

Edgar Filing: BORGWARNER INC - Form 10-Q/A

BORGWARNER INC  
Form 10-Q/A  
August 11, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

FORM 10-Q/A  
QUARTERLY REPORT

Under Section 13 or 15(d) of the  
Securities Exchange Act of 1934  
For the Quarter ended June 30, 2004  
Commission file number: 1-12162

(Exact name of registrant as specified in its charter)

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

|  |            |
|--|------------|
| 200 South Michigan Avenue, Chicago, Illinois | 60604      |
| (Address of principal executive offices)     | (Zip Code) |

Registrant's telephone number, including area code: (312) 322-8500

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12-b2 of the Exchange Act).  
YES  NO

On June 30, 2004 the registrant had 55,813,678 shares of Common Stock outstanding.

-----

BORGWARNER INC.  
FORM 10-Q  
SIX MONTHS ENDED JUNE 30, 2004

INDEX

Page No.

PART I. Financial Information

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

|                            |  |    |
|----------------------------|--|----|
| Item 1.                    | Financial Statements   |    |
|                            | Introduction   | 2  |
|                            | Condensed Consolidated Balance Sheets at<br>June 30, 2004 (Unaudited) and December 31, 2003            | 3  |
|                            | Consolidated Statements of Operations (Unaudited) for<br>the three months ended June 30, 2004 and 2003 | 4  |
|                            | Consolidated Statements of Operations (Unaudited) for<br>the six months ended June 30, 2004 and 2003   | 5  |
|                            | Consolidated Statements of Cash Flows (Unaudited) for<br>The six months ended June 30, 2004 and 2003   | 6  |
|                            | Notes to Consolidated Financial Statements(Unaudited)  | 7  |
| Item 2.                    | Management's Discussion and Analysis of Financial<br>Condition and Results of Operations               | 17 |
| Item 3.                    | Quantitative and Qualitative Disclosures<br>About Market Risks   | 22 |
| Item 4.                    | Controls and Procedures  | 22 |
| PART II. Other Information |  |    |
| Item 1.                    | Legal Proceedings  | 23 |
| Item 2.                    | Changes in Securities, Use of Proceeds and<br>Issuer Purchases of Equity Securities                    | 23 |
| Item 4.                    | Submission of Matters to a Vote of Security<br>Holders   | 24 |
| Item 6.                    | Exhibits and Reports on Form 8-K   | 25 |
| SIGNATURES                 |  | 26 |

BORGWARNER INC.  
FORM 10-Q  
SIX MONTHS ENDED JUNE 30, 2004

### PART I. FINANCIAL INFORMATION

#### Item 1. Financial Statements

##### BorgWarner Inc. and Consolidated Subsidiaries' Financial Statements

The financial statements of BorgWarner Inc. and Consolidated Subsidiaries (the "Company") have been prepared in accordance with the instructions to Form 10-Q under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The statements are unaudited but include all adjustments, consisting only of recurring items, except as noted, which the Company considers necessary for a fair presentation of the information set forth herein. Certain prior period

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

amounts have been reclassified to conform to current period presentation. The results of operations for the three and six months ended June 30, 2004 are not necessarily indicative of the results to be expected for the entire year. The following financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

This Form 10-Q/A has been filed for the sole purpose of correcting a typographical error. On page 3, in the Condensed Consolidated Balance Sheets, the caption "Investments and advances" is \$176.9 million. In the Form 10-Q filed on August 6, 2004, a typographical error caused the amount to be reported as 76.9 million.

### BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (millions of dollars except share data)

|  | June 30,<br>2004 | December 31,<br>2003 |
|--|------------------|----------------------|
|  | -----            | -----                |
| ASSETS (Unaudited)                                     |                  |                      |
| Cash and cash equivalents                              | \$ 144.0         | \$ 113.1             |
| Receivables  | 491.2            | 414.9                |
| Inventories  | 215.6            | 201.3                |
| Deferred income taxes                                  | 32.9             | 32.8                 |
| Investments in businesses held<br>for sale             | 39.6             | 32.0                 |
| Prepayments and other current<br>assets                | 39.6             | 30.5                 |
|  | -----            | -----                |
| Total current assets                                   | 962.9            | 824.6                |
| Property, plant, and equipment<br>at cost              | 1,720.8          | 1,665.7              |
| Less accumulated depreciation                          | (729.9)          | (680.4)              |
|  | -----            | -----                |
| Net property, plant and<br>equipment                   | 990.9            | 985.3                |
| Tooling, net of amortization                           | 101.0            | 90.5                 |
| Investments and advances                               | 176.9*           | 177.3                |
| Goodwill   | 850.6            | 852.0                |
| Other non-current assets                               | 112.5            | 120.7                |
|  | -----            | -----                |
| Total other assets                                     | 1,241.0          | 1,240.5              |
|  | -----            | -----                |
|  | \$ 3,194.8       | \$ 3,050.4           |
|  | =====            | =====                |
| LIABILITIES & STOCKHOLDERS' EQUITY                     |                  |                      |
| Notes payable and current portion of<br>long-term debt | \$ 9.0           | \$ 10.0              |
| Accounts payable and accrued<br>expenses               | 549.5            | 460.3                |
| Income taxes payable                                   | 17.3             | -                    |
|  | -----            | -----                |
| Total current liabilities                              | 575.8            | 470.3                |
| Long-term debt   | 573.9            | 645.5                |
| Long-term retirement-related                           |                  |                      |

Edgar Filing: BORGWARNER INC - Form 10-Q/A

|  |           |           |
|--|-----------|-----------|
| liabilities  | 461.4     | 503.0     |
| Other long-term liabilities  | 184.7     | 154.0     |
|  | -----     | -----     |
| Total long-term liabilities  | 646.1     | 657.0     |
| Minority interest in con-<br>solidated subsidiaries  | 17.4      | 17.2      |
| Capital stock:   |           |           |
| Preferred stock, \$.01 par value;<br>authorized 5,000,000 shares;<br>none issued   | -         | -         |
| Common stock, \$.01 par value;<br>authorized 150,000,000 shares;<br>issued shares: 2004- 55,817,662;<br>2003- 55,229,854; outstanding<br>shares: 2004-55,813,678;2003-<br>55,157,190 | 0.6       | 0.3       |
| Non-voting common stock, \$.01 par<br>value; authorized 25,000,000<br>shares; none issued and<br>outstanding in 2004   | -         | -         |
| Capital in excess of par value   | 784.7     | 756.3     |
| Retained earnings  | 582.9     | 491.3     |
| Accumulated other comprehensive<br>income  | 13.5      | 4.0       |
| Common stock held in treasury, at<br>cost: 2004, 3,984 shares; 2003,<br>72,664 shares  | (0.1)     | (1.5)     |
|  | -----     | -----     |
| Total stockholders' equity   | 1,381.6   | 1,260.4   |
|  | -----     | -----     |
|  | \$3,194.8 | \$3,050.4 |
|  | =====     | =====     |

\*In the Company's Form 10-Q filed on August 6, 2004, a typographical error resulted in this number being reported as 76.9 million.

See accompanying Notes to Consolidated Financial Statements  
BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
(millions of dollars except share data)

|   | Three months ended |         |
|---|--------------------|---------|
|   | June 30,           |         |
|   | 2004               | 2003    |
|   | -----              | -----   |
| Net sales                                       | \$893.2            | \$769.5 |
| Cost of sales                                   | 723.4              | 622.8   |
|   | -----              | -----   |
| Gross profit                                    | 169.8              | 146.7   |
| Selling, general and administrative<br>expenses | 87.8               | 77.0    |
| Other, net                                      | 0.6                | 0.1     |
|   | -----              | -----   |
| Operating income                                | 81.4               | 69.6    |
| Equity in affiliate earnings, net<br>of tax     | (8.4)              | (5.2)   |
| Interest expense and finance charges            | 7.7                | 8.7     |
|   | -----              | -----   |
| Earnings before income taxes                    | 82.1               | 66.1    |
| Provision for income taxes                      | 24.6               | 19.2    |
| Minority interest, net of tax                   | 2.8                | 2.1     |
|   | -----              | -----   |

Edgar Filing: BORGWARNER INC - Form 10-Q/A

|  |              |         |
|--|--------------|---------|
| Net earnings                           | \$ 54.7      | \$ 44.8 |
|  | =====        | =====   |
| Net earnings per share - Basic         | \$ 0.98      | \$ 0.83 |
|  | =====        | =====   |
| Net earnings per share Diluted         | \$ 0.97      | \$ 0.83 |
|  | =====        | =====   |
| Average shares outstanding (thousands) |              |         |
| Basic                                  | 55,766       | 53,670  |
| Diluted                                | 56,38354,216 |         |
| Dividends declared per share           | \$ 0.125     | \$ 0.09 |
|  | =====        | =====   |

See accompanying Notes to Consolidated Financial Statements

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
(millions of dollars except share data)

|  | Six months ended |           |
|--|------------------|-----------|
|  | June 30,         |           |
|  | 2004             | 2003      |
|  | -----            | -----     |
| Net sales                                    | \$1,796.2        | \$1,545.2 |
| Cost of sales                                | 1,453.9          | 1,246.9   |
|  | -----            | -----     |
| Gross profit                                 | 342.3            | 298.3     |
| Selling, general and administrative expenses | 182.5            | 160.7     |
| Other, net                                   | 0.9              | 0.1       |
|  | -----            | -----     |
| Operating income                             | 158.9            | 137.5     |
| Equity in affiliate earnings, net of tax     | (14.9)           | (11.6)    |
| Interest expense and finance charges         | 15.2             | 17.7      |
|  | -----            | -----     |
| Earnings before income taxes                 | 158.6            | 131.4     |
| Provision for income taxes                   | 47.5             | 38.1      |
| Minority interest, net of tax                | 5.3              | 4.3       |
|  | -----            | -----     |
| Net earnings                                 | \$ 105.8         | \$ 89.0   |
|  | =====            | =====     |
| Net earnings per share - Basic               | \$ 1.90          | \$ 1.66   |
| Net earnings per share Diluted               | \$ 1.88          | \$ 1.65   |
| Average shares outstanding (thousands)       |                  |           |
| Basic  | 55,591           | 53,488    |
| Diluted                                      | 56,219           | 53,944    |
| Dividends declared per share                 | \$ 0.25          | \$ 0.18   |
|  | =====            | =====     |

See accompanying Notes to Consolidated Financial Statements

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(millions of dollars)

|  | Six months ended<br>June 30, |         |
|--|------------------------------|---------|
|  | 2004                         | 2003    |
|  | -----                        | -----   |
| Operating  |                              |         |
| Net earnings   | \$ 105.8                     | \$ 89.0 |
| Non-cash charges to operations:  |                              |         |
| Depreciation   | 67.3                         | 60.2    |
| Amortization of tooling  | 19.9                         | 15.7    |
| Employee retirement benefits   | 24.5                         | 6.8     |
| Equity in affiliate earnings, net<br>of dividends received,<br>minority interest and other | 8.0                          | (0.3)   |
|  | -----                        | -----   |
| Net earnings adjusted for non-cash<br>charges  | 225.5                        | 171.4   |
| Changes in assets and liabilities:   |                              |         |
| Increase in receivables  | (81.3)                       | (61.2)  |
| Increase in inventories  | (16.1)                       | (6.9)   |
| Increase in prepayments and other<br>current assets  | (10.2)                       | (2.1)   |
| Increase in accounts payable and<br>accrued expenses                                       | 92.6                         | 6.7     |
| Increase in income taxes payable   | 17.0                         | 16.1    |
| Net change in other long-term assets<br>and liabilities                                    | (6.0)                        | 31.3    |
|  | -----                        | -----   |
| Net cash provided by<br>operating activities   | 221.5                        | 155.3   |
| Investing  |                              |         |
| Capital expenditures   | (84.2)                       | (64.8)  |
| Tooling outlays, net of customer<br>reimbursements   | (30.1)                       | (20.7)  |
| Net proceeds from asset disposals  | 2.5                          | 1.3     |
| Investment in unconsolidated subsidiary  | (9.0)                        | (12.8)  |
|  | -----                        | -----   |
| Net cash used in investing activities  | (120.8)                      | (97.0)  |
| Financing  |                              |         |
| Net decrease in notes payable  | (0.8)                        | (3.6)   |
| Additions to long-term debt  | 1.2                          | 0.4     |
| Reductions in long-term debt   | (59.2)                       | (7.1)   |
| Payments for purchases of treasury stock   | -                            | (2.5)   |
| Proceeds from stock options exercised  | 3.2                          | 0.8     |

**Edgar Filing: BORGWARNER INC - Form 10-Q/A**

|   |          |         |
|---|----------|---------|
| Dividends paid  | (13.9)   | (9.6)   |
|   | -----    | -----   |
| Net cash used in financing activities                         | (69.5)   | (21.6)  |
| Effect of exchange rate changes on cash and cash equivalents  | (0.3)    | 0.1     |
|   | -----    | -----   |
| Net increase in cash and cash equivalents                     | 30.9     | 36.8    |
| Cash and cash equivalents at beginning of period              | 113.1    | 36.6    |
|   | -----    | -----   |
| Cash and cash equivalents at end of period                    | \$ 144.0 | \$ 73.4 |
|   | =====    | =====   |
| Supplemental Cash Flow Information                            |          |         |
| Net cash paid during the period for:                          |          |         |
| Interest  | \$ 15.6  | \$ 18.3 |
| Income taxes  | 3.0      | 11.3    |
| Non-cash financing transactions:                              |          |         |
| Issuance of common stock for Executive Stock Performance Plan | 2.0      | 3.3     |

See accompanying Notes to Consolidated Financial Statements

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

(1) Research and development costs charged to expense for the three and six months ended June 30, 2004 were \$30.8 million and \$60.4 million. Research and development costs charged to expense for the three and six months ended June 30, 2003 were \$28.9 million and \$58.4 million.

(2) Inventories consisted of the following (millions of dollars):

|                   | June 30,<br>2004 | December 31,<br>2003 |
|-------------------|------------------|----------------------|
|                   | -----            | -----                |
| Raw materials     | \$ 88.6          | \$ 95.5              |
| Work in progress  | 86.0             | 65.1                 |
| Finished goods    | 41.0             | 40.7                 |
|                   | -----            | -----                |
| Total inventories | \$215.6          | \$201.3              |
|                   | =====            | =====                |

(3) The Company accounts for its stock-based employee compensation plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in net income for stock options, as all options granted under those plans had an exercise price equal to or in excess of the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provision of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," to all stock-based employee compensation awards.

Three Months Ended June 30,  
2004                          2003

Edgar Filing: BORGWARNER INC - Form 10-Q/A

|  |         |         |
|--|---------|---------|
| Net earnings, as reported  | \$ 54.7 | \$ 44.8 |
| Add:   |         |         |
| Stock-based employee compensation expense included in net income, net of income tax  | 0.3     | 1.5     |
| Deduct:  |         |         |
| Total stock-based employee compensation expense determined under fair value based methods for all awards, net of tax effects | (1.7)   | (2.5)   |
| Pro forma net earnings   | \$53.3  | \$43.8  |
| Net earnings per share   |         |         |
| Basic as reported  | \$ 0.98 | \$ 0.83 |
| Basic pro forma  | 0.95    | 0.82    |
| Diluted as reported  | 0.97    | 0.83    |
| Diluted pro forma  | 0.94    | 0.81    |

|  | Six Months Ended June 30,<br>2004 | 2003    |
|--|-----------------------------------|---------|
| Net earnings, as reported  | \$105.8                           | \$89.0  |
| Add:   |                                   |         |
| Stock-based employee compensation expense included in net income, net of income tax  | 0.7                               | 2.6     |
| Deduct:  |                                   |         |
| Total stock-based employee compensation expense determined under fair value based methods for all awards, net of tax effects | (2.9)                             | (4.7)   |
| Pro forma net earnings   | \$103.6                           | \$86.9  |
| Net earnings per share   |                                   |         |
| Basic as reported  | \$ 1.90                           | \$ 1.66 |
| Basic pro forma  | 1.86                              | 1.62    |
| Diluted as reported  | 1.88                              | 1.65    |
| Diluted pro forma  | 1.84                              | 1.61    |

On May 17, 2004 the Company announced a two-for-one stock split of common stock for stockholders of record on May 3, 2004. All share and per share amounts for prior periods were restated to account for the effect of the stock split.

In calculating earnings per share, earnings are the same for the basic and diluted calculations. Shares increased for diluted earnings per share by 617,000 and 546,000 for the three months ended, and 628,000 and 456,000 for the six months ended June 30, 2004 and 2003, respectively, due to the effects of stock options and shares issuable under the executive stock performance plan.



## Edgar Filing: BORGWARNER INC - Form 10-Q/A

(4) The Company's provision for income taxes is based upon estimated annual tax rates for the year applied to federal, state and foreign income. The effective rate for 2004 differed from the U.S. statutory rate primarily due to a) state income taxes, b) foreign rates which differ from those in the U.S. and c) realization of certain business tax credits, including foreign tax credits and research and development credits. The Company expects its effective tax rate for 2004 to be approximately 30.0%. This rate is about 1.5% higher than the full prior year due to changes in tax laws in some of the countries where the Company does business.

(5) Following is a summary of notes payable and long-term debt:

|   | June 30, 2004         |           | December 31, 2003 |           |
|---|-----------------------|-----------|-------------------|-----------|
|   | Current               | Long-Term | Current           | Long-Term |
| DEBT  | (millions of dollars) |           |                   |           |
| Bank borrowings and other   | \$ 2.2                | \$ 2.9    | \$ 17.8           | \$ 42.5   |
| Term loans due through 2011<br>(at an average rate of 3.3% at<br>June 30, 2004 and 3.4% at<br>December 31, 2003)  | 6.8                   | 27.3      | 7.1               | 31.4      |
| 7% Senior Notes due 2006,<br>net of unamortized discount<br>(\$139 million converted to floating<br>rate of 3.6% by interest rate swap<br>at June 30, 2004)   | -                     | 139.0     | -                 | 139.4     |
| 6.5% Senior Notes due 2009,<br>net of unamortized discount<br>(\$100 million converted to floating<br>rate of 4.3% by interest rate swap<br>at June 30, 2004) | -                     | 136.3     | -                 | 164.7     |
| 8% Senior Notes due 2019,<br>net of unamortized discount (\$75<br>million converted to floating<br>rate of 4.5% by interest rate<br>swap at June 30, 2004)    | -                     | 133.8     | -                 | 133.9     |
| 7.125% Senior Notes due 2029,<br>net of unamortized discount  | -                     | 119.1     | -                 | 122.1     |
|   | -----                 | -----     | -----             | -----     |
| Carrying amount of notes<br>payable and long-term debt  | 9.0                   | 573.3     | 10.0              | 634.0     |
| Fair value adjustment for interest<br>rate swaps (a)  | -                     | 0.6       | -                 | 11.5      |
|   | -----                 | -----     | -----             | -----     |
| Total notes payable and<br>long-term debt   | \$ 9.0                | \$ 573.9  | \$ 10.0           | \$ 645.5  |
|   | =====                 | =====     | =====             | =====     |

(a) The fair value adjustment for interest rate swaps has been reclassified to long-term debt for all periods presented.

The Company has a new revolving credit facility that provides for borrowings up to \$600 million through July 2009. This new facility effective July 22, 2004 replaced the Company's existing facility of \$350 million. At June 30, 2004 and December 31, 2003, there were no borrowings outstanding and no obligations under standby letters of credit under either facility. The lines of credit are subject to the usual terms and conditions applied by banks to an investment grade company. The Company is in compliance with its credit agreement covenants as of June 30, 2004 and expects to be compliant in future periods.

(6) The Company has entered into interest rate and currency swaps to manage interest rate and foreign currency risk. A summary of these instruments

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

outstanding at June 30, 2004 follows (currency in millions):

| Hedge Type                            | Notional Amount | Interest Receive | Interest Pay | rates | Floating interest Rate basis |
|---------------------------------------|-----------------|------------------|--------------|-------|------------------------------|
| -----                                 | -----           | -----            | -----        | ----- | -----                        |
| Interest Rate Swaps (a)               |                 |                  |              |       |                              |
|                                       | (Millions)      |                  |              |       |                              |
| Fixed to floating Fair value          | \$139           | 7.0%             | 3.6%         |       | 6 month LIBOR+1.7%           |
| Fixed to floating Fair value          | \$100           | 6.5%             | 4.3%         |       | 6 month LIBOR+2.4%           |
| Fixed to floating Fair Value          | \$ 75           | 8.0%             | 4.5%         |       | 6 month LIBOR+2.6%           |
| Cross Currency Swap (matures in 2006) |                 |                  |              |       |                              |
| Floating \$ Investment                | \$125           | 3.3%             | -            |       | 6 mo. USD LIBOR+1.4%         |
| To floating Yen Yen                   | 14,930          | -                | 1.7%         |       | 6 mo. JPY LIBOR+1.7%         |

a) The maturity of the swaps corresponds with the maturity of the hedged item as noted in the debt summary, unless otherwise indicated.

The ineffective portion of the swaps was not material. As of June 30, 2004 and December 31, 2003, the fair value of the fixed to floating interest rate swaps was \$0.6 and \$11.5 million, respectively. The cross currency swaps were recorded at their fair value of \$(12.2) and \$(13.6) million at June 30, 2004 and December 31, 2003, respectively. Fair value is based on quoted market prices for contracts with similar maturities.

The Company also entered into certain commodity derivative instruments to protect against commodity price changes related to forecasted raw material and supplies purchases. The primary purpose of the commodity price hedging activities is to manage the volatility associated with these forecasted purchases. The Company primarily utilizes forward and option contracts, which are designated as cash flow hedges. These instruments are intended to offset the effect of changes in commodity prices on forecasted purchases. As of June 30, 2004 the Company had forward and option commodity contracts with a notional value of \$1.9 million and an immaterial unfavorable fair value. At December 31, 2003, the Company had forward and option commodity contracts with a total notional value of \$1.1 million and a fair value of \$0.1 million. During the six months ended June 30, 2004 and 2003, hedge ineffectiveness of these contracts was not material.

The Company uses foreign exchange forward contracts to hedge forecasted future purchases of materials consumed in the production process, and the receivables related to forecasted sales through the second quarter of 2009, and are designated as cash flow hedges. Foreign currency contracts require the Company, at a future date, to either buy or sell foreign currency in exchange for primarily U.S. Dollars, Euro, Japanese Yen and British Pounds Sterling. Contracts outstanding as of June 30, 2004 will mature over the next 3 years and had net sales contract notional amounts of \$14.3 million and 68.8 million and fair value of \$4.1 million, which is deferred in other comprehensive income and will be reclassified and matched into income as the underlying operating transactions are realized. Contracts outstanding as of December 31, 2003 had contract notional amounts of \$21.9 million and 3.0 million and a fair value of \$1.1 million.

(7) The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency (EPA) and certain state environmental agencies and private parties as potentially responsible parties (PRPs) at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 41 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

Based on the information available to the Company, which in most cases, includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation costs; remediation alternatives; estimated legal fees; and other factors, the Company has established a reserve for indicated environmental liabilities with a balance at June 30, 2004 of approximately \$20.4 million. The Company expects this amount to be expended over the next three to five years.

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

In connection with the sale of Kuhlman Electric Corporation, the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities relating to the past operations of Kuhlman Electric. During 2000, Kuhlman Electric notified the Company that it discovered potential environmental contamination at its Crystal Springs, Mississippi plant while undertaking an expansion of the plant.

The Company has been working with the Mississippi Department of Environmental Quality, the EPA and Kuhlman Electric to investigate the extent of and remediate the contamination. The investigation revealed the presence of Polychlorinated Biphenyls (PCBs) in portions of the soil at the plant and neighboring areas. Clean up began in 2000 and is continuing. Kuhlman Electric and others, including the Company, have been sued in numerous related lawsuits, which claim personal injury and property damage. The first of these lawsuits is scheduled to go to trial in August 2004.

The Company believes that the reserve for environmental liabilities and any insurance recoveries are adequate to cover any potential liability associated with environmental matters. However, due to the nature of environmental remediation, there can be no assurance that the actual amount of environmental liabilities will not exceed the amount reserved.

The Company has guaranteed the residual values of certain leased machinery and equipment at one of its facilities. The guarantees extend through the maturity of the underlying lease, which is in 2005. In the event the Company exercises its option not to purchase the machinery and equipment, the Company has guaranteed a residual value of \$16.3 million. The Company does not believe it has any loss exposure due to this guarantee.

The Company entered into two separate royalty agreements with Honeywell International for certain variable turbine geometry (VTG) turbochargers in order to continue shipping to its OEM customers after a German court ruled in favor of Honeywell in a patent infringement action. The two separate royalty agreements were signed in July 2002 and June 2003, respectively. The July 2002 agreement was effective immediately and expired in June 2003. The June 2003 agreement was effective July 2003 and runs through 2006 and calls for a minimum royalty to be paid over stated volume levels, meaning the royalty will increase for any units sold above the stated amounts in the royalty agreement.

The royalty costs recognized under the agreements were \$5.8 million in the second quarter 2003 and \$4.9 million in the second quarter 2004. These costs were all recognized as part of cost of goods sold. These costs will continue to decrease in 2004 and be at minimal levels in 2005 and 2006 as the Company's

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

primary customers have converted most of their requirements to the next generation VTG turbocharger.

The Company provides warranties on some of its products. The warranty terms are typically from one to three years. Provisions for estimated expenses related to product warranty are made at the time products are sold. These estimates are established using historical information about the nature, frequency, and average cost of warranty claims. Management actively studies trends of warranty claims and takes action to improve vehicle quality and minimize warranty claims. Management believes that the warranty reserve is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the reserve. The reserve is represented in both long-term and short-term liabilities on the balance sheet.

Below is a table that shows the activity in the warranty accrual accounts (in millions):

| For the six months ended June 30, | 2004    |
|-----------------------------------|---------|
| Beginning balance                 | \$ 28.7 |
| Provisions                        | 3.9     |
| Incurred                          | (2.8)   |
| Ending balance                    | \$ 29.8 |

(8) Comprehensive income is a measurement of all changes in stockholders' equity that result from transactions and other economic events other than transactions with stockholders. For the Company, this includes foreign currency translation adjustments, changes in the minimum pension liability adjustment, market value changes in certain hedge instruments and net earnings. The amounts presented as other comprehensive income, net of related taxes, are added to net income resulting in comprehensive income.

The following summarizes the components of other comprehensive income on a pretax and after-tax basis for the periods ended June 30, (in millions)

|  | Three Months Ended |                   |           |        |                   |           |
|--|--------------------|-------------------|-----------|--------|-------------------|-----------|
|  | 2004               |                   |           | 2003   |                   |           |
|  | Pretax             | Income Tax Effect | After-tax | Pretax | Income Tax Effect | After-tax |
| Foreign currency translation adjustments | \$(15.5)           | \$1.6             | \$(13.9)  | \$50.0 | \$0.0             | \$50.0    |
| Market value change in hedge instruments | (1.6)              | 0.0               | (1.6)     | 0.0    | 0.0               | 0.0       |
| Net earnings as reported                 |                    |                   | 54.7      |        |                   | 44.8      |
| Total comprehensive income               |                    |                   | \$ 39.2   |        |                   | \$94.8    |

(in millions)

|  | Six Months Ended |                   |           |        |                   |           |
|--|------------------|-------------------|-----------|--------|-------------------|-----------|
|  | 2004             |                   |           | 2003   |                   |           |
|  | Pretax           | Income Tax Effect | After-tax | Pretax | Income Tax Effect | After-tax |
| Foreign currency translation adjustments | \$(7.5)          | \$(0.8)           | \$(8.3)   | \$47.5 | \$0.0             | \$ 47.5   |
| Market value change                      |                  |                   |           |        |                   |           |

Edgar Filing: BORGWARNER INC - Form 10-Q/A

|                            |     |     |         |     |     |         |
|----------------------------|-----|-----|---------|-----|-----|---------|
| in hedge instruments       | 4.1 | 0.0 | 4.1     | 0.0 | 0.0 | 0.0     |
| Net earnings as reported   |     |     | 105.8   |     |     | 89.0    |
| Total comprehensive income |     |     | \$101.6 |     |     | \$136.5 |

The components of accumulated other comprehensive income, net of tax, in the Condensed Consolidated Balance Sheets are as follows:

| (in millions)                                | June 30,<br>2004 | December 31,<br>2003 |
|--|------------------|----------------------|
| Foreign currency translation adjustments     | \$ 66.2          | \$ 74.5              |
| Market value change in hedge instruments     | 4.1              | 0.0                  |
| Minimum pension liability adjustment         | (56.8)           | (60.5)               |
| Total accumulated other comprehensive income | \$ 13.5          | \$ 14.0              |

(9) The following tables show net sales, earnings before interest and taxes and total assets for the Company's reportable operating segments (in millions of dollars).

|                            | Net Sales<br>Three Months Ended June 30, |                   |         |          |                   |          |
|----------------------------|--|-------------------|---------|----------|-------------------|----------|
|                            | 2004                                     |                   | 2003    |          |                   |          |
|                            | Customer                                 | Inter-<br>segment | Net     | Customer | Inter-<br>segment | Net      |
| Drivetrain                 | \$347.4                                  | \$ -              | \$347.4 | \$309.3  | \$ -              | \$ 309.3 |
| Engine                     | 545.8                                    | 13.8              | 559.6   | 460.2    | 11.4              | 471.6    |
| Inter-segment eliminations | -  | (13.8)            | (13.8)  | -        | (11.4)            | (11.4)   |
| Consolidated               | \$893.2                                  | \$ -              | \$893.2 | \$769.5  | \$ -              | \$769.5  |

|                            | Net Sales<br>Six Months Ended June 30, |                   |           |            |                   |           |
|----------------------------|--|-------------------|-----------|------------|-------------------|-----------|
|                            | 2004                                   |                   | 2003      |            |                   |           |
|                            | Customer                               | Inter-<br>segment | Net       | Customer   | Inter-<br>segment | Net       |
| Drivetrain                 | \$707.0                                | \$ -              | \$707.0   | \$631.0    | \$ -              | \$ 631.0  |
| Engine                     | 1,089.2                                | 27.5              | 1,116.7   | 914.2      | 23.2              | 937.4     |
| Inter-segment eliminations | -                                      | (27.5)            | (13.8)    | -          | (23.2)            | (23.2)    |
| Consolidated               | \$1,796.2                              | \$ -              | \$1,796.2 | \$ 1,545.2 | \$ -              | \$1,545.2 |

|  | Earnings Before<br>Interest & Taxes<br>Three Months Ended<br>June 30, |         | Earnings Before<br>Interest & Taxes<br>Six Months Ended<br>June 30, |         |
|--|---|---------|---|---------|
|  | 2004  | 2003    | 2004  | 2003    |
| Drivetrain                                   | \$ 23.8   | \$ 23.7 | \$ 54.5   | \$ 49.8 |
| Engine                                       | 75.7  | 60.5    | 143.7   | 121.2   |
| Total segments                               | 99.5  | 84.2    | 198.2   | 171.0   |
| Corporate, including<br>equity in affiliates | (9.7)   | (9.4)   | (24.4)  | (21.9)  |
| Total  | \$ 89.8   | \$ 74.8 | \$ 173.8  | \$149.1 |

Edgar Filing: BORGWARNER INC - Form 10-Q/A

|  | =====        | =====       | ===== | ===== |
|--|--------------|-------------|-------|-------|
|  | Total Assets |             |       |       |
|  | June 30,     | December 31 |       |       |
|  | 2004         | 2003        |       |       |
|  | -----        | -----       |       |       |
| Drivetrain                                       | \$ 812.8     | \$ 778.8    |       |       |
| Engine   | 2,028.4      | 1,925.1     |       |       |
|  | -----        | -----       |       |       |
| Total segments                                   | 2,841.2      | 2,703.9     |       |       |
| Corporate, including<br>investment in affiliates | 353.6        | 346.5       |       |       |
|  | -----        | -----       |       |       |
| Total  | \$3,194.8    | \$3,050.4   |       |       |
|  | =====        | =====       |       |       |

(10) The Company securitizes and sells certain receivables through third party financial institutions without recourse. The amount sold can vary each month based on the amount of underlying receivables, up to a maximum of \$50 million. During the six months ended June 30, 2004, the amount of receivables sold remained constant at \$50 million and total cash proceeds from sales of accounts receivable were \$300.0 million. For the six months ended June 30, 2004, the Company paid a servicing fee of \$0.3 million related to these receivables, which is included in interest expense and finance charges.

(11) The changes in the carrying amount of goodwill (in millions of dollars) for the six months ended June 30, 2004, are as follows:

|                              | Drivetrain | Engine  | Total   |
|------------------------------|------------|---------|---------|
|                              | -----      | -----   | -----   |
| Balance at December 31, 2003 | \$134.3    | \$717.7 | \$852.0 |
| Translation adjustment       | (0.2)      | (1.2)   | (1.4)   |
|                              | -----      | -----   | -----   |
| Balance at June 30, 2004     | \$134.1    | \$716.5 | \$850.6 |
|                              | =====      | =====   | =====   |

(12) The Company has a number of defined benefit pension plans and other postretirement benefit plans covering eligible salaried and hourly employees. The other postretirement benefits plans, which provide medical and life insurance benefits, are unfunded plans. The estimated contributions for 2004 range from \$32 to \$35 million, of which about \$32 million has been contributed in the first half of the year. The components of net periodic benefit cost recorded in the Company's Consolidated Statement of Operations, are as follows:

|   | Pension Benefits           |        | Other Postretirement Benefits |        |
|---|----------------------------|--------|-------------------------------|--------|
|   | Three months Ended June 30 |        |                               |        |
|   | 2004                       | 2003   | 2004                          | 2003   |
|   | -----                      | -----  | -----                         | -----  |
| Service cost                                    | \$ 3.2                     | \$ 2.5 | \$ 1.7                        | \$ 1.3 |
| Interest cost                                   | 8.0                        | 7.0    | 7.9                           | 7.5    |
| Expected return on plan assets                  | (7.9)                      | (6.6)  | -                             | -      |
| Amortization of unrecognized transition asset   | 0.1                        | 0.1    | -                             | -      |
| Amortization of unrecognized Prior service cost | 0.3                        | 0.3    | -                             | -      |
| Amortization of unrecognized loss               | 2.1                        | 2.4    | 2.9                           | 1.5    |
|   | -----                      | -----  | -----                         | -----  |
| Net periodic benefit cost                       | \$ 5.8                     | \$ 5.7 | \$12.5                        | \$10.3 |
|   | =====                      | =====  | =====                         | =====  |

Edgar Filing: BORGWARNER INC - Form 10-Q/A

|  | Pension<br>Benefits<br>Six months<br>2004 | Other<br>Postretirement<br>Benefits<br>Ended June 30<br>2003 | 2004   | 2003   |
|--|---|--|--------|--------|
|  | -----                                     | -----  | -----  | -----  |
| Service cost                                       | \$ 6.5                                    | \$ 5.0   | \$ 3.4 | \$ 2.6 |
| Interest cost                                      | 16.1                                      | 14.0   | 15.8   | 14.9   |
| Expected return on plan assets                     | (15.8)                                    | (13.2)   | -      | -      |
| Amortization of unrecognized<br>transition asset   | 0.2                                       | 0.2  | -      | -      |
| Amortization of unrecognized<br>Prior service cost | 0.7                                       | 0.7  | -      | -      |
| Amortization of unrecognized loss                  | 4.2                                       | 4.8  | 5.8    | 3.0    |
|  | -----                                     | -----  | -----  | -----  |
| Net periodic benefit cost                          | \$11.9                                    | \$ 11.5  | \$25.0 | \$20.5 |
|  | =====                                     | =====  | =====  | =====  |

(13) In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which was revised in December 2003. FIN No. 46 requires that the assets, liabilities and results of the activity of variable interest entities be consolidated into the financial statements of the entity that has the controlling financial interest. FIN No. 46 also provides the framework for determining whether a variable interest entity should be consolidated based on voting interest or significant financial support provided to it. For the Company, this Interpretation, as revised, was effective January 1, 2004. The Company has no variable interest entities required to be consolidated as a result of adopting FIN No. 46, therefore, there was no impact on our Consolidated Financial Statements.

In December 2003, the FASB issued a revised Statement of Financial Accounting Standards, (SFAS) No. 132, "Employer's Disclosures About Pensions and Other Postretirement Benefits." SFAS No. 132 changes employers' disclosures about pension plans and other postretirement benefits and requires additional disclosures about assets, obligations, cash flows and net periodic benefit cost. The Statement is effective for annual and interim periods ended after December 15, 2003. The Company adopted SFAS No. 132 as of December 31, 2003, resulting in additional disclosures in the Company's annual and interim Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation ("FIN") No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others", which expands previously issued accounting guidance and disclosure requirements for certain guarantees. FIN No. 45 requires the Company to recognize an initial liability for fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN No. 45 on January 1, 2003 did not have any impact on the Company's financial position, operating results or liquidity and resulted in additional disclosures in the Company's Consolidated Financial Statements.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was enacted in the United States. The Act provides, among other things, expanded existing Medicare healthcare benefits to include an outpatient prescription drug benefit to Medicare eligible residents of the U.S. (Medicare Part D) beginning in 2006. Prescription drug coverage will be available to eligible individuals who enroll under the Part D plan. As an alternative, employers may provide drug coverage at least "actuarially

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

equivalent to standard coverage" and receive-free federal subsidy equal to 28% of a portion of a Medicare beneficiary's drug costs for covered retirees who do not enroll in a Part D plan.

In May 2004, the FASB issued Staff Position FAS No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," to provide guidance on accounting for effects of the Act. The Staff Position requires treating the effect of the employer subsidy on the accumulated post retirement benefit obligation (APBO) as an actuarial gain. The effect of the subsidy is to be reflected in the estimate of service cost in measuring the cost of benefits attributable to current service. The effects of plan amendments adopted subsequent to the Act to qualify plans as actuarially equivalent are to be treated as actuarial gains if the effect of the amendments reduces the APBO. The net effect on the APBO of any plan amendments that (a) reduce benefits under the plan and thus disqualify the benefits as actuarially equivalent and (b) eliminate the subsidy are to be accounted for as prior service cost.

The Company has deferred accounting for the effects of the Act pending an assessment of the provisions of the Act on the Company's U.S.- based postretirement healthcare plans; accordingly, the measures of the APBO and expense recognized for the three months ended June 30, 2004 do not reflect any amount associated with the subsidy. The Staff Position is effective for fiscal periods beginning after June 15, 2004. The Company will record the effects of the Act on the Company's U.S. based plans during the third quarter 2004.

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

#### INTRODUCTION

BorgWarner Inc. and Consolidated Subsidiaries (the "Company") is a leading global supplier of highly engineered systems and components for vehicle powertrain applications. Our products help improve vehicle performance, fuel efficiency, handling, and air quality. They are manufactured and sold worldwide, primarily to original equipment manufacturers (OEMs) of passenger cars, sport utility vehicles, trucks, and commercial transportation products. The Company operates manufacturing facilities serving customers in the Americas, Europe and Asia, and is an original equipment supplier to every major OEM in the world.

#### RESULTS OF OPERATIONS

The Company's products fall into two reportable operating segments: Drivetrain and Engine. The following tables present net sales and earnings before interest and taxes (EBIT) by segment for the three and six months ended June 30, 2004 and 2003 in millions of dollars.

| Net Sales                     | Three Months |          | Six Months |            |
|-------------------------------|--------------|----------|------------|------------|
|                               | June 30,     |          | June 30,   |            |
|                               | 2004         | 2003     | 2004       | 2003       |
|                               | -----        | -----    | -----      | -----      |
| Drivetrain                    | \$ 347.4     | \$ 309.3 | \$ 707.0   | \$ 631.0   |
| Engine                        | 559.6        | 471.6    | 1,116.7    | 937.4      |
| Inter-segment<br>eliminations | (13.8)       | (11.4)   | (27.5)     | (23.2)     |
|                               | -----        | -----    | -----      | -----      |
| Net sales                     | \$ 893.2     | \$ 769.5 | \$1,796.2  | \$ 1,545.2 |
|                               | =====        | =====    | =====      | =====      |
| EBIT                          | Three Months |          | Six Months |            |
|                               | June 30,     |          | June 30,   |            |
|                               | 2004         | 2003     | 2004       | 2003       |



## Edgar Filing: BORGWARNER INC - Form 10-Q/A

|              |       |       |       |       |       |       |       |       |
|--------------|-------|-------|-------|-------|-------|-------|-------|-------|
|              | ----- |       | ----- |       | ----- |       | ----- |       |
| Drivetrain   | \$    | 23.8  | \$    | 23.7  | \$    | 54.5  | \$    | 49.8  |
| Engine       |       | 75.7  |       | 60.5  |       | 143.7 |       | 121.2 |
|              |       | ----- |       | ----- |       | ----- |       | ----- |
| Segment EBIT | \$    | 99.5  | \$    | 84.2  | \$    | 198.2 | \$    | 171.0 |
|              |       | ===== |       | ===== |       | ===== |       | ===== |

Consolidated sales for the second quarter ended June 30, 2004 totaled \$893.2 million, a 16.1% increase over the second quarter of 2003. This increase occurred in a market where production was up slightly from the previous year's quarter. Production in North America and Europe was up approximately 1% and 3% respectively. Sales increased \$19.1 million due to stronger currencies, primarily in Europe. Turbochargers and automatic transmissions are the products most affected by currency fluctuations in Europe, Asia, and the Americas. Without the currency impact, the increase in sales would have been 13.6%.

For the 2004 second quarter, the company reported net income of \$54.7 million compared with \$44.8 million from the prior year's second quarter, a 22.1% increase. The increase in income was due primarily from the profits on the increased sales.

The Drivetrain business' sales increased 12.3% and EBIT increased \$0.1 million, or 0.4% from 2003. The strong sales gain was a result of four-wheel drive transfer case programs with General Motors and Ford, increased sales of the Company's Interactive Torque Management (TM) all-wheel drive systems to Honda and Hyundai, and steady demand for transmission components and systems, especially with increased automatic transmission penetration in Europe. The EBIT flatness was due to higher commodity prices including steel and rising health care costs.

The Engine business' second quarter 2004 sales and EBIT increased 18.7% and 25.1% from second quarter 2003, respectively. This group benefited from continued demand for the Company's turbochargers for European passenger cars and commercial vehicles. Sales of timing chains increased as well, particularly to our Asian customers. The EBIT increase was due primarily to the increase in sales and improved productivity on the higher sales level.

Consolidated gross margin for the second quarter of 2004 was 19.0%, compared to the 2003 margin of 19.1%. Gross margin was relatively flat. Higher material prices for commodities, particularly steel, aluminum and copper and health care costs were offset by cost reductions in our operations.

For the second quarter selling, general and administrative (SG&A) costs increased \$10.8 million, but decreased as a percentage of sales from 10.0% to 9.8% of sales. The increase in dollars was due to additional administration needed to support the growth of the Company's various businesses. Spending on research and development (R&D), which is included in SG&A, totaled \$30.8 million, or 3.4% of sales versus \$28.9 million, or 3.8% of sales for the second quarter of 2003.

Second quarter interest expense decreased \$1.0 million from second quarter 2003 as a result of reduced debt levels which more than offset interest rate increases during the quarter. At June 30, 2004, the amount of net debt with fixed interest rates was 51% of total net debt. Equity in affiliate earnings, which consist primarily of the Company's 50% share of NSK-Warner in Japan, was up \$3.2 million. NSK-Warner realized both strong sales and profits in the second quarter from its operations.

The Company's provision for income taxes is based on estimated annual tax rates for the year applied to federal, state and foreign income. The effective rate for 2004 differed from the U.S. statutory rate primarily due to a) state income taxes, b) foreign rates which differ from those in the U.S. and c)

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

realization of certain business tax credits, including foreign tax credits and research and development credits. The Company expects its effective tax rate for 2004 to be approximately 30.0%. This is a slight increase over last year due to changes in tax laws in some of the countries where the Company does business.

Net income was \$54.7 million for the second quarter, or \$0.97 per diluted share, an increase of \$0.14 over the previous year's second quarter. The increase from prior years second quarter was due to operations \$0.15 per share, favorable currency of \$0.03 per share offset by a share dilution impact of \$(0.04) per share. Shares outstanding increased due to the exercise of options and contributions to benefit plans.

For the remainder of 2004, the trends that are driving our growth are expected to continue in the second half of the year. These trends include the growth of diesel engines in Europe, the popularity of cross-over vehicles in North America and the move to chain engine timing systems in both Europe and Asia. The Company maintains a positive long-term outlook for its business and is committed to ongoing strategic investments in capital and new product development to enhance its product leadership strategy.

### FINANCIAL CONDITION AND LIQUIDITY

Net cash provided by operating activities increased from \$155.3 million in 2003 to \$221.5 million in 2004. The main factors were an increase in net income and improved working capital management. The Company made a scheduled royalty payment of \$14.2 million in the first quarter of 2004. Dividend receipts, net of withheld taxes from non-consolidated affiliates were \$14.0 million in the first six months of 2004 compared to \$3.3 million for the first six months of 2003.

Capital spending for the six months was \$84.2 million compared with \$64.8 million last year. Careful capital spending remains an area of focus for the Company, both in order to support new business and for cost reductions and productivity improvements. The Company expects to spend \$180 million - \$190 million on capital in 2004, but this expectation is subject to ongoing review based on market conditions.

As of June 30, 2004, debt decreased from year-end 2003 by \$72.6 million, while cash and cash equivalents increased by \$30.9 million. The debt reduction includes \$58.8 million in principal payments, \$11.0 million reduction in the value of our interest rate swaps and \$2.8 million in foreign exchange translation adjustments. The Company paid dividends of \$7.0 million and \$4.8 million in the second quarter of 2004 and 2003, respectively.

As of June 30, 2004 and December 31, 2003, the Company had sold \$50.0 million of receivables under a Receivables Transfer Agreement for face value without recourse.

From a credit quality perspective, we have an investment grade credit rating of A- from Standard & Poor's and Baa2 from Moody's. The Standard & Poor's rating was upgraded from BBB+ to A- on May 5, 2004. Moody's confirmed their rating on April 22, 2004 and raised their outlook from stable to positive.

Effective July 22, 2004 the Company established a new credit facility that provides for borrowings up to \$600 million through July 2009. The new credit facility replaced the Company's existing \$350 million facility.

The Company believes that the combination of cash from operations and available credit facilities will be sufficient to satisfy its cash needs for the current level of operations and planned operations for the remainder of 2004.

### OTHER MATTERS

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

### Litigation

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency (EPA) and certain state environmental agencies and private parties as potentially responsible parties (PRPs) at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 41 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

Based on the information available to the Company, which in most cases, includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation costs; remediation alternatives; estimated legal fees; and other factors, the Company has established a reserve for indicated environmental liabilities with a balance at June 30, 2004 of approximately \$20.4 million. The Company expects this amount to be expended over the next three to five years.

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

In connection with the sale of Kuhlman Electric Corporation, the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities relating to the past operations of Kuhlman Electric. During 2000, Kuhlman Electric notified the Company that it discovered potential environmental contamination at its Crystal Springs, Mississippi plant while undertaking an expansion of the plant.

The Company has been working with the Mississippi Department of Environmental Quality, the EPA and Kuhlman Electric to investigate the extent of and remediate the contamination. The investigation revealed the presence of Polychlorinated Biphenyls (PCBs) in portions of the soil at the plant and neighboring areas. Clean up began in 2000 and is continuing. Kuhlman Electric and others, including the Company, have been sued in numerous related lawsuits, which claim personal injury and property damage. The first trial in these lawsuits is scheduled to go to trial in August 2004.

The Company believes that the reserve for environmental liabilities and any insurance recoveries are adequate to cover any potential liability associated with environmental matters. However, due to the nature of environmental remediation, there can be no assurance that the actual amount of environmental liabilities will not exceed the amount reserved.

### Stock Split/Dividends

On April 21, 2004, the Company's stockholders approved an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares of common stock from 50,000,000 to 150,000,000. The approval of the amendment allowed the Company to proceed with its previously announced 2-for-1 stock split on May 17, 2004 to stockholders of record on May 3, 2004.

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

On July 21, 2004, the Company declared a \$0.125 per share dividend to be paid on August 16, 2004 to stockholders of record as of August 2, 2004.

### New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51", which was revised in December 2003. FIN No. 46 requires that the assets, liabilities and results of the activity of variable interest entities be consolidated into the financial statements of the entity that has the controlling financial interest. FIN No. 46 also provides the framework for determining whether a variable interest entity should be consolidated based on voting interest or significant financial support provided to it. For the Company, this Interpretation, as revised, was effective January 1, 2004. The Company has no variable interest entities required to be consolidated as a result of adopting FIN No. 46, therefore, there was no impact on our Consolidated Financial Statements.

In December 2003, the FASB issued a revised Statement of Financial Accounting Standards, (SFAS) No. 132, "Employer's Disclosures About Pensions and Other Postretirement Benefits." SFAS No. 132 changes employers' disclosures about pension plans and other postretirement benefits and requires additional disclosures about assets, obligations, cash flows and net periodic benefit cost. The Statement is effective for annual and interim periods ended after December 15, 2003. The Company adopted SFAS No. 132 as of December 31, 2003, resulting in additional disclosures in the Company's annual and interim Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation ("FIN") No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others", which expands previously issued accounting guidance and disclosure requirements for certain guarantees. FIN No. 45 requires the Company to recognize an initial liability for fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN No. 45 on January 1, 2003 did not have any impact on the Company's financial position, operating results or liquidity and resulted in additional disclosures in the Company's Consolidated Financial Statements.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was enacted in the United States. The Act provides, among other things, expanded existing Medicare healthcare benefits to include an outpatient prescription drug benefit to Medicare eligible residents of the U.S. (Medicare Part D) beginning in 2006. Prescription drug coverage will be available to eligible individuals who enroll under the Part D plan. As an alternative, employers may provide drug coverage at least "actuarially equivalent to standard coverage" and receive-free federal subsidy equal to 28% of a portion of a Medicare beneficiary's drug costs for covered retirees who do not enroll in a Part D plan.

In May 2004, the FASB issued Staff Position FAS No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," to provide guidance on accounting for effects of the Act. The Staff Position requires treating the effect of the employer subsidy on the accumulated post retirement benefit obligation (APBO) as an actuarial gain. The effect of the subsidy is to be reflected in the estimate of service cost in measuring the cost of benefits attributable to current service. The effects of plan amendments adopted subsequent to the Act to qualify plans as actuarially equivalent are to be treated as actuarial gains if the effect of the amendments reduces the APBO. The net effect on the APBO of any plan amendments

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

that (a) reduce benefits under the plan and thus disqualify the benefits as actuarially equivalent and (b) eliminate the subsidy are to be accounted for as prior service cost.

The Company has deferred accounting for the effects of the Act pending an assessment of the provisions of the Act on the Company's U.S.- based postretirement healthcare plans; accordingly, the measures of the APBO and expense recognized for the three months ended June 30, 2004 do not reflect any amount associated with the subsidy. The Staff Position is effective for fiscal periods beginning after June 15, 2004. The Company will record the effects of the Act on the Company's U.S. based plans during the third quarter 2004.

### DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

Statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations may contain forward-looking statements as contemplated by the 1995 Private Securities Litigation Reform Act that are based on management's current expectations, estimates and projections. Words such as "expects," "anticipates," "intends," "plans," "believes," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. Forward-looking statements are subject to risks and uncertainties, which could cause actual results to differ materially from those projected or implied in the forward-looking statements. Such risks and uncertainties include: fluctuations in domestic or foreign vehicle production, the continued use of outside suppliers, fluctuations in demand for vehicles containing the Company's products, general economic conditions, as well as other risks detailed in the Company's filings with the Securities and Exchange Commission, including the Cautionary Statements filed as Exhibit 99.1 to the Form 10-K for the fiscal year ended December 31, 2003.

### Item 3. Quantitative and Qualitative Disclosure About Market Risks

There have been no material changes to our exposures to market risk since December 31, 2003.

### Item 4. Controls and Procedures

The Company's management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that information required to be disclosed in reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There have been no changes in internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are likely to materially affect our internal controls over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The Company is party to various judicial and administrative proceedings which are considered to be routine and incidental to its business including those described in the MD&A under Other Matters Litigation. Management does not believe that the results of any of these proceedings are likely to have a material adverse effect on the Company's liquidity, financial condition or results of operations.

Like many other industrial companies, the Company continues to be named as one

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

of the defendants in asbestos-related personal injury actions. Management believes that the Company's involvement is limited to claims that relate to a few types of automotive friction products, manufactured many years ago, that contained encapsulated asbestos. The Company aggressively defends against these lawsuits and has been successful in obtaining dismissal of many cases without any payment whatsoever, or in many cases, for nominal or minimal settlement payments. The Company has significant insurance coverage with solvent carriers and, to date, has not incurred any out-of-pocket costs other than immaterial administration expenses, in connection with these lawsuits or any settlements thereof.

A declaratory judgment action was filed in January 2004 in the Circuit Court of Cook County, Illinois by Continental Casualty Company and related companies ("CNA") against the Company and certain of its other historical general liability insurers. CNA provided the Company with primary and excess insurance, and, in conjunction with another primary insurer, is currently defending and indemnifying the Company in all of its pending asbestos-related claims. The lawsuit seeks to determine the extent of insurance coverage available to the Company including whether the available limits exhaust on a "per occurrence" or an aggregate basis, and to determine how the applicable coverage responsibilities should be apportioned. In addition to the primary insurance available for these claims, the Company has substantial historical excess and umbrella insurance available for any anticipated asbestos-related liabilities. Separately, the Company is in the process of negotiating a cost sharing agreement among the first layer of excess insurers.

Although it is impossible to predict the outcome of pending or future claims, in light of the nature of the products, our experience in defending and resolving claims in the past, our insurance coverage and existing reserves, management does not believe that asbestos-related claims will have a material adverse effect on the Company's liquidity, financial condition or results of operations.

### Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

Between May 20, 2004 and July 2, 2004, the Company issued an aggregate of 37,804 shares of common stock to employees who participated in the BorgWarner Diversified Transmission Products Inc., Muncie Plant Local 287 Retirement Investment Plan. Employees purchased the shares either through payroll deductions or through intra-plan transfers into the company stock fund. The aggregate amount of such purchases was approximately \$1.5 million.

These issuances were not registered under the Securities Act of 1933, as amended, due to an inadvertent failure to timely file a new registration statement on Form S-8. The Company experienced an unforeseen dramatic increase in purchases of the Company's common stock by employees through their benefit plans after the Company completed a stock split in May 2004. The Company immediately began the process of filing a new registration statement on Form S-8 (filed with the SEC on July 6, 2004) to register an additional 150,000 shares of the Company's common stock, with the purpose and effect of ensuring that future issuances would be registered. The Company believes that the aggregate amount of any contingent claims for rescission or damages would not be material to its financial condition.

### Item 4. Submission of Matter to a Vote of Security Holders

On April 21, 2004, the Company held its annual meeting of stockholders. At such meeting Jere A. Drummond, Timothy M. Manganello, and Ernest J. Novak, Jr. were elected as directors to serve for a term expiring in 2007. Each of William E. Butler, Paul E. Glaske, Phyllis O. Bonanno, Andrew F. Brimmer, Alexis P. Michas,

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

and John Rau continued to serve as directors following the meeting. At such meeting, the following votes were cast in the election of directors:

|                       | For<br>----- | Withheld<br>----- |
|-----------------------|--------------|-------------------|
| Jere A. Drummond      | 22,633,176   | 529,170           |
| Timothy M. Manganello | 22,333,337   | 829,009           |
| Ernest J. Novak, Jr.  | 22,567,029   | 595,317           |

At the annual meeting, stockholders also approved of the adoption of the BorgWarner Inc. 2004 Stock Incentive Plan (the "Plan"). The following votes were cast on the proposal to approve of the 2004 Plan:

| For        | Against   | Abstain | Not-Voted |
|------------|-----------|---------|-----------|
| 18,263,597 | 2,333,402 | 130,527 | 2,434,820 |

At the annual meeting, stockholders approved of an amendment to the Company's Restated Certificate of Incorporation to increase the authorized shares of common stock from 50,000,000 shares to 150,000,000 shares. The following votes were cast on the proposal to amend the Restated Certificate of Incorporation:

| For        | Against   | Abstain | Not-Voted |
|------------|-----------|---------|-----------|
| 15,718,223 | 7,347,002 | 97,121  | 0         |

At such meeting, the selection of Deloitte & Touche LLP as independent auditors was approved by the following votes:

| For        | Against | Abstain | Not-Voted |
|------------|---------|---------|-----------|
| 22,364,395 | 776,638 | 21,313  | 0         |

### Item 6. Exhibits and Reports on Form 8-K

#### (a) Exhibits

- Exhibit 3.1      Amendment to Restated Certificate of Incorporation
- Exhibit 10.1     BorgWarner Inc. 2004 Stock Incentive Plan (incorporated by reference to Appendix B of the Company's Proxy Statement dated March 22, 2004 for its 2004 Annual Meeting of Stockholders)
- Exhibit 10.2     Ninth Amendment dated as of February 17, 2004 to Amended and Restated Receivables Loan Agreement dated as of December 23, 1998
- Exhibit 31.1     Rule 13a-14(a)/15d-14(a) Certification by Chief Executive Officer
- Exhibit 31.2     Rule 13a-14(a)/15d-14(a) Certification by Chief Financial Officer
- Exhibit 32        Section 1350 Certifications

#### (b) Reports on Form 8-K

On April 5, 2004, the Company filed a report on Form 8-K, attaching a copy of a press release announcing the appointment of Robin J. Adams to the position of Executive Vice President, Chief Financial Officer and Chief Administration Officer.

## Edgar Filing: BORGWARNER INC - Form 10-Q/A

On April 7, 2004, the Company filed a report on Form 8-K announcing that, in connection with Proposal 2 of the Company's 2004 proxy statement, management decided to recommend to the Board of Directors that the number of shares authorized to be granted as awards other than stock options and SARs under the BorgWarner Inc. 2004 Stock Incentive Plan be limited to 400,000 shares.

On April 8, 2004, the Company filed a report on Form 8-K, furnishing a copy of a news release relating to earnings expectations for the first quarter of 2004 and full year 2004.

On April 22, 2004, the Company filed a report on Form 8-K, furnishing a copy of a news release relating to its earnings for the first quarter of 2004.

On April 22, 2004, the Company filed a report on Form 8-K, attaching a copy of a press release announcing that the stockholders of the Company had approved an increase in the number of shares of authorized common stock allowing for a two-for-one stock split and that the Board had declared a quarterly dividend of \$0.125 per share post-split payable on May 17, 2004 to shareholders of record on May 3, 2004.

On April 22, 2004 the Company filed a report on Form 8-K furnishing a copy of a news release relating to it's earnings for the first quarter of 2004.

### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

BORGWARNER INC.  
(Registrant)

By: /s/ William C. Cline  
WILLIAM C. CLINE  
Vice President and Controller  
(Principal Accounting Officer)

Date: August 11, 2004