NAVISTAR INTERNATIONAL CORP
Form 10-Q
June 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended April 30, 2014

OR
o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-9618

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	þ	Accelerated filer	o
Non-accelerated filer (Do not check if a smaller reporting company)	o	Smaller reporting company	o

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

As of May 31, 2014, the number of shares outstanding of the registrant's common stock was 81,328,555, net of treasury shares.

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Disclosure Regarding Forward-Looking Statements

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

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

- estimates we have made in preparing our financial statements;
- our development of new products and technologies;
- anticipated sales, volume, demand, and markets for our products;
- anticipated performance and benefits of our products and technologies, including our advanced clean engine solutions;
- our business strategies relating to, and our ability to meet, federal and state regulatory heavy-duty diesel emissions standards applicable to certain of our engines, including the timing and costs of compliance and consequences of noncompliance with such standards, as well as our ability to meet other federal, state and foreign regulatory requirements;
- our business strategies and long-term goals, and activities to accomplish such strategies and goals;
- our expectations to achieve the objectives of our "Drive-to-Deliver" turnaround plan, including: (i) leading vehicle uptime, (ii) creating a lean enterprise, (iii) generating future financial growth, and (iv) improving market share profitably;
- anticipated results from our Return-on-Invested-Capital ("ROIC") methodology and the benchmarking study to create a pathway to achieve profitability;
- anticipated results from the realignment of our leadership and management structure;
- anticipated benefits from acquisitions, strategic alliances, and joint ventures we complete;
- our expectations relating to the dissolution of our Blue Diamond Truck joint venture with Ford Motor Company ("Ford") expected in February 2015;
- our expectations and estimates relating to restructuring activities, including restructuring and integration charges and timing of cash payments related thereto, and operational flexibility, savings, and efficiencies from such restructurings;
- our expectations relating to the possible effects of anticipated divestitures and closures of businesses;
- our expectations relating to our cost-reduction actions, including our enterprise-wide reduction-in-force, and other actions to reduce discretionary spending;
- our expectations relating to our ability to service our long-term debt;
- our expectations relating to our retail finance receivables and retail finance revenues;
- our anticipated costs relating to the implementation of our emissions compliance strategy and other product modifications that may be required to meet other federal, state, and foreign regulatory requirements;
- liabilities resulting from environmental, health and safety laws and regulations;
- our anticipated capital expenditures;
- our expectations relating to payments of taxes;
- our expectations relating to warranty costs;
- our expectations relating to interest expense;
- our expectations relating to impairment of goodwill and other assets;
- costs relating to litigation and similar matters;
- estimates relating to pension plan contributions and unfunded pension and postretirement benefits;
- trends relating to commodity prices; and
- anticipated trends, expectations, and outlook relating to matters affecting our financial condition or results of operations.

These statements often include words such as "believe," "expect," "anticipate," "intend," "plan," "estimate," or similar expressions. These statements are not guarantees of performance or results and they involve risks, uncertainties, and assumptions. Although we believe that these forward-looking statements are based on reasonable assumptions, there are many factors that could affect our actual financial results or results of operations and could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause or contribute to differences in our future financial results include those discussed in Item 1A, Risk Factors, included within our Annual Report on Form 10-K for the year ended October 31, 2013, which was filed on December 20, 2013, as well as those discussed elsewhere in this report. All future written and oral forward-looking statements by us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained herein or referred to above. Except for our ongoing obligations to disclose material information as required by the federal securities laws, we do not have any obligations or intention to release publicly any revisions to any forward-looking statements to reflect events or circumstances in the future or to reflect the occurrence of unanticipated events.

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Available Information

We are subject to the reporting and information requirements of the Exchange Act and as a result, are obligated to file annual, quarterly, and current reports, proxy statements, and other information with the United States ("U.S.") Securities and Exchange Commission ("SEC"). We make these filings available free of charge on our website (http://www.navistar.com) as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC. Information on our website does not constitute part of this Quarterly Report on Form 10-Q. In addition, the SEC maintains a website (http://www.sec.gov) that contains our annual, quarterly, and current reports, proxy and information statements, and other information we electronically file with, or furnish to, the SEC. Any materials we file with, or furnish to, the SEC may also be read and/or copied at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

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PART I—Financial Information

Item 1. Financial Statements
Navistar International Corporation and Subsidiaries
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended April 30,		Six Months Ended April 30,	
(in millions, except per share data)	2014	2013	2014	2013
Sales and revenues				
Sales of manufactured products, net	$2,708	$2,487	$4,877	$5,085
Finance revenues	38	39	77	78
Sales and revenues, net	2,746	2,526	4,954	5,163
Costs and expenses				
Costs of products sold	2,468	2,363	4,482	4,649
Restructuring charges	8	6	11	8
Asset impairment charges	151	—	169	—
Selling, general and administrative expenses	237	312	476	597
Engineering and product development costs	83	100	173	211
Interest expense	74	90	156	164
Other expense (income), net	(8)	(19)	6	(57)
Total costs and expenses	3,013	2,852	5,473	5,572
Equity in income of non-consolidated affiliates	3	4	3	3
Loss from continuing operations before income taxes	(264)	(322)	(516)	(406)
Income tax expense	(23)	(22)	(11)	(37)
Loss from continuing operations	(287)	(344)	(527)	(443)
Income (loss) from discontinued operations, net of tax	1	(21)	2	(30)
Net loss	(286)	(365)	(525)	(473)
Less: Net income attributable to non-controlling interests	11	9	20	24
Net loss attributable to Navistar International Corporation	$(297)	$(374)	$(545)	$(497)
Amounts attributable to Navistar International Corporation common shareholders:				
Loss from continuing operations, net of tax	$(298)	$(353)	$(547)	$(467)
Income (loss) from discontinued operations, net of tax	1	(21)	2	(30)
Net loss	$(297)	$(374)	$(545)	$(497)
Earnings (loss) per share:				
Basic:				
Continuing operations	$(3.66)	$(4.39)	$(6.73)	$(5.82)
Discontinued operations	0.01	(0.26)	0.03	(0.37)
	$(3.65)	$(4.65)	$(6.70)	$(6.19)
Diluted:				
Continuing operations	$(3.66)	$(4.39)	$(6.73)	$(5.82)
Discontinued operations	0.01	(0.26)	0.03	(0.37)
	$(3.65)	$(4.65)	$(6.70)	$(6.19)
Weighted average shares outstanding:				

Basic	81.4	80.4	81.3	80.3
Diluted	81.4	80.4	81.3	80.3

See Notes to Condensed Consolidated Financial Statements

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

(in millions)	Three Months Ended April 30,		Six Months Ended April 30,	
	2014	2013	2014	2013
Net loss attributable to Navistar International Corporation	$(297)	$(374)	$(545)	$(497)
Other comprehensive income (loss):				
Foreign currency translation adjustment	48	3	(14)	20
Defined benefit plans (net of tax of $0, $1, $(1), and $1 respectively)	25	40	50	78
Total other comprehensive income	73	43	36	98
Total comprehensive loss attributable to Navistar International Corporation	$(224)	$(331)	$(509)	$(399)

See Notes to Condensed Consolidated Financial Statements

Navistar International Corporation and Subsidiaries
Consolidated Balance Sheets

(in millions, except per share data)	April 30, 2014 (Unaudited)	October 31, 2013
ASSETS		
Current assets		
Cash and cash equivalents	$594	$755
Marketable securities	534	830
Trade and other receivables, net	630	737
Finance receivables, net	1,713	1,597
Inventories	1,384	1,210
Deferred taxes, net	39	72
Other current assets	228	258
Total current assets	5,122	5,459
Restricted cash	112	91
Trade and other receivables, net	28	29
Finance receivables, net	311	338
Investments in non-consolidated affiliates	69	77
Property and equipment (net of accumulated depreciation and amortization of $2,494 and $2,440, respectively)	1,693	1,741
Goodwill	38	184
Intangible assets (net of accumulated amortization of $102 and $97, respectively)	104	138
Deferred taxes, net	153	159
Other noncurrent assets	97	99
Total assets	$7,727	$8,315
LIABILITIES and STOCKHOLDERS' DEFICIT		
Liabilities		
Current liabilities		
Notes payable and current maturities of long-term debt	$956	$1,163
Accounts payable	1,569	1,502
Other current liabilities	1,527	1,596
Total current liabilities	4,052	4,261
Long-term debt	4,144	3,922
Postretirement benefits liabilities	2,496	2,564
Deferred taxes, net	14	33
Other noncurrent liabilities	1,093	1,136
Total liabilities	11,799	11,916
Redeemable equity securities	2	4
Stockholders' deficit		
Series D convertible junior preference stock	3	3
Common stock (86.8 shares issued, $0.10 par value per share and 220 shares authorized, all at both dates)	9	9
Additional paid-in capital	2,502	2,477
Accumulated deficit	(4,608)	(4,063)
Accumulated other comprehensive loss	(1,788)	(1,824)
Common stock held in treasury, at cost (5.5 and 6.3 shares, respectively)	(226)	(251)
Total stockholders' deficit attributable to Navistar International Corporation	(4,108)	(3,649)
Stockholders' equity attributable to non-controlling interests	34	44
Total stockholders' deficit	(4,074)	(3,605)

Total liabilities and stockholders’ deficit	$7,727	$8,315

See Notes to Condensed Consolidated Financial Statements
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Navistar International Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended April 30,	
(in millions)	2014	2013
Cash flows from operating activities		
Net loss	$(525)	$(473)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	122	164
Depreciation of equipment leased to others	63	78
Deferred taxes, including change in valuation allowance	(2)	20
Asset impairment charges	169	8
Gain on sales of investments and businesses, net	—	(13)
Amortization of debt issuance costs and discount	27	31
Stock-based compensation	12	14
Provision for doubtful accounts, net of recoveries	9	13
Equity in income of non-consolidated affiliates, net of dividends	7	8
Write-off of debt issuance cost and discount	1	6
Other non-cash operating activities	(15)	(54)
Changes in other assets and liabilities, exclusive of the effects of businesses disposed	(194)	155
Net cash used in operating activities	(326)	(43)
Cash flows from investing activities		
Purchases of marketable securities	(788)	(759)
Sales of marketable securities	902	358
Maturities of marketable securities	182	134
Net change in restricted cash and cash equivalents	(21)	44
Capital expenditures	(50)	(107)
Purchases of equipment leased to others	(108)	(295)
Proceeds from sales of property and equipment	20	19
Proceeds from sales of affiliates	5	30
Net cash provided by (used in) investing activities	142	(576)
Cash flows from financing activities		
Proceeds from issuance of securitized debt	152	200
Principal payments on securitized debt	(81)	(402)
Proceeds from issuance of non-securitized debt	473	339
Principal payments on non-securitized debt	(509)	(374)
Net increase in notes and debt outstanding under revolving credit facilities	3	80
Principal payments under financing arrangements and capital lease obligations	(14)	(51)
Debt issuance costs	(13)	(14)
Proceeds from financed lease obligations	34	263
Issuance of common stock	—	14
Proceeds from exercise of stock options	18	8
Dividends paid by subsidiaries to non-controlling interest	(30)	(25)
Other financing activities	—	4
Net cash provided by financing activities	33	42
Effect of exchange rate changes on cash and cash equivalents	(10)	(5)
Decrease in cash and cash equivalents	(161)	(582)
Cash and cash equivalents at beginning of the period	755	1,087

Cash and cash equivalents at end of the period	$594	$505

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

(in millions)	Series D Convertible Junior Preference Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury, at cost	Stockholders' Equity Attributable to Non-controlling Interests	Total
Balance as of October 31, 2013	$ 3	$ 9	$ 2,477	$ (4,063)	$ (1,824)	$ (251)	$ 44	$ (3,605)
Net income (loss)				(545)			20	(525)
Total other comprehensive income					36			36
Transfer from redeemable equity securities upon exercise or expiration of stock options			2					2
Stock-based compensation			9					9
Stock ownership programs			(8)			25		17
Equity component of convertible debt instruments, net of tax expense of $16			27					27
Equity component of repurchased convertible debt instruments, net of tax benefit of $3			(5)					(5)
Cash dividends paid to non-controlling interest							(30)	(30)
Balance as of April 30, 2014	$ 3	$ 9	$ 2,502	$ (4,608)	$ (1,788)	$ (226)	$ 34	$ (4,074)
Balance as of October 31, 2012	$ 3	$ 9	$ 2,440	$ (3,165)	$ (2,325)	$ (272)	$ 45	$ (3,265)
Net income (loss)				(497)			24	(473)
Total other comprehensive income					98			98
Transfer from redeemable equity securities upon exercise or expiration of stock options			1					1
Stock-based compensation			9					9
Stock ownership programs			(9)			16		7
Cash dividends paid to non-controlling interest							(25)	(25)
Issuance of common stock, net of issuance cost and fees			14					14

Deconsolidation of a non-controlling interest							(9)	(9)
Other			1					1
Balance as of April 30, 2013	$ 3	$ 9	$ 2,456	$ (3,662)	$ (2,227)	$ (256)	$ 35	$ (3,642)

See Notes to Condensed Consolidated Financial Statements

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

1. Summary of Significant Accounting Policies

Organization and Description of the Business

Navistar International Corporation ("NIC"), incorporated under the laws of the State of Delaware in 1993, is a holding company whose principal operating entities are Navistar, Inc. and Navistar Financial Corporation ("NFC"). References herein to the "Company," "we," "our," or "us" refer collectively to NIC and its consolidated subsidiaries, including certain variable interest entities ("VIEs") of which we are the primary beneficiary.

Our fiscal year ends October 31. As such, all references to 2014 and 2013 contained within this Quarterly Report on Form 10-Q relate to our fiscal year, unless otherwise indicated.

We operate in four principal industry segments: North America Truck, North America Parts, Global Operations (collectively called "Manufacturing operations"), and Financial Services, which consists of NFC and our foreign finance operations (collectively called "Financial Services operations"). These segments are discussed in Note 13, Segment Reporting.

Basis of Presentation and Consolidation

The accompanying unaudited consolidated financial statements include the assets, liabilities, and results of operations of our Manufacturing operations, which include majority-owned dealers ("Dealcors"), and our Financial Services operations, including 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 periods' amounts to conform to the 2014 presentation, which relates to the realignment of our reporting segments that became effective during the fourth quarter of 2013.

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting policies described in our Annual Report on Form 10-K for the year ended October 31, 2013, which should be read in conjunction with the disclosures therein. In our opinion, these interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial condition, results of operations, and cash flows for the periods presented. Operating results for interim periods are not necessarily indicative of annual operating results.

Variable Interest Entities

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

We are the primary beneficiary of our Blue Diamond Parts ("BDP") and Blue Diamond Truck ("BDT") joint ventures with Ford. As a result, our Consolidated Balance Sheets include assets of $298 million and $323 million and liabilities of $225 million and $188 million as of April 30, 2014 and October 31, 2013, respectively, from BDP and BDT, including $79 million and $56 million of cash and cash equivalents, at the respective dates, which are not readily available to satisfy claims against our general assets. The creditors of BDP and BDT do not have recourse to our general credit. In December 2011, Ford notified the Company of its intention to dissolve the BDT joint venture effective December 2014. In September 2013, we agreed with Ford to extend the BDT joint venture through February 2015. We do not expect the dissolution of the BDT joint venture to have a material impact on our consolidated financial statements.

Our Financial Services segment consolidates several VIEs. As a result, our Consolidated Balance Sheets include assets of $1.1 billion and $989 million as of April 30, 2014 and October 31, 2013, respectively, and liabilities of $844 million and $778 million as of April 30, 2014 and October 31, 2013, respectively, all of which are involved in securitizations that are treated as

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asset-backed debt. In addition, our Consolidated Balance Sheets include assets of $66 million and $61 million and corresponding liabilities of $51 million and $49 million as of April 30, 2014 and October 31, 2013, respectively, which are related to other secured transactions that do not qualify for sale accounting treatment, and therefore, are treated as borrowings secured by operating and finance leases. Investors that hold securitization debt have a priority claim on the cash flows generated by their respective securitized assets to the extent that the related trusts are required to make principal and interest payments. Investors in securitizations of these entities have no recourse to our general credit.

We also have an interest in other VIEs, which we do not consolidate because we are not the primary beneficiary. Our financial support and maximum loss exposure relating to these non-consolidated VIEs are not material to our financial condition, results of operations, or cash flows.

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

Product Warranty Liability

The following table presents accrued product warranty and deferred warranty revenue activity:

	Six Months Ended April 30,	
(in millions)	2014	2013
Balance at beginning of period	$1,349	$1,118
Costs accrued and revenues deferred	153	226
Currency translation adjustment	(1)	—
Adjustments to pre-existing warranties(A)(B)	94	204
Payments and revenues recognized	(272)	(327)
Balance at end of period	1,323	1,221
Less: Current portion	626	647
Noncurrent accrued product warranty and deferred warranty revenue	$697	$574

(A) Adjustments to pre-existing warranties reflect changes in our estimate of warranty costs for products sold in prior periods. Such adjustments typically occur when claims experience deviates from historic and expected trends. Our warranty liability is generally affected by component failure rates, repair costs, and the timing of failures. Future events and circumstances related to these factors could materially change our estimates and require adjustments to our liability. In addition, new product launches require a greater use of judgment in developing estimates until historical experience becomes available.

In the first quarter of 2014, we recorded adjustments for changes in estimates of $52 million or $0.64 per diluted share. In the second quarter of 2014, we recorded adjustments for changes in estimates of $42 million, or $0.52 per diluted share. The impact of income taxes on the 2014 adjustments is not material due to our deferred tax valuation allowances on our U.S. deferred tax assets.

In the first quarter of 2013, we recorded adjustments for changes in estimates of $40 million or $0.50 per diluted share. In the second quarter of 2013, we recorded adjustments for changes in estimates of $164 million, or $2.04 per diluted share. The impact of income taxes on the 2013 adjustments is not material due to our deferred tax valuation allowances on our U.S. deferred tax assets.

(B) In the first quarter of 2013, we recognized $13 million of charges for adjustments to pre-existing warranties for a specific warranty issue related to component parts from a supplier. Also during the first quarter of 2013, we reached an agreement for reimbursement from this supplier for this amount and other costs previously accrued. As a result of this agreement, we recognized a recovery of $27 million within Costs of products sold and recorded a receivable within Other current assets. In the second quarter of 2013, we recognized a warranty recovery of $13 million within Loss from discontinued operations, net of tax and recorded a receivable within Other current assets.

Extended Warranty Programs

The amount of deferred revenue related to extended warranty programs was $437 million and $420 million at April 30, 2014 and October 31, 2013, respectively. Revenue recognized under our extended warranty programs was $33 million and $60 million in the three and six months ended April 30, 2014, respectively, and $11 million and $40 million for the three and six months ended April 30, 2013, respectively. In the second quarter of 2014 and 2013, the North America Truck segment recognized charges of $34 million and $33 million, respectively, related to the extended warranty contracts on our 2010 emission standard MaxxForce Big-Bore engines. The majority of these changes are included in the adjustments to pre-existing warranties.

Use of Estimates

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

Concentration Risks

Our financial condition, results of operations, and cash flows are subject to concentration risks related to concentrations of our union employees. As of April 30, 2014, approximately 5,700, or 65%, of our hourly workers and approximately 300, or 4%, of our salaried workers are represented by labor unions and are covered by collective bargaining agreements. Our current master collective bargaining agreement with the UAW will expire in October 2014. Our future operations may be affected by changes in governmental procurement policies, budget considerations, changing national defense requirements, and global, political, regulatory and economic developments in the U.S. and certain foreign countries (primarily Canada, Mexico, and Brazil).

Goodwill and Indefinite-Lived Intangible Assets

Goodwill represents the excess of the cost of an acquired business over the amounts assigned to the net assets. Goodwill is not amortized but is tested for impairment at a reporting unit level on an annual basis or more frequently, if circumstances change or an event occurs that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

Qualitative factors may be assessed to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If the qualitative assessment indicates that the carrying amount is more likely than not higher than the fair value, goodwill is tested for impairment based on a two-step test. The first step compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, thus the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test shall be performed to measure the amount of impairment loss, if any. The second step compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions, and selecting an appropriate control premium. The income approach is based on discounted cash flows which are derived from internal forecasts and economic expectations for each respective reporting unit.

An intangible asset determined to have an indefinite useful life is not amortized until its useful life is determined to no longer be indefinite. Indefinite-lived intangible assets are evaluated each reporting period to determine whether events and circumstances continue to support an indefinite useful life. Indefinite-lived intangible assets are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of the indefinite-lived intangible asset with its carrying amount. If the carrying amount of an indefinite-lived intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Significant judgment is applied when evaluating if an intangible asset has a finite useful life. In addition, for indefinite-lived intangible assets, significant judgment is applied in testing for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, and incorporating general economic and market conditions.

During the second quarter of 2014, the economic downturn in Brazil resulted in the continued decline in actual and forecasted results for the Brazilian engine reporting unit with goodwill of $142 million and an indefinite-lived intangible asset, trademark, of $43 million. As a result, we performed an impairment analysis in the second quarter utilizing the income approach, based on discounted cash flows, which are derived from internal forecasts and economic expectations. It was determined that the carrying value of the Brazilian engine reporting unit, including goodwill, exceeded its fair value. As a result we compared the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. A decrease in the enterprise value of the reporting unit coupled with appreciation in the value of certain tangible assets, which are not recognized for accounting purposes, resulted in the determination that the entire $142 million of goodwill was impaired. In addition, we determined that the related trademark was impaired and recognized an impairment charge of $7 million. The non-cash impairment charges were included in Asset impairment charges in the Company's Consolidated Statements of Operations. The Brazilian engine reporting unit is included in the Global Operations segment.

Recently Adopted Accounting Standards

In the six months ended April 30, 2014, the Company has not adopted any new accounting guidance that has had a material impact on our consolidated financial statements.

Recently Issued Accounting Standards

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. This new guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. Our effective date is November 1, 2017. We are currently evaluating the impact of the adoption of this ASU on our consolidated financial statements.

2. Discontinued Operations and Other Divestitures

The Company is currently evaluating its portfolio of assets to validate their strategic and financial fit. To allow us to increase our focus on our North American core business, we are evaluating product lines, businesses, and engineering programs that fall outside of our core business. We are using Return on Invested Capital ("ROIC") methodology, combined with an assessment of the strategic fit to our core business, to identify areas that are under-performing. For those areas under-performing, we are evaluating whether to fix, divest, or close, and expect to realize incremental benefits from these actions in the near future.

Discontinued Operations

In the first quarter of 2013, the Company completed the idling of the Workhorse Custom Chassis ("WCC") operations, and in the second quarter of 2013, we completed the divestiture of the WCC business for an immaterial amount. The operating results of the WCC operations are reported as discontinued operations in the Consolidated Statements of Operations for all periods presented.

Also in the first quarter of 2013, certain operations of the Monaco recreational vehicle ("RV") business ("Monaco") were determined to be held-for-sale. In May 2013, we divested substantially all of our interest in these operations of Monaco. The operating results of these operations of Monaco are reported as discontinued operations in the Consolidated Statements of Operations for all periods presented. The cash consideration from the divestiture was $19 million. As a result of the divestiture, we impaired certain assets and recognized a loss totaling $24 million.

WCC and Monaco were not material to the Company's Consolidated Balance Sheets or Condensed Consolidated Statements of Cash Flows and have not been reclassified in the respective financial statements.

The following table summarizes the discontinued operations activity in the Company's Consolidated Statements of Operations:

	Three Months Ended April 30,		Six Months Ended April 30,	
(in millions)	2014	2013	2014	2013
Sales and revenues, net	$—	$36	$—	$70
Income (loss) before income taxes	$1	$(21)	$2	$(30)
Income tax benefit (expense)	—	—	—	—
Income (loss) from discontinued operations, net of tax	$1	$(21)	$2	$(30)

We generally use a centralized approach to cash management, financing of our Manufacturing operations, and general corporate related functions, and, accordingly, do not allocate debt, interest expense, or corporate overhead to our discontinued businesses. Any debt and related interest expense of a specific entity within a business is recorded by the

respective entity.
Other Divestitures
Mahindra Joint Ventures
In 2006 and 2008, we formed two joint ventures with Mahindra & Mahindra Ltd. ("Mahindra") in India, which operated under the names of Mahindra Navistar Automotives Ltd. ("MNAL") and Mahindra-Navistar Engines Private Ltd. ("MNEPL")

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(collectively, the "Mahindra Joint Ventures"). In February 2013, the Company sold its stake in the Mahindra Joint Ventures to Mahindra for $33 million. As a result of the divestiture, the Global Operations segment recognized a gain of $26 million in 2013. As part of the transaction, the Company entered into licensing and service agreements with Mahindra.

E-Z Pack

In the second quarter of 2014, the Company sold the E-Z Pack business, which related to the production of truck refuse bodies. E-Z Pack was not material to the Company's Consolidated Statements of Operations, Consolidated Balance Sheets, or Condensed Consolidated Statements of Cash Flows and therefore, its operations have not been reclassified as discontinued operations in the respective financial statements.

3. Restructurings and Impairments

Restructuring charges are recorded on restructuring plans that have been committed to by management and are, in part, based upon management's best estimates of future events. Changes to the estimates may require future adjustments to the restructuring liabilities. In the three and six months ended April 30, 2014, the Company recognized Restructuring charges of $8 million and $11 million, respectively, compared to $6 million and $8 million in the three and six months ended April 30, 2013.

In the three and six months ended April 30, 2014, the Company recognized Asset impairment charges of $151 million and $169 million, respectively. There were no asset impairment charges in the comparable periods of 2013.

The following table reconciles our impairment charges in our Consolidated Statements of Operations:

(in millions)	Three Months Ended April 30, 2014	Six Months Ended April 30, 2014
Goodwill impairment charge	$142	$142
Intangible asset impairment charge	7	7
Other asset impairment charges	2	20
Total asset impairment charges	$151	$169

In the second quarter of 2014, we recognized a non-cash charge of $149 million for the impairment of certain intangible assets of our Brazilian engine reporting unit. As a result of the economic downturn in Brazil causing declines in actual and forecasted results, we tested the goodwill and indefinite-lived intangible asset of our Brazilian engine reporting unit for potential impairment. As a result, we determined that the entire $142 million balance of goodwill and $7 million of trademarks were impaired. For more information, see Note 1, Summary of Significant Accounting Policies.

In the first quarter of 2014, the Company concluded it had a triggering event related to potential sales of assets requiring assessment of impairment for certain intangible and long-lived assets in the North America Truck segment. As a result, certain amortizing intangible assets and long-lived assets were determined to be fully impaired, resulting in an impairment charge of $19 million that was recognized in the six months ended April 30, 2014 in Asset impairment charges in the Company's Consolidated Statements of Operations.

Cost-Reductions and Other Strategic Initiatives

From time to time, we announced actions to control spending across the Company with targeted reductions of certain costs. We are focused on continued reductions in discretionary spending, including but not limited to reductions resulting from efficiencies, and prioritizing or eliminating certain programs or projects.

We continue to focus on improving our core North America Truck and Parts businesses. We continue to evaluate our portfolio of assets, with the purpose of closing or divesting non-core/non-strategic businesses, and identifying opportunities to restructure our business and rationalize our Manufacturing operations in an effort to optimize our cost structure. The Company is currently evaluating its portfolio of assets to validate their strategic and financial fit. To allow us to increase our focus on our North America core businesses, we are evaluating product lines, businesses, and engineering programs that fall outside of our core businesses. We are using ROIC, combined with an assessment of the strategic fit to our core businesses, to identify areas that are not performing to our expectations. For those areas, we are evaluating whether to fix, divest, or close. These actions could result in additional restructuring and other related charges in the future, including but not limited to; (i) impairments, (ii) costs for employee and contractor termination and other related benefits, and (iii) charges for pension and other postretirement contractual benefits and pension curtailments. These charges could be significant.

As a result of our ongoing evaluation of our portfolio of assets to validate their strategic and financial fit, which led to the discontinuation of certain engineering programs related to products that were determined to be outside of our core operations or not performing to our expectations, the North America Truck segment recognized certain charges, which included (i) accelerated depreciation of certain assets of $13 million in the first quarter of 2013, which impacted Cost of products sold in the Company's Consolidated Statements of Operations, and (ii) asset impairments of $17 million in the third quarter of 2013.

Voluntary separation program and reduction-in-force actions

In the fourth quarter of 2012, the Company offered the majority of our U.S.-based non-represented salaried employees the opportunity to apply for a voluntary separation program ("VSP"). Along with the employees who chose to participate in the VSP, we used attrition and an involuntary reduction-in-force to eliminate additional positions in order to meet our targeted reductions goal. In addition to these actions in the U.S., our Brazilian operations utilized an involuntary reduction in force to eliminate positions.

In the fourth quarter of 2013, the Company leveraged efficiencies identified through redesigning our organizational structure and began implementing new cost-reduction initiatives, including an enterprise-wide reduction-in-force. As a result of these actions, the Company recognized restructuring charges of $11 million in personnel costs for employee termination and related benefits, of which a portion was paid in 2013. The Company expects the remaining restructuring charges will be paid throughout 2014.

In the second quarter of 2014, the Company initiated new cost-reduction actions, including an enterprise-wide reduction-in-force. As a result of these actions, the Company recognized restructuring charges of $8 million in personnel costs for employee termination and related benefits, the majority of which is expected to be paid during the remainder of 2014. The Company expects the remaining restructuring charges will be paid throughout 2015.

Warrenville, Illinois Lease Vacancy

In the second quarter of 2012, the Company vacated the premises of its former world headquarters in Warrenville, Illinois. The cash payments associated with the lease vacancy obligation are expected to be completed by the end of 2016.

North American Manufacturing Restructuring Activities

The Company continues to evaluate opportunities to restructure and rationalize its Manufacturing operations in an effort to optimize our cost structure.

Chatham restructuring activities

In the third quarter of 2011, the Company committed to close its Chatham, Ontario heavy truck plant, which had been idled since June 2009. Potential additional charges in future periods could range from $20 million to $70 million, primarily related to pension and postretirement costs and termination benefits, which are subject to employee negotiation, acceptance rates and the resolution of disputes related thereto.

Garland Facility closure

In the fourth quarter of 2012, the Company committed to plans for the closure of its Garland, Texas truck manufacturing operations (the "Garland Facility"). Beginning in early 2013, the Company began transitioning production from the Garland Facility to other North America operations that produce similar models. In the second quarter of 2013, production at the Garland Facility ceased. In the first and second quarters of 2013, we recognized charges of $12 million and $8 million, respectively, for the acceleration of depreciation of certain assets related to the facility that impacted Cost of products sold in the Company's Consolidated Statements of Operations.

Huntsville Facility

In February 2014, the Company announced plans to consolidate its mid-range engine manufacturing footprint and relocate mid-range engine production from its Huntsville, Alabama, facility ("Huntsville Facility") to its Melrose Park, Illinois facility ("Melrose Park Facility"). As a result, in the first quarter of 2014, the North America Truck segment recognized restructuring charges of $1 million for personnel costs related to employee terminations and $2 million for inventory reserves related to the idled production equipment at the Huntsville Facility that impacted Cost of products sold in the Company's Consolidated Statements of Operations.

Restructuring Liability

The following tables summarize the activity in the restructuring liability, which includes amounts related to discontinued operations and excludes pension and other postretirement contractual termination benefits:

(in millions)	Balance at October 31, 2013	Additions	Payments	Adjustments	Balance at April 30, 2014
Employee termination charges	$15	$9	$(8)	$—	$16
Employee relocation costs	—	1	(1)	—	—
Lease vacancy	18	1	(4)	—	15
Other	1	—	(2)	—	(1)
Restructuring liability	$34	$11	$(15)	$—	$30

(in millions)	Balance at October 31, 2012	Additions	Payments	Adjustments	Balance at April 30, 2013
Employee termination charges	$ 72	$1	$(44)	$(3)	$26
Employee relocation costs	—	2	(2)	—	—
Lease vacancy	17	2	(3)	2	18
Other	—	4	(3)	—	1
Restructuring liability	$ 89	$9	$(52)	$(1)	$45

4. Finance Receivables

Finance receivables are receivables of our Financial Services operations. Finance receivables generally consist of wholesale notes and accounts, as well as retail notes, finance leases and accounts. Total finance receivables reported on the Consolidated Balance Sheets are net of an allowance for doubtful accounts. Total assets of our Financial Services operations net of intercompany balances are $2.5 billion and $2.4 billion as of April 30, 2014 and October 31, 2013, respectively. Included in total assets are finance receivables of $2.0 billion and $1.9 billion as of April 30, 2014 and October 31, 2013, respectively. We have two portfolio segments of finance receivables based on the type of financing inherent to each portfolio. The retail portfolio segment represents loans or leases to end-users for the purchase or lease of vehicles. The wholesale portfolio segment represents loans to dealers to finance their inventory.

Our Finance receivables, net, consist of the following:

(in millions)	April 30, 2014	October 31, 2013
Retail portfolio	$807	$751
Wholesale portfolio	1,241	1,207
Total finance receivables	2,048	1,958
Less: Allowance for doubtful accounts	24	23
Total finance receivables, net	2,024	1,935
Less: Current portion, net[(A)]	1,713	1,597
Noncurrent portion, net	$311	$338

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

Securitizations

Our Financial Services operations transfers wholesale notes, retail accounts receivable, retail notes, finance leases, and operating leases through special purpose entities ("SPEs"), which generally are only permitted to purchase these assets, issue asset-backed securities, and make payments on the securities. In addition to servicing receivables, our continued involvement in the SPEs may include an economic interest in the transferred receivables and, in some cases, managing exposure to interest rates using interest rate swaps and interest rate caps. There were no transfers of finance receivables that qualified for sale accounting treatment as of April 30, 2014 and October 31, 2013, and as a result, the transferred finance receivables are included in our Consolidated Balance Sheets and the related interest earned is included in Finance revenues.

We transfer eligible finance receivables into retail note owner trusts or wholesale note owner trusts in order to issue asset-backed securities. These trusts are VIEs of which we are determined to be the primary beneficiary and, therefore, the assets and liabilities of the trusts are included in our Consolidated Balance Sheets. The outstanding balance of finance receivables transferred into these VIEs was $989 million and $948 million as of April 30, 2014 and October 31, 2013, respectively. Other finance receivables related to secured transactions that do not qualify for sale accounting treatment were $2 million and $4 million as of April 30, 2014 and October 31, 2013, respectively. For more information on assets and liabilities of consolidated VIEs and other securitizations accounted for as secured borrowings by our Financial Services segment, see Note 1, Summary of Significant Accounting Policies.

Finance Revenues

The following table presents the components of our Finance revenues:

(in millions)	Three Months Ended April 30, 2014	Three Months Ended April 30, 2013	Six Months Ended April 30, 2014	Six Months Ended April 30, 2013
Retail notes and finance leases revenue	$16	$20	$33	$41
Wholesale notes interest	19	19	37	39
Operating lease revenue	15	12	29	24
Retail and wholesale accounts interest	7	7	13	13
Gross finance revenues	57	58	112	117
Less: Intercompany revenues	(19)	(19)	(35)	(39)
Finance revenues	$38	$39	$77	$78

5. Allowance for Doubtful Accounts

Our two portfolio segments, retail and wholesale, each consist of one class of receivable based on: (i) initial measurement attributes of the receivables, and (ii) the assessment and monitoring of risk and performance of the receivables. For more information, see Note 4, Finance Receivables.

The following tables present the activity related to our allowance for doubtful accounts for our retail portfolio segment, wholesale portfolio segment, and trade and other receivables:

	Three Months Ended April 30, 2014				Three Months Ended April 30, 2013			
(in millions)	Retail Portfolio	Wholesale Portfolio	Trade and Other Receivables	Total	Retail Portfolio	Wholesale Portfolio	Trade and Other Receivables	Total
Allowance for doubtful accounts, at beginning of period	$22	$2	$36	$60	$23	$2	$24	$49
Provision for doubtful accounts, net of recoveries	3	—	1	4	1	—	10	11
Charge-off of accounts(A)	(3)	—	(2)	(5)	(3)	—	—	(3)
Other(B)	—	—	3	3	1	—	—	1
Allowance for doubtful accounts, at end of period	$22	$2	$38	$62	$22	$2	$34	$58

	Six Months Ended April 30, 2014				Six Months Ended April 30, 2013			
(in millions)	Retail Portfolio	Wholesale Portfolio	Trade and Other Receivables	Total	Retail Portfolio	Wholesale Portfolio	Trade and Other Receivables	Total
Allowance for doubtful accounts, at beginning of period	$21	$2	$37	$60	$27	$—	$24	$51
Provision for doubtful accounts, net of recoveries	7	—	3	10	(1)	2	10	11
Charge-off of accounts(A)	(5)	—	(2)	(7)	(6)	—	—	(6)

Other(B)	(1)	—	—	(1)	2	—	—	2
Allowance for doubtful accounts, at end of period	$22	$2	$ 38	$62	$22	$2	$ 34	$58

(A) We repossess sold and leased vehicles on defaulted finance receivables and leases, and place them into Inventories. Losses recognized at the time of repossession and charged against the allowance for doubtful accounts were less than $1 million for the three and six months ended April 30, 2014 as well as for the three and six months ended April 30, 2013.

(B) Amounts include currency translation.

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

The following table presents information regarding impaired finance receivables:

(in millions)	April 30, 2014 Retail Portfolio	Wholesale Portfolio	Total	October 31, 2013 Retail Portfolio	Wholesale Portfolio	Total
Impaired finance receivables with specific loss reserves	$14	$—	$14	$15	$—	$15
Impaired finance receivables without specific loss reserves	1	—	1	1	—	1
Specific loss reserves on impaired finance receivables	6	—	6	6	—	6
Finance receivables on non-accrual status	15	—	15	10	—	10

For the impaired finance receivables in the retail portfolio as of April 30, 2014 and 2013, the average balances of those receivables were $16 million and $13 million during the six months ended April 30, 2014 and 2013, respectively.

The Company uses the aging of its receivables as well as other inputs when assessing credit quality. The following table presents the aging analysis for finance receivables:

(in millions)	April 30, 2014 Retail Portfolio	Wholesale Portfolio	Total	October 31, 2013 Retail Portfolio	Wholesale Portfolio	Total
Current, and up to 30 days past due	$724	$ 1,237	$1,961	$699	$ 1,204	$1,903
30-90 days past due	69	2	71	44	2	46
Over 90 days past due	14	2	16	8	1	9
Total finance receivables	$807	$ 1,241	$2,048	$751	$ 1,207	$1,958

6. Inventories

The following table presents the components of Inventories:

(in millions)	April 30, 2014	October 31, 2013
Finished products	$808	$692
Work in process	74	58
Raw materials	502	460
Total inventories	$1,384	$1,210

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7. Debt

(in millions)	April 30, 2014	October 31, 2013
Manufacturing operations		
Senior Secured Term Loan Credit Facility, as Amended, due 2017, net of unamortized discount of $4 for both periods	$694	$693
8.25% Senior Notes, due 2021, net of unamortized discount of $21 and $22, respectively	1,179	1,178
3.00% Senior Subordinated Convertible Notes, due 2014, net of unamortized discount of $4 and $26, respectively	163	544
4.50% Senior Subordinated Convertible Notes, due 2018, net of unamortized discount of $21 and $23, respectively	179	177
4.75% Senior Subordinated Convertible Notes, due 2019, net of unamortized discount of $43	368	—
Debt of majority-owned dealerships	48	48
Financing arrangements and capital lease obligations	59	77
Loan Agreement related to 6.5% Tax Exempt Bonds, due 2040	225	225
Promissory Note	15	20
Financed lease obligations	205	218
Other	35	39
Total Manufacturing operations debt	3,170	3,219
Less: Current portion	267	658
Net long-term Manufacturing operations debt	$2,903	$2,561

(in millions)	April 30, 2014	October 31, 2013
Financial Services operations		
Asset-backed debt issued by consolidated SPEs, at fixed and variable rates, due serially through 2019	$844	$778
Bank revolvers, at fixed and variable rates, due dates from 2014 through 2019	1,005	1,018
Commercial paper, at variable rates, program matures in 2015	30	21
Borrowings secured by operating and finance leases, at various rates, due serially through 2018	51	49
Total Financial Services operations debt	1,930	1,866
Less: Current portion	689	505
Net long-term Financial Services operations debt	$1,241	$1,361

Manufacturing Operations

4.75% Senior Subordinated Convertible Notes

During the second quarter of 2014, we completed the private sale of $411 million of 4.75% senior subordinated convertible notes due April 2019 ("2019 Convertible Notes"), including a portion of the underwriter's over-allotment option. The Company received proceeds of $402 million, net of $9 million of issuance costs. Interest is payable on April 15 and October 15 of each year until the maturity date. The 2019 Convertible Notes are senior subordinated unsecured obligations of the Company.

In accounting for the issuance, the 2019 Convertible Notes were separated into a debt component and an equity component, resulting in the debt component being recorded at estimated fair value without consideration given to the conversion feature. The excess of the principal amount of the liability component over the carrying amount is treated as debt discount and will be amortized to Interest expense using the effective interest method over the term of the 2019 Convertible Notes. We estimated the fair value of the liability component at $367 million. The equity component of $44 million, is recorded in Additional paid in capital and will not be remeasured as long as it continues to meet the

conditions for equity classification. Issuance costs are also allocated between the debt and equity components resulting in $8 million of debt issue costs being recorded in Other noncurrent assets and $1 million recorded as a reduction in Additional paid in capital. The liability component of the debt issuance costs will be amortized to Interest expense over the term of the 2019 Convertible Notes.
The Company has the option to redeem the 2019 Convertible Notes for cash, in whole or in part, on any business day on or after April 20, 2017 if the last reported sale price of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), during any 30 consecutive trading day period

ending within 10 trading days immediately prior to the date of the redemption notice ("Optional Redemption"). The redemption price is equal to 100% of the principal amount of the Notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date.

Holders may convert the 2019 Convertible Notes into common stock of the Company at any time on or after October 15, 2018. Holders may also convert the 2019 Convertible Notes at their option prior to October 15, 2018, under the following circumstances: (i) during any fiscal quarter (and only during that fiscal quarter) commencing after April 30, 2014, if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each such trading day; (ii) during the 5 business day period after any 5 consecutive trading day period (the "Measurement Period") in which the trading price per $1,000 principal amount of notes for each trading day of that Measurement Period was less than 98% of the product of the last reported sale price of the common stock and the applicable conversion rate on each such trading day; (iii) if the Company exercises its Optional Redemption, as described above, after October 15, 2018, holders of the 2019 Convertible Notes will have the right to convert their 2019 Convertible Notes at any time prior to the close of business on the business day preceding the redemption date, or; (iv) upon the occurrence of specified corporate events, as more fully described in the 2019 Convertible Notes indenture. The conversion rate will initially be 18.4946 shares of common stock per $1,000 principal amount of 2019 Convertible Notes (equivalent to an initial conversion price of approximately $54.07 per share of common stock). The conversion rate may be adjusted for anti-dilution provisions and the conversion price may be decreased by the Board of Directors to the extent permitted by law and listing requirements.

The 2019 Convertible Notes can be settled in common stock, cash, or a combination of common stock and cash. Upon conversion, the Company will satisfy its conversion obligations by delivering, at its election, shares of common stock (plus cash in lieu of fractional shares), cash ("Cash Settlement"), or any combination of cash and shares of common stock ("Combination Settlement"). If the Company elects a Cash Settlement or a Combination Settlement, the amounts due will be based on a daily conversion value calculated on a proportionate basis for each trading day in a 20 trading-day observation period. If a holder converts its 2019 Convertible Notes on or after October 15, 2018, and the Company elects physical settlement, the holder will not receive the shares of common stock into which the 2019 Convertible Notes are convertible until after the expiration of the observation period, even though the number of shares the holder will receive upon settlement will not change. It is our policy to settle the principal and accrued interest on the 2019 Convertible Notes with cash. Subject to certain exceptions, holders may require the Company to repurchase, for cash, all or part of the 2019 Convertible Notes at a price equal to 100% of the principal amount of the 2019 Convertible Notes being repurchased plus any accrued and unpaid interest.

3.00% Senior Subordinated Convertible Notes

In October 2009, we completed the sale of $570 million aggregate principal amount of 3.00% senior subordinated convertible notes ("2014 Convertible Notes"), including over-allotment options. The 2014 Convertible Notes are senior subordinated unsecured obligations of the Company.

In connection with the sale of the 2014 Convertible Notes, the Company purchased call options for $125 million. The call options cover 11,337,870 shares of common stock, subject to adjustments, at an exercise price of $50.27. The call options are intended to minimize share dilution associated with the 2014 Convertible Notes. In addition, in connection with the sale of the 2014 Convertible Notes, the Company also entered into separate warrant transactions whereby, the Company sold warrants for $87 million to sell in the aggregate 11,337,870 shares of common stock, subject to adjustments, at an exercise price of $60.14 per share of common stock.

During the second quarter of 2014, the Company used proceeds from the issuance of the 2019 Convertible Notes, as well as cash on-hand, to repurchase $404 million of notional amount of the 2014 Convertible Notes. The Company recorded a charge of $11 million related to the repurchase which was recognized in Other expense (income), net. In conjunction with the repurchases of the 2014 Convertible Notes, call options representing 8,026,456 shares expired or were unwound by the Company and warrants representing 6,523,319 shares were unwound by the Company.

Financial Services Operations

In March 2014, the maturity date of the $500 million variable funding notes was extended from September 2014 to March 2015.

In November 2013, Navistar Financial, S.A. de C.V., SOFOM, E.N.R, our Mexican financial services affiliate ("NFM"), expanded its facility of five-year notes secured by retail finance receivables by selling an additional P$800 million (the equivalent of approximately US$61 million at April 30, 2014).

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In December 2013, International Truck Leasing Corporation, a special purpose, wholly-owned subsidiary of NFC, issued borrowings secured by operating and finance leases of $21 million.

8. Postretirement Benefits

Defined Benefit Plans

We provide postretirement benefits to a substantial portion of our employees and retirees. Costs associated with postretirement benefits include pension and postretirement health care expenses for employees, retirees, and surviving spouses and dependents. Generally, the pension plans are non-contributory. Our policy is to fund the pension plans in accordance with applicable U.S. and Canadian government regulations and to make additional contributions from time to time. For the three and six months ended April 30, 2014, we contributed $36 million and $65 million, respectively, and for the three and six months ended April 30, 2013 we contributed $30 million and $57 million, respectively, to our pension plans to meet regulatory funding requirements. We currently anticipate additional contributions of $133 million to our pension plans during the remainder of 2014.

We primarily fund other post-employment benefit ("OPEB") obligations, such as retiree medical, in accordance with a 1993 Settlement Agreement (the "1993 Settlement Agreement"), which requires us to fund a portion of the plans' annual service cost to a retiree benefit trust (the "Base Trust"). The 1993 Settlement Agreement resolved a class action lawsuit originally filed in 1992 regarding the restructuring of the Company's then applicable retiree health care and life insurance benefits. Contributions for the six months ended April 30, 2014 and 2013, as well as anticipated contributions for the remainder of 2014, are not material.

Components of Net Periodic Benefit Expense (Income)

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

	Three Months Ended April 30,				Six Months Ended April 30,			
	Pension Benefits		Health and Life Insurance Benefits		Pension Benefits		Health and Life Insurance Benefits	
(in millions)	2014	2013	2014	2013	2014	2013	2014	2013
Service cost for benefits earned during the period	$2	$5	$1	$2	$6	$10	$2	$4
Interest on obligation	40	36	17	16	79	72	34	31
Amortization of cumulative loss	23	32	4	8	47	64	8	15
Amortization of prior service benefit	—	—	(1)	(1)	—	—	(2)	(2)
Premiums on pension insurance	—	1	—	—	—	1	—	—
Expected return on assets	(48)	(47)	(8)	(9)	(96)	(94)	(16)	(17)
Net postretirement benefits expense	$17	$27	$13	$16	$36	$53	$26	$31

Defined Contribution Plans and Other Contractual Arrangements

Our defined contribution plans cover a substantial portion of domestic salaried employees and certain domestic represented employees. The defined contribution plans contain a 401(k) feature and provide most participants with a matching contribution from the Company. Effective February 1, 2013, the Company changed the timing for depositing the matching contributions to the end of the calendar year. Many participants covered by the plans receive annual Company contributions to their retirement accounts based on an age-weighted percentage of the participant's eligible compensation for the calendar year. Defined contribution expense pursuant to these plans was $7 million and $15 million in the three and six months ended April 30, 2014, respectively, and $8 million and $15 million for the three and six months ended April 30, 2013, respectively.

In accordance with the 1993 Settlement Agreement, an independent Retiree Supplemental Benefit Trust (the "Supplemental Trust") was established. The Supplemental Trust, and the benefits it provides to certain retirees pursuant to a certain Retiree Supplemental Benefit Program under the 1993 Settlement Agreement ("Supplemental Benefit Program"), is not part of the Company's consolidated financial statements. The assets of the Supplemental

Trust arise from three sources: (i) the Company's 1993 contribution to the Supplemental Trust of 25.5 million shares of our Class B common stock, which were subsequently sold by the Supplemental Trust prior to 2000, (ii) contingent profit-sharing contributions made by the Company pursuant to a certain Supplemental Benefit Trust Profit Sharing Plan ("Supplemental Benefit Profit Sharing Plan"), and (iii) net investment gains on the Supplemental Trust's assets, if any.

The Company's contingent profit sharing obligations under the Supplemental Benefits Profit Sharing Plan will continue until certain funding targets defined by the 1993 Settlement Agreement are met ("Profit Sharing Cessation"). Upon Profit Sharing Cessation, the Company would assume responsibility for (i) establishing the investment policy for the Supplemental Trust, (ii) approving or disapproving of certain additional supplemental benefits to the extent such benefits would result in higher expenditures than those contemplated upon the Profit Sharing Cessation, and (iii) making additional contributions to the Supplemental Trust as necessary to make up for investment and/or actuarial losses. We have recorded no profit sharing accruals based on the operating performance of the entities that are included in the determination of qualifying profits. For more information, see Note 12, Commitments and Contingencies, for a discussion of pending litigation regarding the Supplemental Benefit Profit Sharing Plan.

9. Income Taxes

We compute on a quarterly basis an estimated annual effective tax rate considering ordinary income and related income tax expense. For all periods presented, U.S. and certain foreign results are excluded from ordinary income due to ordinary losses for which no benefit can be recognized. Ordinary income refers to income (loss) before income tax expense excluding significant unusual or infrequently occurring items. The tax effect of a significant unusual or infrequently occurring item is recorded in the interim period in which it occurs. Items included in income tax expense in the periods in which they occur include the tax effects of material restructurings and impairments, cumulative effect of changes in tax laws or rates, foreign exchange gains and losses, adjustments to uncertain tax positions, and adjustments to our valuation allowance due to changes in judgment regarding the ability to realize deferred tax assets in future years. In the second quarter of 2014, in accordance with the intraperiod tax allocation rules, the Company recorded a net benefit of $13 million in Income tax expense related to continuing operations, and an offsetting reduction in Additional paid in capital, which resulted from the issuance and repurchase of convertible notes. For more information, see Note 7, Debt.

We have evaluated the need to maintain a valuation allowance for deferred tax assets based on our assessment of whether it is more likely than not that deferred tax benefits will be realized through the generation of future taxable income. Appropriate consideration is given to all available evidence, both positive and negative, in assessing the need for a valuation allowance. We continue to maintain a valuation allowance on our U.S. deferred tax assets, as well as certain foreign deferred tax assets, that we believe, on a more-likely-than-not basis, will not be realized. During the second quarter of 2014, our evaluation of the realizability of our Brazilian deferred tax assets resulted in a determination that a valuation allowance was required, due to a deterioration of operating performance in Brazil and an increase in net operating loss carryforwards. As a result, we recorded a net income tax expense of $29 million related to establishment of the valuation allowance and tax impact from the impairment of certain intangible assets. For all remaining deferred tax assets, while we believe that it is more likely than not that they will be realized, we believe that it is reasonably possible that additional deferred tax asset valuation allowances could be required in the next twelve months.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. As of April 30, 2014, the amount of liability for uncertain tax positions was $63 million. If the unrecognized tax benefits are recognized, all but $7 million would impact our effective tax rate. However, to the extent we continue to maintain a full valuation allowance against certain deferred tax assets, the effect may be in the form of an increase in the deferred tax asset related to our net operating loss carry forward, which would be offset by a full valuation allowance.

We recognize interest and penalties related to uncertain tax positions as part of Income tax expense. For the three and six months ended April 30, 2014, total interest and penalties related to our uncertain tax positions resulted in an income tax expense of $1 million and income tax benefit of $2 million, respectively.

We have open tax years back to 2001 with various significant taxing jurisdictions including the U.S., Canada, Mexico, and Brazil. In connection with the examination of tax returns, contingencies may arise that generally result from differing interpretations of applicable tax laws and regulations as they relate to the amount, timing, or inclusion of revenues or expenses in taxable income, or the sustainability of tax credits to reduce income taxes payable. We believe we have sufficient accruals for our contingent tax liabilities. Annual tax provisions include amounts considered

sufficient to pay assessments that may result from examinations of prior year tax returns, although actual results may differ. While it is probable that the liability for unrecognized tax benefits may increase or decrease during the next 12 months, we do not expect any such change would have a material effect on our financial condition, results of operations, or cash flows.
In the three months ended January 31, 2014, we reached a tax settlement with the State of Alabama, which resulted in the recording of a decrease to our uncertain tax positions of $8 million. In the first quarter of 2013, we accrued $12 million related to this matter, but later reduced our accrual by $4 million in the fourth quarter of 2013 in anticipation of the settlement.

10. Fair Value Measurements

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

- Level 1—based upon quoted prices for identical instruments in active markets,
- Level 2—based upon quoted prices for similar instruments, prices for identical or similar instruments in markets that are not active, or model-derived valuations, all of whose significant inputs are observable, and
- Level 3—based upon one or more significant unobservable inputs.

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

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

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

Derivative Assets and Liabilities—We measure the fair value of derivatives assuming that the unit of account is an individual derivative transaction and that each derivative could be sold or transferred on a stand-alone basis. We classify within Level 2 our derivatives that are traded over-the-counter and valued using internal models based on observable market inputs. In certain cases, market data is not available and we estimate inputs such as in situations where trading in a particular commodity is not active. Measurements based upon these unobservable inputs are classified within Level 3. For more information regarding derivatives, see Note 11, Financial Instruments and Commodity Contracts.

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

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

	April 30, 2014				October 31, 2013			
(in millions)	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Marketable securities:								
U.S. Treasury bills	$241	$—	$—	$241	$396	$—	$—	$396
Other	293	—	—	293	434	—	—	434
Derivative financial instruments:								
Foreign currency contracts	—	—	—	—	—	4	—	4
Interest rate caps	—	2	—	2	—	1	—	1
Total assets	$534	$2	$—	$536	$830	$5	$—	$835
Liabilities								
Derivative financial instruments:								
Foreign currency contracts	$—	$—	$—	$—	$—	$—	$—	$—
Guarantees	—	—	6	6	—	—	6	6
Total liabilities	$—	$—	$6	$6	$—	$—	$6	$6

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The following table presents the changes for those financial instruments classified within Level 3 of the valuation hierarchy:

	Three Months Ended April 30,			
	2014		2013	
(in millions)	Guarantees	Commodity contracts	Guarantees	Commodity contracts
Balance at February 1	$(6)	$—	$(7)	$—
Transfers out of Level 3	—	—	—	—
Issuances	—	—	—	—
Settlements	—	—	—	—
Balance at April 30	$(6)	$—	$(7)	$—
Change in unrealized gains on assets and liabilities still held	$—	$—	$—	$—

	Six Months Ended April 30,			
	2014		2013	
(in millions)	Guarantees	Commodity contracts	Guarantees	Commodity contracts
Balance at November 1	$(6)	$—	$(7)	$—
Transfers out of Level 3	—	—	—	—
Issuances	—	—	—	—
Settlements	—	—	—	—
Balance at April 30	$(6)	$—	$(7)	$—
Change in unrealized gains on assets and liabilities still held	$—	$—	$—	$—

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

(in millions)	April 30, 2014	October 31, 2013
Level 2 financial instruments		
Carrying value of impaired finance receivables [(A)]	$14	$15
Specific loss reserve	(6)	(6)
Fair value	$8	$9

(A) Certain impaired finance receivables are measured at fair value on a nonrecurring basis. An impairment charge is recorded for the amount by which the carrying value of the receivables exceeds the fair value of the underlying collateral, net of remarketing costs. Fair values of the underlying collateral are determined by reference to dealer vehicle value publications adjusted for certain market factors.

In the second quarter of 2014, for the purpose of impairment evaluation the Company measured the implied fair value of the Company's Brazilian engine reporting unit's goodwill and the fair value of an indefinite-lived intangible asset, trademark. The Company's Brazilian engine reporting unit's goodwill was determined to be fully impaired and resulted in a non-cash charge of $142 million. In addition, the related trademark, with a carrying value of $43 million was determined to be impaired and a non-cash charge of $7 million was recognized. The impairment charges were included in Asset impairment charges in the Company's Consolidated Statements of Operations. We utilized the income approach to determine the fair value of these Level 3 assets. For more information, see Note 1, Summary of Significant Accounting Policies.

In the first quarter of 2014, the Company concluded it had a triggering event related to potential sales of assets requiring assessment of impairment for certain intangible and long-lived assets in the North America Truck segment.

As a result, certain amortizing intangible assets and long-lived assets with a carrying value of $18 million were determined to be fully impaired, resulting in an impairment charge of $18 million, which was included in Asset impairment charges in the Company's Consolidated Statements of Operations. We utilized the market approach to determine the fair values of these Level 2 assets.

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

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

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

The following tables present the carrying values and estimated fair values of financial instruments:

	As of April 30, 2014				
	Estimated Fair Value				Carrying
(in millions)	Level 1	Level 2	Level 3	Total	Value
Assets					
Retail notes	$—	$—	$306	$306	$302
Notes receivable	—	—	10	10	69
Liabilities					
Debt:					
Manufacturing operations					
Senior Secured Term Loan Credit Facility, as Amended, due 2017	—	—	701	701	694
8.25% Senior Notes, due 2021	1,277	—	—	1,277	1,179
3.00% Senior Subordinated Convertible Notes, due 2014(A)	169	—	—	169	163
4.50% Senior Subordinated Convertible Notes, due 2018(A)	—	—	203	203	179
4.75% Senior Subordinated Convertible Notes, due 2019(A)	—	—	434	434	368
Debt of majority-owned dealerships	—	—	48	48	48
Financing arrangements	—	—	29	29	56
Loan Agreement related to 6.50% Tax Exempt Bonds, due 2040	—	227	—	227	225
Promissory Note	—	—	15	15	15
Financed lease obligations	—	—	205	205	205
Other	—	—	33	33	35
Financial Services operations					
Asset-backed debt issued by consolidated SPEs, at various rates, due serially through 2019	—	—	838	838	844
Bank revolvers, at fixed and variable rates, due dates from 2014 through 2019	—	—	984	984	1,005
Commercial paper, at variable rates, program matures in 2015	30	—	—	30	30
Borrowings secured by operating and finance leases, at various rates, due serially through 2018	—	—	51	51	51

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	As of October 31, 2013				
	Estimated Fair Value				Carrying
(in millions)	Level 1	Level 2	Level 3	Total	Value
Assets					
Retail notes	$—	$—	$390	$390	$390
Notes receivable	—	—	13	13	14
Liabilities					
Debt:					
Manufacturing operations					
Senior Secured Term Loan Credit Facility, as Amended, due 2017	—	—	720	720	693
8.25% Senior Notes, due 2021	1,274	—	—	1,274	1,178
3.00% Senior Subordinated Convertible Notes, due 2014(A)	586	—	—	586	544
4.50% Senior Subordinated Convertible Notes, due 2018(A)	—	—	203	203	177