BORGWARNER INC
Form 10-K
February 12, 2009

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

Form 10-K

ANNUAL REPORT

(Mark One)

þ Annual Report Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2008
OR
o Transition Report Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934
For the transition period from ______________ to ______________

Commission File Number: 1-12162

BorgWarner Inc.
(Exact name of registrant as specified in its charter)

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

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of the voting common stock of the registrant held by stockholders (not including voting common stock held by directors and executive officers of the registrant) on June 30, 2008 (the last business day of the most recently completed second fiscal quarter) was approximately $5.2 billion. As of February 6, 2009, the registrant had 115,532,736 shares of voting common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated herein by reference into the Part of the Form 10-K indicated.

Document	Part of Form 10-K into which incorporated
BorgWarner Inc. Proxy Statement for the 2009 Annual Meeting of Stockholders	Part III

BORGWARNER INC.

FORM 10-K

YEAR ENDED DECEMBER 31, 2008

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CAUTIONARY STATEMENTS FOR FORWARD-LOOKING INFORMATION

Statements contained in this Form 10-K (including Management s Discussion and Analysis of Financial Condition and Results of Operations) may contain forward-looking statements as contemplated by the 1995 Private Securities Litigation Reform Act that are based on management s current outlook, expectations, estimates and projections. Words such as outlook, expects, anticipates, intends, plans, believes, estimates, variations of such words and simi expressions are intended to identify such forward-looking statements. Forward-looking statements are subject to risks and uncertainties, many of which are difficult to predict and generally beyond our control, that could cause actual results to differ materially from those expressed, projected or implied in or by 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 our products, changes in general economic conditions, as well as the other risks noted under Risk Factors. We do not undertake any obligation to update any forward-looking statements.

PART I

Item 1. Business

BorgWarner Inc. and Consolidated Subsidiaries (the Company) is a Delaware corporation that was incorporated in 1987. We are a leading, global supplier of highly engineered automotive systems and components, primarily for powertrain applications. Our products help improve vehicle performance, fuel efficiency, stability and air quality. These products are manufactured and sold worldwide, primarily to original equipment manufacturers (OEMs) of light-vehicles (passenger cars, sport-utility vehicles, vans and light-trucks). The Company s products are also sold to other OEMs of commercial trucks, buses and agricultural and off-highway vehicles. We also manufacture and sell our products to certain Tier One vehicle systems suppliers and into the aftermarket for light and commercial vehicles. The Company operates manufacturing facilities serving customers in the Americas, Europe and Asia, and is an original equipment supplier to every major automotive OEM in the world.

Financial Information About Segments

Refer to Note 21, Reporting Segments and Related Information of the Notes to the Consolidated Financial Statements in Item 8 of this report for financial information about business segments.

Narrative Description of Reporting Segments

The Company reports its results under two reporting segments: Engine and Drivetrain. Net revenues by segment for the three years ended December 31, 2008, 2007 and 2006 are as follows (in millions of dollars):

Net Sales	**Year Ended December 31, 2008**	**2007**	**2006**
	Millions of dollars		
Engine	$ 3,861.5	$ 3,761.3	$ 3,154.9
Drivetrain	1,426.4	1,598.8	1,461.4
Inter-segment eliminations	(24.0)	(31.5)	(30.9)
Net sales	$ 5,263.9	$ 5,328.6	$ 4,585.4

The sales information presented above excludes the sales by the Company s unconsolidated joint ventures (See Joint Ventures section). Such sales totaled approximately $792 million in 2008, $720 million in 2007 and $676 million in 2006.

Engine

The Engine Group develops products to manage engines for fuel efficiency, reduced emissions, and enhanced performance. Concern about fuel prices and availability, and the need to lower CO_2 emissions are driving demand for the Company s products in smaller, more efficient gasoline and diesel engines and alternative powertrains in hybrid vehicles. Engine Group products currently fall into the following major categories: turbochargers, chain products, emissions systems, thermal systems, diesel cold start and gasoline ignition technology and diesel cabin heaters.

The Engine Group provides turbochargers for light-vehicle, commercial-vehicle and off-road applications for diesel and gasoline engine manufacturers in Europe, North America, South America and Asia. The Engine Group has greatly benefited from the growth in turbocharger demand in Europe. This growth is linked to increasing demand for diesel engines in light vehicles which typically use turbochargers and for turbocharged gasoline engines. Benefits of turbochargers in both light-vehicle and commercial-vehicle applications include increased power for a given engine size, improved fuel economy and significantly reduced emissions.

Sales of turbochargers for light-vehicles represented approximately 24%, 21%, and 18% of the Company s total revenues for 2008, 2007 and 2006, respectively. The Company currently supplies light-vehicle turbochargers to many OEMs including VW/Audi, Renault, PSA, Daimler, Hyundai, Fiat and BMW. The Company also supplies commercial-vehicle turbochargers to Caterpillar, John Deere, Daimler, International, Deutz and MAN.

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The Company s newest technologies are its regulated two-stage turbocharging system known as R2S®, variable turbine geometry (VTG) turbochargers and turbochargers for gasoline direct injected engines. In 2006, the Company launched a high temperature VTG turbocharger for a Porsche 3.6 liter gasoline application, an R2S application for a Daimler light-truck called the Sprinter and VTG turbochargers for the Hyundai A-engine family. In 2007, the Company began supplying its R2S turbocharger technology combined with variable turbine geometry to International Engine Group s PowerStroke 6.4-liter V8 diesel engine used in Ford s F-Series heavy-duty pickup trucks. In 2008, the Company announced the start of production of its award winning R2S technology for Daimler s new 4 cylinder diesel engine range. The Company also began shipping VTG turbochargers for VW s new common-rail engine range and announced the launch of a VTG turbocharger for use with low-pressure exhaust gas recirculation to reduce emissions on VW s Jetta Clean Diesel TDI.

The Engine Group also designs and manufactures products to control emissions and improve fuel economy. These products include electric air pumps, turbo actuators that use integrated electronics to precisely control turbocharger speed and pressure ratio, and exhaust gas recirculation valves for gasoline and diesel applications. The Engine Group also manufactures a wide variety of fluid pumps, including engine oil pumps for engine and transmission lubrication, and products for engine air intake management.

The Engine Group s chain and chain systems products include timing chain and timing drive systems, variable cam timing (VCT) systems, crankshaft and camshaft sprockets, tensioners, guides and snubbers, HY-VO® front-wheel drive (FWD) transmission chain and four-wheel drive (4WD) chain, and MORSE GEMINI® chain systems for light-vehicle and commercial-vehicle applications.

The Company s timing chain systems are used in Ford s family of overhead cam engines, including the Duratec and Modular, and in-line 4 cylinder engines, as well as on Chrysler s 2.7 liter, 3.7 liter and 4.7 liter, overhead cam engines, as well as the 4 cylinder World Engine family of engines. In addition, the Company provides timing systems to a number of Asian OEMs and their North American transplant operations, including Honda, Nissan, and Hyundai, and to several European OEMs. The Company believes that it is the world s leading manufacturer of timing chain systems.

The Engine Group has successfully launched its latest VCT product; Cam Torque Actuated™ (CTA) VCT. VCT is a means of precisely controlling the flow of air into and out of an engine by allowing the camshaft to be dynamically phased relative to its crankshaft. The Company s CTA technology utilizes camshaft torque as its main actuation energy, instead of the conventional oil-pressure actuated approach. The CTA system has been launched on Ford s 3.0 liter Duratec engine featured in the Ford Escape, Ford Fusion, Mazda 6, and Mercury Mariner.

The Company believes it is the world s leading manufacturer of chain for FWD transmissions and 4WD transfer cases. HY-VO chain is used to transfer power from the engine to the drivetrain. The Company s MORSE GEMINI transmission chain system emits significantly less chain pitch frequency noise than conventional transmission chain systems. The chain in a transfer case distributes power between a vehicle s front and rear output shafts which, in turn, provide torque to the front and rear wheels.

The Engine Group believes it is a leading global provider of engine thermal solutions for truck, agricultural and off-highway applications. The group designs, manufactures and markets viscous fan drives that control fans to sense and respond to multiple cooling requirements. The Engine Group also manufactures and markets polymer fans for engine cooling systems. The Company s thermal products provide improved vehicle fuel economy and reduced engine emissions while minimizing parasitic horsepower loss. The Company has been awarded the standard position (the OEM-designated preferred supplier of component systems available to the end-customer) at the major global heavy truck producers.

In 2005, the Company acquired approximately 69.4% of the outstanding shares of BERU Aktiengesellschaft (BERU), headquartered in Ludwigsburg, Germany. In 2007, the Company increased its ownership to approximately 82.2%. In the second quarter of 2008, the Company and BERU completed a Domination and Profit Transfer Agreement (DPTA), giving BorgWarner full control of BERU. Refer to Note 20, Recent Transactions of the Notes to the Consolidated Financial Statements in Item 8 of this report for further information related to the Company s DPTA agreement with BERU.

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As a result of the tendering of shares in 2008 in accordance with the DPTA, the Company owns approximately 96% of all BERU s outstanding shares. On January 7, 2009, the Company informed BERU of its intention to purchase the remaining outstanding shares of approximately 4%, using the required German legal process referred to as a squeeze-out to complete the 100% ownership.

BERU s operating results are included within the Company s Engine Group segment. BERU is a leading global automotive supplier of diesel cold starting technology (glow plugs and instant starting systems); gasoline ignition technology (spark plugs and ignition coils); and electronic control units and sensor technology (tire pressure sensors, diesel cabin heaters and selected sensors). In 2008, BERU launched its new Pressure Sensor Glow Plug with which the combustion processes of a diesel engine allowing the lowest CO_2 and NO_x emissions possible.

Drivetrain

The Drivetrain Group leverages the Company s expertise in clutching and control systems to enable efficient transmission of engine torque through the vehicle drivetrain and management of torque distribution to the driven wheels. The Company s technology can improve fuel efficiency and help reduce emissions in all types of powertrains. The Drivetrain Group s major products are transmission components and systems, and AWD torque management systems.

The Drivetrain Group designs and manufactures automatic transmission components and modules and is a supplier to virtually every major automatic transmission manufacturer in the world for both conventional automatic and new dual-clutch transmissions (DCT).

Shift quality products are provided in four principal categories. DCT products include dual-clutch modules, torsional vibration dampers and mechatronic control modules. Friction products include friction plates, transmission bands, torque converter clutches, and friction clutch modules.

One-way clutches and torsional vibration dampers are mechanical products. The controls products line features electro-hydraulic solenoids, solenoid modules and high pressure solenoids for automated manual transmissions (AMT s).

The Company s 50%-owned joint venture in Japan, NSK-Warner Kabushiki Kaisha (NSK-Warner), is a leading producer of friction plates and one-way clutches in Japan. NSK-Warner is also the joint venture partner with a 40% interest in the Drivetrain Group s Korean subsidiary, BorgWarner Transmission Systems Korea, Inc.

The Company has led the globalization of today s DCT technology for over ten years. Following the development of its DCT technology in the 1990s, the Company established its industry-leading position in Europe in 2003 with the production launch of its award-winning DualTronic® innovations with VW/Audi. In 2006, the Company was awarded the first dual-clutch program in China with SAIC. In 2007, the Company launched its first dual-clutch technology application in a Japanese transmission with Nissan.

The Company has announced programs with customers that include VW, Audi, Bugatti, SAIC and Nissan, in addition to Getrag DCT programs with five additional global automakers. Also, the Company is working on over 20 programs with OEMs around the world. BorgWarner DualTronic technology provides both better fuel-efficiency and a great driving experience, enabling a conventional, manual gearbox to function as a fully automatic transmission by eliminating the interruption in power flow that occurs when a single clutch manual transmission shifts gears.

In conventional automatic transmissions, there has been a global market trend from four and five speeds to six, seven, and even eight speed transmissions. Transmissions with more speeds improve fuel economy and vehicle performance and offer growth opportunities.

In 2006 the Drivetrain Group acquired the high-pressure solenoid product lines of Eaton Corporation. Among these solenoids are those used in AMTs. AMTs are a growing niche of the entry-level city-car and light commercial-vehicle segments in Europe and some Asian markets. High pressure control systems are also serving a growing share of the DCT market segment.

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The Drivetrain Group s torque management products include rear-wheel drive (RWD)/all-wheel drive (AWD) transfer case systems, FWD/AWD electromagnetic coupling systems and advanced products. The Company s focus is on electronically controlled (active) torque management devices and systems for their vehicle dynamics, fuel economy and stability benefits. Additional torque management products include synchronizer rings and systems for application in manual, automated manual and DCT.

Transfer cases are installed primarily on light-trucks, sport-utility vehicles (SUV s), rear-wheel drive based cross-over utility vehicles (CUV s) and passenger cars. A transfer case attaches to the transmission and distributes torque to the front and rear axles improving vehicle traction and stability in dynamic driving conditions. Sales of rear-wheel drive based transfer cases and components have declined to approximately 7%, 9% and 10% of the Company s total revenues for 2008, 2007 and 2006, respectively.

The Company is involved in the FWD/AWD market with electromagnetic couplings that use electronically controlled clutches to distribute power to the rear wheels instantly as traction is required. NexTrac® is our latest product innovation that produces outstanding stability and traction while promoting better fuel economy. NexTrac launched in 2008 on the Hyundai Santa Fe, Tucson and KIA Sportage.

With the trend toward vehicle electrification gaining momentum, the Company is also applying its years of expertise to deliver robust and highly efficient single and multiple speed electric gear reduction solutions for hybrids and electric vehicles.

Joint Ventures

As of December 31, 2008, the Company had 10 joint ventures in which it had a less-than-100% ownership interest. Results from the six ventures in which the Company is the majority owner are consolidated as part of the Company s results. Results from the four ventures in which the Company s effective ownership interest is 50% or less, were reported by the Company using the equity method of accounting.

Management of the unconsolidated joint ventures is shared with the Company s respective joint venture partners. Certain information concerning the Company s joint ventures is set forth below:

Joint Venture	Products	Year Organized	Percentage Owned by the Company (a)	Location of Operation	Joint Venture Partner	Fiscal 2008 Sales ($ in millions) (b)
Unconsolidated:						
NSK-Warner K.K.	Transmission components	1964	50%	Japan	NSK Ltd.	$ 637.9
Turbo Energy Limited(c)	Turbochargers	1987	32.6%	India	Sundaram Finance Limited; Brakes India Limited	$ 128.1
BERU Diesel Start Systems Pvt. Ltd.	Glow Plugs	1996	49%	India	Jayant Dave	$ 4.5
BERU-Eichenauer	Sub-systems for diesel cabin heaters	2000	50%	Germany	Fritz Eichenauer GmbH & Co. KG	$ 21.3

Consolidated:							
BorgWarner Transmission Systems Korea, Inc.	Transmission components	1987	60%(d)	Korea	NSK-Warner K.K.	$	108.8
Divgi-Warner Pvt. Ltd.	Transfer cases and automatic locking hubs	1995	60%	India	Divgi Metalwares, Ltd.	$	18.5
Borg-Warner Shenglong (Ningbo) Co. Ltd.	Fans and fan drives	1999	70%	China	Ningbo Shenglong Group Co., Ltd.	$	28.9
BorgWarner TorqTransfer Systems Beijing Co. Ltd.	Transfer cases	2000	80%	China	Beijing Automotive Industry Corporation	$	40.8
SeohanWarner Turbo Systems Ltd.	Turbochargers	2003	71%	Korea	Korea Flange Company	$	45.7
BERU Korea Co. Ltd.	Ignition coils and pumps	2001	51%	Korea	Mr. K.B. Mo and Mr. D.H. Kim	$	34.2

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(a) In the second quarter of 2008, the Company and BERU AG (BERU) completed a Domination and Profit Transfer Agreement (DPTA), giving BorgWarner full control of BERU. For the joint ventures in which BERU is a party, the percentage of ownership for each joint venture reflects BERU s ownership percentage.

(b) All sales figures are for the year ended December 31, 2008, except NSK-Warner and Turbo Energy Limited. NSK-Warner s sales are reported for the 12 months ended November 30, 2008. Turbo Energy Limited s sales are reported for the 12 months ended September 30, 2008

(c) The Company made purchases from Turbo Energy Limited totaling $25.4 million, $25.1 million and $18.7 million for the years ended December 31, 2008, 2007, and 2006, respectively.

(d) BorgWarner Inc. owns 50% of NSK-Warner, which has a 40% interest in BorgWarner Transmission Systems Korea, Inc. This gives the Company an additional indirect effective ownership percentage of 20%. This results in a total effective ownership interest of 80%.

Financial Information About Geographic Areas

Refer to Note 21, Reporting Segments and Related Information of the Notes to the Consolidated Financial Statements in Item 8 of this report for financial information about geographic areas.

Approximately 72% of the Company s consolidated sales for 2008 were outside the United States, including exports. However, a portion of such sales was to OEMs headquartered outside the United States that produce vehicles that are, in turn, exported to the United States.

Customers

Approximately 72% of the Company s total sales in 2008 were for light-vehicle applications, with the remaining 28% of the Company s sales to a diversified group of commercial truck, bus, construction and agricultural vehicle manufacturers, and to distributors of aftermarket replacement parts.

For the most recent three-year period, the Company s worldwide sales to the following customers were approximately as follows:

Customer	**2008**	**2007**	**2006**
Volkswagen	19%	15%	13%
Ford	9%	12%	13%
Daimler	6%	6%	11%

Daimler divested Chrysler in 2007. No other single customer accounted for more than 10% of our consolidated sales in any year of the periods presented.

The Company s automotive products are generally sold directly to OEMs substantially pursuant to negotiated annual contracts, long-term supply agreements or terms and conditions as may be modified by the parties. Deliveries are subject to periodic authorizations based upon the production schedules of the OEMs. The Company typically ships its products directly from its plants to the OEMs.

Sales and Marketing

Each of the Company s business units within its two reporting segments has its own sales function. Account executives for each of our business units are assigned to serve specific OEM customers for one or more of a business unit s products. Our account executives spend the majority of their time in direct contact with OEM purchasing and engineering employees and are responsible for servicing existing business and for identifying and obtaining new business. Because of their close relationship with OEMs, account executives are able to identify and meet customers needs based upon their knowledge of our customer s needs and our products and design and manufacturing capabilities. Upon securing a new order, account executives participate in product launch team activities and serve as a key interface with the customers.

In addition, the sales and marketing employees of our Engine segment and Drivetrain segment often work together to explore cross-development opportunities for the business units. The development of DualTronic, the Company s wet-clutch and control-system technology for a new-concept automated transmission, is an example of a successful collaboration.

Seasonality

The Company s business is moderately seasonal because the Company s largest North American customers typically halt vehicle production for approximately two weeks in July and one week in December. Additionally, customers in Europe and Asia typically shut down vehicle production during portions of July or August and one week in the fourth quarter. Accordingly, the Company s third and fourth quarters may reflect those practices.

Research and Development

The Company conducts advanced engine and drivetrain research at the segment level. This advanced engineering function looks to leverage electronics and the Company s expertise across product lines to create new engine and drivetrain systems and modules that can be commercialized. A venture capital fund that was created by the Company as seed money for new innovation and collaboration across businesses is managed by this function.

In addition, each of the Company s operating segments has its own research and development (R&D) organization. The Company has approximately 800 employees, including engineers, mechanics and technicians, engaged in R&D activities at facilities worldwide. The Company also operates testing facilities such as prototype, measurement and calibration, life cycle testing and dynamometer laboratories.

By working closely with the OEMs and anticipating their future product needs, the Company s R&D personnel conceive, design, develop and manufacture new proprietary automotive components and systems. R&D personnel also work to improve current products and production processes. The Company believes its commitment to R&D will allow it to obtain new orders from its OEM customers.

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

	Year Ended December 31,		
	2008	2007	2006
	Millions of dollars		
Gross R&D expenditures	$ 273.4	$ 246.7	$ 219.5
Customer reimbursements	(67.7)	(35.9)	(31.8)
Net R&D expenditures	$ 205.7	$ 210.8	$ 187.7

The Company s net R&D expenditures are included in the selling, general, and administrative expenses of the Consolidated Statements of Operations. Customer reimbursements are netted against gross R&D expenditures upon billing of services performed. The Company has contracts with several customers at the Company s various R&D locations. No such contract exceeded $6.0 million in any of the years presented.

Patents and Licenses

The Company has approximately 3,800 active domestic and foreign patents and patent applications pending or under preparation, and receives royalties from licensing patent rights to others. While it considers its patents on the whole to be important, the Company does not consider any single patent, any group of related patents or any single license essential to its operations in the aggregate or to the operations of any of the Company s business groups individually. The expiration of the patents individually and in the aggregate is not expected to have a material effect on the Company s financial position or future operating results. The Company owns numerous trademarks, some of which are valuable, but none of which are essential to its business in the aggregate.

The Company owns the BorgWarner and Borg-Warner Automotive trade names and housemarks, and variations thereof, which are material to the Company s business.

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Competition

The Company s operating segments compete worldwide with a number of other manufacturers and distributors which produce and sell similar products. Many of these competitors are larger and have greater resources than the Company. Price, quality, delivery, technological innovation, application engineering development and program launch support are the primary elements of competition.

The Company s major competitors by product type follow:

Product Type: Engine	**Name of Competitor**
Turbochargers:	Honeywell
	IHI
	Mitsubishi Heavy Industries (MHI)
VCT:	Aisin
	Denso
	Hitachi
Chains:	Iwis
	Schaeffler Group
	Tsubaki Group
Emissions products:	Bosch
	Pierburg
	Valeo
Thermal products:	Behr
	Horton/Sachs
	Usui
Diesel cold start technology:	Bosch
	NGK

Product Type: Drivetrain	**Name of Competitor**
Torque transfer products:	GKN Driveline
	JTEKT
	Magna Powertrain
Transmission products:	Bosch
	Denso
	Dynax
	Schaeffler Group

In addition, a number of the Company s major OEM customers manufacture, for their own use and for others, products which compete with the Company s products. Although these OEM customers have indicated that they will continue to rely on outside suppliers, the OEMs could elect to manufacture products to meet their own requirements or to compete with the Company. There can be no assurance that the Company s business will not be adversely affected by increased competition in the markets in which it operates.

For many of its products, the Company s competitors include suppliers in other parts of the world that enjoy economic advantages such as lower labor costs, lower health care costs and, in some cases, export subsidies and/or raw materials subsidies. Also, see Item 1A. Risk Factors.

Employees

As of December 31, 2008, the Company and its consolidated subsidiaries had approximately 13,800 salaried and hourly employees (as compared with approximately 17,700 employees at December 31, 2007), of which approximately 4,100 were U.S. employees. Approximately 13% of the Company s U.S. workforce is unionized. The hourly employees at certain of our international facilities are also unionized. The Company believes its present relations with employees to be satisfactory.

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Our two domestic collective bargaining agreements are for our Muncie, Indiana plant and our Ithaca and Cortland, New York facilities. The Muncie agreement expires on April 24, 2009. The agreement covering the New York facilities expires in September 2012.

Raw Materials

Continuing a trend which began in 2004, several raw materials used in the Company s products hit record pricing levels in the second quarter of 2008, including steel, aluminum, copper, resins and certain alloying elements. This was due to a host of supply and demand factors.

Despite these challenges, the Company used a variety of tactics in order to limit the impact of inflationary prices and supply shortages. The Company formed a global procurement organization to accelerate: cost reductions, purchases from lower cost regions, risk mitigation efforts, and collaborative buying activities. In addition, the Company used long-term contracts, cost sharing arrangements, design changes, customer buy programs, and hedging instruments to help control costs. The Company intends to use similar measures in 2009 and beyond. Refer to Note 11, Financial Instruments of the Notes to the Consolidated Financial Statements in Item 8 of this report for information related to the Company s hedging activities.

For 2009, the Company believes that its supplies of raw materials and energy are adequate and available from multiple sources to support its manufacturing requirements. Manufacturing operations for each of the Company s operating segments are dependent upon natural gas, fuel oil, and electricity.

Environmental Regulation and Proceedings

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency and certain state environmental agencies and private parties as potentially responsible parties (PRPs) at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 35 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

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

Based on information available to the Company (which in most cases includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large, solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation and consulting costs; remediation alternatives; and estimated legal fees), the Company has established an accrual for indicated environmental liabilities with a balance at December 31, 2008 of $11.9 million. The Company has accrued amounts that do not exceed $3.4 million related to any individual site and we do not believe that the costs related to any of these sites will have a material adverse effect on the Company s results of operations, cash flows or financial condition. The Company expects to pay out substantially all of the amounts accrued for environmental liability over the next three to five years.

In connection with the sale of Kuhlman Electric Corporation, the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities, then unknown to the Company, relating to certain operations of

Kuhlman Electric that pre-date the Company s 1999 acquisition of Kuhlman Electric. 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 is continuing to work with the Mississippi Department of Environmental Quality and Kuhlman Electric to investigate and remediate to the extent necessary, historical contamination at the plant and surrounding area. Kuhlman Electric and others, including the Company, were sued in numerous related lawsuits, in which multiple claimants alleged

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personal injury and property damage. In 2005, the Company and other defendants entered into settlements that resolved approximately 99% of the then known personal injury and property damage claims relating to the alleged environmental contamination. Those settlements involved payments by the Company of $28.5 million in the second half of 2005 and $15.7 million in the first quarter of 2006, in exchange for, among other things, dismissal with prejudice of these lawsuits.

In December 2007, a lawsuit was filed against Kuhlman Electric and others, including the Company, on behalf of approximately 209 plaintiffs, alleging personal injury relating to the alleged environmental contamination. In August 2008, two similar lawsuits were filed against Kuhlman Electric and others, including the Company, on behalf of approximately 100 plaintiffs and 30 plaintiffs, respectively, alleging personal injury related to the alleged environmental contamination. Given the early stage of the litigation, the Company cannot make any predictions as to the outcome, but its current intent is to vigorously defend against the suits.

Conditional Asset Retirement Obligations

In March 2005, the FASB issued Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143 (FIN 47), which requires the Company to recognize legal obligations to perform asset retirements in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Certain government regulations require the removal and disposal of asbestos from an existing facility at the time the facility undergoes major renovations or is demolished. The liability exists because the facility will not last forever, but it is conditional on future renovations (even if there are no immediate plans to remove the materials, which pose no health or safety hazard in their current condition). Similarly, government regulations require the removal or closure of underground storage tanks (USTs) and above ground storage tanks (ASTs) when their use ceases, the disposal of polychlorinated biphenyl (PCB) transformers and capacitors when their use ceases, and the disposal of used furnace bricks and liners, and lead-based paint in conjunction with facility renovations or demolition. The Company currently has 32 manufacturing locations that have been identified as containing these items. The fair value to remove and dispose of this material has been estimated and recorded at $1.4 million as of December 31, 2008 and $1.0 million as of December 31, 2007.

Available Information

Through its Internet website (www.borgwarner.com), the Company makes available, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports, and other filings with the Securities and Exchange Commission, as soon as reasonably practicable after they are filed or furnished. The Company also makes the following documents available on its Internet website: the Audit Committee Charter; the Compensation Committee Charter; the Corporate Governance Committee Charter; the Company s Corporate Governance Guidelines; the Company s Code of Ethical Conduct; and the Company s Code of Ethics for CEO and Senior Financial Officers. You may also obtain a copy of any of the foregoing documents, free of charge, if you submit a written request to Mary Brevard, Vice President, Investor Relations, 3850 Hamlin Road, Auburn Hills, Michigan 48326.

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Executive Officers of the Registrant

Set forth below are the names, ages, positions and certain other information concerning the executive officers of the Company as of February 12, 2009.

Name	Age	Position With Company
Timothy M. Manganello	59	Chairman and Chief Executive Officer
Robin J. Adams	55	Executive Vice President, Chief Financial Officer and Chief Administrative Officer
Angela J. D Aversa	62	Vice President, Human Resources
Daniel CasaSanta	54	Vice President
John J. Gasparovic	51	Vice President, General Counsel & Secretary
Anthony D. Hensel	50	Vice President and Treasurer
Bernd W. Matthes	48	Vice President
Jeffrey L. Obermayer	53	Vice President and Controller
Thomas Waldhier	46	Vice President
Alfred Weber	51	Vice President
Roger J. Wood	46	Vice President

Mr. Manganello has been Chairman of the Board since June 2003 and Chief Executive Officer of the Company since February 2003. He was also President and Chief Operating Officer from February 2002 until February 2003. Mr. Manganello is also a director of Bemis Company, Inc. and he serves as the Board Chairman of Federal Reserve Bank of Chicago, Detroit branch.

Mr. Adams has been Executive Vice President, Chief Financial Officer and Chief Administrative Officer since April 2004. He was Executive Vice President Finance and Chief Financial Officer of American Axle & Manufacturing Holdings Inc. (American Axle) from July 1999 until April 2004. Mr. Adams also is a member of the Supervisory Board of BERU AG.

Mr. CasaSanta has been Vice President of the Company and President and General Manager of BorgWarner TorqTransfer Systems Inc. (TTS) since June 2008. He was Vice President and General Manager of Thermal Systems from January 2003 until June 2008.

Ms. D Aversa has been Vice President, Human Resources since October 2004. She was Acting Vice President, Human Resources from April 2004 until September 2004 and Senior Director, Management and Organization Development from April 2004 until September 2004. She was Director Management & Organization Development from January 1995 until March 2004.

Mr. Gasparovic has been Vice President, General Counsel and Secretary of the Company since January 2007. After working as a private investor from January 2004 until January 2005, he was Senior Vice President and General Counsel of Federal-Mogul Corporation from February 2005 until December 2006. From February 2003 until December 2003, he was Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer and from May 2000 until January 2003 he was Vice President, General Counsel (and Secretary since January 2001) of Roadway Corporation.

Mr. Hensel has been Vice President of the Company since July 2002 and Treasurer since January 2005. He was Vice President, Business Development from July 2002 until December 2004. Mr. Hensel also is a member of the

Supervisory Board of BERU AG.

Mr. Matthes has been Vice President of the Company and President and General Manager of BorgWarner Transmission Systems Inc. (Transmission Systems) since July 2005. He was General Manager, Operations Europe for Transmission Systems from August 2004 to July 2005. He was Vice President-Operations Europe for Transmission Systems from January 2003 to August 2004. He was General Manager, DualTronic from November 2000 to July 2005.

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Mr. Obermayer has been Vice President since December 1999 and Controller since January 2005. He was Vice President and Treasurer of the Company from December 1999 to December 2004.

Mr. Waldhier has been Vice President of the Company since November 2008 and Chief Executive Officer of BERU since October 2007. He was a member of the Management Board of SAS Autosystemtechnik and Executive Vice President and Chief Operating Officer of SAS Automotive from April 2004 to October 2007. He was Vice President of Faurecia Interior Systems from January 2001 to March 2004.

Mr. Weber has been Vice President of the Company since July 2002. He has been President and General Manager of BorgWarner Morse TEC Inc. (Morse TEC) since August 2005 and BorgWarner Thermal Systems Inc. since January 2003. He was President and General Manager of BorgWarner Emissions Systems Inc. from July 2002 to July 2005. Mr. Weber also is a member of the Supervisory Board of BERU AG.

Mr. Wood has been Vice President of the Company since January 2001 and President and General Manager of BorgWarner Turbo Systems Inc. and BorgWarner Emissions Systems Inc. since August 2005. He was President and General Manager of Morse TEC from January 2001 to July 2005.

Item 1A. Risk Factors

The following risk factors and other information included in this Annual Report on Form 10-K should be considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business including its financial performance, financial condition, operating results and cash flows could be materially adversely affected.

Our industry is cyclical and our results of operations will be adversely affected by industry downturns.

Automotive and truck production and sales are cyclical and sensitive to general economic conditions and other factors including interest rates, consumer credit, and consumer spending and preferences. Further economic decline that results in further significant reduction in automotive or truck production would have a material adverse effect on our sales to original equipment manufacturers.

We have initiated steps to realign and resize our production capacity and cost structure to meet current and projected operational and market requirements. Further significant declines in the automotive industry and financial declines and restructurings by our significant customers may make it necessary to take further restructuring actions and charges.

We are dependent on market segments that use our key products and would be affected by decreasing demand in those segments.

Some of our products, in particular turbochargers, are currently used primarily in diesel passenger cars and commercial vehicles. Any significant reduction in production in these market segments or loss of business in these market segments could have a material adverse effect on our sales to original equipment manufacturers.

We face strong competition.

We compete worldwide with a number of other manufacturers and distributors that produce and sell products similar to ours. Price, quality and technological innovation are the primary elements of competition. Our competitors include vertically integrated units of our major original equipment manufacturer customers, as well as a large number of independent domestic and international suppliers. We are not as large as a number of these companies and do not have as many financial or other resources. The competitive environment has changed dramatically over the past few years as our traditional U.S. original equipment manufacturer customers, faced with intense international competition, have expanded their worldwide sourcing of components. As a result, we have experienced competition from suppliers in other parts of the world that enjoy economic advantages, such as lower labor costs, lower health care costs and, in some cases, export or raw materials subsidies. Increased competition could adversely affect our businesses.

We are under substantial pressure from original equipment manufacturers to reduce the prices of our products.

There is substantial and continuing pressure on original equipment manufacturers to reduce costs, including costs of products we supply. Although original equipment manufacturers have indicated that they will continue to rely on outside suppliers, a number of our major original equipment manufacturer customers manufacture products for their own uses that directly compete with our products. These original equipment manufacturers could elect to manufacture such products for their own uses in place of the products we currently supply. We believe that our ability to develop proprietary new products and to control our costs will allow us to remain competitive. However, we cannot assure you that we will be able to improve or maintain our gross margins on product sales to original equipment manufacturers or that the recent trend by original equipment manufacturers towards increased outsourcing will continue.

Annual price reductions to original equipment manufacturer customers appear to have become a permanent feature of our business environment. To maintain our profit margins, we seek price reductions from our suppliers, improve production processes to increase manufacturing efficiency, update product designs to reduce costs and develop new products, the benefits of which support stable or increased prices. Our ability to pass through increased raw material costs to our original equipment manufacturer customers is limited, with cost recovery often less than 100% and often on a delayed basis. We cannot assure you that we will be able to reduce costs in an amount equal to annual price reductions and increases in raw material costs.

We are sensitive to the effects of our major customers labor relations.

All three of our primary North American customers, Ford, Chrysler and General Motors, have major union contracts with the United Automobile, Aerospace and Agricultural Implement Workers of America. Because of domestic original equipment manufacturers dependence on a single union, we are affected by labor difficulties and work stoppages at original equipment manufacturers facilities. Similarly, a majority of our global customers operations outside of North America are also represented by various unions. Any extended work stoppage could have an adverse effect on our business.

Part of our labor force is unionized which could subject us to work stoppages.

As of December 31, 2008, approximately 13% of our U.S. workforce was unionized. Our two domestic collective bargaining agreements are for our Muncie, Indiana plant and our Ithaca and Cortland, New York facilities. The Muncie agreement expires on April 24, 2009. The agreement covering the New York facilities expires in September 2012. The hourly employees at certain of our international facilities are also unionized. While we believe that our relations with our employees are satisfactory, a prolonged dispute with our employees could have an adverse effect on our business.

We are subject to extensive environmental regulations.

Our operations are subject to laws governing, among other things, emissions to air, discharges to waters and the generation, handling, storage, transportation, treatment and disposal of waste and other materials. We believe that our business, operations and activities have been and are being operated in compliance in all material respects with applicable environmental, health and safety laws. However, the operation of automotive parts manufacturing plants entails risks in these areas, and we cannot assure you that we will not incur material costs or liabilities as a result. Furthermore, through various acquisitions over the years, we have acquired a number of manufacturing facilities, and we cannot assure you that we will not incur materials costs and liabilities relating to activities that predate our ownership. In addition, potentially significant expenditures could be required in order to comply with evolving environmental, health and safety laws that may be adopted in the future.

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We have contingent liabilities related to environmental, product warranties, regulatory matters, litigation and other claims.

We and certain of our current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency and certain state environmental agencies and private parties as potentially responsible parties at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act and equivalent state laws. As a result, as of December 31, 2008, we may be liable for the cost of clean-up and other remedial activities at 35 of these sites.

We work with outside experts to determine a range of potential liability for environmental sites. The ranges for each individual site are then aggregated into a loss range for the total accrued liability. Management s estimate of the loss range for environmental liability, including conditional asset retirement obligations, for 2008 is between $12.4 million and $26.1 million. We record an accrual at the most probable amount within the range unless one cannot be determined; in which case we record the accrual at the low end of the range. Based on information available to us, we have established an accrual in our financial statements for indicated environmental liabilities, including our conditional asset retirement obligation under FIN 47, with a total balance of $1.4 million at December 31, 2008. We currently expect the substantial portion of this amount to be expended over the next three to five years.

We provide warranties to our customers for some of our products. Under these warranties, we may be required to bear costs and expenses for the repair or replacement of these products. We cannot assure you that costs and expenses associated with these product warranties will not be material, or that those costs will not exceed any amounts accrued for such warranties in our financial statement. Based upon information available to us, we have established an accrual in our financial statements for product warranties of $82.1 million at December 31, 2008.

We are also party to, or have an obligation to defend a party to, various legal proceedings, including those described in Note 15 to the Notes to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K.

We are currently, and may in the future become, subject to legal proceedings and commercial or contractual disputes. These claims typically arise in the normal course of business and may include, but not be limited to, commercial or contractual disputes with our suppliers, intellectual property matters and employment claims. There is a possibility that such claims may have an adverse impact on our business that is greater than we anticipate.

Our growth strategy may prove unsuccessful.

We have a stated goal of increasing revenues and operating revenues at a rate greater than global vehicle production by increasing content per vehicle with innovative new components and through select acquisitions. We may not meet our goal because of any of the following: (a) the failure to develop new products which will be purchased by our customers; (b) technology changes rendering our products obsolete; (c) a reversal of the trend of supplying systems (which allows us to increase content per vehicle) instead of components; and (d) the failure to find suitable acquisition targets or the failure to integrate operations of acquired businesses quickly and cost effectively.

We are subject to risks related to our international operations.

We have manufacturing and technical facilities in many regions and countries, including North America, Europe, China, India, South Korea, Japan, and Brazil and sell our products worldwide. For 2008, approximately 68% of our sales were outside North America. Consequently, our results could be affected by changes in trade, monetary and fiscal policies, trade restrictions or prohibitions, import or other charges or taxes, and fluctuations in foreign currency exchange rates, limitations on the repatriation of funds changing economic conditions, social unrest, political instability and disputes, and international terrorism. Compliance with multiple and potentially conflicting laws and regulations of various countries is burdensome and expensive. See Note 21, Reporting

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Segments and Related Information to Consolidated Financial Statements in the Company s Annual Report on Form 10-K.

We may not realize sales represented by awarded business.

We base our growth projections, in part, on commitments made by our customers. These commitments generally renew yearly during a program life cycle. If actual production orders from our customers do not approximate such commitments, it could adversely affect our business.

We are impacted by the rising cost of providing pension and other post employment benefits.

The automotive industry, like other industries, continues to be impacted by the rising cost of providing pension and other post employment benefits. To partially address this impact, we announced adjustments to certain retiree medical and pension plans to be effective January 1, 2009. See Note 12, Retirement Benefit Plans to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K.

Certain defined benefit pension plans we sponsor are currently underfunded.

We sponsor certain defined benefit pension plans worldwide that are underfunded and will require cash payments. Additionally, if the performance of the assets in our pension plans does not meet our expectations, or if other actuarial assumptions are modified, our required contributions may be higher than we expect. See Note 12, Retirement Benefit Plans to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K.

Negative or unexpected tax consequences could adversely affect our business.

Adverse changes in the underlying profitability and financial outlook of our operations in several jurisdictions could lead to changes in our valuation allowances against deferred tax assets and other tax accruals that could adversely affect our financial performance.

Additionally, we are subject to tax audits by governmental authorities in the U.S. and numerous non-U.S. jurisdictions. Because the results of tax audits are inherently uncertain, negative or unexpected results from one or more such tax audits could adversely affect our business.

We rely on sales to major customers.

We rely on sales to original equipment manufacturers around the world. Supply to several of these customers requires significant investment by the Company in working capital, plant and equipment. Some of our customers are rated by the credit rating agencies as below investment grade. The loss of sales to a major customer, due to any of a variety of factors including non-renewal of purchase orders, the customer s financial hardship or other unforeseen reasons, could adversely affect our business.

Furthermore, some of our sales are concentrated. Our worldwide sales in 2008 to Volkswagen and Ford constituted approximately 19% and 9%, respectively, of our 2008 consolidated sales.

Suppliers economic distress could result in the disruption of our operations and have a material effect on our business.

Unfavorable industry conditions such as lower production volumes; credit tightness; changes in foreign currencies; raw material, commodity, transportation, and energy price escalation; drastic changes in consumer preferences; and others could adversely affect our supply chain, and sometimes with little advanced notice. These conditions could also result in increased commercial disputes and supply interruption risks. In certain instances, it would be difficult and expensive for us to change suppliers that are critical to our business. On occasion, we must provide financial support to distressed suppliers or take other measures to protect our supply lines. While we have taken definite actions to mitigate these factors, we can not predict with certainty the potential adverse effects these costs might have on our business.

We continue to face highly volatile commodity costs used in the production of our products.

The Company uses a variety of commodities (including steel, nickel, copper, aluminum, plastic resins, other raw materials and energy) and materials purchased in various forms such as castings, powder metal, forgings, stampings, and bar stock. Increasing commodity costs will have an impact on our results. We have sought to alleviate the impact of increasing costs by selectively hedging certain commodity exposures or by including a material pass-through provision in our customer contracts wherever possible. Customers frequently challenge these contractual provisions and rarely pay the full cost of any materials increases. The continuation of this practice would adversely affect our business.

From time to time, commodity prices may also fall rapidly. When this happens, suppliers may withdraw capacity from the market until prices improve which may cause periodic supply interruptions. The same may be true of our transportation carriers and energy providers.

We could be adversely affected by supply shortages of components from our suppliers.

In an effort to manage and reduce the cost of purchased goods and services, we have been rationalizing our supply base. As a result, we are dependent on fewer sources of supply for certain components used in the manufacture of our products. The Company selects suppliers based on total value (including total landed price, quality, delivery, and technology), taking into consideration their production capacities and financial condition. We expect that they will deliver to our stated written expectations.

However, there can be no assurance that capacity limitations, labor unrest, weather emergencies, commercial disputes, government actions, riots, wars, sabotage, non-conforming parts, acts of terrorism, Acts of God , or other problems experienced by our suppliers will not result in occasional shortages or delays in their supply of components to us. If we were to experience a significant or prolonged shortage of critical components from any of our suppliers and could not procure the components from other sources, we would be unable to meet the production schedules for some of our key products and could miss customer delivery expectations. This would adversely affect our customer relations and business.

A downgrade in the ratings of our debt could restrict our ability to access the debt capital markets.

Changes in the ratings that rating agencies assign to our debt may ultimately impact our access to the debt capital markets and the costs we incur to borrow funds. If ratings for our debt fall below investment grade, our access to the debt capital markets would become restricted. The tightening in the credit markets and the low level of liquidity in many financial markets due to the current turmoil in the financial and banking industries could also affect our access to the debt capital markets. In the event the Company is unable to access the debt capital markets, we would have the ability to draw on our $600 million revolving credit facility; however, this agreement is scheduled to expire July 22, 2009.

Additionally, our revolving credit agreement includes an increase in interest rates if the ratings for our debt are downgraded. Further, an increase in the level of our indebtedness and related interest costs may increase our vulnerability to adverse general economic and industry conditions and may affect our ability to obtain additional financing.

Conditions in the automotive industry may adversely affect our business.

Our financial performance depends on conditions in the global automotive industry. Ford Motor Company, General Motors Corporation and Chrysler LLP (collectively the Detroit 3) have experienced declining market shares and are burdened with significant structural costs that have affected their profitability and labor relations and may ultimately result in severe financial difficulty, including possible bankruptcy. If the Detroit 3 cannot fund their operations or if major customers reach similar levels of financial distress we may incur significant write-offs of accounts receivable, incur impairment charges or require additional restructuring actions beyond those already taken. Automakers across Europe are also experiencing difficulties from a weakened economy and tightening credit markets. If our customers reduce their orders to us, it would adversely affect our results of operations. A prolonged downturn in the North American or European automotive industries or a significant

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product mix shift due to consumer demand could require us to shut down plants or incur impairment charges. Continued uncertainty relating to the financial condition of the Detroit 3 and other automakers would have a negative impact on our business.

We are subject to possible insolvency of financial counterparties.

The Company engages in numerous financial transactions and contracts including insurance policies, letters of credit, credit line agreements, financial derivatives, and investment management agreements involving various counterparties. The Company is subject to the risk that one or more of these counterparties may become insolvent and therefore be unable to discharge its obligations under such contracts.

We are subject to possible insolvency of outsourced service providers.

The Company relies on third party service providers for administration of workers compensation claims, health care benefits, pension benefits, stockholder and bondholder registration and similar services. These service providers contribute to the efficient conduct of the Company s business, so the Company could be adversely affected in the event of insolvency of one or more of these service providers.

A variety of other factors could adversely affect our business.

Any of the following could materially and adversely affect our business: the loss of or changes in supply contracts or sourcing strategies of our major customers or suppliers; start up expenses associated with new vehicle programs or delays or cancellation of such programs, underutilization of our manufacturing facilities, which can be dependent on a single product line or customer; inability to recover engineering and tooling costs; market and financial consequences of recalls that may be required on products we supplied; delays or difficulties in new product development; the possible introduction of similar or superior technologies by others; and global overcapacity and vehicle platform proliferation.

Item 1B. Unresolved Staff Comments

The Company has received no written comments regarding its periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of its 2008 fiscal year and that remain unresolved.

Item 2. Properties

As of December 31, 2008, the Company had 60 manufacturing, assembly, and technical locations worldwide. In addition to its 14 U.S. manufacturing locations, the Company has 10 locations in Germany; five locations in each of India and Korea; three locations in each of the United Kingdom, France, China, and Japan; and one location in each of Brazil, Canada, Hungary, Ireland, Italy, Monaco, Mexico, Poland, Spain, and Taiwan. The Company also has several sales offices, warehouses and technical centers. The Company s worldwide headquarters are located in a leased facility in Auburn Hills, Michigan. In general, the Company believes its facilities to be suitable and adequate to meet its current and reasonably anticipated needs.

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The following is additional information concerning the principal manufacturing, assembly, and technical facilities operated by the Company, its subsidiaries, and affiliates.(a)

ENGINE

Americas:	Europe:	Asia:
Asheville, North Carolina	Arcore, Italy	Aoyama, Japan
Auburn Hills, Michigan	Bradford, England	Changwon, South Korea(b)
Cadillac, Michigan	Bretten, Germany	Chennai, India
Campinas, Brazil	Chazelles, France	Chungju-City, South Korea
Cortland, New York	Diss, England	Kakkalur, India
Dixon, Illinois	Kandel, Germany(b)	Nabari City, Japan
Fletcher, North Carolina	Kirchheimbolanden, Germany	Ningbo, China
Guadalajara, Mexico	La Ferte Mace, France	Pune, India
Ithaca, New York	Ludwigsburg, Germany	Pyongtaek, South Korea(b)
Marshall, Michigan	Markdorf, Germany	Tainan Shien, Taiwan
Sallisaw, Oklahoma	Muggendorf, Germany	
Simcoe, Ontario, Canada	Neuhaus, Germany	
	Oroszlany, Hungary	
	Rzeszow, Poland	
	Tralee, Ireland	
	Vitoria, Spain	

DRIVETRAIN

Americas:	Europe:	Asia:
Addison, Illinois(b)	Arnstadt, Germany	Beijing, China
Auburn Hills, Michigan	Heidelberg, Germany	Eumsung, South Korea
Bellwood, Illinois	Ketsch, Germany	Fukuroi City, Japan
Frankfort, Illinois	Margam, Wales(d)	Ningbo, China
Livonia, Michigan	Principality of Monaco	Ochang, South Korea(b)
Longview, Texas	Tulle, France	Pune, India
Muncie, Indiana(c)		Shanghai, China
Seneca, South Carolina		Sirsi, India
Water Valley, Mississippi		

(a) The table excludes joint ventures owned less than 50% and administrative offices in Auburn Hills, Michigan USA and Shanghai, China.

(b) Indicates leased land rights or a facility.

(c) Announced closure plans for 2009.

(d) Announced closure plans for 2010.

Item 3. Legal Proceedings

The Company is subject to a number of claims and judicial and administrative proceedings (some of which involve substantial amounts) arising out of the Company s business or relating to matters for which the Company may have a contractual indemnity obligation. Refer to Note 15, Contingencies of the Notes to the Consolidated Financial Statements in Item 8 of this report for a discussion of environmental, asbestos and other litigation.

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

The Company has communicated its plan to reduce the level of benefits provided to the retirees to make them comparable to other Company retiree benefit plans. The change will be effective following expiration of the health insurance agreement in April 24, 2009.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to the Company s security holders during the fourth quarter of 2008.

PART II

Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company s Common Stock is listed for trading on the New York Stock Exchange under the symbol BWA. As of February 6, 2009, there were 2,463 holders of record of Common Stock.

The Company has increased its declared dividend during each of the last seven years. Cash dividends declared and paid per share, adjusted for stock splits in 2004 and 2007, were as follows:

	2008	2007	2006	2005	2004
Dividend Amount	$ 0.44	$ 0.34	$ 0.32	$ 0.28	$ 0.25

While the Company currently expects that the 2009 quarterly cash dividend of $0.12 per share ($0.48 per year) will continue to be paid in the future, the dividend policy is subject to review and change at the discretion of the Board of Directors.

High and low sales prices* (as reported on the New York Stock Exchange composite tape) for the Common Stock for each quarter in 2007 and 2008 were:

Quarter Ended	High	Low
March 31, 2007	$ 39.31	$ 29.02
June 30, 2007	$ 43.43	$ 36.63
September 30, 2007	$ 48.08	$ 37.73
December 31, 2007	$ 53.00	$ 46.11

March 31, 2008	$ 51.39	$ 40.16
June 30, 2008	$ 55.99	$ 42.30
September 30, 2008	$ 45.54	$ 30.82
December 31, 2008	$ 32.69	$ 15.00

* All amounts have been restated, per the 2-for-1 stock split that was effected through a stock dividend on December 17, 2007.

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The line graph below compares the cumulative total shareholder return on our Common Stock with the cumulative total return of companies on the Standard & Poor s (S&P s) 500 Stock Index, companies within BorgWaner s peer group, and companies within Standard Industrial Code (SIC) 3714 Motor Vehicle Parts.

This graph assumes the investment of $100 on September 1, 2003 and the reinvestment of all dividends since that date.

5 Year Cumulative Total Return (%)

BWA, S&P 500 and Peer Group data gleaned from Capital IQ; SIC Code Index gleaned from Research Data Group

	2003	2004	2005	2006	2007	2008
BorgWarner Inc.(1)	100.00	128.95	145.86	143.55	237.45	108.08
S&P 500(2)	100.00	108.99	112.27	127.56	132.06	81.23
SIC Code Index(3)	100.00	109.81	93.13	108.37	114.92	52.88
Peer Group(4)	100.00	106.56	103.25	117.89	127.17	53.08

(1) BorgWarner Inc.

(2) S&P 500 Standard & Poor s 500 Total Return Index

(3) Standard Industrial (SIC) 3714-Motor Vehicle Parts

(4) Peer Group Companies Consists of the following companies:
American Axle & Manufacturing Holdings, Inc., Arvin Meritor Inc., Autoliv Inc., Gentex Corp., Johnson Controls Inc., Lear Corporation, Magna International, Inc., Modine Manufacturing Co., Tenneco Automotive, Inc., TRW Automotive Holdings Corp. and Visteon Corporation

Repurchases of Equity Securities

The Company s Board of Directors previously authorized the purchase of up to 9.8 million shares (adjusted for the company s 2007 two-for-one stock split) of the Company s common stock. As of December 31, 2008, the Company has repurchased 5,422,428 shares.

All shares purchased under this authorization have been and will continue to be repurchased in the open market at prevailing prices and at times the amounts to be determined by management as market conditions and the Company s capital position warrant. The Company may use Rule 10b5-1 plans to facilitate share repurchases.

Repurchased shares will be deemed treasury shares and may subsequently be reissued for general corporate purposes.

The following table provides information about Company purchases of its equity securities that are registered pursuant to Section 12 of the Exchange Act during the quarter ended December 31, 2008, at a total cost of $7.4 million:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
Month Ended October 31, 2008	230,000	$ 23.81	230,000	4,463,072
Month Ended November 30, 2008	85,500	23.04	85,500	4,377,572
Month Ended December 31, 2008				4,377,572
Total	315,500	$ 23.60	315,500	4,377,572

Note: all purchases were made on the open market.

Equity Compensation Plan Information

As of December 31, 2008, the number of stock options and restricted common stock outstanding under our equity compensation plans, the weighted average exercise price of outstanding options and restricted common stock, and the number of securities remaining available for issuance were as follows:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Restricted Common Stock, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Restricted Common Stock, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders	6,459,201	$ 29.65	1,648,449

Equity compensation plans not approved by security holders				
Total	6,459,201	$	29.65	1,648,449

Item 6. Selected Financial Data

Refer to Note 21, Reporting Segments and Related Information of the Notes to the Consolidated Financial Statements in Item 8 of this report for Selected Financial Data for the five years ended December 31, 2008. See the material in response to Item 7 of this report for a discussion of the factors that materially affect the comparability of the information contained in such data.

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Item 7. 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 primarily for powertrain applications. Our products help improve vehicle performance, fuel efficiency, air quality and vehicle stability. They are manufactured and sold worldwide, primarily to original equipment manufacturers (OEMs) of light vehicles (i.e. passenger cars, sport-utility vehicles (SUVs), cross-over vehicles, vans and light trucks). Our products are also manufactured and sold to OEMs of commercial trucks, buses and agricultural and off-highway vehicles. We also manufacture for and sell our products to certain Tier One vehicle systems suppliers and into the aftermarket for light and commercial vehicles. We operate manufacturing facilities serving customers in the Americas, Europe and Asia, and are an original equipment supplier to every major automaker in the world.

The Company s products fall into two reporting segments: Engine and Drivetrain. The Engine segment s products include turbochargers, timing chain systems, air management, emissions systems, thermal systems, as well as diesel and gas ignition systems. The Drivetrain segment s products include all-wheel drive transfer cases, torque management systems, and components and systems for automated transmissions.

Stock Split

On November 14, 2007, the Company s Board of Directors approved a two-for-one stock split effected in the form of a stock dividend on its common stock. To implement this stock split, shares of common stock were issued on December 17, 2007 to stockholders of record as of the close of business on December 6, 2007. All prior year share and per share amounts disclosed in this document have been restated to reflect the two-for-one stock split.

RESULTS OF OPERATIONS

Overview

A summary of our operating results for the years ended December 31, 2008, 2007 and 2006 is as follows:

millions of dollars, except per share data Year Ended December 31,	**2008**	**2007**	**2006**
Net sales	$ 5,263.9	$ 5,328.6	$ 4,585.4
Cost of sales	4,425.4	4,378.7	3,735.5
Gross profit	838.5	949.9	849.9
Selling, general and administrative expenses	542.9	531.9	498.1
Restructuring expense	127.5		84.7
Goodwill impairment charge	156.8		
Other income	(3.1)	(6.8)	(7.5)
Operating income	14.4	424.8	274.6
Equity in affiliates earnings, net of tax	(38.4)	(40.3)	(35.9)
Interest expense and finance charges	38.8	34.7	40.2

Earnings before income taxes and minority interest		14.0		430.4		270.3
Provision for income taxes		33.3		113.9		32.4
Minority interest, net of tax		16.3		28.0		26.3
Net earnings (loss)	$	(35.6)	$	288.5	$	211.6
Earnings (loss) per share diluted	$	(0.31)	$	2.45	$	1.83

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A summary of major factors impacting the Company s net earnings for the year ended December 31, 2008 in comparison to 2007 and 2006 is as follows:

Global financial market and economic crisis in the second half of 2008 significantly impacted consumer demand for light vehicles and negatively impacted our sales.

Continued demand for our products in both Engine and Drivetrain segments.

Lower North American production of light trucks and SUVs.

Continued benefits from our cost reduction programs, including containment of raw material and energy cost increases, health care cost inflation and the costs related to global expansion.

Restructuring expenses in the third and fourth quarters of 2006 to adjust headcount and capacity levels, primarily in North America and primarily in the Drivetrain segment.

Restructuring expenses in the third and fourth quarters of 2008 to adjust headcount and capacity levels, in North America, Europe and Asia.

The write-offs of the excess purchase price allocated to in-process research and development (IPR&D), order backlog and beginning inventory related to the 2007 acquisition of approximately 12.8% of BERU AG (BERU) stock and the 2008 completion of a Domination and Profit Transfer Agreement (DPTA) between the Company and BERU.

The write-offs of the excess purchase price allocated to IPR&D, order backlog and beginning inventory related to the 2006 acquisition of the European Transmission and Engine Controls (ETEC) product lines from Eaton in Monaco.

Favorable currency impact of $13.0 million, $15.2 million and $0.4 million in 2008, 2007 and 2006, respectively.

Adjustments to tax accounts in 2008, 2007 and 2006 upon conclusion of certain tax audits and changes in circumstances, including changes in tax laws.

An approximate $14 million provision in 2007 for a warranty-related issue surrounding a product, built during a 15-month period in 2004 and 2005, that is no longer in production.

An approximate $23.5 million warranty-related issue associated with the company s transmission product sold in Europe, limited to mid-2007 through May 2008 production.

An 111.5 million $(156.8 million) impairment charge in 2008 to adjust BERU s goodwill to its estimated fair value.

Recognition in 2008 of a $4.0 million charge related to an untimely change in the level of benefits provided to BorgWarner Diversified Transmission Products Inc (DTP) retirees.

The establishment of a valuation allowance for foreign tax credit carryforwards in 2008 of $13.5 million.

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The Company s earnings (loss) per diluted share were $(0.31), $2.45 and $1.83 for the years ended December 31, 2008, 2007 and 2006, respectively. The Company believes the following table is useful in highlighting non-recurring or non-comparable items that impacted its earnings per diluted share:

Year Ended December 31,	2008	2007	2006
Non-recurring or non-comparable items:			
Goodwill impairment charge	$ (1.35)	$	$
Restructuring expense	(0.72)		(0.41)
Transmission product related warranty charge	(0.14)		
Tax valuation allowance	(0.12)		
Write-off of the excess purchase price allocated to IPR&D, order backlog and beginning inventory associated with acquisitions	(0.04)	(0.02)	(0.02)
Net gain from divestitures			0.03
Adjustments to tax accounts	0.02	0.03	0.19
Retiree healthcare litigation outcome	(0.03)		
Total impact to earnings per share diluted:	$ (2.38)	$ 0.01	$ (0.21)

The Company s effective tax rate, after giving tax effect to the non-recurring or non-comparable items shown above, was 23.0%, 27.1%, and 26.0% for 2008, 2007, and 2006, respectively.

Net Sales

The table below summarizes the overall worldwide global light vehicle production percentage changes for 2008 and 2007:

Worldwide Light Vehicle Year Over Year Increase (Decrease) in Production

	2008	2007
North America*	(15.8)%	(1.5)%
Europe*	(4.5)%	5.6%
Asia*	2.4%	7.1%
Total Worldwide*	(3.7)%	5.0%
BorgWarner year over year net sales change	(1.2)%	16.2%

* Data provided by CSM Worldwide.

Our net sales decrease in 2008 of 1.2% was slightly better than the estimated worldwide market production decrease of 3.7%. Our net sales increase in 2007 of 16.2% was strong in light of the estimated worldwide market production increase of 5.0%. The effect of changing currency rates had a positive impact on the Company s net sales and net earnings in 2008 and 2007. The effect of non-U.S. currencies, primarily the Euro, increased net sales by

$191.0 million and reduced the Company s net loss by $13.0 million in 2008. In 2007, non-U.S. currencies, primarily the Euro, added $262.1 million to net sales and $15.2 million to net earnings. The year over year decrease in net sales, excluding the favorable impact of currency, was 4.8% in 2008. The year over year increase in net sales, excluding the favorable impact of currency, was 10.5% in 2007.

Consolidated net sales included sales to Volkswagen of approximately 19%, 15%, and 13%; to Ford of approximately 9%, 12%, and 13%; and to Daimler of approximately 6%, 6%, and 11% for the years ended December 31, 2008, 2007 and 2006, respectively. Daimler divested Chrysler in 2007. Both of our reporting segments had significant sales to all three of the customers listed above. Such sales consisted of a variety of products to a variety of customer locations and regions. No other single customer accounted for more than 10% of consolidated sales in any year of the periods presented.

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Outlook

The Company is very cautious about 2009. The recent crisis in the financial sector and deteriorating global economic conditions have increased uncertainty about automotive vehicle sales in every geographic region of the world. The Company expects the unprecedented current global economic environment to continue to affect near-term results and to create difficult conditions through 2009.

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

The impact of non-U.S. currencies is currently expected to be a decline in 2009. When the recovery from current global economic conditions occur, we expect long-term sales and net earnings growth to resume to historical rates.

Results By Reporting Segment

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

The Company allocates resources to each segment based upon the projected after-tax return on invested capital (ROIC) of its business initiatives. The ROIC is comprised of projected earnings before interest and taxes (EBIT) adjusted for taxes compared to the projected average capital investment required.

EBIT is considered a non-GAAP financial measure. Generally, a non-GAAP financial measure is a numerical measure of a company s financial performance, financial position or cash flows that excludes (or includes) amounts that are included in (or excluded from) the most directly comparable measure calculated and presented in accordance with GAAP. EBIT is defined as earnings before interest, taxes and minority interest. Earnings is intended to mean net earnings as presented in the Consolidated Statements of Operations under GAAP.

The Company believes that EBIT is useful to demonstrate the operational profitability of its segments by excluding interest and taxes, which are generally accounted for across the entire Company on a consolidated basis. EBIT is also one of the measures used by the Company to determine resource allocation within the Company. Although the Company believes that EBIT enhances understanding of its business and performance, it should not be considered an alternative to, or more meaningful than, net earnings or cash flows from operations as determined in accordance with GAAP.

The following tables present net sales and Segment EBIT by segment for the years 2008, 2007 and 2006:

Net Sales

millions of dollars Year Ended December 31,	2008	2007	2006
Engine	$ 3,861.5	$ 3,761.3	$ 3,154.9
Drivetrain	1,426.4	1,598.8	1,461.4

Inter-segment eliminations	(24.0)	(31.5)	(30.9)
Net sales	$ 5,263.9	$ 5,328.6	$ 4,585.4

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Earnings Before Interest and Taxes

millions of dollars Year Ended December 31	2008	2007	2006
Engine	$ 394.9	$ 418.0	$ 365.8
Drivetrain	(4.9)	118.1	90.6
Segment earnings before interest and taxes (Segment EBIT)	390.0	536.1	456.4
Restructuring expense	(127.5)		(84.7)
Goodwill impairment charge	(156.8)		
Corporate, including equity in affiliates earnings	(52.9)	(71.0)	(61.2)
Consolidated earnings before interest and taxes (EBIT)	52.8	465.1	310.5
Interest expense and finance charges	38.8	34.7	40.2
Earnings before income taxes and minority interest	14.0	430.4	270.3
Provision for income taxes	33.3	113.9	32.4
Minority interest, net of tax	16.3	28.0	26.3
Net earnings (loss)	$ (35.6)	$ 288.5	$ 211.6

The **Engine** segment 2008 net sales were up 2.7% from 2007, with a 5.5% decrease in Segment EBIT over the same period. The Engine segment continued to benefit from Asian automaker demand for turbochargers and timing systems, European automaker demand for turbochargers, timing systems, exhaust gas recirculation (EGR) valves and diesel engine ignition systems. This benefit was offset by lower North American production of light truck and sport-utility vehicles. The Segment EBIT margin was 10.2% in 2008, down from 11.1% in 2007 (which includes the one-time write-off in 2008 of the excess purchase price allocated to BERU s IPR&D, order backlog and inventory), due to the significant reduction in customer production schedules in the U.S. and European markets, and increased costs for raw materials, principally steel.

The Engine segment 2007 net sales were up 19.2% from 2006, with a 14.3% increase in Segment EBIT over the same period. The Engine segment continued to benefit from Asian automaker demand for turbochargers and timing systems, European automaker demand for turbochargers, timing systems, exhaust gas recirculation (EGR) valves and diesel engine ignition systems, the continued roll-out of its variable cam timing systems with General Motors high-value V6 engines, stronger EGR valve sales in North America, and higher turbocharger and thermal products sales due to stronger global commercial vehicle production. The Segment EBIT margin was 11.1% in 2007 down from 11.6% in 2006 (which includes the one-time write-off in 2007 of the excess purchase price allocated to BERU s IPR&D, order backlog and inventory), due to the significant reduction in customer production schedules in the U.S. market and increased costs for raw materials, principally nickel.

The **Drivetrain** segment 2008 net sales decreased 10.8% from 2007 with a 104.1% decrease in Segment EBIT over the same period. The group was negatively impacted by lower U.S. production of light trucks and SUVs equipped with its torque transfer products and lower sales of its traditional transmission products. Segment EBIT margin was (0.3)% in 2008, down from 7.4% in the prior year, due to the combined effect of DCT product start-up cost pressures and lower North American production of light trucks and sport-utility vehicles equipped with its torque transfer products.

The Drivetrain segment 2007 net sales increased 9.4% from 2006 with a 30.4% increase in Segment EBIT over the same period. The segment continued to benefit from growth outside of North America including the continued ramp up of dual-clutch transmission and torque transfer product sales in Europe. In the U.S., the group was negatively impacted by lower production of light trucks and SUVs equipped with its torque transfer products and lower sales of its traditional transmission products. Segment EBIT margin was 7.4% in 2007, up from 6.2% in the prior year, due to the benefits of restructuring in its North American operations and growth outside of the U.S.

Corporate is the difference between calculated total Company EBIT and the total of the Segments EBIT. It represents corporate headquarters expenses, expenses not directly attributable to the individual segments and equity in affiliates earnings. This net expense was $52.9 million in 2008, $71.0 million in 2007 and $61.2 million in 2006.

Other Factors Affecting Results of Operations

The following table details our results of operations as a percentage of sales:

Year Ended December 31,	**2008**	**2007**	**2006**
Net sales	100.0%	100.0%	100.0%
Cost of sales	84.1	82.2	81.5
Gross profit	15.9	17.8	18.5
Selling, general and administrative expenses	10.3	10.0	10.9
Restructuring expense	2.4		1.8
Goodwill impairment charge	3.0		
Other income	(0.1)	(0.2)	(0.2)
Operating income	0.3	8.0	6.0
Equity in affiliates earnings, net of tax	(0.7)	(0.8)	(0.8)
Interest expense and finance charges	0.7	0.7	0.9
Earnings before income taxes and minority interest	0.3	8.1	5.9
Provision for income taxes	0.7	2.2	0.7
Minority interest, net of tax	0.3	0.5	0.6
Net earnings (loss)	(0.7)%	5.4%	4.6%

Gross profit as a percentage of net sales was 15.9%, 17.8% and 18.5% in 2008, 2007 and 2006, respectively. Our gross profit decrease in 2008 is due to unfavorable product mix as a result of the sudden decline in the North American and European automotive markets, including a 15.8% decrease in light truck and SUV production in North America. The Company has restructured its North American and European operations in the third and fourth quarters of 2008 to align the Company s workforce with forecasted production.

Selling, general and administrative expenses (SG&A) as a percentage of net sales were 10.3%, 10.0% and 10.9% in 2008, 2007 and 2006 respectively. The 2008 increase in SG&A as a percentage of net sales was primarily due to $8.0 million of amortization for the recognition of the remaining 17.8% of the fair value of BERU. $3.3 million of the amortization recognized in the second quarter of 2008 is for the immediate write off of in process R&D and order backlog, the remaining $4.7 million increase is amortization on other intangible assets. The Company also recorded an increase in bad debt expense of $2.7 million in 2008 related to a decline in the financial condition of certain customers.

Research and development (R&D) is a major component of our SG&A expenses. R&D spending, net of customer reimbursements, was $205.7 million, or 3.9% of sales in 2008, compared to $210.8 million, or 4.0% of sales in 2007, and $187.7 million, or 4.1% of sales in 2006. We currently intend to continue to increase our spending in R&D, although the growth rate in the future may not necessarily match the rate of our sales growth. We also intend to continue to invest in a number of cross-business R&D programs, as well as a number of other key programs, all of which are necessary for short and long-term growth. Our current long-term expectation for R&D spending is approximately 4.0% of sales. We intend to maintain our commitment to R&D spending while continuing to focus on controlling other SG&A costs.

Restructuring expense of $127.5 million in 2008 and $84.7 million in 2006 was in response to declines in global customer production levels, customer restructurings and a subsequent evaluation of our headcount levels in North America, Europe and Asia (in 2008 only) and our long-term capacity needs.

On July 31, 2008, the Company announced a restructuring of its operations to align ongoing operations with a continuing, fundamental market shift in the auto industry. As a continuation of the Company s third quarter restructuring, on December 11, 2008, the Company announced plans for additional restructuring actions. As a

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result of these third and fourth quarter restructuring actions, the Company has reduced its North American workforce by approximately 2,400 people, or 33%; its European workforce by approximately 1,600 people, or 18%; and its Asian workforce by approximately 400 people, or 17%. The restructuring expense recognized for employee termination benefits is $54.6 million, of which $10.3 million was paid out in the third and fourth quarters of 2008. The remaining liability will be paid out by the middle of 2010. In addition to employee termination costs, the Company recorded $72.9 million of asset impairment charges related to the North American and European restructuring. The combined restructuring expenses of $127.5 million are broken out by segment as follows: Engine $85.3 million, Drivetrain $40.9 million and Corporate $1.3 million. Refer to Note 19, Restructuring of the Notes to the Consolidated Financial Statements in Item 8 of this report for further discussion.

On September 22, 2006, the Company announced the reduction of its North American workforce by approximately 850 people, or 13%, spread across its 19 operations in the U.S., Canada and Mexico. This third quarter reduction of the North American workforce addressed an immediate need to adjust employment levels to meet customer restructurings and significantly lower production schedules going forward. In addition to employee related costs of $6.7 million, the Company recorded $4.8 million of asset impairment charges related to the North American restructuring. The third quarter restructuring expenses of $11.5 million broken out by segment were as follows: Engine $7.3 million, Drivetrain $3.6 million and Corporate $0.6 million.

During the fourth quarter 2006, the Company evaluated the competitiveness of its North American facilities, as well as its long-term capacity needs. As a result, the Company will be closing the drivetrain plant in Muncie, Indiana and has adjusted the carrying values of other assets, primarily related to its four-wheel drive transfer case product line. Production activity at the Muncie facility is scheduled to cease no later than the expiration of the current labor contract in April 24, 2009. As a result of the fourth quarter restructuring, the Company recorded employee related costs of $14.8 million, asset impairments of $51.6 million and pension curtailment expense of $6.8 million. The fourth quarter restructuring expenses of $73.2 million broken out by segment were as follows: Engine $5.9 million and Drivetrain $67.3 million.

Other income was $(3.1) million, $(6.8) million and $(7.5) million in 2008, 2007 and 2006, respectively. The 2008 income was comprised primarily of interest income, offset by the realization of a loss on the sale of a product line and other asset disposals. The 2007 income was comprised primarily of interest income. The 2006 income was comprised primarily of a $(4.8) million gain from a previous divestiture and $(3.2) million of interest income.

Equity in affiliates earnings, net of tax was $38.4 million, $40.3 million and $35.9 million in 2008, 2007 and 2006, respectively. This line item is primarily driven by the results of our 50% owned Japanese joint venture, NSK-Warner, and our 32.6% owned Indian joint venture, Turbo Energy Limited (TEL). For more discussion of NSK-Warner, see Note 6 of the Consolidated Financial Statements.

Interest expense and finance charges were $38.8 million, $34.7 million and $40.2 million in 2008, 2007 and 2006, respectively. The increase in 2008 expense over 2007 expense was primarily due to costs related to BERU s DPTA. The decrease in 2007 expense over 2006 expense was primarily due to reduced debt levels.

The provision for income taxes resulted in an effective tax rate for 2008 of 237.9% compared with rates of 26.5% in 2007 and 12.0% in 2006. The effective tax rate of 237.9% for 2008 differs from the U.S. statutory rate primarily due to the non-deductibility of the $156.8 million impairment charge in 2008 related to BERU goodwill; a reduction in U.S. income; foreign rates, which differ from those in the U.S.; the realization of certain business tax credits including R&D and foreign tax credits and favorable permanent differences between book and tax treatment for items, including equity in affiliates earnings. If the effects of tax accrual changes and the Company s third quarter $13.5 million valuation allowance are not taken into account, the Company s effective tax rate associated with its on-going business operations was 23.0%. This rate was lower than the 2007 tax rate for on-going operations of 27.1% primarily due to the decline in U.S. earnings.

Minority interest, net of tax of $16.3 million decreased by $11.7 million from 2007 and by $10.0 million from 2006. The decrease is primarily related to the Company s DPTA with BERU, giving BorgWarner full control of BERU.

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LIQUIDITY AND CAPITAL RESOURCES

Capitalization

millions of dollars	2008	2007	% Change
Notes payable	$ 183.8	$ 63.7	
Current portion of long-term debt	136.9		
Long-term debt	459.6	572.6	
Total debt	780.3	636.3	22.6%
Minority interest in consolidated subsidiaries	31.5	117.9	
Total stockholders equity	2,006.0	2,321.1	
Total capitalization	$ 2,817.8	$ 3,075.3	(8.4)%
Total debt to capital ratio	27.7%	20.7%	

The Company intends to settle the current portion of long-term debt (due February 17, 2009) of $136.9 million with cash on hand, cash from operations and affiliate dividend receipts.

The $144.0 million increase in debt was primarily due to the $133.6 million acquisition of additional shares of BERU.

Stockholders equity decreased by $315.1 million in 2008 as follows:

millions of dollars	
Balance, January 1, 2008	$ 2,321.1
Net loss	(35.6)
Currency translation and hedged instruments	(136.9)
Defined benefit post employment plans	(74.7)
Treasury stock purchases, net of options exercised	(40.9)
Dividend payments	(51.1)
Other	24.1
Balance, December 31, 2008	$ 2,006.0

The currency translation component of other comprehensive income decreased in 2008 primarily due to the weakening of the Euro, Korean Won and British Pound in relation to the U.S. Dollar.

Operating Activities

Net cash provided by operating activities was $400.8 million, $603.5 million and $442.1 million in 2008, 2007 and 2006, respectively. The $202.7 million decrease in 2008 from 2007 was primarily due to lower earnings and increased working capital needs. The $161.4 million increase in 2007 from 2006 was primarily due to higher earnings and improved working capital usage. The $400.8 million of net cash provided by operating activities in 2008 consists of a net loss of $35.6 million, increased for non-cash charges of $530.7 million and a $94.3 million decrease in net operating assets and liabilities. Non-cash charges are primarily comprised of $286.8 million in depreciation and amortization expense and a $156.8 million goodwill impairment charge.

Accounts receivable and accounts payable and accrued expenses decreased a total of $163.9 million and $195.6 million, respectively, excluding the impact of currency, due to lower business levels, particularly in North America and Europe. Certain of our European customers tend to have longer payment terms than our North American customers. Inventory increased by $26.3 million excluding the impact of currency, while our full year average inventory turns decreased to 9.8 times from 10.5 in 2007.

Investing Activities

Net cash used in investing activities was $485.1 million, $368.0 million and $341.1 million in 2008, 2007 and 2006, respectively. Capital expenditures, including tooling outlays (capital spending) of $369.7 million in 2008, or 7.0% of sales, increased $75.8 million over the 2007 level of $293.9 million, or 5.5% of sales. Selective capital spending remains an area of focus for us, both in order to support our book of new business and for cost reduction and other purposes. Heading into 2009, we plan to continue to spend capital to support the launch of our new applications and for cost reductions and productivity improvement projects, but at levels considerably lower than 2008.

In 2008, the Company purchased approximately 1.34 million BERU shares, at a cost of $133.6 million. See Note 20, Recent Transactions for further information.

The Company acquired approximately 12.8% of additional BERU shares in 2007 for $138.8 million, including transaction fees.

In 2006, the Company acquired the ETEC product lines from Eaton for $63.7 million, net of cash acquired.

Financing Activities and Liquidity

Liquidity: The Company had $103.4 million of cash on hand at December 31, 2008. The Company has a multi-currency revolving credit facility, which provides for borrowings up to $600 million through July 22, 2009. We intend to extend or renew our existing multi-currency credit facility with terms sufficient for our ongoing financing needs before July 22, 2009. However, if the Company is unable to negotiate a new credit facility or similar access to credit lines, it could adversely affect the Company s ability to operate. At December 31, 2008 and December 31, 2007 there were no outstanding borrowings under the facility. The credit agreement is subject to the usual terms and conditions applied by banks to an investment grade company. The two key covenants of the credit agreement are a net worth test and a debt compared to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) test. The Company was in compliance with all covenants at December 31, 2008 and expects to be compliant in future periods. In addition to the credit facility, the Company has $750 million available under a universal shelf registration statement on file with the Securities and Exchange Commission under which a variety of debt and equity instruments could be issued. The Company also has access to the commercial paper market through a $50 million accounts receivable securitization facility, which is rolled over annually. The current facility matures on April 25, 2009. From a credit quality perspective, the Company has an investment grade credit rating of BBB from Standard & Poor s and Baa3 from Moody s. The current outlook from Standard & Poor s is negative and we are under review for a potential further downgrade from Moody s. None of the Company s debt agreements require accelerated repayment in the event of a decrease in credit ratings.

The Company s significant contractual obligation payments at December 31, 2008 are as follows:

millions of dollars	Total	2009	2010-2011	2012-2013	After 2013
Other post employment benefits excluding pensions(a)	$ 853.1	$ 30.8	$ 66.0	$ 66.0	$ 690.3
Unfunded pension plans(b)	61.6	5.4	9.8	11.4	35.0
Notes payable and long-term debt	782.7	320.7	8.1	4.4	449.5
Projected interest payments(c)	321.7	29.5	47.9	47.9	196.4
Non-cancelable operating leases(d)	65.9	24.3	16.3	13.6	11.7
Capital spending obligations	63.2	63.2			

Inventory purchase obligations	13.2	13.2			
Income tax payments(e)	56.7	56.7			
Domination and Profit Transfer Agreement(f)	44.0	44.0			
Environmental(g)	13.3	5.9	3.0	3.0	1.4
Total	$ 2,275.4	$ 593.7	$ 151.1	$ 146.3	$ 1,384.3

(a) Other post employment benefits excluding pensions include anticipated future payments to cover retiree medical and life insurance benefits. See Note 12 to the Consolidated Financial Statements for disclosures related to the Company s pension and other post employment benefits.

(b) Amount contained in After 2013 column includes estimated payments through 2018. Since the timing and amount of payments for funded defined benefit pension plans are not certain for future years, such payments have been excluded from this table. The Company expects to contribute a total of $10 million to $20 million into all defined benefit pension plans during 2009. See Note 12 to the Consolidated Financial Statements for disclosures related to the Company s pension and other post employment benefits.

(c) Projection is based upon actual fixed rates w here appropriate, and a projected floating rate for the variable rate portion of the total debt portfolio. The floating rate projection is based upon current market conditions and rounded to the nearest 50th basis point (0.50%), w hich is 4.5% for this purpose. Projection is also based upon debt being redeemed upon maturity.

(d) 2009 includes $7.7 million for the guaranteed residual value of production equipment w ith a lease that expires in 2009. Please see Note 16 to the Consolidated Financial Statements for details concerning this lease.

(e) See Note 4 to the Consolidated Financial Statements for disclosures related to the Company s income taxes.

(f) See Note 20 to the Consolidated Financial Statements for disclosures related to the Company s Domination and Profit Transfer Agreement.

(g) See Note 15 to the Consolidated Financial Statements for disclosures related to the Company s environmental liability.

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

Financing Activities: Net debt increases were $107.5 million in 2008 excluding the impact of currency translation. Net debt reductions were $101.7 million in 2007 excluding the impact of currency translation. Proceeds from stock options exercised, net of tax benefit were $17.1 million, $46.3 million and $27.1 million in 2008, 2007 and 2006, respectively. The Company paid dividends to BorgWarner stockholders of $51.1 million, $39.4 million and $36.7 million in 2008, 2007 and 2006, respectively. The Company had treasury stock purchases of $55.9 million and $47.0 million in 2008 and 2007, respectively.

Off Balance Sheet Arrangements

As of December 31, 2008, the accounts receivable securitization facility was sized at $50 million and has been in place with its current funding partner since January 1994. This facility sells accounts receivable without recourse.

The Company has certain leases that are recorded as operating leases. Types of operating leases include leases on the headquarters facility, an airplane, vehicles, and certain office equipment. The Company also has a lease obligation for production equipment at one of its facilities. The total expected future cash outlays for all lease obligations at the end of 2008 is $65.9 million. See Note 16 to the Consolidated Financial Statements for more information on operating leases, including future minimum payments.

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 September 2010. In the event the Company exercises its option not to purchase the machinery and equipment, the Company has guaranteed a residual value of $7.7 million. The Company has accrued $4.1 million as a loss on this guarantee, which is expected to be paid in 2009.

Pension and Other Post Employment Benefits

The Company s policy is to fund its defined benefit pension plans in accordance with applicable government regulations and to make additional contributions when management deems it appropriate. At December 31, 2008, all legal funding requirements had been met. The Company contributed $13.3 million to its defined benefit pension plans in 2008 and $12.4 million in 2007. The Company expects to contribute a total of $10 million to $20 million in 2009.

The funded status of all pension plans was a net unfunded position of $(253.5) million and $(136.5) million at the end of 2008 and 2007, respectively. Of these amounts, $(110.9) million and $(111.1) at the end of 2008 and 2007, respectively, were related to plans in Germany, where there is not a tax deduction allowed under the applicable regulations to fund the plans, hence, the common practice is that they are unfunded plans.

Other post employment benefits primarily consist of post employment health care benefits for certain employees and retirees of the Company s U.S. operations. The Company funds these benefits as retiree claims are incurred. Other post employment benefits had an unfunded status of $(328.5) million at the end of 2008 and $(373.1) million at the end of 2007. The unfunded levels decreased due to an increase in the discount rate assumption and changes in certain plan designs.

The Company believes it will be able to fund the requirements of these plans through cash generated from operations or other available sources of financing for the foreseeable future.

See Note 12 to the Consolidated Financial Statements for more information regarding costs and assumptions for employee retirement benefits.

OTHER MATTERS

Contingencies

In the normal course of business the Company and its subsidiaries are parties to various commercial and legal claims, actions and complaints, including matters involving warranty claims, intellectual property claims, general liability and various other risks. See Notes 8 and 15 to the Consolidated Financial Statements. It is not possible to predict with certainty whether or not the Company and its subsidiaries will ultimately be successful in any of these commercial and legal matters or, if not, what the impact might be. The Company s environmental and product liability contingencies are discussed separately below. The Company s management does not expect that the results in any of these commercial and legal claims, actions and complaints will have a material adverse effect on the Company s results of operations, financial position or cash flows.

Litigation Outcome

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

The Company has communicated its plan to reduce the level of benefits provided to the retirees to make them comparable to other Company retiree benefit plans. The change will be effective following expiration of the health insurance agreement in April 24, 2009.

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Environmental

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency and certain state environmental agencies and private parties as potentially responsible parties (PRPs) at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 35 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

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

Based on information available to the Company (which in most cases includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large, solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation and consulting costs; remediation alternatives; and estimated legal fees), the Company has established an accrual for indicated environmental liabilities with a balance at December 31, 2008 of $11.9 million. The Company has accrued amounts that do not exceed $3.4 million related to any individual site and we do not believe that the costs related to any of these sites will have a material adverse effect on the Company s results of operations, cash flows or financial condition. The Company expects to pay out substantially all of the amounts accrued for environmental liability over the next three to five years.

In connection with the sale of Kuhlman Electric Corporation, the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities, then unknown to the Company, relating to certain operations of Kuhlman Electric that pre-date the Company s 1999 acquisition of Kuhlman Electric. 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 is continuing to work with the Mississippi Department of Environmental Quality and Kuhlman Electric to investigate and remediate to the extent necessary, historical contamination at the plant and surrounding area. Kuhlman Electric and others, including the Company, were sued in numerous related lawsuits, in which multiple claimants alleged personal injury and property damage. In 2005, the Company and other defendants entered into settlements that resolved approximately 99% of the then known personal injury and property damage claims relating to the alleged environmental contamination. Those settlements involved payments by the Company of $28.5 million in the second half of 2005 and $15.7 million in the first quarter of 2006, in exchange for, among other things, dismissal with prejudice of these lawsuits.

In December 2007, a lawsuit was filed against Kuhlman Electric and others, including the Company, on behalf of approximately 209 plaintiffs, alleging personal injury relating to the alleged environmental contamination. In August 2008, two similar lawsuits were filed against Kuhlman Electric and others, including the Company, on behalf of approximately 100 plaintiffs and 30 plaintiffs, respectively, alleging personal injury related to the alleged environmental contamination. Given the early stage of the litigation, the Company cannot make any predictions as to the outcome, but its current intent is to vigorously defend against the suits.

Conditional Asset Retirement Obligations

In March 2005, the FASB issued Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143 (FIN 47), which requires the Company to recognize legal obligations to perform asset retirements in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Certain government regulations require the removal and disposal of asbestos from an existing facility at the time the facility undergoes major renovations or is demolished. The liability exists because the facility will not last forever, but it is conditional on future renovations (even if there are no immediate plans to remove the materials, which pose no health or safety hazard in their current condition). Similarly, government regulations require the removal or closure of underground storage tanks (USTs) and above ground storage tanks (ASTs) when their use ceases, the disposal of polychlorinated biphenyl (PCB) transformers and capacitors when their use ceases, and the disposal of used furnace bricks and liners, and lead-based paint in conjunction with facility renovations or demolition. The Company currently has 32 manufacturing locations that have been identified as containing these items. The fair value to remove and dispose of this material has been estimated and recorded at $1.4 million as of December 31, 2008 and $1.0 million as of December 31, 2007.

Product Liability

Like many other industrial companies who have historically operated in the U.S., the Company (or parties the Company is obligated to indemnify) continues to be named as one of many defendants in asbestos-related personal injury actions. We believe that the Company s involvement is limited because, in general, these claims relate to a few types of automotive friction products that were manufactured many years ago and contained encapsulated asbestos. The nature of the fibers, the encapsulation and the manner of use lead the Company to believe that these products are highly unlikely to cause harm. As of December 31, 2008 and 2007, the Company had approximately 27,000 and 42,000 pending asbestos-related product liability claims, respectively. Of the 27,000 outstanding claims at December 31, 2008, approximately 16,000 are pending in just three jurisdictions, where significant tort and judicial reform activities are underway.

The Company s policy is to aggressively defend against these lawsuits and the Company has been successful in obtaining dismissal of many claims without any payment. The Company expects that the vast majority of the pending asbestos-related product liability claims where it is a defendant (or has an obligation to indemnify a defendant) will result in no payment being made by the Company or its insurers. In 2008, of the approximately 17,500 claims resolved, only 210 (1.2%) resulted in any payment being made to a claimant by or on behalf of the Company. In 2007, of the approximately 4,400 claims resolved, only 194 (4.4%) resulted in any payment being made to a claimant by or on behalf of the Company.

Prior to June 2004, the settlement and defense costs associated with all claims were covered by the Company s primary layer insurance coverage, and these carriers administered, defended, settled and paid all claims under a funding arrangement. In June 2004, primary layer insurance carriers notified the Company of the alleged exhaustion of their policy limits. This led the Company to access the next available layer of insurance coverage. Since June 2004, secondary layer insurers have paid asbestos-related litigation defense and settlement expenses pursuant to a funding arrangement. To date, the Company has paid $50.1 million in defense and indemnity in advance of insurers reimbursement and has received $14.2 million in cash from insurers. The outstanding balance of $35.9 million is expected to be fully recovered. Timing of the recovery is dependent on final resolution of the declaratory judgment action referred to below. At December 31, 2007, insurers owed $20.6 million in association with these claims.

At December 31, 2008, the Company has an estimated liability of $34.7 million for future claims resolutions, with a related asset of $34.7 million to recognize the insurance proceeds receivable by the Company for estimated losses related to claims that have yet to be resolved. Insurance carrier reimbursement of 100% is expected based on the Company s experience, its insurance contracts and decisions received to date in the declaratory judgment action referred to below. At December 31, 2007, the comparable value of the insurance receivable and accrued liability was $39.6 million.

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

millions of dollars	2008	2007
Assets:		
Prepayments and other current assets	$ 22.1	$ 20.1
Other non-current assets	12.6	19.5
Total insurance receivable	$ 34.7	$ 39.6
Liabilities:		
Accounts payable and accrued expenses	$ 22.1	$ 20.1
Other non-current liabilities	12.6	19.5
Total accrued liability	$ 34.7	$ 39.6

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

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 both primary and additional layer insurance, and, in conjunction with other insurers, is currently defending and indemnifying the Company in its pending asbestos-related product liability 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. On August 15, 2005, the Court issued an interim order regarding the apportionment matter. The interim order has the effect of making insurers responsible for all defense and settlement costs pro rata to time-on-the-risk, with the pro-ration method to hold the insured harmless for periods of bankrupt or unavailable coverage. Appeals of the interim order were denied. However, the issue is reserved for appellate review at the end of the action. In addition to the primary insurance available for asbestos-related claims, the Company has substantial additional layers of insurance available for potential future asbestos-related product claims. As such, the Company continues to believe that its coverage is sufficient to meet foreseeable liabilities.

Although it is impossible to predict the outcome of pending or future claims or the impact of tort reform legislation that may be enacted at the State or Federal levels, due to the encapsulated nature of the products, the Company s experiences in aggressively defending and resolving claims in the past, and the Company s significant insurance coverage with solvent carriers as of the date of this filing, management does not believe that asbestos-related product liability claims are likely to have a material adverse effect on the Company s results of operations, cash flows or financial condition.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are prepared in conformity with GAAP. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. Critical accounting policies are those that are most important to the portrayal of the Company s financial condition and results of operations. These policies require management s most difficult, subjective or complex judgments in the preparation of the financial statements and accompanying notes. Management makes estimates and assumptions about the effect of matters that are inherently uncertain, relating to the reporting of assets, liabilities, revenues, expenses and the disclosure of contingent assets and liabilities. Our most critical accounting policies are discussed below.

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Revenue Recognition

The Company recognizes revenue when title and risk of loss pass to the customer, which is usually upon shipment of product. Although the Company may enter into long-term supply agreements with its major customers, each shipment of goods is treated as a separate sale and the price is not fixed over the life of the agreements.

Impairment of Long-Lived Assets

The Company periodically reviews the carrying value of its long-lived assets, whether held for use or disposal, including other intangible assets, when events and circumstances warrant such a review. This review is performed using estimates of future cash flows. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value. Management believes that the estimates of future cash flows and fair value assumptions are reasonable; however, changes in assumptions underlying these estimates could affect the evaluations. Significant judgments and estimates used by management when evaluating long-lived assets for impairment include: (i) an assessment as to whether an adverse event or circumstance has triggered the need for an impairment review; and (ii) undiscounted future cash flows generated by the asset. The Company recognized $72.9 million and $56.4 million in impairment of long-lived assets as part of restructuring expenses in 2008 and 2006, respectively.

See Note 19 to the Consolidated Financial Statements for more information regarding the Company s 2006 and 2008 impairment of long-lived assets.

Goodwill

The Company annually reviews its goodwill for impairment in the fourth quarter of each year for all of its reporting units, or when events and circumstances warrant such a review. This review utilizes the two-step impairment test required under Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangibles,* and requires us to make significant assumptions and estimates about the extent and timing of future cash flows, discount rates and growth rates. The cash flows are estimated over a significant future period of time, which makes those estimates and assumptions subject to an even higher degree of uncertainty. We also utilize market valuation models and other financial ratios, which require us to make certain assumptions and estimates regarding the applicability of those models to our assets and businesses. We believe that the assumptions and estimates used to determine the estimated fair values of each of our reporting units are reasonable. However, different assumptions could materially affect the estimated fair value. The goodwill impairment test was performed in December and September 2008, December 2007 and December 2006. The Company recognized goodwill impairment of $156.8 million in the Engine segment in 2008 and $0.2 million in the Drivetrain segment in 2006. No goodwill impairment was recorded in 2007.

See Note 7 to the Consolidated Financial Statements for more information regarding goodwill.

Environmental Accrual

We work with outside experts to determine a range of potential liability for environmental sites. The ranges for each individual site are then aggregated into a loss range for the total accrued liability. Management s estimate of the loss range for environmental liability, including conditional asset retirement obligations, for 2008 is between $12.4 million and $26.1 million. We record an accrual at the most probable amount within the range unless one cannot be determined; in which case we record the accrual at the low end of the range. At the end of 2008, our total accrued environmental liability was $13.3 million, which includes our conditional asset retirement obligation under FIN 47 of $1.4 million.

See Note 15 to the Consolidated Financial Statements for more information regarding environmental accrual.

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Product Warranty

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 claim settlements; as well as product manufacturing and industry developments and recoveries from third parties. Management actively studies trends of warranty claims and takes action to improve product quality and minimize warranty claims. Management believes that the warranty accrual is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the accrual. The accrual is represented in both current and non-current liabilities on the balance sheet.

See Note 8 to the Consolidated Financial Statements for more information regarding product warranty.

Other Loss Accruals and Valuation Allowances

The Company has numerous other loss exposures, such as customer claims, workers compensation claims, litigation, and recoverability of assets. Establishing loss accruals or valuation allowances for these matters requires the use of estimates and judgment in regard to the risk exposure and ultimate realization. We estimate losses under the programs using consistent and appropriate methods; however, changes to our assumptions could materially affect our recorded accrued liabilities for loss or asset valuation allowances.

Pension and Other Post Employment Defined Benefits

The Company provides post employment defined benefits to a number of its current and former employees. Costs associated with post employment defined benefits include pension and post employment health care expenses for employees, retirees and surviving spouses and dependents. The Company s employee defined benefit pension and post employment health care expenses are dependent on management s assumptions used by actuaries in calculating such amounts. These assumptions include discount rates, health care cost trend rates, inflation, long-term return on plan assets, retirement rates, mortality rates and other factors. Health care cost trend assumptions are developed based on historical cost data, the near-term outlook, and an assessment of likely long-term trends. The inflation assumption is based on an evaluation of external market indicators. Retirement and mortality rates are based primarily on actual plan experience. The Company reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when appropriate. The effects of the modifications are recorded currently or amortized over future periods in accordance with GAAP.

The Company s approach to establishing the discount rate is based upon the market yields of high-quality corporate bonds, with appropriate consideration of each plan s defined benefit payment terms and duration of the liabilities. The discount rate assumption is typically rounded up or down to the nearest 25 basis points for each plan. As a sensitivity measure for the Company s pension plans, a decrease of 25 basis points to the discount rate would increase the Company s 2009 expense by approximately $0.9 million. As for the Company s other post employment benefit plans, a decrease of 25 basis points to the discount rate would increase the Company s 2009 expense by approximately $0.3 million.

The Company determines its expected return on plan asset assumptions by evaluating estimates of future market returns and the plans asset allocation. The Company also considers the impact of active management of the plans invested assets. The Company s expected return on assets assumption reflects the asset allocation of each plan. For 2009, the Company is changing its expected return on U.S. plan assets to 7.50% from 8.75% to reflect adjustments made to its targeted asset allocations. For sensitivity purposes, a 25 basis point decrease in the long-term return on assets would increase the 2009 pension expense by approximately $0.8 million.

The Company determines its health care inflation rate for its other post employment benefit plans by evaluating the circumstances surrounding the plan design, recent experience and health care economics. For sensitivity purposes, a one percentage point increase in the assumed health care cost trend would increase the

Company s projected benefit obligation by $18.9 million at December 31, 2008, and would increase the 2009 expense by $1.4 million.

Based on the information provided by its independent actuaries and other relevant sources, the Company believes that the assumptions used are reasonable; however, changes in these assumptions, or experience different from that assumed, could impact the Company s financial position, results of operations, or cash flows.

See Note 12 to the Consolidated Financial Statements for more information regarding costs and assumptions for employee retirement benefits.

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company records a valuation allowance that primarily represents foreign operating and other loss carryforwards for which utilization is uncertain. Management judgment is required in determining the Company s provision for income taxes, deferred tax assets and liabilities and the valuation allowance recorded against the Company s net deferred tax assets. In calculating the provision for income taxes on an interim basis, the Company uses an estimate of the annual effective tax rate based upon the facts and circumstances known at each interim period. In determining the need for a valuation allowance, the historical and projected financial performance of the operation recording the net deferred tax asset is considered along with any other pertinent information. Since future financial results may differ from previous estimates, periodic adjustments to the Company s valuation allowance may be necessary.

The Company is subject to income taxes in the U.S. and numerous non-U.S. jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes and recording the related assets and liabilities. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is less than certain. The Company is regularly under audit by the various applicable tax authorities. Accruals for income tax contingencies are provided for in accordance with the requirements of FASB interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*. The Company s federal and certain state income tax returns and certain non-U.S. income tax returns are currently under various stages of audit by applicable tax authorities. Although the outcome of tax audits is always uncertain, management believes that it has appropriate support for the positions taken on its tax returns and that its annual tax provisions included amounts sufficient to pay assessments, if any, which may be proposed by the taxing authorities. At December 31, 2008, the Company has recorded a liability for its best estimate of the probable loss on certain of its tax positions, which is included in other non-current liabilities. Nonetheless, the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year.

See Note 4 to the Consolidated Financial Statements for more information regarding income taxes.

New Accounting Pronouncements

In June 2006, the FASB issued interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). The interpretation prescribes a consistent recognition threshold and measurement attribute, as well as clear criteria for subsequently recognizing, derecognizing and measuring such tax positions for financial statement purposes. FIN 48 also requires expanded disclosure with respect to the uncertainty in income taxes. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a $16.6 million reduction to its January 1, 2007 retained earnings balance.

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In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. On January 1, 2008, the Company partially adopted as required, FAS 157. See Note 10 to the Consolidated Financial Statements for more information regarding the implementation of FAS 157.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159). FAS 159 allows entities to irrevocably elect to recognize most financial assets and financial liabilities at fair value on an instrument-by-instrument basis. The stated objective of FAS 159 is to improve financial reporting by giving entities the opportunity to elect to measure certain financial assets and liabilities at fair value in order to mitigate earnings volatility caused when related assets and liabilities are measured differently. FAS 159 is effective for the Company beginning with its quarter ending March 31, 2008. The Company chose to not make the election to adopt.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (Revised 2007), *Business Combinations* (FAS 141(R)). FAS 141(R) establishes principles and requirements for recognizing identifiable assets acquired, liabilities assumed, noncontrolling interest in the acquiree, goodwill acquired in the combination or the gain from a bargain purchase, and disclosure requirements. Under this revised statement, all costs incurred to effect an acquisition will be recognized separately from the acquisition. Also, restructuring costs that are expected but the acquirer is not obligated to incur will be recognized separately from the acquisition. FAS 141(R) is effective for the Company beginning with its quarter ending March 31, 2009. The adoption of FAS 141(R) is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (FAS 160). FAS 160 requires that ownership interests in subsidiaries held by parties other than the parent are clearly identified. In addition, it requires that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the income statement. FAS 160 is effective for the Company beginning with its quarter ending March 31, 2009. The adoption of FAS 160 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In February 2008, the FASB issued FASB Staff Position No. FAS 157-2 (FSP FAS 157-2). FSP FAS 157-2 delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed in the financial statements on a nonrecurring basis to fiscal years beginning after November 15, 2008. Refer to Note 10, Fair Value Measurements of the Notes to the Consolidated Financial Statements for further discussion of the Company s partial adoption of FSP FAS 157-2.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities (FAS 161). FAS 161 requires entities to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. FAS 161 is effective for the Company beginning with its quarter ending March 31, 2009. The adoption of FAS 161 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2008, the FASB issued Staff Position 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets (FAS 132(R)-1). FAS 132(R)-1 requires entities to provide enhanced disclosures about how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period, and significant concentrations of risk within plan assets. FAS 132(R)-1 is effective for the Company beginning with its year ending December 31, 2009. The Company is currently assessing the potential impacts, if any, on its consolidated financial statements.

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In December 2008, the FASB issued Staff Position 140-4 and Financial Interpretation 46(R)-8, Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities (FSP 140-4 and FIN 46(R)-8). FSP 140-4 and FIN 46(R)-8 requires entities to provide enhanced disclosures about how an entity accounts for transfers of financial assets, the nature of involvement, if any, after the financial asset sale and the nature of any restrictions on assets reported by an entity in its statement of financial position that relates to a transferred financial asset, including the carrying amounts of such assets. The Company has adjusted its disclosures to be compliant with FSP 140-4 and FIN 46(R)-8 at December 31,2008.

QUALITATIVE AND QUANTITIVE DISCLOSURE ABOUT MARKET RISK

The Company s primary market risks include fluctuations in interest rates and foreign currency exchange rates. We are also affected by changes in the prices of commodities used or consumed in our manufacturing operations. Some of our commodity purchase price risk is covered by supply agreements with customers and suppliers. Other commodity purchase price risk is addressed by hedging strategies, which include forward contracts. The Company enters into derivative instruments only with high credit quality counterparties and diversifies its positions across such counterparties in order to reduce its exposure to credit losses. We do not engage in any derivative instruments for purposes other than hedging specific operating risks.

We have established policies and procedures to manage sensitivity to interest rate, foreign currency exchange rate and commodity purchase price risk, which include monitoring the level of exposure to each market risk.

Interest Rate Risk

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. The Company manages its interest rate risk by balancing its exposure to fixed and variable rates while attempting to minimize its interest costs. The Company selectively uses interest rate swaps to reduce market value risk associated with changes in interest rates (fair value hedges). At the end of 2008, the amount of net debt with fixed interest rates was 38.5% of total debt, including the impact of the interest rate swaps. Our earnings exposure related to adverse movements in interest rates is primarily derived from outstanding floating rate debt instruments that are indexed to floating money market rates. A 10% increase or decrease in the average cost of our variable rate debt would result in a change in pre-tax interest expense for 2008 of approximately $2.1 million, and $1.8 million in 2007.

We also measure interest rate risk by estimating the net amount by which the fair value of all of our interest rate sensitive assets and liabilities would be impacted by selected hypothetical changes in market interest rates. Fair value is estimated using a discounted cash flow analysis. Assuming a hypothetical instantaneous 10% change in interest rates as of December 31, 2008, the net fair value of these instruments would increase by approximately $24 million if interest rates decreased and would decrease by approximately $22 million if interest rates increased. Our interest rate sensitivity analysis assumes a constant shift in interest rate yield curves. The model, therefore, does not reflect the potential impact of changes in the relationship between short-term and long-term interest rates. Interest rate sensitivity at December 31, 2007, measured in a similar manner, was slightly less than at December 31, 2008.

Foreign Currency Exchange Rate Risk

Foreign currency risk is the risk that we will incur economic losses due to adverse changes in foreign currency exchange rates. Currently, our most significant currency exposures relate to the British Pound, the Euro, the Hungarian Forint, the Japanese Yen, and the South Korean Won. We mitigate our foreign currency exchange rate risk principally by establishing local production facilities and related supply chain participants in the markets we serve, by invoicing customers in the same currency as the source of the products and by funding some of our investments in foreign markets through local currency loans and cross currency swaps. Such non-U.S. Dollar debt was $495.8 million as of December 31, 2008 and $413.5 million as of December 31, 2007. We also monitor our foreign currency exposure in each country and implement strategies to respond to changing economic and political environments. In addition, the Company periodically enters into forward currency contracts in order to reduce exposure to exchange rate risk related to transactions denominated in currencies other than the functional currency. As of December 31, 2008, the Company was holding foreign exchange derivatives with positive and negative fair market values of $10.2 million and $(61.8) million, respectively, of which $9.9 million in gains and $(36.3) million in losses mature in less than one year. As of December 31, 2008, $1.0 million in gains and $(8.2) million in losses did not qualify for deferral.

Commodity Price Risk

Commodity price risk is the possibility that we will incur economic losses due to adverse changes in the cost of raw materials used in the production of our products. Commodity forward and option contracts are executed to offset our exposure to the potential change in prices mainly for various non-ferrous metals and natural gas consumption used in the manufacturing of vehicle components. As of December 31, 2008, the Company had forward and option commodity contracts with a total notional value of $50.2 million. As of December 31, 2008, the Company was holding commodity derivatives with positive and negative fair market values of $2.1 million and $(16.3) million, respectively, of which $1.0 million in gains and $(15.1) million in losses mature in less than one year.

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 outlook , expects, anticipates, intends, plans, believes, estimates, or variations of such words and similar expressions are intended t identify such forward-looking statements. Forward-looking statements are subject to risks and uncertainties, many of which are difficult to predict and generally beyond the control of the Company, which could cause actual results to differ materially from those expressed, projected or implied in or by the forward-looking statements. Such risks and uncertainties include: fluctuations in domestic or foreign automotive production, the continued use of outside suppliers, fluctuations in demand for vehicles containing BorgWarner products, general economic conditions, as well as other risks detailed in the Company s filings with the Securities and Exchange Commission, including the factors identified under Item 1A, Risk Factors, in its most recently filed annual report on Form 10-K. The Company does not undertake any obligation to update any forward-looking statement.

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REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The information in this report is the responsibility of management. BorgWarner Inc. and Consolidated Subsidiaries (the Company) has in place reporting guidelines and policies designed to ensure that the statements and other information contained in this report present a fair and accurate financial picture of the Company. In fulfilling this management responsibility, we make informed judgments and estimates conforming with accounting principles generally accepted in the United States of America.

The accompanying Consolidated Financial Statements have been audited by Deloitte & Touche LLP, an independent registered public accounting firm.

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting.

The Company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America. The internal control process includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Any system of internal control, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2008. In making this assessment, the Company s management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework.*

Based on management s assessment and those criteria, we believe that, as of December 31, 2008, the Company s internal control over financial reporting is effective.

Deloitte & Touche LLP, the Company s independent registered public accounting firm, who audited the Company s financial statements included in this Annual Report, and has issued an attestation report appearing in item 9A of Form 10-K on the effectiveness of the Company s internal control over financial reporting as of December 31, 2008.

The Company s Audit Committee, composed entirely of directors of the Company who are not employees, meets periodically with the Company s management and independent registered public accounting firm to review financial results and procedures, internal financial controls and internal and external audit plans and recommendations. In carrying out these responsibilities, the Audit Committee and the independent registered public accounting firm have unrestricted access to each other with or without the presence of management representatives.

/s/ Timothy M. Manganello
Chairman and Chief Executive Officer

/s/ Robin J. Adams
Executive Vice President,
Chief Financial Officer & Chief Administrative Officer

February 12, 2009

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Refer to Note 11, Financial Instruments of the Notes to the Consolidated Financial Statements in Item 8 of this report for information with respect to interest rate risk and foreign currency exchange risk. Information with respect to the levels of indebtedness subject to interest rate fluctuation is contained in Note 9, Notes Payable and Long-Term Debt to the Consolidated Financial Statements in Item 8. Information with respect to the Company s level of business outside the United States which is subject to foreign currency exchange rate market risk is contained in Note 21, Reporting Segments and Related Information of the Notes to the Consolidated Financial Statements in Item 8.

Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of BorgWarner Inc.
Auburn Hills, Michigan

We have audited the accompanying consolidated balance sheets of BorgWarner Inc. and Consolidated Subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of BorgWarner Inc. and Consolidated Subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting in 2007 for income taxes as a result of adopting FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* and in 2006 for defined benefit pension and other postretirement plans as a result of adopting SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans.*

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 12, 2009 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Detroit, Michigan
February 12, 2009

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

millions of dollars, except share and per share amounts For the Year Ended December 31,	2008	2007	2006
Net sales	$ 5,263.9	$ 5,328.6	$ 4,585.4
Cost of sales	4,425.4	4,378.7	3,735.5
Gross profit	838.5	949.9	849.9
Selling, general and administrative expenses	542.9	531.9	498.1
Restructuring expense	127.5		84.7
Goodwill impairment charge	156.8		
Other income	(3.1)	(6.8)	(7.5)
Operating income	14.4	424.8	274.6
Equity in affiliates earnings, net of tax	(38.4)	(40.3)	(35.9)
Interest expense and finance charges	38.8	34.7	40.2
Earnings before income taxes and minority interest	14.0	430.4	270.3
Provision for income taxes	33.3	113.9	32.4
Minority interest, net of tax	16.3	28.0	26.3
Net earnings (loss)	$ (35.6)	$ 288.5	$ 211.6
Earnings (loss) per share basic	$ (0.31)*	$ 2.49	$ 1.84
Earnings (loss) per share diluted	$ (0.31)*	$ 2.45	$ 1.83
Average shares outstanding (thousands):			
Basic	116,007	116,002	114,806
Diluted	116,007	117,840	115,942

* The Company had a loss for the year ended December 31, 2008. As a result, diluted loss per share is the same as basic loss per share in the period, as any dilutive securities would reduce the loss per share.

See Accompanying Notes to Consolidated Financial Statements.

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIAIRIES

CONSOLIDATED BALANCE SHEETS

millions of dollars December 31,	2008	2007
ASSETS		
Cash	$ 103.4	$ 188.5
Marketable securities		14.6
Receivables, net	607.1	802.4
Inventories, net	451.2	447.6
Deferred income taxes	67.5	42.8
Prepayments and other current assets	79.0	84.4
Total current assets	1,308.2	1,580.3
Property, plant and equipment, net	1,586.2	1,609.1
Investments and advances	266.5	255.1
Goodwill	1,052.4	1,168.2
Other non-current assets	430.7	345.8
Total assets	$ 4,644.0	$ 4,958.5
LIABILITIES AND STOCKHOLDERS EQUITY		
Notes payable	$ 183.8	$ 63.7
Current portion of long-term debt	136.9	
Accounts payable and accrued expenses	923.0	993.0
Income taxes payable	6.3	27.2
Total current liabilities	1,250.0	1,083.9
Long-term debt	459.6	572.6
Other non-current liabilities:		
Retirement-related liabilities	543.8	500.4
Other	353.1	362.6
Total other non-current liabilities	896.9	863.0
Minority interest in consolidated subsidiaries	31.5	117.9
Capital stock:		
Preferred stock, $0.01 par value; authorized shares: 5,000,000; none issued		
Common stock, $0.01 par value; authorized shares: 150,000,000; issued shares: 2008, 117,699,542 and 2007, 117,206,709; outstanding shares: 2008, 115,532,372 and 2007, 116,128,572	1.2	1.2
Non-voting common stock, $0.01 par value; authorized shares: 25,000,000; none issued and outstanding		
Capital in excess of par value	977.6	943.4
Retained earnings	1,200.5	1,295.9
Accumulated other comprehensive income (loss)	(85.9)	127.1

Common stock held in treasury, at cost: 2,167,170 shares in 2008 and 1,078,137 shares in 2007	(87.4)	(46.5)
Total stockholders equity	2,006.0	2,321.1
Total liabilities and stockholders equity	$ 4,644.0	$ 4,958.5

See Accompanying Notes to Consolidated Financial Statements.

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIAIRIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

millions of dollars For the Year Ended December 31,	2008	2007	2006
OPERATING			
Net earnings (loss)	$ (35.6)	$ 288.5	$ 211.6
Adjustments to reconcile net earnings (loss) to net cash flows from operations:			
Non-cash charges (credits) to operations:			
Depreciation and tooling amortization	259.7	243.1	239.1
Amortization of intangible assets and other	27.1	21.5	17.5
Restructuring expense, net of cash paid	115.9		79.4
Goodwill impairment charge	156.8		
Gain on sales of businesses, net of tax			(3.6)
Stock option compensation expense	21.2	16.3	12.7
Deferred income tax benefit	(78.3)	(29.9)	(46.4)
Equity in affiliates earnings, net of dividends received, minority interest and other	28.3	16.0	38.8
Net earnings adjusted for non-cash charges to operations	495.1	555.5	549.1
Changes in assets and liabilities, net of effects of acquisitions and divestitures:			
Receivables	163.9	(6.2)	(57.4)
Inventories	(26.3)	(34.7)	(32.7)
Prepayments and other current assets	16.0	9.0	(25.2)
Accounts payable and accrued expenses	(195.6)	94.2	(8.1)
Income taxes payable	(23.0)	(15.1)	0.5
Other non-current assets and liabilities	(29.3)	0.8	15.9
Net cash provided by operating activities	400.8	603.5	442.1
INVESTING			
Capital expenditures, including tooling outlays	(369.7)	(293.9)	(268.3)
Net proceeds from asset disposals	5.7	17.3	3.6
Payments for businesses acquired, net of cash acquired	(141.2)	(138.8)	(63.7)
Proceeds from sale of business	5.5		
Purchases of marketable securities		(13.0)	(41.5)
Proceeds from sales of marketable securities	14.6	60.4	28.8
Net cash used in investing activities	(485.1)	(368.0)	(341.1)
FINANCING			
Net increase (decrease) in notes payable	114.8	(92.6)	(27.7)
Additions to long-term debt		20.0	289.1
Repayments of long-term debt	(7.3)	(29.1)	(296.6)
Payment for purchase of treasury stock	(55.9)	(47.0)	
Proceeds from stock options exercised, including the tax benefit	17.1	46.3	27.1

Dividends paid to BorgWarner stockholders	(51.1)	(39.4)	(36.7)
Dividends paid to minority shareholders	(12.5)	(17.5)	(15.1)
Net cash provided by (used in) financing activities	5.1	(159.3)	(59.9)
Effect of exchange rate changes on cash	(5.9)	(11.0)	(7.5)
Net increase (decrease) in cash	(85.1)	65.2	33.6
Cash at beginning of year	188.5	123.3	89.7
Cash at end of year	$ 103.4	$ 188.5	$ 123.3
SUPPLEMENTAL CASH FLOW INFORMATION			
Net cash paid during the year for:			
Interest	$ 44.4	$ 42.7	$ 45.0
Income taxes	122.0	91.6	83.8
Non-cash investing transactions:			
Domination and Profit Transfer Agreement	44.0		
Non-cash financing transactions:			
Stock performance plans	5.0	10.0	3.0
Restricted common stock for employees	9.0	1.6	
Restricted common stock for non-employee directors	0.7	0.3	0.5

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIAIRIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (LOSS)

	Number of Shares		millions of dollars Stockholders Equity					
	Issued Common Stock	Common Stock in Treasury	Issued Common Stock	Capital in Excess of par Value	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
Balance, January 1, 2006	114,276,950	(7,968)	$ 0.6	$ 827.6	$ (0.1)	$ 889.2	$ (73.1)	
Dividends declared						(36.7)		
Stock option expense				12.7				
Stock incentive plans	994,372			27.1				
Executive stock plan	100,550			3.0				
Net issuance of restricted stock, less amortization	22,696			0.7				
Net earnings						211.6		$ 211.6
FAS 158 incremental effect							(98.5)	
Defined benefit post employment plans							18.1	18.1
Net unrealized gain (loss) on available-for-sale securities							1.8	1.8
							91.4	91.4

Currency translation and hedge instruments, net								
Balance, December 31, 2006	115,394,568	(7,968)	$ 0.6	$ 871.1	$ (0.1)	$ 1,064.1	$ (60.3)	$ 322.9
Dividends declared						(39.4)		
Stock split			0.6			(0.6)		
Stock option expense				16.3				
Stock incentive plans	1,725,339	19,083		45.7	0.6	(0.1)		
Executive stock plan	78,170			10.0				
Net issuance of restricted stock, less amortization	8,632			0.3				
Purchases of treasury stock		(1,089,252)			(47.0)			
FIN 48 adoption						(16.6)		
Net earnings						288.5		$ 288.5
Defined benefit post employment plans							70.6	70.6
Net unrealized gain (loss) on available-for-sale securities							(0.1)	(0.1)
Currency translation and hedge instruments, net							116.9	116.9
Balance, December 31, 2007	117,206,709	(1,078,137)	$ 1.2	$ 943.4	$ (46.5)	$ 1,295.9	$ 127.1	$ 475.9

Dividends declared						(51.1)		
Stock option expense				12.2				
Stock incentive plans		375,075		10.8	15.0	(8.7)		
Executive stock plan	197,052			1.5				
Net issuance of restricted stock, less amortization	295,781			9.7				
Purchases of treasury stock		(1,464,108)			(55.9)			
Net loss						(35.6)		$ (35.6)
Defined benefit post employment plans							(74.7)	(74.7)
Net unrealized gain (loss) on available-for-sale securities							(1.4)	(1.4)
Currency translation and hedge instruments, net							(136.9)	(136.9)
Balance, December 31, 2008	117,699,542	(2,167,170)	$ 1.2	$ 977.6	$ (87.4)	$ 1,200.5	$ (85.9)	$ (248.6)

See Accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

INTRODUCTION

BorgWarner Inc. and Consolidated Subsidiaries (the Company) is a leading global supplier of highly engineered systems and components primarily for powertrain applications. These products are manufactured and sold worldwide, primarily to original equipment manufacturers of passenger cars, sport-utility vehicles, crossover vehicles, trucks, commercial transportation products and industrial equipment and to certain Tier One vehicle systems suppliers. The Company s products fall into two reporting segments: Engine and Drivetrain.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following paragraphs briefly describe the Company s significant accounting policies.

Use of estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentrations of risk Cash is maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit and therefore bear minimal risk.

The Company performs ongoing credit evaluations of its suppliers and customers and, with the exception of certain financing transactions, does not require collateral from its customers. The Company s customers are primarily original equipment manufacturers of passenger cars, sport-utility vehicles, crossover vehicles, trucks, commercial transportation products and industrial equipment.

Some automotive parts suppliers continue to experience commodity cost pressures and the effects of industry overcapacity. These factors have increased pressure on the industry s supply base, as suppliers cope with higher commodity costs, lower production volumes and other challenges. The Company receives certain of its raw materials from sole suppliers or a limited number of suppliers. The inability of a supplier to fulfill supply requirements of the Company could materially affect future operating results.

Principles of consolidation The Consolidated Financial Statements include all majority-owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

Revenue recognition The Company recognizes revenue when title and risk of loss pass to the customer, which is usually upon shipment of product. Although the Company may enter into long-term supply agreements with its major customers, each shipment of goods is treated as a separate sale and the price is not fixed over the life of the agreements.

Cash Cash is valued at fair market value. It is the Company s policy to classify all highly liquid investments with original maturities of three months or less as cash.

Marketable securities Marketable securities are classified as available-for-sale. These investments are stated at fair value with any unrealized holding gains or losses, net of tax, included as a component of stockholders equity until realized.

See Note 5 to the Consolidated Financial Statements for more information on marketable securities.

Accounts receivable 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. The Company continues to administer the collection of these receivables on behalf of the third party. The maximum size of the facility has been set at $50 million since fourth quarter 2003.

During the years ended December 31, 2008 and 2007, total cash proceeds from sales of accounts receivable were $600 million. The Company paid servicing fees related to these receivables of $1.9 million, $2.9 million and $2.7 million in 2008, 2007 and 2006, respectively. These amounts are recorded in interest expense and finance

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

charges in the Consolidated Statements of Operations. At December 31, 2008 and 2007, the Company had sold $50 million of receivables under a Receivables Transfer Agreement for face value without recourse.

Inventories Inventories are valued at the lower of cost or market. Cost of U.S. inventories is determined by the last-in, first-out (LIFO) method, while the foreign operations use the first-in, first-out (FIFO) or average-cost methods. Inventory held by U.S. operations was $124.1 million and $135.9 million at December 31, 2008 and 2007, respectively. Such inventories, if valued at current cost instead of LIFO, would have been greater by $16.6 million in 2008 and $13.5 million in 2007.

See Note 6 to the Consolidated Financial Statements for more information on inventories.

Pre-production costs related to long-term supply arrangements Engineering, research and development, and other design and development costs for products sold on long-term supply arrangements are expensed as incurred unless the Company has a contractual guarantee for reimbursement from the customer. Costs for molds, dies and other tools used to make products sold on long-term supply arrangements for which the Company either has title to the assets or has the non-cancelable right to use the assets during the term of the supply arrangement are capitalized in property, plant and equipment. Capitalized items specifically designed for a supply arrangement are amortized to cost of sales over the shorter of the term of the arrangement or over the estimated useful lives of the assets, typically 3 to 5 years. Carrying values of assets capitalized according to the foregoing policy are reviewed for impairment when events and circumstances warrant such a review. Costs for molds, dies and other tools used to make products sold on long-term supply arrangements for which the Company has a contractual guarantee for lump sum reimbursement from the customer are capitalized in prepayments and other current assets.

Property, plant and equipment and depreciation Property, plant and equipment are valued at cost less accumulated depreciation. Expenditures for maintenance, repairs and renewals of relatively minor items are generally charged to expense as incurred. Renewals of significant items are capitalized. Depreciation is computed generally on a straight-line basis over the estimated useful lives of the assets. Useful lives for buildings range from 15 to 40 years and useful lives for machinery and equipment range from 3 to 12 years. For income tax purposes, accelerated methods of depreciation are generally used.

See Note 6 to the Consolidated Financial Statements for more information on property, plant and equipment and depreciation.

Impairment of long-lived assets The Company reviews the carrying value of its long-lived assets, whether held for use or disposal, including other intangible assets, when events and circumstances warrant such a review. This review is performed using estimates of future cash flows. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value. Management believes that the estimates of future cash flows and fair value assumptions are reasonable; however, changes in assumptions underlying these estimates could affect the evaluations. Long-lived assets held for sale are recorded at the lower of their carrying amount or fair value less cost to sell. Significant judgments and estimates used by management when evaluating long-lived assets for impairment include: (i) an assessment as to whether an adverse event or circumstance has triggered the need for an impairment review; and (ii) undiscounted future cash flows generated by the asset. The Company recognized $72.9 million and $56.4 million in impairment of long-lived assets as part of restructuring expenses in 2008 and 2006, respectively.

See Note 19 to the Consolidated Financial Statements for more information regarding the Company s 2006 and 2008 impairment of long-lived assets.

Goodwill and other intangible assets Under Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, goodwill is no longer amortized; however, it must be tested for impairment at least annually. In the fourth quarter of each year, or when events and circumstances warrant such a review, the Company reviews the goodwill of all of its reporting units for impairment. The fair value of the Company s businesses used in the determination of goodwill impairment is computed using the expected present

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

value of associated future cash flows. This review requires the Company to make significant assumptions and estimates about the extent and timing of future cash flows, discount rates and growth rates. The cash flows are estimated over a significant future period of time, which makes those estimates and assumptions subject to an even higher degree of uncertainty. The Company also utilizes market valuation models and other financial ratios, which require the Company to make certain assumptions and estimates regarding the applicability of those models to its assets and businesses. The Company believes that the assumptions and estimates used to determine the estimated fair values of each of its reporting units are reasonable. However, different assumptions could materially affect the estimated fair value. The Company recognized goodwill impairment of $156.8 million in the Engine segment in 2008 and $0.2 million in the Drivetrain segment in 2006. No goodwill impairment was recorded in 2007.

See Note 7 to the Consolidated Financial Statements for more information regarding goodwill.

Product warranty 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 claim settlements as well as product manufacturing and industry developments and recoveries from third parties. Management actively studies trends of warranty claims and takes action to improve product quality and minimize warranty claims. Management believes that the warranty accrual is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the accrual. The accrual is represented in both current and non-current liabilities on the balance sheet.

See Note 8 to the Consolidated Financial Statements for more information on product warranties.

Other loss accruals and valuation allowances The Company has numerous other loss exposures, such as customer claims, workers compensation claims, litigation, and recoverability of assets. Establishing loss accruals or valuation allowances for these matters requires the use of estimates and judgment in regard to the risk exposure and ultimate realization. The Company estimates losses under the programs using consistent and appropriate methods; however, changes to its assumptions could materially affect its recorded accrued liabilities for loss or asset valuation allowances.

Derivative financial instruments The Company recognizes that certain normal business transactions generate risk. Examples of risks include exposure to exchange rate risk related to transactions denominated in currencies other than the functional currency, changes in cost of major raw materials and supplies, and changes in interest rates. It is the objective and responsibility of the Company to assess the impact of these transaction risks, and offer protection from selected risks through various methods including financial derivatives. Virtually all derivative instruments held by the Company are designated as hedges, have high correlation with the underlying exposure and are highly effective in offsetting underlying price movements. Accordingly, gains and losses from changes in qualifying hedge fair values are matched with the underlying transactions. All hedge instruments are carried at their fair value based on quoted market prices for contracts with similar maturities. The Company does not engage in any derivative transactions for purposes other than hedging specific risks.

See Note 11 to the Consolidated Financial Statements for more information on derivative financial instruments.

Foreign currency The financial statements of foreign subsidiaries are translated to U.S. Dollars using the period-end exchange rate for assets and liabilities and an average exchange rate for each period for revenues, expenses, and capital expenditures. The local currency is the functional currency for substantially all the Company s foreign subsidiaries. Translation adjustments for foreign subsidiaries are recorded as a component of accumulated other comprehensive income (loss) in stockholders equity. The Company recognizes transaction gains and losses arising from fluctuations in currency exchange rates on transactions denominated in currencies other than the functional currency in earnings as incurred, except for those transactions which hedge purchase commitments and for those intercompany balances which are designated as long-term investments. Net income

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

included a foreign currency transaction loss of $5.8 million in 2008. Net income included foreign currency transaction gains of $4.4 million and $1.6 million in 2007 and 2006, respectively.

See Note 14 to the Consolidated Financial Statements for more information on other comprehensive income (loss).

New Accounting Pronouncements In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a consistent recognition threshold and measurement attribute, as well as clear criteria for subsequently recognizing, derecognizing and measuring such tax positions for financial statement purposes. FIN 48 also requires expanded disclosure with respect to the uncertainty in income taxes. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a $16.6 million reduction to its January 1, 2007 retained earnings balance.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. On January 1, 2008, the Company partially adopted as required, FAS 157. See Note 10 to the Consolidated Financial Statements for more information regarding the implementation of FAS 157.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159). FAS 159 allows entities to irrevocably elect to recognize most financial assets and financial liabilities at fair value on an instrument-by-instrument basis. The stated objective of FAS 159 is to improve financial reporting by giving entities the opportunity to elect to measure certain financial assets and liabilities at fair value in order to mitigate earnings volatility caused when related assets and liabilities are measured differently. FAS 159 is effective for the Company beginning with its quarter ending March 31, 2008. The Company chose to not make the election to adopt.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (Revised 2007), *Business Combinations* (FAS 141(R)). FAS 141(R) establishes principles and requirements for recognizing identifiable assets acquired, liabilities assumed, noncontrolling interest in the acquiree, goodwill acquired in the combination or the gain from a bargain purchase, and disclosure requirements. Under this revised statement, all costs incurred to effect an acquisition will be recognized separately from the acquisition. Also, restructuring costs that are expected but the acquirer is not obligated to incur will be recognized separately from the acquisition. FAS 141(R) is effective for the Company beginning with its quarter ending March 31, 2009. The Company has incurred $3.2 million of on-going acquisition related costs, which will be expensed upon adoption of FAS 141(R) in the first quarter of 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (FAS 160). FAS 160 requires that ownership interests in subsidiaries held by parties other than the parent are clearly identified. In addition, it requires that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the income statement. FAS 160 is effective for the Company beginning with its quarter ending March 31, 2009. The adoption of FAS 160 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In February 2008, the FASB issued FASB Staff Position No. FAS 157-2 (FSP FAS 157-2). FSP FAS 157-2 delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed in the financial statements on a nonrecurring basis to fiscal years beginning after November 15, 2008. Refer to Note 10, Fair Value Measurements of the Notes to the Consolidated Financial Statements for further discussion of the Company s partial adoption of FSP FAS 157-2.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities (FAS 161). FAS 161 requires entities to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

hedged items are accounted for under Statement 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. FAS 161 is effective for the Company beginning with its quarter ending March 31, 2009. The adoption of FAS 161 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2008, the FASB issued Staff Position 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets (FAS 132(R)-1). FAS 132(R)-1 requires entities to provide enhanced disclosures about how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period, and significant concentrations of risk within plan assets. FAS 132(R)-1 is effective for the Company beginning with its year ending December 31, 2009. The Company is currently assessing the potential impacts, if any, on its consolidated financial statements.

In December 2008, the FASB issued Staff Position 140-4 and Financial Interpretation 46(R)-8, Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities (FSP 140-4 and FIN 46(R)-8). FSP 140-4 and FIN 46(R)-8 requires entities to provide enhanced disclosures about how an entity accounts for transfers of financial assets, the nature of involvement, if any, after the financial asset sale and the nature of any restrictions on assets reported by an entity in its statement of financial position that relates to a transferred financial asset, including the carrying amounts of such assets. The Company has adjusted its disclosures to be complaint with FSP 140-4 and FIN 46(R)-8 at December 31, 2008.

NOTE 2 RESEARCH AND DEVELOPMENT COSTS

The following table presents the Company s gross and net expenditures on research and development (R&D) activities:

millions of dollars Year Ended December 31,	**2008**	**2007**	**2006**
Gross R&D expenditures	$ 273.4	$ 246.7	$ 219.5
Customer reimbursements	(67.7)	(35.9)	(31.8)
Net R&D expenditures	$ 205.7	$ 210.8	$ 187.7

The Company s net R&D expenditures are included in the selling, general, and administrative expenses of the Consolidated Statements of Operations. Customer reimbursements are netted against gross R&D expenditures upon billing of services performed. The Company has contracts with several customers at the Company s various R&D locations. No such contract exceeded $6 million in any of the years presented.

NOTE 3 OTHER INCOME

Items included in other income consist of:

millions of dollars Year Ended December 31,	2008	2007	2006
Interest income	$ (7.1)	$ (6.7)	$ (3.2)
Net gain on sale of businesses			(4.8)
Loss on the sale of a product line	2.2		
Net loss on asset disposals	2.0	0.6	1.0
Other	(0.2)	(0.7)	(0.5)
Total other income	$ (3.1)	$ (6.8)	$ (7.5)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 INCOME TAXES

Earnings before income taxes and the provision for income taxes are presented in the following table.

ns of dollars	2008			2007			2006		
Ended December 31,	**U.S.**	**Non-U.S.**	**Total**	**U.S.**	**Non-U.S.**	**Total**	**U.S.**	**Non-U.S.**	**Tot**
ngs before taxes	$ (123.8)	$ 137.8	$ 14.0	$ 48.4	$ 382.0	$ 430.4	$ (27.2)	$ 297.5	$ 27
ion for income taxes:									
nt:									
al/foreign	7.7	99.5	107.2	36.6	106.2	142.8	(11.1)	87.7	7
	1.0		1.0	1.0		1.0	2.2		
current	8.7	99.5	108.2	37.6	106.2	143.8	(8.9)	87.7	7
red	(44.7)	(30.2)	(74.9)	(10.0)	(19.9)	(29.9)	(27.4)	(19.0)	(4
provision for income	$ (36.0)	$ 69.3	$ 33.3	$ 27.6	$ 86.3	$ 113.9	$ (36.3)	$ 68.7	$ 3
ive tax rate	(29.1)%	50.3%	237.9%	57.0%	22.6%	26.5%	(133.5)%	23.1%	1

The provision for income taxes resulted in an effective tax rate for 2008 of 237.9% compared with rates of 26.5% in 2007 and 12.0% in 2006. The effective tax rate of 237.9% for 2008 differs from the U.S. statutory rate primarily due to the non-deductibility of the $156.8 million impairment charge in 2008 related to BERU goodwill; a reduction in U.S. income; foreign rates, which differ from those in the U.S.; the realization of certain business tax credits including R&D and foreign tax credits; and favorable permanent differences between book and tax treatment for items, including equity in affiliates earnings.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a $16.6 million reduction to the January 1, 2007 balance of retained earnings. At December 31, 2007, the Company reported $71.7 million of unrecognized tax benefits; approximately $62.5 million represent the amount that, if recognized, would affect the Company s global effective income tax rate in future periods.

Following is a reconciliation of the Company s total gross unrecognized tax benefits for the year-to-date periods ended December 31, 2008 and 2007, respectively. Of the total $61.1 million of unrecognized tax benefits as of December 31, 2008, approximately $51.1 million of this total represents the amount that, if recognized, would affect the Company s effective income tax rate in future periods. This amount differs from the gross unrecognized tax benefits presented in the table due to the decrease in the U.S. federal income taxes which would occur upon recognition of the state tax benefits included therein.

millions of dollars	2008	2007
Balance, January 1	$ 71.7	$ 50.5
Additions based on tax positions related to current year	0.5	1.2
Additions for tax positions of prior years	0.2	20.0
Reductions for tax positions of prior years	(1.7)	
Settlements	(6.7)	
Translation adjustment	(2.9)	
Balance, December 31	$ 61.1	$ 71.7

In the first quarter of 2008, the Company made a $6.6 million cash payment to the IRS to resolve agreed upon issues of the ongoing IRS examination of the Company s 2002-2004 tax years. There was a reduction in the first quarter of 2008 of $6.7 million related to the Company s unrecognized tax benefits balance due to the settlement of the agreed upon issues primarily related to the Extraterritorial Income Exclusion for the 2002-2004 tax years. The Company is currently in the appeals process on disputed issues related to the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2002-2004 IRS audit, which is not expected to be resolved by December 31, 2009. Other possible changes in the unrecognized tax benefits balance related to other examinations cannot be reasonably estimated within the next 12 months.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. The Company had $9.7 million accrued at January 1, 2008 for the payment of any such interest and penalties. The Company had approximately $11.4 million for the payment of interest and penalties accrued at December 31, 2008.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. The Company is no longer subject to income tax examinations by tax authorities in its major tax jurisdictions as follows:

Tax Jurisdiction	**Years No Longer Subject to Audit**
U.S. Federal	2001 and prior
Brazil	2002 and prior
France	2006 and prior
Germany	2003 and prior
Hungary	2004 and prior
Italy	2002 and prior
Japan	2006 and prior
South Korea	2004 and prior
United Kingdom	2006 and prior

In certain tax jurisdictions the Company may have more than one taxpayer. The table above reflects the status of the major taxpayers in each major tax jurisdiction.

The analysis of the variance of income taxes as reported from income taxes computed at the U.S. statutory rate for consolidated operations is as follows:

millions of dollars	2008	2007	2006
Income taxes at U.S. statutory rate of 35%	$ 4.9	$ 150.6	$ 94.6
Increases (decreases) resulting from:			
Income from non-U.S. sources including withholding taxes	(26.5)	(12.3)	(8.8)
State taxes, net of federal benefit	0.9	(0.6)	(1.5)
Business tax credits	(9.8)	(8.6)	(1.0)
Affiliates earnings	(13.2)	(13.1)	(11.3)
Accrual adjustment and settlement of prior year tax matters	6.0	24.6	(22.9)
Changes in tax laws		(24.2)	(10.4)
Medicare prescription drug benefit	1.1	(2.1)	(3.8)
Capital loss limitation			5.7
Goodwill impairment	54.9		

Restructuring	0.6		(5.0)
Valuation allowance	13.1		
Non-temporary differences and other	1.3	(0.4)	(3.2)
Provision for income taxes as reported	$ 33.3	$ 113.9	$ 32.4

In July 2007, the government of the United Kingdom enacted a statutory income tax rate reduction from 30% to 28%, effective April 1, 2008. In August 2007, the government of Germany enacted a federal statutory income tax rate reduction from 38% to 28%, effective January 1, 2008. In addition, Korea also reduced its federal statutory income tax rate from 27.5% to 24.2% effective January 1, 2009.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Following are the gross components of deferred tax assets and liabilities as of December 31, 2008 and 2007:

millions of dollars	2008	2007
Current deferred tax assets:		
Employee related	$ 28.5	$ 15.5
Inventory	5.1	5.6
Warranties	4.4	2.8
Litigation & environmental	4.0	1.2
Net operating loss carryforwards	1.8	0.6
Derivatives	10.5	4.5
Accrued interest		0.9
Customer claims	2.3	
Other	10.9	11.0
Total current deferred tax assets	$ 67.5	$ 42.1
Current deferred tax liabilities:		
Derivatives	$ (2.0)	$
Employee related		(1.4)
Other	(0.7)	(1.9)
Total current deferred tax liabilities	$ (2.7)	$ (3.3)
Non-current deferred tax assets:		
Pension and other post employment benefits	$ 89.5	$ 102.8
Other comprehensive income	114.5	68.0
Employee related	13.9	16.2
Litigation and environmental	3.2	3.5
Warranties	6.4	6.9
Foreign tax credits	78.3	25.0
Research and development credits	6.6	5.7
Capital loss carryforwards	20.4	19.4
Net operating loss carryforwards	12.9	9.0
Other	8.3	7.0
Total non-current deferred tax assets	$ 354.0	$ 263.5
Non-current deferred tax liabilities:		
Fixed assets	$ (98.3)	$ (127.5)
Goodwill & intangibles	(104.5)	(80.8)
Other comprehensive income	(3.1)	(1.5)
Lease obligation production equipment	(4.0)	(5.0)
Other	(1.3)	(1.7)
Total non-current deferred tax liabilities	$ (211.2)	$ (216.5)

Total	$ 207.6	$ 85.8
Valuation allowances	(31.0)	(24.0)
Net deferred tax asset	$ 176.6	$ 61.8

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The deferred tax assets and liabilities recognized in the Company s Consolidated Balance Sheets are as follows:

millions of dollars	2008	2007
Deferred income taxes current assets	$ 67.5	$ 42.8
Deferred income taxes current liabilities	(2.7)	(3.3)
Other non-current assets	201.4	124.4
Other non-current liabilities	(89.6)	(102.1)
Net deferred tax asset (current and non-current)	$ 176.6	$ 61.8

The deferred income taxes current assets are primarily comprised of amounts from the U.S., France, India, Japan, Mexico and the U.K. The deferred income taxes current liabilities are primarily comprised of amounts from Germany. The other non-current assets are primarily comprised of amounts from the U.S. and Korea. The other non-current liabilities are primarily comprised of amounts from Germany, Hungary, Italy, Monaco and the U.K.

The Company has a U.S. capital loss carryforward of $20.4 million, which will expire in 2010, 2011, 2012 and 2013. A valuation allowance of $16.9 million has been recorded for the tax effect of some of this loss carryforward.

The foreign tax credits of $78.3 million will expire beginning in 2013 through 2018. A valuation allowance of $13.5 million has been recorded for the tax effect of some of this carryforward.

At December 31, 2008, certain non-U.S. subsidiaries have net operating loss carryforwards totaling $63.5 million that are available to offset future taxable income. Carryforwards of $34.6 million expire at various dates from 2009 through 2016 and the balance has no expiration date. A valuation allowance of $1.5 million has been recorded for the tax effect on $5.5 million of the loss carryforwards. Any benefit resulting from the utilization of $6.0 million of the operating loss carryforwards will be applied to reduce goodwill related to the BERU acquisition. Certain U.S. subsidiaries have state net operating loss carryforwards totaling $240.7 million and 235.2 million in 2008 and 2007, respectively, for which a non-current deferred tax asset has been established in 2008 on $7.7 million of the loss carryforward and the remainder is completely offset by a valuation allowance due to risk of realization. Certain non-U.S. subsidiaries located in China and Korea have tax exemptions or tax holidays. The cumulative impact of these tax exemptions or tax holidays to the effective tax rate in 2008 was negligible.

No deferred income taxes have been provided on the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries or foreign equity affiliates totaling $1,465.6 million in 2008, as these amounts are essentially permanent in nature. The excess amount will become taxable upon repatriation of assets, sale, or liquidation of the investment. It is not practicable to determine the unrecognized deferred tax liability on the excess amount because the actual tax liability on the excess amount, if any, is dependent on circumstances existing when remittance occurs.

NOTE 5 MARKETABLE SECURITIES

As of December 31, 2008 the Company had no investments in marketable securities. At December 31, 2007, the Company had $14.6 million in marketable securities, primarily bank notes. The securities are carried at fair value with the unrealized gain or loss, net of tax, reported in other comprehensive income (loss). As of December 31, 2007, $7.3 million of the contractual maturities are within one to five years and $7.3 million are due beyond five years. Gross proceeds from sales of marketable securities were $14.6 million and $60.4 million in 2008 and 2007, respectively. No gain or loss was realized in 2008. A net realized loss of $0.1 million, based on specific identification of securities sold, has been reported in other income for the year ended December 31, 2007.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6 BALANCE SHEET INFORMATION

Detailed balance sheet data are as follows:

millions of dollars December 31,	2008	2007
Receivables:		
Customers	$ 522.7	$ 721.9
Other	90.1	85.7
Gross receivables	612.8	807.6
Bad debt allowance (a)	(5.7)	(5.2)
Net receivables	$ 607.1	$ 802.4
Inventories:		
Raw material and supplies	$ 260.7	$ 246.7
Work in progress	95.7	99.8
Finished goods	111.4	114.6
FIFO inventories	467.8	461.1
LIFO reserve	(16.6)	(13.5)
Net inventories	$ 451.2	$ 447.6
Other current assets:		
Product liability insurance receivable	$ 22.1	$ 20.1
Prepaid tax	1.6	2.2
Prepaid insurance	1.6	1.4
Other	53.7	60.7
Total other current assets	$ 79.0	$ 84.4
Property, plant and equipment:		
Land	$ 56.1	$ 46.3
Buildings	563.7	558.6
Machinery and equipment	1,756.1	1,806.1
Capital leases	1.1	1.1
Construction in progress	160.0	143.4
Total property, plant and equipment	2,537.0	2,555.5
Accumulated depreciation	(1,047.4)	(1,037.9)
	1,489.6	1,517.6

Tooling, net of amortization	96.6	91.5
Property, plant & equipment, net	$ 1,586.2	$ 1,609.1
Investments and advances:		
Investment in equity affiliates	$ 214.3	$ 211.3
Other investments and advances	52.2	43.8
Total investments and advances	$ 266.5	$ 255.1

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

millions of dollars December 31,	2008	2007
Other non-current assets:		
Deferred pension assets	$ 0.5	$ 28.8
Product liability insurance receivable	12.6	19.5
Deferred income taxes	201.4	124.4
Other intangible assets	148.4	139.4
Other	67.8	33.7
Total other non-current assets	$ 430.7	$ 345.8
Accounts payable and accrued expenses:		
Trade payables	$ 466.6	$ 626.3
Severance	51.0	9.1
Payroll and related	95.4	139.7
Environmental	5.9	7.7
Product liability	22.1	20.1
Product warranties	51.4	34.7
Insurance	12.5	11.9
Customer related	23.3	27.0
Interest	10.6	10.3
Dividends payable to minority shareholders	6.4	10.9
Retirement related	38.7	38.0
Current deferred income taxes	2.7	3.3
Domination and Profit Transfer Agreement obligation	44.0	
Derivatives	51.4	20.4
Other	41.0	33.6
Total accounts payable and accrued expenses	$ 923.0	$ 993.0
Other non-current liabilities:		
Environmental	$ 7.4	$ 7.8
Product warranties	30.7	35.4
Deferred income taxes	89.6	102.1
Product liability accrual	12.6	19.5
Self-insurance	7.6	7.0
Lease residual value	4.1	6.0
Employee costs	2.9	7.6
Cross currency swaps	55.1	33.7
Deferred revenue	25.2	23.6
Derivatives	26.7	7.9
Other	91.2	112.0
Total other non-current liabilities	$ 353.1	$ 362.6

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(a) Bad debt allowance:

(millions of dollars)	2008	2007	2006
Beginning balance	$ (5.2)	$ (7.8)	$ (8.3)
Acquisitions			(0.1)
Provision	(2.4)	0.3	(0.8)
Write-offs	1.6	3.0	2.0
Translation adjustment	0.3	(0.7)	(0.6)
Ending balance	$ (5.7)	$ (5.2)	$ (7.8)

Interest costs capitalized during 2008 and 2007 were $13.3 million and $9.6 million, respectively. As of December 31, 2008 and December 31, 2007, accounts payable of $43.2 million and $45.8 million, respectively, were related to property, plant and equipment purchases. As of December 31, 2008 and December 31, 2007, specific assets of $7.4 million and $16.5 million, respectively, were pledged as collateral under certain of the Company s long-term debt agreements.

NSK-Warner

The Company has a 50% interest in NSK-Warner, a joint venture based in Japan that manufactures automatic transmission components. The Company s share of the earnings or losses reported by NSK-Warner is accounted for using the equity method of accounting. NSK-Warner has a fiscal year-end of March 31. The Company s equity in the earnings of NSK-Warner consists of the 12 months ended November 30 so as to reflect earnings on as current a basis as is reasonably feasible. NSK-Warner is the joint venture partner with a 40% interest in the Drivetrain Group s South Korean subsidiary, BorgWarner Transmission Systems Korea Inc. Dividends received from NSK-Warner were $40.8 million, $15.7 million and $41.1 million in 2008, 2007 and 2006, respectively.

Following are summarized financial data for NSK-Warner, translated using the ending or periodic rates as of and for the years ended November 30, 2008, 2007 and 2006 (unaudited):

millions of dollars	2008	2007	2006
Balance sheets:			
Current assets	$ 319.1	$ 304.6	$ 256.8
Non-current assets	185.7	164.3	136.8
Current liabilities	146.3	148.8	128.6
Non-current liabilities	40.5	22.9	19.7
Statements of operations:			
Net sales	$ 637.9	$ 552.1	$ 535.4
Gross profit	140.0	122.7	111.6
Net income	67.6	69.4	54.7

The equity of NSK-Warner as of November 30, 2008 was $318.0 million, there was no debt and their cash and securities were $132.1 million.

Purchases from NSK-Warner for the years ended December 31, 2008, 2007 and 2006 were $25.4 million, $24.2 million and $23.0 million, respectively.

NOTE 7 GOODWILL AND OTHER INTANGIBLES

As of September 30, 2008 and December 31, 2008, the Company recorded an impairment charge of 104.3 $(146.8) million and 7.2 $(10.0) million, respectively, to adjust BERU s goodwill to its estimated fair value. The impairment charge is attributable to a decrease in the operating unit s estimated fair value based primarily upon

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the effect of the decline in European market conditions on current and projected operating results. The impairment charge was also impacted by the recognition of additional goodwill in the second quarter of 2008, which was based on the court determined buy out value of 71.32 per share related to the Domination and Profit Transfer Agreement. Any differences in future results compared to management s estimates could result in fair values different from estimated fair values, which could materially impact the Company s future results of operations and financial condition.

See Note 20, Recent Transactions , for further discussion on the BERU AG Domination and Profit Transfer Agreement.

The changes in the carrying amount of goodwill for the twelve months ended December 31, 2006, 2007 and 2008 are as follows:

millions of dollars	
Balance at January 1, 2006	$ 1,029.8
Goodwill impairment	(0.2)
ETEC acquisition	21.9
Translation adjustment	35.0
Balance at December 31, 2006	$ 1,086.5
BERU acquisition 12.8%	48.7
Translation adjustment	33.0
Balance at December 31, 2007	$ 1,168.2
BERU acquisition 17.8%	74.5
Goodwill impairment	(156.8)
Translation adjustment	(33.5)
Balance at December 31, 2008	$ 1,052.4

The Company s other intangible assets, primarily from acquisitions consist of the following:

	December 31, 2008			December 31, 2007		
millions of dollars	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets						
Patented technology	$ 16.8	$ 4.2	$ 12.6	$ 13.8	$ 2.9	$ 10.9
Unpatented technology	6.6	2.3	4.3	6.5	1.5	5.0
Customer relationships	116.3	32.5	83.8	100.8	22.9	77.9
Distribution network	53.1	31.9	21.2	45.6	23.2	22.4
Miscellaneous	14.7	11.9	2.8	14.7	11.9	2.8

Total amortized intangible assets	207.5	82.8	124.7	181.4	62.4	119.0
Unamortized trade names	23.7		23.7	20.4		20.4
Total intangible assets	$ 231.2	$ 82.8	$ 148.4	$ 201.8	$ 62.4	$ 139.4

Amortization of other intangible assets was $27.1 million, $21.5 million and $17.5 million in 2008, 2007 and 2006, respectively. The amortization totals include non-recurring charges directly attributable to acquisitions, as described in Note 20, Recent Transactions . The estimated useful lives of the Company s amortized intangible assets range from 4 to 12 years. The Company utilizes the straight line method of amortization, recognized over the estimated useful lives of the assets. The estimated future annual amortization expense, primarily for acquired intangible assets, is as follows: $24.9 million in 2009, $17.5 million in 2010, $17.5 million in 2011, $17.4 million in 2012 and $17.3 million in 2013.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A roll-forward of the gross carrying amounts for the years ended December 31, 2008 and 2007 is presented below:

millions of dollars	2008	2007
Beginning balance	$ 201.8	$ 161.3
Acquisitions	36.7	25.0
Translation adjustment	(7.3)	15.5
Ending balance	$ 231.2	$ 201.8

A roll-forward of accumulated amortization for the years ended December 31, 2008 and 2007 is presented below:

millions of dollars	2008	2007
Beginning balance	$ 62.4	$ 40.9
Provisions	27.1	19.4
Non-recurring charges	(3.2)	(2.1)
Translation adjustment	(3.5)	4.2
Ending balance	$ 82.8	$ 62.4

NOTE 8 PRODUCT WARRANTY

The changes in the carrying amount of the Company s total product warranty liability for the years ended December 31, 2008 and 2007 were as follows:

millions of dollars	2008	2007
Beginning balance	$ 70.1	$ 60.0
Acquisition		
Provisions	66.1	60.7
Payments	(50.6)	(54.9)
Translation adjustment	(3.5)	4.3
Ending balance	$ 82.1	$ 70.1

Contained within the 2007 provision is approximately $14 million for a warranty-related issue surrounding a product, built during a 15-month period in 2004 and 2005, that is no longer in production.

Contained within the 2008 provision is approximately $23.5 for a warranty-related issue associated with the company s transmission product sold in Europe, limited to mid-2007 through May 2008 production.

The product warranty liability is classified in the consolidated balance sheets as follows:

millions of dollars	**2008**	**2007**
Accounts payable and accrued expenses	$ 51.4	$ 34.7
Other non-current liabilities	30.7	35.4
Total product warranty liability	$ 82.1	$ 70.1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 NOTES PAYABLE AND LONG-TERM DEBT

Following is a summary of notes payable and long-term debt. The weighted average interest rate on all borrowings outstanding as of December 31, 2008 and 2007 was 5.0% and 5.4%, respectively.

millions of dollars	2008		2007	
December 31,	Current	Long-Term	Current	Long-Term
Bank borrowings and other	$ 130.7	$ 1.0	$ 30.0	$ 6.0
Term loans due through 2015 (at an average rate of 4.9% in 2008 and 4.0% in 2007)	53.1	12.9	33.7	18.8
6.50% Senior Notes due 02/17/09, net of unamortized discount(a)	136.7			136.5
5.75% Senior Notes due 11/01/16, net of unamortized discount(a)		149.2		149.1
8.00% Senior Notes due 10/01/19, net of unamortized discount(a)		133.9		133.9
7.125% Senior Notes due 02/15/29, net of unamortized discount		119.2		119.2
Carrying amount of notes payable and long-term debt	320.5	416.2	63.7	563.5
Impact of derivatives on debt	0.2	43.4		9.1
Total notes payable and long-term debt	$ 320.7	$ 459.6	$ 63.7	$ 572.6

(a) The Company entered into several interest rate swaps, which have the effect of converting $325.0 million of these fixed rate notes to variable rates as of December 31, 2008 and December 31, 2007. The weighted average effective interest rates for these borrowings, including the effects of outstanding swaps as noted in Note 11, were 5.3% and 5.0% as of December 31, 2008 and 2007, respectively.

Annual principal payments required as of December 31, 2008 are as follows (in millions of dollars):

2009	$ 320.7
2010	5.1
2011	3.0
2012	2.2
2013	2.2
After 2013	449.5
Total Payments	$ 782.7
Less: Unamortized Discounts	(2.4)

Total	$ 780.3

The Company s long-term debt includes various financial covenants, none of which are expected to restrict future operations.

The Company has a multi-currency revolving credit facility, which provides for borrowings up to $600 million through July 22, 2009. At December 31, 2008 and December 31, 2007 there were no outstanding borrowings under the facility. The credit agreement is subject to the usual terms and conditions applied by banks to an investment grade company. The two key covenants of the credit agreement are a net worth test and a debt compared to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) test. The Company was in compliance with all covenants at December 31, 2008. At December 31, 2008 and 2007, the Company had

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

outstanding letters of credit of $21.4 million and $22.0 million, respectively. The letters of credit typically act as a guarantee of payment to certain third parties in accordance with specified terms and conditions.

As of December 31, 2008 and 2007, the estimated fair values of the Company s senior unsecured notes totaled $532.3 million and $572.4 million, respectively. The estimated fair values were $6.7 million lower in 2008 and $33.7 million higher in 2007 than their respective carrying values. Fair market values are developed by the use of estimates obtained from brokers and other appropriate valuation techniques based on information available as of year-end. The fair value estimates do not necessarily reflect the values the Company could realize in the current markets.

NOTE 10 FAIR VALUE MEASUREMENTS

On January 1, 2008, the Company partially adopted as required, Statement of Financial Accounting Standards No. 157 Fair Value Measurements (SFAS 157) which expands the disclosure of fair value measurements and its impact on the Company s financial statements. In February 2008, the FASB issued FSP 157-2, which delayed the effective date of adoption with respect to certain non-financial assets and liabilities until 2009. We intend to defer the adoption of SFAS 157 with respect to certain non-financial assets and liabilities as permitted.

Statement No. 157 emphasizes that fair value is a market-based measurement, not an entity specific measurement. Therefore, a fair value measurement should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, SFAS 157 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair values as follows:

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

Assets and liabilities measured at fair value are based on one or more of the following three valuation techniques noted in SFAS 157:

A. Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

B. Cost approach: Amount that would be required to replace the service capacity of an asset (replacement cost).

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table classifies the assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2008:

(millions)	Balance at December 31, 2008	Basis of Fair Value Measurements: Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
Assets:					
Goodwill	$ 174.2	$	$	$ 174.2	C
Fixed assets	21.2				