NAVISTAR INTERNATIONAL CORP
Form 10-K
May 29, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended October 31, 2007

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

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

Common stock, par value $0.10 per share

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 þ

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

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

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

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

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

As of April 30, 2008, the number of shares outstanding of the registrant s common stock was 70,239,785, net of treasury shares.

Documents incorporated by reference: None.

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NAVISTAR INTERNATIONAL CORPORATION FISCAL YEAR 2007 FORM 10-K

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PART I

Item 1. *Business*

Navistar International Corporation (NIC), incorporated under the laws of the state of Delaware in 1993, is a holding company whose principal operating subsidiaries are Navistar, Inc. (formerly known as International Truck and Engine Corporation) and Navistar Financial Corporation (NFC). Both NIC and NFC file periodic reports with the United States Securities and Exchange Commission (SEC). References herein to the company, we, our, or us refer to NIC and its subsidiaries, and certain variable interest entities of which we are the primary beneficiary. We report our annual results for our fiscal year, which ends October 31. As such, all references to 2007, 2006, and 2005 contained within this Annual Report on Form 10-K relate to the fiscal year unless otherwise indicated.

Our Operating Segments

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

Truck Segment

The Truck segment manufactures and distributes a full line of class 4 through 8 trucks and buses in the common carrier, private carrier, government/service, leasing, construction, energy/petroleum, and student and commercial transportation markets under the International and IC Bus, LLC (IC) brands. This segment also produces chassis for motor homes and commercial step-van vehicles under the Workhorse Custom Chassis, LLC (WCC) brand. Additionally, we design, produce, and market a brand of light commercial vehicles for India and exportation under the Mahindra International, Ltd. (Mahindra) brand. Mahindra is a joint venture with Mahindra & Mahindra, Ltd. See Acquisitions, Strategic Agreements, and Joint Ventures for additional discussion.

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

We compete primarily in the class 6 through 8 bus, medium and heavy truck markets within the U.S. and Canada, which we consider our traditional markets. We continue to grow in expansion markets, which include Mexico, international export, non-U.S. military, recreational vehicle (RV), commercial step-van, and other class 4 through 8 truck and bus markets. We market our truck products through our extensive dealer network in North America, which offers a comprehensive range of services and other support functions to our customers. Our trucks are distributed in virtually all key markets in North America through our distribution and service network, comprised of 830 U.S. and Canadian dealer and retail outlets and 83 Mexican dealer locations as of April 30, 2008. In addition, our network of used truck centers and International certified used truck dealers in the U.S. and Canada provides trade-in support to our dealers and national accounts group, and markets all makes and models of reconditioned used trucks to owner-operators and fleet buyers. The Truck segment is our largest operating segment, accounting for the majority of our total external sales and revenues.

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

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The class 4 through 8 truck and bus markets in North America are highly competitive. Major U.S. domestic competitors include: PACCAR Inc. (PACCAR), Ford Motor Company (Ford), and General Motors Corporation (GM). Competing foreign-controlled domestic manufacturers include: Freightliner, Sterling, and Western Star (all subsidiaries of Daimler-Benz AG), and Volvo and Mack (both subsidiaries of Volvo Global Trucks). In addition, smaller, foreign-controlled market participants such as Isuzu Motors America, Inc. (Isuzu), Nissan North America, Inc. (Nissan), Hino (a subsidiary of Toyota Motor Corporation (Toyota)), and Mitsubishi Motors North America, Inc. (Mitsubishi) are competing in the U.S. and Canadian markets with primarily imported products. In Mexico, the major domestic competitors are Kenmex (a subsidiary of PACCAR) and Daimler-Benz AG (Mercedes Benz). In addition to the influence of price, market share is driven by product quality, engineering, styling, utility, fuel efficiency, and distribution.

Engine Segment

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

The Engine segment designs and manufactures diesel engines across the 50 through 375 horsepower range for use in our medium trucks, buses, and selected class 8 heavy truck models. This segment also will begin production of the new MaxxForce 11 and 13 Big-Bore engines that are expected to be introduced into the market in 2008.

According to data provided by independent market researchers, Power System Research, we are the world s largest diesel engine maker across the 160 through 370 horsepower range. Our diesel engines are sold under the MaxxForce brand as well as produced for other OEMs, principally Ford. We supply our V-8 diesel engine to Ford for use in all of Ford s diesel-powered super-duty trucks and vans over 8,500 lbs. gross vehicle weight in North America. Shipments to Ford during the year ended October 31, 2007 account for 94% of our V-8 shipments and 58% of total shipments (including intercompany transactions). We are currently involved in litigation with Ford. For more information regarding our litigation with Ford, see Item 3, *Legal Proceedings*.

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

In South America, we have a substantial share of the diesel engine market in the mid-sized pickup and sport utility vehicle (SUV) markets as well as the mid-range diesel engines produced in that market. Our South American subsidiary MWM International Industria De Motores Da America Do Sul Ltda. (MWM), a leader in the Brazilian mid-range diesel engine market, which also sells products in more than 30 countries on five continents, provides customers with additional engine offerings in the agriculture, marine, and light truck markets. MWM competes with Mitsubishi and Toyota in the Mercosul pickup and SUV markets, Cummins and Mercedes Benz in the light truck market, Mercedes Benz in the bus market, and New Holland (a subsidiary of CNH Global N.V.), Valtra (a subsidiary of AGCO Corporation), and Deere & Company in the agricultural markets.

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

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We also operate two U.S. foundries: Indianapolis Casting Corporation, located in Indianapolis, Indiana, which is a high volume grey iron foundry that casts large complex products such as cylinder heads and crankcases, and our ductile iron foundry located in Waukesha, Wisconsin, which produces a variety of smaller components for the truck and diesel engine markets such as brackets and bedplates.

Parts Segment

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

Our sales force is focused on serving the dealer channel, and is based in five regions within the U.S., one in Canada, one in Mexico, and one for export and military business. In addition, we have a national account sales team, serving major fleet customers throughout North America. We operate 11 regional parts distribution centers in North America in support of our customers and dealers.

Financial Services Segment

The Financial Services segment provides retail, wholesale, and lease financing of products sold by the Truck segment and its dealers within the U.S. and Mexico. We also finance wholesale 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 our truck products. Our Mexican financial services operations primary business is to provide wholesale, retail, and lease financing to the Mexican operations dealers and retail customers.

In 2007, retail, wholesale, and lease financing of products manufactured by others approximated 15% of the financial services segment s total originations. This segment provided wholesale financing in 2007 and 2006 for 94% and 95%, respectively, of our new truck inventory sold by us to our dealers and distributors in the U.S. and provided retail and lease financing of 12% of all new truck units sold or leased by us to retail customers for both years.

Engineering and Product Development Costs

Our engineering and product development programs are focused on product improvements, innovations, and cost reductions. As a diesel engine manufacturer, we have incurred research, development, and tooling costs to design our engine product lines to meet United States Environmental Protection Agency (U.S. EPA), California Air Resources Board (CARB), and other applicable foreign government emission requirements. Our engineering and product development expenditures were $382 million in 2007 compared to $453 million in 2006.

Acquisitions, Strategic Agreements, and Joint Ventures

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

Previously, we entered into a joint venture with Ford to capitalize on our mutual medium truck volumes. The Blue Diamond Truck (BDT) joint venture was originally formed to produce class 3 through 7 commercial vehicles marketed independently under International and Ford brand names. On

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September 28, 2007, we informed Ford of our decision to terminate the venture effective on September 28, 2009. However, upon either party s request and under commercially reasonable terms, either party will continue to supply certain vehicles or vehicle components from the effective date for up to four additional years.

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

In December 2007, we entered into a non-binding memorandum of understanding with GM to purchase certain assets, intellectual property, and distribution rights for the GMC and Chevrolet class 4 through 8 truck business, as well as the related GM service parts business. Although this transaction is expected to be completed in 2008, it is subject to completion of satisfactory due diligence, the negotiation of a definitive purchase agreement, and Board of Directors approval.

Government Contracts

Since 2006, we have secured approximately $5 billion of orders in the global military market. The major military contracts we secured subsequent to the end of 2006 are as follows:

In November 2006 and December 2007, we secured additional delivery orders under the Afghan Family of Medium Tactical Vehicles contract valued at more than $200 million.

In May, June, July, October, and December 2007, we were awarded combined delivery orders valued at more than $2.5 billion to provide approximately 4,500 Mine-Resistant Ambush Protected (MRAP) vehicles and support to the U.S. Marine Corps, to be delivered through July 2008.

In September, October, and December 2007, we were awarded service parts orders valued at approximately $290 million for the U.S. Marine Corps MRAP vehicles.

In March 2008, we were awarded an additional delivery order of approximately 740 MRAP vehicles for the U.S. Marine Corps valued at more than $400 million, which are expected to be completed by November 2008.

In April 2008, we were awarded a contract valued at more than $261 million to upgrade the existing armor and install additional armor to the existing orders of MRAP vehicles.

In May 2008, we were awarded a U.S. Army multi-year contract valued at nearly $1.3 billion to provide medium tactical vehicles for rebuilding and security efforts in Afghanistan and Iraq. We will also be supplying spare parts for these vehicles under this contract.

As a U.S. government contractor, we are subject to specific regulations and requirements as mandated by our contracts. These regulations include Federal Acquisition Regulations, Defense Federal Acquisition Regulations, and the Code of Federal Regulations.

We are also subject to routine audits and investigations by U.S. Government agencies such as the Defense Contract Management Agency and Defense Contract Audit Agency. These agencies review and assess compliance with contractual requirements, cost structure, and applicable laws, regulations, and standards.

Backlog

Our worldwide backlog of unfilled truck orders (subject to cancellation or return in certain events) at October 31, 2007 and 2006 was 18,900 and 43,900 units, respectively. Although the backlog of unfilled orders is one of many indicators of market demand, other factors such as changes in production rates, internal and supplier available capacity, new product introductions, and competitive pricing actions may affect point-in-time comparisons.

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Employees

The following table summarizes the number of employees worldwide as of the dates indicated:

	April 30, 2008	October 31, 2007	2006	2005
Total active employees	15,700	13,300	17,500	17,600
Total inactive employees	1,400	3,900	700	1,000
Total employees worldwide	17,100	17,200	18,200	18,600

Employees are considered inactive in certain situations including disability leave, leave of absence, layoffs, and work stoppages. Inactive employees as of October 31, 2007 include approximately 2,500 United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) workers who had commenced a work stoppage that began on October 23, 2007 and ended on December 16, 2007.

The following table outlines the number of active employees represented by the UAW, the National Automobile, Aerospace and Agricultural Implement Workers of Canada (CAW), and other unions, for the periods as indicated:

	April 30, 2008	October 31, 2007[(A)]	2006	2005
Total Active Union Employees				
Total UAW	3,400	2,000	4,800	4,900
Total CAW	700	600	1,400	1,100
Total other unions	2,700	2,100	1,600	1,400

(A) Active union employee data as of October 31, 2007 excludes 2,500 UAW workers who had commenced a work stoppage that began on October 23, 2007 and ended on December 16, 2007.

Our multi-site contract with the UAW expired on September 30, 2007. The represented workers continued to work without an extension of the contract until October 23, 2007 when they commenced a work stoppage. As of December 16, 2007, a majority of UAW members voted to ratify a new contract that will run through September 30, 2010. Our existing labor contract with the CAW runs through June 30, 2009. See Item 1A, *Risk Factors*, for further discussion related to the risk associated with labor and work stoppages.

Patents and Trademarks

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

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

Supply

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

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

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

Impact of Government Regulation

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

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

Canadian heavy-duty engine emission regulations essentially mirror those of the U.S. EPA. In Mexico, heavy-duty engine emission requirements reflect EPA 98 or Euro III standards with which we are compliant. Beginning in July 2008, heavy-duty engine emission requirements will reflect Euro IV standards with which we will also be compliant. More stringent reductions of nitrogen oxide are required by 2010; however, compliance in Mexico is conditioned on availability of low sulfur diesel fuel that may not be available at that time.

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

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

Available Information

We are subject to the reporting and information requirements of the Securities Exchange Act of 1934 (Exchange Act), as amended and as a result, are obligated to file periodic reports, proxy statements, and other

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information with the 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 such material with, or furnish them to, the SEC. The SEC maintains a website (http://www.sec.gov) that contains our annual, quarterly, and current reports, proxy, and information statements, and other information we file electronically with the SEC. You can read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Room 1850, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Information on our website does not constitute part of this Annual Report on Form 10-K.

Item 1A. ***Risk Factors***
Forward-Looking Statements; Risk Factors

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), Section 21E of the Exchange Act, and the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. You should not place undue reliance on those statements because they are subject to numerous uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control, and such forward-looking statements only speak as of the date hereof. 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, estin or similar expressions. These statements are based on assumptions that we have made in light of our experience in the industry as well as our perceptions of historical trends, current conditions, expected future developments, and other factors we believe are appropriate under the circumstances. As you read and consider the information contained herein, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties, and assumptions. Although we believe that these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect our actual financial results and could cause actual results to differ materially from those in the forward-looking statements. Some of these factors include:

Risks that Relate to Our Delay in Filing Timely Reports with the SEC, the Restatement of Our Consolidated Financial Statements, Accounting and Internal Controls, Our De-listing from the New York Stock Exchange (NYSE), and Our Trading on the Over-the-Counter Market (OTC).

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

We may have difficulty maintaining existing business and may experience a reduction in our credit rating. We may have difficulty maintaining existing business and may experience a reduction in our credit rating, which could have a material adverse effect on us by, among other things, (i) reducing our revenues if existing and potential customers hesitate to, or decide not to, purchase our products or services, (ii) increasing our costs or decreasing our liquidity if suppliers desire a change in existing payment terms, and (iii) increasing our borrowing costs or negatively affecting our ability to obtain new financings on acceptable terms or at all if rating agencies downgrade our credit ratings.

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

Our common stock is currently traded on the OTC and, as a result, stockholders may encounter difficulties in disposing of, or obtaining accurate quotations as to the market value of, our common stock. Due to the delays in filing our periodic reports with the SEC, the NYSE de-listed our common stock effective February 14, 2007. Our common stock is currently traded on the OTC. There is currently an active trading market for the common stock; however, there can be no assurance that an active trading market will be maintained. Trading of securities on the OTC is generally limited and is effected on a less regular basis than on other exchanges or quotation systems, such as the NYSE, and accordingly investors who own or purchase common stock will find that the liquidity or transferability of the common stock may be limited. Additionally, a shareholder may find it more difficult to dispose of, or obtain accurate quotations as to the market value of, our common stock. Although we intend to seek to have our common stock listed on a national security exchange promptly after filing our delayed periodic reports with the SEC, there can be no assurance that our common stock will ever be included for trading on any stock exchange or through any other quotation system, including, without limitation, the NYSE.

Risks that Relate to Business Operations and Liquidity.

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

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

Our business may be adversely impacted by work stoppages and other labor relations matters. We are subject to risk of work stoppages and other labor relations matters because a significant portion of our workforce is unionized. As of October 31, 2007, approximately 67% of our hourly workers and 11% of our salaried workers are represented by labor unions and are covered by collective bargaining agreements. Many of these agreements include provisions that limit our ability to realize cost savings from restructuring initiatives such as plant closings and reductions in workforce. Our current collective bargaining agreement with the UAW will expire October 2010. Any UAW strikes, threats of strikes, or other resistance in connection with the negotiation of a new agreement or otherwise could materially adversely affect our business as well as impair our ability to implement further measures to reduce structural costs and improve production efficiencies. A lengthy strike by the UAW that involves a significant portion of our manufacturing facilities could have a material adverse effect on our results of operations, cash flows, and financial condition. See Item 1, *Business*, Employees.

The loss of business from Ford, our largest customer, could have a negative impact on our business, financial condition, and results of operations. Ford accounted for approximately 14% of our revenues for 2007, 12% of our revenues for 2006, and 19% of our revenues for 2005. In addition, Ford accounted for approximately 58%, 61%, and 68% of our diesel engine unit volume (including

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intercompany transactions) in 2007, 2006, and 2005, respectively, primarily relating to the sale of our V-8 diesel engines. See Item 3, *Legal Proceedings* and Note 16, *Commitments and contingencies*, to the accompanying consolidated financial statements, for information related to our pending litigation with Ford.

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

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

Our business could be negatively impacted in the event NFC is unable to access sufficient capital to engage in its financing activities. NFC supports our manufacturing operations by providing financing to a significant portion of our dealers and retail customers. NFC traditionally obtains the funds to provide such financing from sales of receivables, medium and long-term debt, and equity capital and from short and long-term bank borrowings. If cash provided by operations, bank borrowings, continued sales and securitizations of receivables, and the placement of term debt does not provide the necessary liquidity, NFC may restrict its financing of Navistar, Inc. products both at the wholesale and retail level.

We have significant under-funded postretirement obligations. The under-funded portion of our accumulated benefit obligation was $197 million and $865 million for pension benefits at October 31, 2007 and 2006, respectively, and $1.1 billion and $1.7 billion for postretirement healthcare benefits at October 31, 2007 and 2006, respectively. Moreover, we have assumed expected rates of return on plan assets and growth rates of retiree medical costs and the failure to achieve the expected rates of return and growth rates could have an adverse impact on our under-funded postretirement obligations, results of operations, cash flows, and financial condition.

Our manufacturing operations are dependent upon third-party suppliers, making us vulnerable to a supply shortage. We obtain materials and manufactured components from third-party suppliers. Some of our suppliers are the sole source for a particular supply item. Any delay in receiving supplies could impair our ability to deliver products to our customers and, accordingly, could have a material adverse effect on our business, results of operations, cash flows, and financial condition.

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

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

- Trade protection measures and import or export licensing requirements
- Tax rates in certain foreign countries that exceed those in the U.S. and the imposition of withholding requirements for taxes on foreign earnings
- Difficulty in staffing and managing international operations and the application of foreign labor regulations
- Currency exchange rate risk
- Changes in general economic and political conditions in countries where we operate, particularly in emerging markets.

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

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

- Increase our vulnerability to general adverse economic and industry conditions
- Limit our ability to use operating cash flow in other areas of our business because we must dedicate a portion of these funds to make significantly higher interest payments on our indebtedness
- Limit our ability to obtain additional financing to fund future working capital, acquisitions, capital expenditures, engineering and product development costs, and other general corporate requirements
- Limit our ability to take advantage of business opportunities as a result of various restrictive covenants in our indebtedness

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

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

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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.

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

We have received no written comments regarding our periodic or current reports from the staff of the SEC that were issued 180 days or more preceding the end of 2007 that remain unresolved.

Item 2. ***Properties***

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

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

A majority of the activity of the Financial Services segment is conducted from leased headquarters in Schaumburg, Illinois. The Financial Services segment also leases two other office locations in the U.S., which will be relocated to Schaumburg in May of 2008, and one in Mexico.

All of our facilities are being utilized. We believe they have been adequately maintained, are in good operating condition, and are suitable for our current needs. These facilities, together with planned capital expenditures, are expected to meet our needs in the foreseeable future.

Item 3. ***Legal Proceedings***

Overview

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

Ford Litigation

In January 2007, a complaint was filed against us in Oakland County Circuit Court in Michigan by Ford claiming damages relating to warranty and pricing disputes with respect to certain engines purchased by Ford from us. While Ford s complaint did not quantify its alleged damages, we estimate that Ford may be seeking in excess of $500 million, and that this amount may increase (i) as we continue to sell engines to Ford at a price that

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Ford alleges is too high and (ii) as Ford pays its customers warranty claims, which Ford alleges are attributable to us. We disagree with Ford s position and are defending ourselves vigorously in this litigation. We have filed an answer to the complaint denying Ford s allegations in all material respects. We have also asserted affirmative defenses to Ford s claims, as well as counterclaims alleging that, among other things, Ford has materially breached contracts between it and us in several different respects. Based on our investigation to date, we believe we have meritorious defenses to this matter. There can be no assurance, however, that we will be successful in our defense, and an adverse resolution of the lawsuit could have a material adverse effect on our results of operations, cash flows, or financial condition. In June 2007, we filed a separate lawsuit against Ford in the Circuit Court of Cook County, Illinois, for breach of contract relating to the manufacture of new diesel engines for Ford for use in vehicles including the F-150 pickup truck. In that case we are seeking unspecified damages. In September 2007, the judge dismissed our lawsuit against Ford, directing us to proceed with mediation. In February 2008, we re-filed the lawsuit against Ford because the parties were unable to resolve the dispute through mediation.

Securities and Exchange Commission Investigations

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

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

Litigation Relating to Accounting Controls and Financial Restatement

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

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

The plaintiff in the Garza case brought a derivative claim on behalf of the company against one of the company s executive officers, two of its former executive officers, and certain of its directors, alleging that (i) all of the defendants violated their fiduciary obligations under Delaware law by willfully ignoring certain accounting and financial reporting problems at the company, thereby knowingly disseminating false and misleading financial information about the company, (ii) that certain of the defendants were unjustly enriched in connection with their sale of company stock during the December 2002 to January 2006 period, and (iii) that defendants violated

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Delaware law by failing to hold an annual meeting of shareholders. In connection with this last allegation, the plaintiff seeks an order requiring defendants to schedule an annual meeting of shareholders. Otherwise, the plaintiffs in this matter seek compensatory damages, disgorgement of the proceeds of defendants profits from the sale of company stock, attorneys fees, and other equitable relief.

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

Environmental Matters

In July 2006, the Wisconsin Department of Natural Resources (WDNR) issued to us a Notice of Violation (NOV) in conjunction with the operation of our foundry facility in Waukesha, Wisconsin. Specifically, the WDNR alleged that we violated applicable environmental regulations concerning implementation of storm water pollution prevention plans. Separately, WDNR also issued a NOV regarding the facility in November 2006, in which WDNR alleged that we failed to properly operate and monitor our operations as required by the air permit. In September 2007, WDNR referred the NOVs to the Wisconsin Department of Justice (WDOJ) for further action. On December 18, 2007, WDNR, WDOJ and Navistar, Inc. reached a settlement on these matters for less than $1 million. This settlement will not have a material effect on our results of operations, cash flows, or financial condition.

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

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

No matters were submitted to a vote of security holders during the year ended October 31, 2007.

PART II

Item 5. ***Market for the Registrant s Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities***

Prior to February 14, 2007, our common stock was listed on the NYSE, the Chicago Stock Exchange, and the Pacific Stock Exchange under the abbreviated stock symbol NAV. Effective February 14, 2007, our common stock was de-listed from the aforementioned exchanges and now trades on the OTC under the symbol NAVZ. As of April 30, 2008, there were approximately 13,571 holders of record of our common stock.

The following is the high and low market price per share of our common stock from the NYSE for each quarter of 2006 and the 1st quarter of 2007. Also included are the highs and lows from the OTC for the 3rd and 4th quarters of 2007. For the 2nd quarter of 2007, the high and low market price per share from either the NYSE or the OTC is presented. The OTC market quotations in the table below reflect inter-dealer prices, without retail mark-up, mark-down, or commissions and may not represent actual transactions.

2007	High	Low	2006	High	Low
1st Qtr	$ 44.56	$ 26.89	1st Qtr	$ 30.55	$ 25.55
2nd Qtr	59.50	39.35	2nd Qtr	30.09	26.29
3rd Qtr	74.60	53.10	3rd Qtr	29.13	20.53
4th Qtr	72.00	46.00	4th Qtr	28.80	21.66

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

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

Our directors, who are not employees, receive an annual retainer and meeting fees payable at their election either in shares of our common stock or in cash. A director may also elect to defer any portion of such compensation until a later date. Each such election is made prior to December 31st for the next succeeding calendar year. The Board of Directors also mandates that at least one-fourth of the annual retainer be paid in the form of shares of our common stock. On October 17, 2006, our Board of Directors suspended this requirement during the period in which the directors are prohibited by the securities laws from acquiring shares of our common stock. Accordingly, each director who elected to receive his/her annual retainer in cash received four equal quarterly cash payments for 2007. For those three directors who elected to defer their annual retainer and/or meeting fees in shares for 2007, they collectively were credited with an aggregate of 2,241 phantom stock units as deferred payment (each such stock unit corresponding to one share of common stock) at prices ranging from $27.14 to $33.67. These stock units were issued to our directors without registration under the Securities Act, in reliance on Section 4(2) based on the respective directors financial sophistication and knowledge of the company.

In July 2007, we also issued 5,969 shares of restricted stock to two of our executives upon exercise of stock option awards. The aggregate offering price of these shares was $149,665. These shares were issued without registration under the Securities Act in reliance on Section 4(2) based on the executives financial sophistication and knowledge of the company.

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The following table sets forth information with respect to purchases of shares of our common stock made by us or on our behalf during the year ended October 31, 2007:

Period		Total Number of Shares (or Units) Purchased[1]	Average Price Paid Per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
11/01/2006	11/30/2006		$		
12/01/2006	12/31/2006	295	32.315		
01/01/2007	01/31/2007	2,466	34.224		
02/01/2007	02/28/2007	2,288	45.630		
03/01/2007	03/31/2007				
04/01/2007	04/30/2007	252	48.525		
05/01/2007	05/31/2007				
06/01/2007	06/30/2007	143	65.550		
07/01/2007	07/31/2007	1,624	64.875		
08/01/2007	08/31/2007				
09/01/2007	09/30/2007				
10/01/2007	10/31/2007	6,442	61.825		
Total		13,510	$ 53.558		

(1) The total number of shares purchased is due to shares delivered to or withheld by us in connection with tax obligations arising from the vesting of restricted stock and settlement of restricted stock units.

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Item 6. ***Selected Financial Data***

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

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

Five-Year Summary of Selected Financial and Statistical Data (Unaudited)

As of and for the Years Ended October 31, (in millions, except per share data, units shipped, and percentages)	**2007**	**2006**	**2005**	**2004**	**2003**
RESULTS OF OPERATIONS DATA					
Sales and revenues, net	**$ 12,295**	$ 14,200	$ 12,124	$ 9,678	$ 7,695
Net income (loss)	**$ (120)**	$ 301	$ 139	$ (44)	$ (333)
Basic earnings (loss) per share	**$ (1.70)**	$ 4.29	$ 1.98	$ (0.64)	$ (4.86)
Diluted earnings (loss) per share	**$ (1.70)**	$ 4.12	$ 1.90	$ (0.64)	$ (4.86)
Average number of shares outstanding:					
Basic	**70.3**	70.3	70.1	69.7	68.7
Diluted	**70.3**	74.5	76.3	69.7	68.7
BALANCE SHEET DATA					
Total assets	**$ 11,448**	$ 12,830	$ 10,786	$ 8,750	$ 8,390
Long-term debt[A]:					
Manufacturing operations	**$ 1,665**	$ 1,946	$ 1,476	$ 1,514	$ 1,336
Financial services operations	**4,418**	4,809	3,933	2,106	3,621
Total long-term debt	**$ 6,083**	$ 6,755	$ 5,409	$ 3,620	$ 4,957
Stockholders deficit	**$ (734)**	$ (1,114)	$ (1,699)	$ (1,852)	$ (1,756)
SUPPLEMENTAL DATA					
Capital expenditures	**$ 380**	$ 321	$ 399	$ 376	$ 388
Engineering and product development costs	**$ 382**	$ 453	$ 413	$ 287	$ 270
OPERATING DATA					
Manufacturing gross margin	**14.9%**	15.7%	13.3%	11.9%	9.5%
U.S. and Canadian market share[B]	**26.6%**	26.7%	27.0%	28.1%	28.8%
Unit shipments worldwide					
Truck chargeouts[C]	**113,600**	155,400	131,700	108,800	84,400
Total engine shipments[D]	**404,700**	519,700	522,600	432,200	394,900

(A) Exclusive of current portion of long-term debt.
(B) Based on market-wide information from Wards Communications and R.L. Polk & Co.
(C) Truck chargeouts are defined by management as trucks that have been invoiced.
(D) Includes engine shipments to OEMs and to our Truck segment.

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

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

- Highlights and Executive Summary
- Overview
  - Our Business
  - Key Trends and Business Outlook
- Results of Operations and Segment Review
- Liquidity and Capital Resources
- Off-Balance Sheet Arrangements
- Contractual Obligations
- Other Information
  - Income Taxes
  - Environmental Matters
  - Securitization Transactions
  - Critical Accounting Policies
  - New Accounting Pronouncements

2007 and 2006 Quarterly Financial Results (Unaudited)

Highlights and Executive Summary

We are an international manufacturer of class 4 through 8 trucks and buses and diesel engines, and a provider of proprietary and aftermarket parts for all makes of trucks and trailers. We also provide retail, wholesale, and lease financing of our trucks, and financing for our wholesale accounts and selected retail accounts receivable. We operate in four industry segments: Truck, Engine, Parts, and Financial Services.

Our business is heavily influenced by the overall performance of the traditional medium and heavy truck markets within the U.S. and Canada, which includes vehicles in weight classes 6 through 8, including school buses. These markets are typically cyclical in nature but in certain years they have also been impacted by accelerated purchases of trucks (pre-buy) in anticipation of higher prices due to stricter emissions standards imposed by the U.S. EPA, as was particularly evident during late 2005 and throughout 2006. In turn, the industry has experienced corresponding periods of delayed purchases of trucks, namely in 2007 and 2008. To minimize the impact of the traditional markets cyclicality, our continuing strategy incorporates further growth in our Parts segment and an increased presence in expansion markets such as the non-U.S. military, RV, commercial step-van and export markets. In addition, we continue to focus on improving the cost structure in our Truck and Engine segments while delivering products of distinction and evaluating opportunities to contain our legacy costs, utilize our deferred tax assets, and return to a more conventional capital structure.

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Although unit growth in both the Truck and Engine segments was strong in 2006 and 2005, indicating strong fundamentals in the markets we served, we experienced a decline in unit volumes in 2007. Worldwide Truck segment units invoiced to customers were 113,600 in 2007, a decrease of 26.9% compared to 2006. Conversely, worldwide Truck segment units invoiced to customers were 155,400 in 2006, an increase of 18.0% compared to 2005. Worldwide order backlogs were 18,900 units at the end of 2007, and 43,900 units at the end of 2006 as compared to 27,800 at the end of 2005. Total Engine segment units, which include units delivered both to OEMs and our Truck segment, were 404,700 in 2007, 519,700 in 2006, and 522,600 in 2005. Consistent with our strategy, we focused on strategic acquisitions that have allowed us to further our expansion market growth to minimize the impact of downturns in the traditional markets. In 2006, we finalized a joint venture with Mahindra & Mahindra, Ltd., a leading Indian manufacturer of multi-utility vehicles. During 2007, we continued to focus on strengthening our internal controls over financial reporting and on instituting process improvements throughout the organization to ensure accurate, timely, and transparent financial reporting. We made substantial progress toward becoming a current filer with the SEC by completing all of our annual financial statements through 2007.

In 2006 and 2005, unit volume growth within the traditional markets was the major factor affecting our sales performance with improved pricing on new trucks also contributing to growth in our net sales and revenues. The traditional truck retail industry was particularly strong in 2006, reaching peak levels at 454,700 retail units. This industry strength was partially attributable to strong underlying economic growth and the need to replace aging fleets of trucks, as well as greater customer demand for vehicles containing the pre-2007 emissions-compliant engines ahead of the implementation of stricter engine emissions requirements. Conversely, in 2007, the traditional truck retail industry was depressed, which is reflected in the 319,000 retail units sold during this year. Although engine volumes for 2006 and 2005 benefited from our acquisition of MWM in April 2005, which contributed the majority of our non-Ford customer growth of 37,300 units in 2006 and 64,600 units in 2005, total engine volumes in 2007 mirrored the same decline reflected in the traditional truck markets. Non-Ford customer volumes declined by 34,400 units in 2007 compared to 2006 units. Despite the 2007 downturn experienced throughout the traditional truck markets, we were able to maintain consolidated net sales and revenues for 2007 of $12.3 billion that are consistent with levels recognized in 2005 of $12.1 billion but somewhat less than the peak level of $14.2 billion recognized in 2006.

In 2007, we incurred a net loss of $120 million compared to net income of $301 million and $139 million in 2006 and 2005, respectively. Our diluted loss was $1.70 per share in 2007 compared to diluted earnings of $4.12 per share in 2006 and $1.90 per share in 2005. Despite our consolidated pretax loss for 2007, we incurred $47 million of state, local, and foreign income taxes. During 2007, we incurred significant costs of $234 million compared to $71 million incurred in 2006 attributable to professional consulting and auditing fees and losses of $31 million in 2007 and $23 million in 2006 related to the refinancing and restructuring of our debt. Aside from these costs, we were able to achieve progressive improvements as a percentage of net sales and revenues in our engineering and product development costs and warranty costs through continuous improvement in the reliability of our emissions-compliant engines and vehicles. Since 2005, our focus on reliability and quality has produced significantly improved emissions-compliant engines. In addition to improving our emissions-compliant engines, we also continue to focus on growing our business through our strategy of leveraging our acquisitions and strategic relationships, which will aid us in accomplishing our longer term strategic goals.

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

	Years Ended October 31,		
(in millions, except per share data)	2007	2006	2005
Sales and revenues, net	**$ 12,295**	$ 14,200	$ 12,124
Total costs and expenses	**12,442**	13,904	12,069
Equity in income of non-consolidated affiliates	**74**	99	90
Income (loss) before income tax	**(73)**	395	145
Net income (loss)	**(120)**	301	139
Diluted earnings (loss) per share	**(1.70)**	4.12	1.90

Overview

Our Business

We produce International brand commercial trucks, MaxxForce brand diesel engines, IC brand buses, and WCC brand chassis for motor homes and step-vans. We are a private-label designer and manufacturer of diesel engines for the pickup truck, van, and SUV markets. We also provide truck and diesel engine service parts. We have a wholly-owned subsidiary offering financing services.

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

Key Trends and Business Outlook

Our Strategy

Our strategy is supported by our three pillars:

Great Products

Competitive Cost Structure

Profitable Growth.

A key enabler of these strategies is leveraging the resources we have and those of our partners. Over the last several years, we have launched multiple vehicles and engines that have provided us with new products and brands that are highly recognized by our customers and industry peers. Additionally, we have increased our world-wide purchasing scale and engineering capabilities, negotiated favorable and fair labor agreements, and actively controlled or reduced our legacy costs. We have improved our profitability by providing products to quickly meet market demand and customer needs of distinctive products with improved economic value.

Specific actions supporting our three pillar strategies are:

Growing our Class 8 tractor line, including an expanded line of ProStar™ tractors and the launch of LoneStar®

Working in cooperation with the U.S. military to provide a full line of defense vehicles and support, including but not limited to, MRAP

Increasing our MaxxForce branded engine lines, including the establishment of our new MaxxForce 11 and 13 engine lines

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- Focusing engine research and development in order to have a competitive advantage as the 2010 emissions standards begin to affect customers buying decisions

- Minimizing the impact of our traditional markets cyclicality by growing the Parts segment and expansion markets sales, such as Mexico, international export, non-U.S. military, RV, and commercial step-van

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

- Broadening our Engine segment customer base

- Strengthening our internal control environment by investing in our internal accounting knowledge and technical skills, and enhancing our information systems and processes.

Acquisitions, Strategic Agreements, and Joint Ventures

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

In September 2007, we sold our ownership interest in Siemens Diesel Systems Technology, LLC (SDST) to our joint venture partner, Siemens VDO Automotive Corporation. In conjunction with the sale, we received gross proceeds of $49 million for our percentage ownership in SDST and recognized a gain on this sale amounting to $17 million that was recorded in *Other (income) expenses, net*. Related to our 2004 decision to discontinue purchasing certain engine components from SDST, we agreed to reimburse SDST for the unamortized value of equipment used to build and assemble those engine components. We reimbursed this affiliate $3 million in 2007, $7 million in 2006, and $4 million in 2005. Upon the sale of our ownership interest, we no longer have any further obligation for such reimbursements.

Previously, we had entered into a joint venture with Ford to capitalize on our mutual medium truck volumes. The BDT joint venture was originally formed to produce class 3 through 7 commercial vehicles marketed independently under International and Ford brand names. On September 28, 2007, we informed Ford of our decision to terminate this agreement effective on September 28, 2009. However, upon either party s request and under commercially reasonable terms, either party will continue to supply certain vehicles or vehicle components from the effective date for up to four additional years.

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

In December 2007, we entered into a non-binding memorandum of understanding with GM to purchase certain assets, intellectual property, and distribution rights for the GMC and Chevrolet class 4 through 8 truck business, as well as the related GM service parts business. Although this transaction is expected to be completed in 2008, it is subject to completion of satisfactory due diligence, the negotiation of a definitive purchase agreement, and Board of Directors approval.

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

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Key Trends

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

Emissions Standards Change Impact and Pre-Buy The traditional truck markets in which we compete are typically cyclical in nature due to the strong influence of macro-economic factors such as industrial production, demand for durable goods, capital spending, oil prices, and consumer confidence. Cycles for these markets have historically spanned roughly 5 to 10 years peak-to-peak; however, we had observed a significant industry-wide increase in demand for vehicles containing the pre-2007 emissions-compliant engines ahead of the implementation of those stricter engine emissions requirements through 2006. Conversely, in 2007, we observed a decrease in industry-wide demand as 2007 emissions-compliant vehicles entered the marketplace. We anticipate that this weakness in industry demand is expected to continue throughout the first half of 2008 with gradual growth occurring in the second half of 2008. In 2010, emissions standards will be stricter than in 2007, although it is unknown whether or not there will be a material impact on overall truck industry cyclicality.

Certain Professional Fees As reported in our 2005 Annual Report on Form 10-K and our Current Report on Form 8-K filed March 6, 2008 that included our consolidated financial statements for the year ended October 31, 2006, the process of restating our previously issued consolidated financial statements required considerable efforts at a significant financial cost, which has been expensed as incurred. In addition, we have incurred elevated levels of professional fees in 2008, 2007, and 2006 related to assistance in preparing our financial statements, as well as documenting and performing an assessment of our internal control over financial reporting, as required by the Sarbanes-Oxley Act of 2002. The table below outlines these costs incurred through the second quarter of 2008.

(in millions)	1st & 2nd Qtr 2008	2007	2006	Total
Professional fees associated with the 2005 audit and the re-audit of periods prior to 2005	$ 14	$ 69	$ 23	$ 106
Professional fees associated with the 2007 and 2006 audits	37	16		53
Professional, consulting, and legal fees related to preparation of our public filing documents	46	130	38	214
Professional fees associated with documentation and assessment of internal control over financial reporting	8	19	10	37
Total	$ 105	$ 234	$ 71	$ 410

Professional fees associated with the audit of 2005 and the re-audit of prior periods totaled $106 million compared with the audit of 2006 for a total of $37 million and the audit of 2007 for an expected total of $26 million. In the near term, we anticipate the cost of an annual audit of our operations to be in the range of $20 to $25 million. Additionally, we expect that the cost of all other professional fees will decline significantly as we attain our goal of becoming current with our SEC filings and strengthen our internal control environment. The above external costs are in addition to the costs of approximately 100 new finance and accounting staff in the U.S. since the restatement process began, of which approximately 20 are related to supporting strategic initiatives and growth.

Changes in Debt Structure In 2007 and 2006, we made significant changes to our debt structure. As a result of our delay in filing reports with the SEC, we were in default under certain of our loan covenants, requiring us to refinance our public debt with private financing, significantly increasing the cost of our capital structure. In association with these events, we incurred expenses related to the recognition of unamortized debt issuance costs in both 2007 and 2006 and premiums on the call of our public debt in 2006. These expenses amounted to $31 million in 2007 as compared to $23 million in

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2006 and are reported in *Other (income) expenses, net.* A detailed description of these transactions and the chronology of events are outlined in the Liquidity and Capital Resources section of this Item and Note 10, *Debt*, to the accompanying consolidated financial statements.

Increasing fuel prices Fuel prices in North America have significantly increased over the six month period ended April 30, 2008. Diesel fuel prices have increased by 20% during this timeframe to an all time high of $4.08 per gallon. Consumer demand for diesel powered vehicles has been greatly influenced by the rising cost of fuel which, in turn, could impact 2008 demand for diesel engines. Additional increases in fuel prices or reduced availability of fuel could result in further declines in demand for our trucks and engines and could adversely impact our results of operations, financial condition, and cash flows. During May 2008, Ford announced that it plans to reduce its pick up and SUV productions levels due to current economic conditions. As a significant supplier to Ford, we in turn have lowered engine production and have initiated a temporary layoff in our Indianapolis, Indiana facility. We will continue to evaluate this situation and the impact, if any, on our financial condition and results of operations. See Note 16, *Commitments and contingencies*, to the accompanying consolidated financial statements.

Changes in Credit Markets Beginning in the late summer and early fall of 2007, the financial markets experienced a major correction linked primarily to the sub-prime mortgage lending market. The asset-backed securitization market used by us and our lending conduit banks was affected by this correction. As a result, future borrowings could continue to be more costly than in the past. Our two securitizations in 2008 have been priced at 180 to 200 basis points over London Interbank Offered Rate (LIBOR) or U.S. Treasuries, compared to a historical spread of 50 to 60 basis points.

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

Derivative Financial Instruments We do not apply hedge accounting to any of our derivatives. The adjustments to the derivative fair values are recorded in the consolidated statements of operations which can cause volatility in our results. However, the derivatives do provide us with an economic hedge of the expected future interest cash flows associated with the variable rate debt. We have recognized losses of $38 million in the first six months of 2008, $9 million in 2007 and $7 million in 2006, and a $1 million gain in 2005 related to these derivatives that have been recorded in *Interest expense*. For additional information, see Note 15, *Financial instruments and commodity contracts*, to the accompanying consolidated financial statements.

Postretirement benefits We are subject to a variety of federal rules and regulation