

NAVISTAR INTERNATIONAL CORP  
Form 10-Q  
June 07, 2012  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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Form 10-Q

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(Mark One)

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

For the quarterly period ended April 30, 2012

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

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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.)

2701 Navistar Drive, Lisle, Illinois 60532  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (331) 332-5000

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

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(Do not check if a smaller reporting company)

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

As of May 31, 2012, the number of shares outstanding of the registrant's common stock was 68,546,949, net of treasury shares.

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Disclosure Regarding Forward-Looking Statements

Information provided and statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended ("Securities Act"), Section 21E of the Securities Exchange Act of 1934, as amended ("Exchange Act"), and the Private Securities Litigation Reform Act of 1995. Such forward-looking statements only speak as of the date of this report and Navistar International Corporation assumes no obligation to update the information included in this report.

Such forward-looking statements include, but are not limited to, statements concerning:

- estimates we have made in preparing our financial statements;
- our development of new products and technologies;
- the anticipated sales, volume, demand, and markets for our products;
- the anticipated performance and benefits of our products and technologies, including our exhaust gas recirculation technologies;
- our ability to meet federal and state regulatory heavy duty diesel emission standards applicable to certain of our engines;
- our business strategies and long-term goals and activities to accomplish such strategies and goals;
- anticipated benefits from acquisitions, strategic alliances, and joint ventures we complete;
- our expectations relating to the dissolution of our Blue Diamond Truck joint venture with Ford expected in December 2014;
- our expectations and estimates relating to restructuring activities, including restructuring and integration charges and timing of cash payments related thereto, and operational flexibility, savings, and efficiencies from such restructurings;
- our expectations relating to our retail finance receivables and retail finance revenues;
- our anticipated capital expenditures;
- our expectations relating to payments of taxes;
- our expectations relating to warranty costs;
- costs relating to litigation matters;
- estimates relating to pension plan contributions;
- trends relating to commodity prices; and
- anticipated trends, expectations, and outlook relating to matters affecting our financial condition or results of operations.

These statements often include words such as "believe," "expect," "anticipate," "intend," "plan," "estimate," or similar expressions. These statements are not guarantees of performance or results and they involve risks, uncertainties, and assumptions. Although we believe that these forward-looking statements are based on reasonable assumptions, there are many factors that could affect our actual financial results or results of operations and could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause or contribute to differences in our future financial results include those discussed in Part I, Item 1A, Risk Factors, included within our Annual Report on Form 10-K for the year ended October 31, 2011, which was filed with the United States Securities and Exchange Commission on December 20, 2011 and Part II, Item 1A, Risk Factors, of our Quarterly Report on Form 10-Q for the three months ended January 31, 2012, which was filed with the SEC on March 8, 2012, as well as those discussed elsewhere in this report. 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 herein or referred to above. Except for our ongoing obligations to disclose material information as required by the federal securities laws, we do not have any obligations or intention to release publicly any revisions to any forward-looking statements to reflect events or circumstances in the future or to reflect the occurrence of unanticipated events.

Available Information

We are subject to the reporting and information requirements of the Exchange Act and as a result, are obligated to file annual, quarterly, and current reports, proxy statements, and other 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 them with, or furnish them to, the SEC. Information on our website does not constitute part of this Quarterly Report on Form 10-Q. In addition, 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 electronically file with, or furnish to, the SEC. Any materials we file with, or furnish to, the SEC may also be read and/or copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

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## PART I—Financial Information

## Item 1. Financial Statements

Navistar International Corporation and Subsidiaries  
Consolidated Statements of Operations  
(Unaudited)

|   | Three Months<br>Ended April 30, |         | Six Months Ended<br>April 30, |         |
|---|---------------------------------|---------|-------------------------------|---------|
|   | 2012                            | 2011    | 2012                          | 2011    |
| (in millions, except per share data)  |                                 |         |                               |         |
| Sales and revenues  |                                 |         |                               |         |
| Sales of manufactured products, net   | \$3,255                         | \$3,298 | \$6,263                       | \$5,991 |
| Finance revenues  | 43                              | 57      | 87                            | 107     |
| Sales and revenues, net   | 3,298                           | 3,355   | 6,350                         | 6,098   |
| Costs and expenses  |                                 |         |                               |         |
| Costs of products sold  | 2,944                           | 2,701   | 5,642                         | 4,900   |
| Restructuring charges   | 20                              | 2       | 20                            | 24      |
| Impairment of intangible assets   | 38                              | —       | 38                            | —       |
| Selling, general and administrative expenses                                  | 378                             | 354     | 740                           | 672     |
| Engineering and product development costs                                     | 134                             | 137     | 271                           | 266     |
| Interest expense  | 62                              | 62      | 123                           | 125     |
| Other expense (income), net   | 13                              | (10)    | 21                            | (21)    |
| Total costs and expenses  | 3,589                           | 3,246   | 6,855                         | 5,966   |
| Equity in loss of non-consolidated affiliates                                 | (4)                             | (16)    | (11)                          | (33)    |
| Income (loss) before income taxes   | (295)                           | 93      | (516)                         | 99      |
| Income tax benefit (expense)  | 133                             | (5)     | 214                           | (5)     |
| Net income (loss)   | (162)                           | 88      | (302)                         | 94      |
| Less: Net income attributable to non-controlling interests                    | 10                              | 14      | 23                            | 26      |
| Net income (loss) attributable to Navistar International Corporation          | \$(172)                         | \$74    | \$(325)                       | \$68    |
| Earnings (loss) per share attributable to Navistar International Corporation: |                                 |         |                               |         |
| Basic   | \$(2.50)                        | \$1.01  | \$(4.69)                      | \$0.93  |
| Diluted   | (2.50)                          | 0.93    | (4.69)                        | 0.87    |
| Weighted average shares outstanding:  |                                 |         |                               |         |
| Basic   | 68.7                            | 73.0    | 69.3                          | 72.8    |
| Diluted   | 68.7                            | 78.6    | 69.3                          | 77.3    |

See Notes to Condensed Consolidated Financial Statements

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Navistar International Corporation and Subsidiaries  
 Consolidated Statements of Comprehensive Income (Loss)  
 (Unaudited)

|  | Three Months<br>Ended April 30, |         | Six Months Ended<br>April 30, |         |
|--|---------------------------------|---------|-------------------------------|---------|
|  | 2012                            | 2011    | 2012                          | 2011    |
| (in millions)  |                                 |         |                               |         |
| Net income (loss) attributable to Navistar International Corporation                 | \$(172                          | ) \$74  | \$(325                        | ) \$68  |
| Other comprehensive income (loss):   |                                 |         |                               |         |
| Foreign currency translation adjustment  | (65                             | ) 46    | (78                           | ) 61    |
| Defined benefit plans (net of tax of \$12, \$-, \$24, and \$-, respectively)         | 17                              | 16      | 40                            | 79      |
| Total other comprehensive income (loss)  | (48                             | ) 62    | (38                           | ) 140   |
| Total comprehensive income (loss) attributable to Navistar International Corporation | \$(220                          | ) \$136 | \$(363                        | ) \$208 |

See Notes to Condensed Consolidated Financial Statements

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Consolidated Balance Sheets

|   | April 30,<br>2012 | October 31,<br>2011 |
|---|-------------------|---------------------|
| (in millions, except per share data)  |                   |                     |
|   | (Unaudited)       |                     |
| <b>ASSETS</b>   |                   |                     |
| Current assets  |                   |                     |
| Cash and cash equivalents   | \$400             | \$539               |
| Restricted cash   | —                 | 100                 |
| Marketable securities   | 337               | 718                 |
| Trade and other receivables, net  | 845               | 1,219               |
| Finance receivables, net  | 2,066             | 2,198               |
| Inventories   | 1,948             | 1,714               |
| Deferred taxes, net   | 479               | 474                 |
| Other current assets  | 303               | 273                 |
| Total current assets  | 6,378             | 7,235               |
| Restricted cash   | 145               | 227                 |
| Trade and other receivables, net  | 114               | 122                 |
| Finance receivables, net  | 574               | 715                 |
| Investments in non-consolidated affiliates  | 58                | 60                  |
| Property and equipment (net of accumulated depreciation and amortization of \$2,159 and \$2,056, at the respective dates) | 1,690             | 1,570               |
| Goodwill  | 295               | 319                 |
| Intangible assets (net of accumulated amortization of \$97 and \$99, at the respective dates)                             | 178               | 234                 |
| Deferred taxes, net   | 1,759             | 1,583               |
| Other noncurrent assets   | 193               | 226                 |
| Total assets  | \$11,384          | \$12,291            |
| <b>LIABILITIES and STOCKHOLDERS' EQUITY (DEFICIT)</b>   |                   |                     |
| Liabilities   |                   |                     |
| Current liabilities   |                   |                     |
| Notes payable and current maturities of long-term debt  | \$1,509           | \$1,379             |
| Accounts payable  | 1,927             | 2,122               |
| Other current liabilities   | 1,284             | 1,297               |
| Total current liabilities   | 4,720             | 4,798               |
| Long-term debt  | 2,988             | 3,477               |
| Postretirement benefits liabilities   | 3,095             | 3,210               |
| Deferred taxes, net   | 59                | 59                  |
| Other noncurrent liabilities  | 929               | 719                 |
| Total liabilities   | 11,791            | 12,263              |
| Redeemable equity securities  | 5                 | 5                   |
| Stockholders' equity (deficit)  |                   |                     |
| Series D convertible junior preference stock  | 3                 | 3                   |
| Common stock (\$0.10 par value per share, 220.0 shares authorized, and 75.4 shares issued, at both dates)                 | 8                 | 7                   |
| Additional paid in capital  | 2,272             | 2,253               |
| Accumulated deficit   | (480)             | (155)               |
| Accumulated other comprehensive loss  | (1,982)           | (1,944)             |
| Common stock held in treasury, at cost (6.8 and 4.9 shares, at the respective dates)                                      | (276)             | (191)               |
| Total stockholders' deficit attributable to Navistar International Corporation  | (455)             | (27)                |



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|  |          |          |
|--|----------|----------|
| Stockholders' equity attributable to non-controlling interests | 43       | 50       |
| Total stockholders' equity (deficit)                           | (412     | ) 23     |
| Total liabilities and stockholders' equity (deficit)           | \$11,384 | \$12,291 |

See Notes to Condensed Consolidated Financial Statements

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Table of ContentsNavistar International Corporation and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(Unaudited)

|   | Six Months Ended<br>April 30, |        |
|---|-------------------------------|--------|
|   | 2012                          | 2011   |
| (in millions)   |                               |        |
| Cash flows from operating activities  |                               |        |
| Net income (loss)   | \$(302                        | ) \$94 |
| Adjustments to reconcile net income (loss) to cash provided by operating activities:                  |                               |        |
| Depreciation and amortization   | 136                           | 143    |
| Depreciation of equipment leased to others  | 24                            | 18     |
| Deferred taxes, including change in valuation allowance   | (203                          | ) (5   |
| Impairment of intangible assets   | 38                            | —      |
| Amortization of debt issuance costs and discount  | 19                            | 22     |
| Stock-based compensation  | 14                            | 31     |
| Equity in loss of non-consolidated affiliates, net of dividends                                       | 15                            | 35     |
| Write-off of debt issuance cost and discount  | 8                             | —      |
| Other non-cash operating activities   | 2                             | 5      |
| Changes in other assets and liabilities, exclusive of the effects of businesses acquired and disposed | 298                           | (117   |
| Net cash provided by operating activities   | 49                            | 226    |
| Cash flows from investing activities  |                               |        |
| Purchases of marketable securities  | (563                          | ) (721 |
| Sales or maturities of marketable securities  | 944                           | 569    |
| Net change in restricted cash and cash equivalents  | 182                           | (8     |
| Capital expenditures  | (176                          | ) (185 |
| Purchase of equipment leased to others  | (28                           | ) (23  |
| Proceeds from sales of property and equipment   | 6                             | 23     |
| Investments in non-consolidated affiliates  | (17                           | ) (27  |
| Proceeds from sales of affiliates   | 1                             | 6      |
| Business acquisitions, net of cash received   | (10                           | ) (1   |
| Acquisition of intangibles  | (14                           | ) (7   |
| Net cash provided by (used in) investing activities   | 325                           | (374   |
| Cash flows from financing activities  |                               |        |
| Proceeds from issuance of securitized debt  | 281                           | 348    |
| Principal payments on securitized debt  | (666                          | ) (334 |
| Proceeds from issuance of non-securitized debt  | 555                           | 61     |
| Principal payments on non-securitized debt  | (537                          | ) (64  |
| Net increase (decrease) in notes and debt outstanding under revolving credit facilities               | 2                             | (12    |
| Principal payments under financing arrangements and capital lease obligations                         | (20                           | ) (48  |
| Debt issuance costs   | (15                           | ) (5   |
| Purchase of treasury stock  | (75                           | ) —    |
| Proceeds from exercise of stock options   | 2                             | 28     |
| Dividends paid by subsidiaries to non-controlling interest  | (34                           | ) (32  |
| Other financing activities  | (3                            | ) —    |
| Net cash used in financing activities   | (510                          | ) (58  |
| Effect of exchange rate changes on cash and cash equivalents  | (3                            | ) 11   |
| Decrease in cash and cash equivalents   | (139                          | ) (195 |

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|  |       |       |
|--|-------|-------|
| Cash and cash equivalents at beginning of the period | 539   | 585   |
| Cash and cash equivalents at end of the period       | \$400 | \$390 |

See Notes to Condensed Consolidated Financial Statements

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Table of ContentsNavistar International Corporation and Subsidiaries  
Consolidated Statements of Stockholders' Equity (Deficit)  
(Unaudited)

|   | Series D<br>Convertible<br>Junior<br>Preference<br>Stock | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Common<br>Stock<br>Held in<br>Treasury,<br>at cost | Stockholders'<br>Equity<br>Attributable<br>to<br>Noncontrolling<br>Interests | Total   |
|---|--|-----------------|----------------------------------|------------------------|---|--|--|---------|
| (in millions)   |  |                 |                                  |                        |   |  |  |         |
| Balance as of October 31, 2011  | \$ 3   | \$ 7            | \$ 2,253                         | \$ (155 )              | \$ (1,944 )                                   | \$ (191 )  | \$ 50  | \$ 23   |
| Net income (loss)   |  |                 |                                  | (325 )                 |   |  | 23   | (302 )  |
| Total other comprehensive loss  |  |                 |                                  |                        | (38 )   |  |  | (38 )   |
| Stock-based compensation  |  |                 | 11                               |                        |   |  |  | 11      |
| Stock ownership programs  |  |                 | (10 )                            |                        |   | 11   |  | 1       |
| Stock repurchase programs   |  |                 | 20                               |                        |   | (95 )  |  | (75 )   |
| Cash dividends paid to non-controlling interest   |  |                 |                                  |                        |   |  | (34 )  | (34 )   |
| Increase in ownership interest acquired from non-controlling interest holder            |  |                 | (3 )                             |                        |   |  | 3  | —       |
| Other   |  | 1               | 1                                |                        |   | (1 )   | 1  | 2       |
| Balance as of April 30, 2012  | \$ 3   | \$ 8            | \$ 2,272                         | \$ (480 )              | \$ (1,982 )                                   | \$ (276 )  | \$ 43  | \$(412) |
| Balance as of October 31, 2010  | \$ 4   | \$ 7            | \$ 2,206                         | \$ (1,878 )            | \$ (1,196 )                                   | \$ (124 )  | \$ 49  | \$(932) |
| Net income  |  |                 |                                  | 68                     |   |  | 26   | 94      |
| Total other comprehensive income  |  |                 |                                  |                        | 140   |  |  | 140     |
| Transfer from redeemable equity securities upon exercise or expiration of stock options |  |                 | 3                                |                        |   |  |  | 3       |
| Stock-based compensation  |  |                 | 21                               |                        |   |  |  | 21      |
| Stock ownership programs  |  |                 | 8                                |                        |   | 15   |  | 23      |
| Stock repurchase programs   |  |                 |                                  |                        |   | (1 )   |  | (1 )    |
| Cash dividends paid to non-controlling interest   |  |                 |                                  |                        |   |  | (32 )  | (32 )   |
| Reclassification of convertible debt to mezzanine                                       |  |                 | (84 )                            |                        |   |  |  | (84 )   |
| Other   | (1 )   |                 |                                  |                        |   |  |  | (1 )    |
| Balance as of April 30, 2011  | \$ 3   | \$ 7            | \$ 2,154                         | \$ (1,810 )            | \$ (1,056 )                                   | \$ (110 )  | \$ 43  | \$(769) |

See Notes to Condensed Consolidated Financial Statements

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

1. Summary of Significant Accounting Policies

Organization and Description of the Business

Navistar International Corporation ("NIC"), incorporated under the laws of the State of Delaware in 1993, is a holding company whose principal operating subsidiaries are Navistar, Inc. and Navistar Financial Corporation ("NFC"). References herein to the "Company," "we," "our," or "us" refer collectively to NIC, its subsidiaries, and certain variable interest entities ("VIEs") of which we are the primary beneficiary. We operate in four principal industry segments: Truck, Engine, Parts (collectively called "manufacturing operations"), and Financial Services, which consists of NFC and our foreign finance operations (collectively called "financial services operations"). These segments are discussed in Note 13, Segment Reporting.

Basis of Presentation and Consolidation

The accompanying unaudited consolidated financial statements include the assets, liabilities, and results of operations of our manufacturing operations, majority-owned dealers ("Dealcors"), financial services operations, and VIEs of which we are the primary beneficiary. The effects of transactions among consolidated entities have been eliminated to arrive at the consolidated amounts.

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting policies described in our Annual Report on Form 10-K for the year ended October 31, 2011 and should be read in conjunction with the disclosures therein. In our opinion, these interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial condition, results of operations, and cash flows for the periods presented. Operating results for interim periods are not necessarily indicative of annual operating results.

Variable Interest Entities

We have an interest in several VIEs, primarily joint ventures, established to manufacture or distribute products and enhance our operational capabilities. We have determined for certain of our VIEs that we are the primary beneficiary because we have the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and have the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. Accordingly, we include in our consolidated financial statements the assets and liabilities and results of operations of those entities, even though we may not own a majority voting interest. The liabilities recognized as a result of consolidating these VIEs do not represent additional claims on our general assets; rather they represent claims against the specific assets of the consolidated entities. Assets of these entities are not available to satisfy claims against our general assets.

We are the primary beneficiary of our Blue Diamond Parts ("BDP") and Blue Diamond Truck ("BDT") joint ventures with Ford Motor Company ("Ford"). As a result, our Consolidated Balance Sheets include assets of \$227 million and \$306 million and liabilities of \$119 million and \$158 million as of April 30, 2012 and October 31, 2011, respectively, from BDP and BDT, including \$33 million and \$38 million of cash and cash equivalents, at the respective dates, which are not readily available to satisfy our other obligations. The creditors of BDP and BDT do not have recourse to our general credit. In December 2011, Ford notified the Company of its intention to dissolve the BDT joint venture effective December 2014. We do not expect the dissolution of the BDT joint venture to have a material impact on our consolidated financial statements.

Our Financial Services segment consolidates several VIEs. As a result, our Consolidated Balance Sheets include assets of \$1.4 billion and \$1.8 billion as of April 30, 2012 and October 31, 2011, respectively, and liabilities of \$1.1 billion and \$1.5 billion as of April 30, 2012 and October 31, 2011, respectively, all of which are involved in

securitizations that are treated as borrowings. In addition, our Consolidated Balance Sheets include assets of \$488 million and \$468 million and related liabilities of \$202 million and \$216 million as of April 30, 2012 and October 31, 2011, respectively, all of which are involved in transactions that do not qualify for sale accounting treatment and are therefore treated as borrowings. Investors that hold securitization debt have a priority claim on the cash flows generated by their respective securitized assets to the extent that those trusts are entitled to make principal and interest payments. Investors in securitizations of these entities have no recourse to our general credit.

We are also involved with other VIEs, which we do not consolidate because we are not the primary beneficiary. Our financial support and maximum loss exposure relating to these non-consolidated VIEs are not material to our financial condition, results

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

of operations, or cash flows.

We use the equity method to account for our investments in entities that we do not control under the voting interest or variable interest models, but where we have the ability to exercise significant influence over operating and financial policies. Equity in loss of non-consolidated affiliates includes our share of the net income (loss) of these entities.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses. Significant estimates and assumptions are used for, but are not limited to, pension and other postretirement benefits, allowance for doubtful accounts, income tax contingency accruals and valuation allowances, product warranty accruals, asbestos and other product liability accruals, asset impairment, and litigation-related accruals. Actual results could differ from our estimates.

Concentration Risks

Our financial condition, results of operations, and cash flows are subject to concentration risks related to concentrations of union employees and one customer. As of April 30, 2012, approximately 5,400, or 52%, of our hourly workers and approximately 400, or 4%, of our salaried workers are represented by labor unions and are covered by collective bargaining agreements. For a discussion of customer concentration, see Note 13, Segment Reporting. Additionally, our future operations may be affected by changes in governmental procurement policies, budget considerations, changing national defense requirements, and global, political, regulatory and economic developments in the U.S. and certain foreign countries (primarily Canada, Mexico, and Brazil).

Product Warranty Liability

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

|   | Six Months Ended April<br>30, |       |
|---|-------------------------------|-------|
|   | 2012                          | 2011  |
| (in millions)   |                               |       |
| Balance, at beginning of period                                   | \$598                         | \$506 |
| Costs accrued and revenues deferred                               | 236                           | 175   |
| Adjustments to pre-existing warranties <sup>(A)</sup>             | 227                           | 36    |
| Payments and revenues recognized                                  | (217)                         | (187) |
| Balance, at end of period   | 844                           | 530   |
| Less: Current portion   | 365                           | 240   |
| Noncurrent accrued product warranty and deferred warranty revenue | \$479                         | \$290 |

Adjustments to pre-existing warranties reflect changes in our estimate of warranty costs for products sold in prior periods. Such adjustments typically occur when claims experience deviates from historic and expected trends. Our warranty liability is generally affected by component failure rates, repair costs, and the timing of failures. Future events and circumstances related to these factors could materially change our estimates and require adjustments to our liability. In addition, new product launches require a greater use of judgment in developing estimates until (A) historical experience becomes available. In the first quarter of 2012, we recorded adjustments for changes in estimates of \$123 million, \$119 million net of tax, or \$1.70 per diluted share. In the second quarter of 2012, we recorded adjustments for changes in estimates of \$104 million, \$100 million net of tax, or \$1.46 per diluted share. In the second quarter of 2011, we recorded adjustments for changes in estimates of \$27 million, \$24 million net of tax, or \$0.31 per diluted share. The impact of income taxes on the adjustments reflect the Company's respective periods estimated annual effective tax rate as of April 30, 2012 and 2012, respectively.



The amount of deferred revenue related to extended warranty programs was \$308 million and \$257 million at April 30, 2012 and October 31, 2011, respectively. Revenue recognized under our extended warranty programs was \$16 million and \$31 million for the three and six months ended April 30, 2012, respectively, and \$13 million and \$25 million for the three and six months ended April 30, 2011, respectively. In the second quarter of 2012, the Truck segment recognized a charge of \$24 million, related to the extended warranty contracts on our 2010 emission standard MaxxForce Big-Bore engines. The majority of the charge has been included in the adjustments to pre-existing warranties.

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Recently Adopted Accounting Standards

On February 1, 2012, we adopted guidance issued by the Financial Accounting Standards Board on accounting and disclosure requirements related to fair value measurements. The guidance limits the highest-and-best-use measure to non-financial assets, permits certain financial assets and liabilities with offsetting positions in market or counter-party credit risks to be measured on a net basis, and provides guidance on the applicability of premiums and discounts. Additionally, the guidance expands the disclosure requirements for hierarchy classification to items not presented at fair value on the balance sheet and disclosures on Level 3 inputs by requiring quantitative disclosure of the unobservable inputs and assumptions, as well as a description of the valuation processes and the sensitivity of the fair value to changes in unobservable inputs. Adoption of this new guidance did not have a material impact on our consolidated financial statements. We have complied with the disclosure requirements of the new guidance within Note 10, Fair Value Measurements.

Recently Issued Accounting Standards

There are no recently issued accounting standards for which the Company expects a material impact on our consolidated financial statements upon adoption.

2. Restructurings and Impairments

Engineering Integration

In the first quarter of 2011, the Company committed to a plan for the consolidation of the truck and engine engineering operations as well as the relocation of our world headquarters. The restructuring charges recorded are based on restructuring plans that have been committed to by management and are, in part, based upon management's best estimates of future events. Changes to the estimates may require future adjustments to the restructuring liabilities. The Company is utilizing proceeds from the October 2010 loan agreement related to the 6.5% Tax Exempt Bonds due 2040 to finance the relocation of the Company's world headquarters and engineering center, the expansion of an existing warehouse facility, and the development of certain industrial facilities to facilitate the consolidation of certain operations. In the first quarter of 2011, the Company finalized the purchase of the property and buildings for the consolidation of the truck and engine engineering operations, as well as the relocation of our world headquarters. The Company continues to develop plans for efficient transitions related to these activities and the optimization of the operations and management structure.

In the three months ended April 30, 2012, the Company vacated the premises of its former world headquarters in Warrenville, Illinois and recorded a charge of \$16 million, consisting of \$19 million for the recognition of the fair value of the lease vacancy obligation, partially offset by \$3 million for the reversal of deferred rent expense. This charge was recorded in Corporate and recognized in Restructuring charges. The cash payments associated with the lease vacancy obligation are expected to be completed by the end of 2016.

In the first quarter of 2011, the Company committed to a plan to wind-down and transfer certain operations at the Fort Wayne facility. As a result of the restructuring activities, the Truck segment recognized \$32 million of restructuring charges to date, of which \$3 million was recognized during the three and six months ended April 30, 2012 and \$19 million was recognized during the six months ended April 30, 2011. To date, the restructuring charges consist of \$13 million in personnel costs for employee termination and related benefits, \$7 million of charges for pension and other postretirement contractual termination benefits, and \$12 million of employee relocation costs.

We anticipate additional engineering integration charges to range between \$45 million and \$65 million through 2013.

North American Manufacturing Restructuring Activities and Impairments of Intangible Assets

In the third quarter of 2011, the Company committed to plans for the restructuring of certain North American manufacturing operations. The restructuring charges recorded are based on restructuring plans that have been committed to by management and are, in part, based upon management's best estimates of future events. Changes to the estimates may require future adjustments to the restructuring liabilities.

Chatham restructuring activities

In the third quarter of 2011, the Company committed to close its Chatham, Ontario heavy truck plant, which has been idled since June 2009 due to an inability to reach a collective bargaining agreement with the Canadian Auto Workers ("CAW"). Under the Company's flexible manufacturing strategy, products previously built in Chatham were transitioned to other assembly plants in North America. The commitment to close the plant was also driven by economic, industry, and operational conditions

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that rendered the plant uncompetitive. As a result of the restructuring activities, the Truck segment has recognized \$48 million of restructuring charges since these actions were commenced, substantially all of which were recognized during the three months ended July 31, 2011. To date, the restructuring charges consisted of \$7 million in personnel costs for employee termination and related benefits, \$33 million of charges for pension and other postretirement statutory and contractual termination benefits and related charges, and \$8 million of other costs. Ultimate pension and postretirement costs and termination benefits are subject to employee negotiation and acceptance rates. We anticipate additional charges of \$30 million to \$70 million in future periods. We expect the restructuring charges, excluding pension and other postretirement costs, will be paid over the next year.

Custom Products restructuring and impairment of intangible assets

In the third quarter of 2011, the Company committed to a restructuring plan of its Workhorse Custom Chassis ("WCC") and Monaco RV ("Monaco") recreational vehicles operations (collectively "Custom Products"), including the closure of the Union City, Indiana chassis facility and the wind-down and transfer of certain operations at the RV motor coach plant in Coburg, Oregon. In the second quarter of 2012, the Company decided to discontinue accepting orders for its WCC business and take certain actions to idle the business, which are expected to occur in late 2012. As a result of these restructuring activities relating to Custom Products, the Truck segment has recognized \$10 million of restructuring charges to date, of which \$5 million was recognized in each of the third and fourth quarters of 2011. To date, the restructuring charges consisted of \$6 million in personnel costs for employee termination and related benefits and \$4 million of charges due to a curtailment of other postretirement employee benefit plan and postretirement contractual termination benefits. These actions are expected to be completed by the end of 2012. The Company also expects the restructuring charges, excluding other postretirement costs, will be paid over the next two years.

In the third quarter of 2011, the Truck segment recognized \$51 million of charges for impairments of intangible assets, primarily customer relationships and trade names, associated with the WCC asset group. The asset group was reviewed for recoverability by comparing the carrying value to estimated future undiscounted cash flows and those carrying values were determined to not be fully recoverable. We utilized the income and market approaches to determine the fair value of the asset group. The impairment charges for the asset group reflected market deterioration and reduction in demand below previously anticipated levels.

As a result of the decision in the second quarter of 2012 to idle the WCC business, the WCC asset group was again reviewed for recoverability and determined not to be recoverable. We determined that the remaining intangible asset balances were fully impaired, and the Truck segment recognized asset impairment charges of \$28 million. In addition, the Parts segment recognized a charge of \$10 million for the impairment of certain intangible assets of the parts distribution operations related to the WCC business.

Other

In the first quarter of 2011, certain employees at our Springfield Assembly Plant accepted retirement and separation incentive agreements. As a result, the Truck segment recorded \$4 million of employee termination charges.

Reconciliation of Restructuring Liability

The following table summarizes the activity for the six months ended April 30, 2012 in the restructuring liability, which excludes pension and other postretirement contractual termination benefits:

|                              | Balance at<br>October 31, 2011 | Additions | Payments | Adjustments | Balance at<br>April 30, 2012 |
|------------------------------|--------------------------------|-----------|----------|-------------|------------------------------|
| (in millions)                |                                |           |          |             |                              |
| Employee termination charges | \$ 31                          | \$2       | \$(4 )   | \$(3 )      | \$26                         |
| Employee relocation costs    | —                              | 4         | (4 )     | —           | —                            |
| Lease vacancy                | —                              | 19        | (1 )     | —           | 18                           |
| Other                        | 8                              | 1         | (7 )     | —           | 2                            |
| Restructuring liability      | \$ 39                          | \$26      | \$(16 )  | \$(3 )      | \$46                         |



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The following table summarizes the activity for the six months ended April 30, 2011, in the restructuring liability, which excludes pension and other postretirement contractual termination benefits charges, and the pension curtailment:

|                              | Balance at<br>October 31, 2010 | Additions | Payments | Adjustments | Balance at<br>April 30, 2011 |
|------------------------------|--------------------------------|-----------|----------|-------------|------------------------------|
| (in millions)                |                                |           |          |             |                              |
| Employee termination charges | \$ 5                           | \$17      | \$(4 )   | \$—         | \$18                         |
| Employee relocation costs    | —                              | 1         | (1 )     | —           | —                            |
| Restructuring liability      | \$ 5                           | \$18      | \$(5 )   | \$—         | \$18                         |

### 3. Finance Receivables

Finance receivables are receivables of our financial services operations, which generally can be repaid without penalty prior to contractual maturity. Finance receivables generally consist of retail and wholesale accounts and retail and wholesale notes. Total finance receivables reported on the Consolidated Balance Sheets are net of an allowance for doubtful accounts. Total on-balance sheet assets of our financial services operations net of intercompany balances are \$3.0 billion and \$3.5 billion as of April 30, 2012 and October 31, 2011, respectively. Included in total assets are on-balance sheet finance receivables of \$2.6 billion and \$2.9 billion as of April 30, 2012 and October 31, 2011, respectively. We have two portfolio segments of finance receivables based on the type of financing inherent to each portfolio. The retail portfolio segment represents loans or leases to end-users for the purchase or lease of vehicles. The wholesale portfolio segment represents loans to dealers to finance their inventory.

Our finance receivables by major classification are as follows:

|   | April 30, 2012 | October 31,<br>2011 |
|---|----------------|---------------------|
| (in millions)                             |                |                     |
| Retail portfolio                          | \$1,384        | \$1,613             |
| Wholesale portfolio                       | 1,284          | 1,334               |
| Total finance receivables                 | 2,668          | 2,947               |
| Less: Allowance for doubtful accounts     | 28             | 34                  |
| Total finance receivables, net            | 2,640          | 2,913               |
| Less: Current portion, net <sup>(A)</sup> | 2,066          | 2,198               |
| Noncurrent portion, net                   | \$574          | \$715               |

The current portion of finance receivables is computed based on contractual maturities. Actual cash collections (A) typically vary from the contractual cash flows because of prepayments, extensions, delinquencies, credit losses, and renewals.

### Securitizations

Our Financial Services segment transfers wholesale notes, retail accounts receivable, retail notes, finance leases, and operating leases through special purpose entities ("SPEs"), which generally are only permitted to purchase these assets, issue asset-backed securities, and make payments on the securities. In addition to servicing receivables, our continued involvement in the SPEs includes an economic interest in the transferred receivables, and, historically, managing exposure to interest rates using interest rate swaps, interest rate caps, and forward contracts. Some of these transactions may qualify as sales of financial assets and are accounted for off-balance sheet. For sales that do qualify for off-balance sheet treatment, an initial gain (loss) is recorded at the time of the sale while servicing fees and excess spread income are recorded as revenue when earned over the life of the finance receivables. For transactions that are accounted for as secured borrowings, we record the interest revenue earned on the finance receivables and the interest expense paid on secured borrowings issued in connection with the finance receivables sold.

There were no transfers of finance receivables that qualified for sale accounting treatment during the three and six months ended April 30, 2012 and 2011. Securitization income for the three and six months ended April 30, 2011 relates to the excess spread received and fair value changes on retail accounts sold prior to November 1, 2010. For more information on assets and liabilities of consolidated VIEs and other securitizations accounted for as secured borrowings by our Financial Services segment, see Note 1, Summary of Significant Accounting Policies.

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Our Financial Services segment securitizes wholesale notes through an SPE, which has in place a revolving wholesale note trust ("Master Trust") that provides for funding of eligible wholesale notes. The Master Trust's assets and liabilities are consolidated into the assets and liabilities of the Company. Components of available wholesale note trust funding facilities were as follows:

|                                | Maturity     | April 30, 2012 | October 31, 2011 |
|--------------------------------|--------------|----------------|------------------|
| (in millions)                  |              |                |                  |
| Variable funding notes ("VFN") | July 2012    | \$500          | \$500            |
| Investor notes                 | October 2012 | 350            | 350              |
| Investor notes                 | October 2013 | 224            | —                |
| Investor notes                 | January 2012 | —              | 250              |
| Total wholesale note funding   |              | \$1,074        | \$1,100          |

Unutilized funding related to the variable funding facilities was \$320 million and \$170 million at April 30, 2012 and October 31, 2011, respectively.

On November 2, 2011, NFC completed the sale of \$224 million of two-year investor notes within the wholesale note trust funding facility.

Our Financial Services segment securitizes eligible retail accounts receivable through Truck Retail Accounts Corporation ("TRAC"), a consolidated SPE. In March 2012, the TRAC funding was renewed with a \$125 million facility. The facility is secured by \$209 million of retail accounts and \$31 million of cash equivalents as of April 30, 2012, as compared to \$174 million of retail accounts and \$33 million of cash equivalents as of October 31, 2011. There were \$29 million and \$9 million of unutilized funding at April 30, 2012 and October 31, 2011, respectively. The renewed TRAC funding facility has a maturity date of March 2013.

#### Finance Revenues

Finance revenues consist of the following:

|   | Three Months Ended April 30, |       | Six Months Ended April 30, |       |
|---|------------------------------|-------|----------------------------|-------|
| (in millions)                           | 2012                         | 2011  | 2012                       | 2011  |
| Retail notes and finance leases revenue | \$26                         | \$39  | \$52                       | \$76  |
| Operating lease revenue                 | 11                           | 8     | 20                         | 15    |
| Wholesale notes interest                | 22                           | 26    | 45                         | 51    |
| Retail and wholesale accounts interest  | 8                            | 6     | 18                         | 12    |
| Securitization income                   | —                            | 4     | —                          | 2     |
| Gross finance revenues                  | 67                           | 83    | 135                        | 156   |
| Less: Intercompany revenues             | (24 )                        | (26 ) | (48 )                      | (49 ) |
| Finance revenues                        | \$43                         | \$57  | \$87                       | \$107 |

#### 4. Allowance for Doubtful Accounts

We have two portfolio segments of finance receivables based on the type of financing inherent to each portfolio. The retail portfolio segment represents loans or leases to end-users for the purchase or lease of vehicles. The wholesale portfolio segment represents loans to dealers to finance their inventory. Each portfolio consists of one class of receivable based on: (i) initial measurement attributes of the receivables, and (ii) the assessment and monitoring of risk and performance of the receivables.



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The activity related to our allowance for doubtful accounts for our retail portfolio, wholesale portfolio, and trade and other receivables is summarized as follows:

|   | Three Months Ended April 30, 2012 |                     |                             |       | Three Months Ended April 30, 2011 |                     |                             |       |
|---|-----------------------------------|---------------------|-----------------------------|-------|-----------------------------------|---------------------|-----------------------------|-------|
|   | Retail Portfolio                  | Wholesale Portfolio | Trade and Other Receivables | Total | Retail Portfolio                  | Wholesale Portfolio | Trade and Other Receivables | Total |
| (in millions)   |                                   |                     |                             |       |                                   |                     |                             |       |
| Allowance for doubtful accounts, at beginning of period | \$28                              | \$ 3                | \$ 16                       | \$47  | \$54                              | \$ 2                | \$ 38                       | \$94  |
| Provision for doubtful accounts, net of recoveries      | —                                 | (1 )                | 1                           | —     | 1                                 | —                   | (3 )                        | (2 )  |
| Charge-off of accounts <sup>(A)</sup>                   | (2 )                              | —                   | —                           | (2 )  | (15 )                             | —                   | (1 )                        | (16 ) |
| Allowance for doubtful accounts, at end of period       | \$26                              | \$ 2                | \$ 17                       | \$45  | \$40                              | \$ 2                | \$ 34                       | \$76  |
|   | Six Months Ended April 30, 2012   |                     |                             |       | Six Months Ended April 30, 2011   |                     |                             |       |
|   | Retail Portfolio                  | Wholesale Portfolio | Trade and Other Receivables | Total | Retail Portfolio                  | Wholesale Portfolio | Trade and Other Receivables | Total |
| (in millions)   |                                   |                     |                             |       |                                   |                     |                             |       |
| Allowance for doubtful accounts, at beginning of period | \$31                              | \$ 3                | \$ 16                       | \$50  | \$58                              | \$ 2                | \$ 36                       | \$96  |
| Provision for doubtful accounts, net of recoveries      | (2 )                              | (1 )                | 3                           | —     | (1 )                              | —                   | (1 )                        | (2 )  |
| Charge-off of accounts <sup>(A)</sup>                   | (3 )                              | —                   | (2 )                        | (5 )  | (17 )                             | —                   | (1 )                        | (18 ) |
| Allowance for doubtful accounts, at end of period       | \$26                              | \$ 2                | \$ 17                       | \$45  | \$40                              | \$ 2                | \$ 34                       | \$76  |

We repossess sold and leased vehicles on defaulted finance receivables and leases, and place them into

(A) Inventories. Losses recognized at the time of repossession and charged against the allowance for doubtful accounts were \$2 million and \$3 million for the three and six months ended April 30, 2012, respectively, and \$12 million and \$15 million for the three and six months ended April 30, 2011, respectively.

The accrual of interest income is discontinued on certain impaired finance receivables. Impaired finance receivables include accounts with specific loss reserves and certain accounts that are on non-accrual status. In certain cases, we continue to collect payments on our impaired finance receivables.

Information regarding impaired finance receivables is as follows:

|   | As of April 30, 2012 |                     |       | October 31, 2011 |                     |       |
|---|----------------------|---------------------|-------|------------------|---------------------|-------|
|   | Retail Portfolio     | Wholesale Portfolio | Total | Retail Portfolio | Wholesale Portfolio | Total |
| (in millions)   |                      |                     |       |                  |                     |       |
| Impaired finance receivables with specific loss reserves    | \$16                 | \$ —                | \$16  | \$15             | \$ —                | \$15  |
| Impaired finance receivables without specific loss reserves | 1                    | —                   | 1     | 2                | —                   | 2     |
| Specific loss reserves on impaired finance receivables      | 10                   | —                   | 10    | 10               | —                   | 10    |
| Finance receivables on non-accrual status                   | 12                   | —                   | 12    | 14               | —                   | 14    |

For the impaired finance receivables in the retail portfolio as of April 30, 2012 and 2011, the average balances of those receivables were \$17 million and \$39 million during the six months ended April 30, 2012 and 2011, respectively.

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The Company uses the aging of our receivables as well as other inputs when assessing credit quality. The aging analysis for finance receivables is summarized as follows:

|                           | As of<br>April 30, 2012 |                        |         | October 31, 2011    |                        |         |
|---------------------------|-------------------------|------------------------|---------|---------------------|------------------------|---------|
|                           | Retail<br>Portfolio     | Wholesale<br>Portfolio | Total   | Retail<br>Portfolio | Wholesale<br>Portfolio | Total   |
| (in millions)             |                         |                        |         |                     |                        |         |
| Current                   | \$1,307                 | \$ 1,281               | \$2,588 | \$1,515             | \$ 1,328               | \$2,843 |
| 30-90 days past due       | 65                      | 2                      | 67      | 85                  | 5                      | 90      |
| Over 90 days past due     | 12                      | 1                      | 13      | 13                  | 1                      | 14      |
| Total finance receivables | \$1,384                 | \$ 1,284               | \$2,668 | \$1,613             | \$ 1,334               | \$2,947 |

## 5. Inventories

The components of inventories are as follows:

|                   | As of             |                     |
|-------------------|-------------------|---------------------|
|                   | April 30,<br>2012 | October 31,<br>2011 |
| (in millions)     |                   |                     |
| Finished products | \$1,039           | \$873               |
| Work in process   | 170               | 174                 |
| Raw materials     | 739               | 667                 |
| Total inventories | \$1,948           | \$1,714             |

## 6. Investments in and Advances to Non-consolidated Affiliates

Investments in Non-consolidated Affiliates is comprised of our interests in partially-owned affiliates of which our ownership percentages range from 10% to 50%. We do not control these affiliates, but have the ability to exercise significant influence over their operating and financial policies. Our investment in these affiliates is an integral part of our operations, and we account for them using the equity method of accounting.

Prior to the termination of our NC<sup>2</sup> Global, LLC ("NC<sup>2</sup>") joint venture agreement with Caterpillar, our 50% interest in NC<sup>2</sup> was included in Investments in and Advances to Non-consolidated Affiliates. In September 2011, the Company acquired all of Caterpillar's ownership interest in NC<sup>2</sup>, thereby increasing our equity interest in NC<sup>2</sup> from 50% to 100%. We have consolidated the operating results of NC<sup>2</sup> within our Truck segment since September 30, 2011.

Presented below is summarized financial information representing 100% of NC<sup>2</sup>, which was considered a significant non-consolidated affiliate during the three and six months ended April 30, 2011, prior to the increase of our equity interest in September 2011. Balance sheet information for NC<sup>2</sup> was insignificant to our Consolidated Balance Sheet as of April 30, 2011.

| (in millions)           | Three Months<br>Ended April 30,<br>2011 | Six Months Ended<br>April 30, 2011 |
|-------------------------|---|------------------------------------|
| Net revenue             | \$30                                    | \$79                               |
| Net expenses            | 46                                      | 113                                |
| Loss before tax expense | (16                                     | ) (34                              |
| Net loss                | (16                                     | ) (34                              |

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## 7. Debt

|  | April 30,<br>2012 | October 31,<br>2011 |
|--|-------------------|---------------------|
| (in millions)  |                   |                     |
| Manufacturing operations   |                   |                     |
| 8.25% Senior Notes, due 2021, net of unamortized discount of \$29 and \$33, respectively                         | \$871             | \$967               |
| 3.0% Senior Subordinated Convertible Notes, due 2014, net of unamortized discount of \$62 and \$73, respectively | 508               | 497                 |
| Debt of majority-owned dealerships   | 84                | 94                  |
| Financing arrangements and capital lease obligations   | 155               | 118                 |
| Loan Agreement related to 6.5% Tax Exempt Bonds, due 2040  | 225               | 225                 |
| Promissory Note  | 36                | 40                  |
| Asset-Based Credit Facility  | 100               | —                   |
| Other  | 49                | 39                  |
| Total manufacturing operations debt  | 2,028             | 1,980               |
| Less: Current portion  | 230               | 99                  |
| Net long-term manufacturing operations debt  | \$1,798           | \$1,881             |
| Financial Services operations  |                   |                     |
| Asset-backed debt issued by consolidated SPEs, at variable rates, due serially through 2018                      | \$1,284           | \$1,664             |
| Bank revolvers, at fixed and variable rates, due dates from 2013 through 2017                                    | 1,060             | 1,072               |
| Commercial paper, at variable rates, due serially through 2012   | 59                | 70                  |
| Borrowings secured by operating and finance leases, at various rates, due serially through 2017                  | 66                | 70                  |
| Total financial services operations debt   | 2,469             | 2,876               |
| Less: Current portion  | 1,279             | 1,280               |
| Net long-term financial services operations debt   | \$1,190           | \$1,596             |

## Manufacturing Operations

Our 8.25% Senior Notes, due in 2021 (the "Senior Notes") contain an optional redemption feature allowing the Company not more than once during each twelve-month period ending on November 1, 2010, 2011, 2012, 2013, and 2014, to redeem up to \$50 million in principal amount of the Senior Notes, at a redemption price equal to 103% of the principal amount of the Senior Notes redeemed, plus accrued and unpaid interest, if any. The Company exercised this early redemption feature for a total principal amount of \$100 million, by redeeming \$50 million of Senior Notes on November 1, 2011 and an additional \$50 million of Senior Notes on November 2, 2011. During the six months ended April 30, 2012, the Company recorded \$8 million of charges, relating to the early redemption premium and write-off of related discount and debt issuance costs.

In January 2012, the Company began leasing an existing manufacturing facility in Cherokee, Alabama and purchased certain machinery and equipment within that facility. In relation to the machinery and equipment, the Company entered into a \$40 million promissory note with the lessor. This amount is payable in monthly installments over a ten-year term, in conjunction with the lease of the facility. The Company recorded the machinery and equipment, and the associated liability, at the relative fair value of \$58 million. Accordingly, this arrangement is included within our financing arrangements and capital lease obligations.

In October 2011, Navistar, Inc. and various other U.S. subsidiaries signed a definitive loan agreement relating to a five-year inventory secured, asset-based revolving senior line of credit facility in an aggregate principal amount of \$355 million (the "Asset-Based Credit Facility"). In November 2011, we borrowed \$100 million under the Asset-Based Credit Facility. In June 2012, the Company borrowed an additional \$138 million under the Asset-Based Credit Facility.



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Financial Services Operations

In May 2012, NFC issued \$372 million of asset-backed securities due April 2013 (the "Asset-Backed Securities due April 2013"), and the proceeds were used to repurchase existing asset-backed securities, which are reflected in Notes payable and current maturities of long-term debt in our Consolidated Balance Sheet. The Company intends to refinance the Asset-Backed Securities due April 2013 with a long-term securitization facility during the second half of 2012.

In December 2011, NFC refinanced its bank credit facility dated December 2009, as amended, with a five-year \$840 million facility consisting of a \$340 million term loan and a \$500 million revolving line of credit. The new facility is subject to customary operational and financial covenants. Quarterly principal payments on the term portion are \$4 million for the first eight quarters and \$9 million for the next eleven quarters, with the balance due at maturity.

8. Postretirement Benefits

Defined Benefit Plans

We provide postretirement benefits to a substantial portion of our employees. Costs associated with postretirement benefits include pension and postretirement health care expenses for employees, retirees, and surviving spouses and dependents. Generally, the pension plans are non-contributory. Our policy is to fund the pension plans in accordance with applicable U.S. and Canadian government regulations and to make additional contributions from time to time. For the three and six months ended April 30, 2012, we contributed \$53 million and \$82 million, respectively, and for the three and six months ended April 30, 2011, we contributed \$31 million and \$52 million, respectively, to our pension plans to meet regulatory funding requirements. We currently anticipate additional contributions of \$108 million to our pension plans during the remainder of 2012.

We primarily fund other post-employment benefit ("OPEB") obligations, such as retiree medical, in accordance with a 1993 Settlement Agreement (the "1993 Settlement Agreement"), which requires us to fund a portion of the plans' annual service cost to a retiree benefit trust (the "Base Trust"). That 1993 Settlement Agreement resolved a class action lawsuit originally filed in 1992 regarding the restructuring of the Company's then applicable retiree health care and life insurance benefits. Contributions for each of the six months ended April 30, 2012 and 2011 were \$1 million, and we anticipate contributions for the remainder of 2012 to be \$18 million.

The Early Retiree Reinsurance Program ("ERRP") was created under the Patient Protection and Affordable Care Act ("PPACA") of 2010 to provide temporary financial assistance to health plan sponsors who provide retirement health coverage to pre-Medicare retirees. Under the terms of ERRP, for the six months ended April 30, 2012 and 2011, \$3 million and \$5 million, respectively, was collected and deposited into the Base Trust. In the three months ended April 30, 2012 and 2011, no amounts were collected or deposited into the Base Trust.

During the three months ended January 31, 2011, the Company incurred a charge of \$5 million due to a plan curtailment and contractual termination benefits related to restructuring activities at the Fort Wayne facility. For more information regarding restructuring activities at the Fort Wayne facility, see Note 2, Restructurings and Impairments.

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## Components of Net Periodic Benefit Expense (Income)

Net postretirement benefits expense (income) included in our Consolidated Statements of Operations is comprised of the following:

|  | Three Months Ended April 30, |      |                                    |       | Six Months Ended April 30, |       |                                    |       |
|--|------------------------------|------|------------------------------------|-------|----------------------------|-------|------------------------------------|-------|
|  | Pension Benefits             |      | Health and Life Insurance Benefits |       | Pension Benefits           |       | Health and Life Insurance Benefits |       |
|  | 2012                         | 2011 | 2012                               | 2011  | 2012                       | 2011  | 2012                               | 2011  |
| (in millions)                                      |                              |      |                                    |       |                            |       |                                    |       |
| Service cost for benefits earned during the period | \$4                          | \$5  | \$2                                | \$2   | \$8                        | \$9   | \$4                                | \$4   |
| Interest on obligation                             | 43                           | 47   | 21                                 | 14    | 86                         | 94    | 42                                 | 27    |
| Amortization of cumulative loss                    | 27                           | 25   | 11                                 | —     | 55                         | 50    | 20                                 | —     |
| Amortization of prior service benefit              | —                            | —    | (1)                                | (7)   | —                          | —     | (2)                                | (15)  |
| Settlements and curtailments                       | —                            | —    | —                                  | —     | —                          | 2     | —                                  | —     |
| Contractual termination benefits                   | —                            | —    | —                                  | —     | —                          | 3     | (3)                                | —     |
| Premiums on pension insurance                      | 1                            | 1    | —                                  | —     | 1                          | 1     | —                                  | —     |
| Expected return on assets                          | (48)                         | (53) | (9)                                | (11)  | (96)                       | (105) | (18)                               | (21)  |
| Net postretirement benefits expense (income)       | \$27                         | \$25 | \$24                               | \$(2) | \$54                       | \$54  | \$43                               | \$(5) |

## Defined Contribution Plans and Other Contractual Arrangements

Our defined contribution plans cover a substantial portion of domestic salaried employees and certain domestic represented employees. The defined contribution plans contain a 401(k) feature and provide most participants with a matching contribution from the Company. Many participants covered by the plan receive annual Company contributions to their retirement accounts based on an age-weighted percentage of the participant's eligible compensation for the calendar year. Defined contribution expense pursuant to these plans was \$14 million and \$24 million for the three and six months ended April 30, 2012 respectively, and \$8 million and \$18 million for the three and six months ended April 30, 2011, respectively.

In accordance with the 1993 Settlement Agreement, an independent Retiree Supplemental Benefit Trust (the "Supplemental Trust") was established. The Supplemental Trust, and the benefits it provides to certain retirees, is not part of the Company's consolidated financial statements. The assets of the Supplemental Trust arise from three sources: (i) the Company's 1993 contribution to the Supplemental Trust of 25.5 million shares of our Class B common stock, which was subsequently sold by the Supplemental Trust prior to 2000, (ii) contingent profit-sharing contributions made by the Company, and (iii) net investment gains on the Supplemental Trust's assets, if any. The Company's contingent profit sharing obligations will continue until certain funding targets defined by the 1993 Settlement Agreement are met ("Profit Sharing Cessation"). Upon Profit Sharing Cessation, the Company would assume responsibility for (i) establishing the investment policy for the Supplemental Trust, (ii) approving or disapproving of certain additional supplemental benefits to the extent such benefits would result in higher expenditures than those contemplated upon the Profit Sharing Cessation, and (iii) making additional contributions to the Supplemental Trust as necessary to make up for investment and / or actuarial losses. We have recorded no profit sharing accruals based on our estimate of 2012 results.

## 9. Income Taxes

We compute on a quarterly basis an estimated annual effective tax rate considering ordinary income and related income tax expense. Certain foreign results in 2012 and 2011 are excluded from ordinary income due to ordinary losses for which no benefit can be recognized. Ordinary income refers to income (loss) before income tax expense excluding significant unusual or infrequently occurring items. Our effective rate was higher than the U.S. statutory rate due to the impact of changes in valuation allowances related to our Canadian deferred tax assets, the geographical mix of the jurisdictions recognizing earnings or losses, and the favorable results from uncertain tax positions. The tax

effect of a significant unusual or infrequently occurring item is recorded in the interim period in which it occurs. Items included in income tax expense in the periods in which they occur include the tax effects of material restructurings and impairments, cumulative effect of changes in tax laws or rates, foreign exchange gains and losses, adjustments to uncertain tax positions, and adjustments to our valuation allowance due to changes in judgment regarding the realizability of deferred tax assets in future years.



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We have evaluated the need to maintain a valuation allowance for deferred tax assets based on our assessment of whether it is more likely than not that deferred tax benefits will be realized through the generation of future taxable income. Appropriate consideration is given to all available evidence, both positive and negative, in assessing the need for a valuation allowance. This evaluation resulted in the determination that a significant portion of our valuation allowance on our Canadian deferred tax assets can be released as of April 30, 2012. The qualitative and quantitative analysis of current and expected earnings, industry volumes, tax planning strategies, and general business risks resulted in a more likely than not conclusion of being able to realize a significant portion of our Canadian deferred tax assets. We have begun to realize the benefits of the shift in our Canadian business model from a truck manufacturer to a truck distributor, combined with our existing Parts business, which is expected to continue in the foreseeable future. As a result of our analysis we have recognized an income tax benefit of \$181 million from the release of valuation allowances in the three months ended April 30, 2012. We continue to maintain a valuation allowance on certain federal, state, and foreign deferred tax assets that we believe on a more-likely-than-not basis will not be realized based on current forecasted results.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. As of April 30, 2012, the amount of liability for uncertain tax positions was \$13 million. If the unrecognized tax benefits are recognized, \$17 million would impact our effective tax rate.

We recognize interest and penalties related to uncertain tax positions as part of Income tax benefit (expense). For the three and six months ended April 30, 2012, the tax benefit includes interest and penalties related to our uncertain tax positions of less than a million and \$11 million, respectively, reflecting the ongoing resolution of audits in various jurisdictions. We have open tax years back to 2005 with various significant taxing jurisdictions including the U.S., Canada, Mexico, and Brazil. In connection with the examination of tax returns, contingencies may arise that generally result from differing interpretations of applicable tax laws and regulations as they relate to the amount, timing, or inclusion of revenues or expenses in taxable income, or the sustainability of tax credits to reduce income taxes payable. We believe we have sufficient accruals for our contingent tax liabilities. Interim tax provisions include amounts considered sufficient to pay assessments that may result from examinations of prior year tax returns, although actual results may differ. The liability for unrecognized tax benefits may increase or decrease during the next twelve months. The impact of any such change on our financial condition and results of operation could be in the range of \$0 to \$25 million. We do not expect any such change to have a material effect on our cash flows.

#### 10. Fair Value Measurements

For assets and liabilities measured at fair value on a recurring and nonrecurring basis, a three-level hierarchy of measurements based upon observable and unobservable inputs is used to arrive at fair value. Observable inputs are developed based on market data obtained from independent sources, while unobservable inputs reflect our assumptions about valuation based on the best information available in the circumstances. Depending on the inputs, we classify each fair value measurement as follows:

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

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

• Level 3—based upon one or more significant unobservable inputs.

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

**Cash Equivalents and Restricted Cash Equivalents**—We classify highly liquid investments, with a maturity of 90 days or less at the date of purchase, including U.S. Treasury bills, federal agency securities, and commercial paper, as cash equivalents. The carrying amounts of cash and cash equivalents and restricted cash and cash equivalents approximate fair value because of the short-term maturity and highly liquid nature of these instruments.

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

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

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derivatives, see Note 11, Financial Instruments and Commodity Contracts.

Retained Interests—We retain certain interests in receivables sold in off-balance sheet securitization transactions prior to November 1, 2010. We estimate the fair value of retained interests using internal valuation models that incorporate market inputs and our own assumptions about future cash flows. The fair value of retained interests is estimated based on the present value of monthly collections on the sold finance receivables in excess of amounts accruing to investors and other obligations arising in securitization transactions. In addition to the amount of debt and collateral held by the securitization vehicle, the three key inputs that affect the valuation of the retained interests include credit losses, payment speed, and the discount rate. We classify these assets within Level 3.

Guarantees—We provide certain guarantees of payments and residual values to specific counterparties. Fair value of these guarantees is based upon internally developed models that utilize current market-based assumptions and historical data. We classify these liabilities within Level 3. For more information regarding guarantees, see Note 12, Commitments and Contingencies.

The following tables present the financial instruments measured at fair value on a recurring basis:

|  | As of April 30, 2012 |         |         | Total |
|--|----------------------|---------|---------|-------|
|  | Level 1              | Level 2 | Level 3 |       |
| (in millions)                            |                      |         |         |       |
| Assets                                   |                      |         |         |       |
| Marketable securities:                   |                      |         |         |       |
| U.S. Treasury bills                      | \$249                | \$—     | \$—     | \$249 |
| Other U.S. and non-U.S. government bonds | 68                   | —       | —       | 68    |
| Other                                    | 20                   | —       | —       | 20    |
| Derivative financial instruments:        |                      |         |         |       |
| Foreign currency contracts               | —                    | —       | —       | —     |
| Commodity contracts                      | —                    | 1       | —       | 1     |
| Total assets                             | \$337                | \$1     | \$—     | \$338 |
| Liabilities                              |                      |         |         |       |
| Derivative financial instruments:        |                      |         |         |       |
| Foreign currency contracts               | \$—                  | \$1     | \$—     | \$1   |
| Commodity contracts                      | —                    | 3       | —       | 3     |
| Guarantees                               | —                    | —       | 7       | 7     |
| Total liabilities                        | \$—                  | \$4     | \$7     | \$11  |

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|   | As of October 31, 2011 |         |         | Total |
|---|------------------------|---------|---------|-------|
|   | Level 1                | Level 2 | Level 3 |       |
| (in millions)                           |                        |         |         |       |
| Assets                                  |                        |         |         |       |
| Marketable securities:                  |                        |         |         |       |
| U.S. Treasury bills                     | \$283                  | \$—     | \$—     | \$283 |
| Other U.S and non-U.S. government bonds | 415                    | —       | —       | 415   |
| Other                                   | 20                     | —       | —       | 20    |
| Derivative financial instruments:       |                        |         |         |       |
| Commodity contracts                     | —                      | —       | 1       | 1     |
| Foreign currency contracts              | —                      | 3       | —       | 3     |
| Total assets                            | \$718                  | \$3     | \$1     | \$722 |
| Liabilities                             |                        |         |         |       |
| Derivative financial instruments:       |                        |         |         |       |
| Commodity contracts                     | \$—                    | \$3     | \$3     | \$6   |
| Cross currency swaps                    | —                      | 4       | —       | 4     |
| Guarantees                              | —                      | —       | 6       | 6     |
| Total liabilities                       | \$—                    | \$7     | \$9     | \$16  |

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

|  | 2012       |                    |                     | 2011       |                    |                     |
|--|------------|--------------------|---------------------|------------|--------------------|---------------------|
|  | Guarantees | Retained interests | Commodity contracts | Guarantees | Retained interests | Commodity contracts |
| (in millions)  |            |                    |                     |            |                    |                     |
| Three Months Ended April 30  |            |                    |                     |            |                    |                     |
| Balance at February 1  | \$7        | \$—                | \$—                 | \$—        | \$—                | \$5                 |
| Total gains (losses) (realized/unrealized) included in earnings <sup>(A)</sup> | —          | —                  | —                   | —          | —                  | 2                   |
| Settlements  | —          | —                  | —                   | —          | —                  | (1 )                |
| Balance at April 30  | \$7        | \$—                | \$—                 | \$—        | \$—                | \$6                 |
| Change in unrealized gains on assets and liabilities still held                | \$—        | \$—                | \$—                 | \$—        | \$—                | \$—                 |
| Six Months Ended April 30  |            |                    |                     |            |                    |                     |
| Balance at November 1  | \$6        | \$—                | \$(2 )              | \$—        | \$53               | \$2                 |
| Total gains (losses) (realized/unrealized) included in earnings <sup>(A)</sup> | —          | —                  | (1 )                | —          | 1                  | 6                   |
| Transfers into Level 3   | —          | —                  | —                   | —          | —                  | —                   |
| Transfers out of Level 3   | —          | —                  | 2                   | —          | —                  | —                   |
| Issuances  | 1          | —                  | —                   | —          | —                  | —                   |
| Settlements  | —          | —                  | 1                   | —          | (54 )              | (2 )                |
| Balance at April 30  | \$7        | \$—                | \$—                 | \$—        | \$—                | \$6                 |
| Change in unrealized gains on assets and liabilities still held                | \$—        | \$—                | \$—                 | \$—        | \$—                | \$3                 |

(A) For commodity contracts, gains (losses) are included in Costs of products sold. For retained interests, gains recognized are included in Finance revenues.

During the three and six months ended April 30, 2012 and 2011, there were no purchases or sales of Level 3 financial instruments. Additionally, for the three months ended April 30, 2012 and 2011, there were no issuances of Level 3 financial instruments and there were no transfers into or out of Level 3.

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

|                                    | Level 2        |                     |
|------------------------------------|----------------|---------------------|
|                                    | April 30, 2012 | October 31,<br>2011 |
| (in millions)                      |                |                     |
| Finance receivables <sup>(A)</sup> | \$6            | \$5                 |

Certain impaired finance receivables are measured at fair value on a nonrecurring basis. An impairment charge is recorded for the amount by which the carrying value of the receivables exceeds the fair value of the underlying collateral, net of remarketing costs. As of April 30, 2012, impaired receivables with a carrying amount of \$16 (A) million had specific loss reserves of \$10 million and a fair value of \$6 million. As of October 31, 2011, impaired receivables with a carrying amount of \$15 million had specific loss reserves of \$10 million and a fair value of \$5 million. Fair values of the underlying collateral are determined by reference to dealer vehicle value publications adjusted for certain market factors.

In addition to the methods and assumptions we use for the financial instruments recorded at fair value as discussed above, we use the following methods and assumptions to estimate the fair value for our other financial instruments that are not marked to market on a recurring basis. The carrying amounts of cash and cash equivalents, restricted cash, and accounts payable approximate fair values because of the short-term maturity and highly liquid nature of these instruments. Finance receivables generally consist of retail and wholesale accounts and retail and wholesale notes. The carrying amounts of trade and other receivables and retail and wholesale accounts approximate fair values as a result of the short-term nature of the receivables. The carrying amounts of wholesale notes approximate fair values as a result of the short-term nature of the wholesale notes and their variable interest rate terms. The fair values of these financial instruments are classified as Level 1. Due to the nature of the aforementioned financial instruments, they have been excluded from the fair value amounts presented in the table below.

The fair values of our retail notes are estimated by discounting expected cash flows at estimated current market rates. The fair values of our retail notes are classified as Level 3 financial instruments.

The fair values of our debt instruments classified as Level 1 were estimated using quoted market prices. Our tax exempt bonds are traded but are illiquid and as a result are classified as Level 2. The fair values of our Level 3 debt instruments are generally determined using internally developed valuation techniques such as discounted cash flow modeling. Inputs such as discount rates and credit spreads reflect our estimates of assumptions that market participants would use in pricing the instrument and may be unobservable.

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The carrying values and estimated fair values of financial instruments are summarized in the tables below:

| (in millions)   | As of April 30, 2012 |         |         |       | Carrying Value |
|---|----------------------|---------|---------|-------|----------------|
|   | Estimated Fair Value |         |         |       |                |
|   | Level 1              | Level 2 | Level 3 | Total |                |
| Assets  |                      |         |         |       |                |
| Retail notes  | \$—                  | \$—     | \$773   | \$773 | \$780          |
| Notes receivable  | —                    | —       | 37      | 37    | 39             |
| Liabilities   |                      |         |         |       |                |
| Debt:   |                      |         |         |       |                |
| Manufacturing operations  |                      |         |         |       |                |
| 8.25% Senior Notes, due 2021  | 1,011                | —       | —       | 1,011 | 871            |
| 3.0% Senior Subordinated Convertible Notes, due 2014 <sup>(A)</sup>                             | 591                  | —       | —       | 591   | 508            |
| Debt of majority-owned dealerships  | —                    | —       | 82      | 82    | 84             |
| Financing arrangements  | —                    | —       | 128     | 128   | 132            |
| Loan Agreement related to 6.5% Tax Exempt Bonds, due 2040                                       | —                    | 242     | —       | 242   | 225            |
| Promissory Note   | —                    | —       | 36      | 36    | 36             |
| Asset-Based Credit Facility   | —                    | —       | 100     | 100   | 100            |
| Other   | —                    | —       | 47      | 47    | 49             |
| Financial Services operations   |                      |         |         |       |                |
| Asset-backed debt issued by consolidated SPEs, at various rates, due serially through 2018      | —                    | —       | 1,299   | 1,299 | 1,284          |
| Bank revolvers, at fixed and variable rates, due dates from 2013 through 2017                   | —                    | —       | 1,057   | 1,057 | 1,060          |
| Commercial paper, at variable rates, due serially through 2012                                  | 59                   | —       | —       | 59    | 59             |
| Borrowings secured by operating and finance leases, at various rates, due serially through 2017 | —                    | —       | 64      | 64    | 66             |

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|   | As of October 31, 2011 |         |         |       | Carrying Value |
|---|------------------------|---------|---------|-------|----------------|
|   | Estimated Fair Value   |         |         |       |                |
|   | Level 1                | Level 2 | Level 3 | Total |                |
| (in millions)   |                        |         |         |       |                |
| Assets  |                        |         |         |       |                |
| Retail notes  | \$—                    | \$—     | \$954   | \$954 | \$958          |
| Notes receivable  | —                      | —       | 47      | 47    | 47             |
| Liabilities   |                        |         |         |       |                |
| Debt:   |                        |         |         |       |                |
| Manufacturing operations  |                        |         |         |       |                |
| 8.25% Senior Notes, due 2021  | 1,131                  | —       | —       | 1,131 | 967            |
| 3.0% Senior Subordinated Convertible Notes, due 2014 <sup>(A)</sup>                             | 633                    | —       | —       | 633   | 497            |
| Debt of majority-owned dealerships  | —                      | —       | 88      | 88    | 94             |
| Financing arrangements  | —                      | —       | 112     | 112   | 114            |
| Loan Agreement related to 6.5% Tax Exempt Bonds, due 2040                                       | —                      | 234     | —       | 234   | 225            |
| Promissory Note   | —                      | —       | 39      | 39    | 40             |
| Asset-Based Credit Facility   | —                      | —       | —       | —     | —              |
| Other   | —                      | —       | 26      | 26    | 39             |
| Financial Services operations   |                        |         |         |       |                |
| Asset-backed debt issued by consolidated SPEs, at various rates, due serially through 2018      | —                      | —       | 1,695   | 1,695 | 1,664          |
| Bank revolvers, at fixed and variable rates, due dates from 2013 through 2017                   | —                      | —       | 1,091   | 1,091 | 1,072          |
| Commercial paper, at variable rates, due serially through 2012                                  | 70                     | —       | —       | 70    | 70             |
| Borrowings secured by operating and finance leases, at various rates, due serially through 2017 | —                      | —       | 70      | 70    | 70             |

The carrying value represents the financial statement amount of the debt after allocation of the conversion feature (A) to equity, while the fair value is based on quoted market prices for the convertible note which includes the equity feature.

## 11. Financial Instruments and Commodity Contracts

### Derivative Financial Instruments

We use derivative financial instruments as part of our overall interest rate, foreign currency, and commodity risk management strategies to reduce our interest rate exposure, reduce exchange rate risk for transactional exposures denominated in currencies other than the functional currency, and minimize the effect of commodity price volatility. From time to time, we use foreign currency forward and option contracts to manage the risk of exchange rate movements that would affect the value of our foreign currency cash flows. Foreign currency exchange rate movements create a degree of risk by affecting the value of sales made and costs incurred in currencies other than the functional currency. From time to time, we also use commodity forward contracts to manage our exposure to variability in certain commodity prices. In connection with the sale of the 3.0% Senior Subordinated Convertible Notes due 2014 (the "Convertible Notes"), we purchased call options for \$125 million. The call options are intended to minimize share dilution associated with the Convertible Notes. As the call options and warrants are indexed to our common stock, we recognized them in permanent equity in Additional paid in capital, and will not recognize subsequent changes in fair value as long as the instruments remain classified as equity.

We generally do not enter into derivative financial instruments for speculative or trading purposes and did not during the three and six months ended April 30, 2012 and 2011. None of our derivatives qualified for hedge accounting



treatment during the three and six months ended April 30, 2012 or 2011.

Certain of our derivative contracts contain provisions that require us to provide collateral if certain thresholds are exceeded. No collateral was provided at April 30, 2012 or October 31, 2011. Collateral is not required to be provided by our counter-parties for derivative contracts. We manage exposure to counter-party credit risk by entering into derivative financial instruments with various major financial institutions that can be expected to fully perform under the terms of such instruments. We do not

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anticipate nonperformance by any of the counter-parties. Our exposure to credit risk in the event of nonperformance by the counter-parties is limited to those gains that have been recorded, but have not yet been received in cash. At April 30, 2012 and October 31, 2011, our exposure to the credit risk of others was \$1 million and \$4 million, respectively.

The fair values of all derivatives are recorded as assets or liabilities on a gross basis in our Consolidated Balance Sheets. At April 30, 2012 and October 31, 2011, the fair values of our derivatives and their respective balance sheet locations are presented in the following tables:

| (in millions)              | As of April 30, 2012                    |            |   |            |
|----------------------------|---|------------|---|------------|
|                            | Asset Derivatives                       |            | Liability Derivatives                   |            |
|                            | Location in Consolidated Balance Sheets | Fair Value | Location in Consolidated Balance Sheets | Fair Value |
| Foreign currency contracts | Other current assets                    | \$—        | Other current liabilities               | \$1        |
| Cross currency swaps       | Other current assets                    | —          | Other current liabilities               | —          |
| Commodity contracts        | Other current assets                    | 1          | Other current liabilities               | 3          |
| Total fair value           |   | \$1        |   | \$4        |

| (in millions)              | As of October 31, 2011                  |            |   |            |
|----------------------------|---|------------|---|------------|
|                            | Asset Derivatives                       |            | Liability Derivatives                   |            |
|                            | Location in Consolidated Balance Sheets | Fair Value | Location in Consolidated Balance Sheets | Fair Value |
| Foreign currency contracts | Other current assets                    | \$3        | Other current liabilities               | \$—        |
| Cross currency swaps       | Other current assets                    | —          | Other current liabilities               | 4          |
| Commodity contracts        | Other current assets                    | 1          | Other current liabilities               | 6          |
| Total fair value           |   | \$4        |   | \$10       |

The location and amount of gain (loss) recognized in income on derivatives are as follows:

| (in millions)               | Location in Consolidated Statements of Operations | Amount of Gain (Loss) Recognized  |                                   |
|-----------------------------|---|-----------------------------------|-----------------------------------|
|                             |   | Three Months Ended April 30, 2012 | Three Months Ended April 30, 2011 |
| Cross currency swaps        | Other expense (income), net                       | \$—                               | \$—                               |
| Foreign currency contracts  | Other expense (income), net                       | 1                                 | 2                                 |
| Commodity forward contracts | Costs of products sold                            | —                                 | 5                                 |
| Total gain                  |   | \$1                               | \$7                               |

| (in millions)               | Location in Consolidated Statements of Operations | Amount of Gain (Loss) Recognized |                                 |
|-----------------------------|---|----------------------------------|---------------------------------|
|                             |   | Six Months Ended April 30, 2012  | Six Months Ended April 30, 2011 |
| Cross currency swaps        | Other expense (income), net                       | \$1                              | \$—                             |
| Foreign currency contracts  | Other expense (income), net                       | (3                               | ) 1                             |
| Commodity forward contracts | Costs of products sold                            | (1                               | ) 22                            |
| Total gain (loss)           |   | \$(3                             | ) \$23                          |

#### Foreign Currency Contracts

During 2012 and 2011, we entered into foreign exchange forward and option contracts as economic hedges of anticipated cash flows denominated in Canadian dollars, Indian rupees, Brazilian reais, South African rand and Euros. As of April 30, 2012, we had outstanding forward exchange contracts with notional amounts of €23 million Euros and R163 million South African rand with maturity dates ranging from April 2012 through August 2012. As of

October 31, 2011, we had outstanding forward exchange contracts with notional amounts of €54 million Euros and C\$6 million Canadian dollars. All of these contracts were entered into to protect against the risk that the eventual cash flows resulting from certain transactions will be affected by changes in exchange rates between the U.S. dollar and the respective foreign currency.

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Commodity Forward Contracts

During 2012 and 2011, we entered into commodity forward contracts as economic hedges of our exposure to variability in commodity prices for diesel fuel, lead, steel, and natural rubber. As of April 30, 2012, we had outstanding diesel fuel contracts with aggregate notional values of \$12 million, outstanding lead contracts with aggregate notional values of less than \$1 million, outstanding steel contracts with aggregate notional values of \$78 million, and outstanding natural rubber contracts with aggregate notional values of \$3 million. The commodity forward contracts have maturity dates ranging from April 2012 to December 2013. As of October 31, 2011, we had outstanding diesel fuel contracts with aggregate notional values of \$19 million, outstanding lead contracts with aggregate notional values of \$1 million, outstanding steel contracts with aggregate notional values of \$41 million, and outstanding natural rubber contracts with aggregate notional values of \$14 million. All of these contracts were entered into to protect against the risk that the eventual cash flows related to purchases of the commodities will be affected by changes in prices.

Interest-Rate Contracts

We may enter into various interest-rate contracts, including interest-rate swaps and cross currency interest-rate swaps. Interest-rate swaps involve the exchange of fixed for floating rate or floating for fixed rate interest payments based on the contractual notional amounts in a single currency. Cross currency interest-rate swaps involve the exchange of notional amounts and interest payments in different currencies. We are exposed to interest rate and exchange rate risk as a result of our borrowing activities. The objective of these contracts is to mitigate fluctuations in earnings, cash flows, and fair value of borrowings. As of April 30, 2012 and October 31, 2011, the notional amount of our outstanding interest-rate contracts was \$26 million and \$50 million, respectively.

12. Commitments and Contingencies

Guarantees

We occasionally provide guarantees that could obligate us to make future payments if the primary entity fails to perform under its contractual obligations. We have recognized liabilities for some of these guarantees in our Consolidated Balance Sheets as they meet the recognition and measurement provisions of U.S. GAAP. In addition to the liabilities that have been recognized, we are contingently liable for other potential losses under various guarantees. We do not believe that claims that may be made under such guarantees would have a material effect on our financial condition, results of operations, or cash flows.

In March 2010, we entered into a three-year operating agreement (with one-year automatic extensions and subject to early termination provisions) with GE Capital Corporation and GE Capital Commercial, Inc. (collectively "GE") (the "GE Operating Agreement"). Under the terms of the agreement, GE became our preferred source of retail customer financing for equipment offered by us and our dealers in the U.S. We provide GE a loss sharing arrangement for certain credit losses. The primary features of the loss sharing arrangement include us reimbursing GE for credit losses in excess of the first 10% of the original value of a financed contract. The Company's exposure to loss is mitigated since receivables financed under the operating agreement are secured by the financed equipment. We do not carry the receivables financed under the operating agreement on our Consolidated Balance Sheets. There were \$1.0 billion and \$723 million of outstanding finance receivables as of April 30, 2012 and October 31, 2011, respectively, financed through the operating agreement and subject to the loss sharing arrangement. The related originations of these outstanding finance receivables were \$1.2 billion and \$818 million as of April 30, 2012 and October 31, 2011, respectively.

Based on our historic experience of losses on similar finance receivables and GE's first loss position, we do not believe our share of losses related to balances currently outstanding will be material. Historically our losses, representing the entire loss amount, on similar finance receivables, measured as a percentage of the average balance of the related finance receivable, ranged from 0.3% to 2.1%. While under limited circumstances NFC retains the rights to originate retail customer financing, we expect retail finance receivables and retail finance revenues will decline as our retail portfolio pays down.

For certain independent dealers' wholesale inventory financed by third-party banks or finance companies, we provide limited repurchase agreements to the respective financing institution. The amount of losses related to these arrangements has not been material to our Consolidated Statements of Operations or Cash Flows and the value of the guarantees and accruals recorded are not material to our Consolidated Balance Sheets.

We also have issued limited residual value guarantees in connection with various leases primarily financed by our financial services operations. The amounts of the guarantees are estimated and recorded as liabilities as of April 30, 2012. Our guarantees are contingent upon the fair value of the leased assets at the end of the lease term. The amount of losses related to these arrangements has not been material to our Consolidated Statements of Operations or Cash Flows and the value of the

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guarantees and accruals recorded are not material to our Consolidated Balance Sheets.

We obtain certain stand-by letters of credit and surety bonds from third-party financial institutions in the ordinary course of business when required under contracts or to satisfy insurance-related requirements. The amount of available stand-by letters of credit and surety bonds was \$98 million at April 30, 2012.

We extend credit commitments to certain truck fleet customers, which allow them to purchase parts and services from participating dealers. The participating dealers receive accelerated payments from us with the result that we carry the receivables and absorb the credit risk related to these customers. At April 30, 2012, we have \$33 million of unused credit commitments outstanding under this program.

In addition, as of April 30, 2012, we have entered into various purchase commitments of \$127 million and contracts that have cancellation fees of \$30 million with various expiration dates through 2017.

In the ordinary course of business, we also provide routine indemnifications and other guarantees, the terms of which range in duration and often are not explicitly defined. We do not believe these will result in claims that would have a material impact on our financial condition, results of operations, or cash flows.

The terms of the Ford/Navistar Settlement Agreement of January 9, 2009 require us to indemnify Ford with respect to intellectual property infringement claims, if any, that are brought against Ford or others that use the 6.0 liter or 6.4 liter engines on behalf of Ford. The maximum amount of future payments that we could potentially be required to pay under the indemnification would depend on the magnitude of potential infringement claims and the associated damages and cannot currently be determined. For more information, see 6.0 Liter Diesel Engine Litigation, below.

**Environmental Liabilities**

We have 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 us which, in most cases, consists of data related to quantities and characteristics of material generated at current or former Company locations, material allegedly shipped by us 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 our share, if any, of the probable costs and accruals are recorded in our consolidated financial statements. These accruals are generally recognized no later than completion of the remedial feasibility study and are not discounted to their present value. We review all accruals on a regular basis and believe that, based on these calculations, our share of the potential additional costs for the cleanup of each site will not have a material effect on our financial condition, results of operations, or cash flows.

Three sites formerly owned by us, (i) Solar Turbines in San Diego, California, (ii) the Canton Plant in Canton, Illinois, and (iii) Wisconsin Steel in Chicago, Illinois, were identified as having soil and groundwater contamination. Two sites in Sao Paulo, Brazil, where we are currently operating, were identified as having soil and groundwater contamination. While investigations and cleanup activities continue at these and other sites, we believe that we have adequate accruals to cover costs to complete the cleanup of all sites.

We have accrued \$20 million for these and other environmental matters, which are included within Other current liabilities and Other noncurrent liabilities, as of April 30, 2012. The majority of these accrued liabilities are expected to be paid subsequent to 2013.

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

significant in the future.

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Legal Proceedings

Overview

We are subject to various claims arising in the ordinary course of business, and are party to various legal proceedings that constitute ordinary, routine litigation incidental to our business. The majority of these claims and proceedings relate to commercial, product liability, and warranty matters. In addition, from time to time we are subject to various claims and legal proceedings related to employee compensation, benefits, and benefits administration including, but not limited to, compliance with the Employee Retirement Income Security Act of 1974, as amended, and Department of Labor requirements. In our opinion, apart from the actions set forth below, the disposition of these proceedings and claims, after taking into account recorded accruals and the availability and limits of our insurance coverage, will not have a material adverse effect on our business or our financial condition, results of operations, or cash flows.

Retiree Health Care Litigation

In April 2010, the United Auto Workers ("UAW") and others ("Plaintiffs") filed a "Motion of Plaintiffs Art Shy, UAW, et al for an Injunction to Compel Compliance with the 1993 Settlement Agreement" (the "Shy Motion") in the U.S. District Court for the Southern District of Ohio (the "Court"). The Shy Motion sought to enjoin the Company from implementing an administrative change relating to prescription drug benefits under a healthcare plan for Medicare-eligible retirees (the "Part D Change"). Specifically, Plaintiffs claimed that the Part D Change violated the terms of the 1993 Settlement Agreement previously approved by the Court. That 1993 Settlement Agreement resolved a class action originally filed in 1992 regarding the restructuring of the Company's then applicable retiree health care and life insurance benefits. In May 2010, the Company filed its Opposition to the Shy Motion.

The Part D Change was effective July 1, 2010, and made the Company's prescription drug coverage for post-65 retirees ("Plan 2 Retirees") supplemental to the coverage provided by Medicare. Plan 2 retirees paid the premiums for Medicare Part D drug coverage under the Part D Change.

In February 2011, the Court ruled on the Shy Motion (the "February 2011 Order"). The February 2011 Order sustained the Plaintiffs' argument that the Company did not have authority to unilaterally substitute Medicare Part D for the prescription drug benefit that Plaintiffs had been receiving under the 1993 Settlement Agreement. However, the February 2011 Order denied as moot Plaintiffs' request for injunctive relief to prevent the Company from implementing the Part D Change, because the change already had gone into effect. In February 2011, the Company filed a notice of appeal with the United States Court of Appeals for the Sixth Circuit (the "Appellate Court") concerning the February 2011 Order.

On September 30, 2011, the Court issued an order directing the Company to reinstate the prescription drug benefit that was in effect before the Company unilaterally substituted Medicare Part D for the prior prescription drug benefit (the "September 2011 Order"). The September 2011 Order also requires the Company to reimburse Plan 2 Retirees for any Medicare Part D premiums they have paid since the Part D Change and the extra cost, if any, for the retirees' prescriptions under the Part D Change. On October 14, 2011, the Company filed a notice of appeal with the Appellate Court concerning the September 2011 Order. The Appellate Court consolidated the Company's appeal of the February 2011 Order and the September 2011 Order, and the scheduled briefing was completed in May 2012. Pending the appeal, Plan 2 Retirees do not pay premiums for Medicare Part D drug coverage and the prescription drug formulary available to such retirees reflects the prescription drug benefit in effect prior to the implementation of the Part D Change.

FATMA Notice

International Indústria de Motores da América do Sul Ltda. ("IIAA"), formerly known as Maxion International Motores S/A ("Maxion"), now a wholly owned subsidiary of the Company, received a notice in July 2010 from the State of Santa Catarina Environmental Protection Agency ("FATMA") in Brazil. The notice alleged that Maxion had sent wastes to a facility owned and operated by a company known as Natureza and that soil and groundwater contamination had occurred at the Natureza facility. The notice asserted liability against Maxion and assessed an initial penalty in the amount of R\$2 million (the equivalent of approximately US\$1 million at April 30, 2012), which



is not due and final until all administrative appeals are exhausted. Maxion was one of numerous companies that received similar notices. IIAA filed an administrative defense in August 2010 and has not yet received a decision following that appearance. IIAA disputes the allegations in the notice and intends to vigorously defend itself.

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6.0 Liter Diesel Engine Litigation

On May 20, 2011, 9046-9478 Quebec Inc. ("Quebec Inc.") filed a motion to authorize the bringing of a class action against the Company, as well as Ford and Ford Motor Company of Canada, Limited (collectively, "Ford Defendants") in Superior Court (the "Superior Court") in Quebec, Canada (the "Quebec Action"). The Quebec Action seeks authorization to bring a claim on behalf of a class of Canadian owners and lessees of model year 2003-07 Ford vehicles powered by the 6.0L Power Stroke® engine that the Company previously supplied to Ford. Quebec Inc. alleged that the engines in question have design and manufacturing defects, and that the Company and Ford Defendants are solidarily liable for those defects. For relief, the Quebec Action seeks monetary damages sufficient to remedy the alleged defects, compensate the alleged damages incurred by the proposed class, and compensate plaintiffs' counsel. The Quebec Action also asks the Superior Court to order the Company and the Ford Defendants to recall, repair, or replace the Ford vehicles at issue free of charge. In December 2011, the Company and Quebec Inc. reached an agreement in principle whereby the Company voluntarily would produce certain documents to Quebec Inc. pursuant to a protective order and Quebec Inc. voluntarily would dismiss the Company from the Quebec Action without prejudice. That agreement was confirmed on the record at a case management conference before the Superior Court on February 1, 2012. Quebec Inc. has agreed to file a motion for authorization to remove the Company from the Quebec Action, and the Superior Court has stated such motion will be heard in June 2012.

We also have been made aware of the Kruse Technology Partnership ("Kruse") vs. Ford lawsuit (the "Kruse Case") filed against Ford regarding a potential patent infringement of three patents in the U.S. District Court for the Central District of California. An amended complaint against Ford was filed by Kruse in August 2010. The amended complaint alleges that Ford has infringed the patents by sale or use of engines, such as the Power Stroke diesel engines. The general subject matter of the patents is pilot injection of fuel in the combustion cycle. Navistar formerly supplied Power Stroke diesel engines to Ford, although today Ford manufactures its own Power Stroke engines. In the Ford/Navistar Settlement Agreement of January 9, 2009, Navistar agreed to indemnify Ford for claims of infringement based upon Ford's manufacture, sale, or use of the 6.0 and 6.4 liter Power Stroke engines sold by Navistar to Ford. Ford has not requested Navistar to defend Ford at this time. The judge assigned to the Kruse Case has stayed the case pending resolution of a similar suit against Daimler Chrysler, Detroit Diesel, Freightliner, Western Star, Volkswagen, Cummins, and Chrysler Group. In November 2011, Kruse disclaimed all the claims in one of the patents (U.S. Patent 6,405,704), which effectively terminates the patent rights for this patent. The U.S. Patent Office ended the first re-examinations on the two remaining patents, and ruled that these will be in force with all claims intact. The U.S. Patent Office agreed to commence a new re-examination of U.S. Patent 6,058,904 in April 2012 and U.S. Patent 5,265,562 in May 2012 as a result of third party requests based upon substantial new questions of patentability.

Based on our assessment of the facts underlying the claims in the above action, we are unable to provide meaningful quantification of how the final resolution of these claims may impact our future consolidated financial condition, results of operations, or cash flows.

Lis Franco de Toledo, et. al. vs. Syntex do Brasil and IIAA

In 1973, Syntex do Brasil Industria e Comercio Ltda. ("Syntex"), a predecessor of IIAA, our Brazilian engine manufacturing subsidiary formerly known as MWM International Industria de Motores da America do Sul Ltda ("MWM"), filed a lawsuit in Brazilian court against Dr. Lis Franco de Toledo and others (collectively, "Lis Franco"). Syntex claimed Lis Franco had improperly terminated a contract which provided for the transfer from Lis Franco to Syntex of a patent for the production of a certain vaccine. Lis Franco filed a counterclaim, alleging that he was entitled to royalties under the contract. In 1975, the Brazilian court ruled in favor of Lis Franco, a decision which was affirmed on appeal in 1976. In 1984, while the case was still pending, Syntex' owner, Syntex Comercio e Participacoes Ltda ("Syntex Parent") sold the stock of Syntex to MWM, and in connection with that sale Syntex Parent agreed to indemnify and hold harmless MWM for any and all liabilities of Syntex, including its prior pharmaceutical operations (which had been previously spun-off to another subsidiary wholly-owned by the Syntex

Parent) and any payments that might be payable under the Lis Franco lawsuit. In the mid to late 1990s, Syntex Parent was merged with an entity known as Wyeth Industria Farmaceutica LTDA ("Wyeth"). In 1999, Lis Franco amended its pleadings to add MWM to the lawsuit as a defendant. In 2000, Wyeth acknowledged to the Brazilian court its sole responsibility for amounts due in the Lis Franco lawsuit and MWM asked the court to be dismissed from that action. The judge denied that request. MWM appealed and lost. In his pleadings, Lis Franco alleged that the royalties payable to him were approximately R\$42 million. MWM believed the appropriate amount payable was approximately R\$16 million. In December 2009, the court appointed expert responsible for the preparation of the royalty calculation filed a report with the court indicating royalty damages of approximately R\$70 million. MWM challenged the expert's calculation. In August 2010, the court asked the parties to consider the appointment of a new expert. MWM agreed with this request but Lis Franco objected and, in September 2010, the court accepted and ratified the

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expert's calculation as of May 2010 in the amount of R\$74 million (the equivalent of approximately US\$39 million at April 30, 2012) and entered judgment against MWM. In May 2010, MWM filed a lawsuit against Wyeth seeking recognition that Wyeth is liable for any and all liabilities, costs, expenses, and payments related to the Lis Franco lawsuit.

In September 2010, MWM filed a motion for clarification of the decision which would suspend its enforcement. The Brazilian court denied this motion and MWM appealed the matter to the Rio de Janeiro State Court of Appeals (the "Court of Appeals"). In January 2011, the Court of Appeals granted the appeal and issued an injunction suspending the lower Court's decision and judgment in favor of Lis Franco. In January 2011, MWM merged into IIAA and is now known as IIAA. An expert appointed by the Court of Appeals submitted his calculation report on October 24, 2011, and determined the amount to be R\$11 million (the equivalent of approximately US\$6 million at April 30, 2012). The parties submitted their comments to such report in December 2011. The Court of Appeals is now reviewing the expert's calculation criteria report and the parties' comments to that report.

**Deloitte & Touche LLP**

In April 2011, the Company filed a complaint against Deloitte and Touche LLP ("Deloitte") in the Circuit Court of Cook County, Illinois County Department, Law Division ("Illinois Circuit Court") for fraud, fraudulent concealment, negligent misrepresentation, violation of the Illinois Consumer Fraud and Deceptive Business Practices Act, professional malpractice, negligence, breach of contract, and breach of fiduciary duty. The matters giving rise to the allegations contained in the complaint arise from Deloitte's service as the Company's independent auditor prior to April 2006 and the Company is seeking monetary damages against Deloitte. In May 2011, Deloitte filed a Notice of Removal to remove the case to the United States District Court for the Northern District of Illinois. In June 2011, the Company filed in the federal court a motion to remand the case to Illinois Circuit Court. In July 2011, Deloitte filed a motion to dismiss the Company's complaint and in August 2011, the Company responded to Deloitte's motion to dismiss. In October 2011, the court remanded the case back to the Illinois Circuit Court and denied the motion to dismiss as moot. The Company amended its complaint in January 2012 in Illinois Circuit Court. In February 2012, Deloitte moved to dismiss the Company's amended complaint. The motion was fully briefed, and oral argument was held in May 2012. The parties are currently awaiting the Court's ruling.

**Westbrook vs. Navistar. et. al.**

In April 2011, a False Claims Act qui tam complaint against Navistar, Inc., Navistar Defense, LLC, a wholly owned subsidiary of the Company ("Navistar Defense"), and unrelated third parties was unsealed by the United States District Court for the Northern District of Texas. The complaint was initially filed under seal in August 2010 by a qui tam relator on behalf of the federal government. The complaint alleged violations of the False Claims Act based on allegations that parts of vehicles delivered by Navistar Defense were not painted according to the contract specification, and improper activities in dealing with one of the vendors who painted certain of the vehicle parts. The complaint seeks monetary damages and civil penalties on behalf of the federal government, as well as costs and expenses. The U.S. government notified the Court that it has declined to intervene at this time. Navistar, Inc. was served with the complaint in July 2011, and a scheduling order and a revised scheduling order have been entered by the Court. In December 2011, the Court granted a motion by Navistar, Inc. and Navistar Defense, along with the other named defendants to judicially estop the relator and his affiliated company from participating in any recovery from the action, and to substitute his bankruptcy trustee as the only person with standing to pursue the relator's claims. In March 2012, the Court granted motions by Navistar, Inc., Navistar Defense, and the other named defendants to dismiss the complaint. The dismissal was without prejudice and the relator filed an amended complaint in April 2012. In May 2012, Navistar, Inc., Navistar Defense, and the other named defendants filed motions to dismiss the amended complaint. In addition, the parties jointly filed a motion to stay discovery pending resolution of the motions to dismiss. Based on our assessment of the facts underlying the claims in the above action, we are unable to provide meaningful quantification of how the final resolution of these claims may impact our future consolidated financial condition, results of operations, or cash flows.

EPA Notice of Violation

In February 2012, Navistar, Inc. received a Notice of Violation ("NOV") from the EPA. The NOV pertains to approximately 7,600 diesel engines which, according to EPA, were produced by Navistar, Inc. in 2010 and, therefore, should have met EPA's 2010 emissions standards. Navistar, Inc. previously provided information to EPA showing that the engines were in fact produced in 2009. The NOV contains EPA's conclusion that Navistar, Inc.'s alleged production of the engines in 2010 violated the federal Clean Air Act. The NOV states that EPA reserves the right to file an administrative complaint or to refer this matter to the U.S. Department of Justice with a recommendation that a civil complaint be filed in federal district court.

Based on our assessment of the facts underlying the NOV above, we are unable to provide meaningful quantification of how the final resolution of this matter may impact our future consolidated financial condition, results of operations or cash flows.

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Other

In order to meet the current on-highway heavy-duty diesel (“HDD”) emission standards, HDD engines must be certified by the EPA for compliance with the 0.20g oxides of nitrogen (“NOx”) standard, which also includes standards for on-board diagnostics. Advanced Exhaust Gas Recirculation (“EGR”), combined with other strategies, is our solution to meet the 0.20g NOx standard. Our approach with EGR has dramatically reduced our NOx emissions compared to the previous NOx standard and we believe it is an environmentally friendly approach compared to the liquid-based urea Selective Catalytic Reduction (“SCR”) systems used by our competitors. However, we have not yet been able to obtain 0.20g certification for any of our HDD engines. Currently, we are able to sell our trucks which incorporate HDD engines and sell our engines by using emission credits or paying non-conformance penalties (“NCPs”). Both emission credits and NCPs are described below.

We were able to generate a “bank” of NOx emission credits by producing low-NOx engines earlier than was required by the EPA. Companies are allowed to use such credits to offset exceedances of the 0.20g NOx standard, and we have been doing so for HDD engines since model year 2010. Under current conditions and at the current pace, we estimate that we will fully consume these credits for heavy HDD engines during 2012 and for medium HDD engines during 2013. The pace at which we consume these credits is subject to material change based on a variety of factors, including sales, product mix, improvements in technology, our use of NCPs, the willingness of our customers to buy trucks we sell using NCPs, and our ability to certify engine families at the 0.20g NOx standard.

In certain circumstances, the Clean Air Act requires the EPA to promulgate NCPs. When NCPs are available, companies are permitted to certify engines that do not meet the current NOx standard by paying a penalty for each engine sold. In January 2012, the EPA promulgated an Interim Final Rule establishing NCPs for heavy HDD engines. These NCPs allow us to sell engines emitting up to 0.50g NOx subject to a penalty of up to \$1,919 per engine. Our 11L, 13L, and 15L engines all have certificates from the EPA that incorporate these NCPs; however, some of our competitors filed petitions in the Court of Appeals for the D.C. Circuit (the “D.C. Circuit”) challenging the Interim Final Rule. We intervened in support of the Interim Final Rule, the matter has been fully briefed, and oral argument was held on May 14, 2012. Some of our competitors also filed a separate petition in the D.C. Circuit challenging our certificates incorporating NCPs from the EPA. This petition has been held in abeyance pending a decision on the Interim Final Rule. The D.C. Circuit has not yet ruled on the Interim Final Rule; however, in the event of an adverse ruling from the D.C. Circuit on the Interim Final Rule or the challenge to our certificates, our ability to continue selling heavy HDD engines or our trucks that incorporate such engines could be materially and adversely affected. Also in January 2012, the EPA published a Notice of Proposed Rulemaking for a final NCP rule (the “Final Rule”). The Final Rule would make NCPs available to manufacturers of heavy HDD engines and medium HDD engines in model years 2012 and later for emissions of NOx and would supersede the Interim Final Rule. We cannot provide assurance that the Final Rule will be promulgated in the form currently proposed or when it will be promulgated.

In the three months ended April 30, 2012, the Company recorded charges totaling \$10 million for NCPs for certain 13L engine sales that did not comply with emission standards, recognized in the Engine segment.

Currently, the California Air Resources Board (“CARB”) and the corresponding agencies of nine other states that have adopted California's 0.20g NOx emission standards do not make available engine certification using NCPs. Therefore, we continue to sell engines and trucks in these ten states using the NOx emission credits previously described. Under current conditions and at the current pace, however, our emission credits for heavy HDD engines will be consumed this year. Unless CARB (and the corresponding agencies of the nine other states) begin allowing NCPs for engine sales, or unless CARB certifies our HDD engines to the 0.20g NOx standard, we will no longer be able to sell trucks with HDD engines in these ten states after our credits are consumed.

We submitted to the EPA an application for a 0.20g NOx engine certificate for one 13L engine family on January 31, 2012 and we submitted a similar application to CARB on February 17, 2012, but later withdrew both applications. In response to certain concerns raised by the EPA, on May 21, 2012, we submitted a revised application to the EPA and plan to submit a revised application to CARB. Certain issues raised by the revised application are under review by the

EPA, and we are engaged in ongoing discussions relating to certification of this engine family at 0.20g NOx.

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## 13. Segment Reporting

The following is a description of our four reporting segments:

Our Truck segment manufactures and distributes a full line of Class 4 through 8 trucks, buses, and military vehicles under the International and IC Bus ("IC") brands. Our Truck segment also produces chassis for motor homes and commercial step-van vehicles under the WCC brand and recreational vehicles under the Monaco family of brands. In an effort to strengthen and maintain our dealer network, this segment occasionally acquires and operates dealer locations for the purpose of transitioning ownership.

Our Engine segment designs and manufactures diesel engines for use globally, in Class 3 through 8 vehicles, as well as off-road applications. In North America, these engines primarily go into our Class 6 and 7 medium trucks and buses and Class 8 heavy trucks, and are sold to original equipment manufacturers ("OEMs"). In addition, our Engine segment produces diesel engines in Brazil primarily under the MWM brand for sale to OEMs in South America, as well as contract manufacturing. In all other areas of the world, including North America, engines are sold under the MaxxForce brand name. To control cost and technology, our Engine segment has expanded its operations to include Pure Power Technologies ("PPT"), a components company focused on air, fuel, and aftertreatment systems to meet more stringent Euro and EPA emission standards. Also included in the Engine segment are the operating results of BDP, which manages the sourcing, merchandising, and distribution of certain service parts for vehicles we and Ford sell in North America.

Our Parts segment provides customers with proprietary products needed to support the International commercial and military truck, IC Bus, WCC chassis, and MaxxForce engine lines. Our Parts segment also provides a wide selection of other standard truck, trailer, and engine aftermarket parts. At April 30, 2012, this segment operated eleven regional parts distribution centers that provide 24-hour availability and shipment.

Our Financial Services segment provides retail, wholesale, and lease financing of products sold by the Truck and Parts segments and their dealers within the U.S. and Mexico, as well as financing for wholesale accounts and selected retail accounts receivable.

Corporate contains those items that are not included in our four segments.

## Segment Profit (Loss)

We define segment profit (loss) as net income (loss) attributable to Navistar International Corporation excluding income tax benefit (expense). Operating results for interim reporting periods are not necessarily indicative of annual operating results. Selected financial information is as follows:

|  | Truck <sup>(A)</sup> | Engine   | Parts <sup>(A)</sup> | Financial Services <sup>(B)</sup> | Corporate and Eliminations | Total    |
|--|----------------------|----------|----------------------|-----------------------------------|----------------------------|----------|
| (in millions)  |                      |          |                      |                                   |                            |          |
| Three Months Ended April 30, 2012                      |                      |          |                      |                                   |                            |          |
| External sales and revenues, net                       | \$2,353              | \$440    | \$462                | \$43                              | \$—                        | \$3,298  |
| Intersegment sales and revenues                        | 2                    | 454      | 34                   | 24                                | (514 )                     | —        |
| Total sales and revenues, net                          | \$2,355              | \$894    | \$496                | \$67                              | \$(514 )                   | \$3,298  |
| Net income (loss) attributable to NIC                  | \$(89 )              | \$(108 ) | \$41                 | \$26                              | \$(42 )                    | \$(172 ) |
| Income tax benefit                                     | —                    | —        | —                    | —                                 | 133                        | 133      |
| Segment profit (loss)                                  | \$(89 )              | \$(108 ) | \$41                 | \$26                              | \$(175 )                   | \$(305 ) |
| Depreciation and amortization                          | \$35                 | \$30     | \$4                  | \$8                               | \$5                        | \$82     |
| Interest expense                                       | —                    | —        | —                    | 22                                | 40                         | 62       |
| Equity in income (loss) of non-consolidated affiliates | (6 )                 | —        | 2                    | —                                 | —                          | (4 )     |
| Capital expenditures <sup>(C)</sup>                    | 16                   | 36       | 5                    | 1                                 | 15                         | 73       |





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|  | Truck <sup>(A)</sup> | Engine   | Parts <sup>(A)</sup> | Financial Services <sup>(B)</sup> | Corporate and Eliminations | Total    |
|--|----------------------|----------|----------------------|-----------------------------------|----------------------------|----------|
| Three Months Ended April 30, 2011                      |                      |          |                      |                                   |                            |          |
| External sales and revenues, net                       | \$2,262              | \$524    | \$512                | \$57                              | \$—                        | \$3,355  |
| Intersegment sales and revenues                        | 9                    | 431      | 50                   | 26                                | (516 )                     | —        |
| Total sales and revenues, net                          | \$2,271              | \$955    | \$562                | \$83                              | \$(516 )                   | \$3,355  |
| Net income (loss) attributable to NIC                  | \$92                 | \$2      | \$74                 | \$40                              | \$(134 )                   | \$74     |
| Income tax expense                                     | —                    | —        | —                    | —                                 | (5 )                       | (5 )     |
| Segment profit (loss)                                  | \$92                 | \$2      | \$74                 | \$40                              | \$(129 )                   | \$79     |
| Depreciation and amortization                          | \$38                 | \$30     | \$3                  | \$6                               | \$4                        | \$81     |
| Interest expense                                       | —                    | —        | —                    | 26                                | 36                         | 62       |
| Equity in income (loss) of non-consolidated affiliates | (17 )                | (2 )     | 3                    | —                                 | —                          | (16 )    |
| Capital expenditures <sup>(C)</sup>                    | 22                   | 52       | 3                    | —                                 | 13                         | 90       |
| Six Months Ended April 30, 2012                        |                      |          |                      |                                   |                            |          |
| External sales and revenues                            | \$4,507              | \$860    | \$896                | \$87                              | \$—                        | \$6,350  |
| Intersegment sales and revenues                        | 13                   | 893      | 69                   | 48                                | (1,023 )                   | —        |
| Sales and revenues, net                                | \$4,520              | \$1,753  | \$965                | \$135                             | \$(1,023 )                 | \$6,350  |
| Net income (loss) attributable to NIC                  | \$(130 )             | \$(228 ) | \$91                 | \$53                              | \$(111 )                   | \$(325 ) |
| Income tax benefit                                     | —                    | —        | —                    | —                                 | 214                        | 214      |
| Segment profit (loss)                                  | \$(130 )             | \$(228 ) | \$91                 | \$53                              | \$(325 )                   | \$(539 ) |
| Depreciation and amortization                          | \$69                 | \$59     | \$6                  | \$16                              | \$10                       | \$160    |
| Interest expense                                       | —                    | —        | —                    | 47                                | 76                         | 123      |
| Equity in income (loss) of non-consolidated affiliates | (15 )                | 1        | 3                    | —                                 | —                          | (11 )    |
| Capital expenditures <sup>(C)</sup>                    | 32                   | 76       | 12                   | 2                                 | 54                         | 176      |
| Six Months Ended April 30, 2011                        |                      |          |                      |                                   |                            |          |
| External sales and revenues                            | \$4,053              | \$980    | \$958                | \$107                             | \$—                        | \$6,098  |
| Intersegment sales and revenues                        | 18                   | 758      | 99                   | 49                                | (924 )                     | —        |
| Sales and revenues, net                                | \$4,071              | \$1,738  | \$1,057              | \$156                             | \$(924 )                   | \$6,098  |
| Net income (loss) attributable to NIC                  | \$124                | \$(6 )   | \$130                | \$72                              | \$(252 )                   | \$68     |
| Income tax expense                                     | —                    | —        | —                    | —                                 | (5 )                       | (5 )     |
| Segment profit (loss)                                  | \$124                | \$(6 )   | \$130                | \$72                              | \$(247 )                   | \$73     |
| Depreciation and amortization                          | \$75                 | \$59     | \$5                  | \$13                              | \$9                        | \$161    |
| Interest expense                                       | —                    | —        | —                    | 56                                | 69                         | 125      |
| Equity in income (loss) of non-consolidated affiliates | (35 )                | (2 )     | 4                    | —                                 | —                          | (33 )    |
| Capital expenditures <sup>(C)</sup>                    | 38                   | 84       | 4                    | —                                 | 59                         | 185      |
| As of April 30, 2012                                   |                      |          |                      |                                   |                            |          |
| Segment assets   | \$2,685              | \$1,823  | \$698                | \$3,043                           | \$3,135                    | \$11,384 |
| As of October 31, 2011                                 |                      |          |                      |                                   |                            |          |
| Segment assets   | 2,771                | 1,849    | 700                  | 3,580                             | 3,391                      | 12,291   |

(A) See Note 2, Restructurings and Impairments, for further discussion.

(B)

Total sales and revenues in the Financial Services segment include interest revenues of \$66 million and \$133 million for the three and six months ended April 30, 2012, respectively, and \$82 million and \$153 million for the three and six months ended April 30, 2011, respectively.

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

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Sales of vehicles and service parts to the U.S. government are reported in our Truck and Parts segments and were 14% and 12% of consolidated sales and revenues for the three and six months ended April 30, 2011. No single customer accounted for more than 10% of consolidated sales and revenues for the three and six months ended April 30, 2012.

## 14. Stockholders' Equity (Deficit)

## Share Repurchase Programs

In September 2011, a special committee of our Board of Directors authorized a share repurchase program for up to \$175 million worth of the Company's common stock in the open market or in any private transaction.

In October 2011, the Company entered into a variable term accelerated share repurchase ("ASR") agreement with a third-party financial institution to purchase shares of common stock for an aggregate purchase price of \$100 million. Under the ASR agreement, the Company paid the financial institution \$100 million and received an initial delivery of 2,380,952 shares. The value of the delivered shares on the date of purchase was \$80 million at \$33.60 per share, and was included in Common stock held in treasury in our Consolidated Balance Sheet as of October 31, 2011. The remaining \$20 million was included in Additional paid in capital in our Consolidated Balance Sheet as of October 31, 2011.

In November 2011, the ASR program concluded and the Company received an additional 161,657 shares for a total of 2,542,609 shares. The final settlement was based upon the volume weighted average price of the Company's common stock (subject to a discount agreed upon with the financial institution) over an averaging period. With the conclusion of the agreement, the remaining \$20 million included in Additional paid in capital was reclassified to Common stock held in treasury.

In October 2011, the Company entered into an open market share repurchase ("OMR") agreement with a third-party financial institution to purchase the remaining \$75 million worth of the Company's common stock authorized by a special committee of our Board of Directors in September 2011. The OMR commenced in November 2011, following the completion of the ASR program. In January 2012, the OMR concluded with the Company repurchasing approximately 1,905,600 shares of our common stock. Repurchases of \$70 million were settled in cash during the three months ended January 31, 2012, and the remaining \$5 million was settled in cash in the three months ended April 30, 2012. The share repurchase program expired upon its completion.

## 15. Earnings (Loss) Per Share Attributable to Navistar International Corporation

The following table shows the information used in the calculation of our basic and diluted earnings (loss) per share attributable to Navistar International Corporation:

|   | Three Months<br>Ended April 30, |        | Six Months Ended<br>April 30, |        |
|---|---------------------------------|--------|-------------------------------|--------|
|   | 2012                            | 2011   | 2012                          | 2011   |
| (in millions, except per share data)  |                                 |        |                               |        |
| Numerator:  |                                 |        |                               |        |
| Earnings (loss) attributable to Navistar International Corporation available to common stockholders | \$(172 )                        | \$74   | \$(325 )                      | \$68   |
| Denominator:  |                                 |        |                               |        |
| Weighted average shares outstanding:  |                                 |        |                               |        |
| Basic   | 68.7                            | 73.0   | 69.3                          | 72.8   |
| Effect of dilutive securities   | —                               | 5.6    | —                             | 4.5    |
| Diluted   | 68.7                            | 78.6   | 69.3                          | 77.3   |
| Earnings (loss) per share attributable to Navistar International Corporation:                       |                                 |        |                               |        |
| Basic   | \$(2.50 )                       | \$1.01 | \$(4.69 )                     | \$0.93 |
| Diluted   | (2.50 )                         | 0.93   | (4.69 )                       | 0.87   |

The conversion rate on our Convertible Notes is 19.891 shares of common stock per \$1,000 principal amount of Convertible Notes, equivalent to an initial conversion price of \$50.27 per share of common stock. In connection with the sale of the Convertible Notes, we sold warrants to various counterparties to purchase shares of our common stock from us at an exercise price of \$60.14 per share. The Convertible Notes and warrants are anti-dilutive when calculating diluted earnings per share when our average stock price is less than \$50.27 and \$60.14, respectively.

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Navistar International Corporation and Subsidiaries  
Notes to Condensed Consolidated Financial Statements—(Continued)  
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We also purchased call options in connection with the sale of the Convertible Notes, covering 11.3 million shares at an exercise price of \$50.27 per share, which are intended to minimize share dilution associated with the Convertible Notes; however under accounting guidance, these call options cannot be utilized to offset the dilution of the Convertible Notes for determining diluted earnings per share as they are anti-dilutive.

The computation of diluted earnings per share also excludes outstanding options and other common stock equivalents in periods where inclusion of such potential common stock instruments would be anti-dilutive.

For the three and six months ended April 30, 2012, no dilutive securities were included in the computation of diluted loss per share since they would have been anti-dilutive due to the net loss attributable to Navistar International Corporation. The aggregate shares not included were 28.0 million in both the three and six months ended April 30, 2012.

For the three and six months ended April 30, 2011, aggregate shares not included in the computation of diluted earnings per share since they would have been anti-dilutive were 0.6 million and 0.5 million, respectively.

16. Condensed Consolidating Guarantor and Non-guarantor Financial Information

The following tables set forth condensed consolidating balance sheets as of April 30, 2012 and October 31, 2011, and condensed consolidating statements of operations, condensed consolidating statement of comprehensive income (loss), and condensed consolidating statements of cash flows for the six months ended April 30, 2012 and 2011. The information is presented as a result of Navistar, Inc.'s guarantee, exclusive of its subsidiaries, of NIC's indebtedness under its 8.25% Senior Notes due 2021 and obligations under our Loan Agreement related to the 6.5% Tax Exempt Bonds due 2040. Navistar, Inc. is a direct wholly-owned subsidiary of NIC. None of NIC's other subsidiaries guarantee any of these notes or bonds. The guarantees are "full and unconditional", as those terms are used in Regulation S-X Rule 3-10, except that an individual subsidiary's guarantee will be automatically released in certain customary circumstances, such as when the subsidiary is sold or all of the assets of the subsidiary are sold, the capital stock is sold, when the subsidiary is designated as an "unrestricted subsidiary" for purposes of the indenture, upon liquidation or dissolution of the subsidiary or upon legal or covenant defeasance, or satisfaction and discharge of the notes. Separate financial statements and other disclosures concerning Navistar, Inc. have not been presented because management believes that such information is not material to investors. Within this disclosure only, "NIC" includes the consolidated financial results of the parent company only, with all of its wholly-owned subsidiaries accounted for under the equity method. Likewise, "Navistar, Inc.," for purposes of this disclosure only, includes the consolidated financial results of its wholly-owned subsidiaries accounted for under the equity method and its operating units accounted for on a consolidated basis. "Non-Guarantor Subsidiaries" includes the combined financial results of all other non-guarantor subsidiaries. "Eliminations and Other" includes all eliminations and reclassifications to reconcile to the consolidated financial statements. NIC files a consolidated U.S. federal income tax return that includes Navistar, Inc. and its U.S. subsidiaries. Navistar, Inc. has a tax allocation agreement ("Tax Agreement") with NIC which requires Navistar, Inc. to compute its separate federal income tax liability and remit any resulting tax liability to NIC. Tax benefits that may arise from net operating losses of Navistar, Inc. are not refunded to Navistar, Inc. but may be used to offset future required tax payments under the Tax Agreement. The effect of the Tax Agreement is to allow NIC, the parent company, rather than Navistar, Inc., to utilize current U.S. taxable losses of Navistar, Inc. and all other direct or indirect subsidiaries of NIC.

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

|   | NIC      | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|---|----------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)   |          |                   |                               |                           |              |
| Condensed Consolidating Statement of<br>Operations for the Three Months Ended April 30,<br>2012 |          |                   |                               |                           |              |
| Sales and revenues, net   | \$—      | \$2,172           | \$ 3,011                      | \$(1,885 )                | \$ 3,298     |
| Costs of products sold  | —        | 2,205             | 2,599                         | (1,860 )                  | 2,944        |
| Restructuring charges   | —        | 19                | 1                             | —                         | 20           |
| Impairment of intangible assets   | —        | —                 | 38                            | —                         | 38           |
| All other operating expenses  | 14       | 357               | 241                           | (25 )                     | 587          |
| Total costs and expenses  | 14       | 2,581             | 2,879                         | (1,885 )                  | 3,589        |
| Equity in income (loss) of affiliates   | (96 )    | 271               | (6 )                          | (173 )                    | (4 )         |
| Income (loss) before income taxes   | (110 )   | (138 )            | 126                           | (173 )                    | (295 )       |
| Income tax benefit (expense)  | (62 )    | (63 )             | 221                           | 37                        | 133          |
| Net income (loss)   | (172 )   | (201 )            | 347                           | (136 )                    | (162 )       |
| Less: Net income attributable to non-controlling<br>interests                                   | —        | —                 | 10                            | —                         | 10           |
| Net income (loss) attributable to Navistar<br>International Corporation                         | \$(172 ) | \$(201 )          | \$ 337                        | \$(136 )                  | \$(172 )     |

|   | NIC      | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|---|----------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)   |          |                   |                               |                           |              |
| Condensed Consolidating Statement of<br>Comprehensive Income for the Three Months<br>Ended April 30, 2012 |          |                   |                               |                           |              |
| Net income (loss) attributable to Navistar<br>International Corporation                                   | \$(172 ) | \$(201 )          | \$ 337                        | \$(136 )                  | \$(172 )     |
| Other comprehensive income (loss):  |          |                   |                               |                           |              |
| Foreign currency translation adjustment   | (65 )    | —                 | (65 )                         | 65                        | (65 )        |
| Defined benefit plans (net of tax of \$12, \$12, \$—,<br>\$(12) and \$12, respectively)                   | 17       | 16                | 2                             | (18 )                     | 17           |
| Total other comprehensive income (loss)   | (48 )    | 16                | (63 )                         | 47                        | (48 )        |
| Total comprehensive income (loss) attributable to<br>Navistar International Corporation                   | \$(220 ) | \$(185 )          | \$ 274                        | \$(89 )                   | \$(220 )     |

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

|   | NIC      | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|---|----------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)   |          |                   |                               |                           |              |
| Condensed Consolidating Statement of<br>Operations for the Six Months Ended April 30,<br>2012 |          |                   |                               |                           |              |
| Sales and revenues, net   | \$—      | \$4,134           | \$ 5,835                      | \$ (3,619 )               | \$ 6,350     |
| Costs of products sold  | —        | 4,200             | 5,023                         | (3,581 )                  | 5,642        |
| Restructuring charges   | —        | 20                | —                             | —                         | 20           |
| Impairment of intangible assets   | —        | —                 | 38                            | —                         | 38           |
| All other operating expenses  | 39       | 690               | 477                           | (51 )                     | 1,155        |
| Total costs and expenses  | 39       | 4,910             | 5,538                         | (3,632 )                  | 6,855        |
| Equity in income (loss) of affiliates   | (296 )   | 366               | (13 )                         | (68 )                     | (11 )        |
| Income (loss) before income taxes   | (335 )   | (410 )            | 284                           | (55 )                     | (516 )       |
| Income tax benefit  | 10       | 14                | 187                           | 3                         | 214          |
| Net income (loss)   | (325 )   | (396 )            | 471                           | (52 )                     | (302 )       |
| Less: Net income attributable to non-controlling<br>interests                                 | —        | —                 | 23                            | —                         | 23           |
| Net income (loss) attributable to Navistar<br>International Corporation                       | \$(325 ) | \$(396 )          | \$ 448                        | \$ (52 )                  | \$(325 )     |

|   | NIC      | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|---|----------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)   |          |                   |                               |                           |              |
| Condensed Consolidating Statement of<br>Comprehensive Income for the Six Months Ended<br>April 30, 2012 |          |                   |                               |                           |              |
| Net income (loss) attributable to Navistar<br>International Corporation                                 | \$(325 ) | \$(396 )          | \$ 448                        | \$ (52 )                  | \$(325 )     |
| Other comprehensive income (loss):  |          |                   |                               |                           |              |
| Foreign currency translation adjustment   | (78 )    | —                 | (78 )                         | 78                        | (78 )        |
| Defined benefit plans (net of tax of \$24, \$23, \$1,<br>\$(24) and \$24, respectively)                 | 40       | 36                | 5                             | (41 )                     | 40           |
| Total other comprehensive income (loss)   | (38 )    | 36                | (73 )                         | 37                        | (38 )        |
| Total comprehensive income (loss) attributable to<br>Navistar International Corporation                 | \$(363 ) | \$(360 )          | \$ 375                        | \$ (15 )                  | \$(363 )     |



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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements—(Continued)

(Unaudited)

|  | NIC        | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|--|------------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)  |            |                   |                               |                           |              |
| Condensed Consolidating Balance Sheet as of<br>April 30, 2012                        |            |                   |                               |                           |              |
| Assets   |            |                   |                               |                           |              |
| Cash and cash equivalents  | \$112      | \$48              | \$ 240                        | \$—                       | \$ 400       |
| Marketable securities  | 55         | —                 | 282                           | —                         | 337          |
| Restricted cash and cash equivalents   | 13         | 8                 | 124                           | —                         | 145          |
| Finance and other receivables, net   | 5          | 139               | 3,453                         | 2                         | 3,599        |
| Inventories  | —          | 761               | 1,240                         | (53 )                     | 1,948        |
| Investments in non-consolidated affiliates   | (2,459 )   | 6,286             | 51                            | (3,820 )                  | 58           |
| Property and equipment, net  | —          | 739               | 953                           | (2 )                      | 1,690        |
| Goodwill   | —          | —                 | 295                           | —                         | 295          |
| Deferred taxes, net  | 44         | 1,887             | 306                           | 1                         | 2,238        |
| Other  | 115        | 167               | 394                           | (2 )                      | 674          |
| Total assets   | \$(2,115 ) | \$10,035          | \$ 7,338                      | \$(3,874 )                | \$ 11,384    |
| Liabilities and stockholders' equity (deficit)                                       |            |                   |                               |                           |              |
| Debt   |            |                   |                               |                           |              |
| Debt   | \$1,604    | \$295             | \$ 2,832                      | \$(234 )                  | \$ 4,497     |
| Postretirement benefits liabilities  | —          | 2,893             | 321                           | —                         | 3,214        |
| Amounts due to (from) affiliates   | (5,996 )   | 9,753             | (3,837 )                      | 80                        | —            |
| Other liabilities  | 2,727      | (49 )             | 1,537                         | (135 )                    | 4,080        |
| Total liabilities  | (1,665 )   | 12,892            | 853                           | (289 )                    | 11,791       |
| Redeemable equity securities   | 5          | —                 | —                             | —                         | 5            |
| Stockholders' equity attributable to<br>non-controlling interests                    | —          | —                 | 43                            | —                         | 43           |
| Stockholders' equity (deficit) attributable to<br>Navistar International Corporation | (455 )     | (2,857 )          | 6,442                         | (3,585 )                  | (455 )       |
| Total liabilities and stockholders' equity (deficit)                                 | \$(2,115 ) | \$10,035          | \$ 7,338                      | \$(3,874 )                | \$ 11,384    |

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

|  | NIC    |   | Navistar,<br>Inc. |   | Non-Guarantor<br>Subsidiaries |   | Eliminations<br>and Other |   | Consolidated |   |
|--|--------|---|-------------------|---|-------------------------------|---|---------------------------|---|--------------|---|
| (in millions)  |        |   |                   |   |                               |   |                           |   |              |   |
| Condensed Consolidating Statement of Cash                            |        |   |                   |   |                               |   |                           |   |              |   |
| Flows for the Six Months Ended April 30, 2012                        |        |   |                   |   |                               |   |                           |   |              |   |
| Net cash provided by (used in) operations                            | \$(463 | ) | \$(267            | ) | \$ 248                        |   | \$ 531                    |   | \$ 49        |   |
| Cash flows from investment activities                                |        |   |                   |   |                               |   |                           |   |              |   |
| Net change in restricted cash and cash equivalents                   | 6      |   | 2                 |   | 174                           |   | —                         |   | 182          |   |
| Net sales of marketable securities                                   | 374    |   | —                 |   | 7                             |   | —                         |   | 381          |   |
| Capital expenditures and purchase of equipment                       | —      |   | (115              | ) | (89                           | ) | —                         |   | (204         | ) |
| Other investing activities   | —      |   | (104              | ) | 70                            |   | —                         |   | (34          | ) |
| Net cash provided by (used in) investment activities                 | 380    |   | (217              | ) | 162                           |   | —                         |   | 325          |   |
| Cash flows from financing activities                                 |        |   |                   |   |                               |   |                           |   |              |   |
| Net borrowings (repayments) of debt                                  | (50    | ) | 519               |   | (429                          | ) | (440                      | ) | (400         | ) |
| Other financing activities   | 19     |   | —                 |   | (38                           | ) | (91                       | ) | (110         | ) |
| Net cash provided by (used in) financing activities                  | (31    | ) | 519               |   | (467                          | ) | (531                      | ) | (510         | ) |
| Effect of exchange rate changes on cash and cash equivalents         | —      |   | —                 |   | (3                            | ) | —                         |   | (3           | ) |
| Increase (decrease) in cash and cash equivalents                     | (114   | ) | 35                |   | (60                           | ) | —                         |   | (139         | ) |
| Cash and cash equivalents at beginning of the period                 | 226    |   | 13                |   | 300                           |   | —                         |   | 539          |   |
| Cash and cash equivalents at end of the period                       | \$112  |   | \$48              |   | \$ 240                        |   | \$—                       |   | \$ 400       |   |
|  | NIC    |   | Navistar,<br>Inc. |   | Non-Guarantor<br>Subsidiaries |   | Eliminations<br>and Other |   | Consolidated |   |
| (in millions)  |        |   |                   |   |                               |   |                           |   |              |   |
| Condensed Consolidating Statement of Operations                      |        |   |                   |   |                               |   |                           |   |              |   |
| for the Three Months Ended April 30, 2011                            |        |   |                   |   |                               |   |                           |   |              |   |
| Sales and revenues, net  | \$—    |   | \$2,144           |   | \$ 3,238                      |   | \$ (2,027                 | ) | \$ 3,355     |   |
| Costs of products sold   | 17     |   | 1,987             |   | 2,681                         |   | (1,984                    | ) | 2,701        |   |
| Restructuring charges  | —      |   | 2                 |   | —                             |   | —                         |   | 2            |   |
| All other operating expenses (income)                                | 17     |   | 338               |   | 217                           |   | (29                       | ) | 543          |   |
| Total costs and expenses   | 34     |   | 2,327             |   | 2,898                         |   | (2,013                    | ) | 3,246        |   |
| Equity in income (loss) of affiliates                                | 120    |   | 219               |   | (10                           | ) | (345                      | ) | (16          | ) |
| Income (loss) before income taxes                                    | 86     |   | 36                |   | 330                           |   | (359                      | ) | 93           |   |
| Income tax benefit (expense)   | (12    | ) | (5                | ) | (36                           | ) | 48                        |   | (5           | ) |
| Net income (loss)  | 74     |   | 31                |   | 294                           |   | (311                      | ) | 88           |   |
| Less: Net income attributable to non-controlling interest            | —      |   | —                 |   | 14                            |   | —                         |   | 14           |   |
| Net income (loss) attributable to Navistar International Corporation | \$74   |   | \$31              |   | \$ 280                        |   | \$ (311                   | ) | \$ 74        |   |

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

|   | NIC   | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|---|-------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)   |       |                   |                               |                           |              |
| Condensed Consolidating Statement of<br>Comprehensive Income for the Three Months<br>Ended April 30, 2011 |       |                   |                               |                           |              |
| Net income (loss) attributable to Navistar<br>International Corporation                                   | \$74  | \$31              | \$ 280                        | \$(311 )                  | \$ 74        |
| Other comprehensive income (loss):  |       |                   |                               |                           |              |
| Foreign currency translation adjustment   | 46    | —                 | 46                            | (46 )                     | 46           |
| Defined benefit plans (net of tax of \$– for all<br>subsidiaries presented)                               | 16    | 12                | 4                             | (16 )                     | 16           |
| Total other comprehensive income (loss)   | 62    | 12                | 50                            | (62 )                     | 62           |
| Total comprehensive income (loss) attributable to<br>Navistar International Corporation                   | \$136 | \$43              | \$ 330                        | \$(373 )                  | \$ 136       |

|  | NIC   | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|--|-------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)  |       |                   |                               |                           |              |
| Condensed Consolidating Statement of Operations<br>for the Six Months Ended April 30, 2011 |       |                   |                               |                           |              |
| Sales and revenues, net  | \$—   | \$3,831           | \$ 5,819                      | \$(3,552 )                | \$ 6,098     |
| Costs of products sold   | —     | 3,553             | 4,846                         | (3,499 )                  | 4,900        |
| Restructuring charges  | —     | 23                | 1                             | —                         | 24           |
| All other operating expenses (income)  | 41    | 613               | 441                           | (53 )                     | 1,042        |
| Total costs and expenses   | 41    | 4,189             | 5,288                         | (3,552 )                  | 5,966        |
| Equity in income (loss) of affiliates  | 120   | 344               | (20 )                         | (477 )                    | (33 )        |
| Income (loss) before income taxes  | 79    | (14 )             | 511                           | (477 )                    | 99           |
| Income tax benefit (expense)   | (11 ) | 1                 | (52 )                         | 57                        | (5 )         |
| Net income (loss)  | 68    | (13 )             | 459                           | (420 )                    | 94           |
| Less: Net income attributable to non-controlling<br>interest                               | —     | —                 | 26                            | —                         | 26           |
| Net income (loss) attributable to Navistar<br>International Corporation                    | \$68  | \$(13 )           | \$ 433                        | \$(420 )                  | \$ 68        |

|   | NIC  | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|---|------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)   |      |                   |                               |                           |              |
| Condensed Consolidating Statement of<br>Comprehensive Income for the Six Months Ended<br>April 30, 2011 |      |                   |                               |                           |              |
| Net income (loss) attributable to Navistar<br>International Corporation                                 | \$68 | \$(13 )           | \$ 433                        | \$(420 )                  | \$ 68        |
| Other comprehensive income (loss):  |      |                   |                               |                           |              |
| Foreign currency translation adjustment   | 61   | —                 | 61                            | (61 )                     | 61           |
| Defined benefit plans (net of tax of \$– for all<br>subsidiaries presented)                             | 79   | 70                | (15 )                         | (55 )                     | 79           |
| Total other comprehensive income (loss)   | 140  | 70                | 46                            | (116 )                    | 140          |

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|  |       |      |        |         |          |
|--|-------|------|--------|---------|----------|
| Total comprehensive income (loss) attributable to Navistar International Corporation | \$208 | \$57 | \$ 479 | \$ (536 | ) \$ 208 |
|--|-------|------|--------|---------|----------|

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Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements—(Continued)

(Unaudited)

|  | NIC        | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|--|------------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)  |            |                   |                               |                           |              |
| Condensed Consolidating Balance Sheet as of<br>October 31, 2011                      |            |                   |                               |                           |              |
| Assets   |            |                   |                               |                           |              |
| Cash and cash equivalents  | \$226      | \$13              | \$ 300                        | \$—                       | \$ 539       |
| Marketable securities  | 429        | 1                 | 288                           | —                         | 718          |
| Restricted cash and cash equivalents   | 20         | 9                 | 298                           | —                         | 327          |
| Finance and other receivables, net   | 3          | 154               | 4,070                         | 27                        | 4,254        |
| Inventories  | —          | 650               | 1,113                         | (49 )                     | 1,714        |
| Investments in non-consolidated affiliates   | (2,094 )   | 5,818             | 54                            | (3,718 )                  | 60           |
| Property and equipment, net  | —          | 600               | 972                           | (2 )                      | 1,570        |
| Goodwill   | —          | —                 | 319                           | —                         | 319          |
| Deferred taxes, net  | 31         | 1,912             | 114                           | —                         | 2,057        |
| Other  | 168        | 152               | 416                           | (3 )                      | 733          |
| Total assets   | \$(1,217 ) | \$9,309           | \$ 7,944                      | \$(3,745 )                | \$ 12,291    |
| Liabilities and stockholders' equity (deficit)                                       |            |                   |                               |                           |              |
| Debt   |            |                   |                               |                           |              |
| Postretirement benefits liabilities  | —          | 2,981             | 335                           | —                         | 3,316        |
| Amounts due to (from) affiliates   | (5,574 )   | 9,055             | (3,595 )                      | 114                       | —            |
| Other liabilities  | 2,690      | (194 )            | 1,717                         | (122 )                    | 4,091        |
| Total liabilities  | (1,195 )   | 11,998            | 1,699                         | (239 )                    | 12,263       |
| Redeemable equity securities   | 5          | —                 | —                             | —                         | 5            |
| Stockholders' equity (deficit) attributable to<br>non-controlling interest           | —          | —                 | 52                            | (2 )                      | 50           |
| Stockholders' equity (deficit) attributable to<br>Navistar International Corporation | (27 )      | (2,689 )          | 6,193                         | (3,504 )                  | (27 )        |
| Total liabilities and stockholders' equity (deficit)                                 | \$(1,217 ) | \$9,309           | \$ 7,944                      | \$(3,745 )                | \$ 12,291    |

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

|  | NIC   | Navistar,<br>Inc. | Non-Guarantor<br>Subsidiaries | Eliminations<br>and Other | Consolidated |
|--|-------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions)  |       |                   |                               |                           |              |
| Condensed Consolidating Statement of Cash<br>Flows for the Six Months Ended April 30, 2011 |       |                   |                               |                           |              |
| Net cash provided by (used in) operations  | \$(84 | ) \$61            | \$ 142                        | \$ 107                    | \$ 226       |
| Cash flows from investment activities  |       |                   |                               |                           |              |
| Net change in restricted cash and cash equivalents   | —     | —                 | (8                            | ) —                       | (8           |
| Net purchases in marketable securities   | (34   | ) —               | (118                          | ) —                       | (152         |
| Capital expenditures and purchase of equipment<br>leased to others                         | —     | (104              | ) (104                        | ) —                       | (208         |
| Other investing activities   | —     | (20               | ) 14                          | —                         | (6           |
| Net cash used in investment activities   | (34   | ) (124            | ) (216                        | ) —                       | (374         |
| Cash flows from financing activities   |       |                   |                               |                           |              |
| Net borrowings (repayments) of debt  | 27    | 62                | (36                           | ) (107                    | ) (54        |
| Other financing activities   | 28    | —                 | (32                           | ) —                       | (4           |
| Net cash provided by (used in) financing activities  | 55    | 62                | (68                           | ) (107                    | ) (58        |
| Effect of exchange rate changes on cash and cash<br>equivalents                            | —     | (1                | ) 12                          | —                         | 11           |
| Decrease in cash and cash equivalents  | (63   | ) (2              | ) (130                        | ) —                       | (195         |
| Cash and cash equivalents at beginning of the<br>period                                    | 239   | 22                | 324                           | —                         | 585          |
| Cash and cash equivalents at end of the period   | \$176 | \$20              | \$ 194                        | \$—                       | \$ 390       |

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operation ("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 contained in our Annual Report on Form 10-K for the year ended October 31, 2011. Information in MD&A is intended to assist the reader in obtaining an understanding of (i) our consolidated financial statements, (ii) the changes in certain key items within those financial statements from period-to-period, (iii) the primary factors that contributed to those changes, (iv) any changes in known trends or uncertainties from items disclosed within MD&A of our Annual Report on Form 10-K for the year ended October 31, 2011 that we are aware of and that may have a material effect on our future performance, and (v) how certain accounting principles affect our consolidated financial statements. In addition, MD&A provides information about our business segments and how the results of those segments impact our results of operations and financial condition as a whole. Operating results for interim reporting periods are not necessarily indicative of annual operating results.

Executive Summary

During the second quarter of 2012, we continued making strides that we believe will contribute to our long-term, strategic profitability goals. These actions included:

• We acquired certain assets, including intellectual property, of E-Z Pack Manufacturing, LLC, a leading manufacturer of refuse truck bodies.

• At the 2012 Mid-America Trucking Show, we unveiled the International LoadStar, a severe-service, low cab-over engine, work truck designed for waste, concrete pumping, and airplane refueling applications.

We reached an agreement to explore expanding the scope of our collaboration with Anhui Jianghuai Automobile Co ("JAC"), to design, develop, manufacture and distribute school buses for the Chinese market, and to export trucks from JAC in China to the Company's dealerships in Brazil.

While the first half of 2012 has presented challenges to our results, we expect to show significant improvements in our performance in the second half of 2012. As the U.S. and global markets continue to recover, we believe that the industry will continue to expand from the historic lows experienced in 2009. We anticipate the "traditional" truck industry retail deliveries to be in the range of 300,000 units to 310,000 units for 2012. We are forecasting second half of 2012 volumes to increase across most of our product offerings and expect to see significant margin expansion, as compared to the first half of 2012. We are also expanding our global footprint with improved sales in our existing export markets, as well as product launches through our joint ventures with Mahindra and Mahindra in India, as well as our operations in Australia and Brazil. We expect further improvements in the Parts business, as customers continue to maintain older equipment and increase their overall fleet utilization.

Consolidated net sales and revenues declined slightly in the second quarter of 2012, as compared to the prior year, reflecting higher net sales in the Truck segment that were more than offset by lower net sales in the Engine and Parts segments. Truck segment net sales grew 4% in the quarter, predominantly due to an increase in our "traditional" markets and improved worldwide truck volumes, partially offset by lower military sales. Engine segment net sales decreased 6%, reflecting higher intercompany sales of our Big-Bore engines that were more than fully offset by lower sales volumes in South America. The increase in the Truck segment net sales, as well as the higher intercompany sales of our Big-Bore engines by the Engine segment, reflects the continued industry-wide economic recovery. The net sales from the Parts segment decreased 12%, primarily due to lower military sales, which was partially offset by continued improvements in our U.S. and Canada commercial markets.

In the first half of 2012, our consolidated net sales and revenues grew 4%, as compared to the prior year period. The increase in the consolidated net sales and revenues was driven by the performance from the Truck segment, which grew 11%, predominantly due to an increase in our "traditional" markets and improved worldwide truck volumes. The net sales from the Engine segment were largely flat as compared to the first half of 2011, reflecting higher intercompany sales, offset by lower sales volumes in South America. Parts segment sales decreased 9%, primarily due to lower military sales, which was partially offset by continued improvements in our U.S. and Canada commercial markets.





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In the second quarter and first half of 2012, we incurred a loss attributable to Navistar International Corporation of \$172 million and \$325 million, or a loss of \$2.50 and \$4.69 per diluted share, respectively. Significant items affecting our results:

- \$181 million benefit from the release of a significant portion of our income tax valuation allowance related to our Canadian deferred tax assets in the second quarter,

- \$104 million and \$227 million of charges for adjustments to pre-existing warranties in the second quarter and first half of 2012, respectively,

- \$38 million for the impairment of intangible assets related to actions taken with Workhorse Custom Chassis, as part of the Company's North American restructuring activities in the second quarter,

- \$29 million and \$41 million for costs relating to the Company's Engineering Integration actions in the second quarter and first half of 2012, respectively,

- \$10 million for non-conformance penalties for certain 13L engine sales that did not comply with emission standards in the second quarter.

Adjusting to exclude the impact of these items, net of tax, on our second quarter and first half of 2012 results, we incurred an adjusted loss attributable to Navistar International Corporation of \$137 million and \$201 million, or a loss of \$1.99 and \$2.90 per diluted share, respectively.

For the second quarter and first half of 2011, we had earnings attributable to Navistar International Corporation of \$74 million and \$68 million, or earnings of \$0.93 and \$0.87 per diluted share, respectively. Adjusting to exclude the impacts of our engineering integration actions and charges for adjustments to pre-existing warranties during the second quarter and first half of 2011, we recognized adjusted net income attributable to Navistar International Corporation of \$102 million and \$123 million, or earnings of \$1.30 and \$1.59 of diluted earnings per share, respectively.

The financial measures of adjusted net income (loss) and adjusted diluted earnings (loss) per share attributable to Navistar International Corporation are not in accordance with, or an alternative for, U.S. GAAP. Our definitions of these non-GAAP financial measures, and the reconciliations of these measures to our comparable GAAP financial measures for the periods presented, are set forth in the presentation below.

Comparative operating results in the first half of 2012 were reflective of higher “traditional” and worldwide truck volumes that were more than offset by an increase in adjustments for pre-existing warranty, lower military sales and a shift in order mix, higher commodity costs, and asset impairment charges. The prior year also included favorable commodity hedging impacts that did not recur in the current year. We also incurred higher selling, general, and administrative costs, primarily related to higher postretirement benefits expense due to an unfavorable ruling in our retiree health care litigation matter in the fourth quarter of 2011. Additionally in the second quarter of 2012, the results included the benefit of the release of a portion of our income tax valuation allowance on our Canadian deferred tax assets. We remain committed to our long-term goals, and continue to take actions that we believe will lead to revenue growth and reduced costs, resulting in improved margins during the balance of 2012 while sustaining momentum towards our strategic objectives.

In order to meet the current on-highway heavy-duty diesel (“HDD”) emission standards, HDD engines must be certified by the EPA for compliance with the 0.20g oxides of nitrogen (“NOx”) standard, which also includes standards for on-board diagnostics. Advanced Exhaust Gas Recirculation (“EGR”), combined with other strategies, is our solution to meet the 0.20g NOx standard. Our approach with EGR has dramatically reduced our NOx emissions compared to the previous NOx standard and we believe it is an environmentally friendly approach compared to the liquid-based urea Selective Catalytic Reduction (“SCR”) systems used by our competitors. However, we have not yet been able to obtain 0.20g certification for any of our HDD engines. Currently, we are able to sell our trucks which incorporate HDD engines and sell our engines by using emission credits or paying non-conformance penalties (“NCPs”). Both emission credits and NCPs are described below.

We were able to generate a “bank” of NOx emission credits by producing low-NOx engines earlier than was required by the EPA. Companies are allowed to use such credits to offset exceedances of the 0.20g NOx standard, and we have been doing so for HDD engines since model year 2010. Under current conditions and at the current pace, we estimate that we will fully consume these credits for heavy HDD engines during 2012 and for medium HDD engines during

2013. The pace at which we consume these credits is subject to material change based on a variety of factors, including sales, product mix, improvements in technology, our use of NCPs, the willingness of our customers to buy trucks we sell using NCPs, and our ability to certify engine families at the 0.20g NOx standard.

In certain circumstances, the Clean Air Act requires the EPA to promulgate NCPs. When NCPs are available, companies are permitted to certify engines that do not meet the current NOx standard by paying a penalty for each engine sold. In January 2012, the EPA promulgated an Interim Final Rule establishing NCPs for heavy HDD engines. These NCPs allow us to sell engines emitting up to 0.50g NOx subject to a penalty of up to \$1,919 per engine. Our 11L, 13L, and 15L engines all have certificates from the EPA that incorporate these NCPs; however, some of our competitors filed petitions in the Court of Appeals

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for the D.C. Circuit (the “D.C. Circuit”) challenging the Interim Final Rule. We intervened in support of the Interim Final Rule, the matter has been fully briefed, and oral argument was held on May 14, 2012. Some of our competitors also filed a separate petition in the D.C. Circuit challenging our certificates incorporating NCPs from the EPA. This petition has been held in abeyance pending a decision on the Interim Final Rule. The D.C. Circuit has not yet ruled on the Interim Final Rule; however, in the event of an adverse ruling from the D.C. Circuit on the Interim Final Rule or the challenge to our certificates, our ability to continue selling heavy HDD engines or our trucks that incorporate such engines could be materially and adversely affected.

Also in January 2012, the EPA published a Notice of Proposed Rulemaking for a final NCP rule (the “Final Rule”). The Final Rule would make NCPs available to manufacturers of heavy HDD engines and medium HDD engines in model years 2012 and later for emissions of NO<sub>x</sub> and would supersede the Interim Final Rule. We cannot provide assurance that the Final Rule will be promulgated in the form currently proposed or when it will be promulgated.

Currently, the California Air Resources Board (“CARB”) and the corresponding agencies of nine other states that have adopted California’s 0.20g NO<sub>x</sub> emission standards do not make available engine certification using NCPs. Therefore, we continue to sell engines and trucks in these ten states using the NO<sub>x</sub> emission credits previously described. Under current conditions and at the current pace, however, our emission credits for heavy HDD engines will be consumed this year. Unless CARB (and the corresponding agencies of the nine other states) begin allowing NCPs for engine sales, or unless CARB certifies our HDD engines to the 0.20g NO<sub>x</sub> standard, we will no longer be able to sell trucks with HDD engines in these ten states after our credits are consumed.

We submitted to the EPA an application for a 0.20g NO<sub>x</sub> engine certificate for one 13L engine family on January 31, 2012 and we submitted a similar application to CARB on February 17, 2012, but later withdrew both applications. In response to certain concerns raised by the EPA, on May 21, 2012, we submitted a revised application to the EPA and plan to submit a revised application to CARB. Certain issues raised by the revised application are under review by the EPA, and we are engaged in ongoing discussions relating to certification of this engine family at 0.20g NO<sub>x</sub>.

Our business, financial condition, results of operations, liquidity and capital resources or cash flows could be materially and adversely affected based on numerous factors relating to our continued use and development of engines using EGR, including among others, the decisions from the EPA and CARB on our 0.20g NO<sub>x</sub> engine certificate applications, the outcome of the challenges to the Interim Final Rule and our certificates incorporating NCPs, and the timing of promulgation and content of the Final Rule. If our 0.20g NO<sub>x</sub> certification applications are approved, we will no longer need to use NCPs or emission credits to meet the 0.20g NO<sub>x</sub> standard for the 13L engine family after it goes into production. However, we will still need NCPs and/or emission credits for other heavy HDD engine families that are subject to the 0.20g NO<sub>x</sub> standard. Under current conditions and at the current pace, we expect to use our remaining emission credits for heavy HDD engines in 2012 and for medium HDD engines in 2013. In each case, until we are able to obtain EPA and CARB certification for our engines and engineer the new engines into our trucks, we will have to rely on NCPs, to the extent available, in order to sell trucks with heavy and medium HDD engines. If NCPs are unavailable to us in the future, we will not have sufficient emission credits to continue to sell our heavy HDD engines and trucks with such engines, and if NCPs are available to us, our liquidity and cash flows could be materially and adversely affected by the market impact of such NCPs and the cost of such NCPs as established by the Final Rule. Any of the foregoing outcomes could materially and adversely affect our business, financial condition, results of operations, liquidity and capital resources or cash flows.

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Adjusted net income (loss) and adjusted diluted earnings (loss) per share attributable to Navistar International Corporation reconciliation:

|   | Three Months Ended |        | Six Months Ended |        |
|---|--------------------|--------|------------------|--------|
|   | April 30,          |        | April 30,        |        |
|   | 2012               | 2011   | 2012             | 2011   |
| (in millions, except per share data)  |                    |        |                  |        |
| Income (loss) attributable to Navistar International Corporation  | \$(172 )           | \$74   | \$(325 )         | \$68   |
| Plus:   |                    |        |                  |        |
| Engineering integration costs, net of tax <sup>(A)</sup>  | 31                 | 4      | 39               | 23     |
| Restructuring of North American manufacturing operations, net of tax <sup>(B)</sup>                           | 37                 | —      | 37               | —      |
| Adjustments to pre-existing warranties, net of tax <sup>(C)</sup>   | 138                | 24     | 219              | 32     |
| Charges for non-conformance penalties, net of tax <sup>(D)</sup>  | 10                 | —      | 10               | —      |
| Less:   |                    |        |                  |        |
| Net impact of income tax valuation allowance release <sup>(E)</sup>   | 181                | —      | 181              | —      |
| Adjusted net income (loss) attributable to Navistar International Corporation                                 | \$(137 )           | \$102  | \$(201 )         | \$123  |
| Diluted earnings (loss) per share attributable to Navistar International Corporation                          | \$(2.50 )          | \$0.93 | \$(4.69 )        | \$0.87 |
| Effect of adjustments on diluted earnings (loss) per share attributable to Navistar International Corporation | 0.51               | 0.37   | 1.79             | 0.72   |
| Adjusted diluted earnings (loss) per share attributable to Navistar International Corporation                 | \$(1.99 )          | \$1.30 | \$(2.90 )        | \$1.59 |
| Diluted weighted shares outstanding   | 68.7               | 78.6   | 69.3             | 77.3   |

Engineering integration costs relate to the consolidation of our truck and engine engineering operations, as well as the relocation of our world headquarters. For the three months ended April 30, 2012, the charges included restructuring charges of \$20 million and other related costs of \$9 million. The tax impact of the second quarter adjustments was income tax expense of \$2 million. For the six months ended April 30, 2012, the charges included restructuring charges of \$20 million and other related costs of \$21 million. The tax impact of the first half adjustments was income tax benefit of \$2 million. For the three and six months ended April 30, 2011, the charges

(A) included restructuring charges of \$1 million and \$19 million, respectively, and other related costs of \$5 million and \$7 million, respectively. For the three and six months ended April 30, 2011, the tax impact of the adjustments was income tax benefits of \$2 million and \$3 million, respectively. Our manufacturing operations, primarily our Truck segment, recognized charges of \$11 million and \$19 million relating to these actions in the three and six months ended April 30, 2012, respectively, compared to \$3 million and \$21 million in the three and six months ended April 30, 2011, respectively. For more information, see Note 2, Restructurings and Impairments, to the accompanying consolidated financial statements.

Restructuring of North American manufacturing operations are charges primarily related to our ongoing restructuring plans related to our plans to close our Chatham, Ontario heavy truck plant and WCC chassis plant in Union City, Indiana, and to significantly scale back operations at our Monaco recreational vehicle headquarters and motor coach manufacturing plant in Coburg, Oregon. In the three and six months ended April 30, 2012, the charges included impairments of certain intangible assets of \$38 million. The tax impact of the adjustments was an income tax benefit of \$1 million. The Truck and Parts segments recognized charges of \$28 million and \$10 million, respectively. For more information, see Note 2, Restructurings and Impairments, to the accompanying consolidated financial statements.

(C) During the three and six months ended April 30, 2012, the Company incurred charges of \$104 million and \$227 million, respectively, for adjustments to pre-existing warranties. For the three and six months ended April 30, 2012, the tax impact of the adjustments was income tax expense of \$34 million and income tax benefit of \$8

million, respectively. During the three and six months ended April 30, 2011, the Company incurred charges of \$27 million and \$36 million, respectively. For the three and six months ended April 30, 2011, the tax impact of the adjustments was income tax benefits of \$3 million and \$4 million, respectively. For more information, see Note 1, Summary of Significant Accounting Policies, to the accompanying consolidated financial statements.

(D) In the three months ended April 30, 2012, the Company recorded charges totaling \$10 million for NCPs for certain 13L engine sales that did not comply with emission standards, recognized in the Engine segment. The adjustment did not have a material impact on income taxes. For more information, see Note 12, Commitments and Contingencies, to the accompanying consolidated financial statements.

(E) In the three months ended April 30, 2012, we recognized an income tax benefit of \$181 million from the release of a significant portion of our income tax valuation allowance on our Canadian deferred tax assets. For more information, see Note 9, Income Taxes, to the accompanying consolidated financial statements.

The above charges, A through D, have been adjusted to reflect the impact of income taxes which are calculated based on the respective periods estimated annual effective tax rate. The income tax impact of the second quarter adjustments reflects the impact of a change in the quarter to the Company's estimated annual effective tax rate. The change is the result of updates to the forecasted earnings and the jurisdictional mix. The tax impact of the adjustments may be adjusted for future changes in the estimated annual effective tax rate.

The financial measures of adjusted net income (loss) and adjusted diluted earnings (loss) per share attributable to Navistar International Corporation are not in accordance with, or an alternative for, U.S. GAAP. The non-GAAP financial information presented should be considered supplemental to, and not as a substitute for, or superior to, financial measures calculated in accordance with GAAP. We believe that adjusted net income (loss) and diluted earnings (loss) per share attributable to Navistar International Corporation, excluding the impacts of certain items that are not considered to be part of our ongoing business, improves the comparability of year to year results, and is representative of our underlying performance. We have chosen to provide this supplemental information to investors, analysts and other interested parties to enable them to perform additional analysis of operating results, to illustrate the results of operations giving effect to the non-GAAP adjustments shown in these reconciliations, and to provide an additional measure of performance.

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## Results of Operations

The following information summarizes our Consolidated Statements of Operations and illustrates the key financial indicators used to assess our consolidated financial results.

Results of Operations—Three and six months ended April 30, 2012 compared to three and six months ended April 30, 2011

|   | Three Months<br>Ended April 30, |         | Change | %<br>Change | Six Months Ended<br>April 30, |         | Change | %<br>Change |
|---|---------------------------------|---------|--------|-------------|-------------------------------|---------|--------|-------------|
|   | 2012                            | 2011    |        |             | 2012                          | 2011    |        |             |
| (in millions, except per share data and % change) |                                 |         |        |             |                               |         |        |             |
| Sales and revenues, net                           | \$3,298                         | \$3,355 | \$(57) | (2)%        | \$6,350                       | \$6,098 | \$252  | 4%          |
| Costs of products sold                            | 2,944                           | 2,701   | 243    | 9%          | 5,642                         | 4,900   | 742    | 15%         |
| Restructuring charges                             | 20                              | 2       | 18     | N.M.        | 20                            | 24      | (4)    |             |