

NAVISTAR INTERNATIONAL CORP
Form 10-Q
June 09, 2005

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 2054**

FORM 10-Q

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

For the quarterly period ended April 30, 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**

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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 May 31, 2005, the number of shares outstanding of the registrant's common stock was 70,060,514.

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 April 30		Six Months Ended April 30		
2005	2004	2005	2004	
	* As Restated		* As Restated	
Sales and revenues				
Sales of manufactured products	\$ 2,904	\$ 2,276	\$ 5,395	\$ 4,162
Finance revenue	58	71	120	127
Other income	8	6	13	9
Total sales and revenues	2,970	2,353	5,528	4,298
Costs and expenses				
Cost of products and services sold	2,498	1,976	4,675	3,629
Restructuring and other non-recurring charges	-	-	-	4
Postretirement benefits expense	60	58	119	119
Engineering and research expense	86	51	163	115
Selling, general and administrative expense	202	150	378	299
Interest expense	38	33	71	65
Other expense	5	8	14	15
Total costs and expenses	2,889	2,276	5,420	4,246
Income before income taxes	81	77	108	52

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Income tax expense	28	25	37	14
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	\$ 53	\$ 52	\$ 71	\$ 38
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Earnings per share

Basic	\$ 0.76	\$ 0.75	\$ 1.02	\$ 0.55
Diluted	\$ 0.70	\$ 0.68	\$ 0.95	\$ 0.52

Average shares
outstanding (millions)

Basic	70.1	69.8	70.1	69.5
Diluted	80.1	80.6	80.2	76.3

See Notes to Financial
Statements.

* See Note Q to the Financial
Statements.

STATEMENT OF FINANCIAL CONDITION (Unaudited)

Millions of dollars

Navistar International Corporation and Consolidated Subsidiaries			
	April 30 2005	October 31 2004	April 30 2004
			* As Restated
ASSETS			
Current assets			
Cash and cash equivalents	\$ 665	\$ 605	\$ 398
Marketable securities	160	182	121
Receivables, net	1,114	1,215	959
Inventories	1,008	790	751
Deferred tax asset, net	187	207	156
Other assets	194	168	188
Total current assets	3,328	3,167	2,573
Marketable securities	529	73	515
Finance and other receivables, net	1,024	1,222	804
Property and equipment, net	1,492	1,444	1,380
Investments and other assets	528	374	294
Prepaid and intangible pension assets	69	73	65
Deferred tax asset, net	1,293	1,239	1,307
Total assets	\$ 8,263	\$ 7,592	\$ 6,938
LIABILITIES AND SHAREOWNERS' EQUITY			
Liabilities			
Current liabilities			
Notes payable and current maturities of long-term debt	\$ 1,455	\$ 823	\$ 293
Accounts payable, principally trade	1,527	1,462	1,186
Other liabilities	1,015	965	955
Total current liabilities	3,997	3,250	2,434

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Debt: Manufacturing operations	1,697	1,258	1,026
Financial services operations	158	787	1,367
Postretirement benefits liability	1,408	1,382	1,389
Other liabilities	387	384	354
	<u> </u>	<u> </u>	<u> </u>
Total liabilities	7,647	7,061	6,570
	<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)	2,084	2,096	2,121
Retained earnings (deficit)	(533)	(604)	(803)
Accumulated other comprehensive loss	(769)	(789)	(773)
Common stock held in treasury, at cost (5.3 million, 5.3 million and 5.5 million shares held)	(170)	(176)	(181)
	<u> </u>	<u> </u>	<u> </u>
Total shareowners' equity	616	531	368
	<u> </u>	<u> </u>	<u> </u>
Total liabilities and shareowners' equity	\$ 8,263	\$ 7,592	\$ 6,938
	<u> </u>	<u> </u>	<u> </u>

See Notes to Financial Statements.

* See Note Q to the Financial Statements.

STATEMENT OF CASH FLOW (Unaudited)
Millions of dollars

	Navistar International Corporation and Consolidated Subsidiaries	
	Six Months Ended April 30	
	2005	2004
		* As Restated
Cash flow from operating activities		
Net income	\$ 71	\$ 38
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	120	100
Deferred income taxes	(5)	16
Postretirement benefits funding less than (in excess of) expense	24	(42)
Gains on sales of receivables	(11)	(23)
Other, net	(16)	(38)
Change in operating assets and liabilities, net of effect of acquisitions:		
Receivables	(95)	(80)
Inventories	(200)	(152)
Prepaid and other current assets	(2)	(27)
Accounts payable	98	85
Other liabilities	24	37
Cash provided by (used in) operating activities	8	(86)
Cash flow from investment programs		
Purchases of retail notes and lease receivables	(800)	(755)
Collections/sales of retail notes and lease receivables	1,181	914
Purchases of marketable securities	(846)	(225)
Sales or maturities of marketable securities	424	184
Capital expenditures	(50)	(49)
Property and equipment leased to others	16	13
Investment in affiliates	(228)	(1)
Other investment programs	(47)	(2)

Cash provided by (used in) investment programs	(350)	79
Cash flow from financing activities		
Issuance of debt	413	58
Principal payments on debt	(57)	(88)
Net increase (decrease) in notes and debt outstanding under bank revolving credit facility and commercial paper programs	53	(67)
Other financing activities	(7)	35
Cash provided by (used in) financing activities	402	(62)
Cash and cash equivalents		
Increase (decrease) during the period	60	(69)
At beginning of the period	605	467
Cash and cash equivalents at end of the period	\$ 665	\$ 398
Supplemental cash flow information		
Interest paid	\$ 69	\$ 67
Income taxes paid, net of refunds	\$ 11	\$ 5

See Notes to Financial Statements.

* See Note Q to the Financial Statements.

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 and earnings 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, except per share data	Three Months Ended April 30		Six Months Ended April 30	
	2005	2004	2005	2004
Net income, as reported	\$ 53	\$ 52	\$ 71	\$ 38
Add: Interest expense on 2.5% senior convertible and 4.75% subordinated exchangeable debt for dilutive purposes (net of tax)	3	3	5	2
Adjusted net income available	56	55	76	40

to common shareholders plus assumed conversions				
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards net of related tax effects	(3)	(2)	(6)	(7)
Pro forma net income	\$ 53	\$ 53	\$ 70	\$ 33

Earnings per share:				
Basic - as reported	\$ 0.76	\$ 0.75	\$ 1.02	\$ 0.55
Basic - pro forma	\$ 0.73	\$ 0.72	\$ 0.93	\$ 0.45
Diluted - as reported	\$ 0.70	\$ 0.68	\$ 0.95	\$ 0.52
Diluted - pro forma	\$ 0.67	\$ 0.65	\$ 0.87	\$ 0.43

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

Note B. New Accounting Pronouncements

In December 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 or cash flows.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets," to amend Accounting Principles Board Opinion No. 29, "Accounting for Nonmonetary Transactions" (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 or 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, the company 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.

In March 2005, the FASB issued FASB Interpretation (FIN) No. 47, "Accounting for Conditional Asset Retirement Obligations." This Interpretation addresses diverse accounting practices that developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement of the obligation are conditional on a future event. FIN No. 47 concludes that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005. The company does not have any such asset retirement obligations at this time. The company expects that this Interpretation will have no impact on the company's results of operations, financial condition or cash flows.

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

Note C. Business Combinations

In April 2005, the company's South American engine subsidiary, International Engine South America, acquired MWM Motores Diesel Ltda (MWM), a Brazilian entity. MWM produces a broad line of medium and high-speed diesel engines in the 50 to 310 horsepower range for use in pick-ups, trucks, vans, light and semi-heavy trucks, as well as agricultural, marine and electric generator applications. MWM recorded revenues of approximately \$370 million in 2004. MWM's headquarters and manufacturing facility are located in Sao Paulo, Brazil. The acquisition supports the company's overall growth strategy, adds to its engineering capability and allows the company to better serve customers in the South American market. The acquisition was made effective April 1, 2005, therefore, the company's Condensed Consolidated Financial Statements include the operating results of MWM for the month of April. Management considers the impact of this acquisition to be immaterial to the consolidated financial statements.

While the acquisition has been completed, the Administrative Council for Economic Defense (CADE), the Brazilian antitrust regulatory authority, must review and approve the acquisition, and that review is pending. Only minimal synergies can be achieved prior to CADE approval and CADE may require divestiture of assets or impose other conditions on the acquisition. This uncertainty inhibits the company from completing certain aspects of the purchase accounting associated with the acquisition of MWM. Once CADE finalizes its review, management will evaluate its engine operations within Brazil, decide how to best utilize its resources to meet the needs of its customers and complete the accounting associated with the acquisition.

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 healthcare expenses for employees, retirees and surviving spouses and dependents. In addition, as part of the 1993 restructured healthcare 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 April 30		Six Months Ended April 30	
	2005	2004	2005	2004
Pension expense	\$ 18	\$ 18	\$ 35	\$ 38
Other benefits expense	42	35	84	76
Profit sharing provision to Trust	-	5	-	5
Net postretirement benefits expense	\$ 60	\$ 58	\$ 119	\$ 119

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

Note D. Postretirement Benefits (continued)

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

Millions of dollars	Pension Expense			
	Three Months Ended April 30		Six Months Ended April 30	
	2005	2004	2005	2004
Service costs for benefits earned during the period	\$ 6	\$ 7	\$ 12	\$ 14
Interest on obligation	56	58	111	116
Amortization of cumulative losses	14	12	29	25
Amortization of prior service cost	2	1	4	3
Other	7	7	13	13
Less expected return on assets	(67)	(67)	(134)	(133)
Net pension expense	\$ 18	\$ 18	\$ 35	\$ 38

Millions of dollars	Other Benefits Expense			
	Three Months Ended April 30		Six Months Ended April 30	
	2005	2004	2005	2004
Service costs for benefits earned during the period	\$ 4	\$ 3	\$ 9	\$ 7
Interest on obligation	36	34	72	70
Amortization of cumulative losses	15	10	30	21
Other	-	2	-	5
Less expected return on assets	(13)	(14)	(27)	(27)
Net other benefits expense	\$ 42	\$ 35	\$ 84	\$ 76

“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.

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 April 30, 2005, \$11 million of contributions have been made to the company’s qualified pension plans.

The company also makes contributions to partially fund retiree healthcare benefits. As of April 30, 2005, \$3 million of contributions have been made to the company’s retiree healthcare plans and the company anticipates contributing an additional \$3 million in 2005 for a total contribution of \$6 million.

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

Note E. Income Taxes

The Statement of Income reflects tax expense which primarily reduces the cumulative benefit of NOL carryforwards currently recognized as a deferred tax asset, net of valuation allowances, 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	April 30 2005	October 31 2004	April 30 2004
Finished products	\$ 584	\$ 505	\$ 446
Work in process	102	47	86
Raw materials and supplies	322	238	219
Total inventories	\$ 1,008	\$ 790	\$ 751

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 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 six months of fiscal 2005, NFC sold \$1,174 million of retail notes and leases for a pre-tax gain of \$11 million compared to the first six months of fiscal 2004, when NFC sold \$795 million of retail receivables for a pre-tax gain of \$23 million.

Note H. Debt

In March 2005, the company sold \$400 million in Senior Notes due 2012 (Notes). 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.

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

Note I. 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 April 30, 2005, \$55 million of the total net charge of \$66 million has been incurred.

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

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

In October 2002, Ford Motor Company (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 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, under current agreements, 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 April 30, 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 April 30 2005
Lease terminations	\$ 21	\$ (3)	\$ 18
Dealer terminations and other charges	12	(1)	11
Other non-recurring charges	64	(5)	59
Total	\$ 97	\$ (9)	\$ 88

The remaining liability of \$88 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 \$9 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.

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

Note J. 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 April 30, 2005, NFC's derivative financial instruments had a positive net fair value. Notional amounts of derivative financial instruments do not represent exposure to credit loss.

At April 30, 2005, the notional amounts and fair values of the company's derivatives are presented in the following table, in millions of dollars. The fair values of all these derivatives are recorded in other assets or other liabilities on the Statement of Financial Condition.

Inception Date	Maturity Date	Derivative Type	Notional Amount	Fair Value
November 2002 - April 2005	March 2007 - September 2009	Interest rate swaps*	\$ 79	\$ -
July 2001 - April 2005	June 2005 - June 2011	Interest rate swaps	305	3
October 2000 - December 2004	June 2005 - November 2012	Interest rate caps	1,073	1

*Accounted for as non-hedging instruments.

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

Note K. 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 9.375% 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 April 30, 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 six months ended April 30, 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 April 30, 2005, in millions of dollars.

Entity	Amount of Guaranty	Outstanding Balance	Maturity dates extend to
NIC	\$ 393	\$ 106	2010
NFC	134	92	2010
NIC and NFC	100	24	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 April 30, 2005, totaled approximately \$537 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 April 30, 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 K. Guarantees (continued)

As of April 30, 2005, NFC had guaranteed derivative contracts for 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 April 30, 2005, there was an outstanding notional balance of \$41 million related to interest rate swaps and cross currency swaps, and the fair market value of the outstanding balance was immaterial.

At April 30, 2005, the company's Canadian operating subsidiary was contingently liable for \$411 million of retail customers' contracts and \$36 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 \$92 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 six months ended April 30, 2005, were as follows:

Millions of dollars	
Balance, beginning of period	\$ 286
Change in liability for warranties issued during the period	113
Change in liability for pre-existing warranties	14
Payments made	(134)
Balance, end of period	\$ 279

Note L. 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 results of the company.

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

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

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.

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 results. 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

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

Note L. Legal Proceedings and Environmental Matters (continued)

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 M. Segment Data

Reportable operating segment data is as follows:

Millions of dollars	Truck	Engine	Financial Services	Total
For the quarter ended April 30, 2005				
External revenues	\$ 2,226	\$ 678	\$ 61	\$ 2,965
Intersegment revenues	-	185	15	200
Total revenues	\$ 2,226	\$ 863	\$ 76	\$ 3,165
 Segment profit	 \$ 94	 \$ 15	 \$ 27	 \$ 136
For the six months ended April 30, 2005				
External revenues	\$ 4,144	\$ 1,251	\$ 125	\$ 5,520
Intersegment revenues	-	334	28	362
Total revenues	\$ 4,144	\$ 1,585	\$ 153	\$ 5,882

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Segment profit (loss)	\$	149	\$	(4)	\$	62	\$	207
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As of April 30, 2005

Segment assets	\$	2,097	\$	1,560	\$	2,409	\$	6,066
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For the quarter ended April 30, 2004

External revenues	\$	1,720	\$	557	\$	73	\$	2,350
Intersegment revenues		-		146		10		156
Total revenues	\$	1,720	\$	703	\$	83	\$	2,506

Segment profit	\$	70	\$	32	\$	37	\$	139
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For the six months ended April 30, 2004

External revenues	\$	3,147	\$	1,017	\$	129	\$	4,293
Intersegment revenues		-		281		19		300
Total revenues	\$	3,147	\$	1,298	\$	148	\$	4,593

Segment profit	\$	79	\$	37	\$	60	\$	176
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As of April 30, 2004

Segment assets	\$	1,684	\$	1,070	\$	2,197	\$	4,951
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Navistar International Corporation and Consolidated Subsidiaries
Notes to Financial Statements (Unaudited)

Note M. Segment Data (continued)

Reconciliation to the consolidated financial statements as of and for the three and six months ended April 30 is as follows:

Millions of dollars	Three Months Ended April 30		Six Months Ended April 30	
	2005	2004	2005	2004
Segment sales and revenues	\$ 3,165	\$ 2,506	\$ 5,882	\$ 4,593
Other income	5	3	8	5
Intercompany	(200)	(156)	(362)	(300)
Consolidated sales and revenues	\$ 2,970	\$ 2,353	\$ 5,528	\$ 4,298
Segment profit	\$ 136	\$ 139	\$ 207	\$ 176
Restructuring adjustment	-	-	-	(4)
Corporate items	(41)	(51)	(71)	(95)
Manufacturing net interest expense	(14)	(11)	(28)	(25)
Consolidated pre-tax income	\$ 81	\$ 77	\$ 108	\$ 52
Segment assets	\$ 6,066	\$ 4,951		
Cash and marketable securities	652	379		
Deferred taxes	1,480	1,446		
Corporate intangible pension assets	1	3		
Other corporate and eliminations	64	159		
Consolidated assets	\$ 8,263	\$ 6,938		

Note N. Comprehensive Income

The components of comprehensive income are as follows:

Millions of dollars	Three Months Ended April 30		Six Months Ended April 30	
	2005	2004	2005	2004
Net income	\$ 53	\$ 52	\$ 71	\$ 38
Other comprehensive income	15	2	20	4
Total comprehensive income	\$ 68	\$ 54	\$ 91	\$ 42

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

Note O. Earnings Per Share

Earnings per share was computed as follows:

Millions of dollars, except share and per share data	Three Months Ended April 30		Six Months Ended April 30	
	2005	2004	2005	2004
Net income	\$ 53	\$ 52	\$ 71	\$ 38
Add: Interest expense on 2.5% senior convertible and 4.75% subordinated exchangeable debt for dilutive purposes (net of tax)	3	3	5	2
Net income available to common shareholders plus assumed conversions	\$ 56	\$ 55	\$ 76	\$ 40
Average shares outstanding (millions)				
Basic	70.1	69.8	70.1	69.5
Convertible debt	9.5	9.5	9.5	5.6
Stock options	0.5	1.3	0.6	1.2
Diluted	80.1	80.6	80.2	76.3
Earnings per share				
Basic	\$ 0.76	\$ 0.75	\$ 1.02	\$ 0.55
Diluted	\$ 0.70	\$ 0.68	\$ 0.95	\$ 0.52

The computation of diluted shares outstanding for the six months ended April 30, 2004 excludes incremental shares of 3.9 million related to convertible debt. 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. Slight changes within the diluted shares outstanding are the result of an increase or decrease in the amount of exercisable employee stock options which are affected by fluctuations in the company's stock price.

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

The following tables set forth the condensed consolidating Statements of Financial Condition as of April 30, 2005 and 2004, and the Statements of Income and Cash Flow for the six months ended April 30, 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 9.375% 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 P. 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 SIX MONTHS ENDED APRIL 30, 2005</u>				
Sales and revenues	\$ 4	\$ 4,230	\$ 1,294	\$ 5,528
Cost of products and services sold	3	3,944	728	4,675
All other operating expenses	(16)	540	221	745
Total costs and expenses	(13)	4,484	949	5,420
Equity in income (loss) of non-consolidated subsidiaries	91	286	(377)	-
Income (loss) before income taxes	108	32	(32)	108
Income tax expense (benefit)	37	25	(25)	37
Net income (loss)	\$ 71	\$ 7	\$ (7)	\$ 71

CONDENSED CONSOLIDATING STATEMENT OF FINANCIAL CONDITION AS OF APRIL 30, 2005

Assets				
Cash and marketable securities	\$ 543	\$ 28	\$ 783	\$ 1,354
Receivables, net	1	134	2,003	2,138
Inventories	-	478	530	1,008
Property and equipment, net	-	723	769	1,492

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Investment in affiliates	(2,615)	1,282	1,333	-
Deferred tax asset and other assets	1,427	204	640	2,271
Total assets	\$ (644)	\$ 2,849	\$ 6,058	\$ 8,263

Liabilities and shareowners' equity

Debt	\$ 1,458	\$ 13	\$ 1,839	\$ 3,310
Postretirement benefits liability	-	1,356	230	1,586
Amounts due to (from) affiliates	(2,850)	3,314	(464)	-
Other liabilities	132	1,585	1,034	2,751
Total liabilities	(1,260)	6,268	2,639	7,647

Shareowners' equity (deficit)	616	(3,419)	3,419	616
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Total liabilities and shareowners' equity	\$ (644)	\$ 2,849	\$ 6,058	\$ 8,263
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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOW FOR THE SIX MONTHS ENDED APRIL 30, 2005

Cash provided by (used in) operating activities	\$ (432)	\$ 186	\$ 254	\$ 8
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Cash flow from investment programs

Purchases, net of collections, of finance receivables	-	-	381	381
Net increase (decrease) in marketable securities	26	-	(448)	(422)
Capital expenditures	-	(26)	(24)	(50)
Other investing activities	-	64	(323)	(259)

Cash provided by (used in) investment programs	26	38	(414)	(350)
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Cash flow from financing activities