

NAVISTAR INTERNATIONAL CORP
Form 10-Q
April 25, 2005

**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 January 31, 2005

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

36-3359573

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

4201 Winfield Road, P.O. Box 1488
Warrenville, Illinois 60555

(Address of principal executive offices, 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 and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act.) Yes No

**APPLICABLE ONLY TO ISSUERS INVOLVED
IN BANKRUPTCY PROCEEDINGS DURING**

THE PRECEDING FIVE YEARS

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ___ No ___

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of March 31, 2005, the number of shares outstanding of the registrant's common stock was 70,024,485.

NAVISTAR INTERNATIONAL CORPORATION
AND CONSOLIDATED SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

STATEMENT OF INCOME (Unaudited)

Millions of dollars, except per share data

	Navistar International Corporation and Consolidated Subsidiaries	
	Three Months Ended January 31	
	2005	2004
		* As Restated
Sales and revenues		
Sales of manufactured products	\$ 2,491	\$ 1,886
Finance revenue	62	56
Other income	5	3
	<u>2,558</u>	<u>1,945</u>
Costs and expenses		
Cost of products and services sold	2,177	1,653
Restructuring and other non-recurring charges	-	4
Postretirement benefits expense	59	61
Engineering and research expense	77	64
Selling, general and administrative expense	176	149
Interest expense	33	32
Other expense	9	7
	<u>2,531</u>	<u>1,970</u>
Income (loss) before income taxes	27	(25)
Income tax expense (benefit)	9	(11)
	<u>18</u>	<u>(14)</u>
Net income (loss)	\$ 18	\$ (14)

Earnings (loss) per share			
Basic	\$	0.25	\$ (0.20)
Diluted	\$	0.24	\$ (0.20)
Average shares outstanding (millions)			
Basic		70.1	69.2
Diluted		76.3	69.2

See Notes to Financial Statements.

* See Note P to the Financial Statements.

STATEMENT OF FINANCIAL CONDITION (Unaudited)

Millions of dollars

Navistar International Corporation and Consolidated Subsidiaries			
	January 31 2005	October 31 2004	January 31 2004
			* As Restated
ASSETS			
Current assets			
Cash and cash equivalents	\$ 540	\$ 605	\$ 287
Marketable securities	78	182	42
Receivables, net	806	1,215	1,033
Inventories	865	790	689
Deferred tax asset, net	189	207	161
Other assets	203	168	175
Total current assets	2,681	3,167	2,387
Marketable securities	320	73	255
Finance and other receivables, net	1,363	1,222	989
Property and equipment, net	1,403	1,444	1,414
Investments and other assets	367	374	321
Prepaid and intangible pension assets	71	73	69
Deferred tax asset, net	1,288	1,239	1,325
Total assets	\$ 7,493	\$ 7,592	\$ 6,760
LIABILITIES AND SHAREOWNERS' EQUITY			
Liabilities			
Current liabilities			
Notes payable and current maturities of long-term debt	\$ 1,434	\$ 823	\$ 415
Accounts payable, principally trade	1,286	1,462	1,006
Other liabilities	1,017	965	932
Total current liabilities	3,737	3,250	2,353

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Debt: Manufacturing operations	1,246	1,258	898
Financial services operations	169	787	1,388
Postretirement benefits liability	1,399	1,382	1,435
Other liabilities	394	384	376
	<u> </u>	<u> </u>	<u> </u>
Total liabilities	6,945	7,061	6,450
	<u> </u>	<u> </u>	<u> </u>
Commitments and contingencies			
Shareowners' equity			
Series D convertible junior preference stock	4	4	4
Common stock and additional paid in capital (75.3 million shares issued)	2,085	2,096	2,123
Retained earnings (deficit)	(585)	(604)	(848)
Accumulated other comprehensive loss	(784)	(789)	(775)
Common stock held in treasury, at cost (5.3 million, 5.3 million and 5.7 million shares held)	(172)	(176)	(194)
	<u> </u>	<u> </u>	<u> </u>
Total shareowners' equity	548	531	310
	<u> </u>	<u> </u>	<u> </u>
Total liabilities and shareowners' equity	\$ 7,493	\$ 7,592	\$ 6,760
	<u> </u>	<u> </u>	<u> </u>

See Notes to Financial Statements.

* See Note P to the Financial Statements.

STATEMENT OF CASH FLOW (Unaudited)
Millions of dollars

	Navistar International Corporation and Consolidated Subsidiaries	
	Three Months Ended January 31	
	2005	2004
Cash flow from operations		* As Restated
Net income (loss)	\$ 18	\$ (14)
Adjustments to reconcile net income (loss) to cash used in operations:		
Depreciation and amortization	64	52
Deferred income taxes	(9)	(14)
Postretirement benefits funding less than expense	8	1
Other, net	(10)	(42)
Change in operating assets and liabilities:		
Receivables	(120)	(110)
Inventories	(81)	(92)
Prepaid and other current assets	(34)	(25)
Accounts payable	(199)	(96)
Other liabilities	20	17
Cash used in operations	(343)	(323)
Cash flow from investment programs		
Purchases of retail notes and lease receivables	(445)	(346)
Collections/sales of retail notes and lease receivables	896	264
Purchases of marketable securities	(213)	(88)
Sales or maturities of marketable securities	70	386
Capital expenditures	(16)	(22)
Property and equipment leased to others	6	-
Other investment programs	4	2
Cash provided by investment programs	302	196

Cash flow from financing activities

Issuance of debt	11	93
Principal payments on debt	(48)	(94)
Net (increase) decrease in notes and debt outstanding under bank revolving credit facility and commercial paper programs	22	(78)
Other financing activities	(9)	26
	<u> </u>	<u> </u>
Cash used in financing activities	(24)	(53)
	<u> </u>	<u> </u>

Cash and cash equivalents

Decrease during the period	(65)	(180)
At beginning of the period	605	467
	<u> </u>	<u> </u>
Cash and cash equivalents at end of the period	\$ 540	\$ 287
	<u> </u>	<u> </u>

See Notes to Financial Statements.

* See Note P to the Financial Statements.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note A. Summary of Accounting Policies

Navistar International Corporation (NIC) is a holding company whose principal operating subsidiary is International Truck and Engine Corporation (International). As used hereafter, “company” or “Navistar” refers to Navistar International Corporation and its consolidated subsidiaries. Navistar operates in three principal industry segments: truck, engine (collectively called “manufacturing operations”), and financial services. The consolidated financial statements include the results of the company’s manufacturing operations, majority owned dealers and its wholly owned financial services subsidiaries. The effects of transactions between the manufacturing, dealer and financial services operations have been eliminated to arrive at the consolidated totals.

The accompanying unaudited financial statements have been prepared in accordance with accounting policies described in the 2004 Annual Report on Form 10-K and should be read in conjunction with the disclosures therein.

In the opinion of management, these interim financial statements reflect all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position, results of operations and cash flow for the periods presented. Interim results are not necessarily indicative of results for the full year. Certain 2004 amounts have been reclassified to conform with the presentation used in the 2005 financial statements.

Statement of Financial Accounting Standards (SFAS) No. 123 (SFAS No. 123), “Accounting for Stock-Based Compensation” and Statement of Financial Accounting Standards No. 148 (SFAS No. 148), “Accounting for Stock-Based Compensation - Transition and Disclosure,” encourage, but do not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The company has chosen to continue to account for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations. Accordingly, no compensation cost has been recognized for fixed stock options because the exercise prices of the stock options equal the market value of the company’s common stock at the date of grant. The following table illustrates the effect on the company’s net income (loss) and earnings (loss) per share if the company had applied the fair value recognition provision of SFAS No. 123 in accordance with the disclosure provisions of SFAS No. 148.

Millions of dollars	Three Months Ended January 31	
	2005	2004
Net income (loss), as reported	\$ 18	\$ (14)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(4)	(5)
Pro forma net income (loss)	\$ 14	\$ (19)

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Earnings (loss) per share:

Basic - as reported	\$	0.25	\$	(0.20)
Basic - pro forma	\$	0.20	\$	(0.28)
Diluted - as reported	\$	0.24	\$	(0.20)
Diluted - pro forma	\$	0.19	\$	(0.28)

Based on recent clarifications that affect the company's previous interpretation of the timing of expense recognition under SFAS No. 123 for certain "retirement eligible" recipients of stock option awards, the company has revised the first quarter 2004 pro-forma stock option expense amount of \$3 million, as previously included in its first quarter 2004 Form 10-Q, to \$5 million, as reflected above. The related pro-forma basic and diluted per share amounts have similarly been adjusted to reflect this revision.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note B. New Accounting Pronouncements

In June 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), "Share-Based Payment". This Statement generally requires the recognition of the cost of employee services received in exchange for an award of equity instruments. This cost is based on the grant date fair value of the equity award and will be recognized over the period during which the employee is required to provide service in exchange for the award. The effective date for the company is the beginning of the first fiscal quarter of 2006. The company is still evaluating its share-based payment programs and the related impact, if any, this Statement may have on its results of operations, financial condition or cash flows.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs", to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. The Statement clarifies that abnormal inventory costs should be recognized in the period in which they occur. This Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The company will adopt this Statement in fiscal 2006 and will determine the effect, if any, this Statement may have on its results of operations, financial condition and cash flows.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets", to amend Accounting Principles Board Opinion No. 29 (APB No. 29). The Statement eliminates the exception from fair value measurement for nonmonetary exchanges of similar products in APB No. 29 and replaces it with an exception for exchanges that do not have commercial substance. This Statement will be applied prospectively for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The company does not expect this statement will have a material impact on its results of operations, financial condition and cash flows.

In December 2004, the FASB issued two FASB Staff Positions (FSP's) that provide accounting guidance on how companies should account for the effects of the American Jobs Creation Act of 2004 (the Act) that was signed into law on October 22, 2004. The Act could affect how companies report their deferred income tax balances. The first FSP is FSP FAS 109-1 (FSP 109-1); the second is FSP FAS 109-2 (FSP 109-2). In FSP 109-1, the FASB concludes that the tax relief (special tax deduction for domestic manufacturing) from the Act should be accounted for as a "special deduction" instead of a tax rate reduction. FSP 109-2 gives a company additional time to evaluate the effects of the Act on any plan for reinvestment or repatriation of foreign earnings for purposes of applying SFAS No. 109, "Accounting for Income Taxes." However, companies must provide certain disclosures if it chooses to utilize the additional time granted by the FASB. The company is evaluating the impact, if any, these FSP's may have on its results of operations, financial condition or cash flows.

Note C. Supplemental Cash Flow Information

Consolidated interest payments during the first three months of 2005 and 2004 were \$45 million and \$37 million, respectively. Consolidated tax payments made during the first three months of 2005 and 2004 were \$3 million and \$1 million, respectively.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note D. Postretirement Benefits*Postretirement Benefits Expense*

The company provides postretirement benefits to a substantial portion of its employees. Costs associated with postretirement benefits include pension and postretirement health care expenses for employees, retirees and surviving spouses and dependents. In addition, as part of the 1993 restructured health care and life insurance plans, profit sharing payments to the Retiree Supplemental Benefit Trust (Trust) are required.

The cost of postretirement benefits is segregated as a separate component on the Statement of Income and is as follows:

Millions of dollars	Three Months Ended January 31	
	2005	2004
Pension expense	\$ 17	\$ 20
Other benefits	42	41
Net postretirement benefits expense	\$ 59	\$ 61

Net periodic postretirement benefits expense included on the Statement of Income is composed of the following:

Millions of dollars	Pension Expense for Three Months Ended January 31	
	2005	2004
Service costs for benefits earned during the period	\$ 6	\$ 7
Interest on obligation	55	58
Amortization of cumulative losses	15	13
Amortization of prior service cost	2	2
Other	6	6
Less expected return on assets	(67)	(66)
Net pension expense	\$ 17	\$ 20

**Other Benefits for
Three Months Ended
January 31**

Millions of dollars	2005	2004
Service costs for benefits earned during the period	\$ 4	\$ 4
Interest on obligation	36	36
Amortization of cumulative losses	15	12
Other	-	3
Less expected return on assets	(13)	(14)
Net other benefits expense	\$ 42	\$ 41

“Other” includes the expense related to yearly lump-sum payments to retirees required by negotiated labor contracts, expense related to defined contribution plans and other postretirement benefit costs.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note D. Postretirement Benefits (continued)*Employer Contributions*

The company previously disclosed in its financial statements for the year ended October 31, 2004 that it expected to contribute approximately \$20 million to its pension plans in 2005. Current expectations regarding 2005 pension plan contributions have not changed since that time. As of January 31, 2005, \$6 million of contributions have been made to the company's qualified pension plans.

The company also makes contributions to partially fund retiree health care benefits. As of January 31, 2005, \$2 million of contributions have been made to the company's retiree healthcare plans and the company anticipates contributing an additional \$4 million in 2005 for a total contribution of \$6 million.

Note E. Income Taxes

The tax expense (benefit) on the Statement of Income reflects the tax benefit of current Net Operating Losses (NOL), net of valuation reserves, while the cumulative benefit of NOL carryforwards is recognized as a deferred tax asset in the Statement of Financial Condition. Cash payment of income taxes may be required for certain state income, foreign income and withholding and federal alternative minimum taxes. Until the company has utilized its significant NOL carryforwards, the cash payment of United States (U.S.) federal and state income taxes will be minimal.

Note F. Inventories

Inventories are as follows:

Millions of dollars	January 31 2005	October 31 2004	January 31 2004
Finished products	\$ 544	\$ 505	\$ 417
Work in process	60	47	65
Raw materials and supplies	261	238	207
Total inventories	\$ 865	\$ 790	\$ 689

Note G. Sales of Receivables

Navistar Financial Corporation's (NFC) primary business is to provide wholesale, retail and lease financing for new and used trucks sold by International and International's dealers and, as a result, NFC's finance receivables and leases have a significant concentration in the trucking industry. NFC retains as collateral an ownership interest in the equipment associated with leases and a security interest in equipment associated with wholesale notes and retail notes.

During the first quarter of fiscal 2005, NFC sold \$757 million of retail notes and leases for a pre-tax gain of \$11 million compared to the first quarter of fiscal 2004, when NFC sold \$195 million of retail receivables for a pre-tax

gain of \$4 million.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note H. Restructuring and Other Non-recurring Charges

Restructuring Charges

In 2000 and 2002, the company's board of directors approved separate plans to restructure its manufacturing and corporate operations. The company incurred charges for severance and other benefits, curtailment losses, lease terminations, asset and inventory write-downs and other exit costs relating to these plans. The following are the major restructuring, integration and cost reduction initiatives originally included in the 2000 and 2002 Plans of Restructuring (Plans of Restructuring):

- Replacement of steel cab trucks with a new line of High Performance Vehicles (HPV) and a concurrent realignment of the company's truck manufacturing facilities
 - Launch of the next generation technology diesel engines (NGD)
 - Consolidation of corporate operations
 - Realignment of the bus and truck dealership network and termination of various dealerships' contracts
- Closure of certain facilities and operations and exit of certain activities including the Chatham, Ontario heavy truck assembly facility, the Springfield, Ohio body plant and a manufacturing production line within one of the company's plants
 - Offer of early retirement and voluntary severance programs to certain union represented employees

The Plans of Restructuring originally called for a reduction in workforce of approximately 5,400 employees, primarily in North America, resulting in charges totaling \$169 million. The decision, in 2003, to keep open the Chatham facility along with changes in staffing requirements at other manufacturing facilities lowered the total number of employee reductions to 4,200. The change in expected employee reductions along with an evaluation of the severance reserves related to the HPV and NGD product programs resulted in a net reversal to the previously recorded severance and other benefits reserves totaling \$50 million.

A curtailment loss of \$157 million was recorded in 2002 relating to the company's postretirement plans. This loss was the result of an early retirement program for represented employees at the company's Springfield and Indianapolis plants and the planned closure of the Chatham facility. Subsequently, the decision to keep open the Chatham facility, the offer of an early retirement and voluntary severance program to certain employees at the Chatham facility, and the completion of the sign-up period for the early retirement window program offered to certain eligible, long serviced UAW employees, resulted in a net reduction of \$3 million to the previously recorded curtailment loss. The curtailment liability has been classified as a postretirement benefits liability on the Statement of Financial Condition.

Lease termination charges include estimated lease costs, net of probable sublease income, under long-term non-cancelable lease agreements. These charges primarily relate to the lease at the company's previous corporate office in Chicago, Illinois, which expires in 2010.

Dealer termination costs include the termination of certain dealer contracts in connection with the realignment of the company's bus distribution network. Other exit costs include contractually obligated exit and closure costs associated with facility closures and an accrual for the loss on sale of Harco National Insurance Company. As of January 31, 2005, \$55 million of the total net charge of \$66 million has been incurred, of which \$2 million was incurred during the quarter.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note H. Restructuring and Other Non-recurring Charges (continued)*Other Non-Recurring Charges*

In October 2002, Ford advised the company that its current business case for a V-6 diesel engine in the specified vehicles was not viable and discontinued its program for the use of these engines. Accordingly, the company recorded charges of \$170 million for the write-off of deferred pre-production costs, the write-down of fixed assets that were abandoned, lease obligations under non-cancelable operating leases and accruals for amounts contractually owed to suppliers. In 2003, the company recorded an adjustment of \$11 million for additional amounts contractually owed to suppliers related to the V-6 diesel engine program. In April 2003, the company reached a comprehensive agreement with Ford concerning the termination of its V-6 diesel engine program. The terms of the agreement included compensation to neutralize certain current and future V-6 diesel engine program related costs not accrued for as part of the 2002 non-recurring charge, resolution of ongoing pricing related to the company's V-8 diesel engine program and a release by the parties of all of their obligations under the V-6 diesel engine contract. The company will continue as Ford's exclusive supplier of V-8 diesel engines through 2012. The agreement with Ford does not have a material net impact on the Statement of Financial Condition or the Statement of Income for the periods covered in this report.

Summary

Through January 31, 2005, the company has recorded cumulative charges of \$818 million relating to the Plans of Restructuring and other non-recurring charges.

The remaining components of the company's Plans of Restructuring and other non-recurring charges are shown in the following table.

(Millions of dollars)	Balance October 31 2004	Amount Incurred	Balance January 31 2005
Lease terminations	21	(2)	19
Dealer terminations and other charges	12	(1)	11
Other non-recurring charges	64	(2)	62
Total	\$ 97	\$ (5)	\$ 92

The remaining liability of \$92 million is expected to be funded from existing cash balances and internally generated cash flows from operations. The total cash outlay for the remainder of 2005 is expected to be \$13 million with the remaining obligation of \$79 million, primarily related to non-recurring charges and long-term non-cancelable lease agreements, to be settled in 2006 and beyond.

The company is in the process of completing certain aspects of the Plans of Restructuring and will continue to evaluate the remaining restructuring reserves as the plans are executed. As a result, there may be additional adjustments to the reserves noted above. Since the company-wide restructuring plans are an aggregation of many

individual components requiring judgments and estimates, actual costs have differed from estimated amounts.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note I. Financial Instruments

The company uses derivative financial instruments as part of its overall interest rate and foreign currency risk management strategy.

The 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 selling fixed rate receivables on a fixed rate basis and by utilizing derivative financial instruments. These derivative financial instruments may include interest rate swaps, interest rate caps and forward contracts. 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. NFC manages exposure to counter-party credit risk by entering into derivative financial instruments with major financial institutions that can be expected to fully perform under the terms of such agreements. NFC does not require collateral or other security to support derivative financial instruments with credit risk.

NFC's counter-party credit exposure is limited to the positive fair value of contracts at the reporting date. As of January 31, 2005, NFC's derivative financial instruments had a negative net fair value. Notional amounts of derivative financial instruments do not represent exposure to credit loss.

At January 31, 2005, the notional amounts and fair values of the company's derivatives are presented in the following table. The fair values of all these derivatives are recorded in other assets or other liabilities on the Statement of Financial Condition.

(Millions of dollars)

Inception Date	Maturity Date	Derivative Type	Notional Amount	Fair Value
November 2002 - July 2004	March 2007 - September 2008	Interest rate swaps*	\$ 41	\$ -
July 2001 - January 2005	June 2005 - June 2011	Interest rate swaps	299	6
October 2000 - December 2004	February 2005 - November 2012	Interest rate caps	1,083	-
January 2005	February 2005	Cross Currency Swaps	27	-

*Accounted for as non-hedging instruments.

Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note J. Guarantees

The company and its subsidiaries occasionally provide guarantees that could obligate them to make future payments if the primary entity fails to perform under its contractual obligations. The company has not recorded a liability for these guarantees. The company has no recourse as guarantor in case of default.

International provides a full and unconditional guarantee on the \$400 million 9 3/8% Senior Notes due 2006, the \$250 million 7.5% Senior Notes due 2011 and the \$190 million 2.5% Senior Convertible Notes due 2007. NIC also provides a guarantee on the \$19 million 9.95% Senior Notes due 2011. As of January 31, 2005, the outstanding balance on the 9.95% Senior Notes was \$13 million.

NIC and International are obligated under certain agreements with public and private lenders of NFC to maintain the subsidiary's income before interest expense and income taxes at not less than 125% of its total interest expense. No income maintenance payments were required for the three months ended January 31, 2005.

NIC guarantees lines of credit made available to its Mexican finance subsidiaries by third parties and NFC. NFC guarantees the borrowings of the Mexican finance subsidiaries. The following table summarizes the borrowings as of January 31, 2005, in millions of dollars.

Entity	Amount of Guaranty	Outstanding Balance	Maturity dates extend to
NIC	\$ 393	\$ 99	2010
NFC	\$ 88	\$ 75	2010
NIC and NFC	\$ 100	\$ 37	2005

The company also guarantees many of the operating leases of its operating subsidiaries. The leases have various expiration dates that extend through June 2014. The remaining maximum obligation under these leases as of January 31, 2005, totaled approximately \$521 million.

The company and International also guarantee real estate operating leases of International and of the subsidiaries of the company. The leases have various maturity dates extending through 2019. As of January 31, 2005, the total remaining obligation under these leases is approximately \$44 million.

The company and NFC have issued residual value guarantees in connection with various operating leases. The amount of the guarantees is undeterminable because in some instances, neither the company nor NFC is responsible for the entire amount of the guaranteed lease residual. The company's and NFC's guarantees are contingent upon the fair value of the leased assets at the end of the lease term. The difference between this fair value and the guaranteed lease residual represents the amount of the company's and NFC's exposure.

Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note J. Guarantees (continued)

As of January 31, 2005, NFC had guaranteed derivative contracts for foreign currency forwards, interest rate swaps and cross currency swaps related to two of the company's Mexican finance subsidiaries. NFC is liable up to the fair market value of these derivative contracts only in cases of default by the two Mexican finance subsidiaries. As of January 31, 2005, there was an outstanding notional balance of \$58 million related to interest rate swaps and cross currency swaps, and the fair market value of the outstanding balance was immaterial.

At January 31, 2005, the company's Canadian operating subsidiary was contingently liable for \$409 million of retail customers' contracts and \$35 million of retail leases that are financed by a third party. The Canadian operating subsidiary is responsible for the residual values of these financing arrangements. These contract amounts approximate the resale market value of the collateral underlying the note liabilities.

In addition, the company entered into various guarantees for purchase commitments, insurance loss reserves, credit guarantees and buyback programs with various expiration dates that total approximately \$93 million. In the ordinary course of business, the company also provides routine indemnifications and other guarantees whose terms range in duration and often are not explicitly defined. The company does not believe these will have a material impact on the results of operations or financial condition of the company.

Product Warranty

Provisions for estimated expenses related to product warranty are made at the time products are sold. These estimates are established using historical information about the nature, frequency and average cost of warranty claims. Management actively studies trends of warranty claims and takes action to improve vehicle quality and minimize warranty claims. Management believes that the warranty reserve is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the reserve.

Changes in the product warranty accrual for the three months ended January 31, 2005, were as follows:

Millions of dollars	
Balance, beginning of period	\$ 286
Change in liability for warranties issued during the period	52
Change in liability for preexisting warranties	5
Payments made	(75)
Balance, end of period	\$ 268

Note K. Legal Proceedings and Environmental Matters

The company and its subsidiaries are subject to various claims arising in the ordinary course of business, and are parties to various legal proceedings that constitute ordinary routine litigation incidental to the business of the company and its subsidiaries. The majority of these claims and proceedings relate to commercial, product liability and warranty

matters. In the opinion of the company's management, the disposition of these proceedings and claims, including those discussed below, after taking into account established reserves and the availability and limits of the company's insurance coverage, will not have a material adverse effect on the business or the financial condition of the company.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)**Note K. Legal Proceedings and Environmental Matters (continued)**

The company has been named a potentially responsible party (PRP), in conjunction with other parties, in a number of cases arising under an environmental protection law, the Comprehensive Environmental Response, Compensation and Liability Act, popularly known as the Superfund law. These cases involve sites that allegedly received wastes from current or former company locations. Based on information available to the company which, in most cases, consists of data related to quantities and characteristics of material generated at current or former company locations, material allegedly shipped by the company to these disposal sites, as well as cost estimates from PRPs and/or federal or state regulatory agencies for the cleanup of these sites, a reasonable estimate is calculated of the company's share, if any, of the probable costs and is provided for in the financial statements. These obligations are generally recognized no later than completion of the remedial feasibility study and are not discounted to their present value. The company reviews all accruals on a regular basis and believes that, based on these calculations, its share of the potential additional costs for the cleanup of each site will not have a material effect on the company's financial results.

Two sites formerly owned by the company, Wisconsin Steel in Chicago, Illinois and Solar Turbines in San Diego, California, were identified as having soil and groundwater contamination. While investigations and cleanup activities continue at both sites, the company anticipates that all necessary costs to complete the cleanup have been adequately reserved.

In December 2003, the United States Environmental Protection Agency (US EPA) issued a Notice of Violation to the company in conjunction with the operation of its engine casting facility in Indianapolis, Indiana. Specifically, the US EPA alleged that the company violated applicable environmental regulations by failing to obtain the necessary permit in connection with the construction of certain equipment and complying with the best available control technology for emissions from such equipment. The company is currently in discussions with the US EPA and believes that its discussions will result in capital improvements together with monetary sanctions which will not be material.

Various claims and controversies have arisen between the company and its former fuel system supplier, Caterpillar Inc. (Caterpillar), regarding the ownership and validity of certain patents covering fuel system technology used in the company's new version of diesel engines that were introduced in February 2002. In June 1999, in Federal Court in Peoria, Illinois, Caterpillar sued Sturman Industries, Inc. (Sturman), the company's joint venture partner in developing fuel system technology, alleging that technology invented and patented by Sturman and licensed to the company, belongs to Caterpillar. After a trial, on July 18, 2002, the jury returned a verdict in favor of Caterpillar finding that this technology belongs to Caterpillar under a prior contract between Caterpillar and Sturman. Sturman appealed the adverse judgment, and the jury's verdict was reversed by the appellate court on October 28, 2004 and remanded to the district court for retrial. The company is cooperating with Sturman in this effort. In May 2003, in Federal Court in Columbia, South Carolina, Caterpillar sued the company, its supplier of fuel injectors and joint venture, Siemens Diesel Systems Technology, L.L.C., and Sturman for patent infringement alleging that the Sturman fuel system technology patents and certain Caterpillar patents are infringed in the company's new engines. The company believes that it has meritorious defenses to the claims of infringement of the Sturman patents as well as the Caterpillar patents and will vigorously defend such claims. In January 2002, Caterpillar sued the company in the Circuit Court in Peoria County, Illinois, alleging the company breached the purchase agreement pursuant to which Caterpillar supplied fuel systems for the company's prior version of diesel engines. Caterpillar's claims involve a 1990 agreement to reimburse Caterpillar for costs associated with the delayed launch of the company's V-8 diesel engine program. Reimbursement of the delay costs was made by a surcharge of \$8.08 on each injector purchased and the purchase of certain minimum quantities of spare parts. In 1999, the company concluded that, in accordance with the 1990 agreement, it had fully reimbursed Caterpillar for its delay costs and stopped paying the surcharge and purchasing the minimum quantities of

spare parts. Caterpillar is asserting that the surcharge and the spare parts purchase requirements continue throughout the life of the contract and has sued the company to recover these amounts, plus interest. Caterpillar also asserts that the company failed to purchase all of its fuel injector requirements under the contract and, in collusion with Sturman, failed to pursue a future fuel systems supply relationship with Caterpillar. The company believes that it has meritorious defenses to Caterpillar's claims.

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note K. Legal Proceedings and Environmental Matters (continued)

Along with other vehicle manufacturers, the company and certain of its subsidiaries have been subject to an increase in the number of asbestos-related claims in recent years. Management believes that such claims will not have a material adverse affect on the company's financial condition or results of operations. 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 presence of asbestos in company facilities. In these claims the company is not the sole defendant, and the claims name as defendants numerous manufacturers and suppliers of a wide variety of products allegedly containing asbestos. Management has strongly disputed these claims, and it has been the company's policy to defend against them vigorously. Historically, the actual damages paid out to claimants have not been material to the company's results of operations and financial condition. However, management believes the company and other vehicle manufacturers are being more aggressively targeted, largely as a result of bankruptcies of manufacturers of asbestos and products containing asbestos. 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.

On October 13, 2004, the company received a request from the staff of the Securities and Exchange Commission (SEC) to voluntarily produce certain documents and information related to the company's accounting practices with respect to defined benefit pension plans and other postretirement benefits. The company is fully cooperating with this request. Based on the status of the inquiry, the company is not able to predict the final outcome.

On January 31, 2005, the company announced that it would restate its financial results for fiscal years 2002 and 2003 and the first three quarters of fiscal 2004. The SEC notified the company on February 9, 2005, that it was conducting an informal inquiry into the company's restatement. On March 17, 2005, the company was advised by the SEC that the status of the inquiry had been changed to a formal investigation. The company is fully cooperating with the SEC on this investigation. Based on the status of the investigation, the company is not able to predict the final outcome.

Note L. Segment Data

Reportable operating segment data is as follows:

Millions of dollars	Truck	Engine	Financial Services	Total
For the quarter ended January 31, 2005				
External revenues	\$ 1,918	\$ 573	\$ 64	\$ 2,555
Intersegment revenues	-	149	13	162
Total revenues	\$ 1,918	\$ 722	\$ 77	\$ 2,717
Segment profit (loss)	\$ 55	\$ (19)	\$ 35	\$ 71

As of January 31, 2005

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Segment assets	\$	1,972	\$	1,165	\$	2,246	\$	5,383
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For the quarter ended January 31, 2004

External revenues	\$	1,427	\$	459	\$	57	\$	1,943
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Intersegment revenues		-		135		9		144
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Total revenues	\$	1,427	\$	594	\$	66	\$	2,087
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Segment profit	\$	9	\$	5	\$	23	\$	37
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As of January 31, 2004

Segment assets	\$	1,594	\$	1,065	\$	2,210	\$	4,869
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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note L. Segment Data (continued)

Reconciliation to the consolidated financial statements as of and for the quarters ended January 31 is as follows:

Millions of dollars	2005	2004
Segment sales and revenues	\$ 2,717	\$ 2,087
Other income	3	2
Intercompany	(162)	(144)
Consolidated sales and revenues	\$ 2,558	\$ 1,945
Segment profit	\$ 71	\$ 37
Restructuring adjustment	-	(4)
Corporate items	(30)	(44)
Manufacturing net interest expense	(14)	(14)
Consolidated pre-tax income (loss) from continuing operations	\$ 27	\$ (25)
Segment assets	\$ 5,383	\$ 4,869
Cash and marketable securities	433	224
Deferred taxes	1,477	1,486
Corporate intangible pension assets	1	3
Other corporate and eliminations	199	178
Consolidated assets	\$ 7,493	\$ 6,760

Note M. Comprehensive Income

The components of comprehensive income (loss) are as follows:

Millions of dollars	For the Three Months Ended January 31	
	2005	2004

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Net income (loss)	\$	18	\$	(14)
Other comprehensive income		5		3
		<u> </u>		<u> </u>
Total comprehensive income (loss)	\$	23	\$	(11)
		<u> </u>		<u> </u>

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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note N. Earnings Per Share

Earnings (loss) per share was computed as follows:

Millions of dollars, except share and per share data	For the Three Months Ended January 31	
	2005	2004
Net income (loss)	\$ 18	\$ (14)
Average shares outstanding (millions)		
Basic	70.1	69.2
Diluted	76.3	69.2
Earnings (loss) per share		
Basic	\$ 0.25	\$ (0.20)
Diluted	\$ 0.24	\$ (0.20)

The computation of diluted shares outstanding for the three months ended January 31, 2004, excludes incremental shares of 10.8 million, related to employee stock options, convertible debt and other dilutive securities. These shares are excluded due to their anti-dilutive effect as a result of the company's losses for the first three months of 2004.

Note O. Condensed Consolidating Guarantor and Non-Guarantor Financial Information

The following tables set forth the condensed consolidating Statements of Financial Condition as of January 31, 2005 and 2004, and the Statements of Income and Cash Flow for the three months ended January 31, 2005 and 2004. The following information is included as a result of International's guarantees, exclusive of its subsidiaries, of NIC's indebtedness under its 9 3/8% Senior Notes due 2006, 2.5% Senior Convertible Notes due 2007 and 7.5% Senior Notes due 2011. International is a direct wholly owned subsidiary of NIC. None of NIC's other subsidiaries guarantee any of these notes. Each of the guarantees is full and unconditional. Separate financial statements and other disclosures concerning International have not been presented because management believes that such information is not material to investors. NIC includes the consolidated financial results of the parent company only, with all of its wholly owned subsidiaries accounted for under the equity method. International, for purposes of this disclosure only, includes the consolidated financial results of its wholly owned subsidiaries accounted for under the equity method. "Non-Guarantor Companies and Eliminations" includes the consolidated financial results of all other non-guarantor subsidiaries including the elimination entries for all intercompany transactions. All applicable corporate expenses have been allocated appropriately among the guarantor and non-guarantor subsidiaries.

NIC files a consolidated U.S. federal income tax return that includes International and its U.S. subsidiaries. International has a tax allocation agreement (Tax Agreement) with NIC which requires International to compute its separate federal income tax expense based on its adjusted book income. Any resulting tax liability is paid to NIC. In

addition, under the Tax Agreement, International is required to pay to NIC any tax payments received from its subsidiaries. The effect of the Tax Agreement is to allow the parent company, rather than International, to utilize U.S. operating income/losses and NIC operating loss carryforwards.

Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note O. Condensed Consolidating Guarantor and Non-Guarantor Financial Information (continued)

Millions of dollars	NIC	International	Non-Guarantor Companies and Eliminations	Consolidated
<u>CONDENSED CONSOLIDATING STATEMENT OF INCOME FOR THE THREE MONTHS ENDED JANUARY 31, 2005</u>				
Sales and revenues	\$ 1	\$ 1,966	\$ 591	\$ 2,558
Cost of products and services sold	2	1,832	343	2,177
All other operating expenses	(9)	262	101	354
Total costs and expenses	(7)	2,094	444	2,531
Equity in income (loss) of non-consolidated subsidiaries	19	93	(112)	-
Income (loss) before income taxes	27	(35)	35	27
Income tax expense (benefit)	9	12	(12)	9
Net income (loss)	\$ 18	\$ (47)	\$ 47	\$ 18

CONDENSED CONSOLIDATING STATEMENT OF FINANCIAL CONDITION AS OF JANUARY 31, 2005

Assets				
Cash and marketable securities	\$ 340	\$ 8	\$ 590	\$ 938
Receivables, net	1	265	1,903	2,169
Inventories	-	431	434	865
Property and equipment, net	-	744	659	1,403

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Investment in affiliates	(2,665)	1,130	1,535	-
Deferred tax asset and other assets	1,439	216	463	2,118
Total assets	\$ (885)	\$ 2,794	\$ 5,584	\$ 7,493

Liabilities and shareowners' equity

Debt	\$ 1,058	\$ 14	\$ 1,777	\$ 2,849
Postretirement benefits liability	-	4,408	(2,838)	1,570
Amounts due to (from) affiliates	(2,629)	85	2,544	-
Other liabilities	138	1,513	875	2,526
Total liabilities	(1,433)	6,020	2,358	6,945

Shareowners' equity (deficit)	548	(3,226)	3,226	548
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Total liabilities and shareowners' equity	\$ (885)	\$ 2,794	\$ 5,584	\$ 7,493
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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOW FOR THE THREE MONTHS ENDED JANUARY 31, 2005

Cash provided by (used in) operations	\$ (220)	\$ (66)	\$ (57)	\$ (343)
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Cash flow from investment programs

Purchases, net of collections, of finance receivables	-	-	451	451
Net increase in marketable securities	115	-	(258)	(143)
Capital expenditures	-	(7)	(9)	(16)
Other investing activities	(3)	30	(17)	10

Cash provided by investment programs	112	23	167	302
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Cash flow from financing activities

Net repayments of debt	-	(1)	(14)	(15)
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Other financing activities	(16)	28	(21)	(9)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Cash provided by (used in) financing activities	(16)	27	(35)	(24)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Cash and cash equivalents				
Increase (decrease) during the period	(124)	(16)	75	(65)
At beginning of the period	406	22	177	605
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Cash and cash equivalents at end of the period	\$ 282	\$ 6	\$ 252	\$ 540
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note O. Condensed Consolidating Guarantor and Non-Guarantor Financial Information (continued)

Millions of dollars	NIC	International	Non-Guarantor Companies and Eliminations	Consolidated
<u>CONDENSED CONSOLIDATING STATEMENT OF INCOME FOR THE THREE MONTHS ENDED JANUARY 31, 2004</u>				
Sales and revenues	\$ -	\$ 1,478	\$ 467	\$ 1,945
Cost of products and services sold	11	1,377	265	1,653
Restructuring and other non-recurring charges	-	-	4	4
All other operating expenses	(4)	257	60	313
Total costs and expenses	7	1,634	329	1,970
Equity in income (loss) of non-consolidated subsidiaries	(18)	82	(64)	-
Income (loss) before income taxes	(25)	(74)	74	(25)
Income tax expense (benefit)	(11)	2	(2)	(11)
Net income (loss)	\$ (14)	\$ (76)	\$ 76	\$ (14)
<u>CONDENSED CONSOLIDATING STATEMENT OF FINANCIAL CONDITION AS OF JANUARY 31, 2004</u>				
Assets				
Cash and marketable securities	\$ 85	\$ 24	\$ 475	\$ 584
Receivables, net	1	170	1,851	2,022
Inventories	-	350	339	689

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Property and equipment, net	-	755	659	1,414
Investment in affiliates	(2,788)	890	1,898	-
Deferred tax asset and other assets	1,490	203	358	2,051
Total assets	\$ (1,212)	\$ 2,392	\$ 5,580	\$ 6,760

Liabilities and shareowners' equity

Debt	\$ 840	\$ 16	\$ 1,845	\$ 2,701
Postretirement benefits liability	-	3,122	(1,388)	1,734
Amounts due to (from) affiliates	(2,534)	1,156	1,378	-
Other liabilities	172	1,316	527	2,015
Total liabilities	(1,522)	5,610	2,362	6,450

Shareowners' equity (deficit)	310	(3,218)	3,218	310
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Total liabilities and shareowners' equity	\$ (1,212)	\$ 2,392	\$ 5,580	\$ 6,760
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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOW FOR THE THREE MONTHS ENDED JANUARY 31, 2004

Cash provided by (used in) operations	\$ (174)	\$ (59)	\$ (90)	\$ (323)
--	-----------------	----------------	----------------	-----------------

Cash flow from investment programs

Purchases, net of collections, of finance receivables	-	-	(82)	(82)
Net increase in marketable securities	22	-	276	298
Capital expenditures	-	(12)	(10)	(22)
Other investing activities	(8)	59	(49)	2
Cash provided by investment programs	14	47	135	196

Cash flow from financing

activities

Net repayments of debt	-	(1)	(78)	(79)
Other financing activities	37	16	(27)	26
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Cash provided by (used in) financing activities

	37	15	(105)	(53)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Cash and cash equivalents

Increase (decrease) during the period	(123)	3	(60)	(180)
At beginning of the period	218	21	228	467
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Cash and cash equivalents at end of the period

	\$ 85	\$ 24	\$ 168	\$ 287
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note P: Restatement of Prior Period Financial Statements

In December 2004, NFC determined that it would restate its consolidated financial statements for the first three quarters of fiscal 2004 and the fiscal years ended October 31, 2003 and 2002 due to certain misapplications of GAAP. The primary area where it was determined that GAAP was incorrectly applied was in the accounting for retail note securitizations. As a result of NFC's restatement, the company concluded that it was necessary to restate its financial statements for the same periods. In the course of preparing the restatement of its consolidated financial statements, the company determined that it was appropriate to make other adjustments as well. These adjustments were primarily related to trade payables at the company's Mexican truck assembly facility, accruals relating to employee plans and the consolidation of majority owned truck dealerships.

The significant effects of the restatements on the consolidated financial statements for the period ended January 31, 2004, primarily due to the consolidation of majority owned truck dealerships and the accounting for retail note securitizations at NFC, is included below. The amounts shown below have minor differences to the unaudited Selected Quarterly Financial Data disclosed in Note 22 to the company's Annual Report on Form 10-K. The changes represent timing within the quarters and do not change year-end amounts.

Navistar International Corporation and Consolidated Subsidiaries		
STATEMENT OF INCOME	Three Months Ended January 31, 2004	
Millions of dollars	As Previously Reported [1]	As Restated
Sales and revenues		
Sales of manufactured products	\$ 1,806	\$ 1,886
Finance revenue	50	56
Other income	3	3
Total sales and revenues	1,859	1,945
Costs and expenses		
Cost of products and services sold	1,603	1,653
Restructuring and other non-recurring charges	4	4
Postretirement benefits expense	61	61
Engineering and research expense	64	64
Selling, general and administrative expense	121	149
Interest expense	31	32
Other expense	7	7

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Total costs and expenses	1,891	1,970
Income (loss) before income taxes	(32)	(25)
Income tax expense (benefit)	(14)	(11)
Net income (loss)	\$ (18)	\$ (14)
Earnings (loss) per share		
Basic	\$ (0.27)	\$ (0.20)
Diluted	\$ (0.27)	\$ (0.20)
Average shares outstanding (millions)		
Basic	69.2	69.2
Diluted	69.2	69.2

[1] In addition to the adjustments noted above, first quarter results for 2004 were restated to reflect the retroactive impact of adopting FSP 106-2, regarding accounting for the impact of the Medicare Prescription Drug, Improvement and Modernization Act of 2003, in the third quarter of fiscal 2004.

Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note P: Restatement of Prior Period Financial Statements (continued)

	Navistar International Corporation and Consolidated Subsidiaries	
STATEMENT OF FINANCIAL CONDITION	Three Months Ended January 31, 2004	
Millions of dollars	As Previously Reported	As Restated
ASSETS		
Current assets		
Cash and cash equivalents	\$ 274	\$ 287
Marketable securities	42	42
Receivables, net	1,008	1,033
Inventories	575	689
Deferred tax asset, net	159	161
Other assets	166	175
	2,224	2,387
Total current assets	2,224	2,387
Marketable securities	255	255
Finance and other receivables, net	989	989
Property and equipment, net	1,318	1,414
Investments and other assets	364	321
Prepaid and intangible pension assets	70	69
Deferred tax asset, net	1,500	1,325
	6,720	6,760
Total assets	\$ 6,720	\$ 6,760
LIABILITIES AND SHAREOWNERS' EQUITY		
Liabilities		
Current liabilities		
Notes payable and current maturities of long-term debt	\$ 277	\$ 415

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Accounts payable, principally trade	979	1,006
Other liabilities	936	932
	<u> </u>	<u> </u>
Total current liabilities	2,192	2,353
Debt: Manufacturing operations	854	898
Financial services operations	1,388	1,388
Postretirement benefits liability	1,440	1,435
Other liabilities	526	376
	<u> </u>	<u> </u>
Total liabilities	6,400	6,450
	<u> </u>	<u> </u>
Commitments and contingencies		
Shareowners' equity		
Series D convertible junior preference stock	4	4
Common stock and additional paid in capital (75.3 million shares issued)	2,123	2,123
Retained earnings (deficit)	(860)	(848)
Accumulated other comprehensive loss	(782)	(775)
Common stock held in treasury, at cost (5.7 million shares held)	(165)	(194)
	<u> </u>	<u> </u>
Total shareowners' equity	320	310
	<u> </u>	<u> </u>
Total liabilities and shareowners' equity	\$ 6,720	\$ 6,760
	<u> </u>	<u> </u>

Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note Q: Subsequent Events

In March 2005, the company sold \$400 million in Senior Notes due 2012. The notes were sold in a Rule 144A private unregistered offering and priced to yield 6.25 percent. The Notes are guaranteed on a senior unsecured basis by International. The Notes will rank behind in right of payment to all of the company's future secured debt and equally in right of payment to all of the company's existing and future senior unsecured debt. The company may redeem some or all of the Notes at any time on or after March 1, 2009 at redemption prices set forth in the offering memorandum. The company may also redeem up to 35 percent of the aggregate principal amount of the Notes using the proceeds of certain equity offerings completed before March 1, 2008. The proceeds will be used for general corporate purposes.

The failure of the company and its affiliates to timely complete their respective Quarterly Reports on Form 10-Q and deliver those reports to their respective lenders resulted in a default under such agreements. However, the company and its affiliates did not receive a notice of default and no adverse action was taken by those lenders or lessors against the company or its affiliates. NFC obtained the necessary waivers from its various lenders to prevent a notice of default.

On April 14, 2005, the company announced that its South American engine subsidiary, International Engines South America, completed the acquisition of MWM Motores Diesel Ltda, a major Brazilian diesel engine producer. Although the transaction has been completed, the combination of the two companies will require review by CADE, the Brazilian anti-trust regulatory authority.

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Navistar International Corporation and Consolidated Subsidiaries

Additional Financial Information (Unaudited)

The following additional financial information is provided based upon the continuing interest of certain shareholders and creditors to assist them in understanding our core manufacturing business.

Navistar International Corporation (with financial services operations on an equity basis)

Millions of dollars	Three Months Ended	
	January 31	
Condensed Statement of Income	2005	2004
		As Restated
Sales of manufactured products	\$ 2,491	\$ 1,887
Other income	3	2
Total sales and revenues	2,494	1,889
Cost of products sold	2,168	1,641
Restructuring and other non-recurring charges	-	4
Postretirement benefits expense	58	60
Engineering and research expense	77	65
Selling, general and administrative expense	162	134
Other expense	37	33
Total costs and expenses	2,502	1,937
Income (loss) from continuing operations before income taxes:		
Manufacturing operations	(8)	(48)
Financial services operations	35	23
Income (loss) from continuing operations before income taxes	27	(25)
Income tax expense (benefit)	9	(11)
Net income (loss)	\$ 18	\$ (14)

January 31 October 31 January 31

**Condensed Statement of Financial
Condition**

	2005	2004	2004
			As Restated
Cash, cash equivalents and marketable securities	\$ 518	\$ 737	\$ 291
Inventories	859	779	678
Property and equipment, net	1,255	1,283	1,218
Equity in non-consolidated subsidiaries	564	549	481
Other assets	1,142	1,129	882
Deferred tax asset, net	1,466	1,445	1,484
Total assets	\$ 5,804	\$ 5,922	\$ 5,034
Accounts payable, principally trade	\$ 1,275	\$ 1,436	\$ 997
Postretirement benefits liability	1,548	1,544	1,714
Debt	1,306	1,329	1,068
Other liabilities	1,127	1,082	945
Shareowners' equity	548	531	310
Total liabilities and shareowners' equity	\$ 5,804	\$ 5,922	\$ 5,034

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Navistar International Corporation and Consolidated Subsidiaries

Additional Financial Information (Unaudited)

Navistar International Corporation (with financial services operations on an equity basis)

Millions of dollars

Three Months Ended
January 31**Condensed Statement of Cash Flow****2005**

2004

As Restated

Cash flow from operations

Net income (loss) \$ 18 \$ (14)

Adjustments to reconcile net income (loss) to cash used in operations:

Depreciation and amortization 61 46

Deferred income taxes (24) (21)

Postretirement benefits funding less than expense 8 1

Equity in earnings of investees, net of dividends received (23) (20)

Other, net - (32)

Change in operating assets and liabilities (293) (197)

Cash used in operations (253) (237)**Cash flow from investment programs**

Purchases of marketable securities (213) (88)

Sales or maturities of marketable securities 323 133

Capital expenditures (16) (22)

Receivable from financial services operations 77 (2)

Investment in affiliates - (8)

Other investment programs 4 10

Cash provided by investment programs 175 23**Cash provided by (used in) financing activities (32) 28****Cash and cash equivalents**

Decrease during the period (110) (186)

At beginning of the period 556 444

Cash and cash equivalents at end of the period \$ 446 \$ 258

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Navistar International Corporation is a holding company and its principal operating subsidiary is International Truck and Engine Corporation (International). Navistar operates in three principal industry segments: truck, engine (collectively called "manufacturing operations") and financial services. The company's principal operations are located in the U.S., Canada, Mexico, and Brazil. In this discussion and analysis, "company", "Navistar", "we" or "our" refers to Navistar International Corporation and its consolidated subsidiaries.

The company is currently focused on four key areas: great products, delivering on our commitments, cost and growth. The company will focus on offering new products based on current product platforms while delivering on commitments to our customers as well as our shareowners. The company anticipates growth in the truck and engine segments through new products and new markets while continuing to focus on ways to improve the cost structure to help the company succeed in a competitive marketplace.

Historically, the company experiences its lowest levels of sales and revenues during the first quarter of its fiscal year due to lower manufacturing output as a result of the holiday shutdown periods. Nevertheless, the company recorded a profit of \$18 million or diluted earnings per share of \$0.24 in the first quarter of 2005 compared to losses in the first quarter of previous years. In addition, in the first quarter of fiscal 2005 the company signed a strategic agreement with German engine producer, MAN Nutzfahrzeuge (MAN), to develop and produce International engines in the 11- to 13-liter range to be offered in International Class 8 highway tractors and severe service trucks starting in the fall of 2007. This agreement should allow the company to grow the diesel engine business while controlling costs by leveraging the investment that MAN has made in the development of the base engines.

Restatement of Prior Period Financial Statements

The accompanying management's discussion and analysis gives effect to the restatement of the consolidated financial statements for the period ended January 31, 2004, as discussed in Note P to the consolidated financial statements.

Results of Operations

On April 14, 2005, the company issued an earnings news release and filed a report on Form 8-K with preliminary financial information for the three months ended January 31, 2005. The Form 8-K and earnings news release indicated that the company expected net income for the period to be \$20 million or \$0.27 per diluted share. The company is now reporting in this Form 10-Q, net income for the period ended January 31, 2005, of \$18 million or \$0.24 per diluted share. The decrease in net income is the result of a review which resulted in certain one-time charges at the company's engine foundry operations. Based on the review, which was completed subsequent to the press release, costs of products and services sold increased by \$4 million. The increase in total expenses was partially offset by a favorable \$2 million adjustment to tax expense.

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Results of Operations (continued)

The following table illustrates the key financial indicators that management uses to assess the consolidated financial results for the three months ended January 31, 2005 and 2004.

Key Financial Indicators: (Millions of dollars, except per share data and margin)	Three Months Ended January 31	
	2005	2004
Sales and revenues	\$ 2,558	\$ 1,945
Cost of products and services sold	2,177	1,653
Total expenses	354	317
Total costs and expense	2,531	1,970
Net income/(loss)	\$ 18	\$ (14)
Diluted earnings/(loss) per share	\$ 0.24	\$ (0.20)
Manufacturing gross margin	13.0%	13.1%

The company's sales and revenues were up on strong sales volumes from the truck and engine segments. Improvement in earnings, over the comparable period last year, was a result of better operating results from the truck and financial services segments. The events that impacted the performance of the company's three operating segments will be analyzed, in detail, later in this discussion.

Gross margin from manufacturing operations was essentially unchanged in the first quarter of fiscal 2005 when compared to the first quarter of fiscal 2004. Although manufacturing and design cost reductions were achieved in the first quarter of 2005, these favorable impacts were offset by higher commodity costs, including steel. Higher than expected steel costs are expected to have an impact of approximately \$100 million on our cost structure in fiscal 2005. The company will continue to look for ways to offset the negative impact of commodity cost increases, particularly through surcharges in the pricing of the company's products.

Total expenses increased over the comparable period last year as a result of higher engineering and selling, general and administrative expenses. Engineering expenses were impacted by costs associated with 2007 emissions compliance within the company's engine segment. Selling, general and administrative expenses were impacted by the addition of several new wholly owned dealers and incremental spending within our truck segment.

The following sections analyze the company's first quarter operating results as they relate to its three principal segments: truck, engine and financial services.

Truck

The truck segment manufactures and distributes a full line of Class 6 through 8 diesel-powered trucks and school buses in the common carrier, private carrier, government/service, leasing, construction, energy/petroleum and student transportation markets. The truck segment also provides customers with proprietary products needed to support the Internationalâ truck and the ICTM bus lines, together with a wide selection of other standard truck and trailer aftermarket parts. Sales of Class 6 through 8 trucks have historically been cyclical, with demand affected by such economic factors as industrial production, construction, demand for consumer durable goods, interest rates as well as the earnings and cash flow of dealers and customers. In addition, the Class 6 through 8 truck markets in the U.S. and Canada are highly competitive. The intensity of this competition results in price discounting and margin pressures throughout the industry. Even though sales volume has improved, the company is still experiencing competitive pricing pressure on its new truck sales. In addition to the influence of price, market position is driven by product quality, engineering, styling, utility and distribution.

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Results of Operations (continued)**Truck (continued)**

The following table highlights the truck segment's financial and industry results for the three months ended January 31, 2005 and 2004.

	Three Months Ended January 31	
	2005	2004
Results (Millions of dollars):		
Sales	\$ 1,918	\$ 1,427
Segment profit	55	9
Industry data (in units) [1]:		
U.S. and Canadian sales (Class 6 through 8) n	95,500	73,700
Class 8 heavy truck	64,400	44,200
Class 6 and 7 medium truck [2]	25,400	22,700
School buses	5,700	6,800
Company data (in units):		
U.S. and Canadian sales (Class 6 through 8)	26,200	20,700
Class 8 heavy truck	12,300	6,900
Class 6 and 7 medium truck [2]	10,300	9,700
School buses	3,600	4,100
Order backlog (in units)	29,100	21,700
Overall U.S. and Canada market share (Class 6 through 8 and bus)	27.5%	28.0%

[1] Industry data derived from materials produced by Ward's Communications.

[2] The company does not meaningfully participate in the Class 5 medium truck market.

The truck segment's improved performance is the result of increased sales volume within medium and heavy truck and increased cost reductions within its manufacturing processes. The company's U.S. and Canadian order backlog increased significantly due to strong orders for Class 8 trucks. The company's overall market share decreased slightly over the comparable period last year. Market share was adversely impacted by the industry growth within the Class 8 heavy truck market, a market in which the company has its smallest market share. However, the company's Class 8 heavy truck market share continued to hold at 19%, a level it achieved at the end of 2004, which was an increase of three percentage points over its Class 8 heavy market share of 16% in the first quarter of 2004. The company's growth within the Class 8 heavy truck market is a direct result of the company's recommitment to the market and our dealer distribution strategy. The market share decrease within medium truck is due to increased pricing competition in a very

competitive marketplace. The company's bus market share was up slightly over the comparable period last year.

The company currently projects fiscal 2005 U.S. and Canadian Class 8 heavy truck demand to be 262,000 units, up 19% from 2004. Class 6 and 7 medium truck demand, excluding school buses, is forecast to be essentially unchanged from the 100,000 units in 2004. Demand for school buses is expected to be 27,500 units, up 5% from 2004.

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Results of Operations (continued)*Engine*

The engine segment designs and manufactures diesel engines in the 160-325 horsepower range for use in the company's Class 6 and 7 medium trucks, school buses and selected Class 8 heavy truck models. The company's diesel engines are also produced for original equipment manufacturers (OEMs), principally Ford Motor Company (Ford). This segment also sells engines for industrial and agricultural applications. In addition, the engine segment provides customers with proprietary products needed to support the International engine lines, together with a wide selection of other standard engine and aftermarket parts.

The following table highlights the engine segment's financial and industry results for the three months ended January 31, 2005 and 2004.

	Three Months Ended January 31	
	2005	2004
Results (Millions of dollars):		
Sales	\$ 722	\$ 594
Segment profit/(loss)	(19)	5
Sales data (in units):		
Total engine sales	105,700	91,500
OEM sales	88,800	74,500

The engine segment's revenues improved 22% over the comparable period in 2004, primarily due to higher sales volumes, but reported a net loss for the current period. The increase in engine sales, period over period, was across all product lines. The engine segment's loss for the first quarter of 2005 is the result of a lower profit margin on the segment's new I-6 engine which was launched in the second quarter of 2004; however, further cost and design reductions should continue to improve margins on the new I-6 engine. The results from the first quarter of 2004 included the previous I-6 engine which had a long life-cycle and a higher margin. In addition, the engine segment experienced one-time costs of approximately \$12 million from one of its foundry operations and engineering costs associated with 2007 emission compliance. The company's V-8 shipments to Ford accounted for 84% of all OEM engine sales in the current period as compared to 89% in the comparable period.

The company continues to forecast that OEM shipments of mid-range diesel engines in 2005 are expected to be 365,400 units, 2% higher than 2004.

Financial Services

Financial services provides wholesale, retail and lease financing for sales of new and used trucks sold by the company and its dealers in the U.S. and Mexico. Financial services also finances the company's wholesale accounts and selected

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 the company's truck products.

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Results of Operations (continued)*Financial Services (continued)*

The following table highlights the financial services segment's financial results for the three months ended January 31, 2005 and 2004.

	Three Months Ended January 31	
	2005	2004
Results (Millions of dollars):		
Revenue	\$ 77	\$ 66
Segment profit	35	23
Sales of retail receivables	\$ 757	\$ 195
Gain on sales of retail receivables	11	4

The increase in net income is due to higher sales of receivables and an increased level of wholesale balances. Higher receivables sales volume reflects a timing difference between quarters.

Restructuring and Other Non-recurring Charges*Restructuring*

In 2000 and 2002, the company's board of directors approved two separate plans to restructure its manufacturing and corporate operations (Plans of Restructuring). The company incurred charges for severance and other benefits, curtailment losses, lease terminations, asset and inventory write-downs and other exit costs relating to the major restructuring, integration and cost reduction initiatives originally included in the Plans of Restructuring. A detailed discussion of the charges and initiatives can be found in Note H to the financial statements.

Other Non-Recurring Charges

The company entered into an agreement with Ford to develop and manufacture a V-6 diesel engine to be used in specific Ford vehicles. In October 2002, Ford advised the company that its current business case for a V-6 diesel engine in the specified vehicles was not viable and discontinued its program for the use of these engines. Accordingly, in 2002, the company recorded charges for the write-off of deferred pre-production costs, the write-down of fixed assets that were abandoned, lease obligations under non-cancelable operating leases and accruals for amounts contractually owed to suppliers. In April 2003, the company reached a comprehensive agreement with Ford concerning termination of its V-6 diesel engine program. The terms of the agreement include compensation to neutralize certain current and future V-6 diesel engine program related costs not accrued for as part of the 2002 non-recurring charge, resolution of ongoing pricing related to the company's V-8 diesel engine program and a release by the parties of all of their obligations under the V-6 diesel engine contract. The company will continue as Ford's exclusive supplier of V-8 diesel engines through 2012.

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Restructuring and Other Non-recurring Charges (continued)*Status*

Through January 31, 2005, the company has recorded cumulative charges of \$818 million relating to the Plans of Restructuring and non-recurring charges. The initiatives for the Plans of Restructuring are expected to generate at least \$70 million of annualized savings for the company, primarily from lower salary and benefit costs and plant operating costs. The company will continue to realize these benefits in 2005 and beyond.

The remaining components of the company's Plans of Restructuring and other non-recurring charges are shown in the following table.

(Millions of dollars)	Balance October 31 2004	Amount Incurred	Balance January 31 2005
Lease terminations	21	(2)	19
Dealer terminations and other charges	12	(1)	11
Other non-recurring charges	64	(2)	62
Total	\$ 97	\$ (5)	\$ 92

The remaining liability of \$92 million is expected to be funded from existing cash balances and internally generated cash flows from operations. The total cash outlay for the remainder of 2005 is expected to be \$13 million with the remaining obligation of \$79 million, primarily related to non-recurring charges and long-term non-cancelable lease agreements, to be settled in 2006 and beyond.

The company is in the process of completing certain aspects of the Plans of Restructuring and will continue to e