NAVISTAR INTERNATIONAL CORP
Form 10-Q
March 08, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended January 31, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission file number 1-9618

NAVISTAR INTERNATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

| Delaware | 36-3359573 |
| --- | --- |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 2701 Navistar Drive, Lisle, Illinois | 60532 |
| (Address of principal executive offices) | (Zip Code) |

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

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

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 þ No o

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

| Large accelerated filer | þ | Accelerated filer | o |
| --- | --- | --- | --- |
| Non-accelerated filer | o | Smaller reporting company | o |

(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 o No þ

As of February 29, 2012, the number of shares outstanding of the registrant's common stock was 68,524,813, 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 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 2014;
- our expectations and estimates relating to restructuring activities, including restructuring and integration charges and operational flexibility, savings, and efficiencies;
- 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 Item 1A, Risk Factors, included within our Annual Report on Form 10-K for the year ended October 31, 2011, which was filed on December 20, 2011, 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 United States ("U.S.") Securities and Exchange Commission ("SEC"). We make these filings available free of charge on our website (http://www.navistar.com) as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC. 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 Ended January 31, | |
|---|---|---|
| | 2012 | 2011 |
| (in millions, except per share data) | | |
| Sales and revenues | | |
| Sales of manufactured products, net | $3,008 | $2,693 |
| Finance revenues | 44 | 50 |
| Sales and revenues, net | 3,052 | 2,743 |
| Costs and expenses | | |
| Costs of products sold | 2,698 | 2,199 |
| Restructuring charges | — | 22 |
| Selling, general and administrative expenses | 362 | 318 |
| Engineering and product development costs | 137 | 129 |
| Interest expense | 61 | 63 |
| Other expense (income), net | 8 | (11) |
| Total costs and expenses | 3,266 | 2,720 |
| Equity in loss of non-consolidated affiliates | (7) | (17) |
| Income (loss) before income tax benefit | (221) | 6 |
| Income tax benefit | 81 | — |
| Net income (loss) | (140) | 6 |
| Less: Net income attributable to non-controlling interests | 13 | 12 |
| Net loss attributable to Navistar International Corporation | $(153) | $(6) |
| | | |
| Loss per share attributable to Navistar International Corporation: | | |
| Basic | $(2.19) | $(0.08) |
| Diluted | (2.19) | (0.08) |
| | | |
| Weighted average shares outstanding: | | |
| Basic | 69.9 | 72.5 |
| Diluted | 69.9 | 72.5 |

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 Ended January 31, | |
|---|---|---|
| | 2012 | 2011 |
| (in millions) | | |
| Net loss attributable to Navistar International Corporation | $(153) | $(6) |
| Other comprehensive income: | | |
| Foreign currency translation adjustment | (13) | 15 |
| Defined benefit plans (net of tax of $12 and $0, respectively) | 23 | 63 |
| Total other comprehensive income | 10 | 78 |
| Total comprehensive income (loss) attributable to Navistar International Corporation | $(143) | $72 |

See Notes to Condensed Consolidated Financial Statements

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Navistar International Corporation and Subsidiaries
Consolidated Balance Sheets

| (in millions, except per share data) | January 31, 2012 (Unaudited) | October 31, 2011 |
|---|---|---|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | $488 | $539 |
| Restricted cash | — | 100 |
| Marketable securities | 439 | 718 |
| Trade and other receivables, net | 858 | 1,219 |
| Finance receivables, net | 1,955 | 2,198 |
| Inventories | 1,916 | 1,714 |
| Deferred taxes, net | 481 | 474 |
| Other current assets | 322 | 273 |
| Total current assets | 6,459 | 7,235 |
| Restricted cash | 155 | 227 |
| Trade and other receivables, net | 120 | 122 |
| Finance receivables, net | 661 | 715 |
| Investments in non-consolidated affiliates | 61 | 60 |
| Property and equipment (net of accumulated depreciation and amortization of $2,112 and $2,056, at the respective dates) | 1,671 | 1,570 |
| Goodwill | 312 | 319 |
| Intangible assets (net of accumulated amortization of $105 and $99, at the respective dates) | 227 | 234 |
| Deferred taxes, net | 1,633 | 1,583 |
| Other noncurrent assets | 204 | 226 |
| Total assets | $11,503 | $12,291 |
| LIABILITIES and STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Liabilities | | |
| Current liabilities | | |
| Notes payable and current maturities of long-term debt | $1,097 | $1,379 |
| Accounts payable | 1,861 | 2,122 |
| Other current liabilities | 1,263 | 1,297 |
| Total current liabilities | 4,221 | 4,798 |
| Long-term debt | 3,436 | 3,477 |
| Postretirement benefits liabilities | 3,161 | 3,210 |
| Deferred taxes, net | 66 | 59 |
| Other noncurrent liabilities | 809 | 719 |
| Total liabilities | 11,693 | 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 | 2,273 | 2,253 |
| Accumulated deficit | (308) | (155) |
| Accumulated other comprehensive loss | (1,934) | (1,944) |
| Common stock held in treasury, at cost (6.9 and 4.9 shares, at the respective dates) | (278) | (191) |

| | | |
|---|---|---|
| Total stockholders’ deficit attributable to Navistar International Corporation | (236) | (27) |
| Stockholders’ equity attributable to non-controlling interests | 41 | 50 |
| Total stockholders’ equity (deficit) | (195) | 23 |
| Total liabilities and stockholders’ equity (deficit) | $11,503 | $12,291 |

See Notes to Condensed Consolidated Financial Statements

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

| | Three Months Ended January 31, | |
|---|---|---|
| | 2012 | 2011 |
| (in millions) | | |
| Cash flows from operating activities | | |
| Net income (loss) | $(140) | $6 |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: | | |
| Depreciation and amortization | 68 | 71 |
| Depreciation of equipment leased to others | 10 | 9 |
| Deferred taxes | (52) | — |
| Amortization of debt issuance costs and discount | 9 | 12 |
| Stock-based compensation | 12 | 20 |
| Equity in loss of non-consolidated affiliates, net of dividends | 7 | 18 |
| Write-off of debt issuance cost and discount | 8 | — |
| Other non-cash operating activities | 1 | 7 |
| Changes in other assets and liabilities, exclusive of the effects of businesses acquired and disposed | 196 | (138) |
| Net cash provided by operating activities | 119 | 5 |
| Cash flows from investing activities | | |
| Purchases of marketable securities | (459) | (140) |
| Sales or maturities of marketable securities | 738 | 316 |
| Net change in restricted cash and cash equivalents | 172 | 9 |
| Capital expenditures | (103) | (95) |
| Purchase of equipment leased to others | (25) | (14) |
| Proceeds from sales of property and equipment | 2 | 14 |
| Investments in non-consolidated affiliates | (9) | (27) |
| Business acquisitions, net of cash received | (3) | — |
| Acquisition of intangibles | (12) | — |
| Net cash provided by investing activities | 301 | 63 |
| Cash flows from financing activities | | |
| Proceeds from issuance of securitized debt | 232 | 45 |
| Principal payments on securitized debt | (522) | (176) |
| Proceeds from issuance of non-securitized debt | 479 | 22 |
| Principal payments on non-securitized debt | (480) | (48) |
| Net decrease in notes and debt outstanding under revolving credit facilities | (62) | (50) |
| Principal payments under financing arrangements and capital lease obligations | (16) | (43) |
| Debt issuance costs | (15) | (3) |
| Purchase of treasury stock | (70) | — |
| Proceeds from exercise of stock options | 1 | 15 |
| Dividends paid by subsidiaries to non-controlling interest | (22) | (19) |
| Other financing activities | (3) | — |
| Net cash used in financing activities | (478) | (257) |
| Effect of exchange rate changes on cash and cash equivalents | 7 | 3 |
| Decrease in cash and cash equivalents | (51) | (186) |
| Cash and cash equivalents at beginning of the period | 539 | 585 |
| Cash and cash equivalents at end of the period | $488 | $399 |

See Notes to Condensed Consolidated Financial Statements

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

| | Series D Convertible Junior Preference Stock | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Common Stock Held in Treasury, at cost | Stockholders' Equity Attributable to Noncontrolling Interests | Total |
|---|---|---|---|---|---|---|---|---|
| (in millions) | | | | | | | | |
| Balance as of October 31, 2011 | $ 3 | $ 7 | $ 2,253 | $ (155) | $ (1,944) | $ (191) | $ 50 | $ 23 |
| Net income (loss) | | | | (153) | | | 13 | (140) |
| Total other comprehensive income | | | | | 10 | | | 10 |
| Stock-based compensation | | | 8 | | | | | 8 |
| Stock ownership programs | | | (8) | | | 8 | | — |
| Stock repurchase programs | | | 20 | | | (95) | | (75) |
| Cash dividends paid to non-controlling interest | | | | | | | (22) | (22) |
| Other | | 1 | | | | | | 1 |
| Balance as of January 31, 2012 | $ 3 | $ 8 | $ 2,273 | $ (308) | $ (1,934) | $ (278) | $ 41 | $ (195) |
| | | | | | | | | |
| Balance as of October 31, 2010 | $ 4 | $ 7 | $ 2,206 | $ (1,878) | $ (1,196) | $ (124) | $ 49 | $ (932) |
| Net income (loss) | | | | (6) | | | 12 | 6 |
| Total other comprehensive income | | | | | 78 | | | 78 |
| Transfer from redeemable equity securities upon exercise or expiration of stock options | | | 2 | | | | | 2 |
| Stock-based compensation | | | 13 | | | | | 13 |
| Stock ownership programs | | | 3 | | | 11 | | 14 |
| Cash dividends paid to non-controlling interest | | | | | | | (19) | (19) |
| Other | (1) | | | | | | | (1) |
| Balance as of January 31, 2011 | $ 3 | $ 7 | $ 2,224 | $ (1,884) | $ (1,118) | $ (113) | $ 42 | $ (839) |

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"), wholly-owned financial services subsidiaries, and VIEs of which we are the primary beneficiary. The effects of transactions among consolidated entities have been eliminated to arrive at the consolidated amounts. Certain reclassifications were made to prior year disclosures to conform to the 2012 presentation.

We prepared the accompanying unaudited consolidated financial statements in accordance with United States ("U.S.") generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X issued by the 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 are the primary beneficiary of 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 as 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 $225 million and $306 million and liabilities of $140 million and $158 million as of January 31, 2012 and October 31, 2011, respectively, from BDP and BDT, including $15 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 $1.5 billion and $1.8 billion as of January 31, 2012 and October 31, 2011, respectively, and liabilities of $1.3

billion and $1.5 billion as of January 31, 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 $394 million and $468 million and related liabilities of $166 million and $216 million as of January 31, 2012 and October 31, 2011, respectively, all of which are involved in structures in which we transferred assets 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 the general credit of NIC or any other consolidated entity.

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 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 January 31, 2012, approximately 5,600, or 53%, of our hourly workers and approximately 400, or 5%, 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, 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:

| | Three Months Ended January 31, | |
|---|---|---|
| | 2012 | 2011 |
| (in millions) | | |
| Balance, at beginning of period | $598 | $506 |
| Costs accrued and revenues deferred | 111 | 81 |
| Adjustments to pre-existing warranties[(A)] | 123 | 9 |
| Payments and revenues recognized | (106) | (90) |
| Balance, at end of period | 726 | 506 |
| Less: Current portion | 324 | 250 |
| Noncurrent accrued product warranty and deferred warranty revenue | $402 | $256 |

(A) Adjustments to pre-existing warranties reflect changes in our estimate of warranty costs for products sold in prior periods. Such adjustments typically occur when claims experience deviates from historic and expected trends. 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 historical experience becomes available. In the first quarter of 2012, we recorded adjustments for changes in estimates of $123 million, or $1.76 per diluted share. Net of tax, the adjustments for changes in estimates amounted to $81 million, or $1.16 per diluted share.

The amount of deferred revenue related to extended warranty programs was $282 million and $257 million at January 31, 2012 and October 31, 2011, respectively. Revenue recognized under our extended warranty programs was $15 million and $12 million for the three months ended January 31, 2012 and 2011, respectively.

Recently Adopted Accounting Standards

As of November 1, 2011, we adopted new guidance on the testing of goodwill impairment that allows the option to assess qualitative factors to determine whether performing the two step goodwill impairment assessment is necessary. Under the option, the calculation of the reporting unit's fair value is not required to be performed unless as a result of the qualitative assessment, it is more likely than not that the fair value of the reporting unit is less than the unit's carrying amount. The adoption of this guidance impacts testing steps only, and therefore adoption did not have an impact on our consolidated financial statements.

As of November 1, 2011, we adopted new guidance on the presentation of comprehensive income. Specifically, the new guidance allows an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate but consecutive statements. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. We elected to adopt the two separate but consecutive statement presentation, and the adoption of this guidance did not have a material impact on our consolidated financial statements.

As of November 1, 2011, we adopted new guidance regarding disclosures about fair value measurements. The guidance requires new disclosures related to activity in Level 3 fair value measurements. This guidance requires purchases, sales, issuances, and settlements to be presented separately in the rollforward of activity in Level 3 fair value measurements. 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 financial statements.

## 2. Restructurings

### 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 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 $29 million of restructuring charges to date, of which $18 million was recognized during the three months ended January 31, 2011. To date, the restructuring charges consisted 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 $9 million of employee relocation costs.

We anticipate additional engineering integration charges, excluding any potential lease vacancy charges, to range between $70 million and $90 million through 2013.

### North American manufacturing restructuring activity

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.

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 driven by economic,

industry, and operational conditions 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

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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.

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. As a result of these restructuring activities, the Truck segment has recognized $10 million of restructuring charges to date, of which $5 million was recognized during both of the three months periods ending July 31, 2011 and October 31, 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 second quarter of 2012, and the Company anticipates additional charges of $5 million to $10 million. The Company also expects the restructuring charges, excluding other postretirement costs, will be paid over the next two years.

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 three months ended January 31, 2012 in the restructuring liability, which excludes pension and other postretirement contractual termination benefits:

| (in millions) | Balance at October 31, 2011 | Additions | Payments | Adjustments | Balance at January 31, 2012 |
|---|---|---|---|---|---|
| Employee termination charges | $ 31 | $1 | $(2) | $(2) | $28 |
| Employee relocation costs | — | 1 | (1) | — | — |
| Other | 8 | — | (7) | — | 1 |
| Restructuring liability | $ 39 | $2 | $(10) | $(2) | $29 |

The following table summarizes the activity for the three months ended January 31, 2011 in the restructuring liability, which excludes pension and other postretirement contractual termination benefits charges, and the pension curtailment:

| (in millions) | Balance at October 31, 2010 | Additions | Payments | Adjustments | Balance at January 31, 2011 |
|---|---|---|---|---|---|
| Employee termination charges | $ 5 | $17 | $(3) | $— | $19 |

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 $3.1 billion and $3.5 billion as of January 31, 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 January 31, 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:

| (in millions) | January 31, 2012 | October 31, 2011 |
|---|---|---|
| Retail portfolio | $1,382 | $1,613 |
| Wholesale portfolio | 1,265 | 1,334 |
| Total finance receivables | 2,647 | 2,947 |
| Less: Allowance for doubtful accounts | (31) | (34) |
| Total finance receivables, net | 2,616 | 2,913 |
| Less: Current portion, net[(A)] | (1,955) | (2,198) |
| Noncurrent portion, net | $661 | $715 |

______________

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

Securitizations

Our financial services operations transfer wholesale notes, retail accounts receivable, retail notes, finance leases, and operating leases through special purpose entities ("SPE"), 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 month periods ended January 31, 2012 and 2011. Securitization income for the three months ended January 31, 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 borowings by our Financial Services segment, see Note 1, Summary of significant accounting policies.

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:

| (in millions) | Maturity | January 31, 2012 | October 31, 2011 |
|---|---|---|---|
| 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 $280 million and $170 million at January 31, 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 retail notes through Truck Retail Accounts Corporation ("TRAC"), a consolidated SPE, which utilizes a $100 million funding facility arrangement that provides for the funding of eligible retail accounts receivables. The facility is secured by $104 million of retail accounts and $26 million of cash equivalents as of January 31, 2012, as compared to $174 million of retail accounts and $33 million of cash equivalents as of October 31, 2011. There were

$53 million and $9 million of unutilized funding at January 31, 2012 and October 31, 2011, respectively. The TRAC funding facility has a maturity date of March 2012.

Finance Revenues

Finance revenues consist of the following:

| | Three Months Ended January 31, | |
|---|---|---|
| (in millions) | 2012 | 2011 |
| Retail notes and finance leases revenue | $26 | $37 |
| Operating lease revenue | 9 | 7 |
| Wholesale notes interest | 23 | 25 |
| Retail and wholesale accounts interest | 10 | 6 |
| Securitization income | — | (2) |
| Gross finance revenues | 68 | 73 |
| Less: Intercompany revenues | (24) | (23) |
| Finance revenues | $44 | $50 |

4. Allowance for doubtful accounts

We determined that 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. As the initial measurement attributes and the monitoring and assessment of credit risk or the performance of the receivables are consistent within each of our receivable portfolios, the Company determined that each portfolio consisted of one class of receivable.

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 January 31, 2012 | | | |
|---|---|---|---|---|
| (in millions) | Retail Portfolio | Wholesale Portfolio | Trade and Other Receivables | Total |
| Allowance for doubtful accounts, at beginning of period | $31 | $2 | $17 | $50 |
| Provision for doubtful accounts, net of recoveries | (2) | 1 | 1 | — |
| Charge-off of accounts[(A)] | (1) | — | (2) | (3) |
| Allowance for doubtful accounts, at end of period | $28 | $3 | $16 | $47 |

| | Three Months Ended January 31, 2011 | | | |
|---|---|---|---|---|
| (in millions) | Retail Portfolio | Wholesale Portfolio | Trade and Other Receivables | Total |
| Allowance for doubtful accounts, at beginning of period | $58 | $2 | $36 | $96 |
| Provision for doubtful accounts, net of recoveries | (2) | — | 2 | — |
| Charge-off of accounts[(A)] | (2) | — | — | (2) |
| Allowance for doubtful accounts, at end of period | $54 | $2 | $38 | $94 |

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(A) We repossess sold and leased vehicles on defaulted finance receivables and leases, and place them into Inventories. Losses recognized at the time of repossession and charged against the allowance for doubtful accounts

were $1 million and $3 million for the three months ended January 31, 2012 and 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 | | | | | |
|---|---|---|---|---|---|---|
| | January 31, 2012 | | | October 31, 2011 | | |
| | Retail Portfolio | Wholesale Portfolio | Total | Retail Portfolio | Wholesale Portfolio | Total |
| (in millions) | | | | | | |
| Impaired finance receivables with specific loss reserves | $17 | $— | $17 | $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 |

The average balance of impaired finance receivables was $13 million and $44 million for the three months ended January 31, 2012 and 2011, respectively.

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 | | | | | |
|---|---|---|---|---|---|---|
| | January 31, 2012 | | | October 31, 2011 | | |
| | Retail Portfolio | Wholesale Portfolio | Total | Retail Portfolio | Wholesale Portfolio | Total |
| (in millions) | | | | | | |
| Current | $1,336 | $ 1,258 | $2,594 | $1,515 | $ 1,328 | $2,843 |
| 30-90 days past due | 32 | 6 | 38 | 85 | 5 | 90 |
| Over 90 days past due | 14 | 1 | 15 | 13 | 1 | 14 |
| Total finance receivables | $1,382 | $ 1,265 | $2,647 | $1,613 | $ 1,334 | $2,947 |

5. Inventories

The components of inventories are as follows:

| | As of | |
|---|---|---|
| | January 31, 2012 | October 31, 2011 |
| (in millions) | | |
| Finished products | $985 | $873 |
| Work in process | 222 | 174 |
| Raw materials | 709 | 667 |
| Total inventories | $1,916 | $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 $NC^2$ Global, LLC ("$NC^2$") joint venture agreement with Caterpillar, our 50% interest in $NC^2$ was included in Investments in and advances to non-consolidated affiliates. In September 2011, the Company

acquired all of Caterpillar's ownership interest in $NC^2$, thereby increasing the Company's equity interest in $NC^2$ from 50% to 100%. We have consolidated the operating results of $NC^2$ within our Truck segment since September 30, 2011.



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Presented below is summarized financial information representing 100% of NC[2], which was considered a significant non-consolidated affiliate during the three months ended January 31, 2011, prior to increasing the equity interest in September 2011. Balance sheet information for NC[2] was insignificant to our Consolidated Balance Sheet as of January 31, 2011.

| (in millions) | Three Months Ended January 31, 2011 |
|---|---|
| Net revenue | $49 |
| Net expenses | 67 |
| Loss before tax expense | (18) |
| Net loss | (18) |

7. Debt

| (in millions) | January 31, 2012 | October 31, 2011 |
|---|---|---|
| Manufacturing operations | | |
| 8.25% Senior Notes, due 2021, net of unamortized discount of $29 and $33 at the respective dates | $871 | $967 |
| 3.0% Senior Subordinated Convertible Notes, due 2014, net of unamortized discount of $68 and $73 at the respective dates | 502 | 497 |
| Debt of majority-owned dealerships | 92 | 94 |
| Financing arrangements and capital lease obligations | 160 | 118 |
| Loan Agreement related to 6.5% Tax Exempt Bonds, due 2040 | 225 | 225 |
| Promissory Note | 38 | 40 |
| Asset-Based Credit Facility | 100 | — |
| Other | 42 | 39 |
| Total manufacturing operations debt | 2,030 | 1,980 |
| Less: Current portion | 200 | 99 |
| Net long-term manufacturing operations debt | $1,830 | $1,881 |
| Financial services operations | | |
| Asset-backed debt issued by consolidated SPEs, at variable rates, due serially through 2018 | $1,371 | $1,664 |
| Bank revolvers, at fixed and variable rates, due dates from 2013 through 2017 | 997 | 1,072 |
| Commercial paper, at variable rates, due serially through 2012 | 63 | 70 |
| Borrowings secured by operating and finance leases, at various rates, due serially through 2017 | 72 | 70 |
| Total financial services operations debt | 2,503 | 2,876 |
| Less: Current portion | 897 | 1,280 |
| Net long-term financial services operations debt | $1,606 | $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 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 three months

ending January 31, 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 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 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.

Financial Services Operations

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 will be $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 months ended January 31, 2012 and 2011, we contributed $29 million and $21 million, respectively, to our pension plans to meet regulatory funding requirements. We currently anticipate additional contributions of $160 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 the three months ended January 31, 2012 and 2011, and anticipated contributions for the remainder of 2012, are not material.

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 three months ended January 31, 2012 and 2011, $3 million and $5 million, respectively, was collected and 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.

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Components of Net Periodic Benefit Expense (Income)

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

| | Three Months Ended January 31, | | | |
|---|---|---|---|---|
| | Pension Benefits | | Health and Life Insurance Benefits | |
| | 2012 | 2011 | 2012 | 2011 |
| (in millions) | | | | |
| Service cost for benefits earned during the period | $4 | $4 | $1 | $2 |
| Interest on obligation | 43 | 47 | 21 | 13 |
| Amortization of cumulative loss | 28 | 25 | 9 | — |
| Amortization of prior service benefit | — | — | (1) | (8) |
| Curtailments | — | 2 | — | — |
| Contractual termination benefits | — | 3 | (2) | — |
| Expected return on assets | (48) | (52) | (9) | (10) |
| Net postretirement benefits expense (income) | $27 | $29 | $19 | $(3) |

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 $10 million for both of the three month periods ended January 31, 2012 and 2011.

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. 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 restructuring 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.

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. 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 realizable based on current forecasted results. However, it is reasonably possible within the next twelve months that the Company may release a portion of its existing valuation allowance based on the results of business

strategies that would indicate deferred tax assets more likely than not will be realized.

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 January 31, 2012, the amount of liability for uncertain tax positions was $25 million. If the unrecognized tax benefits are recognized, $29 million would impact our effective tax rate.

We recognize interest and penalties related to uncertain tax positions as part of Income tax benefit. The tax benefit for the first quarter 2012 includes interest and penalties related to our uncertain tax positions of $12 million, 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 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.

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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 table presents the financial instruments measured at fair value on a recurring basis:

| | January 31, 2012 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| (in millions) | | | | |
| Assets | | | | |
| Marketable securities | | | | |
| U.S. Treasury bills | $199 | $— | $— | $199 |
| Other U.S. and non-U.S. government bonds | 220 | — | — | 220 |
| Other | 20 | — | — | 20 |
| Derivative financial instruments | | | | |
| Foreign currency contracts | — | — | — | — |
| Commodity contracts | — | 1 | — | 1 |
| Total assets | $439 | $1 | $— | $440 |
| Liabilities | | | | |
| Derivative financial instruments | | | | |
| Foreign currency contracts | $— | $1 | $— | $1 |
| Commodity contracts | | | | |