250 million of two-year investor notes within the wholesale note trust funding facility. This sale was also eligible for funding under TALF. Also in February 2010, we paid off previously issued investor notes of \$212 million upon maturity.

In April 2010, the remaining balance in the variable funding certificate of \$20 million was paid off and refinanced under the VFN. As of April 30, 2010, no funding was utilized under the VFN.

Unutilized funding related to the variable funding facilities was \$500 million and \$300 million at April 30, 2010 and October 31, 2009, respectively.

We use another SPE, Truck Retail Accounts Corporation (TRAC), that utilizes a \$100 million conduit funding arrangement, which provides for the funding of eligible accounts receivables. The SPE owned \$96 million of retail accounts and \$20 million of cash equivalents as of April 30, 2010, and \$89 million of retail accounts and \$20 million of cash equivalents as of October 31, 2009. There was \$77 million and \$92 million of unutilized funding at April 30, 2010 and October 31, 2009, respectively.

For sold receivables, wholesale notes balances past due over 60 days were \$1 million as of April 30, 2010 and October 31, 2009. Retail balances past due over 60 days for accounts receivable financing were less than \$1 million and \$2 million as of April 30, 2010 and October 31, 2009, respectively. No credit losses on sold receivables were recorded for the three and six months ended April 30, 2010 and 2009.

Retained Interests in Off-Balance Sheet Securitizations

Our financial services operations are under no obligation to repurchase any transferred receivables that become delinquent in payment or are otherwise in default. The terms of receivable transfers generally require our financial services operations to provide credit enhancements in the form of excess seller's interests and/or cash reserves, which are owned by the trust and conduit. The maximum exposure under all credit enhancements was \$223 million and \$291 million as of April 30, 2010 and October 31, 2009, respectively, and consists entirely of retained interests.

Retained interests, which arise from the credit enhancements, represent the fair value of the excess of the cash flows from the assets held by the QSPE and conduit over the future payments of debt service to investors in the QSPE and conduit. The securitization agreements entitle us to these excess cash flows. Our retained interests are restricted assets that are subordinated to the interests of the investors in either the QSPE or the conduit. Our retained interests are recognized as an asset in *Finance receivables, net*.

The key economic assumptions and the sensitivity of the current fair values of residual cash flows comprising our retained interests to an immediate adverse change of 10 percent and 20 percent in each assumption are as follows:

	As of		Fair Value Change at April 30, 2010	
	April 30, 2010	October 31, 2009	Adverse 10%	Adverse 20%
(dollars in millions)				
Discount rate	7.7 to 18.8%	9.1 to 20.5%	\$ 2	\$ 4
Estimated credit losses	0.0 to 0.24%	0.0 to 0.24%		
Payment speed (percent of portfolio per month)	4.4 to 77.1%	4.9 to 70.8%	1	1

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The lower end of the discount rate assumption range and the upper end of the payment speed assumption range were used to value the retained interests in the retail account securitization. No percentage for estimated credit losses was assumed for retail account securitizations as no losses have been incurred to date. The upper end of the discount rate assumption range and the lower end of the payment speed assumption range were used to value the retained interests in the wholesale note securitization facility.

The effect of a variation of a particular assumption on the fair value of the retained interests is calculated based upon changing one assumption at a time. Oftentimes however, changes in one factor may result in changes in another, which in turn could magnify or counteract these reported sensitivities.

Finance Revenues

Finance revenues derived from receivables that are both on and off-balance sheet consist of the following:

(in millions)	Three Months Ended April 30,		Six Months Ended April 30,	
	2010	2009	2010	2009
Finance revenues from on-balance sheet receivables:				
Retail notes and finance leases revenue	\$ 45	\$ 62	\$ 98	\$ 126
Operating leases revenue	6	5	12	11
Wholesale notes interest	6	3	12	11
Retail and wholesale accounts interest	4	5	9	10
Other income	1	2	2	2
Total finance revenues from on-balance sheet receivables	62	77	133	160
Revenues from off-balance sheet securitization:				
Fair value adjustments	13	10	20	29
Excess spread income	10	9	21	11
Servicing fees revenue	2	2	4	4
Losses on sale of finance receivables	(11)	(10)	(27)	(25)
Investment revenue				2
Securitization Income	14	11	18	21
Gross finance revenues	76	88	151	181
Less: Intercompany revenues	(23)	(21)	(47)	(39)
Finance revenues	\$ 53	\$ 67	\$ 104	\$ 142

Cash flows from off-balance sheet securitization transactions are as follows:

Three Months Ended April 30,	Six Months Ended April 30,
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(in millions)	2010	2009	2010	2009
Proceeds from finance receivables	\$ 954	\$ 898	\$ 2,027	\$ 1,940
Servicing fees	5	2	7	4
Cash from net excess spread	20	8	31	10
Investment income				1
Net cash from securitization transactions	\$ 979	\$ 908	\$ 2,065	\$ 1,955

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****6. Inventories**

The components of inventories are as follows:

	As of	
	April 30,	October
	2010	31,
		2009
(in millions)		
Finished products	\$ 866	\$ 840
Work in process	265	214
Raw materials	588	612
Total inventories	\$ 1,719	\$ 1,666

7. Debt

The following table summarizes our debt obligations:

	April 30,	October 31,
	2010	2009
		(Revised) ^(A)
(in millions)		
Manufacturing operations		
8.25% Senior Notes, due 2021, net of unamortized discount of \$36 and \$37 at the respective dates	\$ 964	\$ 963
3.0% Senior Subordinated Convertible Notes, due 2014, net of unamortized discount of \$104 and \$114 at the respective dates	466	456
Debt of majority-owned dealerships	148	148
Financing arrangements and capital lease obligations	241	271
Other	20	23
Total manufacturing operations debt	1,839	1,861
Less: Current portion	(201)	(191)
Net long-term manufacturing operations debt	\$ 1,638	\$ 1,670
Financial services operations		
Asset-backed debt issued by consolidated SPEs, at variable rates, due serially through 2016	\$ 941	\$ 1,227
Bank revolvers, at fixed and variable rates, due dates from 2010 through 2015	1,074	1,518
Revolving retail warehouse facility, at variable rates, due 2010	500	500
Commercial paper, at variable rates, due serially through 2010	60	52
Borrowings secured by operating and finance leases, at various rates, due serially through 2016	131	134
Total financial services operations debt	2,706	3,431

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Less: Current portion	(805)	(945)
Net long-term financial services operations debt	\$ 1,901	\$ 2,486

(A) Revised; See Note 1, *Summary of significant accounting policies*.

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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Financial Services Operations

In December 2009, NFC's Revolving Credit Agreement dated March 2007, as amended, was refinanced with an \$815 million, three year facility that matures in December 2012, with an interest rate of LIBOR plus 425 basis points. The new facility contains a term loan of \$365 million and a revolving loan of \$450 million with a Mexican sub-revolver of \$100 million. Under the new agreement, NFC is subject to customary operational and financial covenants including an initial minimum collateral coverage ratio of 120%. Concurrent with the refinancing, NFC issued borrowings secured by asset-backed securities due serially through October 2016 and issued a term loan secured by retail notes and leases that matures in March 2013, with weighted average interest rates of 5.7% and 5.9%, respectively. These borrowings generated proceeds of \$304 million in total.

8. Fair value measurements

On November 1, 2008, we adopted guidance on accounting for fair value measurements, for assets and liabilities measured at fair value on a recurring basis. On November 1, 2009, we adopted guidance on accounting for fair value measurements for our non-financial assets and liabilities. We did not have any significant non-financial assets or liabilities measured at fair value on a nonrecurring basis during the three and six month period ended April 30, 2010. The guidance:

defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date, and establishes a framework for measuring fair value,

establishes a hierarchy of fair value measurements based upon the observability of inputs used to value assets and liabilities,

requires consideration of nonperformance risk, and

expands disclosures about the methods used to measure fair value.

The guidance establishes a three-level hierarchy of measurements based upon the reliability of observable and unobservable inputs used to arrive at fair value. Observable inputs are independent market data, while unobservable inputs reflect our assumptions about valuation. Depending on the inputs, we classify each fair value measurement as follows:

Level 1 based upon quoted prices for *identical* instruments in active markets,

Level 2 based upon quoted prices for *similar* instruments, prices for identical or similar instruments in markets that are not active, or model-derived valuations all of whose significant inputs are observable, and

Level 3 based upon one or more significant unobservable inputs.

The following section describes key inputs and assumptions in our valuation methodologies:

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Cash Equivalents and Restricted Cash Equivalents. We classify highly liquid investments, with a maturity of 90 days or less at the date of purchase, including U.S. Treasury bills, federal agency securities, and commercial paper, as cash equivalents. We use quoted prices where available and use a matrix of observable market-based inputs when quoted prices are unavailable.

Marketable Securities. Our marketable securities portfolios are classified as available-for-sale and include investments in U.S. government and commercial paper with a maturity of greater than 90 days at the date of purchase. We use quoted prices from active markets to determine their fair values.

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

Wholesale Notes. Wholesale notes are classified as held-for-sale and are valued at the lower of amortized cost or fair value on an aggregate basis. Amortized cost approximates fair value as a result of the short-term nature and variable interest terms inherent to wholesale notes.

Derivative Assets and Liabilities. We measure the fair value of derivatives assuming that the unit of account is an individual derivative transaction and that derivative could be sold or transferred on a stand-alone basis. We classify within Level 2 our derivatives that are traded over-the-counter and valued using internal models based on readily available observable market inputs. In certain cases, market data is not available and we estimate inputs such as in situations where trading in a particular commodity is not active, or for instruments with notional amounts that fluctuate over time. Measurements based upon these unobservable assumptions are classified within Level 3. For more information regarding derivatives, see Note 11, *Financial instruments and commodity contracts*.

Retained Interests. We retain certain interests in receivables sold in off-balance sheet securitization transactions. We estimate the fair value of retained interests using internal valuation models that incorporate market inputs and our own assumptions about future cash flows. The fair value of retained interests is estimated based on the present value of monthly collections on the sold finance receivables in excess of amounts accruing to investors and other obligations arising in securitization transactions. In addition to the amount of debt and collateral held by the securitization vehicle, the three key inputs that affect the valuation of the retained interests include credit losses, payment speed, and the discount rate. We classify these assets within Level 3. For more information regarding retained interest, see Note 5, *Finance receivables*.

The following table presents the financial instruments measured at fair value on a recurring basis as of April 30, 2010:

	Level 1	Level 2	Level 3	Total
(in millions)				
Assets				
Marketable securities:				
U.S. treasury bills	\$ 105	\$	\$	\$ 105
Other U.S. and non-U.S. government bonds	70			70
Derivative financial instruments:				
Interest rate swaps			15	15
Interest rate caps purchased		2		2
Commodity contracts		5		5
Foreign currency contracts		1		1
Retained interests			223	223
Total assets	\$ 175	\$ 8	\$ 238	\$ 421
Liabilities				
Derivative financial instruments:				
Interest rate swaps	\$	\$ 14	\$ 15	\$ 29
Interest rate caps sold		2		2
Total liabilities	\$	\$ 16	\$ 15	\$ 31

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The following table presents the financial instruments measured at fair value on a recurring basis as of October 31, 2009:

(in millions)	Level 1	Level 2	Level 3	Total
Assets				
Derivative financial instruments:				
Interest rate swaps	\$	\$	\$ 32	\$ 32
Interest rate caps purchased		5		5
Commodity contracts			1	1
Retained interests			291	291
Total assets	\$	\$ 5	\$ 324	\$ 329
Liabilities				
Derivative financial instruments:				
Interest rate swaps	\$	\$ 30	\$ 31	\$ 61
Interest rate caps sold		4		4
Commodity contracts			1	1
Total liabilities	\$	\$ 34	\$ 32	\$ 66

The table below presents the changes for those financial instruments classified within Level 3 of the valuation hierarchy:

(in millions)	2010		2009			
	Interest rate swap assets and liabilities	Retained interests	Commodity contracts	Interest rate swap assets and liabilities	Retained interests	Commodity contracts
Three Months Ended April 30						
Balance at February 1	\$	\$ 315	\$	\$ 2	\$ 199	\$ (3)
Total gains (losses) (realized/unrealized) included in earnings ^(A)		5		(2)		(3)
Purchases, issuances and settlements		(97)		1	40	2
Balance at April 30		223		1	239	(4)
Change in unrealized gains (losses) on assets and liabilities still held	\$	\$ 5	\$	\$	\$	\$ (1)
Six Months Ended April 30						
Balance at November 1	\$ 1	\$ 291	\$	\$	\$ 230	\$ 1
Total gains (losses) (realized/unrealized) included in earnings ^(A)	(1)			1	5	(8)
Purchases, issuances and settlements		(68)			4	3

Table of Contents**Navistar International Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The following table presents the financial instruments measured at fair value on a nonrecurring basis:

(in millions)	April 30, 2010	Level 2 October 31, 2009
Finance receivables ^(A)	\$ 20	\$ 38

(A) Certain impaired finance receivables are measured at fair value on a nonrecurring basis. An impairment charge is recorded for the amount by which the carrying value of the receivables exceeds the fair value of the underlying collateral, net of remarketing costs. As of April 30, 2010, impaired receivables with a carrying amount of \$41 million had specific loss reserves of \$21 million and a fair value of \$20 million. As of October 31, 2009, impaired receivables with a carrying amount of \$62 million had specific loss reserves of \$24 million and a fair value of \$38 million. Fair values of the underlying collateral are determined by reference to dealer vehicle value publications adjusted for certain market factors.

In addition to the methods and assumptions we use for the financial instruments recorded at fair value discussed above, we used the following methods and assumptions to estimate the fair value for our other financial instruments which are not marked to market on a recurring or nonrecurring basis. The carrying amounts of cash and cash equivalents, restricted cash and cash equivalents, and accounts payable approximate fair values because of the short-term maturity and highly liquid nature of these instruments. The carrying amounts of customer receivables and retail and wholesale accounts approximate fair values as a result of the short-term nature of the receivables. Due to the nature of the aforementioned financial instruments, they have been excluded from the fair value amounts presented in the table below. The fair values of our finance receivables are estimated by discounting expected cash flows at estimated current market rates. We also use quoted market prices, when available, or the present value of estimated future cash flows to determine fair values of debt instruments.

The carrying values and estimated fair values of financial instruments as of April 30, 2010 and October 31, 2009 are summarized in the table below:

(in millions)	April 30, 2010		October 31, 2009	
Assets	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Finance receivables	\$ 2,249	\$ 2,077	\$ 2,355	\$ 2,177
Notes receivable	35	35	16	