EVERGREEN UTILITIES & HIGH INCOME FUND
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-Q

QUARTERLY SCHEDULE OF PORTFOLIO HOLDINGS OF REGISTERED MANAGEMENT INVESTMENT COMPANY

Investment Company Act file number **811-21507**

Evergreen Utilities and High Income Fund

(Exact name of registrant as specified in charter)

200 Berkeley Street

Boston, Massachusetts 02116

(Address of principal executive offices) (Zip code)

Michael H. Koonce, Esq.

200 Berkeley Street

Boston, Massachusetts 02116

(Name and address of agent for service)

Registrant's telephone number, including area code: **(617) 210-3200**

Date of fiscal year end: Registrant is making a quarterly filing for one of its series, Evergreen Utilities and High Income Fund, for the quarter ended November 30, 2007. This one series has a August 31

	fiscal year end.
Date of reporting period:	**November 30, 2007**

Item 1 – Schedule of Investments

EVERGREEN UTILITIES AND HIGH INCOME FUND
SCHEDULE OF INVESTMENTS

November 30, 2007 (unaudited)

	Principal Amount	Value
CORPORATE BONDS 35.7%		
CONSUMER DISCRETIONARY 6.9%		
Auto Components 0.7%		
Cooper Tire & Rubber Co., 7.625%, 03/15/2027	$ 530,000	$ 471,700
Goodyear Tire & Rubber Co.:		
9.00%, 07/01/2015	630,000	674,100
11.25%, 03/01/2011	375,000	401,250
		1,547,050
Automobiles 0.2%		
Ford Motor Co., 7.875%, 06/15/2010	380,000	352,909
Diversified Consumer Services 0.0%		
Service Corporation International, 6.75%, 04/01/2015	70,000	68,250
Hotels, Restaurants & Leisure 2.0%		
Caesars Entertainment, Inc.:		
7.875%, 03/15/2010	315,000	322,875
8.125%, 05/15/2011	135,000	134,325
Inn of the Mountain Gods Resort & Casino, 12.00%, 11/15/2010	770,000	809,462
Isle of Capri Casinos, Inc., 7.00%, 03/01/2014	1,431,000	1,230,660
Pokagon Gaming Authority, 10.375%, 06/15/2014 144A	415,000	446,125
Seneca Gaming Corp., 7.25%, 05/01/2012	370,000	373,700
Shingle Springs Tribal Gaming Authority, 9.375%, 06/15/2015 144A	505,000	497,425
Universal City Development Partners, Ltd., 11.75%, 04/01/2010	265,000	274,938
		4,089,510
Household Durables 0.5%		
Centex Corp., 4.875%, 08/15/2008	115,000	110,542
Hovnanian Enterprises, Inc.:		
6.00%, 01/15/2010	90,000	59,400
6.50%, 01/15/2014	61,000	42,700
Libbey, Inc., FRN, 12.38%, 06/01/2011	380,000	404,700
Meritage Homes Corp., 6.25%, 03/15/2015	100,000	72,750
Pulte Homes, Inc., 4.875%, 07/15/2009	370,000	334,850
Standard Pacific Corp., 5.125%, 04/01/2009	150,000	113,250
		1,138,192
Media 2.4%		
Cablevision Systems Corp., Ser. B, 8.00%, 04/15/2012	510,000	488,325
CSC Holdings, Inc., 7.625%, 04/01/2011	1,000,000	985,000
Dex Media West, LLC, 8.50%, 08/15/2010	420,000	429,450
Idearc, Inc., 8.00%, 11/15/2016	205,000	192,700
Lamar Media Corp.:		
6.625%, 08/15/2015	1,130,000	1,079,150
Ser. B, 6.625%, 08/15/2015	70,000	66,850
Ser. C, 6.625%, 08/15/2015 144A	120,000	114,600
Mediacom Broadband, LLC, 8.50%, 10/15/2015	60,000	53,700
Mediacom Communications Corp., 9.50%, 01/15/2013	785,000	733,975

R.H. Donnelley Corp., Ser. A-4, 8.875%, 10/15/2017 144A	770,000	700,700
Sinclair Broadcast Group, Inc., 8.00%, 03/15/2012	90,000	92,250
		4,936,700
Multi-line Retail 0.1%		
Neiman Marcus Group, Inc., 9.00%, 10/15/2015	100,000	104,500
Specialty Retail 0.3%		
Home Depot, Inc., 5.875%, 12/16/2036	75,000	63,725
Payless ShoeSource, Inc., 8.25%, 08/01/2013	615,000	575,025
		638,750

EVERGREEN UTILITIES AND HIGH INCOME FUND
SCHEDULE OF INVESTMENTS continued

November 30, 2007 (unaudited)

	Principal Amount	Value
CORPORATE BONDS continued		
CONSUMER DISCRETIONARY continued		
Textiles, Apparel & Luxury Goods 0.7%		
Oxford Industries, Inc., 8.875%, 06/01/2011	$ 815,000	$ 812,963
Warnaco Group, Inc., 8.875%, 06/15/2013	725,000	746,750
		1,559,713
CONSUMER STAPLES 1.7%		
Beverages 0.1%		
Constellation Brands, Inc., 8.375%, 12/15/2014 #	250,000	253,125
Food & Staples Retailing 0.7%		
Ingles Markets, Inc., 8.875%, 12/01/2011	495,000	502,425
Rite Aid Corp., 8.125%, 05/01/2010	1,000,000	1,005,000
		1,507,425
Food Products 0.4%		
Del Monte Foods Co.:		
6.75%, 02/15/2015	475,000	448,875
8.625%, 12/15/2012	240,000	243,600
Pilgrim's Pride Corp.:		
7.625%, 05/01/2015	125,000	123,125
8.375%, 05/01/2017	35,000	34,475
Smithfield Foods, Inc., 7.75%, 07/01/2017	20,000	19,500
		869,575
Household Products 0.2%		
Church & Dwight Co., 6.00%, 12/15/2012	345,000	338,100
Personal Products 0.3%		
Central Garden & Pet Co., 9.125%, 02/01/2013	620,000	554,900
ENERGY 5.4%		
Energy Equipment & Services 1.1%		
Bristow Group, Inc.:		
6.125%, 06/15/2013	10,000	9,575
7.50%, 09/15/2017 144A	240,000	242,100
Dresser-Rand Group, Inc., 7.375%, 11/01/2014	110,000	109,175
Hornbeck Offshore Services, Inc., Ser. B, 6.125%, 12/01/2014	700,000	666,750
Parker Drilling Co., 9.625%, 10/01/2013	395,000	422,650
PHI, Inc., 7.125%, 04/15/2013	885,000	862,875
		2,313,125
Oil, Gas & Consumable Fuels 4.3%		
Chesapeake Energy Corp., 6.875%, 01/15/2016	980,000	967,750
El Paso Corp., 7.00%, 06/15/2017	190,000	191,362
Encore Acquisition Co.:		
6.00%, 07/15/2015	235,000	212,675
6.25%, 04/15/2014	120,000	111,600
Exco Resources, Inc., 7.25%, 01/15/2011	575,000	562,063
Forest Oil Corp., 7.75%, 05/01/2014	1,000,000	1,020,000

Frontier Oil Corp., 6.625%, 10/01/2011	150,000	149,625
Mariner Energy, Inc., 8.00%, 05/15/2017	80,000	76,000
Overseas Shipholding Group, Inc., 8.25%, 03/15/2013	625,000	642,188
Peabody Energy Corp.:		
5.875%, 04/15/2016	120,000	114,600
6.875%, 03/15/2013	875,000	881,562
Plains Exploration & Production Co., 7.75%, 06/15/2015	180,000	179,100
Regency Energy Partners, LP, 8.375%, 12/15/2013	525,000	551,250
Sabine Pass LNG, LP, 7.25%, 11/30/2013	750,000	725,625
Targa Resources, Inc., 8.50%, 11/01/2013 144A	475,000	467,875
Tesoro Corp., 6.625%, 11/01/2015	500,000	497,500

EVERGREEN UTILITIES AND HIGH INCOME FUND
SCHEDULE OF INVESTMENTS continued

November 30, 2007 (unaudited)

	Principal Amount	Value
CORPORATE BONDS continued		
ENERGY continued		
Oil, Gas & Consumable Fuels continued		
Williams Cos., 7.125%, 09/01/2011	$ 1,000,000	$ 1,055,000
Williams Partners, LP, 7.25%, 02/01/2017	545,000	561,350
		8,967,125
FINANCIALS 5.6%		
Consumer Finance 3.0%		
Ford Motor Credit Co., LLC:		
5.70%, 01/15/2010	880,000	794,582
7.375%, 10/28/2009	1,360,000	1,288,199
9.75%, 09/15/2010	400,000	388,771
General Motors Acceptance Corp., LLC:		
5.125%, 05/09/2008	155,000	150,440
5.625%, 05/15/2009	285,000	269,510
6.12%, 05/15/2009	470,000	440,537
6.875%, 09/15/2011	1,330,000	1,162,949
6.875%, 08/28/2012	930,000	791,392
7.25%, 03/02/2011	90,000	79,768
7.75%, 01/19/2010	300,000	284,932
8.00%, 11/01/2031	770,000	654,883
Qwest Capital Funding, Inc., 6.50%, 11/15/2018	145,000	123,612
		6,429,575
Diversified Financial Services 0.4%		
Leucadia National Corp., 8.125%, 09/15/2015	810,000	810,000
Insurance 0.0%		
Crum & Forster Holdings Corp., 7.75%, 05/01/2017	105,000	102,375
Real Estate Investment Trusts 1.5%		
Host Marriott Corp.:		
7.125%, 11/01/2013	455,000	458,413
Ser. O, 6.375%, 03/15/2015	105,000	103,163
Ser. Q, 6.75%, 06/01/2016	605,000	603,487
Omega Healthcare Investors, Inc., 7.00%, 04/01/2014	1,000,000	995,000
Ventas, Inc., 7.125%, 06/01/2015	1,000,000	1,000,000
		3,160,063
Thrifts & Mortgage Finance 0.7%		
Residential Capital, LLC:		
7.625%, 11/21/2008	310,000	243,350
7.875%, 06/30/2010	1,690,000	1,153,425
		1,396,775
HEALTH CARE 1.1%		
Health Care Equipment & Supplies 0.0%		
Universal Hospital Services, Inc., 8.50%, 06/01/2015 144A	57,000	57,285
Health Care Providers & Services 1.1%		

HCA, Inc., 9.25%, 11/15/2016	1,510,000	1,566,625
Omnicare, Inc.:		
6.125%, 06/01/2013	320,000	289,600
6.875%, 12/15/2015	490,000	453,250
		2,309,475

EVERGREEN UTILITIES AND HIGH INCOME FUND
SCHEDULE OF INVESTMENTS continued

November 30, 2007 (unaudited)

	Principal Amount	Value
CORPORATE BONDS continued		
INDUSTRIALS 3.5%		
Aerospace & Defense 2.0%		
Alliant Techsystems, Inc., 6.75%, 04/01/2016	$ 110,000	$ 109,450
DRS Technologies, Inc.:		
6.625%, 02/01/2016	310,000	306,900
7.625%, 02/01/2018	215,000	219,837
Hexcel Corp., 6.75%, 02/01/2015	120,000	118,200
L-3 Communications Holdings, Inc.:		
5.875%, 01/15/2015	2,260,000	2,180,900
6.375%, 10/15/2015	1,275,000	1,268,625
		4,203,912
Commercial Services & Supplies 0.6%		
Browning-Ferris Industries, Inc.:		
7.40%, 09/15/2035	610,000	564,250
9.25%, 05/01/2021	315,000	337,050
Corrections Corporation of America, 6.25%, 03/15/2013	35,000	34,737
Geo Group, Inc., 8.25%, 07/15/2013	250,000	251,250
Mobile Mini, Inc., 6.875%, 05/01/2015	130,000	118,300
Norcross Safety Products, LLC, Ser. B, 9.875%, 08/15/2011	80,000	82,600
		1,388,187
Machinery 0.5%		
Commercial Vehicle Group, Inc., 8.00%, 07/01/2013	810,000	733,050
Manitowoc Co., 7.125%, 11/01/2013	135,000	133,988
Terex Corp., 8.00%, 11/15/2017	190,000	191,900
		1,058,938
Road & Rail 0.3%		
Avis Budget Car Rental, LLC:		
7.625%, 05/15/2014	435,000	419,775
7.75%, 05/15/2016	30,000	28,463
Hertz Global Holdings, Inc.:		
8.875%, 01/01/2014	145,000	145,725
10.50%, 01/01/2016	20,000	20,800
		614,763
Trading Companies & Distributors 0.1%		
United Rentals, Inc., 6.50%, 02/15/2012	170,000	

The Facilities contain customary provisions for financings of this type, including, without limitation, representations and warranties, affirmative and negative covenants, and events of default and cross-default. One of the affirmative covenants contained in the Facilities requires that, once we become current in our SEC filings, subsequent Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q must be provided to the agents within 90 days and 45 days of the annual and quarterly period end, respectively. Furthermore, in the event that either NIC or NFC is unable to complete their required filings by the end of the waiver period allowed under the NFC Credit Agreement (discussed below), unless NFC were able to obtain a further waiver and subsequent to all applicable grace periods, there would be a default under that agreement which would give rise to a cross-default of the Facilities.

The Facilities also require that we maintain a fixed charge coverage ratio of not less than 1.1 to 1.0. All draws under the Facilities are subject to the satisfaction of customary conditions precedent for financings of this type, including, without limitation, certain officers certificates and opinions of counsel and the absence of any material adverse change since October 31, 2004, except for previously disclosed items.

In June 2007, we signed a definitive loan agreement relating to a five-year senior inventory-secured, asset-based revolving credit facility in an aggregate principal amount of $200 million. This new loan facility matures in June 2012 and is secured by certain of our domestic manufacturing plant inventory and service parts inventory as well as our used truck inventory. All borrowings under this new loan facility accrue interest at a rate equal to a base rate or an adjusted LIBOR plus a spread. The spread, which is based on an availability-based measure, ranges from 25 to 75 basis points for Base Rate borrowings and from 125 to 175 basis points for LIBOR borrowings. The initial LIBOR spread was 150 basis points. Borrowings under this new facility are available for general corporate purposes.

Financial services operations debt

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

Under the terms of the Credit Agreement, NFC is required to maintain a debt to tangible net worth ratio of no greater than 6:1, a twelve-month rolling fixed charge coverage ratio of no less than 125%, and a twelve-month rolling combined retail/lease losses to liquidations ratio of no greater than 6%. The Credit Agreement grants security interests in substantially all of NFC s unsecuritized assets to the participants in the Credit Agreement. Compensating cash balances are not required. Facility fees of 0.375% are paid quarterly on the revolving loan portion only, regardless of usage.

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In March 2007, NFC entered into the First Amendment to its Credit Agreement increasing the term loan component from $400 million to $620 million, increasing the remaining principal payments to $6 million in both 2008 and 2009 and $598 million in 2010, and increasing the maximum permitted debt to tangible net worth ratio from 6:1 to 7:1 through November 1, 2007, and from 6:1 to 6.5:1 for the period from November 1, 2007 through April 30, 2008. After April 30, 2008, the ratio returns to 6:1 for all periods thereafter.

In addition, the First Amendment increased the amount of dividends permitted to be paid from NFC to Navistar, Inc. to $400 million plus net income and any non-core asset sale proceeds from May 1, 2007 through the date of such payment. As of October 31, 2007, the maximum amount of dividends that were available for distribution to Navistar, Inc was $18 million.

The Credit Agreement requires both NIC and NFC to file and provide to NFC s lenders copies of their respective Annual Reports on Form 10-K for each year, their Quarterly Reports on Form 10-Q for each of the first three quarters of each year, and the related financial statements on or before the dates specified in the Credit Agreement. Failure to do so results in a default under the Credit Agreement, during which NFC may not incur any additional indebtedness under the Credit Agreement until the default is cured or waived. In January 2006, NIC and NFC filed Current Reports on Form 8-K stating that they would miss the filing deadline for their Annual Reports on Form 10-K for 2005. On January 17, 2006, NFC received a waiver that waived through May 31, 2006, (i) the defaults created under the Credit Agreement by the failure of NIC and NFC to file and deliver such reports and financial statements, (ii) the potential defaults that would otherwise be created by their failure to provide such reports and financial statements to the lenders in the future as required under the Credit Agreement, and (iii) the cross default to certain indebtedness of NIC created by such failures, provided the applicable lenders did not have the right to accelerate the applicable debt. On March 2, 2006, NFC received a second waiver, which extended the existing waivers through January 31, 2007, and expanded the waivers to include the failure of NIC and NFC to file their Quarterly Reports on Form 10-Q and to deliver the related financial statements through the date thereof. The second waiver also waived the default, if any, created by the right of the holders of NIC s long-term debt to accelerate payment of that debt as a result of the failure of NIC and NFC to file the required reports. In November 2006, NFC received a third waiver that extended the existing waivers through October 31, 2007, and expanded the waivers to include any default or event of default that would result solely from NIC s or NFC s failure to meet the filing requirements of Sections 13 and 15 of the Exchange Act, as amended, with respect to their Annual Reports on Form 10-K for 2005 and 2006 and their Quarterly Reports on Form 10-Q for the periods from November 1, 2005 through July 31, 2007.

In October 2007, NFC executed a Second Amendment to its Credit Agreement and received a fourth waiver. The fourth waiver extended through December 31, 2007 and expanded the previous waivers, which waive any default or event of default that would result, solely from NFC s and NIC s failure to meet the filing requirements of Sections 13 and 15 of the Exchange Act, as amended, with respect to their Annual Reports on Form 10-K for 2005 and 2006, and certain of their Quarterly Reports on Form 10-Q. During the period from November 1, 2007 until the waiver terminates, interest rates on certain loans under the Credit Agreement are increased by 0.25%.

Truck Retail Instalment Paper Corporation (TRIP), a special purpose, wholly-owned subsidiary of NFC, has a $500 million revolving retail facility which matures in June 2010 and is subject to optional early redemption in full without penalty or premium upon satisfaction of certain terms and conditions on any date on or after April 15, 2010. NFC uses TRIP to temporarily fund retail notes and retail leases, other than operating leases. This facility is used primarily during the periods prior to a securitization of retail notes and finance leases. NFC retains a repurchase option against the retail notes and leases sold into TRIP; therefore, TRIP s assets and liabilities are consolidated in our balance sheets. As of October 31, 2007 and 2006, NFC had $443 million and $148 million, respectively, in retail notes and finance leases in TRIP.

The majority of the asset-backed debt is issued by consolidated Special Purpose Entities (SPEs) and is payable out of collections on the finance receivables sold to the SPEs. This debt is the legal obligation of the SPEs and not NFC. The balance outstanding was $2.6 billion and $3.1 billion as of October 31, 2007 and 2006,

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respectively. The carrying amount of the retail notes and finance leases used as collateral was $2.6 billion and $3.1 billion as of October 31, 2007 and 2006 respectively.

Failure to deliver audited financial statements on a timely basis could be declared a servicer default by the investors of various retail and wholesale securitizations. If default is declared, the remedy could be the replacement as servicer or accelerated debt amortization from assets in the trust. We do not believe a delay in the delivery of audited financial statements would have a material adverse affect on the investors, as required for a servicer default; therefore, waivers on public securitizations have not been obtained.

NFC enters into secured borrowing agreements involving vehicles subject to operating and finance leases with retail customers. The balances are classified under financial services operations debt as borrowings secured by leases. In connection with the securitizations and secured borrowing agreements of certain of its leasing portfolio assets, NFC and its subsidiary, Navistar Leasing Services Corporation (NLSC), have established Navistar Leasing Company (NLC), a Delaware business trust. NLSC was formerly known as Harco Leasing Company, Inc. prior to its name change effective September 21, 2006. NLC holds legal title to leased vehicles and is the lessor on substantially all leases originated by NFC. NLSC owns beneficial interests in the titles held by NLC and NLSC has transferred other beneficial interests issued by NLC to purchasers under secured borrowing agreements and securitizations. Neither the beneficial interests held by purchasers under secured borrowing agreements or the assets represented thereby, nor legal interest in any assets of NLC, are available to NLSC, NFC, or its creditors. The balance of the secured borrowings issued by NLC totaled $8 million and $24 million as of October 31, 2007 and 2006, respectively. The carrying amount of the finance and operating leases used as collateral was $7 million and $20 million as of October 31, 2007 and 2006, respectively.

International Truck Leasing Corporation (ITLC), a special purpose, wholly-owned subsidiary of NFC, provides NFC with another entity to obtain borrowings secured by leases. The balances are classified under financial services operations debt as borrowings secured by leases. ITLC s assets are available to satisfy its creditors claims prior to such assets becoming available for ITLC s use or to NFC or affiliated companies. The balance of these secured borrowings issued by ITLC totaled $125 million and $92 million as of October 31, 2007 and 2006, respectively. The carrying amount of the finance and operating leases used as collateral was $114 million and $84 million as of October 31, 2007 and 2006, respectively. *Restricted cash and cash equivalents* used as collateral was $11 million as of October 31, 2007 and $12 million as of October 31, 2006.

We financed $1.2 billion of funds denominated in U.S. dollars and Mexican pesos to be used for investment in our Mexican financial services operations. As of October 31, 2007, borrowings outstanding under these arrangements were $583 million, including $140 million of asset-backed debt, of which 15% is denominated in dollars and 85% in pesos. The interest rates on the dollar-denominated debt are at a negotiated fixed rate or at a variable rate based on LIBOR. On peso-denominated debt, the interest rate is based on the Interbank Interest Equilibrium Rate. The effective interest rate for the combined dollar and peso denominated debt was 8.3% for 2007 and 8.4% for 2006. As of October 31, 2007 and 2006, $226 million and $283 million, respectively, of our Mexican financial services operations receivables were pledged as collateral for bank borrowings.

Subsequent Events

Financial services operations debt

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

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

In February 2008 and April 2008, NFC completed separate securitization transactions for the sale of retail notes in the amount of $536 million and $247 million, respectively. These transactions do not qualify for sale treatment under Financial Accounting Standards Board (FASB) Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* and, therefore, were recorded as secured borrowings.

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

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

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

Funding of Financial Services

The Financial Services segment, mainly NFC, has traditionally obtained the funds to provide financing to our dealers and retail customers from sales of finance receivables, short and long-term bank borrowings, commercial paper, and medium and long-term debt. As of October 31, 2007, our funding consisted of asset-backed securitization debt of $2.7 billion, bank borrowings and revolving credit facilities of $1.9 billion, commercial paper of $117 million, and borrowings of $133 million secured by operating and financing leases. We have previously used a number of SPEs to securitize and sell receivables. The current SPEs include Navistar Financial Retail Receivables Corporation (NFRRC), Navistar Financial Security Corporation (NFSC), Truck Retail Accounts Corporation (TRAC), ITLC, and TRIP, all wholly-owned subsidiaries. The sales of finance receivables in each securitization for TRAC and NFSC constitute sales under GAAP and therefore the sold receivables are removed from our consolidated balance sheet and the investors interests in the interest bearing securities issued to affect the sale are not recognized as liabilities.

Our Mexican financial services operations include Navistar Financial, S.A. de C.V. SOFOM E.N.R. (NF), Arrendadora Financiera Navistar, S.A. de C.V. SOFOM E.N.R. (Arrendadora), and Navistar Comercial S.A. de C.V. In December 2007, Arrendadora merged with NF and the resulting entity is known as Navistar Financial, S.A. de C.V., Sociedad Financiera de Objeto Multiple, Entidad No Regulada (NFM). NFM provides financing to our dealers and retail customers in Mexico. Similar to NFC, NFM obtains funds through the sales of finance receivables, short and long-term bank borrowings, and commercial paper.

During 2007, we privately securitized $825 million and $140 million of retail notes and finance leases through NFRRC and NFM, respectively. Our shelf registration for public securitizations expired March 31, 2006 without any further issuances pursuant to it since October 31, 2005. Our retail notes and finance leases securitization arrangements do not qualify for sales accounting treatment under FASB Statement No. 140. As a result, the sold receivables and associated secured borrowings are included on the consolidated balance sheet and no gain or loss is recognized for these transactions.

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The following table sets forth the other funding facilities that we have in place as of October 31, 2007:

Company (in millions)	Instrument Type	Total Amount	Purpose of Funding	Amount Utilized	Matures or Expires
NFSC	Revolving wholesale note trust	$ 1,212(A)	Eligible wholesale notes	$ 982	2007 2010
TRAC	Revolving retail account conduit	100	Eligible retail accounts	60	2008
TRIP	Revolving retail facility	500	Retail notes and leases	443	2010
NFC	Credit Agreement(B)	1,310	Retail notes and leases, and general corporate purposes	1,029	2010
NFM	Bank revolvers and commercial paper	553	General corporate purposes	443	2007 - 2012
NFM	Revolving retail facility	140	Retail notes and leases	140	2011

(A) Exclusive of a subordinated interest in the amount of $200 million.

(B) Exclusive of $100 million utilized by NFM.

As of October 31, 2007, the aggregate amount available to fund finance receivables under the various facilities was $718 million.

The wholesale notes and retail accounts securitization arrangements through NFSC and TRAC qualify for sale treatment under FASB Statement No. 140 and, therefore, the receivables and associated liabilities are removed from the consolidated balance sheet.

We are obligated under certain agreements with public and private lenders of NFC to maintain the subsidiary s income before interest expense and income taxes at not less than 125% of its total interest expense. Under these agreements, if NFC s consolidated income before interest expense and income taxes is less than 125% of its interest expense, NIC and Navistar, Inc. must make payments to NFC to achieve the required ratio. No such payments were required during the year ended October 31, 2007.

Derivative Instruments

As disclosed in Note 1, *Summary of significant accounting policies,* and Note 15, *Financial instruments and commodity contracts*, to the accompanying consolidated financial statements, we may use derivative financial instruments as part of our overall interest rate and foreign currency risk management strategy to reduce our interest rate exposure, to potentially increase the return on invested funds, and to reduce exchange rate risk for transactional and economic exposures.

We recognize all derivatives as assets or liabilities in the statement of financial condition and measure them at fair value. The changes in the fair value of derivatives that are not designated as, or which do not qualify as, hedges for accounting purposes are reported in earnings in the period in which they occur. Our manufacturing operations may use derivative instruments to reduce our exposure to foreign exchange fluctuations on the purchase of parts and materials denominated in currencies other than the functional currency. Derivative instruments may also be used to reduce exposure to price changes associated with contracted purchases of commodities or manufacturing equipment.

We enter into natural gas basis (delivery) purchase contracts, which commit us to a future purchase of a specific volume of natural gas for a set basis price. In some locations, we exercise the option to also lock in the natural gas commodity price for the future purchases in an attempt to reduce the volatility of natural gas prices. Future volumes committed are expected to be fully consumed in normal operations; however, there is a settlement feature for the difference between the actual gas usage and the committed volume. We may only sell any unused gas back to the energy provider.

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Our manufacturing operations may also use derivative financial instruments for the following: (i) to increase the return on invested funds, (ii) to manage interest rate exposure on outstanding debt obligations, (iii) to offset the potentially dilutive effects associated with convertible debt, and (iv) to assist with share buy-back programs. Generally, we do not use derivatives for speculative purposes.

Our financial services operations may also use derivative instruments to reduce our exposure to interest rate volatility associated with future interest payments on notes and certificates related to an expected sale of receivables. Interest rate risk arises when we fund a portion of fixed rate receivables with floating rate debt. We manage this exposure to interest rate changes by funding floating rate receivables with floating rate debt and fixed rate receivables with fixed rate debt, floating rate debt, and equity capital. We reduce the net exposure, which results from the funding of fixed rate receivables with floating rate debt by generally selling fixed rate receivables on a fixed rate basis and by utilizing derivative financial instruments, primarily swaps, when appropriate. We also use foreign currency forward and option contracts to manage exposure to exchange rate movements.

Our consolidated financial statements and operational cash flows may be impacted by fluctuations in commodity prices, foreign currency exchange rates, and interest rates.

The majority of our derivative financial instruments are valued using quoted market prices. The remaining derivative instruments are valued using industry standard pricing models. These pricing models may require us to make a variety of assumptions including, but not limited to, market data of similar financial instruments, interest rates, forward curves, volatilities, and financial instruments cash flows.

For more information, see Note 15, *Financial instruments and commodity contracts,* to the accompanying consolidated financial statements.

Capital Resources

We expend capital to support our operating and strategic plans. Such expenditures include investments to meet regulatory and emissions requirements, maintain capital assets, develop new products or improve existing products, and to enhance capacity or productivity. Many of the associated projects have long lead-times and require commitments in advance of actual spending.

Business units provide their estimates of costs of capital projects, expected returns, and benefits to senior management. Those projects are evaluated from the perspective of expected return and strategic importance, with a goal to maintain the annual capital expenditure spending in the $250 to $350 million range, exclusive of capital expenditures for assets held for or under lease.

Pension and Other Postretirement Benefits

Generally, our pension plans are funded by contributions made by us. Our policy is to fund the pension plans in accordance with applicable U.S. and Canadian government regulations and to make additional contributions from time to time. At October 31, 2007, we have met all legal funding requirements. We contributed $28 million and $30 million to our pension plans in 2007 and 2006, respectively.

In August 2006, the PPA was signed into law in the U.S. The effective date of the PPA was deferred until January 2008, subject to a transition period. The PPA increases the funding requirements for defined benefit pension plans to 100% of the liability and requires unfunded liabilities, or changes in unfunded liabilities, to be fully amortized over a seven-year period. In 2008, we expect to contribute $100 million to meet the minimum required contributions for all plans. Additionally, based on our current forecasts, we expect to contribute approximately $105 million during the years 2009 through 2011 to the larger U.S. pension plans to satisfy the minimum requirements under the new funding rules.

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Other postretirement benefit obligations, such as retiree medical, are primarily funded in accordance with a 1993 legal agreement (Settlement Agreement) between us, our employees, retirees, and collective bargaining organizations, which eliminated certain benefits provided prior to that date and provided for cost sharing between us and participants in the form of premiums, co-payments, and deductibles. Our contributions totaled $6 million in both 2007 and 2006. We expect to contribute $5 million to our other post-retirement benefit plans during 2008.

As part of the Settlement Agreement, a Base Program Trust was established in June 1993 to provide a vehicle for funding the health care liability through our contributions and retiree premiums. A separate independent Retiree Supplemental Benefit Program was also established, which included our contribution of Class B Common Stock, originally valued at $513 million, to potentially reduce retiree premiums, co-payments, and deductibles and provide additional benefits in subsequent periods. In addition to the base plan fund, we also add profit sharing contributions to the Retiree Supplemental Benefit Trust to potentially improve upon the basic benefits provided through the base plan fund. These profit sharing contributions are determined by means of a calculation as established through the Settlement Agreement. Profit sharing contributions to the Retiree Supplemental Benefit Trust have been less than $2 million in each year from 2005 through 2007.

The funded status of our plans is derived by subtracting the actuarially-determined present value of the projected benefit obligations at year end from the end of year fair value of plan assets.

The under-funded status of our pension plans improved by $668 million during 2007 due largely to significant returns on plan assets experienced during the year. Our long-term expected return on plan assets is 9% and our actual return experience during 2007 was approximately 25% for the U.S. pension plans. Rising discount rates also reduced the present value of the projected benefit obligation. This benefit is reflected as a component of the actuarial net gain realized during 2007.

The effect of the above experience has placed one of our larger U.S. pension plans into the corridor discussed within FASB Statement No. 87, *Employers Accounting for Pensions*, and FASB Statement No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*. The implication of being within the corridor is that the amortization of cumulative losses (a component of net postretirement benefits expense) for the subsequent year is suspended for that plan. As such, we will not have amortization for the U.S. plan inside the corridor in 2008 compared to $32 million in 2007 and $40 million in 2006. The expected return on plan assets will likely outpace interest expense during 2008. This effect, combined with the elimination of the amortization previously discussed, is expected to result in pension income during 2008. Additionally, the settlement of the lump sum defined benefit plan that resulted from the December 16, 2007 UAW contract ratification will generate an additional net gain during 2008. The benefit obligation for the lump sum benefit plan was $52 million at October 31, 2007.

The improvement in the under-funded status of our health and life insurance benefits of $529 million was largely due to the negotiation of a Medicare Advantage Fee-For-Service contract with one of our health insurance benefit providers. This product fully insured the company s Medicare eligible population in its largest postretirement medical plan, covering medical services at a fixed rate during most of 2007 and all of 2008. The effect of the negotiated contract was incorporated into the company s medical trend rates for 2007 and 2008, having the effect of a reduction in the company s accumulated benefit obligation of approximately $210 million during the year. While not placing this plan inside the corridor mentioned above, this favorable experience gain resulted in a significant reduction in the pool of unrecognized cumulative losses during 2007. Amortization for this plan is expected to be less than $1 million in 2008 compared to $22 million in 2007 and $53 million in 2006. Additionally, interest expense during 2008 will be favorable when compared to 2007 as a result of the reduction in the accumulated benefit obligation.

We have collective bargaining agreements that include participation in multiemployer pension plans. Under the terms of such collective bargaining agreements, contributions are paid to the multiemployer pension plans during a union member s period of employment. Our obligations are satisfied once those contributions are paid

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to these plans. A withdrawal liability may be assessed by the multiemployer pension plan if we no longer have an obligation to contribute or all covered operations at the facility cease. We previously notified the Western Conference of Teamsters of our intent to cease operations at our Richmond Parts Distribution Center that occurred in July 2007. The most recent estimate of withdrawal liability indicates no withdrawal liability will be assessed as the multiemployer pension plan is well funded.

Off-Balance Sheet Arrangements

We enter into various arrangements not recognized in our consolidated balance sheets that have or could have an effect on our financial condition, results of operations, liquidity, capital expenditures, or capital resources. The principal off-balance sheet arrangements that we enter into are guarantees and sales of receivables. The following discussions address each of these items for the company:

Guarantees

We have provided guarantees to third parties that could obligate us to make future payments if the responsible party fails to perform under its contractual obligations. We have recognized liabilities in the consolidated balance sheets for guarantees that meet the recognition and measurement provisions of FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of the Indebtedness of Others.*

We have issued residual value guarantees in connection with various leases. The estimated amount of the guarantees is recorded as a liability as of October 31, 2007. Our guarantees are contingent upon the fair value of the leased assets at the end of the lease term. The excess of the guaranteed lease residual value over the fair value of the residual represents the amount of our exposure.

At October 31, 2007, one of our Canadian operating subsidiaries is contingently liable for the residual values of $25 million of retail customers contracts and $49 million of retail leases that are financed by a third party. These amounts approximate the estimated future resale market value of the collateral underlying those contracts and leases. As of October 31, 2007, we have recorded accruals totaling $5 million and $6 million for potential losses on the retail customers contracts and retail leases, respectively.

In addition, we have entered into various guarantees for purchase commitments, credit guarantees, and contract cancellation fees with expiration dates through 2012 that amounted to $62 million at October 31, 2007.

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

Sales of Receivables

We typically sell our finance receivables to third parties while continuing to service the receivables thereafter. In these securitization transactions, we transfer retail notes and finance leases to a trust or a conduit, which then issues asset-backed securities to investors. In addition, securitizations include sales of wholesale notes receivables, retail accounts receivables, and finance and operating lease receivables.

At this time, none of our retail note and finance lease securitization arrangements qualify for sale accounting under FASB Statement No. 140. As a result, the receivables and associated borrowings are included on the consolidated balance sheet and no gain or loss is recognized for these transactions. The total amount of receivables that collateralize these borrowings was $3.7 billion and $3.8 billion at October 31, 2007 and 2006, respectively.

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The sale of wholesale note receivables qualify for sale treatment under FASB Statement No. 140 and, therefore, the receivables and associated liabilities are removed from the consolidated balance sheet and the gains and losses are recorded in our revenues. In total, proceeds from the sale of wholesale notes amounted to $5.1 billion, $8.2 billion, and $8.7 billion in 2007, 2006, and 2005, respectively.

Contractual Obligations

The following table provides aggregated information on our outstanding contractual obligations as of October 31, 2007:

	Payments Due by Year Ending October 31,				
(in millions)	Total	2008	2009-2010	2011-2012	2013 +
Type of contractual obligation:					
Long-term debt obligations(A)	$ 6,512	$ 695	$ 2,095	$ 1,912	$ 1,810
Interest on long-term debt(B)	1,460	356	625	366	113
Financing arrangements and capital lease obligations(C)	413	124	270	13	6
Operating lease obligations(D)(E)	264	49	74	52	89
Purchase obligations(F)	35	1	18	16	
Total	$ 8,684	$ 1,225	$ 3,082	$ 2,359	$ 2,018

(A) Included in long-term debt obligations are amounts owed on our notes payable to banks and others. These borrowings are further explained in Note 10, *Debt*, to the accompanying consolidated financial statements.
(B) Amounts represent estimated contractual interest payments on outstanding debt. Rates in effect as of October 31, 2007 are used for variable rate debt. For more information, see Note 10, *Debt,* to the accompanying consolidated financial statements.
(C) We lease many of our facilities as well as other property and equipment under financing arrangements and capital leases in the normal course of business including $44 million of interest obligation. For more information, see Note 7, *Property and equipment*, *net,* to the accompanying consolidated financial statements.
(D) Lease obligations for facility closures are included in operating leases. For more information, see Note 7, *Property and equipment*, *net,* to the accompanying consolidated financial statements.
(E) Future operating lease obligations are not recognized in our consolidated balance sheet.
(F) Purchase obligations include various commitments in the ordinary course of business that would include the purchase of goods or services and they are not recognized in our consolidated balance sheet.

In addition to the above contractual obligations, we are also required to fund our pension plans in accordance with the requirements of the PPA. We expect to contribute $100 million in 2008 to meet the minimum required contributions for all plans. Additionally, based on our current forecasts, we expect to contribute approximately $105 million between 2009 and 2011 to the larger U.S. pension plans to satisfy the minimum requirements under the new funding rules. Our pension plan contributions beyond 2011, if any, are uncertain at this time. For additional information, see Note 11, *Postretirement benefits*, to the accompanying consolidated financial statements.

Other Information

Income Taxes

We file a consolidated U.S. federal income tax return for NIC and its eligible domestic subsidiaries. Our non-U.S. subsidiaries file income tax returns in their respective local jurisdictions. We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax benefit carryforwards. Deferred tax liabilities and assets at the end of each period are determined using enacted tax rates.

Under the provisions of FASB Statement No. 109, *Accounting for Income Taxes*, a valuation allowance is required to be established or maintained when, based on currently available information and other factors, it is

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more likely than not that all or a portion of a deferred tax asset will not be realized. FASB Statement No. 109 provides that an important factor in determining whether a deferred tax asset will be realized is whether there has been sufficient taxable income in recent years and whether sufficient income is expected in future years in order to utilize the deferred tax asset. Based on our recent history of U.S. operating and taxable losses, the inconsistency of U.S. profits, and the uncertainty of our U.S. financial outlook, we determined that it was more likely than not that we would not be able to realize the value of our deferred tax assets attributable to U.S. operations and we therefore maintain a valuation allowance against such assets.

We believe that our evaluation of deferred tax assets and our maintenance of a valuation allowance against such assets involve critical accounting estimates because they are subject to, among other things, estimates of future taxable income in the U.S. and in other non-U.S. tax jurisdictions. These estimates are susceptible to change and dependent upon events that may or may not occur, and accordingly, our assessment of the valuation allowance is material to the assets reported on our consolidated balance sheet and changes in the valuation allowance may be material to our results of operations. We intend to continue to assess our valuation allowance in accordance with the requirements of FASB Statement No. 109.

The determination of our income tax provision is complex due to the fact that we have operations in numerous tax jurisdictions outside the U.S. that are subject to certain risks that ordinarily would not be encountered in the U.S.

Environmental Matters

We have been named a potentially responsible party (PRP), in conjunction with other parties, in a number of matters arising under an environmental protection law, the Comprehensive Environmental Response, Compensation, and Liability Act, popularly known as the Superfund law. These matters involve sites that allegedly received wastes from current or former locations. Based on information available to us which, in most cases, consists of data related to quantities and characteristics of material generated at current or former company locations, material allegedly shipped by us to these disposal sites, as well as cost estimates from PRPs and/or federal or state regulatory agencies for the cleanup of these sites, a reasonable estimate is calculated of our share, if any, of the probable costs and accruals are recorded in our consolidated financial statements. These accruals are generally recognized no later than completion of the remedial feasibility study and are not discounted to their present value. We review all accruals on a regular basis and believe that, based on these calculations, our share of the potential additional costs for the cleanup of each site will not have a material effect on our results of operations, cash flows, or financial condition.

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

In July 2006, the WDNR issued to us a NOV in conjunction with the operation of our foundry facility in Waukesha, Wisconsin. Specifically, the WDNR alleged that we violated applicable environmental regulations concerning implementation of storm water pollution prevention plans. Separately, WDNR also issued a NOV regarding the facility in November 2006, in which WDNR alleged that we failed to properly operate and monitor our operations as required by the air permit. In September 2007, WDNR referred the NOVs to the WDOJ for further action. On December 18, 2007, WDNR, WDOJ, and Navistar, Inc. reached a settlement on these matters for less than $1 million. This settlement will not have a material effect on our results of operations, cash flows, or financial condition.

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

Securitization Transactions

We finance receivables using a process commonly known as securitization, whereby asset-backed securities are sold via public offering or private placement. In a typical securitization transaction, we sell a pool of finance receivables to a SPE. The SPE then transfers the receivables to a bankruptcy-remote, legally isolated entity, generally a trust or a conduit, in exchange for proceeds from interest bearing securities. These securities are issued by the trust and are secured by future collections on the receivables sold to the trust. These transactions are subject to the provisions of FASB Statement No. 140.

When we securitize receivables, we may have retained interests in the receivables sold (transferred). The retained interests may include senior and subordinated securities, undivided interests in receivables and over-collateralizations, restricted cash held for the benefit of the trust, and interest-only strips. Our retained interests are the first to absorb any credit losses on the transferred receivables because we have the most subordinated interests in the trust, including subordinated securities, the right to receive excess spread (interest-only strip), and any residual or remaining interests of the trust after all asset-backed securities are repaid in full. Our exposure to credit losses on the transferred receivables is limited to our retained interests. The SPE s assets are available to satisfy the creditors claims against the assets prior to such assets becoming available for the SPE s own uses or the uses of our affiliated companies. Since the transfer constitutes a legal sale, we are under no obligation to repurchase any transferred receivable that becomes delinquent in payment or otherwise is in default. We are not responsible for credit losses on transferred receivables other than through our ownership of the lowest tranches in the securitization structures. We do not guarantee any securities issued by trusts.

We, as seller and the servicer of the finance receivables, are obligated to provide certain representations and warranties regarding the receivables. Should any of the receivables fail to meet these representations and warranties, we, as servicer, are required to repurchase the receivables.

Most of our retail notes and finance leases securitization arrangements do not qualify for sales accounting treatment under FASB Statement No. 140. As a result, the sold receivables and associated secured borrowings are included on the consolidated balance sheet and no gain or loss is recognized for these transactions. For those that do qualify under FASB Statement No. 140, gains or losses are reported in *Finance revenues.*

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with GAAP. In connection with the preparation of our consolidated financial statements, we use estimates and make judgments and assumptions about future events that affect the reported amounts of assets, liabilities, revenue, expenses, and the related disclosures. Our assumptions, estimates, and judgments are based on historical experience, current trends, and other factors we believe are relevant at the time we prepare our consolidated financial statements.

Our significant accounting policies are discussed in Note 1, *Summary of significant accounting policies*, to the accompanying consolidated financial statements and should be reviewed in connection with the following discussion. We believe that the following policies are the most critical to aid in fully understanding and evaluating our reported results as they require us to make difficult, subjective, and complex judgments. In determining whether an estimate is critical, we consider if:

- The nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change.

- The impact of the estimates and assumptions on financial condition or operating performance is material.

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Description	Judgments and Uncertainties	Effect if Actual Results Differ from Assumptions
Pension and Other Postretirement Benefits We provide pension and other postretirement benefits to a substantial portion of our employees, former employees, and their beneficiaries. The assets, liabilities, and expenses we recognize and disclosures we make about plan actuarial and financial information are dependent on the assumptions used in calculating such amounts. The primary assumptions include factors such as discount rates, health care cost trend rates, inflation, expected return on plan assets, retirement rates, mortality rates, rate of compensation increases, and other factors.	Health care cost trend rates are developed based upon historical retiree cost trend data, short term health care outlook, and industry benchmarks and surveys.	As of October 31, 2007, an increase in the discount rate of 0.5%, assuming inflation remains unchanged, would result in a decrease of $161 million in the pension obligations and a decrease of $6 million in the net periodic benefit cost. A 1% increase in the discount rate of the other postretirement plans would result in a decrease of $169 million for the obligation and a decrease of $11 million in the net periodic benefit cost.
	The inflation assumption is based upon our retiree medical trend assumptions. The assumptions are based upon both our specific trends and nationally expected trends.	
	The discount rates are obtained by matching the anticipated future benefit payments for the plans to the Citigroup yield curve to establish a weighted average discount rate for each plan.	A decrease of 0.5% in the discount rate as of October 31, 2007, assuming inflation remains unchanged, would result in an increase of $179 million in the pension obligations and an increase of $5 million in the net periodic benefit cost. A decrease of 1% in the discount rate of the other postretirement benefit plans would result in an increase in other postretirement obligations of $197 million and an increase of $14 million in the net periodic benefit cost.
	The expected return on plan assets is derived from historical plan returns and reviews of asset allocation strategies, expected long-term performance of asset classes, risks and other factors adjusted for our specific investment strategy. The focus of the information is on long-term trends and provides for the consideration for recent plan performance.	The calculation of the expected return on plan assets is described in Note 11, *Postretirement benefits*, to the accompanying consolidated financial statements. The expected rate of return was 9% for 2007, 2006, and 2005. The expected rate of return is a long-term assumption; its accuracy can only be measured over a long time period based upon past experience. A variation in the expected return by 0.5% as of October 31, 2007 would result in a variation of $19 million in the net periodic benefit cost.
	Retirement rates are based upon actual and projected plan experience.	
	Mortality rates are developed from actual and projected plan experience.	
	Rate of compensation increase reflects our long-term actual experience and our projected future increases including contractually agreed upon wage rate increases for represented employees.	

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Description	Judgments and Uncertainties	Effect if Actual Results Differ from Assumptions
		The sensitivities stated above are based upon changing one assumption at a time, but often economic factors impact multiple assumptions simultaneously.
Allowance for Losses		
The allowance for losses is our estimate of losses incurred in our receivable portfolio. The portfolio consists of retail notes, finance leases and wholesale notes, and accounts and other receivables. The allowance is established through a charge to provision for losses and is an estimate of the amount required to absorb losses on the existing portfolio. The allowance for losses related to the finance receivables is evaluated based on a pool method by type of receivable, primarily using historical and current net loss experience in conjunction with current portfolio trends in delinquencies, repossession frequency, and recovery percentages for each receivable type. Specific allowances are made for significant impaired receivables.	Establishing our allowance for losses involves significant uncertainties because the calculation requires us to make estimates about the timing, frequency, and severity of future losses and the impact of general economic conditions as well as current delinquency, repossession, and recovery rates.	As of October 31, 2007, we had an allowance of $60 million for all finance receivables and operating leases owned by us. If we were to adjust the estimated loss rate using the upper and lower limit of the estimated weighted average loss percentage used by us from 2002 through 2007, the required allowance would increase to $90 million or decrease to $35 million for finance receivables and operating leases. The weighted average loss percentage is based upon the historic actual losses with a two-thirds weight and a forecast based upon current general economic conditions with a one-third weight. This creates a probability range in which the most probable outcome is recorded.
Sales of Receivables		
We securitize finance receivables through SPEs, which then issue securities to public and private investors. Some of these securitization transactions qualify as sales under FASB Statement No. 140 whereas the buyers of the receivables have limited recourse. Gains or losses on sales of receivables are credited or charged to *Finance revenues* in the periods in which the sales occur. Amounts due from sales of receivables, also known as retained interests, which include interest-only receivables, cash reserve accounts, and subordinated certificates, are recorded at fair value	We estimate the payment speed for the receivables sold, the discount rate used to determine the present value of future cash flows, and the anticipated net losses on the receivables to calculate the gain or loss. The method for calculating the gain or loss aggregates the receivables into a homogeneous pool. Cash flow estimates based upon historical and current experience, anticipated future portfolio performance, market-based discount rates, and other factors and are made for each securitization transaction. In addition, we re-measure the fair	The critical estimate impacting the valuation of receivables sold is the market-based discount rate. As of October 31, 2007, if we were to adjust the discount rate used for calculating net present value by a 10% adverse change, the result would be a decrease in pre-tax income of $2 million.

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Description	Judgments and Uncertainties	Effect if Actual Results Differ from Assumptions
in the periods in which the sales occur. The accretion of the discount related to the retained interests is recognized on an effective yield basis.	value of the retained interests each reporting period and recognize the related changes in *Finance revenues*.	
	The fair value of the interest-only receivable is based on present value estimates of expected cash flows using our assumptions of prepayment speed, discount rates, and net losses.	
Income Taxes		
We account for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying values of existing assets and liabilities and their respective tax bases. Deferred tax assets are also recorded with respect to net operating losses and other tax attribute carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the years in which temporary differences are expected to be recovered or settled. Valuation allowances are established when it is more likely than not that deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the income of the period that includes the enactment date.	The ultimate recovery of deferred tax assets is dependent upon the amount and timing of future taxable income and other factors such as the taxing jurisdiction in which the asset is to be recovered. A high degree of judgment is required to determine if, and the extent that, valuation allowances should be recorded against deferred tax assets. We have provided valuation allowances at October 31, 2007 and 2006, aggregating $1.7 billion and $1.8 billion, respectively, against U.S. deferred tax assets based on our recent history of U.S. operating and taxable losses, the inconsistency of U.S. profits, and the uncertainty of our U.S. financial outlook. Of these amounts, $49 million as of October 31, 2007, relate to net operating losses for which subsequently recognized tax benefits will be allocated to additional paid in capital.	Although we believe that our approach to estimates and judgments as described herein is reasonable, actual results could differ and we may be exposed to increases or decreases in income taxes that could be material.
Contingent tax liabilities are accounted for separately from deferred tax assets and liabilities. An accrual is recorded when we believe it is probable that a liability has been incurred for taxes and related interest and penalties, if any. It must be probable that a contingent tax benefit will be realized before the contingent benefit is recognized for financial reporting purposes.	Contingent tax liabilities are based on our assessment of the likelihood that we have incurred a liability. Such liabilities are reviewed based on recent changes in tax laws and regulations, including judicial rulings. As of October 31, 2007 and 2006, we have $80 million and $93 million, respectively, of accruals for contingent tax liabilities.	

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Description	Judgments and Uncertainties	Effect if Actual Results Differ from Assumptions
Impairment of Long-Lived Assets		
We review the carrying value of our long-lived assets held and used (other than goodwill and intangible assets with indefinite lives and assets to be disposed of as discussed below) when events and circumstances warrant. This review is performed using estimates of future cash flows discounted at a rate commensurate with the risk involved. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value.	Our impairment loss calculations require us to apply judgments in estimating future cash flows and asset fair values. Assets could become impaired in the future or require additional charges as a result of declines in profitability due to changes in volume, market pricing, cost, manner in which an asset is used, physical condition of an asset, laws and regulations, or in the business environment.	Significant adverse changes to our business environment and future cash flows could cause us to record an impairment charge in future periods which could be material.
Contingent Liabilities		
We are subject to product liability lawsuits and claims in the normal course of business. We record product liability accruals for the self- insured portion of any pending or threatened product liability actions.	For product liability, we determine appropriate case-specific accruals based upon our judgment and the advice of legal counsel. These estimates are evaluated and adjusted based upon changes in facts or circumstances surrounding the case. We also obtain a third party actuarial analysis to assist with the determination of the amount of additional accruals required to cover certain alleged claims and incurred but not reported (IBNR) product liability matters. The actual settlement values of outstanding claims may differ from the original estimates due to circumstances related to the specific claims. The IBNR estimates are impacted by changes in claims frequency and/or severity over historical levels.	The case-specific accruals aggregate $28 million as of October 31, 2007. These accruals typically require adjustment as additional information becomes available for each case, but the amounts of such adjustments are not determinable. As of October 31, 2007, the IBNR accrual was $25 million. A 10% change in claim amount would increase or decrease this accrual by $3 million.
We are subject to claims by various governmental authorities regarding environmental remediation matters.	With regard to environmental remediation, many factors are involved including interpretations of local, state, and federal laws and regulations, whether wastes or other hazardous material are contaminating the surrounding land or water, or have the potential to cause such contamination.	As of October 31, 2007, we accrued $22 million for environmental remediation, which represents our best estimate of the accruals required for these matters.

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Description	Judgments and Uncertainties	Effect if Actual Results Differ from Assumptions
We are subject to claims related to illnesses alleged to have resulted from asbestos exposure from component parts found in older vehicles, although some claims relate to the alleged presence of asbestos in our facilities.	The asbestos related cases are subject to a variety of factors in that other vehicle manufacturers and various component suppliers are also named defendants. Historically, our actual damages paid out to individual claimants have not been material.	Although we believe that our estimates and judgments related to asbestos related claims are reasonable, actual results could differ and we may be exposed to losses that could be material.
Product Warranty		
We record a liability for standard and extended warranty for products sold as well as for certain claims outside the contractual obligation period. As a result of the uncertainty surrounding the nature and frequency of product recall programs, the liability for such programs is recorded when we commit to a recall action, which generally occurs when it is announced. Supplier recoveries related to warranties are recorded when the supplier confirms their liability under the recall and collection is reasonably assured.	Product warranty estimates are established using historical information about the nature, frequency, and average cost of warranty claims. Warranty claims are influenced by factors such as new product introductions, technological developments, the competitive environment, and the costs of component parts. We estimate warranty claims and take action to improve vehicle quality and minimize warranty claims. Actual payments for warranty claims could differ from the amounts estimated requiring adjustments to the liabilities in future periods.	Although we believe that the estimates and judgments discussed herein are reasonable, actual results could differ and we may be exposed to increases or decreases in our warranty accrual that could be material.
Goodwill and Intangible Assets		
Goodwill represents the excess of the purchase price over the fair value of the net assets of acquired companies. We test goodwill for impairment using a fair value approach at the reporting unit level. We are required to test for impairment at least annually, absent some triggering event that would accelerate an impairment assessment.	We have recognized goodwill in our reporting units, which are one level below the segment level for purposes of performing our goodwill impairment testing. We determine the fair values of our reporting units using the discounted cash flow valuation technique, which requires us to make assumptions and estimates regarding industry economic factors and the profitability of future business strategies.	Changes in the underlying factors may cause our estimates related to fair values to change and may cause impairment which may have a material impact.
We continue to review the carrying values of amortizable intangible assets whenever facts and circumstances change in a manner that indicates their carrying values may not be recoverable. We test indefinite lived intangible assets at least annually, absent some triggering event that would accelerate an impairment assessment.	Our testing for impairment of intangible assets requires us to apply judgments in estimating future cash flows and asset fair values. Intangible assets could become impaired as a result of declines in profitability due to changes in volume, market pricing, cost, manner in which an asset is used, laws and regulations, or in the business environment.	

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New Accounting Pronouncements

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

Pronouncement	Effective Date	Impact on Our Financial Condition and Results of Operations
FASB Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets*	Effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Our effective date is November 1, 2009.	We are evaluating the potential impact, if any
FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133*	Effective for fiscal years and interim reporting periods beginning after November 15, 2008. Our effective date is February 1, 2009.	When effective, we will comply with the disclosure provisions of this Statement.
FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51*	Effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. Our effective date is November 1, 2009.	We are evaluating the potential impact, if any.
FASB Statement No. 141(R), *Business Combinations*	Applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. Our effective date is November 1, 2009.	We will adopt this Statement on a prospective basis.
Emerging Issues Task Force Issue No. 07-03, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*	Effective for financial statements issued for fiscal years beginning after December 15, 2007. Our effective date is November 1, 2008.	We are evaluating the potential impact, if any.
SAB No. 109, *Written Loan Commitments Recorded at Fair Value through Earnings*	Effective as of the first fiscal quarter beginning after December 15, 2007. Our effective date is February 1, 2008.	This Bulletin will not have a material impact on our financial statements.
FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*	Effective as of the beginning of the first fiscal year beginning after November 15, 2007. Early adoption was permitted under certain limited circumstances; we did not choose to early adopt. If we adopt the Fair Value Option, our effective date is November 1, 2008.	We are evaluating the potential impact, if any. We have not determined whether to adopt the fair value option.

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Pronouncement	Effective Date	Impact on Our Financial Condition and Results of Operations
FASB Statement No. 157, *Fair Value Measurements*	Effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. Our effective date is November 1, 2008.	We are evaluating the potential impact, if any.
FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*	Effective for fiscal years beginning after December 15, 2006. Our effective date is November 1, 2007.	We do not expect this Interpretation to have a material impact on our financial condition and results of operations.

2007 and 2006 Quarterly Financial Results (Unaudited)

Selected quarterly financial information for 2007 and 2006 include the following:

Consolidated statements of operations for the quarters ended January 31, April 30, July 31, and October 31

Consolidated balance sheets as of January 31, April 30, and July 31

Comparison of Truck segment chargeouts and Engine segment shipments for the quarters ended January 31, April 30, July 31, and October 31

Consolidated comparison of business results for the quarters ended January 31, April 30, July 31, and October 31.

Quarterly Consolidated Statements of Operations

	For the Quarters Ended							
	January 31		April 30		July 31		October 31	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
(in millions, except per share data)								
Sales and revenues								
Sales of manufactured products, net	**$ 3,050**	$ 2,743	**$ 2,900**	$ 3,383	**$ 2,852**	$ 3,583	**$ 3,108**	$ 4,169
Finance revenues	**98**	77	**90**	74	**104**	84	**93**	87
Sales and revenues, net	**3,148**	2,820	**2,990**	3,457	**2,956**	3,667	**3,201**	4,256
Costs and expenses								
Costs of products sold	**2,605**	2,386	**2,472**	2,829	**2,428**	2,998	**2,626**	3,490
Selling, general and administrative expenses	**297**	293	**345**	301	**368**	321	**451**	417
Engineering and product development costs	**103**	113	**95**	116	**86**	114	**98**	110
Interest expense	**111**	87	**131**	104	**125**	118	**135**	122
Other (income) expenses, net	**29**	(17)	**(16)**	4	**(34)**	(17)	**(13)**	15
Total costs and expenses	**3,145**	2,862	**3,027**	3,354	**2,973**	3,534	**3,297**	4,154
Equity in income of non-consolidated affiliates	**22**	19	**18**	23	**22**	23	**12**	34
Income (loss) before income tax	**25**	(23)	**(19)**	126	**5**	156	**(84)**	136
Income tax (expense) benefit	**(13)**	(13)	**(6)**	(27)	**(9)**	(22)	**(19)**	(32)

Net income (loss)	**12**	$ (36)	**$ (25)**	$ 99	**$ (4)**	$ 134	**$ (103)**	$ 104
Basic earnings (loss) per share	**$ 0.17**	$ (0.52)	**$ (0.36)**	$ 1.41	**$ (0.05)**	$ 1.90	**$ (1.46)**	$ 1.49
Diluted earnings (loss) per share	**$ 0.17**	$ (0.52)	**$ (0.36)**	$ 1.33	**$ (0.05)**	$ 1.78	**$ (1.46)**	$ 1.49
Weighted average shares outstanding								
Basic	**70.3**	70.2	**70.3**	70.2	**70.3**	70.3	**70.3**	70.3
Diluted	**70.9**	70.2	**70.3**	75.9	**70.3**	75.8	**70.3**	70.3

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Quarterly Consolidated Balance Sheets

	January 31		April 30		July 31	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
(in millions)						
ASSETS						
Current assets						
Cash and cash equivalents	**$ 398**	$ 562	**$ 648**	$ 887	**$ 674**	$ 713
Marketable securities	**3**	3	**20**	4	**5**	20
Finance and other receivables, net	**2,797**	2,420	**3,035**	2,992	**2,730**	2,814
Inventories	**1,717**	1,561	**1,484**	1,724	**1,475**	1,809
Deferred taxes, net	**44**	61	**42**	63	**39**	64
Other current assets	**154**	159	**168**	177	**187**	177
Total current assets	**5,113**	4,766	**5,397**	5,847	**5,110**	5,597
Restricted cash and cash equivalents	**433**	502	**537**	653	**632**	372
Finance and other receivables, net	**2,567**	2,389	**2,537**	2,485	**2,537**	2,498
Investments in and advances to non-consolidated affiliates	**203**	180	**202**	186	**183**	194
Property and equipment, net	**2,114**	2,094	**2,096**	2,085	**2,096**	2,105
Goodwill	**313**	311	**322**	323	**339**	313
Intangible assets, net	**289**	295	**287**	293	**287**	289
Pension assets	**58**	51	**61**	46	**64**	33
Deferred taxes, net	**45**	49	**44**	49	**43**	49
Other noncurrent assets	**78**	66	**78**	92	**81**	96
Total assets	**$ 11,213**	$ 10,703	**$ 11,561**	$ 12,059	**$ 11,372**	$ 11,546
LIABILITIES AND STOCKHOLDERS DEFICIT						
Liabilities						
Current liabilities						
Notes payable and current maturities of long-term debt	**$ 794**	$ 1,099	**$ 788**	$ 856	**$ 772**	$ 848
Accounts payable	**1,591**	1,748	**1,684**	2,087	**1,590**	1,906
Other current liabilities	**1,470**	1,600	**1,379**	1,733	**1,450**	1,584
Total current liabilities	**3,855**	4,447	**3,851**	4,676	**3,812**	4,338
Long-term debt	**6,103**	5,309	**6,486**	6,317	**6,324**	5,994
Postretirement benefits liabilities	**1,621**	1,850	**1,613**	1,859	**1,614**	1,865
Other noncurrent liabilities	**734**	803	**715**	794	**696**	809
Total liabilities	**12,313**	12,409	**12,665**	13,646	**12,446**	13,006
Stockholders deficit						
Series D convertible junior preference stock	**4**	4	**4**	4	**4**	4
Common stock and additional paid-in capital	**2,097**	2,080	**2,097**	2,083	**2,099**	2,086
Accumulated deficit	**(2,387)**	(2,736)	**(2,413)**	(2,637)	**(2,417)**	(2,504)
Accumulated other comprehensive loss	**(648)**	(887)	**(627)**	(871)	**(595)**	(880)
Common stock held in treasury, at cost	**(166)**	(167)	**(165)**	(166)	**(165)**	(166)
Total stockholders deficit	**(1,100)**	(1,706)	**(1,104)**	(1,587)	**(1,074)**	(1,460)
Total liabilities and stockholders deficit	**$ 11,213**	$ 10,703	**$ 11,561**	$ 12,059	**$ 11,372**	$ 11,546

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Comparison of Truck Segment Chargeouts and Engine Segment Shipments

	For the Quarters Ended							
	January 31		April 30		July 31		October 31	
	2007	2006	2007	2006	2007	2006	2007	2006
Truck Segment Chargeouts (in units):								
Traditional Markets (U.S. and Canada)								
School buses	**3,400**	4,100	**4,100**	4,500	**3,200**	4,300	**3,900**	5,100
Class 6 and 7 medium trucks	**9,700**	7,300	**6,800**	11,500	**5,600**	12,100	**6,600**	14,300
Class 8 heavy trucks	**7,000**	7,900	**4,500**	9,900	**2,600**	10,200	**3,300**	15,400
Class 8 severe service trucks(A)	**4,200**	4,000	**3,700**	4,600	**3,900**	5,200	**4,300**	6,700
Sub-total combined class 8 trucks	**11,200**	11,900	**8,200**	14,500	**6,500**	15,400	**7,600**	22,100
Total Traditional Markets	**24,300**	23,300	**19,100**	30,500	**15,300**	31,800	**18,100**	41,500
Total Expansion Markets	**9,400**	6,100	**9,200**	7,000	**9,300**	7,800	**8,900**	7,400
Total World-wide Units	**33,700**	29,400	**28,300**	37,500	**24,600**	39,600	**27,000**	48,900

(A) Includes 300, 400, 400, and 600 units in 2007 and 100, 100, 900, and 400 units in 2006 related to U.S. military contracts in the quarters ended January 31, April 30, July 31, and October 31, respectively.

	For the Quarters Ended							
	January 31		April 30		July 31		October 31	
	2007	2006	2007	2006	2007	2006	2007	2006
Engine Segment Shipments (in units):								
World-wide shipments								
OEM sales	**81,000**	105,500	**82,600**	121,200	**94,500**	101,700	**81,200**	92,200
Intercompany sales	**23,100**	17,600	**12,100**	24,300	**13,700**	25,100	**16,500**	32,100
Total sales	**104,100**	123,100	**94,700**	145,500	**108,200**	126,800	**97,700**	124,300

Quarterly Comparison of Business Consolidated Results

Quarter Ended January 31, 2007 Compared to Quarter Ended January 31, 2006

For the quarter ended January 31, 2007, we recorded net sales and revenues of $3.1 billion as compared with net sales and revenues of $2.8 billion for the quarter ended January 31, 2006. Truck segment sales and Engine segment sales together comprise the majority of the total net sales and revenues for the quarters ended January 31, 2007 and 2006. Truck segment sales were $2.1 billion and Engine segment sales were $829 million for the quarter ended January 31, 2007 as compared with $1.8 billion of Truck segment sales and $775 million of Engine segment sales for the comparable period in 2006. Truck net sales and revenues increased over the prior period primarily due to the pre-buy of 2006 vehicles prior to the introduction of 2007 emissions-compliant vehicles, and growth in our expansion markets. World-wide Truck chargeouts were 33,700 units and 29,400 units for the quarters ended January 31, 2007 and 2006, respectively. The increase in world-wide Truck chargeouts was primarily attributable to growth in expansion markets of 3,300 units driven by chargeouts to customers in Mexico and other export markets. Based on market-wide information from Wards Communications and R.L. Polk & Co, units sold for the traditional truck retail industry were 109,600 and 102,500 for the quarters ended January 31, 2007 and 2006, respectively, and our combined share of these markets was 24.7% and 24.2%, respectively. Our retail market share for the quarter ended January 31, 2007 in the bus, medium, heavy, and severe service vehicle classes was 61.4%, 36.7%, 15.6%, and 24.0%, respectively, which compared to our market share for the same vehicle classes for the quarter ended January 31, 2006 of 64.1%, 35.7%, 14.4%, and 21.9%, respectively. Changes in our market shares were impacted by competitive pricing strategies by our competitors, new market entrants, and timing of customer purchases. Engine net sales and revenues included improved pricing

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over the 2006 quarter, which was offset by a reduction in shipments. Engine shipments were 104,100 units and 123,100 units during the quarters ended January 31, 2007 and 2006, respectively. Engine unit volume shipped to Ford was lower in this quarter by 20,200 units due to a reduction in their purchasing requirements. In addition, our Parts and Financial Services segments recorded $361 million and $138 million, respectively, in net sales and revenues for the quarter ended January 31, 2007, which compared with net sales and revenues of $358 million for the Parts segment and $106 million for the Financial Services segment for the comparable period in 2006.

Costs of products sold were $2.6 billion and $2.4 billion for the quarters ended January 31, 2007 and 2006, respectively, representing approximately 85.4% and 87.0% of net sales of manufactured products for the quarters ended January 31, 2007 and 2006, respectively. As is typical in a cyclical manufacturing environment, the benefit of spreading our fixed costs over larger production volumes is greatly reduced thereby inflating our *Costs of products sold* percentage in lower production volume periods and the inverse occurs in higher production volume periods. *Costs of products sold* include $64 million and $80 million of product warranty costs for the quarters ended January 31, 2007 and 2006, respectively. The $16 million decrease in product warranty costs coincides primarily with our reduced volumes compared to the prior year period. During the quarter ended January 31, 2007, we continued to experience an elevated level of commodity and direct material costs compared to historical levels. In particular, costs related to steel, precious metals, resins, and petroleum products increased by $10 million in the first quarter over the comparable period in the prior year. Generally, we have been able to mitigate the effects of these cost increases via a combination of design changes, material substitution, resourcing, global sourcing efforts, and pricing performance.

Selling, general and administrative expenses were $297 million and $293 million for the quarters ended January 31, 2007 and 2006, respectively. *Selling, general and administrative expenses* increased by $45 million due to professional fees to restate our previously issued financial statements and perform an assessment of our internal control over financial reporting and $16 million of Dealcor expenses due to the acquisition of two Dealcors, partially offset by a reduction in legal fees. *Selling, general and administrative expenses* represented 9.4% and 10.4% of total net sales and revenues for the quarters ended January 31, 2007 and 2006, respectively.

Engineering and product development costs were $103 million and $113 million in the first quarters of 2007 and 2006, respectively, supporting the ongoing development of new products and emission capabilities for our vehicles and engines. 2006 expenses were greater than 2007 as a result of the development activities related to the launch of our 2007 emission-compliant engine and new vehicles. Generally, postretirement expenses are included in *Costs of products sold, Selling, general and administrative expenses,* and *Engineering and product development costs*, at approximately 30%, 65%, and 5% of total expenses, respectively, throughout the 2007 and 2006 reporting periods. For the quarter ended January 31, 2007, total postretirement expenses, inclusive of company 401(k) contributions, were $36 million, a decrease of $23 million from the $59 million incurred in the quarter ended January 31, 2006. During first quarter 2007, we recorded a $19 million expense related to post-employment benefits provided to certain individuals under a disability benefit program, substantially all of which relates to periods prior to 2005.

Interest expense was $111 million and $87 million for the quarters ended January 31, 2007 and 2006, respectively. The increase in *Interest expense* for the first quarter of 2007 compared to 2006 was primarily due to increased borrowings related to the financing of dealers pre-2007 emissions vehicle inventory and higher interest rates related to our new debt structure. *Other (income) expenses, net* amounted to net expense of $29 million and net income of $17 million for the quarters ended January 31, 2007 and 2006, respectively. The net increase in *Other (income) expenses, net* for the periods ended January 31 was primarily attributable to the $31 million loss related to refinancing and restructuring of our debt.

Equity in income of non-consolidated affiliates was $22 million and $19 million for the first quarter of 2007 and 2006, respectively, which was derived primarily from our Blue Diamond affiliates. *Income tax expense* was $13 million for the quarter ended January 31, 2007, which was flat versus the comparable period in 2006. We recorded net income of $12 million for the quarter ended January 31, 2007 compared to a net loss of $36 million for the quarter ended January 31, 2006.

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Quarter Ended April 30, 2007 Compared to Quarter Ended April 30, 2006

For the quarter ended April 30, 2007, we recorded net sales and revenues of $3.0 billion as compared with net sales and revenues of $3.5 billion for the quarter ended April 30, 2006. Truck segment sales and Engine segment sales together comprised the majority of our total net sales and revenues for the quarters ended April 30, 2007 and 2006. Truck segment sales were $1.8 billion and Engine segment sales were $772 million for the quarter ended April 30, 2007 as compared with $2.3 billion of Truck segment sales and $945 million of Engine segment sales for the comparable period in 2006. Truck net sales and revenues decreased over the prior period primarily due to the introduction of 2007 emissions-compliant vehicles partially offset by 2007 emission pricing increases and growth in our expansion markets. World-wide Truck chargeouts were 28,300 units and 37,500 units for the quarters ended April 30, 2007 and 2006, respectively. The decrease in world-wide Truck chargeouts in this quarter was partially offset by expansion markets growth of 2,200 units primarily driven by chargeouts to customers in other export markets. Based on market-wide information from Wards Communications and R.L. Polk & Co, units sold for the traditional truck retail industry were 82,500 and 116,400 for the quarters ended April 30, 2007 and 2006, respectively, and our combined share of these markets was 25.1% and 27.1%, respectively. Our retail market share for the quarter ended April 30, 2007 in the bus, medium, heavy, and severe service vehicle classes was 60.3%, 34.2%, 12.2%, and 27.6%, respectively, which compared to our market share for the same vehicle classes for the quarter ended April 30, 2006 of 61.6%, 39.5%, 18.4%, and 22.5%, respectively. Changes in our market shares were impacted by competitive pricing strategies by our competitors, new market entrants, and timing of customer purchases. Engine net sales and revenues included new pricing related to the 2007 emissions-compliant engines which is offset by a reduction in shipments over prior quarter 2006. Engine shipments were 94,700 units and 145,500 units during the quarters ended April 30, 2007 and 2006, respectively. Engine unit volume shipped to Ford was lower in this quarter by 36,000 units due to a reduction in their purchasing requirements. In addition, our Parts and Financial Services segments recorded $387 million and $125 million, respectively, in net sales and revenues for the quarter ended April 30, 2007, which compared with net sales and revenues of $389 million for the Parts segment and $109 million for the Financial Services segment for the comparable period in 2006.

Costs of products sold were $2.5 billion and $2.8 billion for the quarters ended April 30, 2007 and 2006, respectively, representing approximately 85.2% and 83.6% of net sales of manufactured products for the quarters ended April 30, 2007 and 2006, respectively. As is typical in a cyclical manufacturing environment, the benefit of spreading our fixed costs over larger production volumes is greatly reduced thereby inflating our *Costs of products sold* percentage in lower production volume periods and the inverse occurs in higher production volume periods. *Costs of products sold* include $43 million and $60 million of product warranty costs for the quarters ended April 30, 2007 and 2006, respectively. The $17 million decrease in product warranty costs coincides primarily with our reduced volumes compared to the prior year period. During the quarter ended April 30, 2007, we continued to experience an elevated level of commodity and direct material costs compared to historical levels. In particular, costs related to steel, precious metals, resins, and petroleum products increased by $26 million in the second quarter over the comparable period in the prior year. Generally, we have been able to mitigate the effects of these cost increases via a combination of design changes, material substitution, resourcing, global sourcing efforts, and pricing performance.

Selling, general and administrative expenses were $345 million and $301 million for the quarters ended April 30, 2007 and 2006, respectively. *Selling, general and administrative expenses* increased by $36 million due to professional fees to restate our previously issued financial statements and perform an assessment of our internal control over financial reporting, and $14 million of Dealcor expenses due to further integration of two Dealcors acquired in the first quarter. *Selling, general and administrative expenses* represented 11.5% and 8.7% of total net sales and revenues for the quarters ended April 30, 2007 and 2006, respectively.

Engineering and product development costs were $95 million and $116 million in the second quarter of 2007 and 2006, respectively, supporting the ongoing development of new products and emission capabilities for our vehicles and engines. 2006 expenses were greater than 2007 as a result of the development activities related

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to the launch of our 2007 emission-compliant engine and new vehicles. For the quarter ended April 30, 2007, total postretirement expenses, inclusive of company 401(k) contributions, were $35 million, a decrease of $20 million from the $55 million incurred in the quarter ended April 30, 2006.

Interest expense was $131 million and $104 million for the quarters ended April 30, 2007 and 2006, respectively. The increase in *Interest expense* for the quarters ended April 30 was primarily due to increased borrowings related to the financing of dealers pre-2007 emissions vehicle inventory. *Other (income) expenses, net* amounted to net income of $16 million and net expense of $4 million for the quarters ended April 30, 2007 and 2006, respectively.

Equity in income of non-consolidated affiliates was $18 million and $23 million for the second quarter of 2007 and 2006, respectively, which was derived primarily from our Blue Diamond affiliates. *Income tax expense* was $6 million and $27 million for the quarters ended April 30, 2007 and 2006, respectively. We recorded a net loss of $25 million and net income of $99 million for the quarters ended April 30, 2007 and 2006, respectively.

Quarter Ended July 31, 2007 Compared to Quarter Ended July 31, 2006

For the quarter ended July 31, 2007, we recorded net sales and revenues of $3.0 billion as compared with net sales and revenues of $3.7 billion for the quarter ended July 31, 2006. Truck segment sales and Engine segment sales together comprised the majority of our total net sales and revenues for the quarters ended July 31, 2007 and 2006. Truck segment sales were $1.7 billion and Engine segment sales were $971 million for the quarter ended July 31, 2007 as compared with $2.6 billion of Truck segment sales and $863 million of Engine segment sales for the comparable period in 2006. Truck net sales and revenues decreased over the prior period primarily due to introduction of 2007 emissions-compliant vehicles partially offset by 2007 emissions pricing increases and expansion markets growth. World-wide Truck chargeouts were 24,600 units and 39,600 units for the quarters ended July 31, 2007 and 2006, respectively. The decrease in world-wide Truck chargeouts in this quarter was partially offset by expansion markets growth of 1,500 units primarily driven by chargeouts to customers in other export and WCC markets. Based on market-wide information from Wards Communications and R.L. Polk & Co, units sold for the traditional truck retail industry were 63,300 and 117,000 for the quarters ended July 31, 2007 and 2006, respectively, and our combined share of these markets was 27.2% and 25.3%, respectively. Our retail market share for the quarter ended July 31, 2007 in the bus, medium, heavy, and severe service vehicle classes was 57.4%, 34.4%, 15.7%, and 26.4%, respectively, which compared to our market share for the same vehicle classes for the quarter ended July 31, 2006 of 63.2%, 37.2%, 16.1%, and 23.8%, respectively. Changes in our market shares were impacted by competitive pricing strategies by our competitors, new market entrants, and timing of customer purchases. Engine net sales and revenues increased due to new pricing related to the 2007 emissions-compliant engines which is partially offset by a reduction in shipments over prior quarter 2006. Engine shipments were 108,200 units and 126,800 units during the quarters ended July 31, 2007 and 2006, respectively. Engine unit volume shipped to Ford was lower in this quarter by 9,800 units due to a reduction in their purchasing requirements. In addition, our Parts and Financial Services segments recorded $405 million and $133 million, respectively, in net sales and revenues for the quarter ended July 31, 2007, which compared with net sales and revenues of $373 million for the Parts segment and $123 million for the Financial Services segment for the comparable period in 2006.

Costs of products sold were $2.4 billion and $3.0 billion for the quarters ended July 31, 2007 and 2006, respectively, representing approximately 85.1% and 83.7% of net sales of manufactured products for the quarter ended July 31, 2007 and 2006, respectively. As is typical in a cyclical manufacturing environment, the benefit of spreading our fixed costs over larger production volumes is greatly reduced thereby inflating our *Costs of products sold* percentage in lower production volume periods and the inverse occurs in higher production volume periods. *Costs of products sold* include $51 million and $71 million of product warranty costs for the quarters ended July 31, 2007 and 2006, respectively. The $20 million decrease in product warranty costs was primarily due to reduced volumes compared to the prior year period. During the quarter ended July 31, 2007, we continued to experience an elevated level of commodity and direct material costs compared to historical levels. In particular, costs related to steel, precious metals, resins, and petroleum products increased by $20 million in the

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third quarter over the comparable period in the prior year. Generally, we have been able to mitigate the effects of these cost increases via a combination of design changes, material substitution, resourcing, global sourcing efforts, and pricing performance.

Selling, general and administrative expenses were $368 million and $321 million for the quarters ended July 31, 2007 and 2006, respectively. *Selling, general and administrative expenses* increased by $42 million due to professional fees to restate our previously issued financial statements and perform an assessment of our internal control over financial reporting. *Selling, general and administrative expenses* represented 12.4% and 8.8% of total net sales and revenues for the quarters ended July 31, 2007 and 2006, respectively.

Engineering and product development costs were $86 million and $114 million in the third quarter of 2007 and 2006, respectively, supporting the ongoing development of new products and emission capabilities for our vehicles and engines. 2006 expenses were greater than 2007 as a result of the development activities related to the launch of our 2007 emission-compliant engine and new vehicles. For the quarter ended July 31 2007, total postretirement expenses, inclusive of company 401(k) contributions, were $35 million, a decrease of $21 million from the $56 million incurred in the quarter ended July 31 2006.

Interest expense was $125 million and $118 million for the quarters ended July 31, 2007 and 2006, respectively. The increase in *Interest expense* for the quarters ended July 31, 2007 and 2006 was primarily due to increased borrowings related to the financing of dealers vehicle inventory. *Other (income) expenses, net* amounted to net income of $34 million and $17 million for the quarters ended July 31, 2007 and 2006, respectively.

Equity in income of non-consolidated affiliates was $22 million and $23 million for the third quarter of 2007 and 2006, respectively, which was derived primarily from our Blue Diamond affiliates. *Income tax expense* was $9 million and $22 million for the quarters ended July 31, 2007 and 2006, respectively. We recorded a net loss of $4 million and net income of $134 million for the quarters ended July 31, 2007 and 2006, respectively.

Quarter Ended October 31, 2007 Compared to Quarter Ended October 31, 2006

For the quarter ended October 31, 2007, we recorded net sales and revenues of $3.2 billion as compared with net sales and revenues of $4.3 billion for the quarter ended October 31, 2006. Truck segment sales and Engine segment sales together comprised the majority of our total net sales and revenues for the quarters ended October 31, 2007 and 2006. Truck segment sales were $2.0 billion and Engine segment sales were $890 million for the quarter ended October 31, 2007 as compared with $3.2 billion of Truck segment sales and $889 million of Engine segment sales for the comparable period in 2006. Truck net sales and revenues decreased over the prior period primarily due to the introduction of 2007 emissions-compliant vehicles partially offset by 2007 emissions pricing increases and expansion markets growth. World-wide Truck chargeouts were 27,000 units and 48,900 units for the quarters ended October 31, 2007 and 2006, respectively. The decrease in world-wide Truck chargeouts in this quarter was partially offset by expansion markets growth of 1,500 units primarily driven by chargeouts to customers in the WCC markets. Based on market-wide information from Wards Communications and R.L. Polk & Co, units sold for the traditional truck retail industry were 63,600 and 118,800 for the quarters ended October 31, 2007 and 2006, respectively, and our combined share of these markets was 31.0% and 29.8%, respectively. Our retail market share for the quarter ended October 31, 2007 in the bus, medium, heavy, and severe service vehicle classes was 59.1%, 37.3%, 17.1%, and 31.9%, respectively, which compared to our market share for the same vehicle classes for the quarter ended October 31, 2006 of 66.2%, 47.4%, 19.0%, and 23.7%, respectively. Changes in our market shares were impacted by competitive pricing strategies by our competitors, new market entrants, and timing of customer purchases. Engine net sales and revenues included new pricing related to the 2007 emissions-compliant engines which is offset by a reduction in shipments over prior quarter 2006. Engine shipments were 97,700 units and 124,300 units during the quarters ended October 31, 2007 and 2006, respectively. Engine unit volume shipped to Ford was lower in this quarter by 14,600 units due to a reduction in their purchasing requirements. In addition, our Parts and Financial Services segments recorded

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$409 million and $121 million, respectively, in net sales and revenues for the quarter ended October 31, 2007, which compared with net sales and revenues of $396 million for the Parts segment and $125 million for the Financial Services segment for the comparable period in 2006.

Costs of products sold were $2.6 billion and $3.5 billion for the quarters ended October 31, 2007 and 2006, respectively, representing approximately 84.5% and 83.7% of net sales of manufactured products for the quarter ended October 31, 2007 and 2006, respectively. As is typical in a cyclical manufacturing environment, the benefit of spreading our fixed costs over larger production volumes is greatly reduced thereby inflating our *Costs of products sold* percentage in lower production volume periods and the inverse occurs in higher production volume periods. *Costs of products sold* include $46 million and $87 million of product warranty costs for the quarters ended October 31, 2007 and 2006, respectively. The $41 million decrease in product warranty costs was primarily due to reduced volumes compared to prior year period. During the quarter ended October 31, 2007, we continued to experience an elevated level of commodity and direct material costs compared to historical levels. In particular, costs related to steel, precious metals, resins, and petroleum products increased by $30 million in the fourth quarter over the comparable period in the prior year. Generally, we have been able to mitigate the effects of these cost increases via a combination of design changes, material substitution, resourcing, global sourcing efforts, and pricing performance.

Selling, general and administrative expenses were $451 million and $417 million for the quarter ended October 31, 2007 and 2006, respectively. *Selling, general and administrative expenses* increased by $40 million due to professional fees to restate our previously issued financial statements and perform an assessment of our internal control over financial reporting, partially offset by a reduction in legal fees. *Selling, general and administrative expenses* represented 14.1% and 9.8% of total net sales and revenues for the quarters ended October 31, 2007 and 2006, respectively.

Engineering and product development costs were $98 million and $110 million in the fourth quarter of 2007 and 2006, respectively, supporting the ongoing development of new products and emission capabilities for our vehicles and engines. 2006 expenses were greater than 2007 as a result of the development activities related to the launch of our 2007 emission-compliant engine and new vehicles. For the quarter ended October 31, 2007, total postretirement expenses, inclusive of company 401(k) contributions, were $41 million, a decrease of $20 million from the $61 million incurred in the quarter ended October 31, 2006.

Interest expense was $135 million and $122 million for the quarters ended October 31, 2007 and 2006, respectively. The increase in *Interest expense* for the periods ended October 31 was primarily due to increased borrowings related to the financing of dealers vehicle inventory. *Other (income) expenses, net* amounted to net income of $13 million and net expense of $15 million for the quarters ended October 31, 2007 and 2006, respectively.

Equity in income of non-consolidated affiliates was $12 million and $34 million for the fourth quarter of 2007 and 2006, respectively, which was derived primarily from our Blue Diamond affiliates. *Income tax expense* was $19 million and $32 million for the quarters ended October 31, 2007 and 2006, respectively. We recorded a net loss of $103 million and net income of $104 million for the quarters ended October 31, 2007 and 2006, respectively.

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Item 7A. ***Quantitative and Qualitative Disclosures about Market Risk***

Our primary market risks include fluctuations in interest rates and currency exchange rates. We are also exposed to changes in the prices of commodities used in our manufacturing operations. Commodity price risk related to our current commodity financial instruments are not material. We do not hold a material portfolio of market risk sensitive instruments for trading purposes.

We have established policies and procedures to manage sensitivity to interest rate and foreign currency exchange rate market risk. These procedures include the monitoring of our level of exposure to each market risk, the funding of variable rate receivables primarily with variable rate debt, and limiting the amount of fixed rate receivables that may be funded with floating rate debt. These procedures also include the use of derivative financial instruments to mitigate the effects of interest rate fluctuations and to reduce our exposure to exchange rate risk.

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. We measure our interest rate risk by estimating the net amount by which the fair value of all of our interest rate sensitive assets and liabilities would be impacted by selected hypothetical changes in market interest rates. Fair value is estimated using a discounted cash flow analysis. Assuming a hypothetical instantaneous 10% adverse change in interest rates as of October 31, 2007, the fair value of these instruments would decrease, resulting in a loss of $3 million. Our interest rate sensitivity analysis assumes a parallel shift in interest rate yield curves. The model, therefore, does not reflect the potential impact of changes in the relationship between short-term and long-term interest rates.

We are exposed to changes in the price of commodities, particularly for aluminum, copper, precious metals, resins, and steel and their impact on the acquisition cost of various parts used in our manufacturing operations. We have been able to mitigate the effects of price increases via a combination of design changes, material substitution, resourcing, global sourcing, and price performance. In certain cases, we use derivative instruments to reduce exposure to price changes. During 2007, steel, other metals, and petroleum products prices were significantly higher than in 2006, resulting in an approximate $90 million increase in our cost from suppliers.

Foreign currency risk is the risk that we will incur economic losses due to adverse changes in foreign currency exchange rates. Our primary exposures to foreign currency exchange fluctuations are the Canadian dollar/U.S. dollar, Mexican peso/U.S. dollar and Brazilian real/U.S. dollar. Assuming that no offsetting derivative financial instruments exist, a hypothetical instantaneous 10% adverse change in quoted foreign currency spot rates applied to foreign currency sensitive instruments would result in a loss of $2 million at October 31, 2007.

For further information regarding models, assumptions and parameters related to market risk, please see Note 14, *Fair value of financial instruments,* and Note 15, *Financial instruments and commodity contracts*, to the accompanying consolidated financial statements.

Item 8. ***Financial Statements and Supplementary Data***

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders Navistar International Corporation:

We have audited the accompanying consolidated balance sheets of Navistar International Corporation and subsidiaries (the Company) as of October 31, 2007 and 2006, and the related consolidated statements of operations, stockholders deficit, and cash flows for each of the years in the three-year period ended October 31, 2007. We also have audited Navistar International Corporation s internal control over financial reporting as of October 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control over Financial Reporting appearing under Item 9A of the Company s October 31, 2007 annual report on Form 10-K. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis. The following categories of material weaknesses have been identified and included in management s assessment: control environment, accounting policies and procedures, internal audit, segregation of duties, information technology, journal entries, account reconciliations, period-end close process, pension and other postretirement benefits accounting, revenue accounting, warranty accounting, and income tax accounting.

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These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Navistar International Corporation and subsidiaries as of October 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended October 31, 2007, in conformity with U.S. generally accepted accounting principles. Also in our opinion, because of the effect of the aforementioned material weaknesses on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of October 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by COSO.

As described in Note 1 to the accompanying consolidated financial statements, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* as of October 31, 2007 and SFAS No. 123(R), *Share-Based Payment,* during the year ended October 31, 2006.

KPMG LLP

Chicago, Illinois

May 29, 2008

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Navistar International Corporation and Subsidiaries

Consolidated Statements of Operations

(in millions, except per share data)	For the Years Ended October 31 2007	2006	2005
Sales and revenues			
Sales of manufactured products, net	**$ 11,910**	$ 13,878	$ 11,827
Finance revenues	**385**	322	297
Sales and revenues, net	**12,295**	14,200	12,124
Costs and expenses			
Costs of products sold	**10,131**	11,703	10,250
Selling, general and administrative expenses	**1,461**	1,332	1,067
Engineering and product development costs	**382**	453	413
Interest expense	**502**	431	308
Other (income) expenses, net	**(34)**	(15)	31
Total costs and expenses	**12,442**	13,904	12,069
Equity in income of non-consolidated affiliates	**74**	99	90
Income (loss) before income tax	**(73)**	395	145
Income tax expense	**(47)**	(94)	(6)
Net income (loss)	**$ (120)**	$ 301	$ 139
Basic earnings (loss) per share	**$ (1.70)**	$ 4.29	$ 1.98
Diluted earnings (loss) per share	**$ (1.70)**	$ 4.12	$ 1.90
Weighted average shares outstanding			
Basic	**70.3**	70.3	70.1
Diluted	**70.3**	74.5	76.3

See Notes to Consolidated Financial Statements

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Navistar International Corporation and Subsidiaries

Consolidated Balance Sheets

(in millions, except per share data)	As of October 31 2007	2006
ASSETS		
Current assets		
Cash and cash equivalents	**$ 777**	$ 1,157
Marketable securities	**6**	136
Finance and other receivables, net	**2,941**	3,127
Inventories	**1,412**	1,736
Deferred taxes, net	**115**	68
Other current assets	**194**	144
Total current assets	**5,445**	6,368
Restricted cash and cash equivalents	**419**	700
Finance and other receivables, net	**2,478**	2,598
Investments in and advances to non-consolidated affiliates	**154**	207
Property and equipment, net	**2,086**	2,157
Goodwill	**353**	313
Intangible assets, net	**286**	293
Pension assets	**103**	54
Deferred taxes, net	**35**	49
Other noncurrent assets	**89**	91
Total assets	**$ 11,448**	$ 12,830
LIABILITIES AND STOCKHOLDERS DEFICIT		
Liabilities		
Current liabilities		
Notes payable and current maturities of long-term debt	**$ 798**	$ 891
Accounts payable	**1,770**	2,222
Other current liabilities	**1,423**	1,719
Total current liabilities	**3,991**	4,832
Long-term debt	**6,083**	6,755
Postretirement benefits liabilities	**1,327**	1,605
Other noncurrent liabilities	**781**	752
Total liabilities	**12,182**	13,944
Stockholders deficit		
Series D convertible junior preference stock	**4**	4
Common stock and additional paid in capital (par value $0.10 per share, 75.4 million shares issued in 2007 and 2006)	**2,101**	2,097
Accumulated deficit	**(2,519)**	(2,399)
Accumulated other comprehensive loss	**(155)**	(650)
Common stock held in treasury, at cost (5.1 million shares in 2007 and 5.2 million shares in 2006)	**(165)**	(166)
Total stockholders deficit	**(734)**	(1,114)
Total liabilities and stockholders deficit	**$ 11,448**	$ 12,830

See Notes to Consolidated Financial Statements

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Navistar International Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	For the Years Ended October 31		
(in millions)	**2007**	**2006**	**2005**
Cash flows from operating activities			
Net income (loss)	**$ (120)**	$ 301	$ 139
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities			
Depreciation and amortization	**308**	308	267
Depreciation of equipment held for or under lease	**63**	56	55
Deferred taxes	**(3)**	(3)	(72)
Amortization of debt issuance costs	**9**	13	8
Stock-based compensation	**7**	14	4
Provision for doubtful accounts	**52**	28	24
Equity in income of non-consolidated affiliates	**(74)**	(99)	(90)
Dividends from non-consolidated affiliates	**111**	83	83
Gain from sales of non-consolidated affiliates	**(26)**		
Loss on sale of property and equipment	**9**	8	16
Impairment of property and equipment			23
Loss on refinancing and repurchases of debt	**31**	23	
(Increase) decrease in operating assets, exclusive of the effects of businesses acquired and disposed			
Current finance and other receivables	**173**	(751)	(378)
Inventories	**321**	(359)	(67)
Other current assets	**(47)**	27	(9)
Pension assets	**(267)**	3	10
Noncurrent finance and other receivables	**102**	(290)	(274)
Other noncurrent assets	**(70)**	(12)	(27)
Increase (decrease) in operating liabilities, exclusive of the effects of businesses acquired and disposed			
Accounts payable	**(419)**	283	216
Other current liabilities	**(157)**	(160)	261
Postretirement benefits liabilities	**193**	47	68
Other noncurrent liabilities	**2**	224	23
Other, net	**(21)**	2	(5)
Total adjustments	**297**	(555)	136
Net cash provided by (used in) operating activities	**177**	(254)	275
Cash flows from investing activities			
Purchases of marketable securities	**(221)**	(179)	(828)
Sales or maturities of marketable securities	**351**	134	918
Net change in restricted cash and cash equivalents	**281**	(104)	(277)
Capital expenditures	**(312)**	(230)	(295)
Purchase of equipment held for or under lease	**(68)**	(91)	(104)
Proceeds from sales of property and equipment	**60**	51	73
Investments in and advances to non-consolidated affiliates	**(34)**	(31)	(4)
Proceeds from sales of non-consolidated affiliates	**75**		
Business acquisitions, net of cash acquired	**(7)**	(54)	(563)
Other investing activities	**9**	7	(1)

Net cash provided by (used in) investing activities	**134**	(497)	(1,081)

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See Notes to Consolidated Financial Statements

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Navistar International Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Continued)

	For the Years Ended October 31		
(in millions)	2007	2006	2005
Cash flows from financing activities			
Proceeds from issuance of securitized debt	**949**	1,630	1,956
Principal payments on securitized debt	**(1,368)**	(1,337)	(1,201)
Proceeds from issuance of non-securitized debt	**1,609**	1,720	1,376
Principal payments on non-securitized debt	**(1,692)**	(27)	(981)
Repurchases of debt		(1,429)	
Net increase (decrease) in notes and debt outstanding under revolving credit facilities	**(209)**	587	(61)
Principal payments under financing arrangements and capital lease obligations	**(44)**	(49)	(82)
Settlement of call options, net		6	
Debt issuance costs	**(24)**	(46)	(16)
Proceeds from sale of treasury stock		1	5
Net cash provided by (used in) financing activities	**(779)**	1,056	996
Effect of exchange rate changes on cash and cash equivalents	**88**	23	36
Increase (decrease) in cash and cash equivalents	**(380)**	328	226
Cash and cash equivalents at beginning of year	**1,157**	829	603
Cash and cash equivalents at end of the year	**$ 777**	$ 1,157	$ 829
Supplemental cash flow information			
Cash paid during the year for			
Interest, net of amounts capitalized	**$ 519**	$ 427	$ 296
Income taxes	**103**	86	32
Supplemental schedule of non-cash investing and financing activities			
Property and equipment acquired under capital leases	**12**	46	13

See Notes to Consolidated Financial Statements

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Navistar International Corporation and Subsidiaries

Consolidated Statements of Stockholders Deficit

(in millions)	Series D Convertible Junior Preference Stock	Number of Common Shares Outstanding	Common Stock and Additional Paid in Capital	Compre-hensive Income (Loss)	Accumulated Deficit	Accumulated Other Comprehensive Loss	Common Stock Held in Treasury, at Cost	Total
Balance as of November 1, 2004	**$ 4**	**69.8**	**$ 2,076**		**$ (2,832)**	**$ (918)**	**$ (182)**	**$ (1,852)**
Net income				$ 139	139			139
Other comprehensive income								
Foreign currency translation adjustments				45				45
Pension liability adjustment, net of $2 of income tax benefit				(37)				(37)
Other comprehensive income				8		8		
Comprehensive income				$ 147				
Issuance of restricted stock		0.1						
Stock-based compensation			4					4
Stock ownership programs		0.3	(6)		(6)		14	2
Balance as of October 31, 2005	**4**	**70.2**	**2,074**		**(2,699)**	**(910)**	**(168)**	**(1,699)**
Net income				$ 301	301			301
Other comprehensive income								
Foreign currency translation adjustments				17				17
Pension liability adjustment, net of $(3) of income tax expense				243				243
Other comprehensive income				260		260		
Comprehensive income				$ 561				
Settlement of call options			6					6
Amounts due from officers and directors			1					1
Stock-based compensation			16					16
Stock ownership programs					(1)		2	1
Balance as of October 31, 2006	**4**	**70.2**	**2,097**		**(2,399)**	**(650)**	**(166)**	**(1,114)**
Net loss				$ (120)	(120)			(120)
Other comprehensive income								
Foreign currency translation adjustments				86				86
Impact of FASB Statement No. 158, net of $12 of tax benefit						(390)		(390)
Pension liability adjustment, net of $8 of income tax expense				799				799

Other comprehensive income				885		885		
Comprehensive income				$ 765				
Conversion of debt		0.1					1	1
Stock-based compensation			5					5
Stock ownership programs			(1)					(1)
Balance as of October 31, 2007	**$ 4**	**70.3**	**$ 2,101**		**$ (2,519)**	**$ (155)**	**$ (165)**	**$ (734)**

See Notes to Consolidated Financial Statements

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Navistar International Corporation

Notes to Consolidated Financial Statements

1. Summary of significant accounting policies

Organization and Description of the Business

Navistar International Corporation (NIC), incorporated under the laws of the state of Delaware in 1993, is a holding company whose principal operating subsidiaries are Navistar, Inc. (formerly known as International Truck and Engine Corporation) and Navistar Financial Corporation (NFC). References herein to the company, we, our, or us refer collectively to NIC, its subsidiaries, and certain variable interest entities (VI which we are the primary beneficiary. We operate in four principal industry segments: Truck, Engine, Parts (collectively called manufacturing operations), and Financial Services. The Financial Services segment consists of NFC and our foreign finance operations (collectively called financial services operations). These segments are discussed in Note 17, *Segment reporting*.

We report our annual results for our fiscal year, which ends on October 31. As such, all references to 2007, 2006, and 2005 relate to the fiscal year unless otherwise indicated.

Basis of Presentation and Consolidation

The accompanying consolidated financial statements include the assets, liabilities, revenues, and expenses of our manufacturing operations, majority owned dealers, wholly-owned financial services operations, and VIEs of which we are the primary beneficiary. The effects of transactions among consolidated entities have been eliminated to arrive at the consolidated amounts. Certain reclassifications were made to prior years amounts to conform to the 2007 presentation.

Financial Accounting Standards Board (FASB) Interpretation No. 46 (Revised 2003), *Consolidation of Variable Interest Entities,* addresses the consolidation of business enterprises to which the usual condition of consolidation does not apply (i.e. ownership of a majority voting interest). We are the primary beneficiary of several VIEs, primarily joint ventures established to produce product and enhance our operational capabilities. Accordingly, we include in our consolidated financial statements the assets and liabilities and results of operations of those entities, even though we may not own a majority voting interest. As a result, our consolidated financial statements include assets of $104 million and $116 million and liabilities of $102 million and $118 million as of October 31, 2007 and 2006, respectively. The liabilities recognized as a result of consolidating these VIEs do not represent additional claims on our general assets; rather they represent claims against the specific assets of the consolidated VIEs. Conversely, assets recognized as a result of consolidating these VIEs do not represent assets that could be used to satisfy claims against our general assets. We are also involved with other VIEs, which we do not consolidate because we are not the primary beneficiary. The maximum loss exposure relating to these non-consolidated VIEs is not material to our financial position, results of operations, or cash flows.

We use the equity method to account for our investments in entities (i) that we do not control, but where we have the ability to exercise significant influence over operating and financial policies and (ii) where we are not the primary beneficiary. Consolidated net income (loss) includes our share of the net earnings of these entities. As of October 31, 2007, we use the equity method to account for investments in 14 partially-owned affiliates (which include four corporations, three limited liability companies, and seven unincorporated joint ventures), in which NIC or one of its subsidiaries is a shareholder, general or limited partner, or venturer, as applicable.

Use of Estimates

The preparation of financial statements in conformity with United States (U.S.) generally accepted accounting principles (GAAP) requires us to make estimates and assumptions that affect the reported amounts

Navistar International Corporation

Notes to Consolidated Financial Statements (Continued)

of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses. Significant estimates and assumptions are used for, but are not limited to, pension and other postretirement benefits, allowance for doubtful accounts, sales of receivables, income tax contingency accruals and valuation allowances, product warranty and asbestos accruals, asset impairment, and litigation related accruals. Actual results could differ from our estimates.

Risks and Uncertainties

Our financial position, results of operations, and cash flows are subject to various risks and uncertainties. Factors that could affect our future financial statements and cause actual results to vary materially from expectations include, but are not limited to, adverse changes in global market conditions, overcapacity and intense competition in the truck industry, dependence on suppliers for parts with primarily single source suppliers, fluctuations in currency exchange rates, diesel fuel cost, interest rates, commodity prices for commodities used in our operations, government regulations affecting our industry, and labor negotiations that impact a significant portion of our workforce. As of April 30, 2008, approximately 6,100, or 64%, of our hourly workers and approximately 700, or 10%, of our salaried workers are represented by labor unions and are covered by collective bargaining agreements. Additionally, our future operations may be affected by changes in governmental procurement policies, budget considerations, changing national defense requirements, and global, political, and economic developments in the U.S. and certain foreign countries (primarily Canada, Mexico, Brazil, and Argentina).

Revenue Recognition

Our manufacturing operations recognize revenue when we meet four basic criteria: (i) persuasive evidence that a customer arrangement exists, (ii) the price is fixed or determinable, (iii) collectibility is reasonably assured, and (iv) delivery of product has occurred or services have been rendered.

Truck sales are generally recognized when risk of ownership passes. Sales to fleet customers and governmental entities are recognized in accordance with the terms of each contract. Revenue on certain customer requested bill and hold arrangements is not recognized until after the customer is notified that the product (i) has been completed according to customer specifications, (ii) has passed our quality control inspections, and (iii) is ready for delivery based upon the established delivery terms. Engine sales are generally recognized at the time of shipment from our plants.

Parts sales are recognized at the time of shipment. An allowance for sales returns is recorded as a reduction to revenue based upon estimates using historical information about returns. For the sale of service parts that include a core component, we record revenue on a gross basis including the fair market value of the core. A core component is the basic forging or casting, such as an engine block, that can be remanufactured by a certified remanufacturing supplier. When a dealer returns a core within the specified eligibility period, we provide a core return credit. At times, we may mark up the core charge beyond the amount we are charged by the supplier. This mark up is recorded as a liability, as it represents the amount that will be paid to the dealer upon return of the core component and is in excess of the fair value to be received from the supplier.

Sales to the U.S. government, of non-commercial products manufactured to the government s specifications, are recognized using the units-of-delivery measure under the percentage-of-completion accounting method as units are delivered and accepted by the government. Revenue from service contracts with the U.S. government is generally recorded on a straight-line basis over the period of contract performance, unless otherwise agreed that the obligations are fulfilled upon achievement of an agreed milestone or occurrence of a specified event.

Navistar International Corporation

Notes to Consolidated Financial Statements (Continued)

Concurrent with our recognition of revenue, we recognize price allowances and the cost of incentive programs in the normal course of business based on programs offered to dealers. Estimates are made for sales incentives on certain vehicles in dealer stock inventory when special programs that provide a specific incentive to the dealer are offered in order to facilitate a sale to the end customer.

Shipping and handling amounts billed to our customers are included in *Sales of manufactured products, net* and the related shipping and handling costs incurred are included in *Costs of products sold.*

Financial services operations recognize revenue from retail notes, finance leases, wholesale notes, retail accounts, and wholesale accounts as *Finance revenues* over the term of the receivables utilizing the effective interest method. Certain direct origination costs and fees are deferred and recognized as an adjustment to yield and are reported as part of *Finance revenues* over the life of the receivable. Loans are considered to be impaired when we conclude there is a high likelihood the customer will not be able to make full payment after reviewing the customer s financial performance, payment ability, capital-raising potential, management style, economic situation, etc. The accrual of interest on such loans is discontinued when the collection of the account becomes doubtful (non-accrual status loans). When the accrual of interest is discontinued, all unpaid accrued interest is charged against *Finance revenues*. *Finance revenues* on these loans are recognized only to the extent cash payments are received. We resume accruing interest on these accounts when payments are current according to the terms of the loans and future payments are reasonably assured.

Operating lease revenues are recognized on a straight-line basis over the life of the lease. Recognition of revenue is suspended when management determines the collection of future income is not probable. Income recognition is resumed if collection again becomes probable.

Selected receivables are securitized and sold to public and private investors with limited recourse. Our financial services operations continue to service the sold receivables and receive fees for such services. Gains or losses on sales of receivables that qualify for sales accounting treatment are credited or charged to *Finance revenues* in the period in which the sale occurs. Discount accretion is recognized on an effective yield basis.

Cash and Cash Equivalents

All highly liquid financial instruments with maturities of 90 days or less from date of purchase, consisting primarily of bankers acceptances, commercial paper, and U.S. government floating rate notes, are classified as cash equivalents.

Restricted cash and cash equivalents are related to our securitized facilities, senior and subordinated floating rate asset-backed notes, wholesale trust agreements, indentured trust agreements, letters of credit, Environmental Protection Agency requirements, and workers compensation requirements. The restricted cash and cash equivalents for our securitized facilities is restricted to pay interest expense, principal, or other amounts associated with our securitization agreements.

Marketable Securities

Marketable securities consist of available-for-sale securities and are measured and reported at fair value. The difference between amortized cost and fair value is recorded as a component of *Accumulated other comprehensive loss (AOCL)* in *Stockholders deficit,* net of taxes. Most securities with remaining maturities of less than twelve months and other investments needed for current cash requirements are classified as current in

Navistar International Corporation

Notes to Consolidated Financial Statements (Continued)

our consolidated balance sheets. Gains and losses on the sale of marketable securities are determined using the specific identification method and are recorded in *Other (income) expenses, net*.

We evaluate our investments in marketable securities at the end of each reporting period to determine if a decline in fair value is other than temporary. When a decline in fair value is determined to be other than temporary, an impairment charge is recorded and a new cost basis in the investment is established.

Derivative Instruments

We utilize derivative instruments to manage our exposure to changes in foreign currency exchange rates, interest rates, and certain commodity prices. The fair values of all derivative instruments are recognized as assets or liabilities at the balance sheet date. Changes in the fair value of these derivative instruments are recognized in income or included in *AOCL*, depending on whether the derivative instrument is a fair value or cash flow hedge and whether it qualifies for hedge accounting treatment.

For derivative instruments qualifying as fair value hedges, changes in the fair value of the instruments are included in *Costs of products sold, Interest expense*, or *Other (income) expenses, net* depending on the underlying exposure. For derivative instruments qualifying as cash flow hedges, gains and losses are included in *AOCL*, net of taxes, to the extent the hedges are effective. When the hedged items affect earnings, the effective portions of the cash flow hedges are recognized as *Costs of products sold, Interest expense,* or *Other (income) expenses, net*, depending on the underlying exposure. For derivative instruments used as hedges of our net investment in foreign operations, gains and losses are included in *AOCL*, net of taxes, as part of the cumulative translation adjustment to the extent the hedges are effective. The exchange of cash associated with hedging derivative transactions is classified in the consolidated statements of cash flows in the same category as the cash flows from the items being hedged. The ineffective portions of cash flow hedges and hedges of net investments in foreign operations, if any, are recognized in *Costs of products sold*, *Interest expense*, and *Other (income) expenses, net*. If the derivative instrument is terminated, we continue to defer the related gain or loss and include it as a component of the cost of the underlying hedged item. Upon determination that the underlying hedged item will not be part of an actual transaction, we recognize the related gain or loss in net income in that period.

Gains and losses on derivative instruments not qualifying for hedge accounting are recognized in *Costs of products sold*, *Interest expense*, or *Other (income) expenses, net* depending on the underlying exposure. The exchange of cash associated with these non-hedging derivative transactions is classified in the consolidated statements of cash flows in the same category as the cash flows from the items subject to the economic hedging relationships.

Trade and Finance Receivables

Trade Receivables

Trade accounts receivable and notes receivable primarily arise from sales of goods to independently owned and operated dealers, original equipment manufacturers (OEMs), and retail customers in the normal course of business. Notes receivable arise when there is a documented note owed to us by a third party, while accounts receivable arise in the normal and ordinary course of business. Under the terms of sale for notes receivable, interest is charged to customers on outstanding balances.

Finance Receivables

Finance receivables consist of the following:

Retail notes Retail notes primarily consist of fixed rate loans to commercial customers to facilitate their purchase of new and used trucks, trailers, and related equipment.

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Notes to Consolidated Financial Statements (Continued)

Finance leases Finance leases consist of direct financing leases to commercial customers for acquisition of new and used trucks, trailers, and related equipment.

Wholesale notes Wholesale notes primarily consist of variable rate loans to our dealers for the purchase of new and used trucks, trailers, and related equipment.

Retail accounts Retail accounts consist of short-term accounts receivable that finance the sale of products to retail customers.

Wholesale accounts Wholesale accounts consist of short-term accounts receivable primarily related to the sales of items other than trucks, trailers, and related equipment (e.g. service parts) to dealers.

Wholesale notes and amounts due from sale of receivables are classified as held-for-sale and valued at the lower of cost or fair value on an aggregate basis, with unrealized gains or losses recorded to current earnings. All other finance receivables are classified as held-to-maturity and are recorded at gross value less unearned income and are reported net of allowances for doubtful accounts. Unearned revenue is amortized to revenue over the life of the receivable using the effective interest method. Our financial services operations purchase the majority of the wholesale notes receivable and some retail notes and accounts receivable arising from our manufacturing operations. NFC retains as collateral a security interest in the equipment associated with retail notes, wholesale notes, and finance leases.

Sales of Finance Receivables

We sell finance receivables using a process commonly known as securitization, whereby asset-backed securities are sold via public offering or private placement. These transactions are considered sales from a legal standpoint. However, most of our retail note and finance lease securitization arrangements do not qualify for sales accounting treatment. As a result, the transferred receivables and the associated secured borrowings are included in our consolidated balance sheets and no gain or loss is recorded for these transactions. For those transfers that do qualify for sales accounting treatment, gains or losses are included in *Finance revenues*.

Our wholesale note securitization arrangements qualify for sale treatment. Therefore, the notes receivable are removed from our consolidated balance sheets. Gains or losses from these sales are recognized in the period of sale based upon the relative fair value of the portion sold and the portion allocated to the retained interests, and are included in *Finance revenues*.

We may retain interests in the receivables sold (transferred). The retained interests may include senior and subordinated securities, undivided interests in receivables used as over-collateralization (excess sellers interests), restricted cash held for the benefit of the trust, and interest-only strips. Our subordinated retained interests, including subordinated securities, the right to receive excess spread (interest-only strip), and any residual interest in the trust, are the first to absorb any credit losses on the transferred receivables. Our exposure to credit losses on the transferred receivables is limited to our retained interests. Other than being required to repurchase receivables that fail to satisfy certain representations and warranties provided at the time of the securitization, we are under no obligation to repurchase any transferred receivable that becomes delinquent in payment or otherwise is in default. The holders of the asset-backed securities have no recourse to us or our other assets for credit losses on transferred receivables, and have no ability to require us to repurchase their securities. We do not guarantee any securities issued by trusts.

We also act as servicer of transferred receivables in exchange for a fee. The servicing duties include collecting payments on receivables and preparing monthly investor reports on the performance of the receivables

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Notes to Consolidated Financial Statements (Continued)

that are used by the trustee to distribute monthly interest and principal payments to investors. While servicing the receivables, we apply the same servicing policies and procedures that are applied to our owned receivables. The servicing income received by us is adequate to compensate us for our servicing responsibilities. Therefore, no servicing asset or liability is recorded.

We determine the fair value of our retained interests by discounting the future expected cash flows. The future expected cash flows are primarily affected by expected payment speeds and default rates. We estimate the payment speeds for the receivables sold, the discount rate used to determine the present value of the interest-only receivables, and the anticipated net losses on the receivables in order to calculate the gain or loss on arrangements that qualify for sales treatment. Estimates are based on historical experience, anticipated future portfolio performance, market-based discount rates, and other factors and are calculated separately for each securitized transaction. In addition, we re-measure the fair values of the retained interests on a quarterly basis and recognize changes in *Finance revenues* as required. The retained interests are classified as trading.

Allowance for Doubtful Accounts

An allowance for doubtful accounts on trade, notes, and finance receivables is established through a charge to *Selling, general and administrative expenses*. The allowance for trade accounts and notes receivable is maintained at an amount we consider appropriate in relation to the outstanding receivables portfolio and other business conditions. The allowance for finance receivables is an estimate of the amount required to absorb probable losses on the existing portfolio of finance receivables that may become uncollectible. The receivables are charged off when amounts due are determined to be uncollectible.

Troubled loan accounts are specifically identified and segregated from the remaining owned loan portfolio. The expected loss on troubled accounts is fully reserved in a separate calculation as a specific reserve. A specific reserve is set up if the past due balance exceeds $1 million, it is believed that there is a greater than 50% likelihood that the account could be impaired, and if the value of the underlying collateral is less than the principal balance of the loan. We calculate a general reserve on the remaining loan portfolio using loss ratios based on a pool method by asset type: retail notes and finance leases, retail accounts, and wholesale accounts. Loss ratios are determined using historical loss experience in conjunction with current portfolio trends in delinquencies and repossession frequency for each receivable or asset type.

When we evaluate the adequacy of the loss allowance for finance receivables, several risk factors are considered for each type of receivable. For retail notes, finance leases, and retail accounts, the primary risk factors are the general economy, fuel prices, type of freight being hauled, length of freight movements, number of competitors our customers have in their service territory, how extensively our customers use independent operators, profitability of owner operators, and expected value of the underlying collateral.

To establish a specific reserve in the loss allowance for receivables, we look at many of the same factors listed above but also consider the financial strength of the customer or dealer and key management, the timeliness of payments, the number and location of satellite locations (especially for the dealer), the number of dealers of competitor manufacturers in the market area, type of equipment normally financed, and the seasonality of the business.

Repossessions

Gains or losses arising from the sale of repossessed collateral supporting finance receivables and operating leases are recognized in *Selling, general and administrative expenses*. Repossessed assets are recorded within *Inventories* at the lower of historical cost or fair value, less estimated costs to sell.

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Notes to Consolidated Financial Statements (Continued)

Inventories

Inventories are valued at the lower of cost or market. Cost is principally determined using the first-in, first-out and average cost methods.

Property and Equipment

We report land, buildings, leasehold improvements, and machinery and equipment, including tooling and pattern equipment, at cost, net of depreciation and asset impairments, if applicable. We report assets under capital lease obligations at the lower of their fair value or the present value of the aggregate future minimum lease payments as of the beginning of the lease term. We depreciate our assets using the straight-line method over the shorter of the lease term or the estimated useful lives of the assets. The ranges of estimated useful lives are as follows:

	Years	
Buildings	20	50
Leasehold improvements	3	20
Machinery and equipment	3	12
Furniture, fixtures, and equipment	3	15
Equipment under or for capital lease obligations	3	12

The carrying amounts of all long-lived assets are evaluated periodically to determine if adjustment to the depreciation and amortization period or to the unamortized balance is warranted. Such evaluation is based principally on the expected utilization of the long-lived assets.

We depreciate trucks, tractors, and trailers leased to customers under operating lease agreements on a straight-line basis over the lease term, from one to eight years, to the equipment s estimated residual value. The residual values of the equipment represent estimates of the value of the assets at the end of the lease contracts and are initially recorded based on estimates of future market values. Realization of the residual values is dependent on our future ability to market the equipment. We review residual values periodically to determine that recorded amounts are appropriate and the equipment has not been impaired.

Maintenance and repairs of property and equipment are expensed as incurred. We capitalize replacements and improvements that increase the estimated useful life or productive capacity of an asset and we capitalize interest on major construction and development projects while in progress.

Upon sale, retirement, or disposal of property and equipment, the asset cost and related accumulated depreciation balances are removed from the respective accounts, and the resulting net amount, less any proceeds, is recognized as a gain or loss in *Other (income) expenses, net*.

We test for impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value of an asset or asset group (hereinafter referred to as asset group) may not be recoverable by comparing the sum of the estimated undiscounted future cash flows expected to result from the operation of the asset group and its eventual disposition to the carrying value. If the sum of the undiscounted future cash flows is less than the carrying value, an impairment charge is recorded in *Other (income) expenses, net*. The amount of impairment is calculated by subtracting the fair value of the asset group from the carrying value of the asset group.

Goodwill and Other Intangible Assets

We evaluate goodwill and other intangible assets not subject to amortization for impairment annually at October 31 or more frequently whenever indicators of potential impairment exist. Goodwill is considered

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Notes to Consolidated Financial Statements (Continued)

impaired when the fair value of a reporting unit is determined to be less than the carrying value including goodwill. The amount of impairment loss is determined based on a comparison of the implied fair value of the reporting unit s goodwill to the actual carrying value. Intangible assets not subject to amortization are considered impaired when the intangible asset s fair value is determined to be less than the carrying value.

We use the present value of estimated future cash flows to establish the estimated fair value of our reporting units as of the testing date. This approach includes many assumptions related to future growth rates, discount factors, and tax rates, among other considerations. Changes in economic and operating conditions impacting these assumptions could result in an impairment of goodwill in future periods. When available and as appropriate, we use comparative market multiples to corroborate the estimated fair value.

Intangible assets subject to amortization are also evaluated for impairment periodically or when indicators of impairment are determined to exist. We test for impairment of intangible assets subject to amortization by comparing the sum of the estimated undiscounted future cash flows expected to result from the use of the asset to the carrying value. If the sum of the estimated undiscounted future cash flows is less than the carrying value, an impairment charge is required. The amount of impairment is calculated by subtracting the fair value of the asset from the carrying value of the asset. We amortize the cost of intangible assets over their respective estimated useful lives on a straight-line basis. The ranges for the amortization periods are as follows:

	Years
Customer base	6 15
Trademarks	20
Supply agreements	3
Other	3 7

Investments in and Advances to Non-consolidated Affiliates

Equity method investments are recorded at original cost and adjusted periodically to recognize (i) our proportionate share of the investees net income or losses after the date of investment, (ii) additional contributions made and dividends or distributions received, and (iii) impairment losses resulting from adjustments to net realizable value.

We assess the potential impairment of our equity method investments and determine fair value based on valuation methodologies, as appropriate, including the present value of estimated future cash flows, estimates of sales proceeds, and external appraisals. If an investment is determined to be impaired and the decline in value is other than temporary, we record an appropriate write-down.

Financing Costs

We amortize financing costs and premiums, and accrete discounts, over the remaining life of the related debt using the effective interest method. The related income or expense is included in *Interest expense*. We record discounts or premiums as a direct deduction from, or addition to, the face amount of the debt.

Pensions and Postretirement Benefits

We use actuarial methods and assumptions to account for our defined benefit pension plans and our postretirement benefit plans. Pension and postretirement benefit expense includes the actuarially computed cost of benefits earned during the current service period, the interest cost on accrued obligations, the expected return on plan assets based on fair market values, the straight-line amortization of net actuarial gains and losses, and adjustments due to plan amendments. Net actuarial gains and losses are generally amortized over the expected average remaining service period of the employees.

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Notes to Consolidated Financial Statements (Continued)

Effective October 31, 2007, we adopted FASB Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R)*, which requires that the consolidated balance sheets reflect the funded status of the pension and postretirement plans. See Note 11, *Postretirement benefits*, for further discussion regarding the effect of adopting this standard.

Engineering and Product Development Costs

Engineering and product development costs arise from ongoing costs associated with improving existing products and manufacturing processes and for the introduction of new truck and engine components and products, and are expensed as incurred.

Advertising Costs

Advertising costs are expensed as incurred and are included in *Selling, general and administrative expenses*. These costs totaled $21 million, $26 million, and $18 million for the years ended October 31, 2007, 2006, and 2005, respectively.

Litigation Accruals

We accrue for loss contingencies associated with outstanding litigation for which we have determined it is probable that a loss has occurred and the amount of loss can be reasonably estimated. Our asbestos, product liability, environmental, and workers compensation accruals also include estimated future legal fees associated with the loss contingency, as we believe we can reasonably estimate those costs. In all other instances, legal fees are expensed as incurred. These expenses may be recorded in *Costs of products sold, Selling, general and administrative expenses,* or *Other (income) expenses, net*. These estimates are based heavily on our expectations of the scope, length to complete, and complexity of the claims. In the future, additional adjustments may be recorded as the scope, length, or complexity of outstanding litigation changes.

Warranty

We generally offer one to five-year warranty coverage for our truck and engine products and our service parts. Terms and conditions vary by product, customer, and country. Optional extended warranty contracts can be purchased for periods ranging from one to ten years. We accrue warranty related costs under standard warranty terms and for claims that we choose to pay as an accommodation to our customers even though we are not contractually obligated to do so. Warranty revenues related to extended warranty contracts are amortized to income, over the life of the contract, using the straight-line method. Costs under extended warranty contracts are expensed as incurred. We base our warranty accruals on estimates of the expected warranty costs that incorporate historical information and forward assumptions about the nature, frequency, and average cost of warranty claims. When collection is reasonably assured, we also estimate the amount of warranty claim recoveries to be received from our suppliers and record them in *Other current assets* and *Other noncurrent assets*. Recoveries related to specific product recalls, in which a supplier confirms its liability under the recall, are recorded in *Finance and other receivables, net*. Warranty costs are included in *Costs of products sold*.

We have arrangements with Ford Motor Company (Ford) that provide for sharing warranty costs, if certain conditions are met, for engines that we produce and sell to Ford. Our obligations under these arrangements have become the subject of a disagreement with Ford, which is described more fully in Note 16, *Commitments and contingencies*. For the periods up to and including July 31, 2005, we recorded amounts in our warranty accrual for future payments to Ford that we believed were probable and estimable. As a result of the

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Notes to Consolidated Financial Statements (Continued)

disagreement, we have not recorded any additional amounts in our warranty accrual for engine sales to Ford since July 31, 2005. Further, the previously-recorded amount has not been reversed, even though we may not be legally required to make any payments under such provisions.

As of October 31, accrued product warranty and deferred warranty revenue activity is as follows:

(in millions)	2007	2006	2005
Balance, at beginning of year	**$ 777**	$ 730	$ 561
Costs accrued and revenues deferred	**244**	377	350
Acquisitions			26
Adjustments to pre-existing warranties(A)	**22**	9	110
Payments and revenues recognized	**(366)**	(339)	(317)
Balance, at end of year	**$ 677**	$ 777	$ 730

(A) Adjustments to pre-existing warranties reflect changes in our estimate of warranty costs for products sold in prior years.

The amount of deferred revenue related to extended warranty programs at October 31, 2007, 2006, and 2005 was $127 million, $118 million, and $81 million, respectively. Revenue recognized under our extended warranty programs in 2007, 2006, and 2005 was $32 million, $27 million, and $20 million, respectively.

Stock-based Compensation

We have various plans that provide for the granting of stock-based compensation to certain employees, directors, and consultants, which are described more fully in Note 20, *Stock-based compensation plans*. Shares are issued upon option exercise from *Common stock held in treasury*. Prior to 2006, we accounted for those plans using the recognition and measurement principles of the intrinsic value method of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and its related interpretations, and applied the disclosure-only provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Effective November 1, 2005, we adopted the provisions of FASB Statement No. 123 (Revised 2004), *Share-Based Payment*, which revises FASB Statement No. 123 and supersedes APB Opinion No. 25 and its related interpretations.

The revised statement focuses primarily on accounting for transactions in which we obtain employee services in share-based payment transactions. FASB Statement No. 123(R) eliminates the alternative of applying the intrinsic value measurement provisions of APB Opinion No. 25 to stock compensation awards issued to employees. The new standard requires us to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. We must recognize the cost over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). We elected the modified prospective application method, and we apply FASB Statement No. 123(R) to awards granted in and subsequent to 2006 and to awards modified, repurchased, or cancelled after the date of adoption of this standard.

After adoption of FASB Statement No. 123(R), stock-based compensation expense in 2006 was $14 million and there was no related income tax benefit. The impact of adopting FASB Statement No. 123(R) on 2006 net income and basic and diluted earnings per share was a decrease of $11 million, $0.16, and $0.15, respectively. Stock based compensation expense in 2007 was $7 million.

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Notes to Consolidated Financial Statements (Continued)

If we had recognized compensation expense using the fair value recognition provisions of FASB Statement No. 123, prior to the adoption of FASB Statement No. 123(R), the pro forma amounts of our net income and earnings per share for the year ended October 31, 2005 would have been as follows:

(in millions, except per share amounts)	**2005**
Net income, as reported	$ 139
Add: Stock-based compensation expense included in reported net income	4
Deduct: Total stock-based compensation expense determined under fair value based method for all awards	(29)
Pro forma net income	$ 114
Earnings per share:	
Basic as reported	$ 1.98
Basic pro forma	1.63
Diluted as reported	1.90
Diluted pro forma	1.57

Prior to the adoption of FASB Statement No. 123(R), we presented all tax benefits of deductions resulting from exercise of stock options within operating cash flows in the consolidated statement of cash flows. Beginning on November 1, 2005, we changed our cash flow presentation to include the cash flows resulting from tax benefits for deductions in excess of compensation cost recognized, in financing cash flows in accordance with the requirements of FASB Statement No. 123(R). The impact on our consolidated statement of cash flows for the year ended October 31, 2006 was not material.

Foreign Currency Translation

We translate the financial statements of foreign subsidiaries, whose local currency is their functional currency, to U.S. dollars using period-end exchange rates for assets and liabilities and weighted-average exchange rates for each period for revenues and expenses. Differences arising from exchange rate changes are included in the *Foreign currency translation adjustments* component of *AOCL.* For those foreign subsidiaries whose functional currency is the U.S. dollar, no translation adjustments are required. Gains and losses arising from fluctuations in currency exchange rates on transactions denominated in currencies other than the functional currency are recognized in earnings as incurred. We recognized foreign currency transaction gains of $12 million in 2007 and $16 million in both 2006 and 2005, which were recorded in *Other (income) expenses, net*.

Income Taxes

We file a consolidated U.S. federal income tax return for NIC and its eligible domestic subsidiaries. Our non-U.S. subsidiaries file income tax returns in their respective local jurisdictions. We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax benefit carryforwards. Deferred tax assets and liabilities at the end of each period are determined using enacted tax rates.

Under the provisions of FASB Statement No. 109, *Accounting for Income Taxes*, a valuation allowance is required to be established or maintained when, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred tax asset will not be realized. FASB Statement No. 109 provides that an important factor in determining whether a deferred tax asset will be realized is whether there has been sufficient taxable income in recent years and whether sufficient taxable income can reasonably be expected

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Notes to Consolidated Financial Statements (Continued)

in future years in order to utilize the deferred tax asset. Based on our recent history of U.S. operating and taxable losses, the inconsistency of U.S. profits, and the uncertainty of our U.S. financial outlook, we believe that it is more likely than not that U.S. deferred tax assets will not be realized. As a result, we continue to maintain a full valuation allowance for U.S. deferred tax assets as of October 31, 2007.

We accrue for loss contingencies related to income tax matters for which we have determined it is probable that additional taxes will be assessed and the amount can be reasonably estimated. In connection with examinations of tax returns, contingencies may arise that generally result from differing interpretations of applicable tax laws and regulations as they relate to the amount, timing, or inclusion of revenues or expenses in taxable income, or the sustainability of tax credits to reduce income taxes payable.

Earnings (Loss) Per Share

The calculation of basic earnings (loss) per share is based on the weighted-average number of our common shares outstanding during the applicable period. The calculation for diluted earnings (loss) per share recognizes the effect of all potential dilutive common shares that were outstanding during the respective periods, unless their impact would be anti-dilutive.

Diluted earnings per share recognizes the dilution that would occur if securities or other contracts to issue common stock were exercised or converted into shares. For us, these potential shares arise from common stock options, convertible debt, and exchangeable debt.

We use the treasury stock method to calculate the dilutive effect of our stock options (using the average market price) and the if-converted method to calculate the dilutive effect of our convertible and exchangeable debt. Shares potentially issuable for certain stock options and convertible securities were not included in the computation of diluted earnings per share for the periods presented because inclusion would be anti-dilutive. In addition, for periods in which there was a net loss to common stockholders, no potentially dilutive securities are included in the calculation of diluted loss per share, as inclusion of these securities would have reduced the net loss per share.

New Accounting Pronouncements

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

Pronouncement	Effective Date	Impact on Our Financial Condition and Results of Operations
FASB Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets*	Effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Our effective date is November 1, 2009.	We are evaluating the potential impact, if any
FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133*	Effective for fiscal years and interim reporting periods beginning after November 15, 2008. Our effective date is February 1, 2009.	When effective, we will comply with the disclosure provisions of this Statement.

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Notes to Consolidated Financial Statements (Continued)

Pronouncement	Effective Date	Impact on Our Financial Condition and Results of Operations
FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51*	Effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. Our effective date is November 1, 2009.	We are evaluating the potential impact, if any.
FASB Statement No. 141(R), *Business Combinations*	Applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. Our effective date is November 1, 2009.	We will adopt this Statement on a prospective basis.
Emerging Issues Task Force Issue No. 07-03, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*	Effective for financial statements issued for fiscal years beginning after December 15, 2007. Our effective date is November 1, 2008.	We are evaluating the potential impact, if any.
SAB No. 109, *Written Loan Commitments Recorded at Fair Value through Earnings*	Effective as of the first fiscal quarter beginning after December 15, 2007. Our effective date is February 1, 2008.	This Bulletin will not have a material impact on our financial statements.
FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*	Effective as of the beginning of the first fiscal year beginning after November 15, 2007. Early adoption was permitted under certain limited circumstances; we did not choose to early adopt. If we adopt the Fair Value Option, our effective date is November 1, 2008.	We are evaluating the potential impact, if any. We have not determined whether to adopt the fair value option.
FASB Statement No. 157, *Fair Value Measurements*	Effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. Our effective date is November 1, 2008.	We are evaluating the potential impact, if any.
FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*	Effective for fiscal years beginning after December 15, 2006. Our effective date is November 1, 2007.	We do not expect this Interpretation to have a material impact on our financial condition and results of operations.

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Notes to Consolidated Financial Statements (Continued)

2. Acquisition and disposal of businesses

Dealership Acquisitions

We acquire and dispose of dealerships from time to time to facilitate the transition of dealerships from one independent owner to another. In 2007, 2006, and 2005, we obtained 100% voting equity interest in two, nine, and four entities, respectively, whose principal business is operating a dealership, for an aggregate purchase price of $9 million, $62 million, and $26 million, respectively, which was paid primarily in cash. In 2007 and 2005, all of the acquired entities were based in the U.S., while in 2006, six of the entities were based in the U.S. and three were based in Canada. These dealerships are included in our consolidated financial statements from their respective dates of acquisition in our Truck segment. Goodwill, franchise rights, and customer base recognized in those transactions amounted to $2 million, $2 million, and $1 million in 2007, and $2 million, $17 million, and $6 million in 2006, respectively. Approximately $2 million of the goodwill related to certain 2006 acquisitions is expected to be deductible for tax purposes. The goodwill related to 2007 acquisitions is not expected to be deductible for tax purposes.

Other Acquisitions

In 2005, we acquired all of the voting equity interests in the following entities:

MWM International Industria De Motores Da America Do Sul Ltda. (MWM), formerly MWM Motores Diesel, Ltda., a Brazilian entity that produces a broad line of medium and high-speed diesel engines across the 50 to 310 horsepower range for use in pickups, trucks, vans, light and semi-heavy trucks, as well as agricultural, marine, and electric generator applications. MWM s financial results are included in our consolidated financial statements from the date of acquisition, April 1, 2005. MWM is included in our Engine segment.

Workhorse Custom Chassis, LLC (WCC), a leading U.S. manufacturer of chassis for motor homes and commercial step-van vehicles. WCC s financial results are included in our consolidated financial statements from the date of acquisition, August 19, 2005. WCC is included in our Truck segment.

In conjunction with the WCC acquisition, we also purchased Uptime Parts, LLC (Uptime), a U.S. parts distribution network that supplies commercial fleets and recreational vehicle dealers. Uptime s financial results are included in our consolidated financial statements from the date of acquisition, August 19, 2005. Uptime is included in our Parts segment.

The purpose of the MWM, WCC, and Uptime acquisitions was to increase our product line diversification, broaden our customer base, and increase our manufacturing and distribution operations on a domestic and international basis.

As part of our acquisition of WCC, $25 million of the purchase price was set aside in an escrow account to be used to indemnify us for certain contingencies assumed upon acquisition. As of October 31, 2007, $20 million remained in escrow and we have asserted claims in excess of that amount for reimbursement from the seller. These claims have been disputed by the seller. No significant amounts have yet been recorded as recoverable by us from the undistributed portion of the escrow.

Pro Forma Financial Information

The unaudited pro forma financial information in the table below summarizes the combined results of operations of the company and the entities acquired in 2005 as though the acquired companies had been combined as of the beginning of 2005. The impact of acquisitions in 2007 and 2006 was not material, and are not included in the pro forma presentation below. The unaudited pro forma financial information below is presented

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for information purposes only and is not indicative of the results of operations that would have been achieved if these acquisitions had taken place at the beginning of 2005, or that may result in the future.

(in millions, except per share data)	Unaudited Pro Forma Information for the Year Ended October 31, 2005
Sales and revenues, net	$ 12,645
Net income	151
Diluted earnings per share	2.06

Dispositions

We sold three, two, and one of our dealer operations (Dealcor) during the years ended October 31, 2007, 2006, and 2005, respectively. The losses associated with the sale of these Dealcors were insignificant.

See Note 9, *Investments in and advances to non-consolidated affiliates* for discussion of acquisitions and disposals of non-consolidated affiliates.

Subsequent Events

Since October 31, 2007, we have sold two of our Dealcor locations.

In December 2007, we sold all of our interests in a heavy-duty truck parts remanufacturing business. In connection with the sale, we received gross proceeds of $22 million.

3. Marketable securities

As of October 31, our investments in marketable securities are as follows:

	2007		2006	
(in millions)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. government and agency securities	**$ 1**	**$ 1**	$ 103	$ 103
Corporate bonds and notes	**5**	**5**	33	33
Total	**$ 6**	**$ 6**	$ 136	$ 136

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4. Finance and other receivables, net

As of October 31, our finance and other receivables by major classification are as follows:

(in millions)	2007	2006
Accounts receivable	**$ 1,189**	$ 908
Retail notes	**3,238**	3,459
Finance leases	**434**	351
Wholesale notes	**340**	375
Amounts due from sales of receivables	**319**	707
Finance and other receivables	**5,520**	5,800
Less: Allowance for doubtful accounts	**(101)**	(75)
Finance and other receivables, net	**5,419**	5,725
Less: Current portion, net	**(2,941)**	(3,127)
Noncurrent portion, net	**$ 2,478**	$ 2,598

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

Contractual maturities as of October 31, 2007 are as follows:

(in millions)	Accounts Receivable	Retail Notes	Finance Leases	Whole-Sale Notes	Due from Sale of Receivables	Total
Due in:						
2008	$ 1,156	$ 1,140	$ 183	$ 340	$ 319	$ 3,138
2009	33	966	106			1,105
2010		721	92			813
2011		451	76			527
2012		217	53			270
Thereafter		75	7			82
Gross receivables	1,189	3,570	517	340	319	5,935
Unearned finance income		(332)	(83)			(415)
Finance and other receivables	$ 1,189	$ 3,238	$ 434	$ 340	$ 319	$ 5,520

As of October 31, information regarding impaired finance receivables is as follows:

(in millions)	2007	2006	2005
Outstanding balances with specific loss reserves	**$ 52**	$ 43	$ 3
Specific loss reserves	**11**	3	1
Outstanding balances on non-accrual status loans	**39**	1	1
Average balance of impaired finance receivables	**42**	13	8
Balances with payments over 90 days past due	**120**	22	20

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The activity related to our allowance for doubtful accounts for finance and other receivables for the years ended October 31 is summarized as follows:

(in millions)	2007	2006	2005
Balance, at beginning of year	**$ 75**	$ 71	$ 74
Provision for doubtful accounts	**52**	28	24
Charge-off of accounts, net of recoveries	**(26)**	(24)	(27)
Balance, at end of year	**$ 101**	$ 75	$ 71

The components of the allowance for doubtful accounts by receivable type are as follows as of October 31:

(in millions)	2007	2006
Accounts receivable	**$ 43**	$ 31
Retail notes	**40**	35
Finance leases	**14**	6
Wholesale notes	**4**	3
Total	**$ 101**	$ 75

Repossessions

We repossess leased and sold trucks on defaulted finance receivables and leases, and place them back into *Inventories*. We liquidate these repossessions to partially recover the credit losses in our portfolio. Losses recognized at the time of repossession and charged against the allowance for doubtful accounts were $18 million, $10 million, and $9 million in 2007, 2006, and 2005, respectfully. Losses recognized upon the sale of repossessed vehicles were $3 million, $2 million, and $3 million in 2007, 2006, and 2005, respectively.

A summary of the activity related to repossessed trucks for the years ended October 31 is as follows:

(in millions)	2007	2006
Repossessions, at beginning of year	**$ 6**	$ 10
Acquisitions	**54**	30
Liquidations	**(35)**	(34)
Repossessions, at end of year	**$ 25**	$ 6

5. Sales of receivables

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

NFC finances receivables through Navistar Financial Retail Receivables Corporation, Navistar Financial Securities Corporation (NFSC), Truck Retail Accounts Corporation (TRAC), Truck Retail Instalment Paper Corporation (TRIP), and International Truck Leasing Corporation (ITLC), which are all special purpose,

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wholly-owned subsidiaries (SPEs) of NFC. In accordance with FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, these transactions are accounted for either as a sale with gain or loss recorded at the date of sale and a retained interest recorded, or as secured borrowings. We provide limited recourse for all subordinated receivables. The recourse is limited to our subordinated interest and relates to credit risk only.

Off Balance Sheet Securitizations

NFC sells wholesale notes through NFSC, which has in place a revolving wholesale note trust that provides for the funding of eligible wholesale notes. The trust owned $1.1 billion of wholesale notes and $85 million of marketable securities as of October 31, 2007 and $1.7 billion of wholesale notes as of October 31, 2006.

Components of available wholesale note trust funding certificates as of October 31 were as follows:

(in millions)	Maturity	2007	2006
Investor certificate	July 2008	**$ 200**	$ 200
Investor certificate	February 2010	**212**	212
Investor certificate	May 2007		212
Variable funding certificate	November 2008	**800**	800
Total		**$ 1,212**	$ 1,424

The utilized portion of the variable funding certificate (VFC) was $570 million and $800 million as of October 31, 2007 and 2006, respectively. The NFSC seller s subordinated interest was $200 million as of October 31, 2007 and $294 million as of October 31, 2006. In January 2007, the expiration date was extended from May 2007 to January 2008. In December 2007, the VFC expiration date was extended again from January 2008 to November 2008.

TRAC finances its retail accounts with a bank conduit that provides for the funding of up to $100 million of eligible retail accounts, which expires on August 8, 2008. As of October 31, 2007 and 2006, the utilized portion was $60 million and $100 million, respectively. TRAC had a subordinated interest in the facility of $119 million as of October 31, 2007 and $413 million as of October 31, 2006.

Retained Interests

The SPEs assets are available to satisfy their creditors claims prior to such assets becoming available for the SPEs own uses or to NFC or affiliated companies. NFC is under no obligation to repurchase any sold receivable that becomes delinquent in payment or otherwise is in default. The terms of receivable sales generally require NFC to provide credit enhancements in the form of excess sellers interests and/or cash reserves with the trusts and conduits. The use of such cash reserves by NFC is restricted under the terms of the securitized sales agreements. The maximum credit exposure under all receivable sale recourse provisions was $319 million and $707 million as of October 31, 2007 and October 31, 2006, respectively. Our retained interests in the related trusts or assets held by the trusts are recognized in *Finance and other receivables, net.*

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The following is a summary of amounts due from sales of receivables (retained interest) as of October 31:

(in millions)	2007	2006
Excess seller s interests	**$ 296**	$ 670
Interest only strip	**11**	20
Restricted cash reserves	**12**	17
Total amounts due from sales of receivables	**$ 319**	$ 707

We estimate the payment speed for the receivables sold, expected net credit losses, and the discount rate used to determine the fair value of the retained interests. Estimates of payment speeds, expected credit losses, and discount rates are based on historical experience, anticipated future portfolio performance, and other factors and are made separately for each securitization transaction. In addition, we estimate the fair value of the retained interests on a quarterly basis utilizing updated estimates of these factors.

The key economic assumptions as of October 31, 2007 and the sensitivity of the current fair values of residual cash flows to an immediate adverse change of 10 percent and 20 percent in that assumption are as follows:

			Fair Value Change at October 31, 2007	
(dollars in millions)			Adverse 10%	Adverse 20%
Discount rate (annual)	10.3	18.8%	$ 2.4	$ 4.8
Estimated credit losses	0	0.18%	0.1	0.1
Payment speed (percent of portfolio per month)	9.9	69.2%	0.3	0.7

The lower end of the discount rate assumption r