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April 11, 2011

Stock Rating
Overweight

Industry View
Attractive

Navistar International

Upgrading to Overweight, Lower Risk, Attractive Value

What's Changed

Rating	Equal-weight to Overweight
Price Target	\$61.00 to \$89.00

Investment conclusion: Navistar becomes our top pick, after extensive work that suggests 1) the company's 2010 engines are performing well, and may in fact end up being the better technology path and 2) downside risk that the engines will struggle is much lower than perceived, as the company's Pure Power/Amminex solution looks very viable as an alternate emissions path. Despite the stock's outperformance we see uncertainty and opportunity in the shares; the EPS estimate spread on Navistar is the widest across machinery stocks, and the earnings multiple is the lowest.

Bull case more likely: Navistar's EGR emissions technology is working, and may work at previously hard to believe 0.2 NOx levels: Fleets tell us Navistar's EGR-only 2010 engine is getting better fuel economy than expected, and its trucks may match SCR driven trucks on overall economy, a positive surprise. Navistar argues its engines are running cool/well even at the tougher 0.2 NOx hurdle; most folks believe the company can't sustainably get emissions that low.

Bear case less likely; little risk of switching to an outside engine supplier or to liquid SCR, and much lower risk of damaged engines/residuals hurting NAV in the future: Navistar showed a disassembled 2010 engine with 400k miles and very little wear; we've heard similar reports of low wear from fleets. We worried about engine recalibration issues, but fleets we spoke with agree with NAV's view the issues are minor. Amminex is a near term emissions option that works. And the finance sub is shrinking, we now think investor concern about residual value guarantees are too extreme; if the engine works, there's no issue, and we don't think there are any material guarantees anyway.

Key Ratios and Statistics

Reuters: NAV.N Bloomberg: NAV US

Machinery / United States of America

Price target	\$89.00
Shr price, close (Apr 8, 2011)	\$66.63
Mkt cap, curr (mm)	\$5,049
52-Week Range	\$70.79-40.59

Fiscal Year ending	10/10	10/11e	10/12e	10/13e
ModelWare EPS (\$)	3.18	5.66	8.05	8.17
Prior ModelWare EPS (\$)	-	5.51	7.68	7.51
P/E	15.1	11.8	8.3	8.2
Consensus EPS (\$) §	3.19	5.33	7.37	9.17
Div yld (%)	0.0	0.0	0.0	0.0

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

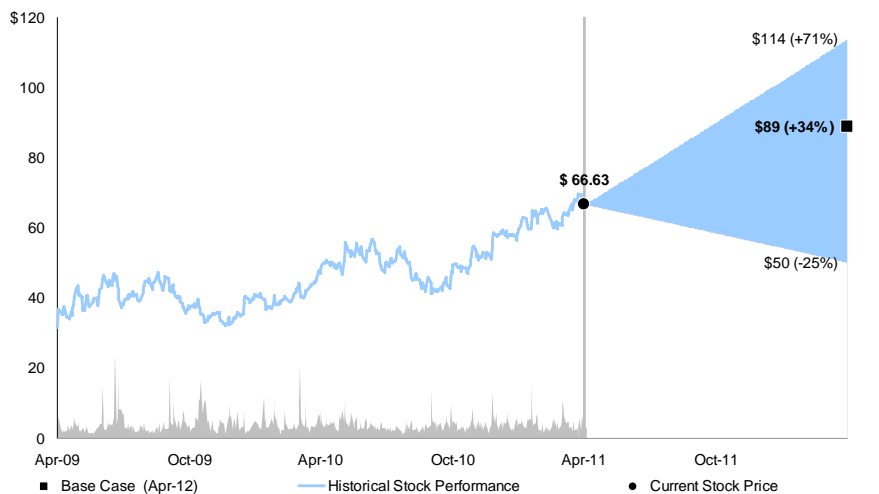
e = Morgan Stanley Research estimates

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Risk-Reward Snapshot: Navistar International (NAV, \$89 PT, OW)

Risk-Reward View: EGR Performance Driving Improved Risk Profile



Source: Company data, Morgan Stanley Research

Our principal valuation methods are forward P/E, P/E relative to the S&P 500, FCF yield, and DCF analysis. Our \$89 price target is based on 11x 2012e EPS of \$8.00. The 11x multiple is approximately in-line with the historical average.

Bull Case \$114	10x Bull Case '12e EPS of \$11.38	NAV gains share in N.A. class 8 market on shift to 13L and preference for EGR/ASDS technology approach to emissions. N.A. cl. 8 share increases to 27-28% range. Medium duty 2012 N.A. unit sales slightly exceed prior peak on medium duty more depressed than class 8 during the recent downturn, and NAV leads market with 35% share. Engine sales ~\$2.5B driven by continued strength in S. America. Truck margins at 7.0%, Engines at 5.5% and Parts at 16.5%.
Base Case \$89	11x Base Case '12e EPS of \$8.05	NAV N.A. Class 8 market share 24-25%, in line with average over last 3 years. 2012 N.A. Class 8 industry sales of 320k units, ~50k units below 2006 peak and in-line with 2005 sales. Medium duty 2012 N.A. unit sales slightly below 2005/2006 levels; NAV share at historical average. Solid Engine unit sales on S. America demand and new customer wins. Truck margins at 6%, Engines at 3.2% and Parts at 15.5%.
Bear Case \$50	11x Bear Case '12e EPS of \$4.59	Tepid N.A. Class 8 recovery peaks at 275k units in 2012. Conversion of 15L to 13L lags expectations and industry widely accepts urea SCR. NAV Class 8 share settles at 20%, below goal of 25%+, but partially supported by NAV investments in solid-state SCR technology. Medium duty share drops to 30% from 36-37% average last three years on preference for competitor engine technology. Engine sales drop on volume declines in S. America. Segment margins depressed on low volumes. Military business slows to \$500M revs in 2012 on low volumes with no program wins and weak parts revs after prior replacement cycle.

Investment Debates

- Structural mix shift from 15L to 13L
- Success of advanced EGR vs SCR
- Sustainability of \$2.0B in annual military revenues
- Profitability in international truck markets

Competitive Advantage

- Leading market share in medium-duty trucks
- Strong engine presence in South America and export markets
- Growth opportunities from new products such as class 4/5 trucks and E-star All-Electric vehicle

Potential Catalysts

- Market share gains throughout 2011
- 13L certification at 0.2 NOx
- Demand for Amminex solid-state SCR technology

Risks

- Loss of truck market share on delayed ramp up in 15L production
- Supply chain bottlenecks on ramp-up of N. America Class 8 demand
- High legacy costs
- SCR with urea is the predominant preference for emissions requirements – other solutions not accepted
- Difficult to sustain military revenues in the ~\$2B range

We See Significant Risk/Reward Improvements

Navistar’s decision to pursue an EGR only emissions path (exhaust gas recirculation) versus the rest of the industry moving to SCR (selective catalytic reduction) has weighed on the stock for years. Despite recent outperformance, the shares trade at the lowest multiple in our coverage, ~9x 2012 estimates vs our machinery group at 13.8x.

NAV management is focused on putting the EGR debate in the past, but the market is not there yet, in our view, as reflected in NAV’s depressed multiple vs comps. We think the risk profile on EGR is vastly diminished vs 6-12 months ago. Fleets that purchased 2010 13L engines early on have reached ~250k miles and performance has exceeded expectations. We hear there are engines out there with ~500k miles that continue to perform well. Overall, engines are now reaching high enough mileage levels to gain greater confidence in performance feedback, which is largely much more positive than anticipated.

Emissions credits remain a well-guarded secret, but shouldn’t create any near-term risks for NAV. Mgmt believes that NAV has sufficient emissions credits to meet mandates until a 0.2 g/bhp-hr NOx solution is fully available. To the extent that NAV’s 2010 emissions standards engines emit less than 0.5 NOx, the pace of credit use would decline. NAV has also announced the submission of its 13L engine for EPA certification at 0.2 NOx.

Fuel efficiency is exceeding expectations with the gap to SCR smaller than expected. Early on, SCR was expected to outperform EGR by ~3-6% on a fluid consumption basis (to account for fuel and urea in SCR systems). We’ve heard from fleets that EGR is just slightly below to in-line with SCR, with 13L owners getting ~7 MPG. One of the debates on EGR is in a rising fuel cost environment and given lower fuel economy, would there be a larger shift to SCR. If EGR can in fact perform more or less in line with SCR on fluid consumption standards there should be lower risk of a demand shift to SCR solutions.

Diesel Particulate Filter (DPF) risks exist, but they are not specific to NAV. There is some discussion in the channel of more frequent regeneration to break down soot build up in EGR engines. Navistar strongly refutes this, and we haven’t heard anything from fleets to support EGR-specific regen concerns. Across the industry, clogged DPFs could become a bigger issue. DPFs need to be cleaned around every 250k miles. In some cases it appears that carriers haven’t maintained the filters well enough and that cleaning won’t suffice to restore the filter. The cost of cleaning runs about \$400 vs a new DPF that is \$4,000 to \$5,000. We don’t anticipate a material impact, but if fleets need to invest in replacing DPFs, it could mean delayed new truck investment in some cases.

Exhibit 1

	Urea SCR: An aftertreatment solution in which Diesel Emissions Fluid (DEF), a 32% urea solution, is added to the exhaust stream. Urea converts to ammonia, and in the presence of a catalyst, transforms NOx into nitrogen & gas	EGR: Recirculates a portion of exhaust gas to the engine cylinders. Intermixing exhaust gas with the incoming air lowers the concentration of oxygen in the combustion chamber, decreases flame temperatures, and reduces NOx emission
Pros:	<ul style="list-style-type: none"> Increases engine fuel efficiency 3-5% by eliminating most regenerations of particulate filters, which require injection of fuel. Considered a “proven” technology, given success in Europe. Urea is considered safe for handling, and SCR’s end product is nitrogen, water, and CO₂. 	<ul style="list-style-type: none"> No end-user intervention required.
Cons:	<ul style="list-style-type: none"> SCR may be more costly and/or inconvenient due to dependency on DEF. That said, urea refills are only required every 9,000 miles given a 30 gallon tank and 6,000 miles given a 20 gallon tank. Urea freezes at F°12, so heated storage may be required. SCR system adds significant weight (200-450 lbs). EPA compliance depends on end-users using DEF. Most effective at constant speeds and high loads. SCR catalysts are composed of precious metals and subject to price volatility. 	<ul style="list-style-type: none"> Reduces engine fuel economy by lowering combustion temperatures. Creates more PM as well as CO, and hydrocarbon. DPFs are employed to reduce PM, but are an additional service requirement. May not function effectively if fuel with higher concentrations of sulfur are used.

Source: www.factsaboutscr.com, Morgan Stanley Research

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Recalibration efforts appear to be progressing well:

Channel feedback has been mostly positive in response to questions on recalibrations of NAV's EPA 2010 engines. Warranty claims and performance issues are apparently starting to drop off, and the recalibration efforts are taking hold. NAV is now on the 4th iteration of recalibration. Dealers and customers we've spoken with agree with NAV's point that this is an electronic control module fix and not an issue with any of the hardware. The issues don't seem to be severe enough to hurt the brand or the sell through, and advanced EGR is off to a successful start with enough miles accumulating to gain more confidence in the viability of this approach to emissions requirements.

With solid early performance the residual value risk is reduced. Concerns around advanced EGR engine durability heightened the risk of lower residual values at first trade. Channel checks indicate that the engines are meeting or even exceeding performance expectations. At the Mid-America Trucking Show NAV displayed a 13L with just under 400k miles and over 10,000 engine hours. After just routine maintenance and oil changes every 25k miles the engine still delivered horsepower and torque to factory specs. As confidence builds that engines are performing well after logging 100-400k miles, residual values are more likely to follow historical trends.

Bull Case Upside also Expands with the 15L in Production, 0.2 NOx In-Sight and Investments in Promising Alternative SCR Technology

Production of the 15L began in January, and NAV has completed the first 50-100 in the International ProStar+, with delivery expected to begin in the end of April. Some engine calibration work is still ongoing, but the 13L provided a helpful roadmap to meeting 0.5 NOx. With a strategic focus on 13L, NAV's 15L will serve a more specific purpose among severe service and particular long-haul jobs with high power requirements. So far, the industry appears to be trending in Navistar's favor. The 15L / 13L split has historically been about 60/40 and today the industry is closer to 40/60. It's not clear how much of this is a structural shift, but early on there has been a faster adoption of more 13L's than we expected. NAV targets a more lopsided breakdown, aiming to meet roughly 90% of its class 8 demand with the 13L.

There is no immediate 0.2 NOx requirement given sufficient engine credits, but NAV has already submitted a 0.2 NOx 13L for certification. This may be more marketing than anything else to relieve NAV from EGR skepticism, but getting to 0.2 improves the bull case. NAV is committed to an

in-cylinder solution to emissions requirements. We are more focused on a pathway to getting to 0.2, and less on what technology is used. If unable to meet emissions in-cylinder, we were concerned about alternatives for NAV and the possible need to source technology externally. We now see two viable solutions, with in-cylinder now submitted for EPA certification and alternative after-treatment also on the table.

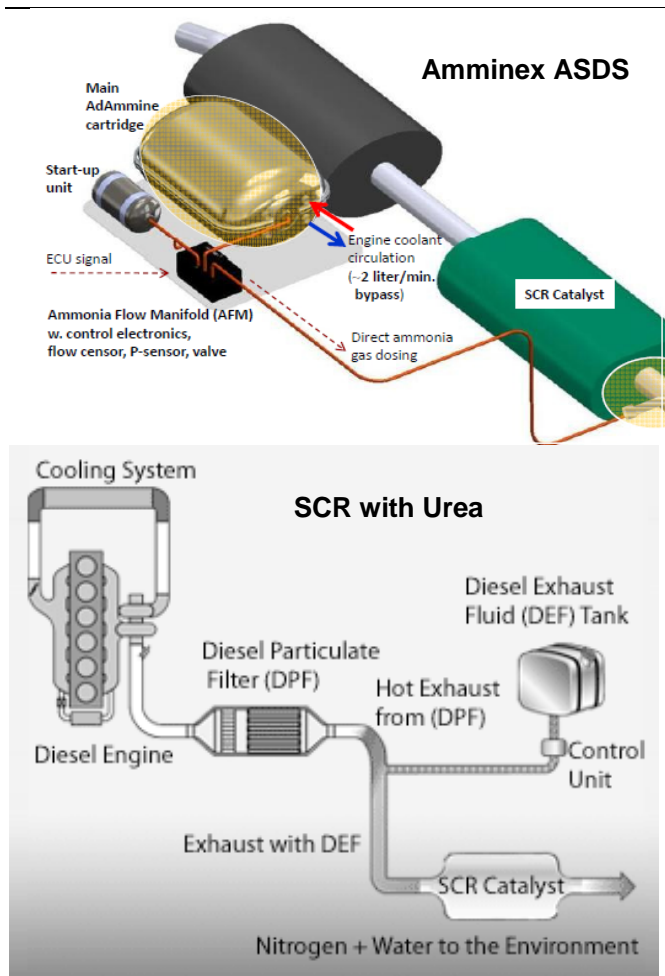
We spent a lot of time at the Pure Power Technologies booth at MATS, and walked away very positive on Amminex technology. This is NAV's EGNR solution, or Exhaust Gas NOx Reduction. Navistar management remains strongly committed to in-cylinder solutions to emissions requirements, but we think Amminex's ammonia storage and delivery system (ASDS) provides insurance against future EGR complications and it could become a widely used after-treatment option.

Cost and weight competitive with current urea-based SCR solutions. The total ASDS system (main cartridge, start-up unit, and Ammonia Flow Manifold) weighs under 200lbs vs urea systems that can run ~200-450 lbs. depending on the urea level. Cost of the system is also targeted to compete with urea solutions, though ongoing maintenance is expected to be less demanding. On average, urea tanks need to be refilled every 10 days, while Amminex cartridges would be exchanged every 25k+ miles, in line with routine oil changes. While urea refill occurs at the fuel station, limiting the inconvenience, drivers are still responsible for monitoring and refilling, vs ASDS cartridges that require no driver effort.

Infrastructure shouldn't impede Amminex penetration: Urea is now widely available across the U.S. in travel centers, sold at the pump and in pre-packaged containers. Availability of cartridges for ASDS should be similarly convenient. Dealers would maintain a stock of cartridges, with a third party employed to re-charge used cartridges. In essence, this is pretty similar to the backyard grill experience and exchanging gas tanks, the only difference is the truck driver wouldn't even need to exchange the tank as this would happen at the service center during the oil change.

Exhibit 2

SCR Systems: Solid State ASDS vs Liquid Based Urea



Source: Company data, Morgan Stanley Research

Navistar Financial Corp (NFC) has De-Risked

We worked with our accounting team and spoke at length with Navistar Financial, as well as with contacts in the field, and we believe that the risk profile associated with the finance business has improved considerably.

Navistar's core competency is selling trucks, and the company has moved away from competing against to instead partnering with GE on the financing side – a positive move in our view. All receivables were on-balance sheet as of January 31st, 2011, adding transparency to exposure. Retail receivables were \$1.8B at the end of fiscal 1Q'11, down \$200M from 4Q'10. This should continue to drop as business transitions to GE, although

run rate retail receivables will likely normalize at ~\$500M as NAV continues to write some retail paper and maintains the wholesale side of its credit business.

Trade-in Guarantees are not a big risk: Guaranteed buybacks were popular in the early 2000s, and created significant challenges for some OEMs in the downturn. Navistar is not doing guaranteed buybacks anymore. OEMs are, however, extending trade-in guarantees, though this is really a big fleet program for OEMs selling directly to fleets.

With trade-in guarantees, the trade value is guaranteed, but contingent upon purchase of a new truck, and the new truck price is uncertain. This presumably gives the OEM flexibility to offset underwater trade guarantees, though in practice we suspect that flexibility is limited. Solid performance thus far on NAV's EPA 2010 engines adds support to residual values, downsizing the risk of negative trades. On top of that, trade guarantees are a very small portion of NFC's portfolio. Only 10% of NFC's portfolio is retail, and then only a portion of that has trade-in guarantees.

Loss sharing arrangement offers comfortable threshold for NAV: For certain credit losses, Navistar will share in the losses with GE. GE assumes the first 10% of risk, with the 10% applied to the original asset value. So on a \$100k tractor, GE would assume the first \$10k of losses, after which Navistar takes some of the remaining risk. We believe with GE holding the first \$10k of risk, the threshold is high enough that any remaining risk to Navistar is quite limited.

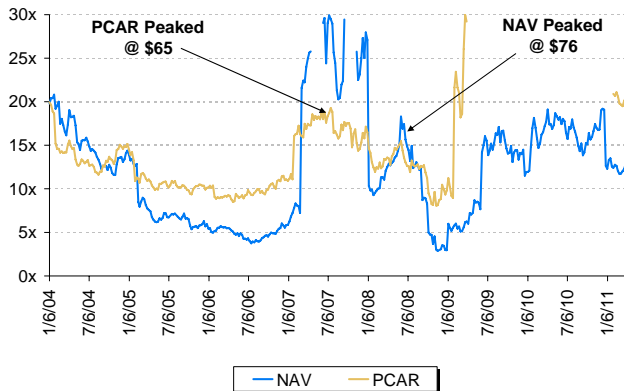
Residual value guarantees are not a concern: GE now writes the leases and sets the residual values. Navistar's only role is really to assist in remarketing at the end of the lease through its distribution assets. Navistar is not guaranteeing debt and there is no SPV utilized between Navistar and GE.

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Valuation: Multiple Discount Over-Penalizes NAV

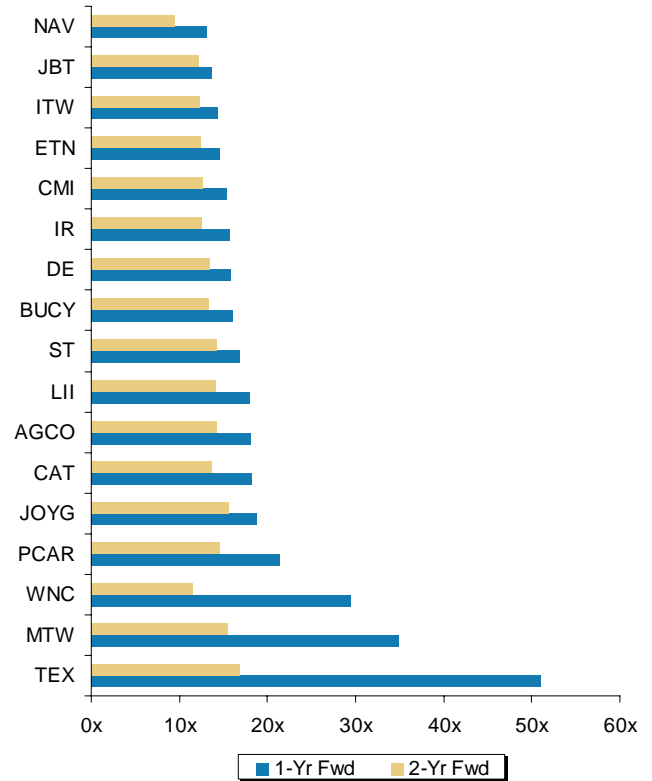
NAV's one-year forward multiple back to 2004 is 12.8x vs 18.1x for PCAR, when capped at 50x. When capped at 30x, the spread shrinks with NAV at 12.1x and PCAR at 13.2x. On prior peak stock price, the spread was also less severe than today, with PCAR at 19.3x and NAV at 17.4x. Heading into the upcycle with NAV de-risking, we think the current 5-turn multiple premium is overextended – not on where PCAR is trading, but on the risk discount applied to NAV.

Exhibit 3 PCAR Multiple Premium Somewhat Skewed from Trough Support



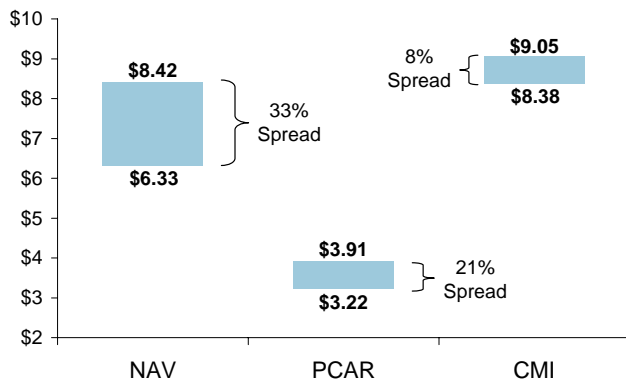
Source: FactSet, Morgan Stanley Research

Exhibit 5 NAV is the Cheapest Stock We Cover on 1-Yr and 2-Yr Fwd Earnings



Source: FactSet, Morgan Stanley Research

Exhibit 4 2012: Top Half Consensus Avg vs Bottom Half: NAV Remains the Biggest Debate Stock



Source: FactSet, Morgan Stanley Research

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Exhibit 6

Navistar International – Key Assumptions

<u>Sales Growth</u>	2006A	2007A	2008A	2009A	2010A	2011E	2012E	2013E	2014E
Truck	25.3%	-21.6%	32.1%	-29.3%	12.5%	15.0%	30.0%	-2.0%	-12.0%
Engine	8.3%	-0.3%	-5.9%	-17.4%	11.0%	25.0%	5.0%	5.0%	2.0%
Parts	10.4%	3.0%	16.8%	19.1%	-13.3%	5.0%	5.0%	5.0%	5.0%
Financial Services	16.6%	11.9%	-21.8%	-14.1%	-11.2%	-9.9%	-10.2%	-20.0%	-8.9%
Total	17.1%	-13.4%	19.8%	-21.4%	5.0%	13.3%	21.9%	-0.4%	-7.8%
Engine Intersegment Sales						37.0%	37.0%	37.0%	37.0%
<u>Profit Margins</u>									
Truck	6.7%	2.0%	7.9%	2.5%	5.8%	6.0%	6.5%	7.0%	6.5%
Engine	-2.0%	2.3%	-1.6%	1.8%	1.8%	3.2%	5.0%	5.5%	5.5%
Parts	9.6%	10.0%	13.7%	19.8%	14.0%	15.5%	15.7%	16.0%	16.0%
Corporate expenses/Other inc. interest, restruct	48.7%	62.7%	47.7%	41.5%	47.5%	34.0%	34.0%	34.0%	34.0%
Total Pretax Profit Margin	2.1%	-1.2%	3.2%	2.7%	2.4%	3.8%	4.7%	5.1%	4.6%
<u>Manufacturing Operating Margin, Cont Ops</u>	3.5%	0.4%	5.4%	2.5%	3.7%	4.6%	5.5%	5.9%	5.4%
<u>Equity Income non-consolidated</u>	99	74	71	46	-50	0	0	0	35
<u>Manufacturing Income Statement Assumptions</u>									
SG&A as % of sales	9.4%	12.1%	9.8%	11.6%	11.6%	9.7%	10.0%	10.0%	10.0%
R&D as % of sales	3.3%	3.1%	2.7%	3.8%	3.9%	3.4%	2.7%	3.0%	3.0%
Statutory tax rate	72.3%	14.1%	36.1%	31.7%	39.7%	16.0%	20.0%	24.0%	30.0%
Common dividends per share	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Minority Interest Growth %	0.0%	0.0%	0.0%	0.0%	76.0%	0.0%	0.0%	5.0%	5.0%
Capex \$	230	312	176	151	234	275	300	300	250
Issuance of Debt	0	0	0	0	0	0	0	0	0
Payment of Debt	0	0	0	0	0	200	100	100	100
<u>Financial Services Balance Sheet Assumptions</u>									
Total Finance Receivables	0	0	3,951	3,358	3,084	2,776	2,220	1,776	1,865
Growth in Finance Receivables	0.0%	0.0%	0.0%	-15.0%	-8.2%	-10.0%	-20.0%	-20.0%	5.0%
Change in Total Receivables	0	0	0	-593	-274	-308	-555	-444	89
Change in finance debt	0	0	-612	-809	-546	-308	-555	-444	89
Total Financial Services Debt	0	4,852	4,240	3,431	2,885	2,577	2,021	1,577	1,666
Ratio of change in fin debt to receivables	0.0%	0.0%	0.0%	136.4%	199.3%	100.0%	100.0%	100.0%	100.0%
<u>Financial Services Income Statement Assumptions</u>									
Interest earned on Avg Finance Receivables	0.0%	0.0%	10.3%	9.5%	9.6%	9.5%	10.0%	10.0%	10.0%
Financial Services Revenue	463	518	405	348	309	278	250	200	182
Financial Services Revenue Growth %	16.6%	11.9%	-21.8%	-14.1%	-11.2%	-9.9%	-10.2%	-20.0%	-8.9%
SG&A Financial % of sales	0.0%	21.8%	36.8%	37.4%	39.8%	25.0%	30.0%	35.0%	35.0%
Interest Expense % of Avg Debt	0.0%	0.0%	6.9%	4.2%	3.6%	4.2%	4.8%	4.8%	4.5%
Equipment Leased to Others \$	43	37	39	46	45	45	45	45	45
<u>Balance sheet metrics</u>									
Avg. Days Inventory in Stock	47	55	45	62	59	55	50	52	55
Avg. Days Receivables Out	0	23	23	31	29	30	28	28	28
Avg. Days Payables Out	68	76	61	79	72	70	63	64	65

E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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Exhibit 7

Navistar International – Annual Manufacturing Segment Income Statement

(\$ Millions, Except Per Share Data)	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Manufacturing Income Statement									
Financial Services on Equity Basis									
Truck	9,953	7,804	10,314	7,294	8,205	9,436	12,266	12,021	10,579
Engine	2,596	2,798	2,499	2,031	2,031	2,351	2,469	2,593	2,644
Parts	1,329	1,308	1,586	1,975	1,690	1,781	1,870	1,964	2,062
Net Manufacturing Sales	13,878	11,910	14,399	11,300	11,926	13,568	16,606	16,577	15,285
Cost of Goods	11,703	10,109	11,942	9,366	9,741	11,169	13,591	13,445	12,470
Gross Profit	2,175	1,801	2,457	1,934	2,185	2,399	3,014	3,133	2,815
<i>Gross Margin %</i>	15.7%	15.1%	17.1%	17.1%	18.3%	17.7%	18.2%	18.9%	18.4%
Selling, General & Admin.	1,234	1,380	1,292	1,218	1,293	1,316	1,661	1,658	1,528
<i>SG&A as a % of Sales</i>	8.9%	11.6%	9.0%	10.8%	10.8%	9.7%	10.0%	10.0%	10.0%
Engineering and product development costs	453	375	384	433	464	455	448	497	459
<i>R&D as a % Sales</i>	3.3%	3.1%	2.7%	3.8%	3.9%	3.4%	2.7%	3.0%	3.0%
Impairment of property and equipment	-	-	358	31	-	-	-	-	-
Restructuring charges	-	-	-	59	(19)	21	-	-	-
Postretirement benefits expense	-	-	-	-	-	-	-	-	-
Mfg Operating Income as reported	488	46	423	193	447	608	906	978	828
<i>Operating Margin</i>	3.5%	0.4%	2.9%	1.7%	3.7%	4.5%	5.5%	5.9%	5.4%
Reversal of one time items	-	-	358	90	-	18	-	-	-
Mfg Operating Income, continuing operations	488	46	781	283	447	626	906	978	828
<i>Operating Margin, continuing operations</i>	3.5%	0.4%	5.4%	2.5%	3.7%	4.6%	5.5%	5.9%	5.4%
Interest expense	191	197	156	99	154	139	135	127	119
Interest income	-	-	-	-	-	-	-	-	-
Interest expense, net	191	197	156	99	154	139	135	127	119
Equity in income of non-consolidated affiliates	99	74	71	46	(50)	-	-	-	35
Equity income from financial services operations	147	127	(24)	40	95	101	66	44	45
Other (income) expenses	148	123	123	(179)	48	15	-	-	-
Pretax Income as reported	395	(73)	191	359	290	554	836	895	789
Other Nonrecurring Items	-	-	37	(208)	10	(1)	-	-	-
Pretax Income, continuing operations	395	(73)	586	241	300	571	836	895	789
<i>Pretax Margin</i>	2.8%	-0.6%	4.1%	2.1%	2.5%	4.2%	5.0%	5.4%	5.2%
Income Taxes (benefit) reported	94	47	58	34	23	89	167	215	237
Tax Rate	23.8%	-64.4%	30.4%	9.5%	7.9%	16.0%	20.0%	24.0%	30.0%
Income tax on one time items	-	-	1	(3)	-	-	-	-	-
Minority interest	-	-	-	(25)	(44)	(44)	(44)	(46)	(49)
Extraordinary gain, net of tax	-	-	-	23	-	-	-	-	-
Net Income from continuing operations	301	(120)	528	205	233	439	625	634	504
loss from discontinued operations and disposal	-	-	-	-	-	-	-	-	-
Income/Loss from Other One-time Items	-	-	-	-	-	-	-	-	-
Non-recurring items	-	-	(394)	115	(10)	(18)	-	-	-
Net Income, reported	301	(120)	134	320	223	421	625	634	504
<i>Net margin</i>	2.2%	-1.0%	0.9%	2.8%	1.9%	3.1%	3.8%	3.8%	3.3%
<i>check</i>	-	-	-	-	-	0	-	(0)	0
Effect of Dilutive Securities	6	0	0	0	0	0	0	0	0
Earnings Per Share									
Diluted recurring EPS Before Gains/(Charges)	\$4.12	(\$1.71)	\$7.21	\$2.86	\$3.18	\$5.66	\$8.05	\$8.17	\$6.49
Diluted, Income/Loss from Other One-time items	-	-	(5.38)	1.60	(0.14)	(0.23)	-	-	-
Diluted reported EPS After Gains/(Charges) GAAP	\$4.12	(\$1.71)	\$1.83	\$4.46	\$3.05	\$5.42	\$8.05	\$8.17	\$6.49
<i>check</i>	-	-	-	-	-	0	-	(0)	0
Shares Outstanding (Mil.)									
Diluted average	75	70	73	72	73	78	78	78	78

E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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Navistar International

Exhibit 8

Navistar International – Quarterly Manufacturing Segment Income Statement

(\$ Millions, Except Per Share Data)	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11E	3Q11E	4Q11E
Mfg Income Statement - Fin Serv on Equity Basis								
Truck	1,716	1,847	2,311	2,331	1,800	2,216	2,657	2,763
Engine	625	444	456	506	481	558	585	728
Parts	417	399	395	479	412	434	436	499
Net Manufacturing Sales	2,758	2,690	3,162	3,316	2,693	3,208	3,677	3,990
Cost of Goods	2,262	2,189	2,525	2,765	2,199	2,641	3,037	3,292
Gross Profit	496	501	637	551	494	566	640	699
<i>Gross Margin %</i>	18.0%	18.6%	20.1%	16.6%	18.3%	17.7%	17.4%	17.5%
Selling, General & Admin.	306	338	331	318	302	321	342	351
<i>SG&A as a % of Sales</i>	11.1%	12.6%	10.5%	9.6%	11.2%	10.0%	9.3%	8.8%
Engineering and product development costs	109	116	113	126	129	112	114	99
<i>R&D as a % Sales</i>	4.0%	4.3%	3.6%	3.8%	4.8%	3.5%	3.1%	2.5%
Impairment of property and equipment	-	-	-	-	-	-	-	-
Restructuring charges	(17)	-	(10)	8	21	-	-	-
Postretirement benefits expense	-	-	-	-	-	-	-	-
Mfg Operating Income as reported	98	47	203	99	42	133	184	248
<i>Operating Margin</i>	3.6%	1.7%	6.4%	3.0%	1.6%	4.2%	5.0%	6.2%
Reversal of one time items	-	-	-	-	18	-	-	-
Mfg Operating Income, continuing operations	98	47	203	99	60	133	184	248
<i>Operating Margin, continuing operations</i>	3.6%	1.7%	6.4%	3.0%	2.2%	4.2%	5.0%	6.2%
Interest expense	39	37	40	38	36	35	35	34
Interest income	-	-	-	-	-	-	-	-
Interest expense, net	39	37	40	38	36	35	35	34
Equity in income of non-consolidated affiliates	(6)	(13)	(13)	(18)	(17)	-	5	12
Equity income from financial services operations	12	16	33	34	33	24	23	21
Other (income) expenses	27	(20)	15	26	15	-	-	-
Pretax Income as reported	38	33	168	51	7	123	177	247
Other Nonrecurring Items	-	-	-	10	(1)	-	-	-
Pretax Income, continuing operations	38	33	168	61	24	123	177	247
<i>Pretax Margin</i>	1.4%	1.2%	5.3%	1.8%	0.9%	3.8%	4.8%	6.2%
Income Taxes (benefit) reported	8	(10)	19	6	-	20	28	41
Tax Rate	21.1%	-30.3%	11.3%	11.8%	0.0%	16.0%	16.0%	16.4%
Income tax on one time items	-	-	-	-	-	-	-	-
Minority interest	(13)	(13)	(12)	(6)	(12)	(11)	(11)	(10)
Extraordinary gain, net of tax	-	-	-	-	-	-	-	-
Net Income from continuing operations	17	30	137	49	12	92	138	197
loss from discontinued operations and disposal	-	-	-	-	-	-	-	-
Income/Loss from Other One-time Items	-	-	-	-	-	-	-	-
Non-recurring items	-	-	-	(10)	(18)	-	-	-
Net Income, reported	17	30	137	39	(6)	92	138	197
<i>Net margin</i>	0.6%	1.1%	4.3%	1.2%	-0.2%	2.9%	3.8%	4.9%
<i>check</i>	-	-	-	-	-	(0)	(0)	0
Earnings Per Share								
Diluted recurring EPS Before Gains/(Charges)	\$0.24	\$0.41	\$1.84	\$0.68	\$0.16	\$1.19	\$1.77	\$2.49
Diluted, Income/Loss from Other One-time items	-	-	-	(0.14)	(0.24)	-	-	-
Diluted reported EPS After Gains/(Charges) GAAP	\$0.24	\$0.41	\$1.83	\$0.54	(\$0.08)	\$1.19	\$1.77	\$2.49
Shares Outstanding (Mil.)								
Diluted average	72.1	72.8	74.3	73.6	75.9	77.6	78.0	78.9
Basic, average	71.2	71.4	72.0	72.2	72.5	78.0	78.0	77.8
Basic, period end	70.9	71.6	71.7	71.9	72.4	78.0	78.0	77.6

E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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Navistar International

Exhibit 9

Navistar International – Manufacturing Balance Sheet

Manufacturing Operations Balance Sheet									
	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Assets:									
Cash & Cash Equivalents	1,078	716	775	1,152	534	572	835	1,228	1,554
Marketable Securities	-	-	-	-	566	566	566	566	566
Restricted cash and cash equivalents	-	-	8	30	29	29	29	29	29
Accounts Receivables	756	788	1,051	915	1,030	1,131	1,292	1,289	1,189
Inventories	1,730	1,380	1,584	1,634	1,556	1,706	1,888	1,942	1,905
Investments in and advances to financial services operations	709	397	387	423	502	603	669	713	759
Investments in and advances to non-consolidated affiliates	207	154	156	62	103	103	103	103	138
Total Current Assets	4,480	3,435	3,961	4,216	4,320	4,710	5,381	5,871	6,139
Net property plant and equipment	2,054	1,980	1,390	1,345	1,329	1,343	1,371	1,385	1,336
Goodwill	606	639	529	318	324	324	324	324	324
Deferred taxes, net	98	123	67	107	109	109	109	109	109
Other assets	409	331	177	517	821	794	770	748	729
Total Assets	7,647	6,508	6,124	6,503	6,903	7,280	7,955	8,437	8,637
Liabilities and Shareholders' Equity:									
Accounts payable	2,371	1,888	2,162	1,929	1,974	2,172	2,378	2,390	2,252
Postretirement benefits liabilities	1,587	1,310	1,726	2,660	2,066	1,947	1,799	1,629	1,433
Debt	2,471	2,028	1,834	1,861	1,985	1,785	1,685	1,585	1,485
Deferred Taxes / Other Liabilities	2,332	2,016	1,754	1,727	1,802	1,836	1,882	1,943	2,024
Total Liabilities	8,761	7,242	7,476	8,177	7,827	7,739	7,745	7,547	7,194
Minority Interest	-	-	-	61	49	93	137	183	232
Redeemable equity securities	-	140	143	13	8	8	8	8	8
Stockholders' deficit	(1,114)	(874)	(1,495)	(1,748)	(981)	(560)	65	699	1,203
Total Liabilities & Equity	7,647	6,508	6,124	6,503	6,903	7,280	7,955	8,437	8,637

E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

April 11, 2011

Navistar International

Exhibit 10

Navistar International – Manufacturing Cash Flow Statement

Manufacturing Operations Cash Flow	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Net Income (Loss)	301	(120)	134	345	267	465	669	680	553
Depreciation & Amortization	317	312	333	284	261	266	276	287	297
Depreciation of equipment leased to others	34	40	44	35	27	24	22	20	19
Amortization of debt issuance costs	-	-	-	6	26	-	-	-	-
Deferred income taxes	(3)	39	82	(14)	(3)	-	-	-	-
Impairment of PPE, goodwill, intangibles	-	-	372	41	-	-	-	-	-
Extraordinary gain on acquisition of subsidiary	-	-	-	(23)	-	-	-	-	-
Gain on increased equity interest in subsidiary	-	-	24	(23)	-	-	-	-	-
Equity in income of non-consolidated affiliates	(99)	(74)	(71)	(46)	50	-	-	-	(35)
Equity in income of financial service affiliates	(147)	(127)	25	(40)	(95)	(101)	(66)	(44)	(45)
Dividends from non-consolidated affiliates	83	111	85	59	5	-	-	-	-
Change in intercompany receivables and payables	-	-	-	(82)	11	-	-	-	-
Other, net	10	(12)	(599)	(8)	(140)	(88)	(102)	(109)	(112)
Working Capital									
Accounts Receivable						(101)	(161)	2	101
Inventory						(150)	(181)	(54)	37
Accounts Payable						198	207	12	(139)
Increase in Working Capital						(53)	(135)	(40)	(1)
Cash from Operations	496	169	429	534	409	513	663	793	675
Purchases of marketable securities	(179)	(221)	(42)	(382)	(1,856)	-	-	-	-
Sales or maturities of marketable securities	134	351	46	384	1,290	-	-	-	-
Net change in restricted cash and cash equivalents	1	24	7	(23)	1	-	-	-	-
Capital Expenditures	(228)	(309)	(168)	(148)	(232)	(275)	(300)	(300)	(250)
Purchase of equipment leased to others	-	-	-	(2)	(16)	-	-	-	-
Business acquisitions, net of escrow receipt	(54)	(7)	(60)	(60)	(17)	-	-	-	-
Other investing activities	(25)	92	1	(51)	(86)	-	-	-	-
Cash from Investing Activities	(351)	(70)	(216)	(282)	(916)	(275)	(300)	(300)	(250)
Issuance of Debt						-	-	-	-
Payment of Debt						(200)	(100)	(100)	(100)
Cash provided (used) from Financing	140	(480)	(133)	36	(110)	(200)	(100)	(100)	(100)
Effect of exchange rate on cash and cash equivalents	17	19	(21)	9	(1)	-	-	-	-
Increase in cash upon consolidation of BDP and BDT	-	-	-	80	-	-	-	-	-
Change in Manufacturing Cash	302	(362)	59	377	(618)	38	263	393	325
Cash at Beginning	776	1,078	716	775	1,152	534	572	835	1,228
Cash at Ending	1,078	716	775	1,152	534	572	835	1,228	1,554

E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

April 11, 2011
Navistar International



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Overweight/Buy	1195	42%	469	47%	39%
Equal-weight/Hold	1153	40%	406	40%	35%
Not-Rated/Hold	114	4%	22	2%	19%
Underweight/Sell	389	14%	108	11%	28%
Total	2,851		1005		

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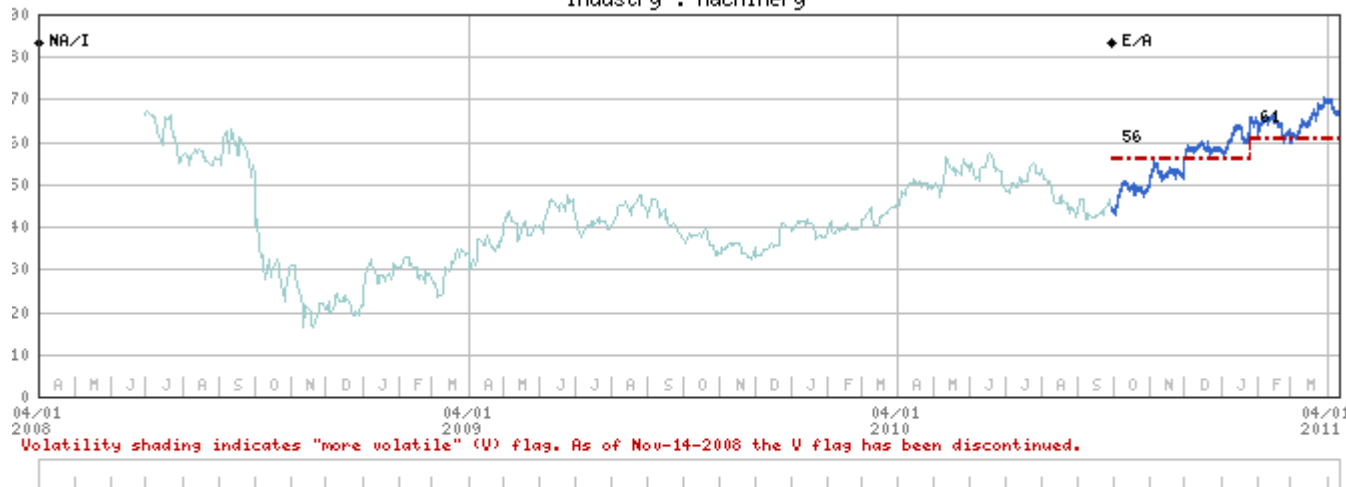
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Navistar International Corp. (NAV.N) - As of 4/10/11 in USD
Industry : Machinery



Stock Rating History: 4/1/08 : NA/I; 9/30/10 : E/A

Price Target History: 9/30/10 : 56; 1/26/11 : 61

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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April 11, 2011

Navistar International

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Industry Coverage: Machinery

Company (Ticker)	Rating (as of)	Price* (04/08/2011)
Robert Wertheimer		
AGCO (AGCO.N)	E (12/07/2009)	\$53.01
Bucyrus International Inc. (BUCY.O)	E (11/16/2010)	\$91.45
Caterpillar (CAT.N)	O (02/09/2010)	\$109.82
Cummins Inc. (CMI.N)	E (09/30/2010)	\$108.89
Deere (DE.N)	E (11/22/2010)	\$95.93
Eaton (ETN.N)	E (07/03/2008)	\$54.26
Illinois Tool Works (ITW.N)	O (11/16/2009)	\$54.33
Ingersoll-Rand (IR.N)	E (02/09/2010)	\$47.98
John Bean Technologies Corp (JBT.N)	NR (10/31/2008)	\$19.17
Joy Global Inc (JOYG.O)	U (11/16/2010)	\$98.92
Lennox International (LII.N)	U (10/18/2010)	\$52.06
Manitowoc Company Inc. (MTW.N)	O (08/03/2010)	\$21.6
Navistar International Corp. (NAV.N)	O (04/11/2011)	\$66.63
PACCAR Inc. (PCAR.O)	E (02/02/2011)	\$51.28
Sensata Technologies Holding N.V. (ST.N)	O (04/20/2010)	\$34.56
Terex (TEX.N)	U (11/05/2009)	\$34.35
Wabash National Corporation (WNC.N)	O (09/30/2010)	\$11.27
Westport Innovations Inc. (WPRT.O)	O (01/21/2011)	\$26.74

Stock Ratings are subject to change. Please see latest research for each company.
* Historical prices are not split adjusted.