

NAVISTAR INTERNATIONAL CORP
Form 10-Q
June 27, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended April 30, 2008

OR

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

For the transition period from To

Commission file number 1-9618

NAVISTAR INTERNATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of

36-3359573
(I.R.S. Employer

incorporation or organization)

Identification No.)

4201 Winfield Road, P.O. Box 1488,

Warrenville, Illinois
(Address of principal executive offices)

60555
(Zip Code)

Registrant's telephone number, including area code (630) 753-5000

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

Indicate by check mark whether the registrant is 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

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

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

Documents incorporated by reference: None.

NAVISTAR INTERNATIONAL CORPORATION FORM 10-Q

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PART I

Item 1. Condensed Consolidated Financial Statements

Navistar International Corporation and Subsidiaries

Consolidated Statements of Operations

(Unaudited)

| | Three Months Ended April 30, | | Six Months Ended April 30, | |
|---|---------------------------------|------------------|-------------------------------|------------------|
| | 2008 | 2007 | 2008 | 2007 |
| (in millions, except per share data) | | | | |
| Sales and revenues | | | | |
| Sales of manufactured products, net | \$ 3,853 | \$ 2,900 | \$ 6,713 | \$ 5,950 |
| Finance revenues | 96 | 90 | 190 | 188 |
| Sales and revenues, net | 3,949 | 2,990 | 6,903 | 6,138 |
| Costs and expenses | | | | |
| Costs of products sold | 3,196 | 2,472 | 5,647 | 5,077 |
| Selling, general and administrative expenses | 364 | 345 | 685 | 642 |
| Engineering and product development costs | 99 | 95 | 181 | 198 |
| Interest expense | 102 | 131 | 269 | 242 |
| Other (income) expenses, net | (4) | (16) | (5) | 13 |
| Total costs and expenses | 3,757 | 3,027 | 6,777 | 6,172 |
| Equity in income of non-consolidated affiliates | 21 | 18 | 45 | 40 |
| Income (loss) before income tax | 213 | (19) | 171 | 6 |
| Income tax benefit (expense) | 2 | (6) | (9) | (19) |
| Net income (loss) | \$ 215 | \$ (25) | \$ 162 | \$ (13) |
| Basic earnings (loss) per share | \$ 3.06 | \$ (0.36) | \$ 2.30 | \$ (0.19) |
| Diluted earnings (loss) per share | \$ 2.94 | \$ (0.36) | \$ 2.22 | \$ (0.19) |
| Weighted average shares outstanding | | | | |
| Basic | 70.3 | 70.3 | 70.3 | 70.3 |
| Diluted | 73.2 | 70.3 | 72.9 | 70.3 |

See Notes to Condensed Consolidated Financial Statements

Navistar International Corporation and Subsidiaries

Consolidated Balance Sheets

(Unaudited)

| | As of | |
|--|-------------------|---------------------|
| | April 30, 2008 | October 31, 2007 |
| (in millions, except per share data) | | |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 675 | \$ 777 |
| Marketable securities | 38 | 6 |
| Finance and other receivables (net of allowance for losses of \$53 and \$60 as of April 30, 2008 and October 31, 2007, respectively) | 3,142 | 2,941 |
| Inventories | 1,364 | 1,412 |
| Deferred taxes, net | 115 | 115 |
| Other current assets | 167 | 194 |
| Total current assets | 5,501 | 5,445 |
| Restricted cash and cash equivalents | | |
| | 735 | 419 |
| Finance and other receivables (net of allowance for losses of \$40 and \$41 as of April 30, 2008 and October 31, 2007, respectively) | 2,330 | 2,478 |
| Investments in and advances to non-consolidated affiliates | 175 | 154 |
| Property and equipment (net of accumulated depreciation and amortization of \$2,266 and \$2,199 as of April 30, 2008 and October 31, 2007, respectively) | 1,980 | 2,086 |
| Goodwill | 359 | 353 |
| Intangible assets (net of accumulated amortization of \$65 and \$53 as of April 30, 2008 and October 31, 2007, respectively) | 273 | 286 |
| Pension assets | 121 | 103 |
| Deferred taxes, net | 20 | 35 |
| Other noncurrent assets | 120 | 89 |
| Total assets | \$ 11,614 | \$ 11,448 |
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| Liabilities | | |
| Current liabilities | | |
| Notes payable and current maturities of long-term debt | \$ 856 | \$ 798 |
| Accounts payable | 2,027 | 1,770 |
| Other current liabilities | 1,203 | 1,423 |
| Total current liabilities | 4,086 | 3,991 |
| Long-term debt | 6,028 | 6,083 |
| Postretirement benefits liabilities | 1,235 | 1,327 |
| Other noncurrent liabilities | 827 | 781 |
| Total liabilities | 12,176 | 12,182 |
| Stockholders deficit | | |
| Series D convertible junior preference stock | 4 | 4 |
| Common stock and additional paid in capital (par value \$0.10 per share, 75.4 million shares issued as of April 30, 2008 and October 31, 2007) | 2,107 | 2,101 |
| Accumulated deficit | (2,362) | (2,519) |
| Accumulated other comprehensive loss | (146) | (155) |
| Common stock held in treasury, at cost (5.1 million shares as of April 30, 2008 and October 31, 2007) | (165) | (165) |

| | | |
|---|------------------|------------------|
| Total stockholders deficit | (562) | (734) |
| Total liabilities and stockholders deficit | \$ 11,614 | \$ 11,448 |

See Notes to Condensed Consolidated Financial Statements

Navistar International Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

| (in millions) | Six Months Ended | |
|---|------------------|-------------------|
| | 2008 | April 30, 2007 |
| Cash flows from operating activities | | |
| Net income (loss) | \$ 162 | \$ (13) |
| Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities | | |
| Depreciation and amortization | 156 | 151 |
| Depreciation of equipment held for or under lease | 30 | 27 |
| Deferred taxes | | (4) |
| Amortization of debt issuance costs | 10 | 5 |
| Stock-based compensation | 2 | 4 |
| Provision for doubtful accounts | 18 | 16 |
| Equity in income of non-consolidated affiliates | (45) | (40) |
| Dividends from non-consolidated affiliates | 29 | 52 |
| Gain on sale of affiliate | (4) | |
| (Gain) loss on sale of property and equipment | (2) | 6 |
| Loss on repurchases of debt | | 31 |
| Changes in other assets and liabilities | (45) | (468) |
| Total adjustments | 149 | (220) |
| Net cash provided by (used in) operating activities | 311 | (233) |
| Cash flows from investing activities | | |
| Purchases of marketable securities | (42) | (148) |
| Sales or maturities of marketable securities | 11 | 264 |
| Net change in restricted cash and cash equivalents | (316) | 163 |
| Capital expenditures | (103) | (139) |
| Purchase of equipment held for or under lease | (27) | (29) |
| Proceeds from sale of property and equipment | 20 | 10 |
| Investments and advances to non-consolidated affiliates | (4) | (7) |
| Proceeds from sale of affiliate | 19 | |
| Business acquisitions, net of cash acquired | | (7) |
| Other investing activities | 1 | (1) |
| Net cash provided by (used in) investing activities | (441) | 106 |
| Cash flows from financing activities | | |
| Proceeds from issuance of securitized debt | 813 | 473 |
| Principal payments on securitized debt | (980) | (671) |
| Proceeds from issuance of non-securitized debt | 101 | 1,548 |
| Principal payments on non-securitized debt | (8) | (1,525) |
| Net increase (decrease) in notes and debt outstanding under revolving credit facilities | 143 | (186) |
| Principal payments under financing arrangements and capital lease obligations | (51) | (30) |
| Debt issuance costs | (7) | (19) |
| Net cash provided by (used in) financing activities | 11 | (410) |

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| | | |
|---|---------------|---------------|
| Effect of exchange rate changes on cash and cash equivalents | 17 | 28 |
| Decrease in cash and cash equivalents | (102) | (509) |
| Cash and cash equivalents at beginning of period | 777 | 1,157 |
| Cash and cash equivalents at end of the period | \$ 675 | \$ 648 |

See Notes to Condensed Consolidated Financial Statements

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. The Financial Services segment consists of *NFC* and our foreign finance operations (collectively called *financial services operations*).

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements include the assets, liabilities, revenues, and expenses of our manufacturing operations, majority owned dealers, 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 amounts to conform to the 2008 presentation.

We prepared the accompanying unaudited condensed consolidated financial statements in accordance with United States (*U.S.*) generally accepted accounting principles (*GAAP*) for interim financial information and with 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 condensed consolidated financial statements have been prepared in accordance with accounting policies described in the Annual Report on Form 10-K for the year ended October 31, 2007 and should be read in conjunction with the disclosures therein. In our opinion, these interim financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position, results of operations, and cash flows for the periods presented. Operating results for interim periods are not necessarily indicative of annual operating results.

Accounting Changes

As of November 1, 2007, we adopted Financial Accounting Standards Board (*FASB*) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109*. See Note 9, *Income taxes*, for more information.

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 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 losses, sales of receivables, income tax contingency accruals and valuation allowances, product warranty accruals, asbestos accruals, asset impairment, and litigation related accruals. Actual results could differ from our estimates.

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Concentration Risks

Our financial position, results of operations, and cash flows are subject to concentration risks related to concentrations of union employees and two customers. As of April 30, 2008, approximately 6,100, or 64%, of our hourly workers and approximately 700, or 10%, of our salaried workers are represented by labor unions and are covered by collective bargaining agreements. See Note 13, *Segment reporting*, for discussions on customer concentration.

Product Warranty Liability

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

| (in millions) | Six Months Ended April 30, | |
|---|-------------------------------|--------|
| | 2008 | 2007 |
| Balance, at beginning of period | \$ 677 | \$ 777 |
| Costs accrued and revenues deferred | 100 | 120 |
| Adjustments to pre-existing warranties ^(A) | 5 | 25 |
| Payments and revenues recognized | (174) | (170) |
| Balance, at end of period | \$ 608 | \$ 752 |

(A) Adjustments to pre-existing warranties reflect changes in our estimate of warranty costs for products sold in prior periods. The amount of deferred revenue related to extended warranty programs as of April 30, 2008 and October 31, 2007 was \$125 million and \$127 million, respectively. Revenue recognized under our extended warranty programs was \$12 million and \$6 million, and \$23 million and \$11 million for three months and six months ended April 30, 2008 and 2007, respectively.

New Accounting Pronouncements

Accounting pronouncements issued by various standard setting and governmental authorities that have not yet become effective with respect to our condensed consolidated financial statements are described below, together with our assessment of the potential impact they may have on our financial position, results of operations, or cash flows:

| Pronouncement | Effective Date | Impact on Our Financial Condition and Results of Operations |
|--|--|---|
| Emerging Issues Task Force Issue No. 08-3, <i>Accounting by Lessees for Nonrefundable Maintenance Deposits</i> | Effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is not permitted. Our effective date is November 1, 2009. | We are evaluating the potential impact, if any. |

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

| Pronouncement | Effective Date | Impact on Our Financial Condition and Results of Operations |
|--|---|--|
| FASB Staff Position No. FAS 142-3, <i>Determination of the Useful Life of Intangible Assets</i> | Effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Our effective date is November 1, 2009. | We are evaluating the potential impact, if any. |
| FASB Statement No. 161, <i>Disclosures about Derivative Instruments and Hedging Activities</i> An <i>Amendment of FASB</i> <i>Statement No. 133</i> | Effective for fiscal years and interim reporting periods beginning after November 15, 2008. Our effective date is February 1, 2009. | When effective, we will comply with the disclosure provisions of this Statement. |
| FASB Statement No. 160, <i>Noncontrolling Interests in Consolidated Financial Statements</i> An <i>Amendment of ARB No. 51</i> | Effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. Our effective date is February 1, 2009. | We are evaluating the potential impact, if any. |
| FASB Statement No. 141(R), <i>Business Combinations</i> | Applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. Our effective date is November 1, 2009. | We will adopt this Statement on a prospective basis. |
| Emerging Issues Task Force Issue No. 07-03, <i>Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities</i> | Effective for financial statements issued for fiscal years beginning after December 15, 2007. Our effective date is November 1, 2008. | We are evaluating the potential impact, if any. |
| FASB Statement No. 159, <i>The Fair Value Option for Financial Assets and Financial Liabilities</i> | Effective as of the beginning of the first fiscal year beginning after November 15, 2007. If we adopt the Fair Value Option, our effective date is November 1, 2008. | We are evaluating the potential impact, if any. We have not determined whether to adopt the fair value option. |
| FASB Statement No. 157, <i>Fair Value Measurements</i> | Effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. Our effective date is November 1, 2008. | We are evaluating the potential impact, if any. |

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

2. Disposal of business

In December 2007, we sold all of our interests in a heavy duty truck parts remanufacturing business. In connection with the sale, we received gross proceeds of \$22 million, including liabilities assumed, resulting in a gain of \$4 million.

3. Finance and other receivables, net

Information regarding impaired finance receivables is as follows:

| | As of | |
|--|-------------------|---------------------|
| | April 30, 2008 | October 31, 2007 |
| (in millions) | | |
| Outstanding balances with specific loss reserves | \$ 55 | \$ 52 |
| Specific loss reserves | 8 | 11 |
| Outstanding balances on non-accrual status loans | 42 | 39 |
| Average balance of impaired finance receivables | 55 | 42 |
| Outstanding balances with payments over 90 days past due | 129 | 120 |

Impaired receivables include accounts identified as critical accounts as a result of financial difficulties and accounts that are on non-accrual status. In certain cases, we continue to collect payments on our impaired receivables.

The activity related to our allowance for losses for finance and other receivables is summarized as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------|------------------|-------|
| | April 30, | | April 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| (in millions) | | | | |
| Balance, at beginning of period | 107 | 78 | 101 | 75 |
| Provision for doubtful accounts | 6 | 10 | 18 | 15 |
| Charge-off of accounts, net of recoveries | (20) | (8) | (26) | (10) |
| Balance, at end of period | \$ 93 | \$ 80 | \$ 93 | \$ 80 |

Repossessions

We repossess leased and sold trucks on defaulted finance receivables and leases, and place them into *Inventories*. We liquidate these repossessions to partially recover the credit losses in our portfolio. Losses recognized at the time of repossession and charged against the allowance for losses for the three months ended April 30, 2008 and 2007 were \$12 million and \$6 million, and for the six months ended April 30, 2008 and 2007 were \$16 million and \$7 million, respectively. Losses recognized upon the sale of repossessed vehicles for the three months ended April 30, 2008 and 2007 were \$4 million and less than \$1 million, and for the six months ended April 30, 2008 and 2007 were \$4 million and \$1 million, respectively.

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

A summary of the activity related to repossessed vehicles is as follows:

| (in millions) | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------|-------------------|-------|
| | April 30, 2008 | 2007 | April 30, 2008 | 2007 |
| Repossessed vehicles, at beginning of period | 31 | 10 | 25 | 6 |
| Repossessions | 42 | 15 | 62 | 23 |
| Liquidations | (25) | (8) | (39) | (12) |
| Repossessed vehicles, at end of period | \$ 48 | \$ 17 | \$ 48 | \$ 17 |

4. Sales of receivables

The primary business of our financial services operations is to provide wholesale, retail, and lease financing for new and used trucks sold by us and our dealers and, as a result, our finance receivables and leases have a significant concentration in the trucking industry. On a geographic basis, there is not a disproportionate concentration of credit risk in any area of the U.S. or other countries where we have financial service operations. We retain as collateral an ownership interest in the equipment associated with leases and, on behalf of the various trusts we maintain, a security interest in equipment associated with wholesale notes and retail notes.

NFC finances receivables through Navistar Financial Retail Receivables Corporation (NFRRC), Navistar Financial Securities Corporation (NFSC), Truck Retail Accounts Corporation (TRAC), Truck Retail Instalment Paper Corporation (TRIP), and International Truck Leasing Corporation (ITLC), which are all special purpose, wholly-owned subsidiaries (SPEs) of NFC. In accordance with FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, these transactions are accounted for either as a sale with gain or loss recorded at the date of sale and a retained interest recorded, or as secured borrowings. We provide limited recourse for all subordinated receivables. The recourse is limited to our retained interest and relates to credit risk only.

Off-Balance Sheet Securitizations

The NFSC trust owned \$956 million of wholesale notes and \$35 million of marketable securities as of April 30, 2008 and \$1.1 billion of wholesale notes and \$85 million of marketable securities as of October 31, 2007.

Components of available wholesale note trust funding certificates related to NFSC were as follows:

| (in millions) | Maturity | As of | |
|------------------------------|---------------|-------------------|---------------------|
| | | April 30, 2008 | October 31, 2007 |
| Investor certificate | July 2008 | \$ 200 | \$ 200 |
| Investor certificate | February 2010 | 212 | 212 |
| Variable funding certificate | November 2008 | 800 | 800 |
| Total funding available | | 1,212 | 1,212 |
| Funding utilized | | (832) | (982) |

Unutilized funding

\$ 380

\$ 230

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

All of the unutilized funding is related to the variable funding certificate (VFC). Our retained interest was \$164 million and \$200 million as of April 30, 2008 and October 31, 2007, respectively.

The TRAC trust owned \$111 million of retail accounts and \$9 million of marketable securities as of April 30, 2008, and \$155 million of retail accounts and \$26 million of marketable securities as of October 31, 2007.

The amount of available retail accounts funding related to TRAC was as follows:

| (in millions) | Maturity | As of | |
|--------------------|-------------|-------------------|---------------------|
| | | April 30, 2008 | October 31, 2007 |
| Funding conduit | August 2008 | \$ 100 | \$ 100 |
| Funding utilized | | (43) | (60) |
| Unutilized funding | | \$ 57 | \$ 40 |

Our retained interest was \$76 million and \$119 million as of April 30, 2008 and October 31, 2007, respectively.

For the three months ended April 30, 2008 and 2007, proceeds from the sale of finance receivables with off balance sheet treatment were \$1.0 billion and \$1.2 billion, respectively. For the six months ended April 30, 2008 and 2007, proceeds from the sale of finance receivables with off balance sheet treatment were \$1.8 billion and \$2.8 billion, respectively.

Retained Interests

The SPEs' assets are available to satisfy their creditors' claims prior to such assets becoming available for the SPEs' own uses or to NFC or affiliated companies. NFC is under no obligation to repurchase any sold receivable that becomes delinquent in payment or otherwise is in default. The terms of receivable sales generally require NFC to provide credit enhancements in the form of excess seller's interest and/or cash reserves with the trusts and conduits. The use of such cash reserves by NFC is restricted under the terms of the securitized sales agreements. The maximum exposure under all receivable sale recourse provisions was \$240 million and \$319 million as of April 30, 2008 and October 31, 2007, respectively.

The following is a summary of amounts due from sales of receivables (retained interest):

| (in millions) | As of | |
|---|-------------------|---------------------|
| | April 30, 2008 | October 31, 2007 |
| Excess seller's interest | \$ 222 | \$ 296 |
| Interest only strip | 8 | 11 |
| Restricted cash reserves | 10 | 12 |
| Total amounts due from sales of receivables | \$ 240 | \$ 319 |

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The key economic assumptions used in valuing our retained interests are as follows:

| | As of | |
|--|-------------------|---------------------|
| | April 30, 2008 | October 31, 2007 |
| Discount rate (annual) | 10.5 to 16.5% | 10.3 to 18.8% |
| Estimated credit losses | 0 to 0.18% | 0 to 0.18% |
| Payment speed (percent of portfolio per month) | 10.0 to 75.0% | 9.9 to 69.2% |

The lower end of the discount rate assumption range and the upper end of the payment speed assumption range were used to value the retained interests in the TRAC retail account securitization. No percentage for estimated credit losses were assumed for TRAC as no losses have been incurred to date. The upper end of the discount rate assumption range and the lower end of the payment speed assumption range were used to value the retained interests in the wholesale note securitization facility.

The following tables reconcile the total serviced portfolio to NFC's on-balance sheet portfolio, net of unearned income:

| | Retail Notes | Finance Leases | Wholesale Notes | Accounts Receivable | Total |
|-------------------------------|-----------------|-------------------|--------------------|------------------------|----------|
| (in millions) | | | | | |
| As of April 30, 2008 | | | | | |
| Total portfolio | \$2,735 | \$132 | \$1,113 | \$354 | \$4,334 |
| Less: Sold receivables | | | (820) | (111) | (931) |
| Total on balance sheet | \$2,735 | \$132 | \$293 | \$243 | \$3,403 |
| As of October 31, 2007 | | | | | |
| Total portfolio | \$ 3,012 | \$ 157 | \$ 1,025 | \$ 424 | \$ 4,618 |
| Less: Sold receivables | | | (919) | (155) | (1,074) |
| Total on balance sheet | \$ 3,012 | \$ 157 | \$ 106 | \$ 269 | \$ 3,544 |

Securitization Income

The following table sets forth the activity related to off-balance sheet securitizations, which are reported in *Finance revenues*:

| | Three Months Ended April 30, | | Six Months Ended April 30, | |
|--------------------------------|---------------------------------|--------|-------------------------------|------|
| | 2008 | 2007 | 2008 | 2007 |
| (in millions) | | | | |
| Fair value adjustments | \$ 2 | \$ (1) | \$ 5 | \$ 6 |
| Excess spread income | 6 | 12 | 11 | 31 |
| Servicing fees revenue | 3 | 4 | 6 | 8 |
| Losses on sales of receivables | (4) | (2) | (7) | (5) |

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| | | | | |
|-----------------------|-------------|--------------|--------------|--------------|
| Investment revenue | 1 | 1 | 3 | 3 |
| Securitization income | \$ 8 | \$ 14 | \$ 18 | \$ 43 |

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

5. Inventories

The components of inventories are as follows:

| | As of | |
|--------------------------|-------------------|---------------------|
| (in millions) | April 30, 2008 | October 31, 2007 |
| Finished products | \$ 835 | \$ 851 |
| Work in process | 118 | 210 |
| Raw materials | 353 | 293 |
| Supplies | 58 | 58 |
| Total inventories | \$ 1,364 | \$ 1,412 |

6. Investments in and advances to non-consolidated affiliates

Investments in and advances to non-consolidated affiliates is comprised of a 49 percent ownership interest in Blue Diamond Parts (BDP), a 51 percent ownership interest in Blue Diamond Truck (BDT), and thirteen other partially-owned affiliates. We do not control these affiliates, but have the ability to exercise significant influence over their operating and financial policies. Our ownership percentages in the thirteen other affiliates range from 9.9 percent to 51 percent. Our investment in these affiliates is an integral part of our operations, and we account for them using the equity method of accounting.

Presented below is summarized financial information for BDP, which is considered a significant unconsolidated affiliate. BDP manages sourcing, merchandising, and distribution of various replacement parts. The following table summarizes results of operations information of BDP:

| | Three Months Ended April 30, | | Six Months Ended April 30, | |
|---------------------------|---------------------------------|-------|-------------------------------|--------|
| (in millions) | 2008 | 2007 | 2008 | 2007 |
| Net service revenue | \$ 57 | \$ 49 | \$ 108 | \$ 109 |
| Net expenses | 7 | 7 | 16 | 18 |
| Income before tax expense | 50 | 42 | 92 | 91 |
| Net income | 50 | 42 | 91 | 90 |

7. Debt

NFC's Revolving Credit Agreement (Credit Agreement), as amended in March 2007, has two primary components, a term loan of \$620 million and a revolving bank loan of \$800 million. The latter has a Mexican sub-revolver (\$100 million), which may be used by NIC's Mexican financial services operations.

The Credit Agreement requires both NIC and NFC to file with the SEC and provide to NFC's lenders copies of their respective Annual Reports on Form 10-K for each year, their Quarterly Reports on Form 10-Q for each of the first three quarters of each year, and the related financial statements on or before the dates specified in the Credit Agreement. Failure to do so results in a default under the Credit Agreement, during which NFC may not incur any additional indebtedness under the Credit Agreement until the default is cured or waived, and which would give

rise to a cross-default to NIC s \$1.5 billion five-year term loan facility and synthetic revolving facility.

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

NFC received a series of waivers extending through December 31, 2007, which waived any default or event of default that would result solely from NFC's and NIC's failure to meet the filing requirements of Sections 13 and 15 of the Securities Exchange Act of 1934, as amended, with respect to their Annual Reports on Form 10-K for 2005 and 2006 and certain of their Quarterly Reports on Form 10-Q.

In December 2007, NFC received a fifth waiver to the Credit Agreement extending the waiver period through November 30, 2008. This waiver expands the scope of certain reporting default conditions to include the Annual Report on Form 10-K for 2007 and the Quarterly Reports on Form 10-Q for 2008. The fifth waiver continues the 0.25% rate increase through the waiver's expiration.

In November and December 2007, NFC obtained waivers for the private retail securitizations and the VFC portion of the wholesale note securitizations. These waivers are similar in scope to the Credit Agreement waivers and expire upon the earlier of November 30, 2008, or the date on which NIC and NFC each shall have timely filed a report on Form 10-K or Form 10-Q with the SEC, which will not occur prior to filing of the Form 10-Q for the third quarter of 2008.

In February 2008 and April 2008, NFC completed separate securitization transactions for the sale of retail notes in the amount of \$536 million and \$247 million, respectively. These transactions do not qualify for sale treatment under FASB Statement No. 140 and, therefore, were recorded as secured borrowings. NFC also utilized an additional \$252 million of the bank revolving credit facility.

In March 2008, NFC received an Acknowledgement and Consent from the lenders under the Credit Agreement, whereby the filing of the audited financial statements for 2006 on a Current Report on Form 8-K filed March 6, 2008 was deemed satisfactory by the lenders.

In April 2008, NFC received a second Acknowledgement and Consent from the lenders under the Credit Agreement acknowledging that the method used in calculating various financial covenants was in accordance with the Credit Agreement.

8. Postretirement benefits

Defined Benefit Plans

Generally, our 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 and six months ended April 30, 2008, we contributed \$14 million and \$21 million, respectively, to our pension plans to meet regulatory minimum funding requirements. For the three and six months ended April 30, 2007, we contributed \$7 million and \$15 million respectively to meet minimum funding requirements. We currently anticipate additional contributions of approximately \$79 million during the remainder of 2008.

On December 16, 2007, the majority of company employees represented by the United Automobile, Aerospace and Agriculture Implement Workers of America voted to ratify a new contract that will run through September 30, 2010. Among the changes from the prior contract was the cessation of annual lump sum payments that had been made to certain retirees. We accounted for these payments as a defined benefit plan based on the historical substance of the underlying arrangement. The elimination of these payments and other changes resulted in a net settlement and curtailment of the plan resulting in income of \$42 million, which is presented as a reduction of *Selling, general and administrative expenses*, for the six months ended April 30, 2008.

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

We primarily fund other post-employment benefit (OPEB) obligations, such as retiree medical, in accordance with a 1993 legal agreement, which requires us to fund a portion of the plans' annual service cost. For the three months and six months ended April 30, 2008, we contributed \$1 million and \$2 million, respectively, to our OPEB plans to meet legal funding requirements. For the three and six months ended April 30, 2007, we contributed \$1 million and \$3 million respectively, to our OPEB plans to meet legal funding requirements. We currently anticipate additional contributions of approximately \$3 million during the remainder of 2008.

Components of Net Postretirement Benefits (Income) Expense

Net postretirement benefits (income) expense included in our consolidated statements of operations is composed 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 | |
| (in millions) | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost for benefits earned during the period | \$ 6 | \$ 6 | \$ 3 | \$ 4 | \$ 12 | \$ 13 | \$ 6 | \$ 8 |
| Interest on obligation | 56 | 55 | 28 | 28 | 112 | 110 | 57 | 56 |
| Amortization of net cumulative losses | 3 | 15 | | 5 | 7 | 30 | | 11 |
| Amortization of prior service cost (benefit) | 1 | 1 | (1) | (2) | 1 | 2 | (2) | (4) |
| Settlements and curtailments | | | | | (42) | | (1) | |
| Premiums on pension insurance | 1 | | | | 1 | | | |
| Expected return on assets | (81) | (69) | (17) | (14) | (162) | (139) | (34) | (28) |
| Net postretirement benefits (income) expense | \$ (14) | \$ 8 | \$ 13 | \$ 21 | \$ (71) | \$ 16 | \$ 26 | \$ 43 |

Defined Contribution Plans

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 account based on an age-weighted percentage of the participant's eligible compensation for the calendar year.

Defined contribution expense pursuant to these plans was \$6 million and \$12 million for each of the three months and six months ended April 30, 2008 and 2007, respectively.

9. Income taxes

Under Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*, we compute on a quarterly basis an estimated annual effective tax rate considering ordinary income and related income tax expense. Ordinary income refers to income (loss) before income tax benefit (expense) excluding significant unusual or infrequently occurring items. The tax effect of an unusual or infrequently occurring item is recorded in the interim period in which it occurs. To the extent a company cannot reliably estimate annual projected taxes

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

for a taxing jurisdiction, taxes on ordinary income for such a jurisdiction are reported in the period in which they are incurred, which is the case for our domestic tax jurisdictions. Other items included in income tax expense in the periods in which they occur include the cumulative effect of changes in tax laws or rates, foreign exchange gains and losses, and adjustments to our valuation allowance due to judgment in the realizability of deferred tax assets in future years.

We have assessed the need to maintain a valuation allowance for deferred tax assets based on an 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. Due to our recent history of U.S. operating and taxable losses, the inconsistency of U.S. profits, and the uncertainty of our U.S. financial outlook, we continue to maintain a full valuation allowance against our domestic deferred tax assets.

On November 1, 2007, we adopted FASB Interpretation No. 48, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FASB Interpretation No. 48, we may 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 should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FASB Interpretation No. 48 also provides guidance on de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods. Upon adoption, we increased our liability for unrecognized tax benefits by \$5 million, resulting in a comparable increase to *Accumulated deficit*. As of November 1, 2007, after adoption of FASB Interpretation No. 48, the amount of the liability for unrecognized tax benefits was \$107 million, \$105 million of which, if recognized, would favorably affect the income tax rate.

We continued our policy of recognizing interest and penalties related to uncertain tax positions as part of *Income tax benefit (expense)*. Total interest and penalties recognized in the consolidated balance sheet at November 1, 2007 were \$15 million.

While it is probable that the liability for unrecognized tax benefits may increase or decrease during the 12 months after adoption of FASB Interpretation No. 48, we do not expect any such change would have a material effect on our financial condition and results of operations.

We have open tax years from 1993 to 2007 with significant tax jurisdictions in the U.S., Canada, Mexico, and Brazil.

10. Fair value of financial instruments

In January 2007, we signed a definitive loan agreement for a five-year senior unsecured term loan facility and synthetic revolving facility in the aggregate principal amount of \$1.5 billion (Facilities). The Facilities were arranged by JP Morgan Chase Bank and a group of lenders that included Credit Suisse, Banc of America Securities, and Citigroup Global Markets. The Facilities are guaranteed by Navistar, Inc. The outstanding balance of the Facilities as of April 30, 2008 and October 31, 2007 was \$1.3 billion. The fair value of the Facilities as of April 30, 2008 and October 31, 2007 was \$1.2 billion and \$1.3 billion, respectively, resulting in a decline in the fair value of \$78 million over the six month period. This decline in the fair value is due to the increase in the discount rate as a result of current credit market conditions.

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

11. Financial instruments

We use derivative financial instruments as part of our overall interest rate and foreign currency risk management strategy to reduce our interest rate exposure, to potentially increase the return on invested funds, and to reduce exchange rate risk for transactional exposures denominated in currencies other than the functional currency. From time to time, we also use commodity forward contracts to manage variability related to exposure to certain commodity price risk.

Our financial services operations manage exposure to fluctuations in interest rates by limiting the amount of fixed rate assets funded with variable rate debt. This is accomplished by funding fixed rate receivables utilizing a combination of fixed rate debt and variable rate debt and derivative financial instruments. These derivative financial instruments may include interest rate swaps, interest rate caps, and forward contracts. The fair value of these instruments is estimated based on quoted market prices and is subject to market risk, as the instruments may become less valuable due to changes in market conditions or interest rates. Notional amounts of derivative financial instruments do not represent exposure to credit loss.

In connection with a sale of retail notes, our financial services operations entered into additional interest rate swap agreements during the six month period ending April 30, 2008. The purpose and structure of these swaps is to convert the floating rate portion of the asset-backed securities into fixed rate swap interest to match the interest basis of the receivables pool sold to the owner trust and to protect our financial services operations from interest rate volatility.

As of April 30, 2008, the net fair value of our derivative financial instruments was \$46 million consisting of \$49 million recorded in *Other noncurrent assets* and \$95 million in *Other noncurrent liabilities*. The net fair value of our derivatives as of October 31, 2007 was \$18 million consisting of \$20 million recorded in *Other noncurrent assets*, \$37 million in *Other noncurrent liabilities* and \$1 million in *Other current liabilities*. The maturities of these derivatives range from 2010 through 2016.

Interest expense includes mark to market (gains) losses under our interest rate swap agreements of (\$1) million and \$6 million, and \$39 million and less than \$1 million for the three month and six month periods ended April 30, 2008 and April 30, 2007, 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. As described below, we have recognized liabilities for some of these guarantees in our consolidated balance sheets as they meet the recognition and measurement provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of the Indebtedness of Others*. In addition to the liabilities that have been recognized as described below, 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 position, results of operations, or cash flows.

We have issued residual value guarantees in connection with various leases that extend through 2010. The amounts of the guarantees are estimated and recorded as liabilities, and were \$27 million as of April 30, 2008. Our guarantees are contingent upon the fair value of the leased assets at the end of the lease term.

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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. Outstanding stand-by letters of credit and surety bonds were \$49 million at April 30, 2008.

As of April 30, 2008, our Canadian operating subsidiary was contingently liable for the residual value, calculated at inception, of \$24 million of retail customers' contracts and \$47 million of retail leases that are financed by a third party. These amounts approximate the estimated future resale market value of the collateral underlying these contracts and leases at their inception. As of April 30, 2008, we have recorded accruals totaling \$5 million and \$6 million for potential losses on the retail customers' contracts and retail leases, respectively.

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. As of April 30, 2008, we have \$39 million of unused credit commitments outstanding under this program.

In addition, we have entered into various guarantees for purchase commitments, credit guarantees, and contract cancellation fees with various expiration dates through 2012 totaling \$52 million at April 30, 2008. 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 position, results of operations, or cash flows.

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 condensed 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 position, results of operations, or cash flows.

Four sites formerly owned by us, Wisconsin Steel in Chicago, Illinois, Solar Turbines in San Diego, California, West Pullman Plant in Chicago, Illinois, and the Canton Plant in Canton, Illinois, were identified as having soil and groundwater contamination. While investigations and cleanup activities continue at all sites, we believe that we have adequate accruals to cover costs to complete the cleanup of these sites.

In 2007, a former facility location in the City of Springfield, Ohio, which we voluntarily demolished in 2004 and conducted environmental sampling on, was sold to the City of Springfield. The city has obtained funds from the U.S. Environmental Protection Agency and the State of Ohio to address relatively minor soil contamination prior to commercial/industrial redevelopment of the site. Also in 2007, we engaged the City of Canton, Illinois in a remediation plan for the environmental clean-up of a former company facility. We anticipate that execution of this plan will not have a material effect on our financial position, results of operations, or cash flows.

We have accrued \$20 million and \$22 million for these environmental matters, which are included within *Other current liabilities* and *Other noncurrent liabilities*, as of April 30, 2008 and October 31, 2007,

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

respectively. As of April 30, 2008, the majority of these accrued liabilities are expected to be paid out during the period from 2008 through 2011.

Along with other vehicle manufacturers, we have been subject to an increase in the number of asbestos-related claims in recent years. In general, these claims relate to illnesses alleged to have resulted from asbestos exposure from component parts found in older vehicles, although some cases relate to the alleged presence of asbestos in our facilities. In these claims, we are not the sole defendant, and the claims name as defendants numerous manufacturers and suppliers of a wide variety of products allegedly containing asbestos. We have strongly disputed these claims, and it has been our policy to defend against them vigorously. Historically, the actual damages paid out to claimants have not been material in any year to our financial position, 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.

Legal Proceedings

Overview

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

Ford Litigation

In January 2007, a complaint was filed against us in Oakland County Circuit Court in Michigan by Ford Motor Company (Ford) claiming damages relating to warranty and pricing disputes with respect to certain engines purchased by Ford from us. While Ford 's complaint did not quantify its alleged damages, we estimate that Ford may be seeking in excess of \$500 million, and that this amount may increase (i) as we continue to sell engines to Ford at a price that Ford alleges is too high and (ii) as Ford pays its customers ' warranty claims, which Ford alleges are attributable to us. We disagree with Ford 's position and are defending ourselves vigorously in this litigation. We have filed an answer to the complaint denying Ford 's allegations in all material respects. We have also asserted affirmative defenses to Ford 's claims, as well as counterclaims alleging that, among other things, Ford has materially breached contracts between it and us in several different respects. Based on our investigation to date, we believe we have meritorious defenses to this matter. There can be no assurance, however, that we will be successful in our defense, and an adverse resolution of the lawsuit could have a material adverse effect on our results of operations, cash flows, or financial condition. In June 2007, we filed a separate lawsuit against Ford in the Circuit Court of Cook County, Illinois, for breach of contract relating to the manufacture of new diesel engines for Ford for use in vehicles including the F-150 pickup truck. In that case, we are seeking unspecified damages. In September 2007, the judge dismissed our lawsuit against Ford, directing us to proceed with mediation. In February 2008, we re-filed the lawsuit against Ford because the parties were unable to resolve the dispute through mediation.

Securities and Exchange Commission Investigations

In October 2004, we received a request from the staff of the SEC to voluntarily produce certain documents and information related to our accounting practices with respect to defined benefit pension plans and other

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

postretirement benefits. We are fully cooperating with this request. Based on the status of the inquiry, we are not able to predict the final outcome of this matter.

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

Litigation Relating to Accounting Controls and Financial Restatement

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

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

The plaintiff in the Garza case brought a derivative claim on behalf of the company against one of the company's executive officers, two of its former executive officers and certain of its directors, alleging that (i) all of the defendants violated their fiduciary obligations under Delaware law by willfully ignoring certain accounting and financial reporting problems at the company; thereby knowingly disseminating false and misleading financial information about the company, (ii) that certain of the defendants were unjustly enriched in connection with their sale of company stock during the December 2002 to January 2006 period and (iii) that defendants violated Delaware law by failing to hold an annual meeting of shareholders. In connection with this last allegation, the plaintiff seeks an order requiring defendants to schedule an annual meeting of shareholders. Otherwise, the plaintiffs in this matter seek compensatory damages, disgorgement of the proceeds of defendants' profits from the sale of company stock, attorneys' fees, and other equitable relief.

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

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 and buses under the International and IC Bus, LLC (IC) brands. We also produce chassis for motor homes and commercial step-van vehicles under the Workhorse Custom Chassis, LLC (WCC) brand. In an effort to strengthen and maintain our dealer network, this segment occasionally acquires and operates dealer locations (Dealcors) for the purpose of transitioning ownership or providing temporary operational assistance.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Our *Engine* segment designs and manufactures diesel engines for use primarily in our class 6 and 7 medium trucks and buses and selected class 8 heavy truck models, and for sale to original equipment manufacturers (OEMs) primarily in North America. In addition, we produce diesel engines in Brazil primarily for distribution in South America. Ford accounted for 54% of our diesel unit volume (including intercompany transactions) for the three months and six months ended April 30, 2008 and 59% and 58% for the same periods in 2007, respectively.

Our *Parts* segment provides customers with products needed to support the International truck, IC bus, WCC, and the MaxxForce™ engine lines, together with a wide selection of other standard truck, trailer, and engine aftermarket parts.

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

Corporate contains those items that do not fit into our four segments.

Segment Profit (Loss)

We define segment profit (loss) as adjusted earnings (loss) before income tax. Our results for interim periods are not necessarily indicative of results for a full year. Beginning in 2008, the sales from the Parts segment to the Truck segment, specifically our Dealcors, are recorded as intersegment sales, which are eliminated within Corporate and Eliminations. Previously, such sales were eliminated within the Truck segment's external sales and revenues. As such, the Parts and Truck segment sales and revenues, in the amounts of \$65 million and \$125 million for the three months and six months ended April 30, 2007, have been restated to conform to the 2008 presentation. Selected financial information is as follows:

| (in millions) | Truck | Engine | Parts | Financial Services ^(A) | Corporate and Eliminations | Total |
|--|----------|--------|--------|-----------------------------------|----------------------------|----------|
| Three Months Ended April 30, 2008 | | | | | | |
| External sales and revenues, net | \$ 2,717 | \$ 751 | \$ 385 | \$ 96 | \$ | \$ 3,949 |
| Intersegment sales and revenues | | 188 | 53 | 21 | (262) | |
| Total sales and revenues, net | \$ 2,717 | \$ 939 | \$ 438 | \$ 117 | \$ (262) | \$ 3,949 |
| Depreciation and amortization | \$ 45 | \$ 39 | \$ 2 | \$ 5 | \$ 6 | \$ 97 |
| Interest expense | | | | 67 | 35 | 102 |
| Equity in income (loss) of non-consolidated affiliates | (3) | 23 | 1 | | | 21 |
| Segment profit (loss) | 213 | 51 | 56 | 19 | (126) | 213 |
| Capital expenditures | 42 | 28 | 1 | 9 | 2 | 82 |
| Three Months Ended April 30, 2007 | | | | | | |
| External sales and revenues, net | \$ 1,896 | \$ 682 | \$ 322 | \$ 90 | \$ | \$ 2,990 |
| Intersegment sales and revenues | 2 | 90 | 65 | 35 | (192) | |
| Total sales and revenues, net | \$ 1,898 | \$ 772 | \$ 387 | \$ 125 | \$ (192) | \$ 2,990 |
| Depreciation and amortization | \$ 39 | \$ 38 | \$ 2 | \$ 5 | \$ 4 | \$ 88 |

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| | | | | | | |
|---|----|----|----|----|-------|------|
| Interest expense | | | | 78 | 53 | 131 |
| Equity in income of non-consolidated affiliates | 1 | 16 | 1 | | | 18 |
| Segment profit (loss) | 36 | 18 | 40 | 28 | (141) | (19) |
| Capital expenditures | 25 | 17 | 2 | 9 | 3 | 56 |

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

| (in millions) | Truck | Engine | Parts | Financial Services ^(A) | Corporate and Eliminations | Total |
|--|----------|----------|--------|-----------------------------------|----------------------------|----------|
| Six Months Ended April 30, 2008 | | | | | | |
| External sales and revenues, net | \$ 4,600 | \$ 1,385 | \$ 728 | \$ 190 | \$ | \$ 6,903 |
| Intersegment sales and revenues | | 340 | 111 | 43 | (494) | |
| Total sales and revenues, net | \$ 4,600 | \$ 1,725 | \$ 839 | \$ 233 | \$ (494) | \$ 6,903 |
| Depreciation and amortization | \$ 86 | \$ 76 | \$ 4 | \$ 10 | \$ 10 | \$ 186 |
| Interest expense | | | | 186 | 83 | 269 |
| Equity in income (loss) of non-consolidated affiliates | (3) | 46 | 2 | | | 45 |
| Segment profit (loss) | 234 | 85 | 105 | (6) | (247) | 171 |
| Capital expenditures | 68 | 39 | 2 | 17 | 4 | 130 |
| Six Months Ended April 30, 2007 | | | | | | |
| External sales and revenues, net | \$ 4,041 | \$ 1,286 | \$ 623 | \$ 188 | \$ | \$ 6,138 |
| Intersegment sales and revenues | 4 | 315 | 125 | 75 | (519) | |
| Total sales and revenues, net | \$ 4,045 | \$ 1,601 | \$ 748 | \$ 263 | \$ (519) | \$ 6,138 |
| Depreciation and amortization | \$ 76 | \$ 80 | \$ 4 | \$ 10 | \$ 8 | \$ 178 |
| Interest expense | | | | 146 | 96 | 242 |
| Equity in income of non-consolidated affiliates | 1 | 37 | 2 | | | 40 |
| Segment profit (loss) | 125 | 6 | 77 | 84 | (286) | 6 |
| Capital expenditures | 111 | 22 | 4 | 23 | 8 | 168 |
| As of April 30, 2008 | | | | | | |
| Segment assets | 2,724 | 2,243 | 542 | 5,446 | 659 | 11,614 |
| As of October 31, 2007 | | | | | | |
| Segment assets | 2,696 | 2,151 | 550 | 5,292 | 759 | 11,448 |

(A) Total sales and revenues in the Financial Services segment include interest revenues of \$102 million and \$200 million for the three months and six months ended April 30, 2008, respectively, and \$101 million and \$204 million for the same periods in 2007, respectively. The following are descriptions of our two customers that are greater than 10% of our consolidated *Sales and revenues, net*:

Sales of vehicles and service parts to the U.S. military were 26% and 23% of consolidated sales and revenues for the three months and six months ended April 30, 2008 and 2% for the same periods in 2007, respectively. U.S. military receivable balances totaled \$452 million and \$71 million as of April 30, 2008 and October 31, 2007, respectively.

Sales of diesel engines to Ford were 10% and 11% of consolidated sales and revenues for the three months and six months ended April 30, 2008 and 14% and 13% for the same periods in 2007, respectively. Ford receivable balances totaled \$250 million and \$245 million as of April 30, 2008 and October 31, 2007, respectively.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

14. Comprehensive income (loss)

Total comprehensive income (loss) is summarized as follows:

| (in millions) | Three Months Ended April 30, | | Six Months Ended April 30, | |
|--|---------------------------------|---------|-------------------------------|---------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income (loss) | \$ 215 | \$ (25) | \$ 162 | \$ (13) |
| Other comprehensive income (loss) | | | | |
| Foreign currency translation adjustments | 22 | 17 | 15 | 18 |
| Unrealized gains on marketable securities | | 1 | | |
| Pension amortization and settlements, net of tax | 2 | 2 | (6) | 4 |
| Total other comprehensive income | 24 | 20 | 9 | 22 |
| Total comprehensive income (loss) | \$ 239 | \$ (5) | \$ 171 | \$ 9 |

15. Earnings (loss) per share

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

| (in millions, except per share data) | Three Months Ended April 30, | | Six Months Ended April 30, | |
|--|---------------------------------|------------------|-------------------------------|------------------|
| | 2008 | 2007 | 2008 | 2007 |
| Numerator: | | | | |
| Net income (loss) available to common stockholders | \$ 215 | \$ (25) | \$ 162 | \$ (13) |
| Denominator: | | | | |
| Weighted average shares outstanding | | | | |
| Basic | 70.3 | 70.3 | 70.3 | 70.3 |
| Effect of dilutive securities Stock options | 2.9 | | 2.6 | |
| Diluted | 73.2 | 70.3 | 72.9 | 70.3 |
| Basic earnings (loss) per share | \$ 3.06 | \$ (0.36) | \$ 2.30 | \$ (0.19) |
| Diluted earnings (loss) per share | \$ 2.94 | \$ (0.36) | \$ 2.22 | \$ (0.19) |

Shares not included in the computation of diluted earnings (loss) per share, as they would be anti-dilutive, were 1.8 million and 1.2 million for the three months and six months ended April 30, 2007, respectively.

16. Condensed consolidating guarantor and non-guarantor financial information

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The following tables set forth condensed consolidating balance sheets as of April 30, 2008 and October 31, 2007, condensed consolidating statements of operations for the three months and six months ended April 30, 2008 and 2007, and condensed consolidating statements of cash flows for the six months ended April 30, 2008 and 2007. The information is presented as a result of Navistar, Inc.'s guarantee, exclusive of its subsidiaries, of NIC's indebtedness under its 7.5% Senior Notes due 2011. Navistar, Inc. is a direct wholly-owned subsidiary of NIC. None of NIC's other subsidiaries guarantee any of these notes. The guarantee is full and unconditional. Separate financial statements and other disclosures concerning Navistar, Inc. have not been presented because

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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. 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 condensed consolidated financial statements. NIC files a consolidated U.S. federal income tax return that includes Navistar, Inc. and its U.S. subsidiaries, and NIC's U.S. subsidiaries. Navistar, Inc. is party to 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 realize the benefit of current U.S. taxable losses of Navistar, Inc. and all other direct or indirect subsidiaries of NIC.

| (in millions) | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|--|--------|-------------------|-------------------------------|---------------------------|--------------|
| Condensed Consolidating Statement of Operations for the Three Months Ended April 30, 2008 | | | | | |
| Sales and revenues, net | \$ | \$ 2,048 | \$ 3,412 | \$ (1,511) | \$ 3,949 |
| Costs of products sold | | 1,840 | 2,859 | (1,503) | 3,196 |
| All other operating expenses (income) | (64) | 366 | 195 | 64 | 561 |
| Total costs and expenses | (64) | 2,206 | 3,054 | (1,439) | 3,757 |
| Equity in income (loss) of non-consolidated affiliates | 151 | 280 | 20 | (430) | 21 |
| Income (loss) before income tax | 215 | 122 | 378 | (502) | 213 |
| Income tax benefit (expense) | | (2) | 4 | | 2 |
| Net income (loss) | \$ 215 | \$ 120 | \$ 382 | \$ (502) | \$ 215 |

| (in millions) | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|--|-------|-------------------|-------------------------------|---------------------------|--------------|
| Condensed Consolidating Statement of Operations for the Six Months Ended April 30, 2008 | | | | | |
| Sales and revenues, net | \$ | \$ 3,519 | \$ 6,097 | \$ (2,713) | \$ 6,903 |
| Costs of products sold | | 3,219 | 5,111 | (2,683) | 5,647 |
| All other operating expenses (income) | (111) | 715 | 453 | 73 | 1,130 |
| Total costs and expenses | (111) | 3,934 | 5,564 | (2,610) | 6,777 |
| Equity in income (loss) of non-consolidated affiliates | 51 | 434 | 44 | (484) | 45 |
| Income (loss) before income tax | 162 | 19 | 577 | (587) | 171 |
| Income tax benefit (expense) | | (5) | (4) | | (9) |

| | | | | | |
|--------------------------|--------|-------|--------|----------|--------|
| Net income (loss) | \$ 162 | \$ 14 | \$ 573 | \$ (587) | \$ 162 |
|--------------------------|--------|-------|--------|----------|--------|

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

| (in millions) | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|---|-------------------|-------------------|-------------------------------|---------------------------|------------------|
| Condensed Consolidating Balance Sheet as of April 30, 2008 | | | | | |
| Assets | | | | | |
| Cash, cash equivalents, and marketable securities | \$ 442 | \$ 35 | \$ 971 | \$ | \$ 1,448 |
| Finance and other receivables, net | | 234 | 5,236 | 2 | 5,472 |
| Inventories | | 586 | 823 | (45) | 1,364 |
| Goodwill | | | 359 | | 359 |
| Property and equipment, net | | 824 | 1,158 | (2) | 1,980 |
| Investments in and advances to non-consolidated affiliates | (2,517) | 3,344 | 209 | (861) | 175 |
| Deferred taxes, net | 49 | 115 | (27) | (2) | 135 |
| Other | 23 | 206 | 452 | | 681 |
| Total assets | \$ (2,003) | \$ 5,344 | \$ 9,181 | \$ (908) | \$ 11,614 |
| Liabilities and stockholders equity (deficit) | | | | | |
| Debt | \$ 1,345 | \$ 345 | \$ 5,420 | \$ (226) | \$ 6,884 |
| Postretirement benefits liabilities | | 1,078 | 157 | | 1,235 |
| Amounts due to (from) affiliates | (3,362) | 5,359 | (2,055) | 58 | |
| Other liabilities | 576 | 1,300 | 2,270 | (89) | 4,057 |
| Total liabilities | (1,441) | 8,082 | 5,792 | (257) | 12,176 |
| Stockholders equity (deficit) | (562) | (2,738) | 3,389 | (651) | (562) |
| Total liabilities and stockholders equity (deficit) | \$ (2,003) | \$ 5,344 | \$ 9,181 | \$ (908) | \$ 11,614 |

| (in millions) | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|--|--------------|-------------------|-------------------------------|---------------------------|---------------|
| Condensed Consolidating Statement of Cash Flows for the Six Months Ended April 30, 2008 | | | | | |
| Net cash provided by (used in) operations | \$ 24 | \$ 414 | \$ 380 | \$ (507) | \$ 311 |
| Cash flow from investment activities | | | | | |
| Net change in restricted cash and cash equivalents | 1 | 4 | (321) | | (316) |
| Net decrease in marketable securities | (31) | | | | (31) |
| Capital expenditures | | (10) | (120) | | (130) |
| Other investing activities | 20 | (428) | 118 | 326 | 36 |
| Net cash provided by (used in) investment activities | (10) | (434) | (323) | 326 | (441) |
| Cash flow from financing activities | | | | | |
| Net borrowings (repayments) of debt | | | 69 | (58) | 11 |
| Other financing activities | | | (227) | 227 | |

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| | | | | | |
|---|--------|-------|--------|-----|--------|
| Net cash provided by (used in) financing activities | | | (158) | 169 | 11 |
| Effect of exchange rate changes on cash and cash equivalents | | | 5 | 12 | 17 |
| Cash and cash equivalents | | | | | |
| Increase (decrease) during the period | 14 | (20) | (96) | | (102) |
| At beginning of the period | 391 | 47 | 339 | | 777 |
| Cash and cash equivalents at end of the period | \$ 405 | \$ 27 | \$ 243 | \$ | \$ 675 |

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

| | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|--|---------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions) | | | | | |
| Condensed Consolidating Statement of Operations for the Three Months Ended April 30, 2007 | | | | | |
| Sales and revenues, net | \$ | \$ 1,786 | \$ 2,141 | \$ (937) | \$ 2,990 |
| Costs of products sold | | 1,605 | 1,780 | (913) | 2,472 |
| All other operating expenses (income) | (17) | 206 | 205 | 161 | 555 |
| Total costs and expenses | (17) | 1,811 | 1,985 | (752) | 3,027 |
| Equity in income (loss) of non-consolidated affiliates | (42) | (45) | 15 | 90 | 18 |
| Income (loss) before income tax | (25) | (70) | 171 | (95) | (19) |
| Income tax benefit (expense) | | (1) | (5) | | (6) |
| Net income (loss) | \$ (25) | \$ (71) | \$ 166 | \$ (95) | \$ (25) |

| | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|--|---------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions) | | | | | |
| Condensed Consolidating Statement of Operations for the Six months ended April 30, 2007 | | | | | |
| Sales and revenues, net | \$ | \$ 3,731 | \$ 4,660 | \$ (2,253) | \$ 6,138 |
| Costs of products sold | | 3,398 | 3,886 | (2,207) | 5,077 |
| All other operating expenses (income) | (14) | 576 | 414 | 119 | 1,095 |
| Total costs and expenses | (14) | 3,974 | 4,300 | (2,088) | 6,172 |
| Equity in income (loss) of non-consolidated affiliates | (29) | 152 | 36 | (119) | 40 |
| Income (loss) before income tax | (15) | (91) | 396 | (284) | 6 |
| Income tax benefit (expense) | 2 | (4) | (17) | | (19) |
| Net income (loss) | \$ (13) | \$ (95) | \$ 379 | \$ (284) | \$ (13) |

| | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|---|--------|-------------------|-------------------------------|---------------------------|--------------|
| (in millions) | | | | | |
| Condensed Consolidating Balance Sheet as of October 31, 2007 | | | | | |
| Assets | | | | | |
| Cash, cash equivalents and marketable securities | \$ 396 | \$ 60 | \$ 746 | \$ | \$ 1,202 |
| Finance and other receivables, net | | 179 | 5,253 | (13) | 5,419 |
| Inventories | | 560 | 910 | (58) | 1,412 |

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| | | | | | |
|--|-------------------|-----------------|-----------------|---------------|------------------|
| Goodwill | | | 353 | | 353 |
| Property and equipment, net | | 889 | 1,199 | (2) | 2,086 |
| Investments in and advances to non-consolidated affiliates | (2,503) | 2,239 | 149 | 269 | 154 |
| Deferred taxes, net | (1) | 171 | (19) | (1) | 150 |
| Other | 26 | 204 | 442 | | 672 |
| Total assets | \$ (2,082) | \$ 4,302 | \$ 9,033 | \$ 195 | \$ 11,448 |

Navistar International Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

| (in millions) | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|--|------------|-------------------|-------------------------------|---------------------------|--------------|
| Liabilities and stockholders equity (deficit) | | | | | |
| Debt | \$ 1,345 | \$ 390 | \$ 5,375 | \$ (229) | \$ 6,881 |
| Postretirement benefits liabilities | | 1,170 | 157 | | 1,327 |
| Amounts due to (from) affiliates | (3,272) | 4,900 | (1,657) | 29 | |
| Other liabilities | 579 | 1,291 | 2,193 | (89) | 3,974 |
| Total liabilities | (1,348) | 7,751 | 6,068 | (289) | 12,182 |
| Stockholders equity (deficit) | (734) | (3,449) | 2,965 | 484 | (734) |
| Total liabilities and stockholders equity (deficit) | \$ (2,082) | \$ 4,302 | \$ 9,033 | \$ 195 | \$ 11,448 |

| (in millions) | NIC | Navistar, Inc. | Non-Guarantor Subsidiaries | Eliminations and Other | Consolidated |
|--|----------|-------------------|-------------------------------|---------------------------|--------------|
| Condensed Consolidating Statement of Cash Flows for the Six Months Ended April 30, 2007 | | | | | |
| Net cash provided by (used in) operations | \$ (692) | \$ (479) | \$ 551 | \$ 387 | \$ (233) |
| Cash flow from investment activities | | | | | |
| Net change in restricted cash and cash equivalents | | 8 | 155 | | 163 |
| Net increase in marketable securities | 76 | | 40 | | 116 |
| Capital expenditures | | (49) | (119) | | (168) |
| Other investing activities | 197 | (138) | (132) | 68 | (5) |
| Net cash provided by (used in) investment activities | 273 | (179) | (56) | 68 | 106 |
| Cash flow from financing activities | | | | | |
| Net borrowings (repayments) of debt | (48) | 667 | (375) | (654) | (410) |
| Other financing activities | | | (199) | 199 | |
| Net cash provided by (used in) financing activities | (48) | 667 | (574) | (455) | (410) |
| Effect of exchange rate changes on cash and cash equivalents | | | 28 | | 28 |
| Cash and cash equivalents | | | | | |
| Increase (decrease) during the period | (467) | 9 | (51) | | (509) |
| At beginning of the period | 814 | 20 | 323 | | 1,157 |
| Cash and cash equivalents at end of the period | \$ 347 | \$ 29 | \$ 272 | \$ | \$ 648 |

17. Subsequent events

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In May 2008, NFC received a third Acknowledgement and Consent from the lenders under the Credit Agreement that clarified certain definitions used to measure the fixed charge coverage ratio.

In May 2008, Ford announced that it planned to reduce its pickup production levels due to current economic conditions. As a significant supplier to Ford, we in turn have lowered engine production and have initiated a temporary layoff in our Indianapolis, Indiana facility. For further discussion related to Ford see Note 12, *Commitments and contingencies*.

In June 2008, we announced that we entered into a memorandum of understanding with Caterpillar Inc. to pursue a strategic alliance in the mutual development of on-highway truck business opportunities and global truck collaboration. The strategic alliance would include the cooperative development of mid-range diesel engines and access to global distribution centers. This transaction is subject to completion of due diligence, execution of definitive agreements, and regulatory approvals.

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

Forward-Looking Statements; Risk Factors

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 (*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 the company assumes no obligation to update the information included in this report. Such forward-looking statements include information concerning our possible or assumed future results of operations, including descriptions of our business strategy. These statements often include words such as *believe*, *expect*, *anticipate*, *intend*, *plan*, *estimate* or similar expressions. These statements are not guarantees of performance and they involve risks, uncertainties and assumptions. For a further description of these factors, see Item 1A. Risk Factors included within our Form 10-K for the year ended October 31, 2007, which was filed on May 29, 2008. 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.

Management's Discussion and Analysis of Financial Condition and Results of Operations (*MD&A*) is designed to provide information that is supplemental to, and should be read together with, our consolidated financial statements and the accompanying notes contained in the *Financial Statements and Supplementary Data* section of our 2007 Annual Report on Form 10-K. Information in this Item is intended to assist the reader in obtaining an understanding of our condensed consolidated financial statements, information about our business segments and how the results of those segments impact our results of operations and financial condition as a whole, and how certain accounting principles affect the company's condensed consolidated financial statements. Our MD&A includes the following sections:

Executive Summary

Results of Operations and Segment Results of Operations

Liquidity and Capital Resources

Other Information

Critical Accounting Policies

New Accounting Pronouncements

Executive Summary

We are an international manufacturer of International brand commercial trucks, IC brand buses, MaxxForce brand diesel engines, WCC brand chassis for motor homes and step vans, and a provider of service parts for all makes of trucks and trailers. Additionally, we are a private-label designer and manufacturer of diesel engines for the pickup truck, van, and SUV markets. We also provide retail, wholesale, and lease financing of our trucks, and financing for our wholesale accounts and selected retail accounts receivable. We operate in four industry segments: Truck, Engine, Parts (referred to as our *manufacturing segments*), and Financial Services. Corporate contains those items that do not fit into our four segments. Selected financial data for each segment can be found in Note 13, *Segment reporting*, to the accompanying condensed consolidated financial statements.

Our business is heavily influenced by the overall performance of the traditional medium and heavy truck markets within U.S. and Canada, which includes vehicles in weight classes 6 through 8, including school buses. These markets are typically cyclical in nature but in certain years they have also been impacted by accelerated purchases of trucks (*pre-buy*) in anticipation of higher prices due to stricter emissions standards imposed by the U.S. Environmental Protection Agency, as was particularly evident throughout 2006. In turn, the industry has experienced corresponding periods of delayed purchases of trucks during the last three quarters of

2007 and into 2008. To minimize the impact of the traditional markets cyclical, our continuing strategy incorporates further growth in our Parts segment and an increased presence in expansion markets such as the non-U.S. military, recreational vehicle, commercial step-van and export markets. In addition within the traditional markets, we continue to focus on U.S. military growth and market share expansion to further mitigate the impact of traditional markets volatility. Furthermore, we continue to focus on improving the cost structure in our Truck and Engine segments while delivering products of distinction and evaluating opportunities to contain our legacy costs, utilize our deferred tax assets, and return to a more conventional capital structure.

We experienced a decline in unit volumes in both the Truck and Engine segments during the six month period ended April 30, 2008 compared to the same period in 2007 despite an increase in unit volumes within the Engine segment for the second quarter of 2008. Worldwide Truck segment units invoiced to customers were 27,200 (a decrease of 3.9%) and 46,500 (a decrease of 25.0%) for the quarter and the six month period ended April 30, 2008, respectively, compared to the same three month and six month periods in 2007. Total Engine segment units, which include units delivered both to OEMs and our Truck segment, were 102,500 (an increase of 8.2%) and 188,300 (a decrease of 5.3%) during the second quarter and first half of 2008, respectively, which compares to 94,700 and 198,800 in the same periods of 2007.

During the quarter ended April 30, 2008, the traditional truck retail industry, as well as the heavy duty pickup market, remained depressed, which is reflected in the 61,200 retail units sold during this period compared to 82,400 units sold in the second quarter of 2007. Total traditional truck units sold during the six month period ended April 30, 2008 amounted to 118,300 that compares to 192,000 units for the same six month period in 2007. The depressed sales in the retail truck industry did not significantly impact our total engine volumes in the second quarter of 2008 primarily due to volume growth with OEMs other than Ford. Our engine volumes increased by 7,800 units in the second quarter of 2008 when compared to the same period in 2007. Despite the continuation of the downturn experienced throughout the traditional truck markets during the second quarter of 2008, we attained consolidated net sales and revenues for the quarter and the six month period ended April 30, 2008 of \$3.9 billion and \$6.9 billion, respectively, which compares with \$3.0 billion and \$6.1 billion for the same respective periods in 2007. Growth in our U.S. military sales, the introduction of new products, competitive pricing strategies, and a slight increase in sales in our expansion markets contributed to overall sales and revenue growth during the second quarter and first half of 2008 compared to the same period in 2007. U.S. military sales included in our consolidated net sales and revenues were \$1.0 billion and \$1.6 billion in the second quarter and first half of 2008, respectively, compared to \$63 million and \$107 million for the comparable periods in 2007.

For the quarter and six month period ended April 30, 2008, we realized net income of \$215 million and \$162 million, respectively, compared to net losses of \$25 million and \$13 million for the respective periods in 2007. Our diluted earnings were \$2.94 per share for the quarter ended April 30, 2008 compared to a diluted loss of \$0.36 per share for the same period in 2007. Our diluted earnings were \$2.22 per share for the six month period ended April 30, 2008 that compares to a diluted loss of \$0.19 per share for the same period in 2007. During the second quarter and first half year of 2008, we recognized a benefit of \$2 million and incurred an expense of \$9 million, respectively, of state, local, and foreign income taxes. Included in the change in our results were the following items in the second quarter of 2008: non-cash mark to market benefit in our interest rate swap agreements of \$1 million during the second quarter of 2008 as compared to a charge of \$6 million in the same period in 2007, and professional, consulting, and auditing expenses of \$40 million in the second quarter of 2008 as compared to expense of \$41 million in the same period in 2007. Included in the change in our results were the following items in the first half of 2008: non-cash mark to market charge on our interest rate swap agreements of \$39 million during the first half of 2008 as compared to a nominal amount in the same period in 2007, professional, consulting, and auditing expenses of \$105 million in the first half of 2008 as compared to expenses of \$86 million in the same period in 2007, debt refinancing and restructuring costs of \$31 million in the first half of 2007 that did not occur in the same period in 2008, and a \$42 million reduction in postretirement expense in the first half of 2008 due to changes in our UAW agreement that did not impact the same period in 2007.

A summary of our condensed results of operations, including diluted earnings (loss) per share, is as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------|------------------|----------|
| | April 30, | | April 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| (in millions, except per share data) | | | | |
| Sales and revenues, net | \$ 3,949 | \$ 2,990 | \$ 6,903 | \$ 6,138 |
| Total costs and expenses | 3,757 | 3,027 | 6,777 | 6,172 |
| Equity in income of non-consolidated affiliates | 21 | 18 | 45 | 40 |
| Income (loss) before income tax | 213 | (19) | 171 | 6 |
| Net income (loss) | 215 | (25) | 162 | (13) |
| Diluted earnings (loss) per share | 2.94 | (0.36) | 2.22 | (0.19) |

Subsequent Event

During May 2008, Ford announced that it planned to reduce its pickup production levels due to current economic conditions. As a significant supplier to Ford, we in turn have lowered engine production and have initiated a temporary layoff in our Indianapolis, Indiana facility. A prolonged reduction in Ford's demand for our engines could have a material impact on our financial position, results of operations, or cash flows.

Results of Operations and Segment Results of Operations

The following tables summarize our consolidated statements of operations and illustrate the key financial indicators used to assess the consolidated financial results. Financial information is presented for the quarters and six month periods ended April 30, 2008 and 2007, as prepared in accordance with U.S. GAAP for interim financial information.

Results of Operations

| | Three Months Ended | | Change | Percentage Change |
|---|--------------------|-----------|---------|-------------------|
| | April 30, | | | |
| | 2008 | 2007 | | |
| (in millions, except per share data and percentage change) | | | | |
| Sales and revenues, net | \$ 3,949 | \$ 2,990 | \$ 959 | 32.1% |
| Costs of products sold | 3,196 | 2,472 | 724 | 29.3 |
| Selling, general and administrative expenses | 364 | 345 | 19 | 5.5 |
| Engineering and product development costs | 99 | 95 | 4 | 4.2 |
| Interest expense | 102 | 131 | (29) | (22.1) |
| Other income, net | (4) | (16) | 12 | N.M. |
| Total costs and expenses | 3,757 | 3,027 | 730 | 24.1 |
| Equity in income of non-consolidated affiliates | 21 | 18 | 3 | 16.7 |
| Income (loss) before income tax | 213 | (19) | 232 | N.M. |
| Income tax benefit (expense) | 2 | (6) | 8 | N.M. |
| Net income (loss) | \$ 215 | \$ (25) | \$ 240 | N.M. |
| Diluted earnings (loss) per share | \$ 2.94 | \$ (0.36) | \$ 3.30 | N.M. |

N.M. Not meaningful.

| | Six Months Ended | | Change | Percentage Change |
|---|------------------|----------------|---------|-------------------|
| | 2008 | April 30, 2007 | | |
| (in millions, except per share data and percentage change) | | | | |
| Sales and revenues, net | \$ 6,903 | \$ 6,138 | \$ 765 | 12.5% |
| Costs of products sold | 5,647 | 5,077 | 570 | 11.2 |
| Selling, general and administrative expenses | 685 | 642 | 43 | 6.7 |
| Engineering and product development costs | 181 | 198 | (17) | (8.6) |
| Interest expense | 269 | 242 | 27 | 11.2 |
| Other (income) expenses, net | (5) | 13 | (18) | N.M. |
| Total costs and expenses | 6,777 | 6,172 | 605 | 9.8 |
| Equity in income of non-consolidated affiliates | 45 | 40 | 5 | 12.5 |
| Income before income tax | 171 | 6 | 165 | N.M. |
| Income tax expense | (9) | (19) | 10 | N.M. |
| Net income (loss) | \$ 162 | \$ (13) | \$ 175 | N.M. |
| Diluted earnings (loss) per share | \$ 2.22 | \$ (0.19) | \$ 2.41 | N.M. |
| <i>Net Sales and Revenues</i> | | | | |

Our net sales and revenues are comprised of the following:

| | | Three Months Ended | | Change | Percentage Change |
|--|-----------------------|--------------------|----------------|--------|-------------------|
| | | 2008 | April 30, 2007 | | |
| (in millions, except percentage change) | | | | | |
| Sales of manufactured products, net | U.S. and Canada | \$ 3,230 | \$ 2,399 | \$ 831 | 34.6% |
| Sales of manufactured products, net | Rest of world (ROW) | 623 | 501 | 122 | 24.4 |
| Total sales of manufactured products, net | | 3,853 | 2,900 | 953 | 32.9 |
| Finance revenues | | 96 | 90 | 6 | 6.7 |
| Sales and revenues, net | | \$ 3,949 | \$ 2,990 | \$ 959 | 32.1 |

| | | Six Months Ended | | Change | Percentage Change |
|--|-----------------|------------------|----------------|--------|-------------------|
| | | 2008 | April 30, 2007 | | |
| (in millions, except percentage change) | | | | | |
| Sales of manufactured products, net | U.S. and Canada | \$ 5,567 | \$ 5,003 | \$ 564 | 11.3% |
| Sales of manufactured products, net | ROW | 1,146 | 947 | 199 | 21.0 |
| Total sales of manufactured products, net | | 6,713 | 5,950 | 763 | 12.8 |
| Finance revenues | | 190 | 188 | 2 | 1.1 |
| Sales and revenues, net | | \$ 6,903 | \$ 6,138 | \$ 765 | 12.5 |

Our Truck segment was our largest segment as measured in net sales and revenues, representing 68.8% and 63.5% of total consolidated net sales and revenues for the second quarter of 2008 and 2007, respectively, and 66.6% and 65.9% of total consolidated net sales and revenues for the six month period ended April 30, 2008 and 2007, respectively. Net sales and revenues increased within this segment by \$819 million or 43.2% during the second quarter of 2008 as compared to the same period in 2007. Net sales and revenues increased by \$555 million or 13.7% for the

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six month period ended April 30, 2008 as compared to the same period in 2007. Contributing to the increase in net sales and revenues was the growth in our U.S. military sales, the introduction

of new products, and competitive pricing strategies. While our share of retail deliveries by traditional truck class fluctuated in 2008 and 2007, the Truck segment's bus, medium and severe service classes continue to lead their markets with the greatest relative retail market share in each of their classes by brand.

Our Engine segment was our second largest segment in net sales and revenues with \$939 million and \$1.7 billion in the second quarter and first half of 2008 that compares with \$772 million and \$1.6 billion for the same respective periods in 2007. Due to the decrease in demand for heavy duty pickup trucks, engine units shipped to Ford in North America during the quarter ended April 30, 2008 decreased by 3,000 units or 5.9% compared to the prior year quarter and decreased by 15,400 units or 14.7% compared to the six month period ended April 30, 2007. The Engine segment was able to mitigate the second quarter 2008 reduction in shipments to Ford North America through growth of 22.9% or 6,600 units in the South American markets, as compared to the same period in 2007. Intersegment sales began to recover in the second quarter of 2008 as inventory levels of the pre-2007 emission compliant engines were consumed.

Our Parts segment grew net sales 13.2% and 12.2% in the quarter and six month period ended April 30, 2008 as compared to the same respective periods in 2007. This increase was primarily due to growth in our U.S. military sales and improved pricing.

Our Financial Services segment net revenues declined by 6.4% and 11.4% in the second quarter and for the first half of 2008 as compared to the same respective periods in 2007. Revenue for the first half of 2007 included additional revenue related to the financing of dealer inventory of pre-2007 emissions compliant vehicles. In the first half of 2008 we incurred a reduction of financing opportunities resulting from fewer purchases of vehicles and components due to reduced customer demand, related to higher interest rates, current tightening of the credit environment, and increased diesel fuel prices.

Costs and Expenses

The following tables summarize the key components of *Costs of products sold*:

| | Three Months Ended | | Change | Percentage Change |
|---|--------------------|----------|--------|-------------------|
| | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | |
| Costs of products sold, excluding items presented separately below | \$ 3,147 | \$ 2,417 | \$ 730 | 30.2% |
| Postretirement benefits expense allocated to costs of products sold | 5 | 12 | (7) | (58.3) |
| Product warranty costs | 44 | 43 | 1 | 2.3 |
| Total costs of products sold | \$ 3,196 | \$ 2,472 | \$ 724 | 29.3 |

| | Six Months Ended | | Change | Percentage Change |
|---|------------------|----------|--------|-------------------|
| | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | |
| Costs of products sold, excluding items presented separately below | \$ 5,550 | \$ 4,943 | \$ 607 | 12.3% |
| Postretirement benefits expense allocated to costs of products sold | 10 | 24 | (14) | (58.3) |
| Product warranty costs | 87 | 110 | (23) | (20.9) |
| Total costs of products sold | \$ 5,647 | \$ 5,077 | \$ 570 | 11.2 |

Costs of products sold increased 29.3% and 11.2% for the quarter and six month period ended April 30, 2008, respectively, as compared to the same respective periods in 2007. As a percentage of net sales of manufactured products, *Costs of products sold* decreased to 82.9% and 84.1% for the quarter and six month period ended April 30, 2008 from 85.2% and 85.3% for the same respective periods in 2007. Product warranty

costs, including extended warranty program costs and net of vendor recoveries (product warranty costs), were \$44 million and \$87 million for the second quarter and first half of 2008, respectively, and \$43 million and \$110 million for the comparable periods of 2007. Postretirement benefits expense included in *Costs of products sold*, inclusive of company 401(k) contributions, was \$5 million and \$10 million for the quarter and six month period ended April 30, 2008 that compares with \$12 million and \$24 million for the same respective periods in 2007. Apart from product warranty costs and postretirement benefits expense, *Costs of products sold* as a percentage of net sales of manufactured products decreased to 81.7% and 82.7% during the second quarter and first half of 2008 from 83.3% and 83.1% for the same respective periods in 2007. The decrease in costs of products sold as a percentage of net sales of manufactured products between the quarters and the six month periods ended April 30, 2008 and 2007 is primarily due to improved pricing and improvement in manufacturing performance offset by a decrease in production volumes and the corresponding loss of operational efficiencies and margin benefits normally associated with greater production volumes.

The product warranty costs increased by \$1 million for the three months ended April 30, 2008 and decreased by \$23 million for the six month period ended April 30, 2008 as compared to the same respective periods in 2007. The increase in the three months ended April 30, 2008 as compared to the same respective period in 2007 was primarily a result of higher volumes offset by lower costs per unit. The decrease in product warranty costs for the six months ended April 30, 2008 as compared to the same respective period in 2007 was primarily the result of lower volumes, lower per unit costs, and the impact of changes to pre-existing warranties. During the second quarter and first half of 2008, we incurred \$1 million of product warranty cost reductions and \$5 million of warranty expense associated with adjustments to pre-existing warranties compared to \$1 million and \$25 million in expense for the same respective periods in 2007. These adjustments reflect changes in our estimate of warranty costs for sales recognized in prior years associated with products at the Truck and Engine segments attributed to eliminating or rectifying warranty related issues earlier in the product life cycle. For more information regarding product warranty costs, see Note 1, *Summary of significant accounting policies*, to the accompanying condensed consolidated financial statements.

Direct material costs have been impacted by industry-wide increases in commodity and fuel prices, which affected all of our manufacturing operations. Costs related to steel, precious metals, resins, and petroleum products increased by \$13 million during the quarter ended April 30, 2008 as compared to the immediately preceding quarter and increased by \$20 million on a year to date basis. However, we generally have been able to mitigate the effects by our efforts to reduce costs through a combination of design changes, material substitution, alternative supplier resourcing, global sourcing, and price performance. We expect our direct material costs will continue to increase in the future as global demand for these commodities continue to escalate.

Selling, general and administrative expenses, including certain key items, are highlighted in the following tables:

| | Three Months Ended | | Change | Percentage Change |
|--|--------------------|----------------|--------|-------------------|
| | 2008 | April 30, 2007 | | |
| (in millions, except percentage change) | | | | |
| Selling, general and administrative expenses, excluding items presented separately below | \$ 257 | \$ 204 | \$ 53 | 26.0% |
| Professional consulting and auditing fees | 40 | 41 | (1) | (2.4) |
| Postretirement benefits (income) expense allocated to selling, general and administrative expenses | (1) | 20 | (21) | N.M. |
| Dealcor expenses | 62 | 70 | (8) | (11.4) |
| Provision for losses on receivables | 6 | 10 | (4) | (40.0) |
| Total selling, general and administrative expenses | \$ 364 | \$ 345 | \$ 19 | 5.5 |

| (in millions, except percentage change) | Six Months Ended | | Change | Percentage Change |
|--|------------------|----------------|--------|-------------------|
| | 2008 | April 30, 2007 | | |
| Selling, general and administrative expenses, excluding items presented separately below | \$ 486 | \$ 364 | \$ 122 | 33.5% |
| Professional consulting and auditing fees | 105 | 86 | 19 | 22.1 |
| Postretirement benefits (income) expense allocated to selling, general and administrative expenses | (44) | 41 | (85) | N.M. |
| Dealcor expenses | 120 | 137 | (17) | (12.4) |
| Provision for losses on receivables | 18 | 14 | 4 | 28.6 |
| Total selling, general and administrative expenses | \$ 685 | \$ 642 | \$ 43 | 6.7 |

Selling, general and administrative expenses amounted to \$364 million and \$685 million for the quarter and six month period ended April 30, 2008, respectively, that compares to \$345 million and \$642 million for the same respective periods in 2007. Our Truck segment occasionally acquires and operates dealer locations for the purpose of transitioning ownership or providing temporary operational assistance, which may increase or decrease *Selling, general and administrative expenses* in the period of acquisitions and disposals. Our ratio of *Selling, general and administrative expenses* to net sales and revenues decreased by 2.3 percentage points to 9.2% for the quarter ended April 30, 2008 as compared to 11.5% for the same period in 2007. This ratio of *Selling, general and administrative expenses* as a percentage of net sales and revenues decreased by 0.6 percentage points to 9.9% for the six month period ended April 30, 2008 compared to 10.5% for the same period in 2007. After separating the effects of professional, consulting, and auditing fees, postretirement benefits (income) expense, Dealcor expenses and provision for losses on receivables, *Selling, general and administrative expenses* as a percentage of net sales and revenues decreased from 6.8% during the quarter ended April 30, 2007 to 6.5% for the same period in 2008 but increased from 5.9% for the six month period ended April 30, 2007 to 7.0% for the same period in 2008. In addition to the above mentioned items, we have established an accrual for incentive compensation and profit-sharing in the amount of \$22 million and \$45 million for the quarter and six month period ended April 30, 2008 that compares to a nominal amount in the same periods in 2007. The remaining differences that impacted *Selling, general and administrative expenses* were increased overhead and infrastructure enhancements in support of the company's growth initiatives. It is not uncommon for *Selling, general and administrative expenses* as a percentage of net sales to increase in lower production periods and to decline in higher production periods.

Engineering and product development costs increased 4.2% during the second quarter of 2008 and decreased 8.6% during the first half of 2008 as compared to the same respective periods in 2007. *Engineering and product development costs* were primarily incurred by our Truck and Engine segments for product innovation and cost reductions, and to provide our customers with product and fuel-usage efficiencies. *Engineering and product development costs* incurred at our Engine segment increased \$8 million or 16.3% and decreased \$2 million or 2.0% during the second quarter and first half of 2008, respectively, as compared to the same respective periods in 2007. This fluctuation in costs is a result of our previously incurred efforts to develop reliable, high-quality emissions-compliant engines that we introduced in 2007 and begin developing the next generation of emission-compliant engines. Throughout the first half of 2008, we incurred lower costs associated with the development of the MaxxForce Big-Bore engine line and our emissions-compliant products. *Engineering and product development costs* incurred at the Truck segment were \$42 million and \$83 million for the second quarter and first half of 2008, which compares to the \$43 million and \$91 million incurred in the same respective periods of 2007, and relate primarily to the further development of our ProStar class 8 long-haul truck. In addition, the Truck segment also incurred costs, to a lesser extent, in 2007 related to the development and roll-out of our 2007 emissions-compliant products and the development of the LoneStar class 8 tractor.

The following tables present the amounts of postretirement benefits (income) expenses allocated between *Costs of products sold*, *Selling, general and administrative expenses*, and *Engineering and product development costs*:

| | Three Months Ended | | Change | Percentage Change |
|--|--------------------|--------------|----------------|-------------------|
| | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | |
| Postretirement benefits expense included in: | | | | |
| Costs of products sold | \$ 5 | \$ 12 | \$ (7) | (58.3%) |
| Selling, general and administrative expenses | (1) | 20 | (21) | N.M. |
| Engineering and product development costs | 1 | 3 | (2) | (66.7) |
| Total postretirement benefits expenses | \$ 5 | \$ 35 | \$ (30) | (85.7) |

| | Six Months Ended | | Change | Percentage Change |
|---|------------------|--------------|-----------------|-------------------|
| | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | |
| Postretirement benefits (income) expense included in: | | | | |
| Costs of products sold | \$ 10 | \$ 24 | \$ (14) | (58.3%) |
| Selling, general and administrative expenses | (44) | 41 | (85) | N.M. |
| Engineering and product development costs | 1 | 6 | (5) | (83.3) |
| Total postretirement benefits (income) expense | \$ (33) | \$ 71 | \$ (104) | (146.5) |

Total postretirement benefits (income) expense includes defined benefit plans (pensions and post employment benefits primarily health and life insurance) and defined contribution plans (401K contributions for active employees) as described in Note 8, *Postretirement benefits*, to the accompanying condensed consolidated financial statements.

We recognized income related to our postretirement benefits from defined benefit plans of \$1 million in the second quarter of 2008 compared to an expense of \$29 million for the same period in 2007. The \$30 million reduction in defined benefit plan expense resulted from better than expected returns and a significant reduction in the projected benefit obligation resulting from fully insuring our Medicare eligible population in our largest postretirement medical plan. Each of these actions occurred in 2007 and represent variances from prior actuarial estimates. These variances significantly reduced the cumulative loss pool during 2007. Such costs amortize into income in the subsequent years as a component of postretirement benefits (income) expense. Amortization of the loss pool for pension and health and welfare plans was \$3 million in the second quarter of 2008 compared to \$21 million for the same period in 2007. Additionally, the growth in the asset base from the better than expected returns during 2007 had the effect of increasing the expected return on plan assets in 2008 (another component of postretirement benefits (income) expense). The expected return on plan assets for pension and health and welfare plans in the first quarter of 2008 was \$98 million compared to \$83 million for the same period in 2007. See Note 8, *Postretirement benefits*, of the condensed consolidated financial statements for further information on postretirement benefits.

We recognized income related to our postretirement benefits from defined benefit plans of \$45 million in the six months ended April 30, 2008 compared to an expense of \$59 million for the same period in 2007. On December 16, 2007 the majority of company employees represented by the United Automobile, Aerospace and Agriculture Implement Workers of America voted to ratify a new contract that will run through September 30, 2010. Among the changes from the prior contract was the cessation of annual lump sum payments that had been made to certain retirees. We previously accounted for these payments as a defined benefit plan based on the historical substance of the underlying arrangement. The elimination of these payments and other changes resulted in a net settlement and curtailment of the plan resulting in income of \$42 million for the three months ended January 31, 2008.

Excluding the effects of the plan settlement and curtailment described above, postretirement benefits income from defined benefit plans was \$3 million in the six months ended April 30, 2008. The \$62 million reduction in defined benefit plan expense resulted from better than expected returns and a significant reduction in the projected benefit obligation resulting from fully insuring our Medicare eligible population in our largest postretirement medical plan. Each of these actions took place in 2007 and represent variances from prior actuarial estimates. These variances significantly reduced the cumulative loss pool during 2007. Such costs amortize into income in the subsequent years as a component of postretirement benefits (income) expense. Amortization of the loss pool for pension and health and welfare plans was \$7 million for the six months ended April 30, 2008 compared to \$41 million for the same period in 2007. Additionally, the growth in the asset base from the better than expected returns during 2007 had the effect of increasing the expected return on plan assets in 2008 (another component of postretirement benefits (income) expense). The expected return on plan assets for pension and health and welfare plans for the six months ended April 30, 2008 was \$196 million compared to \$167 million for the same period in 2007. See Note 8, *Postretirement benefits*, of the condensed consolidated financial statements for further information on postretirement benefits.

Postretirement benefits expense resulting from the defined contribution plans was \$6 million and \$12 million for each of the three months and six months ended April 30, 2008 and 2007, respectively.

The following tables represent the components of *Interest expense*:

| (in millions, except percentage change) | Three Months Ended | | Change | Percentage Change |
|--|--------------------|----------------|---------|-------------------|
| | 2008 | April 30, 2007 | | |
| Manufacturing operations debt | \$ 35 | \$ 53 | \$ (18) | (34.0%) |
| Financial Services operations debt | 68 | 72 | (4) | (5.6) |
| Non-cash mark to market charge (income) in our interest rate swap agreements | (1) | 6 | (7) | N.M. |
| Total Interest expense | \$ 102 | \$ 131 | \$ (29) | (22.1) |

| (in millions, except percentage change) | Six Months Ended | | Change | Percentage Change |
|--|------------------|----------------|---------|-------------------|
| | 2008 | April 30, 2007 | | |
| Manufacturing operations debt | \$ 83 | \$ 96 | \$ (13) | (13.5%) |
| Financial Services operations debt | 147 | 147 | | |
| Non-cash mark to market charge (income) in our interest rate swap agreements | 39 | (1) | 40 | N.M. |
| Total Interest expense | \$ 269 | \$ 242 | \$ 27 | 11.2 |

The overall decrease in the three month period ended April 30, 2008 was primarily due to a decrease in interest rates and lower debt balances. The overall increase for the six month period ended April 30, 2008 was primarily due to non-cash mark to market adjustments in our interest rate swap agreements in the Financial Services segment and offset by a decrease in interest rates and lower debt balances. For more information, see Note 10, *Debt*, included in the Annual report on Form 10-K for 2007 and see Note 11, *Financial instruments* to the accompanying condensed consolidated financial statements.

Other (income) expenses, net amounted to \$4 million and \$5 million of other income for the quarter and six month period ended April 30, 2008, respectively, and compares with \$16 million of other income and \$13 million of other expense for the quarter and six month period ended April 30, 2007, respectively. *Other (income) expenses, net* includes \$31 million of expenses related to the early extinguishment of debt in the first six months

of 2007, which did not recur in 2008. Excluding the expenses related to the early retirement of debt in 2007, interest income earned of \$10 million and \$23 million for the three month and six month periods ended April 30, 2008, respectively, compares to \$11 million and \$28 million for the comparable three month and six month periods ended April 30, 2007, respectively, and was primarily offset by other miscellaneous expenses.

Equity in income of non-consolidated affiliates

Income and losses reported in *Equity in income of non-consolidated affiliates* are derived from our ownership interest in BDP, BDT, and thirteen other partially-owned affiliates. We reported \$21 million and \$45 million of income for the quarter and six month period ended April 30, 2008 as compared to \$18 million and \$40 million for the quarter and six month period ended April 30, 2007 with a majority of the income throughout these periods being derived from BDP. For more information, see Note 6, *Investments in and advances to non-consolidated affiliates*, to the accompanying condensed consolidated financial statements.

Income tax benefit (expense)

Income tax benefit (expense) was a benefit of \$2 million and an expense of \$9 million for the second quarter and first half of 2008 as compared to \$6 million and \$19 million of expense for the comparable periods in 2007. Our income tax expense each quarter is affected by various items, including deferred tax asset valuation allowances, research and development credits, Medicare reimbursements, and other items. We record income tax expense on domestic operations for current state income taxes and other items which amounted to a benefit of \$8 million in the second quarter of 2008. We currently have \$1.0 billion of U.S. net operating losses as of October 31, 2007. For so long as we are able to offset our current taxable income by these net operating losses, we believe that our cash payment of U.S. taxes will be minimal. For additional information, see Note 9, *Income taxes*, to the accompanying condensed consolidated financial statements.

Net income (loss) and Diluted earnings (loss) per share

For the quarter and six month period ended April 30, 2008, we recorded net income of \$215 million and \$162 million, respectively, which compares to net losses of \$25 million and \$13 million for the quarter and six month period ended April 30, 2007, respectively. Diluted earnings for the quarter and six month period ended April 30, 2008 was \$2.94 and \$2.22 per share, respectively, calculated on approximately 73.2 and 72.9 million shares, respectively. For the quarter and six month period ended April 30, 2007, our diluted loss was \$0.36 and \$0.19 per share, respectively, calculated on approximately 70.3 million shares, respectively. Diluted shares reflect the impact of common stock options in accordance with the treasury stock method.

Segment Results of Operations

We define segment profit (loss) as adjusted income (loss) before income tax. Our results for interim periods are not necessarily indicative of results for a full year. Beginning in 2008, the sales from the Parts segment to the Truck segment, specifically our Dealcors, are recorded as intersegment sales, which are eliminated within Corporate and Eliminations. Previously, such sales were eliminated within the Truck segment's external sales and revenues. As such, the Parts and Truck segments sales and revenues in the amounts of \$65 million and \$125 million for the three months and six months ended April 30, 2007, respectively, have been restated to conform to the 2008 presentation. The following sections analyze operating results as they relate to our four industry segments.

Truck Segment

The following tables summarize our Truck segment's financial and key operating results:

| | Three Months Ended | | Change | Percentage Change |
|--|--------------------|----------------|--------|-------------------|
| | 2008 | April 30, 2007 | | |
| (in millions, except percentage change) | | | | |
| Segment sales | \$ 2,717 | \$ 1,898 | \$ 819 | 43.2% |
| Segment profit | 213 | 36 | 177 | 491.7 |

| | Six Months Ended | | Change | Percentage Change |
|--|------------------|----------------|--------|-------------------|
| | 2008 | April 30, 2007 | | |
| (in millions, except percentage change) | | | | |
| Segment sales | \$ 4,600 | \$ 4,045 | \$ 555 | 13.7% |
| Segment profit | 234 | 125 | 109 | 87.2 |

Chargeouts are defined by management as trucks that have been invoiced to customers with units held in dealer inventory primarily representing the difference between retail deliveries and chargeouts. The following tables reflect our chargeouts in units.

| | Three Months Ended | | Change | Percentage Change |
|--|--------------------|----------------|----------------|-------------------|
| | 2008 | April 30, 2007 | | |
| Traditional Markets (U.S. and Canada) | | | | |
| School buses | 3,300 | 4,100 | (800) | (19.5%) |
| Class 6 and 7 medium trucks | 6,300 | 6,800 | (500) | (7.4) |
| Class 8 heavy trucks | 3,900 | 4,500 | (600) | (13.3) |
| Class 8 severe service trucks ^(A) | 5,400 | 3,700 | 1,700 | 45.9 |
| Sub-total combined class 8 trucks | 9,300 | 8,200 | 1,100 | 13.4 |
| Total Traditional Markets | 18,900 | 19,100 | (200) | (1.0) |
| Total Expansion Markets | 8,300 | 9,200 | (900) | (9.8) |
| Total Worldwide Units | 27,200 | 28,300 | (1,100) | (3.9) |

(A) Includes 2,000 and 400 units in the three months ended April 30, 2008 and 2007, respectively, related to U.S. military contracts.

| | Six Months Ended | | Change | Percentage Change |
|--|------------------|----------------|---------|-------------------|
| | 2008 | April 30, 2007 | | |
| Traditional Markets (U.S. and Canada) | | | | |
| School buses | 6,400 | 7,500 | (1,100) | (14.7%) |
| Class 6 and 7 medium trucks | 10,000 | 16,500 | (6,500) | (39.4) |
| Class 8 heavy trucks | 6,500 | 11,500 | (5,000) | (43.5) |
| Class 8 severe service trucks ^(B) | 9,100 | 7,900 | 1,200 | 15.2 |
| Sub-total combined class 8 trucks | 15,600 | 19,400 | (3,800) | (19.6) |

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| | | | | |
|----------------------------------|---------------|--------|----------|--------|
| Total Traditional Markets | 32,000 | 43,400 | (11,400) | (26.3) |
| Total Expansion Markets | 14,500 | 18,600 | (4,100) | (22.0) |
| Total Worldwide Units | 46,500 | 62,000 | (15,500) | (25.0) |

(B) Includes 3,300 and 700 units in the six months ended April 30, 2008 and 2007, respectively, related to U.S. military contracts.

Truck Segment Sales

| | | Three Months Ended April 30, | | Change | Percentage Change |
|--|-----------------|---------------------------------|-----------------|---------------|----------------------|
| | | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | | |
| Truck segment sales of manufactured products, net | U.S. and Canada | \$ 2,418 | \$ 1,612 | \$ 806 | 50.0% |
| Truck segment sales of manufactured products, net | ROW | 299 | 286 | 13 | 4.5 |
| Total truck segment sales of manufactured products, net | | \$ 2,717 | \$ 1,898 | \$ 819 | 43.2 |

| | | Six Months Ended April 30, | | Change | Percentage Change |
|--|-----------------|-------------------------------|-----------------|---------------|----------------------|
| | | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | | |
| Truck segment sales of manufactured products, net | U.S. and Canada | \$ 4,031 | \$ 3,478 | \$ 553 | 15.9% |
| Truck segment sales of manufactured products, net | ROW | 569 | 567 | 2 | 0.4 |
| Total truck segment sales of manufactured products, net | | \$ 4,600 | \$ 4,045 | \$ 555 | 13.7 |

During the three months and six months ended April 30, 2008, the Truck segment's net sales increased from the same respective periods in 2007 primarily due to growth in U.S. military sales, new truck pricing performance, and a slight increase in our expansion markets.

We observed that the traditional markets began to experience a downturn at the end of our first quarter of 2007 and continued into the first half of 2008. Strongly influencing this downturn was the industry-wide increase in demand for vehicles containing the pre-2007 emissions-compliant engines ahead of the implementation of stricter engine emissions requirements which accounts for the majority of the change between our second quarter and first half of 2008 and 2007, respectively. Traditional industry retail units delivered in the three months and six months ended April 30, 2008 amounted to 61,200 and 118,300 retail units, respectively, and were 25.7% and 38.4% less than the same respective periods in 2007 of 82,400 and 192,000 industry retail units. Traditional market retail deliveries for the three and six months ended April 30, 2008 and 2007 are categorized by relevant class in the tables below. The Truck segment traditional retail units sold declined by 2,800 and 13,500 units during the second quarter and first half of 2007, respectively, or a 13.5% and 28.2% reduction, respectively.

The following tables summarize industry retail deliveries, in the traditional truck markets in the U.S. and Canada, in units, according to Wards Communications and R.L. Polk & Co.:

| | | Three Months Ended April 30, | | Change | Percentage Change |
|--|--|---------------------------------|---------------|-----------------|----------------------|
| | | 2008 | 2007 | | |
| Traditional Markets (U.S. and Canada) | | | | | |
| School buses | | 5,800 | 6,800 | (1,000) | (14.7%) |
| Class 6 and 7 medium trucks | | 16,300 | 22,800 | (6,500) | (28.5) |
| Class 8 heavy trucks | | 24,600 | 37,700 | (13,100) | (34.7) |
| Class 8 severe service trucks | | 14,500 | 15,100 | (600) | (4.0) |
| Sub-total combined class 8 trucks | | 39,100 | 52,800 | (13,700) | (25.9) |
| Total Traditional Truck Markets | | 61,200 | 82,400 | (21,200) | (25.7) |

| | Six Months Ended | | Change | Percentage Change |
|--|------------------|----------------|-----------------|-------------------|
| | 2008 | April 30, 2007 | | |
| Traditional Markets (U.S. and Canada) | | | | |
| School buses | 11,200 | 12,500 | (1,300) | (10.4%) |
| Class 6 and 7 medium trucks | 30,900 | 49,800 | (18,900) | (38.0) |
| Class 8 heavy trucks | 48,700 | 94,600 | (45,900) | (48.5) |
| Class 8 severe service trucks | 27,500 | 35,100 | (7,600) | (21.7) |
| Sub-total combined class 8 trucks | 76,200 | 129,700 | (53,500) | (41.2) |
| Total Traditional Truck Markets | 118,300 | 192,000 | (73,700) | (38.4) |

The following tables summarize our retail delivery market share percentages based on market-wide information from Wards Communications and R.L. Polk & Co.:

| | Three Months Ended | |
|---|--------------------|----------------|
| | 2008 | April 30, 2007 |
| Traditional Markets (U.S. and Canada) | | |
| School buses | 56.9% | 60.3% |
| Class 6 and 7 medium trucks | 35.0 | 34.2 |
| Class 8 heavy trucks | 15.0 | 12.2 |
| Class 8 severe service trucks | 35.9 | 27.8 |
| Sub-total combined class 8 trucks | 22.8 | 16.7 |
| Total Traditional Truck Markets | 29.2 | 25.1 |
| Impact of excluding U.S. military deliveries | | |
| Class 8 severe service trucks, exclusive of U.S. military deliveries | 25.6 | 25.9 |
| Sub-total combined class 8 trucks, exclusive of U.S. military deliveries | 18.6 | 16.0 |
| Total Traditional Truck Markets, exclusive of U.S. military deliveries | 26.9 | 24.8 |

| | Six Months Ended | |
|---|------------------|----------------|
| | 2008 | April 30, 2007 |
| Traditional Markets (U.S. and Canada) | | |
| School buses | 57.1% | 60.0% |
| Class 6 and 7 medium trucks | 34.3 | 35.5 |
| Class 8 heavy trucks | 15.4 | 14.4 |
| Class 8 severe service trucks | 35.6 | 25.6 |
| Sub-total combined class 8 trucks | 22.7 | 17.4 |
| Total Traditional Truck Markets | 29.0 | 24.9 |
| Impact of excluding U.S. military deliveries | | |
| Class 8 severe service trucks, exclusive of U.S. military deliveries | 26.9 | 24.1 |
| Sub-total combined class 8 trucks, exclusive of U.S. military deliveries | 19.2 | 17.0 |
| Total Traditional Truck Markets, exclusive of U.S. military deliveries | 27.0 | 24.6 |

For the three months and six months ended April 30, 2008, our school bus, class 6 and 7 medium, and class 8 severe service classes all led their markets with the greatest retail market share in each of their classes by brand. Our continuing strategy is to maintain and grow these market share positions at our required margins while aggressively pursuing market share gains in the heavy truck class, the class in which we have the lowest market share. We demonstrated our long-term commitment to the heavy truck market through our 2007 introduction of the ProStar class 8 long-haul truck. Additionally, we recently unveiled our new LoneStar class 8 tractor to the public at the Chicago International Auto Show in February 2008.

Our class 8 heavy truck market share rose by 2.8 and 1.0 percentage points for the three months and six months ended April 30, 2008, respectively, compared to the same periods in 2007, due to our reengagement in this class with new models, re-established scale, and increased supplier relationships. Market share in the school bus class was 56.9% and 57.1% for the three months and six months ended April 30, 2008, respectively, and 60.3% and 60.0% for the same respective periods in 2007 and was primarily attributable to our distribution strategy and our on-going efforts to further engage and support our dealer and customer networks. Market share in the school bus class declined over the reporting period as a result of competitive pricing strategies and our desire to collect for the intrinsic value of our product. Market share in class 6 and 7 medium increased to 35.0% from 34.2% during the second quarter of 2008 and was down slightly during the first half of 2008. We have been able to mitigate the impact of new entrants into this class and discount programs instituted by our competitors. Our severe service class market share increased 8.1 and 10.0 percentage points during the second quarter and first half of 2008, respectively, as compared to market share of 27.8% and 25.6% for the three months and six months ended April 30, 2007, due to our growth in U.S. military deliveries offsetting the industry downturn in residential and non-residential construction and federal transportation spending.

Net sales grew during the second quarter and first half of 2008 in our expansion markets, which include Mexico, international export, non-U.S. military, recreational vehicle, commercial step-van, and other truck and bus classes. Products such as the Low-Cab Forward vehicle, class 4 and 5 small bus, and our recreational vehicle products, as well as our entrance into the non-U.S. military market contributed to incremental sales within these quarters in addition to our traditional markets. It is our goal to continue to diversify into these expansion markets in future periods. The Mexican truck market increased 5.4% and decreased 13.0% in the three months and six months ended April 30, 2008, respectively, compared to the same respective periods in 2007. The enactment of a new tax on inventory of Mexican dealers' inventory as of December 31, 2007 deterred dealers from holding inventory as of calendar year end resulting in higher competitive discounts which impacted the industry and our market share. Our Mexican truck market share was 33.0% and 31.5% for the quarters ended April 30, 2008 and 2007, respectively, and 31.7% and 36.2% for the six months ended April 30, 2008 and 2007, respectively.

Truck segment costs and expenses

| | Three Months Ended | | | Percentage Change |
|---|--------------------|----------|--------|-------------------|
| | April 30, | | Change | |
| (in millions, except percentage change) | 2008 | 2007 | | |
| Costs of products sold, excluding items presented separately below | \$ 2,260 | \$ 1,630 | \$ 630 | 38.7% |
| Postretirement benefits expense allocated to costs of products sold | 4 | 9 | (5) | (55.6) |
| Product warranty costs | 32 | 26 | 6 | 23.1 |
| Total costs of products sold | \$ 2,296 | \$ 1,665 | \$ 631 | 37.9 |

| | Six Months Ended | | | Percentage Change |
|---|------------------|----------|--------|-------------------|
| | April 30, | | Change | |
| (in millions, except percentage change) | 2008 | 2007 | | |
| Costs of products sold, excluding items presented separately below | \$ 3,890 | \$ 3,417 | \$ 473 | 13.8% |
| Postretirement benefits expense allocated to costs of products sold | 9 | 18 | (9) | (50.0) |
| Product warranty costs | 59 | 71 | (12) | (16.9) |
| Total costs of products sold | \$ 3,958 | \$ 3,506 | \$ 452 | 12.9 |

Our *Costs of products sold* decreased to 84.5% and 86.0% during the second quarter and first half of 2008, respectively, from 87.7% and 86.7% during the same respective periods in 2007 as a percentage of net sales of

manufactured products. Product warranty costs are included in *Costs of products sold*. Generally, we offer one- to five-year warranty coverage for our trucks, although the terms and conditions can vary. In addition, in an effort to strengthen and grow relationships with our customer base, we may incur warranty costs for claims that are outside of the contractual obligation period. Product warranty costs at the Truck segment were 1.4% and 1.5% of Truck segment's costs of products sold for the three months and six months ended April 30, 2008, respectively, compared to 1.6% and 2.0% of Truck segment's costs of products sold for the same respective periods in 2007. We accrue warranty related costs under standard warranty terms and for claims that we may choose to pay as an accommodation to our customers even though we are not contractually obligated to do so (out-of-policy). Our warranty cost declined as a result of a reduction in truck shipments for the three month and six month periods ended April 30, 2008, respectively, as compared to the same respective periods of 2007. In addition, quality improvements, a decrease in pre-existing warranty costs of \$3 million and \$12 million during the second quarter and first half of 2008, and reduced levels of out-of-policy claims have allowed us to mitigate our warranty cost for the second quarter and first half of 2008. Our *Costs of products sold* as a percentage of net sales of manufactured products, exclusive of product warranty costs and postretirement benefits expenses, decreased by 2.7 percentage points for the second quarter of 2008 compared to the same period in 2007 primarily due to improved pricing and operating efficiency. Our *Costs of products sold* as a percentage of net sales of manufactured products, exclusive of product warranty costs and postretirement benefits expense, increased by 0.1 percentage points for the first half of 2008 compared to the same period in 2007 primarily due to improved pricing mitigating the impact of lower volumes and the associated decline in operating efficiency.

| | Three Months Ended | | Change | Percentage Change |
|---|--------------------|---------------|---------------|-------------------|
| | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | |
| Selling, general and administrative expenses, excluding items presented separately below | \$ 92 | \$ 79 | \$ 13 | 16.5% |
| Postretirement benefits expense allocated to selling, general and administrative expenses | | 2 | (2) | (100.0) |
| Dealcor expenses | 62 | 70 | (8) | (11.4) |
| Provision for losses on receivables | (2) | 3 | (5) | (166.7) |
| Total selling, general and administrative expenses | \$ 152 | \$ 154 | \$ (2) | (1.3) |

| | Six Months Ended | | Change | Percentage Change |
|---|------------------|---------------|-----------|-------------------|
| | 2008 | 2007 | | |
| (in millions, except percentage change) | | | | |
| Selling, general and administrative expenses, excluding items presented separately below | \$ 178 | \$ 155 | \$ 23 | 14.8% |
| Postretirement benefits expense allocated to selling, general and administrative expenses | | 4 | (4) | (100.0) |
| Dealcor expenses | 120 | 137 | (17) | (12.4) |
| Provision for losses on receivables | 3 | 5 | (2) | (40.0) |
| Total selling, general and administrative expenses | \$ 301 | \$ 301 | \$ | |

The Truck segment's *Selling, general and administrative expenses* were \$152 million and \$154 million for the quarters ended April 30, 2008 and 2007, respectively and amounted to \$301 million for both the six months ended April 30, 2008 and 2007. Our relative ratio of *Selling, general and administrative expenses* to net sales and revenues, exclusive of postretirement benefits expense, Dealcor expenses and provision for losses on receivables decreased to 3.4% from 4.2% for the three month periods ended April 30, 2008 and 2007, respectively, but slightly increased to 3.9% compared to 3.8% for the six month periods ended April 30, 2008 and 2007, respectively. *Selling, general and administrative expenses* for the Truck segment include expenses attributable to segment overhead and infrastructure enhancements in support of sales activity.

For the three month and six month periods ended April 30, 2008, the Truck segment's *Engineering and product development costs* approximated \$42 million and \$83 million, respectively, which compares to \$43 million and \$91 million for the same respective periods in 2007.

Approximately half of our total consolidated *Engineering and product development costs* were incurred at the Truck segment during the three months and six months ended April 30, 2008 and 2007, respectively. During this time, our top developmental priority was establishing our ProStar and LoneStar class 8 long-haul trucks and redeveloping our emissions-compliant vehicles, both of which required significant labor, material, outside engineering, and prototype tooling. Besides innovation, we also focus resources on continuously improving our existing products as a means of streamlining our manufacturing process, minimizing warranty costs, and providing our customers with product and fuel-usage efficiencies.

Truck segment profit

The Truck segment increased profitability for the quarter and six month period ended April 30, 2008 by \$177 million and \$109 million, respectively, to \$213 million and \$234 million, respectively, compared to \$36 million and \$125 million for the comparable periods in 2007. This increase in profitability for the three months and six months ended April 30, 2008 was primarily attributable to growth in our U.S. military sales, new truck pricing performance, and improved operational efficiencies.

Engine Segment

The following tables summarize our Engine segment's financial results and sales data:

| (in millions) | Three Months Ended April 30, | | Change | Percentage Change |
|-------------------------------|---------------------------------|--------|--------|----------------------|
| | 2008 | 2007 | | |
| Segment sales | \$ 939 | \$ 772 | \$ 167 | 21.6% |
| Segment profit | 51 | 18 | 33 | 183.3 |
| Sales data (in units): | | | | |
| Ford sales | 55,300 | 56,200 | (900) | (1.6) |
| Other OEM sales | 31,400 | 26,400 | 5,000 | 18.9 |
| Intercompany sales | 15,800 | 12,100 | 3,700 | 30.6 |
| Total sales | 102,500 | 94,700 | 7,800 | 8.2 |

| (in millions) | Six Months Ended April 30, | | Change | Percentage Change |
|-------------------------------|-------------------------------|----------|----------|----------------------|
| | 2008 | 2007 | | |
| Segment sales | \$ 1,725 | \$ 1,601 | \$ 124 | 7.7% |
| Segment profit | 85 | 6 | 79 | N.M. |
| Sales data (in units): | | | | |
| Ford sales | 102,300 | 116,200 | (13,900) | (12.0) |
| Other OEM sales | 57,300 | 47,400 | 9,900 | 20.8 |
| Intercompany sales | 28,700 | 35,200 | (6,500) | (18.5) |
| Total sales | 188,300 | 198,800 | (10,500) | (5.3) |

Engine segment sales

| | | Three Months Ended April 30, | | | Percentage Change |
|--|-----------------|---------------------------------|--------|--------|----------------------|
| | | 2008 | 2007 | Change | |
| (in millions, except percentage change) | | | | | |
| Engine segment sales of manufactured products, net | U.S. and Canada | \$ 641 | \$ 579 | \$ 62 | 10.7% |
| Engine segment sales of manufactured products, net | ROW | 298 | 193 | 105 | 54.4 |
| Total engine segment sales of manufactured products, net | | \$ 939 | \$ 772 | \$ 167 | 21.6 |

| | | Six Months Ended April 30, | | | Percentage Change |
|--|-----------------|-------------------------------|----------|---------|----------------------|
| | | 2008 | 2007 | Change | |
| (in millions, except percentage change) | | | | | |
| Engine segment sales of manufactured products, net | U.S. and Canada | \$ 1,195 | \$ 1,262 | \$ (67) | (5.3%) |
| Engine segment sales of manufactured products, net | ROW | 530 | 339 | 191 | 56.3 |
| Total engine segment sales of manufactured products, net | | \$ 1,725 | \$ 1,601 | \$ 124 | 7.7 |

The Engine segment continues to be our second largest segment as measured in net sales and revenues, representing 23.8% and 25.0% of total consolidated net sales and revenues for the three months and six months ended April 30, 2008, respectively, compared to 25.8% and 26.1% of total consolidated net sales and revenues for the same respective periods in 2007. The Engine segment experienced an increase in net sales for the three months and six months ended April 30, 2008 compared to the same respective periods in 2007. The primary drivers in the second quarter of 2008 were increased ROW volumes and improved pricing. In the first half of 2008, the decreased product volume in U.S. and Canada, primarily Ford, was greatly offset by increased ROW volumes and improved pricing. Volume reductions in our second quarter are primarily attributable to our largest diesel engine customer, Ford. This was the result of Ford reducing its purchasing requirements as a result of higher diesel fuel prices which impacted customer demand for the heavy duty pick up trucks. Sales of engines to Ford represented 54.0% and 54.3% of our unit volume for the second quarter and first half of 2008, respectively, compared to 59.3% and 58.5% of our unit volume for the same respective periods in 2007.

Sales to non-Ford customers, including intercompany sales, increased approximately 8,700 and 3,400 units during the second quarter and first half of 2008 compared to the same respective periods in 2007 largely attributed to the increase in South American volumes and recovery of truck sales.

Engine segment costs and expenses

| | | Three Months Ended April 30, | | | Percentage Change |
|---|--|---------------------------------|--------|--------|----------------------|
| | | 2008 | 2007 | Change | |
| (in millions, except percentage change) | | | | | |
| Costs of products sold, excluding items presented separately below | | \$ 828 | \$ 684 | \$ 144 | 21.1% |
| Postretirement benefits expense allocated to costs of products sold | | 1 | 5 | (4) | (80.0) |
| Product warranty costs | | 11 | 12 | (1) | (8.3) |
| Total costs of products sold | | \$ 840 | \$ 701 | \$ 139 | 19.8 |

| (in millions, except percentage change) | Six Months Ended | | Change | Percentage Change |
|--|------------------|----------------|--------|-------------------|
| | 2008 | April 30, 2007 | | |
| Costs of products sold, excluding items presented separately below | \$ 1,534 | \$ 1,452 | \$ 82 | 5.6% |
| Postretirement benefits expenses allocated to costs of products sold | 1 | 10 | (9) | (90.0) |
| Product warranty costs | 26 | 41 | (15) | (36.6) |
| Total costs of products sold | \$ 1,561 | \$ 1,503 | \$ 58 | 3.9 |

For the three months ended April 30, 2008, *Costs of products sold* as a percentage of net sales of manufactured products decreased to 89.5% compared to 90.8% for the same period in 2007. The decrease of 1.3 percentage points for the three months ended April 30, 2008 compared to the corresponding period in 2007 is primarily attributable to the increased production volumes and the corresponding gain of operational efficiencies and increased selling prices. For the six months ended April 30, 2008, *Costs of products sold* as a percentage of net sales of manufactured products decreased to 90.5% compared to 93.9% for the same period in 2007. The decrease of 3.4 percentage points for the six months ended April 30, 2008 compared to the corresponding period in 2007 is primarily attributable to improved manufacturing performance as a result of the change over in production to the 2007 emissions-compliant engines and increased selling prices.

Product warranty costs for the three months and six months ended April 30, 2008 approximated 1.3% and 1.7% of the Engine segment's cost of product sold compared to 1.7% and 2.7% of the Engine segment's cost of product sold for the same respective periods of 2007. The decrease in product warranty costs at the Engine segment was attributable to a combination of lower per unit costs and a charge to pre-existing warranty in 2007 that did not recur in 2008. The reduction in pre-existing warranty was nominal for the second quarter and \$10 million for the first half of 2008 compared to the same periods in 2007. Progressive improvements in product warranty costs were also achieved by focusing on controlling the reliability and quality of our emissions-compliant engines as evidenced by the level of spending incurred during previous quarters and periods within *Engineering and product development costs*. Costs are accrued per unit based on expected warranty claims that incorporate historical information and forward assumptions about the nature, frequency, and average cost of warranty claims.

Selling, general and administrative expenses incurred during the second quarter and six month period ended April 30, 2008 were \$31 million and \$61 million, respectively, and compared to \$32 million and \$56 million for the comparable periods in 2007.

Engineering and product development costs incurred during the second quarter and six month period ended April 30, 2008 were \$57 million and \$98 million, respectively, and compare to \$49 million and \$100 million for the comparable periods in 2007. The Engine segment's *Engineering and product development costs* represented approximately half of our total consolidated *Engineering and product development costs* for the second quarter and first half of the year in both 2008 and 2007. Our top developmental priorities focus on further design changes to our diesel engines and the development of our MaxxForce Big-Bore engines. We have also begun development on new products to meet the requirements of the 2010 emissions regulations.

Engine segment profit

The Engine segment has made substantial investments in various affiliated entities and joint ventures. The most significant Engine segment joint venture in terms of income is BDP. We account for these entities using the equity method of accounting, and our percentage share of the income associated with these affiliates amounted to \$23 million and \$46 million for the second quarter and first half of 2008 and compares to \$16 million and \$37 million for the same respective periods in 2007.

As a result of the above items, the Engine segment recognized a profit of \$51 million and \$85 million for the three months and six months ended April 30, 2008 that compares to a profit of \$18 million and \$6 million for the same respective periods in 2007.

Parts Segment

The following tables summarize our Parts segment's financial results:

| (in millions) | Three Months Ended April 30, | | Change | Percentage Change |
|----------------|---------------------------------|--------|--------|----------------------|
| | 2008 | 2007 | | |
| Segment sales | \$ 438 | \$ 387 | \$ 51 | 13.2% |
| Segment profit | 56 | 40 | 16 | 40.0 |

| (in millions) | Six Months Ended April 30, | | Change | Percentage Change |
|----------------|-------------------------------|--------|--------|----------------------|
| | 2008 | 2007 | | |
| Segment sales | \$ 839 | \$ 748 | \$ 91 | 12.2% |
| Segment profit | 105 | 77 | 28 | 36.4 |

Parts segment sales

For the three month and six month periods ended April 30, 2008, the Parts segment sales growth was due primarily to an increase in U.S. military sales and improved pricing.

Parts segment profit

Selling, general and administrative expenses amounted to \$41 million and \$79 million for both the three months and six months ended April 30, 2008 and 2007, respectively. Our relative ratio of *Selling, general and administrative expenses* to net sales and revenues was approximately 9.4% for the quarter and six months ended April 30, 2008 compared to 10.6% for the comparable periods in 2007.

During the three month and six month periods ended April 30, 2008, a large portion of our profitability was due to volume growth primarily with the U.S. military while containing our *Selling, general and administrative expenses*.

Financial Services Segment

The following tables summarize this segment's financial results:

| (in millions) | Three Months Ended April 30, | | Change | Percentage Change |
|------------------|---------------------------------|--------|--------|----------------------|
| | 2008 | 2007 | | |
| Segment revenues | \$ 117 | \$ 125 | \$ (8) | (6.4%) |
| Segment profit | 19 | 28 | (9) | (32.1) |

| (in millions) | Six Months Ended April 30, | | Change | Percentage Change |
|-----------------------|-------------------------------|--------|---------|----------------------|
| | 2008 | 2007 | | |
| Segment revenues | \$ 233 | \$ 263 | \$ (30) | (11.4%) |
| Segment profit (loss) | (6) | 84 | (90) | (107.1) |

Financial Services segment revenues

The Financial Services segment revenues include revenues from retail notes and finance leases, operating lease revenues, wholesale notes, retail and wholesale accounts, and securitization income. The Financial Services segment net revenues declined during the second quarter and first half of 2008 compared to the same periods in 2007 due to the decline in the credit markets, fewer originations, and a decrease in rental income. The decline in revenues was primarily due to a decrease in dealer inventory of pre-2007 emissions-compliant vehicles. In addition, we experienced a reduction in customer financing opportunities of purchases for vehicles and components due to the difficult credit environment and increased diesel fuel prices.

The Financial Services segment also receives interest income from the Truck and Parts segments relating to financing of wholesale notes, wholesale accounts, and retail accounts. This income is eliminated upon consolidation of financial results. Substantially all revenues earned on wholesale and retail accounts are received from other segments. Aggregate interest revenue provided by the Truck and Parts segments was \$21 million and \$43 million for the three months and six months ended April 30, 2008, respectively, and compares with \$35 million and \$75 million for the comparable periods in 2007.

Financial Services segment profit (loss)

The following tables present the components of *Interest expense*:

| | Three Months Ended April 30, | | Change | Percentage Change |
|--|---------------------------------|--------------|----------------|----------------------|
| | 2008 | 2007 | | |
| <i>(in millions, except percentage change)</i> | | | | |
| Interest expense related to debt | \$ 68 | \$ 72 | \$ (4) | (5.6%) |
| Non-cash mark to market charge (income) on our interest rate swap agreements | (1) | 6 | (7) | N.M. |
| Total interest expense | \$ 67 | \$ 78 | \$ (11) | (14.1) |

| | Six Months Ended April 30, | | Change | Percentage Change |
|---|-------------------------------|---------------|--------------|----------------------|
| | 2008 | 2007 | | |
| <i>(in millions, except percentage change)</i> | | | | |
| Interest expense related to debt | \$ 147 | \$ 147 | \$ | |
| Non-cash mark to market charge in our interest rate swap agreements | 39 | (1) | 40 | N.M. |
| Total interest expense | \$ 186 | \$ 146 | \$ 40 | 27.4 |

In connection with our retail securitization transactions we enter into various derivative financial instruments, primarily interest rate swaps and caps to convert our interest rate exposure on both the finance receivables we originate and then sell as well as the notes issued as secured borrowings. Our intent is to convert our interest rate exposure related to our secured borrowings from a floating rate to a fixed rate in order to better match the cash flow of our fixed rate finance receivables so that the net margin spread over the life of the securitization is more predictable. Given the dramatic decrease in interest rates from October 31, 2007 to April 30, 2008, the required periodic mark to market of the derivative financial instruments resulted in a non-cash charge (gain) of (\$1) million and \$39 million in our consolidated statements of operations for the second quarter and the first half of 2008, respectively, and a nominal amount in the same periods in 2007. While these derivative instruments provide us with an economic hedge of the expected future interest cash flows associated with the secured borrowings, they do not qualify for hedge accounting under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, thus the non-cash charge (gain). Further movement in interest rates could change the mark to market adjustments of the fair values of the derivatives in future periods.

Repossessions and delinquencies increased during the second quarter and first half of 2008 compared to the same respective periods in 2007 driven primarily by weakness in the underlying trucking economy, which is currently impacting our overall customer portfolio. Decreases in tonnage hauled, suppressed freight rates driven by excess capacity, increased fuel costs, and the sub-prime mortgage market crisis have all contributed to the distress of our customers. We provide for certain losses related to the repossession and liquidation of collateral underlying finance receivables with dealers and retail customers. During the second quarter and first half of 2008, our provision for losses on receivables was reduced by \$7 million and increased by \$14 million, respectively, which compares with increases of \$6 million and \$8 million for the same respective periods in 2007.

In addition to the above items, we experienced a reduction in the net interest rate spread between our financing rates and the cost of our borrowings due to the timing of customer financing compared to our funding of the related debt. The Financial Services segment recognized a profit of \$19 million and a loss of \$6 million for the three months and six months ended April 30, 2008 that compares to a profit of \$28 million and \$84 million for the same respective periods in 2007.

Liquidity and Capital Resources

Cash Requirements

We generate cash flow primarily from the sale of trucks, diesel engines, and parts. In addition, we generate cash flow from product financing provided to our dealers and retail customers by the Financial Services segment. It is our opinion that, in the absence of significant unanticipated cash demands, current and forecasted cash flow from our manufacturing operations, financial services operations, and financing capacity will provide sufficient funds to meet anticipated operating requirements, capital expenditures, equity investments, and strategic acquisitions. We also believe that collections on the outstanding receivables portfolios as well as funds available from various funding sources will permit the financial services operations to meet the financing requirements of our dealers and retail customers. The manufacturing operations are generally able to access sufficient sources of financing to support our business plan. At April 30, 2008 our manufacturing operations had a total of \$339 million available under committed credit facilities that mature in 2012.

Sources and Uses of Cash

| (in millions) | Six Months Ended | |
|--|------------------|----------------|
| | 2008 | April 30, 2007 |
| Net cash provided by (used in) operating activities | \$ 311 | \$ (233) |
| Net cash provided by (used in) investing activities | (441) | 106 |
| Net cash provided by (used in) financing activities | 11 | (410) |
| Effect of exchange rate changes on cash and cash equivalents | 17 | 28 |
| Decrease in cash and cash equivalents | (102) | (509) |
| Cash and cash equivalents at beginning of period | 777 | 1,157 |
| Cash and cash equivalents at end of the period | \$ 675 | \$ 648 |

Cash Flow from Operating Activities

Cash provided by operating activities was \$311 million for the six months ended April 30, 2008 compared with cash used in operating activities of \$233 million for the six months ended April 30, 2007. The increase in cash provided by operating activities for the six months ended April 30, 2008 compared with the same period in 2007 was due primarily to higher net income and an increase in operating liabilities, partially offset by an

increase in operating assets. The changes in net income and operating cash flows were primarily attributed to growth in our military and export business, primarily related to Mine-Resistant Ambush Protected vehicles, as well as better pricing as a result of the introduction of our 2007 emissions-compliant products. Net income for the six months ended April 30, 2008 was \$162 million compared with net loss of \$13 million for the six months ended April 30, 2007.

Cash paid for interest, net of amounts capitalized, was \$271 million for the six months ended April 30, 2008 versus \$256 million for the six months ended April 30, 2007. The increase was due primarily to higher average interest rates for the six months of 2008 compared with the six months of 2007. During the six months of 2008, \$128 million was paid for certain fees associated with the ongoing consulting and other professional services related to the preparation of our public filing documents and documentation and assessment of internal control over financial reporting. Cash paid during the six months of 2008 for income taxes, net of refunds, was \$28 million lower than the six months of 2007 due to decreased income in foreign jurisdictions.

Cash Flow from Investing Activities

Cash used in investing activities was \$441 million for the six months ended April 30, 2008 compared with net cash provided by investing activities of \$106 million for the six months ended April 30, 2007. The increase in cash used in investing activities for the six months of 2008 compared with the six months of 2007 was due primarily to lower net sales or maturities of marketable securities and a net increase in restricted cash and cash equivalents for the six months of 2008 compared with a net decrease in restricted cash and cash equivalents for the six months of 2007. The net increase in restricted cash and cash equivalents for the six months of 2008 compared with the same period in 2007 resulted from timing of transactions at one of our financial services subsidiaries. At the end of April 2008, this subsidiary's assets were all restricted cash equivalents rather than a combination of restricted cash, note receivables, and lease receivables.

Cash Flow from Financing Activities

Cash flow provided by financing activities was \$11 million for the six months ended April 30, 2008 compared with net cash used in financing activities of \$410 million for the six months ended April 30, 2007. The increase in cash provided by financing activities for the six months of 2008 compared with the six months of 2007 was due primarily to a net increase in notes and debt outstanding under revolving credit facilities.

Credit Markets

In the late summer and early fall of 2007, the financial markets began a correction and period of credit tightening precipitated by large losses in the sub-prime mortgage market that bled over into other sectors of the market. The effects of this credit tightening manifested themselves primarily in our financial services operations. Pricing and liquidity were impacted in the asset-backed securitization market, a source of funding within our financial services operations. Substantial increases in the spreads on borrowing rates were seen at all credit rating levels. As a result, although we continue to believe that we will have sufficient liquidity to fund our financial services operations, future borrowings could be more costly than in the past.

Other Information

Critical Accounting Policies

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. In connection with the preparation of our condensed consolidated financial statements, we use estimates and make judgments and assumptions about future events that affect the reported amounts of assets, liabilities, revenue, expenses, and the related disclosures. Our assumptions, estimates, and judgments are based on historical

experience, current trends, and other factors we believe are relevant at the time we prepare our condensed consolidated financial statements. Our significant accounting policies and critical accounting estimates are consistent with those described in Note 1, *Summary of significant accounting policies*, accompanying the condensed consolidated financial statements and the MD&A section of our 2007 Annual Report on Form 10-K. There are no significant changes in our application of our critical accounting policies in the six months ended April 30, 2008 with exception to the adoption of FASB Interpretation No. 48, as further described in Note 9, *Income taxes*, to the accompanying condensed consolidated financial statements.

To aid in fully understanding and evaluating our reported results, we have identified the following accounting policies as our most critical because they require us to make difficult, subjective, and complex judgments.

Pension and Other Postretirement Benefits

Allowance for Losses

Sales of Receivables

Income Taxes

Impairment of Long-Lived Assets

Contingent Liabilities

Product Warranty

Goodwill and Intangible Assets

New Accounting Pronouncements

Accounting pronouncements issued by various standard setting and governmental authorities that have not yet become effective with respect to our condensed consolidated financial statements are described below, together with our assessment of the potential impact they may have on our financial position, results of operations and cash flows:

| Pronouncement | Effective Date | Impact on Our Financial Condition and Results of Operations |
|---|---|--|
| Emerging Issues Task Force Issue No. 08-3, <i>Accounting by Lessees for Nonrefundable Maintenance Deposits</i> | Effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is not permitted. Our effective date is November 1, 2009. | We are evaluating the potential impact, if any. |
| FASB Staff Position No. FAS 142-3, <i>Determination of the Useful Life of Intangible Assets</i> | Effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Our effective date is November 1, 2009. | We are evaluating the potential impact, if any. |
| FASB Statement No. 161, <i>Disclosures about Derivative Instruments and Hedging Activities</i> An Amendment of FASB Statement No. 133 | Effective for fiscal years and interim reporting periods beginning after November 15, 2008. Our effective date is February 1, 2009. | When effective, we will comply with the disclosure provisions of this Statement. |
| FASB Statement No. 160, <i>Noncontrolling Interests in Consolidated Financial Statements</i> An Amendment of ARB No. 51 | Effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. Our effective date is February 1, 2009. | We are evaluating the potential impact, if any. |
| FASB Statement No. 141(R), <i>Business Combinations</i> | Applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. Our effective date is November 1, 2009. | We will adopt this Statement on a prospective basis. |
| Emerging Issues Task Force Issue No. 07-03, <i>Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities</i> | Effective for financial statements issued for fiscal years beginning after December 15, 2007. Our effective date is November 1, 2008. | We are evaluating the potential impact, if any. |

Impact on Our Financial Condition and

| Pronouncement | Effective Date | Results of Operations |
|---|--|--|
| FASB Statement No. 159, <i>The Fair Value Option for Financial Assets and Financial Liabilities</i> | Effective as of the beginning of the first fiscal year beginning after November 15, 2007. If we adopt the Fair Value Option, our effective date is November 1, 2008. | We are evaluating the potential impact, if any. We have not determined whether to adopt the fair value option. |
| FASB Statement No. 157, <i>Fair Value Measurements</i> | Effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. Our effective date is November 1, 2008. | We are evaluating the potential impact, if any. |

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in our exposure to market risk since October 31, 2007. For further information please see Note 10, *Fair value of financial instrument* and Note 11, *Financial instruments*, to the accompanying condensed consolidated financial statements, and Item 7A of our Annual Report on Form 10-K for the year ended October 31, 2007.

Item 4. Controls and Procedures***Evaluation of Disclosure Controls and Procedures***

Our evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act was performed under the supervision and with the participation of our senior management, including our Chief Executive Officer and Chief Financial Officer. The purpose of disclosure controls and procedures is to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

As previously disclosed under Item 9A *Controls and Procedures* in our Annual Report on Form 10-K for the fiscal year ended October 31, 2007, we concluded that our internal control over financial reporting was not effective based on the material weaknesses identified. Based on those material weaknesses, which we view as an integral part of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the quarter ended April 30, 2008, our disclosure controls and procedures were not effective. Nevertheless, based on a number of factors, including the performance of additional procedures by management designed to ensure the reliability of our financial reporting, we believe that the condensed consolidated financial statements in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP.

Management's Remediation Initiatives

We continue to make progress toward achieving the effectiveness of our disclosure controls and procedures. Remediation generally requires making changes to how controls are designed and then adhering to those changes for a sufficient period of time such that the effectiveness of those changes is demonstrated with an appropriate amount of consistency. We believe that we have made significant improvements in our internal control over financial reporting and are committed to remediating our material weaknesses. Our Sarbanes Oxley compliance function is responsible for helping develop and monitor our short-term and long-term remediation plans. In

addition, we have assigned executive owners to each material weakness to oversee the necessary remedial changes to the overall design of our internal control environment and to address the root causes of our material weaknesses.

Our remediation initiatives summarized below are intended to further address our specific material weaknesses and to continue to enhance our internal control over financial reporting.

Our leadership team remains committed to achieving and maintaining a strong control environment, high ethical standards and financial reporting integrity. This commitment will continue to be communicated to and reinforced with our employees.

We continue to foster awareness and understanding of standards and principles for accounting and financial reporting. This includes the implementation and clarification of specific accounting policies and procedures and effective execution of our newly designed accounting training program.

We continue to enhance the development, communication, and monitoring of processes and controls to ensure that appropriate account reconciliations and journal entry controls are performed, documented, and reviewed as part of our standardized procedures.

We continue to invest in modifications of our information systems to improve the reliability of our financial reporting and increase the completeness and consistency of the controls around logical access, program change and computer operations.

We plan to redesign our period-end closing and financial statement preparation process in order to improve both its effectiveness and efficiency.

We continue to support our Disclosure Committee and our internal Management Representation Letter process, both of which have been re-designed to ensure the timely assessment of accounting and disclosure matters requiring our attention.

Collectively, these and other actions are improving the foundation of our internal control over financial reporting.

Changes in Internal Control over Financial Reporting

There were no material changes in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15 and 15d-15 that occurred during the quarter ended April 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 6. Exhibits

| Exhibit: | Page |
|--|-------------|
| (3) Articles of Incorporations and By-Laws | E-1 |
| (10) Material Contracts | E-16 |
| (31.1) CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | E-18 |
| (31.2) CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | E-19 |
| (32.1) CEO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | E-20 |
| (32.2) CFO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | E-21 |
| (99.1) Additional Financial Information (Unaudited) | E-22 |

All exhibits other than those indicated above are omitted because of the absence of the conditions under which they are required or because the information called for is shown in the financial statements and notes thereto in the Quarterly Report on Form 10-Q for the period ended April 30, 2008.

NAVISTAR INTERNATIONAL CORPORATION

AND CONSOLIDATED SUBSIDIARIES

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NAVISTAR INTERNATIONAL CORPORATION
(Registrant)

/s/ JOHN P. WALDRON
John P. Waldron
Vice President and Controller
(Principal Accounting Officer)

June 27, 2008