

BORGWARNER INC  
Form 10-Q  
May 01, 2014  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549  
FORM 10-Q  
QUARTERLY REPORT  
(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2014

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: 1-12162  
BORGWARNER INC.

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(Exact name of registrant as specified in its charter)

Delaware 13-3404508  
State or other jurisdiction of (I.R.S. Employer  
Incorporation or organization Identification No.)

3850 Hamlin Road, Auburn Hills, Michigan 48326  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (248) 754-9200

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions 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 Exchange Act).

YES  NO

As of April 25, 2014, the registrant had 228,622,421 shares of voting common stock outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| (millions of dollars)                      | March 31,<br>2014 | December 31,<br>2013 |
|--|-------------------|----------------------|
| <b>ASSETS</b>                              |                   |                      |
| Cash                                       | \$808.1           | \$939.5              |
| Receivables, net                           | 1,546.1           | 1,248.5              |
| Inventories, net                           | 516.9             | 458.1                |
| Deferred income taxes                      | 51.5              | 68.7                 |
| Prepayments and other current assets       | 98.7              | 83.7                 |
| Total current assets                       | 3,021.3           | 2,798.5              |
| Property, plant and equipment, net         | 2,027.8           | 1,939.4              |
| Investments and advances                   | 440.2             | 405.1                |
| Goodwill                                   | 1,244.8           | 1,197.0              |
| Other non-current assets                   | 623.7             | 577.0                |
| Total assets                               | \$7,357.8         | \$6,917.0            |
| <b>LIABILITIES AND EQUITY</b>              |                   |                      |
| Notes payable and other short-term debt    | \$338.5           | \$201.6              |
| Accounts payable and accrued expenses      | 1,562.6           | 1,383.8              |
| Income taxes payable                       | 9.8               | 38.5                 |
| Total current liabilities                  | 1,910.9           | 1,623.9              |
| Long-term debt                             | 1,027.6           | 1,021.0              |
| Other non-current liabilities:             |                   |                      |
| Retirement-related liabilities             | 313.7             | 312.9                |
| Other                                      | 368.3             | 326.8                |
| Total other non-current liabilities        | 682.0             | 639.7                |
| Common stock                               | 2.5               | 2.5                  |
| Capital in excess of par value             | 1,092.4           | 1,121.9              |
| Retained earnings                          | 3,308.1           | 3,177.4              |
| Accumulated other comprehensive loss       | (16.8)            | (14.0)               |
| Common stock held in treasury              | (702.7)           | (727.2)              |
| Total BorgWarner Inc. stockholders' equity | 3,683.5           | 3,560.6              |
| Noncontrolling interest                    | 53.8              | 71.8                 |
| Total equity                               | 3,737.3           | 3,632.4              |
| Total liabilities and equity               | \$7,357.8         | \$6,917.0            |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of ContentsBORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| (in millions, except per share amounts)                              | Three Months Ended |           |   |
|--|--------------------|-----------|---|
|  | March 31,          |           |   |
|  | 2014               | 2013      |   |
| Net sales  | \$2,084.1          | \$1,851.1 |   |
| Cost of sales  | 1,638.3            | 1,476.4   |   |
| Gross profit   | 445.8              | 374.7     |   |
| Selling, general and administrative expenses                         | 173.8              | 159.3     |   |
| Other expense  | 38.8               | 16.9      |   |
| Operating income   | 233.2              | 198.5     |   |
| Equity in affiliates' earnings, net of tax                           | (8.8               | ) (9.7    | ) |
| Interest income  | (1.5               | ) (1.0    | ) |
| Interest expense and finance charges                                 | 8.2                | 9.7       |   |
| Earnings before income taxes and noncontrolling interest             | 235.3              | 199.5     |   |
| Provision for income taxes   | 68.1               | 50.9      |   |
| Net earnings   | 167.2              | 148.6     |   |
| Net earnings attributable to the noncontrolling interest, net of tax | 8.1                | 6.6       |   |
| Net earnings attributable to BorgWarner Inc.                         | \$159.1            | \$142.0   |   |
| Earnings per share — basic   | \$0.70             | \$0.62    |   |
| Earnings per share — diluted   | \$0.69             | \$0.61    |   |
| Weighted average shares outstanding:                                 |                    |           |   |
| Basic  | 227.430            | 230.372   |   |
| Diluted  | 229.327            | 233.130   |   |
| Dividends declared per share   | \$0.125            | \$—       |   |

See accompanying Notes to Condensed Consolidated Financial Statements.

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (UNAUDITED)

| (millions of dollars)  | Three Months Ended |         |
|--|--------------------|---------|
|  | March 31,          |         |
|  | 2014               | 2013    |
| Net earnings attributable to BorgWarner Inc.                   | \$159.1            | \$142.0 |
| Other comprehensive income (loss)                              |                    |         |
| Foreign currency translation adjustments <sup>(a)</sup>        | (2.7               | ) (84.8 |
| Hedge instruments <sup>(a)</sup>                               | (1.3               | ) 11.1  |
| Defined benefit postretirement plans <sup>(a)</sup>            | 1.2                | 5.8     |
| Total other comprehensive loss attributable to BorgWarner Inc. | (2.8               | ) (67.9 |
| Comprehensive income attributable to BorgWarner Inc.           | 156.3              | 74.1    |
| Comprehensive loss attributable to the noncontrolling interest | (1.1               | ) (1.2  |
| Comprehensive income   | \$155.2            | \$72.9  |

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(a) Net of income taxes.

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of ContentsBORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| (millions of dollars)  | Three Months Ended<br>March 31, |         |
|--|---------------------------------|---------|
|  | 2014                            | 2013    |
| <b>OPERATING</b>   |                                 |         |
| Net earnings   | \$167.2                         | \$148.6 |
| Adjustments to reconcile net earnings to net cash flows from operations: |                                 |         |
| Non-cash charges (credits) to operations:                                |                                 |         |
| Depreciation and tooling amortization                                    | 74.1                            | 68.2    |
| Amortization of intangible assets and other                              | 6.0                             | 6.7     |
| Restructuring expense, net of cash paid                                  | 34.3                            | —       |
| Stock-based compensation expense   | 7.8                             | 15.2    |
| Deferred income tax provision (benefit)                                  | 15.6                            | (17.0)  |
| Equity in affiliates' earnings, net of dividends received, and other     | (9.0)                           | (15.6)  |
| Net earnings adjusted for non-cash charges to operations                 | 296.0                           | 206.1   |
| Changes in assets and liabilities:                                       |                                 |         |
| Receivables  | (246.5)                         | (197.2) |
| Inventories  | (7.9)                           | (18.6)  |
| Prepayments and other current assets                                     | (2.2)                           | (11.9)  |
| Accounts payable and accrued expenses                                    | 69.3                            | 54.8    |
| Income taxes payable   | (30.9)                          | (27.7)  |
| Other non-current assets and liabilities                                 | (31.4)                          | 10.8    |
| Net cash provided by operating activities                                | 46.4                            | 16.3    |
| <b>INVESTING</b>   |                                 |         |
| Capital expenditures, including tooling outlays                          | (126.2)                         | (87.4)  |
| Net proceeds from asset disposals  | 1.5                             | 13.8    |
| Payments for business acquired, net of cash acquired                     | (106.4)                         | —       |
| Net cash used in investing activities                                    | (231.1)                         | (73.6)  |
| <b>FINANCING</b>   |                                 |         |
| Net increase (decrease) in notes payable                                 | 111.3                           | (11.0)  |
| Additions to long-term debt, net of debt issuance costs                  | 100.0                           | 161.0   |
| Repayments of long-term debt, including current portion                  | (100.1)                         | (15.6)  |
| Payments for purchase of treasury stock                                  | —                               | (49.9)  |
| Proceeds from stock options exercised, including the tax benefit         | 9.4                             | 11.4    |
| Taxes paid on employees' restricted stock award vestings                 | (22.2)                          | (27.2)  |
| Dividends paid to BorgWarner stockholders                                | (28.4)                          | —       |
| Dividends paid to noncontrolling stockholders                            | (14.0)                          | (9.0)   |
| Net cash provided by financing activities                                | 56.0                            | 59.7    |
| Effect of exchange rate changes on cash                                  | (2.7)                           | (22.7)  |
| Net decrease in cash   | (131.4)                         | (20.3)  |
| Cash at beginning of year  | 939.5                           | 715.7   |
| Cash at end of period  | \$808.1                         | \$695.4 |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b>                                |                                 |         |
| Net cash paid during the period for:                                     |                                 |         |
| Interest   | \$18.1                          | \$12.3  |

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|  |      |      |
|--|------|------|
| Income taxes   | 72.8 | 94.5 |
| Non-cash investing transactions  |      |      |
| Liabilities assumed from business acquired                             | 3.2  | —    |
| Non-cash financing transactions  |      |      |
| Debt assumed from business acquired                                    | 33.3 | —    |
| See accompanying Notes to Condensed Consolidated Financial Statements. |      |      |

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (UNAUDITED)

## (1) Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of BorgWarner Inc. and Consolidated Subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes necessary for a comprehensive presentation of financial position, results of operations and cash flow activity required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of results have been included. Operating results for the three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The balance sheet as of December 31, 2013 was derived from the audited financial statements as of that date. For further information, refer to the Consolidated Financial Statements and Footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

On November 13, 2013, the Company's Board of Directors declared a two-for-one stock split effected in the form of a stock dividend on its common stock. To implement this stock split, shares of common stock were issued on December 16, 2013 to stockholders of record as of the close of business on December 2, 2013. All prior year share and per share amounts disclosed in this document have been restated to reflect the two-for-one stock split.

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and accompanying notes, as well as, the amounts of revenues and expenses reported during the periods covered by those financial statements and accompanying notes. Actual results could differ from these estimates.

## (2) Research and Development Expenditures

The Company's net Research & Development ("R&D") expenditures are included in selling, general and administrative expenses of the Condensed Consolidated Statements of Operations. Customer reimbursements are netted against gross R&D expenditures as they are considered a recovery of cost. Customer reimbursements for prototypes are recorded net of prototype costs based on customer contracts, typically either when the prototype is shipped or when it is accepted by the customer. Customer reimbursements for engineering services are recorded when performance obligations are satisfied in accordance with the contract and accepted by the customer. Financial risks and rewards transfer upon shipment, acceptance of a prototype component by the customer or upon completion of the performance obligation as stated in the respective customer agreement.

The following table presents the Company's gross and net expenditures on R&D activities:

| (millions of dollars)   | Three Months Ended |        |
|-------------------------|--------------------|--------|
|                         | March 31,          |        |
|                         | 2014               | 2013   |
| Gross R&D expenditures  | \$94.5             | \$82.2 |
| Customer reimbursements | (12.5)             | (10.4) |
| Net R&D expenditures    | \$82.0             | \$71.8 |



The Company has contracts with several customers at the Company's various R&D locations. No such contract exceeded 5% of annual net R&D expenditures in any of the periods presented.

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## (3) Other Expense

Items included in other expense consist of:

| (millions of dollars)          | Three Months Ended |        |
|--------------------------------|--------------------|--------|
|                                | March 31,          |        |
|                                | 2014               | 2013   |
| Restructuring expense          | \$39.5             | \$—    |
| Program termination agreement  | —                  | 11.3   |
| Retirement related obligations | —                  | 5.9    |
| Other income                   | (0.7               | ) (0.3 |
| Other expense                  | \$38.8             | \$16.9 |

During the first quarter of 2014, the Company recorded restructuring expense of \$39.5 million primarily related to continued Drivetrain segment actions designed to improve future profitability and competitiveness. See Note 15 for further discussion of these expenses.

In March 2013, the Company recorded an \$11.3 million expense related to a program termination agreement, which was paid in 2013.

During the fourth quarter of 2012, the Company waived the forfeiture provision associated with future restricted stock grants made to certain retiring Named Executive Officers. The Company recorded a \$5.9 million retirement related obligation primarily related to a first quarter 2013 grant of restricted stock awards to these Named Executive Officers.

## (4) Income Taxes

The Company's provision for income taxes is based upon an estimated annual tax rate for the year applied to federal, state and foreign income. On a quarterly basis, the annual effective tax rate is adjusted, as appropriate, based upon changed facts and circumstances, if any, as compared to those forecasted at the beginning of the fiscal year and each interim period thereafter.

At March 31, 2014, the Company's effective tax rate for the first quarter was 28.9%, which includes tax benefits of \$8.8 million related to restructuring expense discussed in the Other Expense footnote.

At March 31, 2013, the Company's effective tax rate for the first quarter was 25.5%. This rate included tax benefits of \$3.8 million and \$2.1 million related to the program termination agreement and retirement related obligations discussed in the Other Expense footnote. This rate also included a net tax benefit of \$1.7 million, which is comprised of a \$6.6 million tax benefit related to the extension of the federal research and development credit and other international tax provisions resulting from the retroactive impact of U.S. legislation enacted in January 2013, partially offset by a \$4.9 million tax expense related to a comprehensive income adjustment.

The annual effective tax rates differ from the U.S. statutory rate primarily due to foreign rates which differ from those in the U.S., the realization of certain business tax credits, including foreign tax credits, and favorable permanent differences between book and tax treatment for certain items, including equity in affiliates' earnings.

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## (5) Inventories, net

Inventories are valued at the lower of cost or market. The cost of U.S. inventories is determined by the last-in, first-out (“LIFO”) method, while the operations outside the U.S. use the first-in, first-out (“FIFO”) or average-cost methods. Inventories consisted of the following:

| (millions of dollars)     | March 31,<br>2014 | December 31,<br>2013 |
|---------------------------|-------------------|----------------------|
| Raw material and supplies | \$317.1           | \$279.8              |
| Work in progress          | 93.4              | 78.0                 |
| Finished goods            | 123.7             | 116.3                |
| FIFO inventories          | 534.2             | 474.1                |
| LIFO reserve              | (17.3             | ) (16.0              |
| Inventories, net          | \$516.9           | \$458.1              |

## (6) Property, Plant and Equipment, net

| (millions of dollars)                                 | March 31,<br>2014 | December 31,<br>2013 |
|---|-------------------|----------------------|
| Land, land use rights and buildings                   | \$774.1           | \$753.9              |
| Machinery and equipment                               | 1,970.6           | 1,897.5              |
| Capital leases  | 10.7              | 2.4                  |
| Construction in progress                              | 282.7             | 272.3                |
| Total property, plant and equipment, gross            | 3,038.1           | 2,926.1              |
| Less: accumulated depreciation                        | (1,134.5          | ) (1,099.3           |
| Property, plant and equipment, net, excluding tooling | 1,903.6           | 1,826.8              |
| Tooling, net of amortization                          | 124.2             | 112.6                |
| Property, plant and equipment, net                    | \$2,027.8         | \$1,939.4            |

As of March 31, 2014 and December 31, 2013, accounts payable of \$48.5 million and \$62.8 million, respectively, were related to property, plant and equipment purchases.

Interest costs capitalized for the three months ended March 31, 2014 and 2013 were \$3.5 million and \$2.5 million, respectively.

## (7) Product Warranty

The Company provides warranties on some, but not all, of its products. The warranty terms are typically from one to three years. Provisions for estimated expenses related to product warranty are made at the time products are sold. These estimates are established using historical information about the nature, frequency and average cost of warranty claim settlements as well as product manufacturing and industry developments and recoveries from third parties. Management actively studies trends of warranty claims and takes action to improve product quality and minimize warranty claims. Management believes that the warranty accrual is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the accrual.

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The following table summarizes the activity in the product warranty accrual accounts:

| (millions of dollars)        | 2014   | 2013   |
|------------------------------|--------|--------|
| Beginning balance, January 1 | \$72.7 | \$64.9 |
| Provisions                   | 5.0    | 11.6   |
| Acquisition <sup>(a)</sup>   | 22.8   | —      |
| Payments                     | (7.3   | ) (7.2 |
| Translation adjustment       | —      | (1.3   |
| Ending balance, March 31     | \$93.2 | \$68.0 |

(a) The Company has recorded a \$12.4 million insurance receivable related to the \$22.8 million liability, which is classified in the Condensed Consolidated Balance Sheet in Investments and Advances.

The product warranty liability is classified in the Condensed Consolidated Balance Sheets as follows:

| (millions of dollars)                 | March 31,<br>2014 | December 31,<br>2013 |
|---------------------------------------|-------------------|----------------------|
| Accounts payable and accrued expenses | \$33.2            | \$38.4               |
| Other non-current liabilities         | 60.0              | 34.3                 |
| Total product warranty liability      | \$93.2            | \$72.7               |

## (8) Notes Payable and Long-Term Debt

As of March 31, 2014 and December 31, 2013, the Company had short-term and long-term debt outstanding as follows:

| (millions of dollars)                                      | March 31,<br>2014 | December 31,<br>2013 |
|--|-------------------|----------------------|
| Short-term debt  |                   |                      |
| Short-term borrowings                                      | \$221.6           | \$84.8               |
| Receivables securitization                                 | 110.0             | 110.0                |
| Total short-term debt                                      | \$331.6           | \$194.8              |
| Long-term debt   |                   |                      |
| 5.75% Senior notes due 11/01/16 (\$150 million par value)  | \$149.7           | \$149.7              |
| 8.00% Senior notes due 10/01/19 (\$134 million par value)  | 134.0             | 133.9                |
| 4.625% Senior notes due 09/15/20 (\$250 million par value) | 248.2             | 248.2                |
| 7.125% Senior notes due 02/15/29 (\$121 million par value) | 119.4             | 119.4                |
| Multi-currency revolving credit facility                   | 320.0             | 320.0                |
| Term loan facilities and other                             | 48.0              | 40.4                 |
| Unamortized portion of debt derivatives                    | 15.2              | 16.2                 |
| Total long-term debt                                       | 1,034.5           | 1,027.8              |
| Less: current portion                                      | 6.9               | 6.8                  |
| Long-term debt, net of current portion                     | \$1,027.6         | \$1,021.0            |

The weighted average interest rate on all borrowings outstanding as of March 31, 2014 and December 31, 2013 was 3.4% and 3.7%, respectively.

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On February 11, 2014, the Company's universal shelf registration expired. The Company filed a new universal shelf registration with the Securities and Exchange Commission on February 28, 2014.

The Company's \$750 million multi-currency revolving credit facility includes a feature that allows the Company's borrowings to be increased to \$1 billion. The credit facility provides for borrowings through June 30, 2016 and is guaranteed by the Company's material domestic subsidiaries. The credit facility has two key financial covenants, a debt compared to EBITDA (“Earnings Before Interest, Taxes, Depreciation and Amortization”) test and an interest coverage test. The Company was in compliance with all covenants at March 31, 2014 and expects to remain compliant in future periods. At March 31, 2014 and December 31, 2013, the Company had outstanding borrowings of \$320.0 million under this facility.

On March 12, 2014, the Company entered into a new commercial paper program pursuant to which the Company may issue short-term, unsecured commercial paper notes up to a maximum aggregate principal amount outstanding of \$1.0 billion. Under this program, the Company may issue notes from time to time and will use the proceeds for general corporate purposes. At March 31, 2014, the Company had outstanding borrowings of \$100.0 million under this program, which is classified in the Condensed Consolidated Balance Sheet in Notes Payable and Other Short-Term Debt.

As of March 31, 2014 and December 31, 2013, the estimated fair values of the Company's senior unsecured notes totaled \$739.7 million and \$729.7 million, respectively. The estimated fair values were \$88.4 million and \$78.5 million higher than their carrying value at March 31, 2014 and December 31, 2013, respectively. Fair market values of the senior unsecured notes are developed using observable values for similar debt instruments, which are considered Level 2 inputs as defined by ASC Topic 820. The carrying values of the Company's multi-currency revolving credit facility and commercial paper program are equal to their fair values. The fair value estimates do not necessarily reflect the values the Company could realize in the current markets.

The Company had outstanding letters of credit of \$27.6 million and \$27.8 million at March 31, 2014 and December 31, 2013, respectively. The letters of credit typically act as guarantees of payment to certain third parties in accordance with specified terms and conditions.

### (9) Fair Value Measurements

ASC Topic 820 emphasizes that fair value is a market-based measurement, not an entity specific measurement. Therefore, a fair value measurement should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC Topic 820 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair values as follows:

- Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets;
- Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of the following three valuation techniques noted in ASC Topic 820:

- A. Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities or a group of assets or liabilities, such as a business.
- B. Cost approach: Amount that would be required to replace the service capacity of an asset (replacement cost).



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C. Income approach: Techniques to convert future amounts to a single present amount based upon market expectations (including present value techniques, option-pricing and excess earnings models).

The following tables classify assets and liabilities measured at fair value on a recurring basis as of March 31, 2014 and December 31, 2013:

| (millions of dollars)   | Balance at<br>March 31, 2014 | Basis of fair value measurements  |  |  | Valuation<br>technique |
|---|------------------------------|---|--|--|------------------------|
|   |                              | Quoted prices in<br>active markets<br>for identical<br>items<br>(Level 1) | Significant other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |                        |
| Assets:   |                              |   |  |  |                        |
| Foreign currency contracts  | \$2.2                        | \$—   | \$2.2  | \$—  | A                      |
| Other non-current assets<br>(insurance settlement agreement<br>note receivable) | \$29.9                       | \$—   | \$29.9   | \$—  | C                      |
| Liabilities:  |                              |   |  |  |                        |
| Foreign currency contracts  | \$4.7                        | \$—   | \$4.7  | \$—  | A                      |
| Net investment hedge contracts  | \$23.7                       | \$—   | \$23.7   | \$—  | A                      |

| (millions of dollars)   | Balance at<br>December 31,<br>2013 | Basis of fair value measurements  |  |  | Valuation<br>technique |
|---|------------------------------------|---|--|--|------------------------|
|   |                                    | Quoted prices in<br>active markets<br>for identical<br>items<br>(Level 1) | Significant other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |                        |
| Assets:   |                                    |   |  |  |                        |
| Foreign currency contracts  | \$3.4                              | \$—   | \$3.4  | \$—  | A                      |
| Other non-current assets<br>(insurance settlement agreement<br>note receivable) | \$35.6                             | \$—   | \$35.6   | \$—  | C                      |
| Liabilities:  |                                    |   |  |  |                        |
| Foreign currency contracts  | \$7.4                              | \$—   | \$7.4  | \$—  | A                      |
| Net investment hedge contracts  | \$24.3                             | \$—   | \$24.3   | \$—  | A                      |

## (10) Financial Instruments

The Company's financial instruments include cash and marketable securities. Due to the short-term nature of these instruments, their book value approximates their fair value. The Company's financial instruments also include long-term debt, interest rate and cross-currency swaps, commodity derivative contracts and foreign currency derivatives. All derivative contracts are placed with counterparties that have an S&P, or equivalent, investment grade credit rating at the time of the contracts' placement. At March 31, 2014 and December 31, 2013, the Company had no derivative contracts that contained credit risk related contingent features.

The Company selectively uses cross-currency swaps to hedge the foreign currency exposure associated with our net investment in certain foreign operations (net investment hedges). At March 31, 2014 and December 31, 2013, the following cross-currency swaps were outstanding:

| (in millions)<br>As of March 31, 2014 | Cross-currency swaps |             | Duration |
|---------------------------------------|----------------------|-------------|----------|
|                                       | Notional in          | Notional in |          |

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|                           | USD     | local currency |          |
|---------------------------|---------|----------------|----------|
| Floating \$ to floating € | \$75.0  | €58.5          | Oct - 19 |
| Floating \$ to floating ¥ | \$125.0 | ¥14,651.3      | Nov - 16 |

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| (in millions)             | Cross-currency swaps |                            |          |
|---------------------------|----------------------|----------------------------|----------|
|                           | Notional in USD      | Notional in local currency | Duration |
| As of December 31, 2013   |                      |                            |          |
| Floating \$ to floating € | \$75.0               | €58.5                      | Oct - 19 |
| Floating \$ to floating ¥ | \$150.0              | ¥17,581.5                  | Nov - 16 |

The Company uses certain commodity derivative contracts to protect against commodity price changes related to forecasted raw material and supplies purchases. The Company primarily utilizes forward and option contracts, which are designated as cash flow hedges. The Company did not have any commodity derivative contracts outstanding at March 31, 2014 and December 31, 2013.

The Company uses foreign currency forward and option contracts to protect against exchange rate movements for forecasted cash flows, including capital expenditures, purchases, operating expenses or sales transactions designated in currencies other than the functional currency of the operating unit. Foreign currency derivative contracts require the Company, at a future date, to either buy or sell foreign currency in exchange for the operating units' local currency.

At March 31, 2014 and December 31, 2013, the following foreign currency derivative contracts were outstanding:

## Foreign currency derivatives (in millions)

| Functional currency | Traded currency  | Notional in traded currency March 31, 2014 | Notional in traded currency December 31, 2013 | Duration  |
|---------------------|------------------|--|---|-----------|
| Brazilian real      | US dollar        | 14.6                                       | 19.3  | Dec - 14  |
| Chinese yuan        | Japanese yen     | —  | 215.0   | Feb - 14  |
| Chinese yuan        | US dollar        | 9.7  | 12.3  | Dec - 14  |
| Euro                | British pound    | 2.2  | 3.0   | Dec - 14  |
| Euro                | Hungarian forint | 4,763.3                                    | 6,430.5                                       | Dec - 14  |
| Euro                | Japanese yen     | 4,288.9                                    | 5,830.7                                       | Dec - 14  |
| Euro                | Korean won       | 414.5                                      | 663.1   | Jul - 14  |
| Euro                | Polish zloty     | 69.2                                       | 96.0  | Dec - 14  |
| Euro                | US dollar        | 21.6                                       | 29.4  | Dec - 14  |
| Hungarian forint    | Euro             | 4.7  | 6.6   | Dec - 14  |
| Japanese yen        | Chinese yuan     | 64.1                                       | 84.0  | Dec - 14  |
| Japanese yen        | Korean won       | 5,115.6                                    | 5,715.5                                       | Dec - 14  |
| Japanese yen        | US dollar        | 2.7  | 4.2   | Dec - 14  |
| Korean won          | Euro             | 19.9                                       | 23.6  | Dec - 14  |
| Korean won          | Japanese yen     | 224.3                                      | 380.5   | Aug - 14  |
| Korean won          | US dollar        | 4.7  | —   | Dec - 14  |
| Mexican peso        | US dollar        | 11.4                                       | —   | Dec - 14  |
| Swedish krona       | Euro             | 25.5                                       | 33.7  | Dec - 14  |
| US dollar           | Japanese yen     | 3,139.5                                    | 3,209.3                                       | Sept - 14 |

At March 31, 2014 and December 31, 2013, the following amounts were recorded in the Condensed Consolidated Balance Sheets as being payable to or receivable from counterparties under ASC Topic 815:

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| (millions of dollars)          | Assets                               |                | Liabilities       |                                       |                |                   |
|--------------------------------|--------------------------------------|----------------|-------------------|---------------------------------------|----------------|-------------------|
|                                | Location                             | March 31, 2014 | December 31, 2013 | Location                              | March 31, 2014 | December 31, 2013 |
| Foreign currency contracts     | Prepayments and other current assets | \$2.2          | \$3.4             | Accounts payable and accrued expenses | \$4.7          | \$7.4             |
| Net investment hedge contracts | Other non-current assets             | \$—            | \$—               | Other non-current liabilities         | \$23.7         | \$24.3            |

Effectiveness for cash flow and net investment hedges is assessed at the inception of the hedging relationship and quarterly, thereafter. To the extent that derivative instruments are deemed to be effective, gains and losses arising from these contracts are deferred into accumulated other comprehensive income (loss) ("AOCI") and reclassified into income as the underlying operating transactions are recognized. These realized gains or losses offset the hedged transaction and are recorded on the same line in the statement of operations. To the extent that derivative instruments are deemed to be ineffective, gains or losses are recognized into income.

The table below shows deferred gains (losses) reported in AOCI as well as the amount expected to be reclassified to income in one year or less. The amount expected to be reclassified to income in one year or less assumes no change in the current relationship of the hedged item at March 31, 2014 market rates.

| (millions of dollars) | Deferred gain (loss) in AOCI at |                   | Gain (loss) expected to be reclassified to income in one year or less |
|-----------------------|---------------------------------|-------------------|---|
|                       | March 31, 2014                  | December 31, 2013 |   |
| Contract Type         |                                 |                   |   |
| Foreign currency      | \$ (2.4 )                       | \$ (3.7 )         | \$ (2.4 )   |
| Net investment hedges | (25.9 )                         | (22.1 )           | —   |
| Total                 | \$ (28.3 )                      | \$ (25.8 )        | \$ (2.4 )   |

Derivative instruments designated as hedging instruments as defined by ASC Topic 815 held during the period resulted in the following gains and losses recorded in income:

| (millions of dollars) | Contract Type       | Location           | Gain (loss) reclassified from AOCI to income (effective portion) |                | Gain (loss) recognized in income (ineffective portion) |                |
|-----------------------|---------------------|--------------------|--|----------------|--|----------------|
|                       |                     |                    | Three Months Ended   |                | Three Months Ended                                     |                |
|                       |                     |                    | March 31, 2014   | March 31, 2013 | March 31, 2014   | March 31, 2013 |
|                       | Foreign currency    | Sales              | \$0.3  | \$1.2          | \$—  | \$0.1          |
|                       | Foreign currency    | Cost of goods sold | \$ (0.8 )  | \$ (1.4 )      | \$0.1  | \$ (0.3 )      |
|                       | Foreign currency    | SG&A expense       | \$ (0.3 )  | \$—            | \$—  | \$—            |
|                       | Cross-currency swap | N/A                |  |                | \$0.7  | \$ (0.7 )      |

At March 31, 2014, derivative instruments that were not designated as hedging instruments as defined by ASC Topic 815 were immaterial.

(11) Retirement Benefit Plans

The Company has a number of defined benefit pension plans and other postretirement benefit plans covering eligible salaried and hourly employees and their dependents. The estimated contributions to the Company's defined benefit pension plans for 2014 range from \$15.0 million to \$25.0 million, of which \$5.0 million has been contributed through the first three months of the year. The other postretirement benefit plans, which provide medical and life insurance benefits, are unfunded plans.

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The components of net periodic benefit cost recorded in the Condensed Consolidated Statements of Operations are as follows:

| (millions of dollars)                              | Pension benefits |        |        |        | Other post-retirement benefits |        |
|--|------------------|--------|--------|--------|--------------------------------|--------|
|  | 2014             |        | 2013   |        | 2014                           | 2013   |
| Three Months Ended March 31,                       | US               | Non-US | US     | Non-US |                                |        |
| Service cost                                       | \$—              | \$3.3  | \$—    | \$3.1  | \$—                            | \$0.1  |
| Interest cost                                      | 3.1              | 4.6    | 2.9    | 4.2    | 1.7                            | 1.7    |
| Expected return on plan assets                     | (4.4 )           | (5.4 ) | (4.6 ) | (2.7 ) | —                              | —      |
| Amortization of unrecognized prior service benefit | (0.2 )           | —      | (0.2 ) | —      | (1.6 )                         | (1.6 ) |
| Amortization of unrecognized loss                  | 1.6              | 1.2    | 2.1    | 1.3    | 0.7                            | 1.2    |
| Net periodic benefit cost                          | \$0.1            | \$3.7  | \$0.2  | \$5.9  | \$0.8                          | \$1.4  |

## (12) Stock-Based Compensation

Under the Company's 2004 Stock Incentive Plan ("2004 Plan"), the Company granted options to purchase shares of the Company's common stock at the fair market value on the date of grant. The options vested over periods up to three years and have a term of 10 years from date of grant. At its November 2007 meeting, the Company's Compensation Committee decided that restricted common stock awards and stock units ("restricted stock") would be awarded in place of stock options for long-term incentive award grants to employees. Restricted stock granted to employees vests 50% after two years and the remainder after three years from the date of grant. Restricted stock granted to non-employee directors generally vests on the anniversary date of the grant. Under the 2004 Plan, 25.0 million shares are authorized for grant, of which approximately 2.6 million shares are available for future issuance as of March 31, 2014. In February 2014, the Company's Board of Directors replaced the expired 2004 Plan by adopting the BorgWarner Inc. 2014 Stock Incentive Plan ("the 2014 Plan"). On April 30, 2014, the Company's stockholders voted and approved the 2014 Plan.

Stock options A summary of the Company's stock option activity for the three months ended March 31, 2014 is as follows:

|  | Shares under option (thousands) | Weighted average exercise price | Weighted average remaining contractual life (in years) | Aggregate intrinsic value (in millions) |
|--|---------------------------------|---------------------------------|--|---|
| Outstanding and exercisable at December 31, 2013 | 1,997                           | \$15.82                         | 2.6  | \$80.0                                  |
| Exercised  | (54 )                           | \$14.41                         |  |   |
| Outstanding and exercisable at March 31, 2014    | 1,943                           | \$15.86                         | 2.4  | \$88.6                                  |

Restricted stock The value of restricted stock is determined by the market value of the Company's common stock at the date of grant. In 2014, restricted stock in the amount of 419,926 shares was granted to employees under the 2004 Stock Incentive Plan. The value of the awards is recorded as unearned compensation within capital in excess of par value in equity and is amortized as compensation expense over the restriction periods.

The Company recorded restricted stock compensation expense of \$4.5 million and \$11.1 million for the three months ended March 31, 2014 and 2013, respectively.

During the fourth quarter of 2012, the Company waived the forfeiture provision associated with future restricted stock grants made to certain retiring Named Executive Officers. The expense of \$11.1 million for

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the three months ended March 31, 2013 includes \$5.5 million of expense related to the grant of restricted stock awards to these Named Executive Officers.

A summary of the Company's nonvested restricted stock for the three months ended March 31, 2014 is as follows:

|                                | Shares subject<br>to restriction<br>(thousands) | Weighted<br>average price |
|--------------------------------|---|---------------------------|
| Nonvested at December 31, 2013 | 1,411   | \$37.86                   |
| Granted                        | 420   | \$53.90                   |
| Vested                         | (498)   | ) \$37.38                 |
| Forfeited                      | (16)  | ) \$39.54                 |
| Nonvested at March 31, 2014    | 1,317   | \$43.08                   |

## (13) Accumulated Other Comprehensive Income (Loss)

The following table summarizes the activity within accumulated other comprehensive income (loss) during the three months ended March 31, 2014:

| (millions of dollars)   | Foreign<br>currency<br>translation<br>adjustments | Hedge<br>instruments | Defined<br>benefit<br>postretirement<br>plans | Other   | Total    |
|---|---|----------------------|---|---------|----------|
| Beginning Balance, December 31, 2013  | \$181.1   | \$(16.0)             | ) \$(181.5)                                   | ) \$2.4 | \$(14.0) |
| Comprehensive loss before reclassifications                                       | (2.7)   | ) (3.4)              | ) —   | —       | (6.1)    |
| Income taxes associated with comprehensive income (loss) before reclassifications | —   | 1.3                  | —   | —       | 1.3      |
| Reclassification from accumulated other comprehensive income                      | —   | 0.9                  | 1.7   | —       | 2.6      |
| Income taxes reclassified into net earnings                                       | —   | (0.1)                | ) (0.5)                                       | ) —     | (0.6)    |
| Ending Balance March 31, 2014   | \$178.4   | \$(17.3)             | ) \$(180.3)                                   | ) \$2.4 | \$(16.8) |

## (14) Contingencies

In the normal course of business, the Company is party to various commercial and legal claims, actions and complaints, including matters involving warranty claims, intellectual property claims, general liability and various other risks. It is not possible to predict with certainty whether or not the Company will ultimately be successful in any of these commercial and legal matters or, if not, what the impact might be. The Company's environmental and product liability contingencies are discussed separately below. The Company's management does not expect that an adverse outcome in any of these commercial and legal claims, actions and complaints will have a material adverse effect on the Company's results of operations, financial position or cash flows, although it could be material to the results of operations in a particular quarter.

## Litigation

In January 2006, BorgWarner Diversified Transmission Products Inc. ("DTP"), a subsidiary of the Company, filed a declaratory judgment action in United States District Court, Southern District of Indiana (Indianapolis Division) against the United Automobile, Aerospace, and Agricultural Implements Workers of America ("UAW") Local No. 287 and Gerald Poor, individually and as the representative of a defendant class. DTP sought the Court's affirmation that DTP did not violate the Labor-Management Relations Act or the Employee Retirement Income Security Act (ERISA) by unilaterally amending certain medical plans effective April 1, 2006 and October 1, 2006, prior to the expiration of the then-current collective bargaining agreements. On September 10, 2008, the Court found that DTP's reservation of the right to make such amendments reducing the level of benefits provided to retirees was limited by its collectively bargained

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health insurance agreement with the UAW, which did not expire until April 24, 2009. Thus, the amendments were untimely. In 2008, the Company recorded a charge of \$4.0 million as a result of the Court's decision.

DTP filed a declaratory judgment action in the United States District Court, Southern District of Indiana (Indianapolis Division) against the UAW Local No. 287 and Jim Barrett and others, individually and as representatives of a defendant class, on February 26, 2009 again seeking the Court's affirmation that DTP did not violate the Labor - Management Relations Act or ERISA by modifying the level of benefits provided retirees to make them comparable to other Company retiree benefit plans after April 24, 2009. Certain retirees, on behalf of themselves and others, filed a mirror-image action in the United States District Court, Eastern District of Michigan (Southern Division) on March 11, 2009, for which a class has been certified. During the last quarter of 2009, the action pending in Indiana was dismissed, while the action in Michigan is continuing. The Company is vigorously defending against the suit. This contingency is subject to many uncertainties, therefore based on the information available to date, the Company cannot reasonably estimate the amount or the range of potential loss, if any.

Environmental

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency and certain state environmental agencies and private parties as potentially responsible parties ("PRPs") at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act ("Superfund") and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 27 such sites.

Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

The Company believes that none of these matters, individually or in the aggregate, will have a material adverse effect on its results of operations, financial position or cash flows. Generally, this is because either the estimates of the maximum potential liability at a site are not material or the liability will be shared with other PRPs, although no assurance can be given with respect to the ultimate outcome of any such matter.

Based on information available to the Company (which in most cases includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large, solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation and consulting costs; and remediation alternatives), the Company has an accrual for indicated environmental liabilities of \$7.7 million and \$4.0 million at March 31, 2014 and at December 31, 2013, respectively. The Company expects to pay out substantially all of the amounts accrued for environmental liability over the next five years.

In connection with the sale of Kuhlman Electric Corporation ("Kuhlman Electric"), the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities, then unknown to the Company, relating to certain operations of Kuhlman Electric that pre-date the Company's 1999 acquisition of Kuhlman Electric. The Company previously settled or obtained dismissals of various lawsuits that were filed against Kuhlman Electric and others, including the Company, on behalf of plaintiffs alleging personal injury relating to alleged environmental contamination at its Crystal Springs, Mississippi plant. The Company filed a lawsuit against Kuhlman Electric and a related entity challenging the validity of the indemnity and the defendants filed counterclaims and a related lawsuit. In addition, two lawsuits by plaintiffs alleging environmental contamination relating to Kuhlman Electric's Crystal Springs plant are still pending and the Company may in the future become subject to further legal proceedings.



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Product Liability

Like many other industrial companies who have historically operated in the U.S., the Company (or parties the Company is obligated to indemnify) continues to be named as one of many defendants in asbestos-related personal injury actions. We believe that the Company's involvement is limited because, in general, these claims relate to a few types of automotive friction products that were manufactured many years ago and contained encapsulated asbestos. The nature of the fibers, the encapsulation and the manner of use lead the Company to believe that these products are highly unlikely to cause harm. As of March 31, 2014 and December 31, 2013, the Company had approximately 17,500 and 17,000 pending asbestos-related product liability claims, respectively. Of the approximately 17,500 outstanding claims at March 31, 2014, approximately half were pending in jurisdictions that have undergone significant tort and judicial reform activities subsequent to the filing of these claims.

The Company's policy is to vigorously defend against these lawsuits and the Company has been successful in obtaining dismissal of many claims without any payment. The Company expects that the vast majority of the pending asbestos-related product liability claims where it is a defendant (or has an obligation to indemnify a defendant) will result in no payment being made by the Company or its insurers. In 2014, of the approximately 600 claims resolved, 105 (18%) resulted in payment being made to a claimant by or on behalf of the Company. In the full year of 2013, of the approximately 1,500 claims resolved, 297 (20%) resulted in any payment being made to a claimant by or on behalf of the Company.

Prior to June 2004, the settlement and defense costs associated with all claims were paid by the Company's primary layer insurance carriers under a series of funding arrangements. In addition to the primary insurance available for asbestos-related claims, the Company has substantial excess insurance coverage available for potential future asbestos-related product claims. In June 2004, primary layer insurance carriers notified the Company of the alleged exhaustion of their policy limits.

A declaratory judgment action was filed in January 2004 in the Circuit Court of Cook County, Illinois by Continental Casualty Company and related companies against the Company and certain of its historical general liability insurers. The court has issued a number of interim rulings and discovery is continuing. The Company has entered into settlement agreements with some of its insurance carriers, resolving their coverage disputes by agreeing to pay specified amounts to the Company. The Company is vigorously pursuing the litigation against the remaining insurers.

In August 2013, the Los Angeles Superior Court entered a jury verdict against the Company in an asbestos-related personal injury action with damages of \$35.0 million, \$32.5 million of which was non-compensatory and will not be recoverable through insurance if the verdict is upheld. The Company has appealed this verdict. The Company posted a surety bond of \$55.0 million related to the appeal. The Company cannot predict the outcome of this pending litigation and therefore cannot reasonably estimate the amount of possible loss, if any, that could result from this action. Although it is impossible to predict the outcome of pending or future claims or the impact of tort reform legislation that may be enacted at the state or federal levels, due to the encapsulated nature of the products, the Company's experience in vigorously defending and resolving claims in the past, and the Company's significant insurance coverage with solvent carriers as of the date of this filing, management does not believe that asbestos-related product liability claims are likely to have a material adverse effect on the Company's results of operations, financial position or cash flows.

To date, the Company has paid and accrued \$294.1 million in defense and indemnity in advance of insurers' reimbursement and has received \$124.8 million in cash and notes from insurers. The net balance of \$169.3 million, is expected to be fully recovered, of which approximately \$20.0 million is expected to be recovered within one year. Timing of recovery is dependent on final resolution of the declaratory judgment



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action referred to above or additional negotiated settlements. At December 31, 2013, insurers owed \$153.6 million in association with these claims.

In addition to the \$169.3 million net balance relating to past settlements and defense costs, the Company has estimated a liability of \$107.1 million for claims asserted, but not yet resolved and their related defense costs at March 31, 2014. The Company also has a related asset of \$107.1 million to recognize proceeds from the insurance carriers, which is expected to be fully recovered. Receipt of these proceeds is not expected prior to the resolution of the declaratory judgment action referred to above, which, more-likely-than-not, will occur subsequent to March 31, 2015. At December 31, 2013, the comparable value of the accrued liability and associated insurance asset was \$96.7 million.

The amounts recorded in the Condensed Consolidated Balance Sheets related to the estimated future settlement of existing claims are as follows:

| (millions of dollars)                 | March 31,<br>2014 | December 31,<br>2013 |
|---------------------------------------|-------------------|----------------------|
| Assets:                               |                   |                      |
| Other non-current assets              | \$107.1           | \$96.7               |
| Total insurance assets                | \$107.1           | \$96.7               |
| Liabilities:                          |                   |                      |
| Accounts payable and accrued expenses | \$44.1            | \$41.1               |
| Other non-current liabilities         | 63.0              | 55.6                 |
| Total accrued liabilities             | \$107.1           | \$96.7               |

The 2014 increase in the accrued liability and associated insurance asset is primarily due to an expected higher rate of claim settlement based on recent litigation claim activity.

The Company cannot reasonably estimate possible losses, if any, in excess of those for which it has accrued, because it cannot predict how many additional claims may be brought against the Company (or parties the Company has an obligation to indemnify) in the future, the allegations in such claims, the possible outcomes, or the impact of tort reform legislation that may be enacted at the state or federal levels.

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## (15) Restructuring

In the fourth quarter of 2013, the Company initiated actions primarily in the Drivetrain segment designed to improve future profitability and competitiveness. As a continuation of these actions, the Company finalized severance agreements with two labor unions at separate facilities in Western Europe for approximately 350 employees. The Company recorded \$39.5 million of restructuring expense in the first quarter of 2014, primarily related to one of these facilities. Included in this restructuring expense are employee termination benefits of \$32.8 million and other expense of \$6.7 million.

The Company expects an additional \$26.0 million of employee termination benefits to be incurred over the next two years as employees render service in accordance with terms of the agreements. Future cash payments for these restructuring activities are expected to be complete by the end of 2015.

Estimates of restructuring expense are based on information available at the time such charges are recorded. Due to the inherent uncertainty involved in estimating restructuring expenses, actual amounts paid for such activities may differ from amounts initially recorded. Accordingly, the Company may record revisions of previous estimates by adjusting previously established accruals.

The following table displays a rollforward of the employee related restructuring accruals recorded within the Company's Consolidated Balance Sheet and the related cash flow activity for the three months ended March 31, 2014:

| (millions of dollars)        | Employee Related Costs |        |        |
|------------------------------|------------------------|--------|--------|
|                              | Drivetrain             | Engine | Total  |
| Balance at December 31, 2013 | \$8.4                  | \$2.8  | \$11.2 |
| Provision                    | 32.1                   | 0.7    | 32.8   |
| Cash payments                | (1.2                   | ) (1.6 | ) (2.8 |
| Translation adjustment       | —                      | —      | —      |
| Balance at March 31, 2014    | \$39.3                 | \$1.9  | \$41.2 |

## (16) Earnings Per Share

The Company presents both basic and diluted earnings per share of common stock ("EPS") amounts. Basic EPS is calculated by dividing net earnings attributable to BorgWarner Inc. by the weighted average shares of common stock outstanding during the reporting period. Diluted EPS is calculated by dividing net earnings attributable to BorgWarner Inc. by the weighted average shares of common stock and common equivalent stock outstanding during the reporting period.

The dilutive impact of stock-based compensation is calculated using the treasury stock method. The treasury stock method assumes that the Company uses the assumed proceeds from the exercise of awards to repurchase common stock at the average market price during the period. The assumed proceeds under the treasury stock method include the purchase price that the grantee will pay in the future, compensation cost for future service that the Company has not yet recognized and any windfall/(shortfall) tax benefits that would be credited/(debited) to capital in excess of par value when the award generates a tax deduction. Options are only dilutive when the average market price of the underlying common stock exceeds the exercise price of the options.

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The following table reconciles the numerators and denominators used to calculate basic and diluted earnings per share of common stock:

| (in millions, except per share amounts)                                       | Three Months Ended<br>March 31, |         |
|---|---------------------------------|---------|
|   | 2014                            | 2013    |
| Basic earnings per share:   |                                 |         |
| Net earnings attributable to BorgWarner Inc.                                  | \$159.1                         | \$142.0 |
| Weighted average shares of common stock outstanding                           | 227.430                         | 230.372 |
| Basic earnings per share of common stock                                      | \$0.70                          | \$0.62  |
| Diluted earnings per share:   |                                 |         |
| Net earnings attributable to BorgWarner Inc.                                  | \$159.1                         | \$142.0 |
| Adjustment for net interest expense on convertible notes                      | —                               | —       |
| Diluted net earnings attributable to BorgWarner Inc.                          | \$159.1                         | \$142.0 |
| Weighted average shares of common stock outstanding                           | 227.430                         | 230.372 |
| Effect of 3.50% convertible senior notes                                      | —                               | —       |
| Effect of warrant   | —                               | —       |
| Effect of stock-based compensation  | 1.897                           | 2.758   |
| Weighted average shares of common stock outstanding including dilutive shares | 229.327                         | 233.130 |
| Diluted earnings per share of common stock                                    | \$0.69                          | \$0.61  |
| Total anti-dilutive shares:   |                                 |         |
| Call options  | —                               | —       |

## (17) Reporting Segments

The Company's business is comprised of two reporting segments: Engine and Drivetrain. These segments are strategic business groups, which are managed separately as each represents a specific grouping of related automotive components and systems.

The Company allocates resources to each segment based upon the projected after-tax return on invested capital ("ROIC") of its business initiatives. ROIC is comprised of Adjusted EBIT after deducting notional taxes compared to the projected average capital investment required. Adjusted EBIT is comprised of earnings before interest, income taxes and noncontrolling interest ("EBIT") adjusted for restructuring, goodwill impairment charges, affiliates' earnings and other items not reflective of on-going operating income or loss.

Adjusted EBIT is the measure of segment income or loss used by the Company. The Company believes Adjusted EBIT is most reflective of the operational profitability or loss of our reporting segments. The following tables show segment information and Adjusted EBIT for the Company's reporting segments.

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## Net Sales by Reporting Segment

| (millions of dollars)      | Three Months Ended |           |   |
|----------------------------|--------------------|-----------|---|
|                            | March 31,          |           |   |
|                            | 2014               | 2013      |   |
| Engine                     | \$1,412.1          | \$1,257.5 |   |
| Drivetrain                 | 680.7              | 601.4     |   |
| Inter-segment eliminations | (8.7               | ) (7.8    | ) |
| Net sales                  | \$2,084.1          | \$1,851.1 |   |

## Adjusted Earnings Before Interest, Income Taxes and Noncontrolling Interest ("Adjusted EBIT")

| (millions of dollars)  | Three Months Ended |         |   |
|--|--------------------|---------|---|
|  | March 31,          |         |   |
|  | 2014               | 2013    |   |
| Engine   | \$231.7            | \$202.3 |   |
| Drivetrain   | 80.5               | 56.0    |   |
| Adjusted EBIT  | 312.2              | 258.3   |   |
| Restructuring expense  | 39.5               | —       |   |
| Program termination agreement  | —                  | 11.3    |   |
| Retirement related obligations   | —                  | 5.9     |   |
| Corporate, including equity in affiliates' earnings and stock-based compensation | 30.7               | 32.9    |   |
| Interest income  | (1.5               | ) (1.0  | ) |
| Interest expense and finance charges   | 8.2                | 9.7     |   |
| Earnings before income taxes and noncontrolling interest                         | 235.3              | 199.5   |   |
| Provision for income taxes   | 68.1               | 50.9    |   |
| Net earnings   | 167.2              | 148.6   |   |
| Net earnings attributable to the noncontrolling interest, net of tax             | 8.1                | 6.6     |   |
| Net earnings attributable to BorgWarner Inc.                                     | \$159.1            | \$142.0 |   |

## Total Assets

| (millions of dollars) | March 31, |           | December 31, |  |
|-----------------------|-----------|-----------|--------------|--|
|                       | 2014      |           | 2013         |  |
| Engine                | \$4,002.5 | \$3,519.1 |              |  |
| Drivetrain            | 1,863.8   | 1,786.6   |              |  |
| Total                 | 5,866.3   | 5,305.7   |              |  |
| Corporate (a)         | 1,491.5   | 1,611.3   |              |  |
| Total assets          | \$7,357.8 | \$6,917.0 |              |  |

(a) Corporate assets include investments and advances and deferred income taxes.

## (18) Recent Transactions

On February 28, 2014, the Company acquired 100% of the equity interests in Gustav Wahler GmbH u. Co. KG and its general partner ("Wahler"). Wahler is a producer of exhaust gas recirculation ("EGR") valves, EGR tubes and thermostats, and has operations in Germany, Brazil, the U.S., China and Slovakia. The cash paid, net of cash acquired was \$106.4 million (77.1 million Euro).

The Wahler acquisition is expected to strengthen the Company's strategic position as a producer of complete EGR systems and create additional market opportunities in both passenger and commercial vehicle applications.



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The operating results and assets are reported within the Company's Engine reporting segment as of the date of the acquisition. The impact of Wahler is not expected to be material to 2014 consolidated revenues and earnings. The Company paid \$106.4 million, which is recorded as an investing activity in the Company's Condensed Consolidated Statement of Cash Flows. Additionally, the Company assumed retirement-related liabilities of \$3.2 million and assumed debt of \$33.3 million, which are reflected in the supplemental cash flow information on the Company's Condensed Consolidated Statement of Cash Flows.

The following table summarizes the aggregated estimated fair value of the assets acquired and liabilities assumed on February 28, 2014, the date of acquisition:

(millions of dollars)

|  |         |   |
|--|---------|---|
| Receivables, net                             | \$52.4  |   |
| Inventories, net                             | 50.9    |   |
| Property, plant and equipment, net           | 55.7    |   |
| Goodwill                                     | 47.3    |   |
| Other intangible assets                      | 36.6    |   |
| Other assets and liabilities                 | (28.6   | ) |
| Accounts payable and accrued expenses        | (71.4   | ) |
| Total consideration, net of cash acquired    | 142.9   |   |
| Less: Assumed retirement-related liabilities | 3.2     |   |
| Less: Assumed debt                           | 33.3    |   |
| Cash paid, net of cash acquired              | \$106.4 |   |

In connection with the acquisition, the Company capitalized \$18.8 million for customer relationships, \$10.2 million for know-how, \$4.1 million for patented technology and \$3.5 million for the Wahler trade name. Customer relationships and know-how will be amortized over a period of up to 15 years, patented technology will be amortized over seven years and the Wahler trade name will not be amortized as it has an indefinite useful life. The income approach was used to determine the fair value of all intangible assets. Additionally, \$25.4 million in goodwill is expected to be non-deductible for tax purposes.

The Company is in the process of finalizing all purchase accounting adjustments related to the Wahler acquisition. Subsequent adjustments may be necessary based on the finalization of certain estimates, including any fair value or working capital adjustments.



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

INTRODUCTION

BorgWarner Inc. and Consolidated Subsidiaries (the "Company") is a leading global supplier of highly engineered automotive systems and components primarily for powertrain applications. Our products help improve vehicle performance, fuel efficiency, stability and air quality. These products are manufactured and sold worldwide, primarily to original equipment manufacturers ("OEMs") of light vehicles (passenger cars, sport-utility vehicles ("SUVs"), vans and light trucks). The Company's products are also sold to other OEMs of commercial vehicles (medium-duty trucks, heavy-duty trucks and buses) and off-highway vehicles (agricultural and construction machinery and marine applications). We also manufacture and sell our products to certain Tier One vehicle systems suppliers and into the aftermarket for light, commercial and off-highway vehicles. The Company operates manufacturing facilities serving customers in the Americas, Europe and Asia and is an original equipment supplier to every major automotive OEM in the world.

The Company's products fall into two reporting segments: Engine and Drivetrain. The Engine segment's products include turbochargers, timing devices and chain products, emissions systems, thermal systems, diesel cold start and gasoline ignition technology. The Drivetrain segment's products include transmission components and systems and all-wheel drive torque management systems.

Stock Split

On November 13, 2013, the Company's Board of Directors declared a two-for-one stock split effected in the form of a stock dividend on our common stock. To implement this stock split, shares of common stock were issued on December 16, 2013 to stockholders of record as of the close of business on December 2, 2013. All prior year share and per share amounts disclosed in this document have been restated to reflect the two-for-one stock split.

RESULTS OF OPERATIONS

Three Months Ended March 31, 2014 vs. Three Months Ended March 31, 2013

Net sales for the three months ended March 31, 2014 totaled \$2,084.1 million, a 12.6% increase from the three months ended March 31, 2013. Excluding the impact of the 2014 acquisition of Gustav Wahler GmbH u. Co. KG and its general partner ("Wahler") and strengthening foreign currencies, primarily the Euro, partially offset by the weakening Real and Yen, net sales increased approximately 9%.

Cost of sales as a percentage of net sales decreased to 78.6% in the three months ended March 31, 2014 from 79.8% in the three months ended March 31, 2013. Gross profit and gross margin were \$445.8 million and 21.4% in the three months ended March 31, 2014 compared to \$374.7 million and 20.2% in the three months ended March 31, 2013. The Company's material cost of sales was approximately 50% of net sales in both the three months ended March 31, 2014 and 2013. The Company's remaining cost to convert raw material to finished product (conversion cost) slightly decreased compared to the three months ended March 31, 2013.

Selling, general and administrative ("SG&A") expenses for the three months ended March 31, 2014 increased \$14.5 million to \$173.8 million from \$159.3 million, and decreased as a percentage of net sales to 8.3% from 8.6% in the three months ended March 31, 2013. Research and Development ("R&D") expenses, which are included in SG&A expenses, increased \$10.2 million to \$82.0 million from \$71.8 million as compared to the three months ended March 31, 2013. As a percentage of net sales, R&D expenses were 3.9% in the three months ended March 31, 2014 and 2013. Our continued investment in a number of cross-business R&D programs, as well as other key programs, is necessary for the Company's short- and long-term growth.



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Other expense of \$38.8 million for the three months ended March 31, 2014 is primarily related to \$39.5 million of additional restructuring expense, largely associated with continued Drivetrain segment actions designed to improve future profitability and competitiveness. The Company estimates that additional restructuring charges of approximately \$51.0 million will be incurred over the next two years related to the Drivetrain segment restructuring plan. For the three months ended March 31, 2013, the other expense of \$16.9 million was primarily related to an \$11.3 million expense associated with a program termination agreement and a \$5.9 million retirement related obligation related to a first quarter 2013 grant of restricted stock awards to certain retiring Named Executive Officers, which resulted from the Company's fourth quarter 2012 decision to waive the forfeiture provision associated with future restricted stock grants made to these Named Executive Officers.

Equity in affiliates' earnings of \$8.8 million decreased \$0.9 million as compared with the three months ended March 31, 2013 primarily due to lower earnings from the Company's 50% interest in NSK-Warner.

At March 31, 2014, the Company's effective tax rate for the first quarter was 28.9%, which includes tax benefits of \$8.8 million related to restructuring expense discussed in the Other Expense footnote. Excluding the impact of these non-comparable items, the Company has estimated its annual effective tax rate associated with ongoing operations to be approximately 28% for the year ending December 31, 2014.

At March 31, 2013, the Company's effective tax rate for the first quarter was 25.5%. This rate included tax benefits of \$3.8 million and \$2.1 million related to the program termination agreement and retirement related obligations discussed in the Other Expense footnote. This rate also included a net tax benefit of \$1.7 million, which is comprised of a \$6.6 million tax benefit related to the extension of the federal research and development credit and other international tax provisions resulting from the retroactive impact of U.S. legislation enacted in January 2013, partially offset by a \$4.9 million tax expense related to a comprehensive income adjustment. At March 31, 2013, excluding the impact of these non-comparable items, the Company estimated its annual effective tax rate associated with ongoing operations to be approximately 27% for the year ended December 31, 2013.

The Company's earnings per diluted share were \$0.69 and \$0.61 for the three months ended March 31, 2014 and 2013, respectively. The Company believes the following table is useful in highlighting non-comparable items that impacted its earnings per diluted share.

|  | Three Months<br>Ended<br>March 31, 2014 | Three Months<br>Ended<br>March 31, 2013 |
|--|---|---|
| Non-comparable items:                                    |   |   |
| Restructuring expense                                    | \$(0.13                                 | ) \$—                                   |
| Program termination agreement                            | —                                       | (0.03 )                                 |
| Retirement related obligations                           | —                                       | (0.02 )                                 |
| Tax adjustments  | —                                       | 0.01                                    |
| Total impact of non-comparable items per share — diluted | \$(0.13                                 | ) \$(0.04 )                             |

## Reporting Segments

The Company's business is comprised of two reporting segments: Engine and Drivetrain. These segments are strategic business groups, which are managed separately as each represents a specific grouping of related automotive components and systems.

The Company allocates resources to each segment based upon the projected after-tax return on invested capital ("ROIC") of its business initiatives. ROIC is comprised of Adjusted EBIT after deducting notional taxes compared to

the projected average capital investment required. Adjusted EBIT is comprised of earnings

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before interest, income taxes and noncontrolling interest ("EBIT") adjusted for restructuring, goodwill impairment charges, affiliates' earnings and other items not reflective of on-going operating income or loss.

Adjusted EBIT is the measure of segment income or loss used by the Company. The Company believes Adjusted EBIT is most reflective of the operational profitability or loss of our reporting segments. The following tables show segment information and Adjusted EBIT for the Company's reporting segments.

## Net Sales by Reporting Segment

| (millions of dollars)      | Three Months Ended |           |
|----------------------------|--------------------|-----------|
|                            | March 31,          |           |
|                            | 2014               | 2013      |
| Engine                     | \$1,412.1          | \$1,257.5 |
| Drivetrain                 | 680.7              | 601.4     |
| Inter-segment eliminations | (8.7)              | (7.8)     |
| Net sales                  | \$2,084.1          | \$1,851.1 |

## Adjusted Earnings Before Interest, Income Taxes and Noncontrolling Interest ("Adjusted EBIT")

| (millions of dollars)  | Three Months Ended |         |
|--|--------------------|---------|
|  | March 31,          |         |
|  | 2014               | 2013    |
| Engine   | \$231.7            | \$202.3 |
| Drivetrain   | 80.5               | 56.0    |
| Adjusted EBIT  | 312.2              | 258.3   |
| Restructuring expense  | 39.5               | —       |
| Program termination agreement  | —                  | 11.3    |
| Retirement related obligations   | —                  | 5.9     |
| Corporate, including equity in affiliates' earnings and stock-based compensation | 30.7               | 32.9    |
| Interest income  | (1.5)              | (1.0)   |
| Interest expense and finance charges   | 8.2                | 9.7     |
| Earnings before income taxes and noncontrolling interest                         | 235.3              | 199.5   |
| Provision for income taxes   | 68.1               | 50.9    |
| Net earnings   | 167.2              | 148.6   |
| Net earnings attributable to the noncontrolling interest, net of tax             | 8.1                | 6.6     |
| Net earnings attributable to BorgWarner Inc.                                     | \$159.1            | \$142.0 |

## Three Months Ended March 31, 2014 vs. Three Months Ended March 31, 2013

The Engine segment net sales increased \$154.6 million, or 12.3%, from the three months ended March 31, 2013. Excluding the impact of the 2014 Wahler acquisition and strengthening foreign currencies, primarily the Euro, partially offset by the weakening Real and Yen, net sales increased approximately 8% from the three months ended March 31, 2013, primarily due to higher sales of turbochargers, EGR coolers and engine timing devices. The Engine segment Adjusted EBIT margin was 16.4% in the three months ended March 31, 2014 up from 16.1% in the three months ended March 31, 2013.

The Drivetrain segment net sales increased \$79.3 million, or 13.2%, from the three months ended March 31, 2013. Excluding the impact of strengthening foreign currencies, primarily the Euro, net sales increased approximately 12% from the three months ended March 31, 2013, primarily due to higher sales of all-wheel drive systems, traditional transmission components and dual clutch transmission modules. The Drivetrain segment Adjusted EBIT margin was 11.8% in the three months ended March 31, 2014 up from 9.3% in the three months ended March 31, 2013.

## Outlook for 2014

Our overall outlook for 2014 is positive. The Company expects moderate global vehicle production growth in 2014 compared with 2013. However, the Company's sales growth is expected to outpace global vehicle production in 2014 due to rapid adoption of BorgWarner products around the world.

The Company maintains a positive long-term outlook for its global business and is committed to new product development and strategic capital investments to enhance its product leadership strategy. The trends that are driving our long-term growth are expected to continue, including the growth of direct injection diesel and gasoline engines worldwide, the increased adoption of automated transmissions in Europe and Asia-Pacific, and the move to variable cam and chain engine timing systems in Europe and Asia-Pacific.

## FINANCIAL CONDITION AND LIQUIDITY

The Company maintains various liquidity sources including cash and cash equivalents and the unused portion of our multi-currency revolving credit agreement. At March 31, 2014, the Company had \$808.1 million of cash, of which \$750.7 million of cash held by our subsidiaries outside of the United States. Cash held by these subsidiaries is used to fund foreign operational activities and future investments, including acquisitions. The vast majority of cash held outside the United States is available for repatriation, however, doing so could result in increased foreign and U.S. federal, state and local income taxes. A deferred tax liability has been recorded for the portion of these funds anticipated to be repatriated to the United States. The Company uses its U.S. liquidity for various corporate purposes, including but not limited to, debt service, share repurchases, dividend distributions and other corporate expenses.

The Company's \$750 million multi-currency revolving credit facility includes a feature that allows the Company's borrowings to be increased to \$1 billion. The credit facility provides for borrowings through June 30, 2016 and is guaranteed by the Company's material domestic subsidiaries. The credit facility has two key financial covenants, a debt compared to EBITDA ("Earnings Before Interest, Taxes, Depreciation and Amortization") test and an interest coverage test. The Company was in compliance with all covenants at March 31, 2014 and expects to remain compliant in future periods. At March 31, 2014 and December 31, 2013, the Company had outstanding borrowings of \$320.0 million under this facility.

On March 12, 2014, the Company entered into a new commercial paper program pursuant to which the Company may issue short-term, unsecured commercial paper notes up to a maximum aggregate principal amount outstanding of \$1.0 billion. Under this program, the Company may issue notes from time to time and will use the proceeds for general corporate purposes. At March 31, 2014, the Company had outstanding borrowings of \$100.0 million under this program, which is classified in the Condensed Consolidated Balance Sheet in Notes Payable and Other Short-Term Debt.

On February 11, 2014, the Company's universal shelf registration expired. The Company filed a new universal shelf registration with the Securities and Exchange Commission on February 28, 2014. In addition to the credit facility, the Company's universal shelf registration has an unlimited amount of various debt and equity instruments that could be issued.

On January 22, 2014, the Company's Board of Directors declared a quarterly cash dividend of \$0.125 per share of common stock. This dividend was paid on February 17, 2014 to stockholders of record on February 3, 2014. On April 21, 2014, the Company's Board of Directors declared a quarterly cash dividend of \$0.125 per share of common stock. This dividend will be paid on May 16, 2014 to stockholders of record on May 2, 2014.

The Company's debt net of cash to capital ratio was 13.0% at March 31, 2014 versus 7.2% at December 31, 2013. This increase is primarily due to the February 28, 2014 acquisition of Wahler.



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From a credit quality perspective, the Company has a credit rating of Baa2 from Moody's and BBB+ from both Standard & Poor's and Fitch Ratings. The current outlook from Moody's is positive. The outlook from both Standard & Poor's and Fitch Ratings is stable. None of the Company's debt agreements require accelerated repayment in the event of a downgrade in credit ratings.

Net cash provided by operating activities increased \$30.1 million to \$46.4 million in the first three months of 2014 from \$16.3 million in the first three months of 2013. This increase primarily reflects higher earnings during the first three months of 2014 compared with the first three months of 2013.

Net cash used in investing activities increased \$157.5 million to \$231.1 million in the first three months of 2014 from \$73.6 million in the first three months of 2013. This increase is primarily due to the \$106.4 million acquisition of Wahler and higher capital expenditures, including tooling outlays.

Net cash provided by financing activities decreased \$3.7 million to \$56.0 million in the first three months of 2014 from \$59.7 million in the first three months of 2013. This decrease is primarily driven by dividends paid to BorgWarner stockholders and lower net borrowings in 2014, partially offset by payments for the purchase of treasury stock in 2013.

We believe that the combination of cash from operations, cash balances, available credit facilities, and the remaining shelf registration capacity will be sufficient to satisfy our cash needs for our current level of operations and our planned operations for the foreseeable future. We will continue to balance our needs for internal growth, external growth, debt reduction and cash conservation.

## CONTINGENCIES

In the normal course of business, the Company is party to various commercial and legal claims, actions and complaints, including matters involving warranty claims, intellectual property claims, general liability and various other risks. It is not possible to predict with certainty whether or not the Company will ultimately be successful in any of these commercial and legal matters or, if not, what the impact might be. The Company's environmental and product liability contingencies are discussed separately below. The Company's management does not expect that an adverse outcome in any of these commercial and legal claims, actions and complaints will have a material adverse effect on the Company's results of operations, financial position or cash flows, although it could be material to the results of operations in a particular quarter.

### Litigation

In January 2006, BorgWarner Diversified Transmission Products Inc. ("DTP"), a subsidiary of the Company, filed a declaratory judgment action in United States District Court, Southern District of Indiana (Indianapolis Division) against the United Automobile, Aerospace, and Agricultural Implements Workers of America ("UAW") Local No. 287 and Gerald Poor, individually and as the representative of a defendant class. DTP sought the Court's affirmation that DTP did not violate the Labor-Management Relations Act or the Employee Retirement Income Security Act (ERISA) by unilaterally amending certain medical plans effective April 1, 2006 and October 1, 2006, prior to the expiration of the then-current collective bargaining agreements. On September 10, 2008, the Court found that DTP's reservation of the right to make such amendments reducing the level of benefits provided to retirees was limited by its collectively bargained health insurance agreement with the UAW, which did not expire until April 24, 2009. Thus, the amendments were untimely. In 2008, the Company recorded a charge of \$4.0 million as a result of the Court's decision.



DTP filed a declaratory judgment action in the United States District Court, Southern District of Indiana (Indianapolis Division) against the UAW Local No. 287 and Jim Barrett and others, individually and as representatives of a defendant class, on February 26, 2009 again seeking the Court's affirmation that DTP

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did not violate the Labor - Management Relations Act or ERISA by modifying the level of benefits provided retirees to make them comparable to other Company retiree benefit plans after April 24, 2009. Certain retirees, on behalf of themselves and others, filed a mirror-image action in the United States District Court, Eastern District of Michigan (Southern Division) on March 11, 2009, for which a class has been certified. During the last quarter of 2009, the action pending in Indiana was dismissed, while the action in Michigan is continuing. The Company is vigorously defending against the suit. This contingency is subject to many uncertainties, therefore based on the information available to date, the Company cannot reasonably estimate the amount or the range of potential loss, if any.

## Environmental

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency and certain state environmental agencies and private parties as potentially responsible parties (“PRPs”) at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (“Superfund”) and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 27 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

The Company believes that none of these matters, individually or in the aggregate, will have a material adverse effect on its results of operations, financial position or cash flows. Generally, this is because either the estimates of the maximum potential liability at a site are not material or the liability will be shared with other PRPs, although no assurance can be given with respect to the ultimate outcome of any such matter.

Based on information available to the Company (which in most cases includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large, solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation and consulting costs; and remediation alternatives), the Company has an accrual for indicated environmental liabilities of \$7.7 million and \$4.0 million at March 31, 2014 and at December 31, 2013, respectively. The Company expects to pay out substantially all of the amounts accrued for environmental liability over the next five years.

In connection with the sale of Kuhlman Electric Corporation (“Kuhlman Electric”), the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities, then unknown to the Company, relating to certain operations of Kuhlman Electric that pre-date the Company's 1999 acquisition of Kuhlman Electric. The Company previously settled or obtained dismissals of various lawsuits that were filed against Kuhlman Electric and others, including the Company, on behalf of plaintiffs alleging personal injury relating to alleged environmental contamination at its Crystal Springs, Mississippi plant. The Company filed a lawsuit against Kuhlman Electric and a related entity challenging the validity of the indemnity and the defendants filed counterclaims and a related lawsuit. In addition, two lawsuits by plaintiffs alleging environmental contamination relating to Kuhlman Electric's Crystal Springs plant are still pending and the Company may in the future become subject to further legal proceedings.

## Product Liability

Like many other industrial companies who have historically operated in the U.S., the Company (or parties the Company is obligated to indemnify) continues to be named as one of many defendants in asbestos-related personal injury actions. We believe that the Company's involvement is limited because, in general, these claims relate to a few types of automotive friction products that were manufactured many years ago and contained encapsulated asbestos. The nature of the fibers, the encapsulation and the manner of use lead the Company to believe that these products are highly unlikely to cause harm. As of March 31, 2014 and December 31, 2013, the Company had approximately

17,500 and 17,000 pending asbestos-related product liability claims, respectively. Of the approximately 17,500 outstanding claims at March 31, 2014,

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approximately half were pending in jurisdictions that have undergone significant tort and judicial reform activities subsequent to the filing of these claims.

The Company's policy is to vigorously defend against these lawsuits and the Company has been successful in obtaining dismissal of many claims without any payment. The Company expects that the vast majority of the pending asbestos-related product liability claims where it is a defendant (or has an obligation to indemnify a defendant) will result in no payment being made by the Company or its insurers. In 2014, of the approximately 600 claims resolved, 105 (18%) resulted in payment being made to a claimant by or on behalf of the Company. In the full year of 2013, of the approximately 1,500 claims resolved, 297 (20%) resulted in any payment being made to a claimant by or on behalf of the Company.

Prior to June 2004, the settlement and defense costs associated with all claims were paid by the Company's primary layer insurance carriers under a series of funding arrangements. In addition to the primary insurance available for asbestos-related claims, the Company has substantial excess insurance coverage available for potential future asbestos-related product claims. In June 2004, primary layer insurance carriers notified the Company of the alleged exhaustion of their policy limits.

A declaratory judgment action was filed in January 2004 in the Circuit Court of Cook County, Illinois by Continental Casualty Company and related companies against the Company and certain of its historical general liability insurers. The court has issued a number of interim rulings and discovery is continuing. The Company has entered into settlement agreements with some of its insurance carriers, resolving their coverage disputes by agreeing to pay specified amounts to the Company. The Company is vigorously pursuing the litigation against the remaining insurers.

In August 2013, the Los Angeles Superior Court entered a jury verdict against the Company in an asbestos-related personal injury action with damages of \$35.0 million, \$32.5 million of which was non-compensatory and will not be recoverable through insurance if the verdict is upheld. The Company has appealed the verdict. The Company posted a surety bond of \$55.0 million related to the appeal. The Company cannot predict the outcome of this pending litigation and therefore cannot reasonably estimate the amount of possible loss, if any, that could result from this action. Although it is impossible to predict the outcome of pending or future claims or the impact of tort reform legislation that may be enacted at the state or federal levels, due to the encapsulated nature of the products, the Company's experience in vigorously defending and resolving claims in the past, and the Company's significant insurance coverage with solvent carriers as of the date of this filing, management does not believe that asbestos-related product liability claims are likely to have a material adverse effect on the Company's results of operations, financial position or cash flows.

To date, the Company has paid and accrued \$294.1 million in defense and indemnity in advance of insurers' reimbursement and has received \$124.8 million in cash and notes from insurers. The net balance of \$169.3 million, is expected to be fully recovered, of which approximately \$20.0 million is expected to be recovered within one year. Timing of recovery is dependent on final resolution of the declaratory judgment action referred to above or additional negotiated settlements. At December 31, 2013, insurers owed \$153.6 million in association with these claims.

In addition to the \$169.3 million net balance relating to past settlements and defense costs, the Company has estimated a liability of \$107.1 million for claims asserted, but not yet resolved and their related defense costs at March 31, 2014. The Company also has a related asset of \$107.1 million to recognize proceeds from the insurance carriers, which is expected to be fully recovered. Receipt of these proceeds is not expected prior to the resolution of the declaratory judgment action referred to above, which, more-likely-than-not, will occur subsequent to March 31, 2015. At December 31, 2013, the comparable value of the accrued liability and associated insurance asset was \$96.7 million.



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The amounts recorded in the Condensed Consolidated Balance Sheets related to the estimated future settlement of existing claims are as follows:

| (millions of dollars)                 | March 31,<br>2014 | December 31,<br>2013 |
|---------------------------------------|-------------------|----------------------|
| Assets:                               |                   |                      |
| Other non-current assets              | \$107.1           | \$96.7               |
| Total insurance assets                | \$107.1           | \$96.7               |
| Liabilities:                          |                   |                      |
| Accounts payable and accrued expenses | \$44.1            | \$41.1               |
| Other non-current liabilities         | 63.0              | 55.6                 |
| Total accrued liabilities             | \$107.1           | \$96.7               |

The 2014 increase in the accrued liability and associated insurance asset is primarily due to an expected higher rate of claim settlement based on recent litigation claim activity.

The Company cannot reasonably estimate possible losses, if any, in excess of those for which it has accrued, because it cannot predict how many additional claims may be brought against the Company (or parties the Company has an obligation to indemnify) in the future, the allegations in such claims, the possible outcomes, or the impact of tort reform legislation that may be enacted at the state or federal levels.

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CAUTIONARY STATEMENTS FOR FORWARD-LOOKING STATEMENTS

Statements contained in this Form 10-Q (including Management's Discussion and Analysis of Financial Condition and Results of Operations) may contain forward-looking statements as contemplated by the 1995 Private Securities Litigation Reform Act (the "Act") that are based on management's current outlook, expectations, estimates and projections. Words such as "anticipates," "believes," "continues," "could," "designed," "effect," "estimates," "evaluates," "expects," "forecasts," "goal," "initiative," "intends," "outlook," "plans," "potential," "project," "pursue," "seek," "should," "target," "when," "would," variations of such words and similar expressions are intended to identify such forward-looking statements. All statements, other than statements of historical fact contained or incorporated by reference in this Form 10-Q, that we expect or anticipate will or may occur in the future regarding our financial position, business strategy and measures to implement that strategy, including changes to operations, competitive strengths, goals, expansion and growth of our business and operations, plans, references to future success and other such matters, are forward-looking statements. Accounting estimates, such as those described under the heading "Critical Accounting Policies" in Item 7 of our most recent Annual Report on Form 10-K, are inherently forward-looking. These statements are based on assumptions and analysis made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. Forward-looking statements are not guarantees of performance and the Company's actual results may differ materially from those expressed, projected or implied in or by the forward-looking statements.

You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report. Forward-looking statements are subject to risks and uncertainties, many of which are difficult to predict and generally beyond our control. Such risks and uncertainties include: fluctuations in domestic or foreign vehicle production, the continued use by original equipment manufacturers of outside suppliers, fluctuations in demand for vehicles containing our products, changes in general economic conditions, as well as the other risks noted under Item 1A, "Risk Factors," of our Annual Report on Form 10-K and in other reports that we file with the Securities and Exchange Commission. We do not undertake any obligation to update or announce publicly any updates to or revision to any of the forward-looking statements in this Form 10-Q to reflect any change in our expectations or any change in events, conditions, circumstances, or assumptions underlying the statements.

This section is intended to provide meaningful cautionary statements for purposes of the safe harbor provisions of the Act. This should not be construed as a complete list of all of the economic, competitive, governmental, technological and other factors that could adversely affect our expected consolidated financial position, results of operations or liquidity. Additional risks and uncertainties not currently known to us or that we currently believe are immaterial also may impair our business, operations, liquidity, financial condition and prospects.

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Item 3. Quantitative and Qualitative Disclosure About Market Risk

There have been no material changes to the information concerning our exposures to market risk as stated in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Item 4. Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) that are designed to provide reasonable assurance that the information required to be disclosed in the reports it files with the Securities and Exchange Commission is collected and then processed, summarized and disclosed within the time periods specified in the rules of the Securities and Exchange Commission. Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that these procedures are effective. There have been no changes in internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to a number of claims and judicial and administrative proceedings (some of which involve substantial amounts) arising out of the Company's business or relating to matters for which the Company may have a contractual indemnity obligation. See Note 14 — Contingencies to the Condensed Consolidated Financial Statements for a discussion of environmental, product liability and other litigation, which is incorporated herein by reference.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Company's Board of Directors authorized the purchase of up to 59.6 million shares of the Company's common stock. As of March 31, 2014, the Company had repurchased 48,581,610 shares under the Common Stock Repurchase Program. All shares purchased under this authorization have been and will continue to be repurchased in the open market at prevailing prices and at times and in amounts to be determined by management as market conditions and the Company's capital position warrant. The Company may use Rule 10b5-1 plans to facilitate share repurchases. Repurchased shares will be deemed common stock held in treasury and may subsequently be reissued for general corporate purposes.

Employee transactions include restricted shares withheld to offset statutory minimum tax withholding that occurs upon vesting of restricted shares. The BorgWarner Inc. Amended and Restated 2004 and 2014 Stock Incentive Plans provide that the withholding obligations be settled by the Company retaining stock that is part of the Award. Withheld shares will be deemed common stock held in treasury and may subsequently be reissued for general corporate purposes.



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The following table provides information about the Company's purchases of its equity securities that are registered pursuant to Section 12 of the Exchange Act during the quarter ended March 31, 2014:

## Issuer Repurchases of Equity Securities

| Period                          | Total number of shares repurchased | Average price per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased |
|---------------------------------|------------------------------------|-------------------------|--|--|
| Month Ended January 31, 2014    |                                    |                         |  |  |
| Common Stock Repurchase Program | —                                  | \$—                     | —  | 11,018,390   |
| Employee transactions           | —                                  | \$—                     | —  |  |
| Month Ended February 28, 2014   |                                    |                         |  |  |
| Common Stock Repurchase Program | —                                  | \$—                     | —  | 11,018,390   |
| Employee transactions           | 409,904                            | \$54.45                 | —  |  |
| Month Ended March 31, 2014      |                                    |                         |  |  |
| Common Stock Repurchase Program | —                                  | \$—                     | —  | 11,018,390   |
| Employee transactions           | —                                  | \$—                     | —  |  |

## Item 6. Exhibits

|                 |   |
|-----------------|---|
| Exhibit 31.1    | Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer.* |
| Exhibit 31.2    | Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer.* |
| Exhibit 32.1    | Section 1350 Certifications.*   |
| Exhibit 101.INS | XBRL Instance Document.   |
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document.                                    |
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.                      |
| Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase Document.                            |
| Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.                     |
| Exhibit 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.                       |

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\*Filed herewith.

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SIGNATURES

Pursuant to the requirements 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.

BorgWarner Inc.

(Registrant)

By /s/ Steven G. Carlson  
(Signature)

Steven G. Carlson

Vice President and Controller  
(Principal Accounting Officer)

Date: May 1, 2014