



 **BorgWarner**



We are
product leaders



2003
annual
report





AUDI A4



HUMMER H2



VW GOLF



FORD EXPEDITION



NISSAN XTERRA



GEELY MERRIE



SSANG YONG MUSSO



PUEGEOT 307



HYUNDAI SANTA FE



AUDI TT



CADILLAC SRX



BENTLEY CONTINENTAL GT



MACK TRUCK



TATA SAFARI



VOLVO V70

We are
enhancing the



PORSCHE 911



HONDA ACCORD



DODGE CARAVAN



RENAULT MEGANE



JAGUAR



JEEP® LIBERTY



FORD EXPLORER



BMW 325i



MERCEDES CL600



GM MALIBU



DODGE RAM PICKUP



CHERY QQ



HONDA PILOT



VW TOURAN



TOYOTA CAMRY



ACURA MDX



BUGATTI VEYRON



MAHINDRA & MAHINDRA SCORPIO



KIA SORENTO



LEXUS RX330

driving experience



FORD F-150



SATURN VUE



HONDA CIVIC HYBRID



CASE NEW HOLLAND



MERCEDES SPRINTER

Financial Highlights

millions of dollars, except employee and per share data	2003	2002	% Change
Net sales	\$3,069.2	\$2,731.1	12.4%
Net earnings before cumulative effect of accounting change	174.9	149.9	16.7%
Cumulative effect of change in accounting principle, net of tax	—	(269.0)	
Net earnings (loss)	174.9	(119.1)	
Net earnings per share before cumulative effect of accounting change — diluted	6.40	5.58	14.7%
Net earnings (loss) per share — diluted	6.40	(4.44)	
Average number of shares outstanding — diluted (millions)	27.3	26.9	
Capital spending	172.0	138.4	24.3%
Research & Development	118.2	109.1	8.3%
Debt	644.0	646.7	(0.4)%
Stockholders' equity	1,260.4	981.4	
Number of employees	14,300	14,000	

Technology aimed at the fastest growing segments of the vehicle market has driven profitable growth.



We are leaders in advanced powertrain solutions for vehicle makers worldwide. Our products play a key role in the fuel-efficient and reliable operation of engines, transmissions and four-wheel drive systems to deliver growth that outpaces that of our industry.



FOCUSED CAPITAL SPENDING

percentage of sales



DEBT IMPROVEMENTS

debt, net of cash and cash equivalents, in millions of dollars



COMMITMENT TO RESEARCH & DEVELOPMENT

millions of dollars



to our shareholders

2003 was a year of significant milestones — financial, technological, cultural and personal.

- Our record sales broke the \$3 billion mark. Earnings were \$6.40 per share, another record. We reduced debt to its lowest level since 1998. Our stock price rose significantly. All this in an industry with no growth in 2003.
- The past year was our 10th anniversary as a public company and marked 75 years since the formation of the first Borg-Warner. John Fiedler, the man who nurtured us through our

years of survival in the mid-90s and led the growth surge in recent years, retired. We all benefited from John's successful career at BorgWarner and appreciate his contributions.

- Our technology flourished. Our innovative DualTronic transmission modules launched with VW and Audi to the rave reviews of the European press and the delight of our customer. The accolades for this first-to-market technology enhanced the pride of our people and the enthusiasm of our shareholders. You have to drive DualTronic to believe it.

- Because of tremendous growth with customers like Honda, Hyundai and VW/Audi, our sales to the non-“Big Three” automakers exceeded 50% of sales in 2003 including our unconsolidated joint ventures. This strategic focus proves beneficial as market shares among the global automakers shift in favor of our faster growing customers.

- To prepare for the next wave of growth, we reaffirmed our vision of product leadership and reiterated our long-established values. These are qualities that are more important today than ever before.

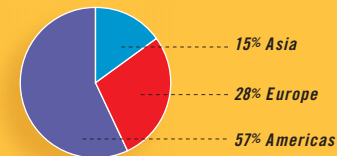
- *respect for each other*
- *power of collaboration*
- *passion for excellence*
- *personal integrity*
- *responsibility to our communities*

- We renewed our focus on operating efficiency as a key enabler of product leadership. True product leadership is product technology married to manufacturing excellence. This combination is our real competitive advantage, and the reason we can survive and thrive in a price-conscious environment.

We are ***creating shareholder value***

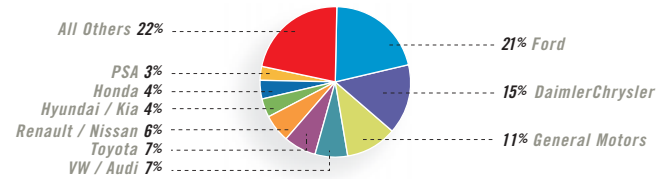
Geographic Breadth

sales include unconsolidated joint ventures



Customer Diversity

sales include unconsolidated joint ventures



Confidence and Collaboration

We enter our second decade as a public company with confidence. Our growth goals build on our strengths — a strong balance sheet, one of the most diverse customer bases in the industry, broad geographic presence, and technology and operating know-how that can deliver internal growth and nurture a product leadership culture. We have worked hard to establish our financial credentials — and Wall Street rewarded us for our efforts.

We have enabled increased collaboration with the formation of our Engine

and Drivetrain Groups. These groups are charged with harvesting synergies, along with driving cross-business innovation and growth. Our road map for continued profitable growth emerged from a meeting of our top worldwide managers last fall. We looked at where we are as a company, assessed the key factors impacting our business and identified our strengths and weaknesses in light of these factors.

As a result, we developed broad frameworks for driving growth. Our long-term goals of 8% to 11% sales growth and 12% to 16% earnings growth were tested in our growth

model and are achievable. To answer the question of how we will grow, we identified and agreed upon key “Enterprise Strategies.” These strategies fall into the broad categories of people, cooperative action or synergy, and global growth, both internally and externally. We believe we have a powerful plan to drive sustained profitable growth — in the midst of some pretty tough economic conditions and in a brutal automotive marketplace.

We are BorgWarner

This report is a look at who we are as we embark upon the next leg of our growth journey, and why we are well-positioned to provide value to our shareholders, customers and employees. Our 14,300 employees at more than 40 locations in 14 countries are leveraging their *Know-how, Passion and Innovation* into the next generation of new concepts and integrated systems. I thank them for their efforts. I also appreciate the support and guidance of our board of directors.

To be successful, BorgWarner must adapt to the challenges of a dynamic marketplace. I envision BorgWarner as the powerhouse of the powertrain business. We play to set records, not simply to win the game. We strive to post better results year after year. That’s why we push ourselves for growth and profitability.

BorgWarner applies its broad engine and drivetrain expertise to address vehicle makers’ most pressing needs — increased fuel efficiency, reduced emissions and enhanced vehicle stability and performance. These needs are not going away anytime soon. For the person behind the wheel, our technology also enhances the driving experience. BorgWarner has the right resources, in the right places, to continue to excel.

Timothy M. Manganello
Chairman and CEO



business profile

2003 HIGHLIGHTS

Sales rose 13%, boosted by continued strong demand for turbochargers for European passenger cars and commercial vehicles. The demand for small, fuel-efficient diesel engines enhanced by our products again made Europe our fastest growing market. This growth offset the chain and emissions portions of the group, which experienced softness as a result of weaker auto production, particularly in North America. Increased turbocharger production and productivity improvements boosted margins, partially offset by start-up costs for new products and operations for chain products.

GROWTH DRIVERS AND OPPORTUNITIES

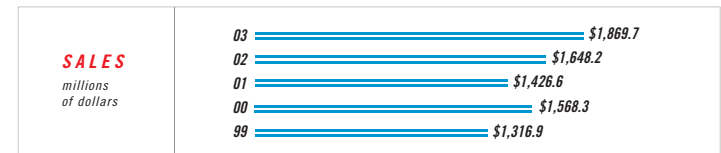
- Stricter emission regulations for Europe, North America and Asia
- Continued growth of diesel engines in European passenger cars
- Tighter emission regulations related to commercial diesels
- Engine downsizing for improved fuel consumption and emissions in gasoline engines
- Electronic controls
- Continued popularity of light trucks and SUVs
- Engine timing systems moving from belts to chains
- Development of variable cam timing systems
- Growth of overhead cam engines
- Systems integration; alternative technologies

KEY TECHNOLOGIES

Chain Products Global leader in the design and manufacture of automotive chain systems for engine timing, automatic transmission and torque transfer including four- and all-wheel drive applications. Fully integrated timing chain system supplier including chains, sprockets, tensioners, control arms and guides, and variable cam timing phasers.

Boosting Systems Leading designer and manufacturer of turbochargers and boosting systems for the passenger car and commercial vehicle markets.

Emissions and Thermal Systems Leading designer and supplier of components and systems for engine air and thermal management designed to control emissions.



engine group

The Engine Group develops strategies and products to manage engines for fuel efficiency, reduced emissions and enhanced performance. BorgWarner's expertise in engine timing, boosting, air and noise management, cooling and controls is the foundation for this collaboration.

PLANTS AND TECHNICAL CENTERS

† Plants * Technical Centers

Americas

Asheville, North Carolina † * Dixon, Illinois † Sallisaw, Oklahoma †
 Auburn Hills, Michigan * Fletcher, North Carolina † Simcoe, Ontario, Canada †
 Cadillac, Michigan † Guadalajara, Mexico † Water Valley, Mississippi †
 Campinas, Brazil † Ithaca, New York † *
 Cortland, New York † Marshall, Michigan *

Asia

Changwon, South Korea † Nabari City, Japan † *
 Chennai, India † Ningbo, China (JV) †
 Chennai, India (JV) † Tainan Shien, Taiwan †
 Hitachinaka City, Japan (JV) †
 Kakkalur, India (JV) †

Europe

Arcore, Italy † *
 Bradford, England †
 Kirchheimbolanden, Germany † *
 Markdorf, Germany † *
 Oroszlany, Hungary †

2003 HIGHLIGHTS

Revenue increased 11% driven by sales of four-wheel and all-wheel drive systems to General Motors, Honda and Hyundai, and steady demand for transmission components and systems. These sales gains were offset by automotive production declines in Europe and North America. Operating margins were affected by start-up costs for our transmission technology, a less favorable product mix and an increase in pension and health care costs. During the year, a new facility in Arnstadt, Germany, opened to produce our newly launched DualTronic transmission technology for VW and Audi.

GROWTH DRIVERS AND OPPORTUNITIES

- Introduction of new automated transmission systems for Europe and North America
- Introduction of new five- and six-speed transmissions
- Shift from components to modules
- European and Korean market growth of automatic transmissions
- Subsystems for continuously variable transmissions (CVT)
- Substitution of modular wet starting clutches for torque converters
- Growing popularity of four-wheel drive and all-wheel drive passenger cars and crossover vehicles
- Continued application of electronically controlled torque management devices in four-wheel drive and all-wheel drive vehicles
- Expanded customer base in rear-wheel drive based four-wheel drive segment
- Growing focus on improved shiftability within manual transmission

KEY TECHNOLOGIES

Transmission Products “Shift quality” components and systems including one-way clutches, transmission bands, friction plates, clutch pack assemblies and controls supplied to virtually every automatic transmission maker in the world.

Torque Management Leading global designer and producer of torque distribution and management systems — 4WD transfer cases, InterActive Torque Management (ITM) devices and synchronizer systems. These systems enhance vehicle stability, drivability, shift quality and handling.



drivetrain

group

The Drivetrain Group harnesses our 100-year legacy as an industry innovator in transmission and four-wheel drive technology. The group will leverage this understanding of powertrain torque management to develop interactive control systems and strategies for our traditional mechanical products.

**PLANTS AND
TECHNICAL
CENTERS**

‡ Plants * Technical Centers

Americas

- | | |
|--------------------------|--------------------------|
| Auburn Hills, Michigan * | Lombard, Illinois ‡ |
| Bellwood, Illinois ‡ | Longview, Texas ‡ |
| Frankfort, Illinois ‡ | Muncie, Indiana ‡ |
| Livonia, Michigan ‡ | Seneca, South Carolina ‡ |

Asia

- | | |
|------------------------------|---------------------|
| Beijing, China (JV) ‡ | Pune, India (JV) ‡ |
| Eumsung, South Korea (JV) ‡ | Sirsi, India (JV) ‡ |
| Eumsung, South Korea ‡ | |
| Fukuroi City, Japan (JV) ‡ * | |

Europe

- Arnstadt, Germany ‡
- Heidelberg, Germany ‡
- Ketsch, Germany ‡ *
- Margam, Wales ‡
- Tulle, France ‡

we are

***focused on air management strategies
optimize engine fuel efficiency,
enhance vehicle performance.***

engine group

technologies and products that reduce emissions and

*chain timing systems
turbochargers
variable cam timing
emission controls
air management
thermal management*



VW GOLF



HONDA CIVIC



GM MALIBU



MERCEDES SPRINTER



NISSAN XTERRA



Variable Cam Timing

Patented Variable Cam Timing systems use camshaft oscillation to deliver extremely high actuation rates, independent of engine speed, oil pressure and oil temperature. The resulting benefit over competitive technologies is twice the emissions reduction and three times the fuel-efficiency improvement over that recommended in the U.S. EPA cycle.

3x

Air management systems and integrated cooling modules combine electronics with mechanical functionality for reliability, durability and fast and accurate response. The result is precision control, increased power and reduced emissions — as much as a 41% reduction in hydrocarbons in the case of our secondary air systems.

Air Management

41%



engine group



35%

Turbochargers

Advanced boosting systems provide world-class torque, power and drivability while improving fuel economy up to 15 percent. Demand for passenger-car turbochargers is expected to grow 35% in five years to almost 15 million units worldwide, primarily from direct-injected gasoline and diesel engine applications in Europe and Japan.

Chain timing systems prolong the life of an engine, as well as increase fuel efficiency and reduce emissions. Other benefits include increased power and durability, noise reduction and more compact packaging. By 2005, we estimate that 70% of the global market will use chain timing.

Engine Timing Systems

70%





Global Consistency Nabari City, Japan

Demand for durable chain systems that fit the strict packaging, wear and low noise requirements of Japanese automakers poses unique manufacturing challenges. The people of Nabari have risen to the task. With a global presence, we serve customers both in their home market and throughout the world.



Lean Manufacturing Asheville, NC, USA

Using lean manufacturing principles, the Asheville team has integrated the production, welding and assembly of a new generation of turbochargers with error-proofing systems. These actions enable quality while reducing work in process and floor space requirements.

making it happen

know-how

passion

innovation



Fast To Market Markdorf, Germany

Engineering and manufacturing work together in a simultaneous process that leads both to shorter development times and more advanced thermal management product designs. State-of-the-art facilities plus unique, specialized programs help the Markdorf team be proactive in finding efficiencies, improving performance and researching new cost-reduction measures.



Safety First Dixon, IL, USA

With an increased focus on safety, the Dixon team has significantly reduced the number of work-related injuries. The facility has also been recognized as a Star Work Site under OSHA's Voluntary Protection Program. The keys to this stellar performance are training, prevention and promotion.



we are

***harnessing our 100-year legacy
in transmission and four-wheel
the next generation of creative***

drive train

group

of industry innovation drive technology for solutions.

automatic transmission components

friction clutch modules

transmission control modules

dual clutch transmission technology

active torque management

four-wheel drive systems



TOYOTA CAMRY



HYUNDAI SANTA FE



FORD F-150



CADILLAC SRX



AUDI TT



InterActive Torque
Management

100x

Better traction and improved stability are benefits of this patented technology that electronically senses front-wheel slippage, and instantaneously transfers power from front to rear axles and from side to side. Our electronically controlled systems are more than 100 times more responsive than mechanical systems.



drive train

Exciting new technology offers drivers the convenience of an automatic transmission with the efficiency and sportiness of a manual transmission — up to 15% more fuel economy in a responsive, fun-to-drive package. Just launched, the technology could capture 20% of the European market by 2015. Volkswagen DSG with BorgWarner modules is shown.

DualTronic

15%

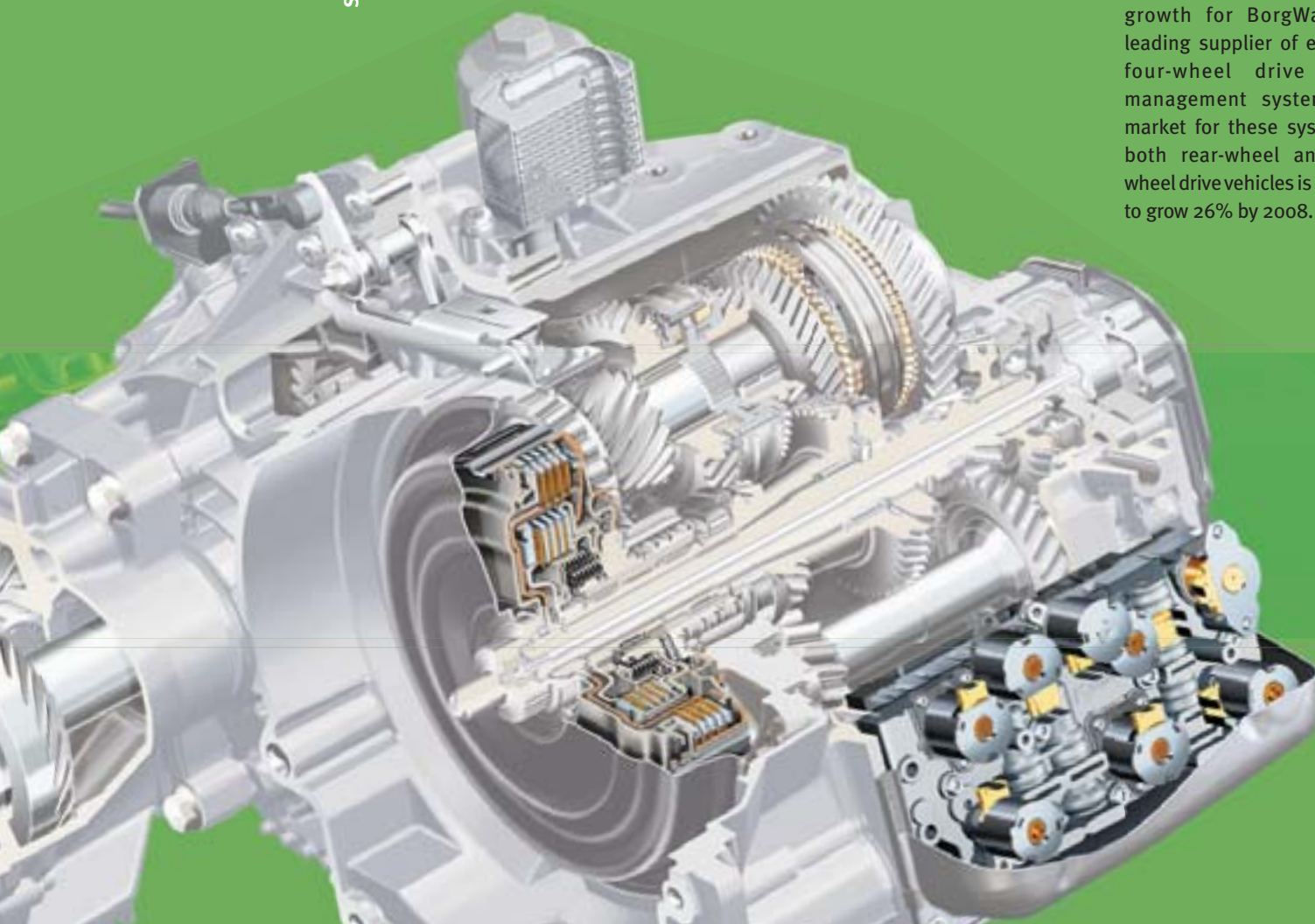




70%

Shift Quality Systems

Added automatic transmission speeds and the shift from components to subsystems offer growth opportunities for BorgWarner. We supply “shift quality” components and systems to all of the world’s automatic transmission makers. By 2013, over 70% of vehicles produced globally will have some type of automatic transmission.



Four-Wheel Drive

26%

The popularity of light trucks, sport-utility and crossover vehicles means continued growth for BorgWarner, a leading supplier of electronic four-wheel drive torque management systems. The market for these systems for both rear-wheel and front-wheel drive vehicles is expected to grow 26% by 2008.



drivetrain

group

we are



Integrated Assemblies Ketsch, Germany

To meet the growing demand in Europe for automatic transmission components and systems, integrated assembly techniques are core to manufacturing in Ketsch. Almost 20% of European vehicles are now produced with automatic transmissions.



Tooling Savings Seneca, SC, USA

Combining expert machining and engineering experiences, this Seneca team achieved a greater than 60% reduction in scrap and improved tooling savings by more than 80%. The operation has doubled productivity and significantly improved quality and cost in the production of all-wheel drive systems.

making it happen

know-how

passion

innovation



Balanced Investment Muncie, IN, USA

Producing complete four-wheel drive systems in a tough competitive environment requires creativity and flexibility in investing for new programs and maintaining existing business. The people of Muncie are focused on the challenge to provide quality products to customers while improving returns to shareholders.



Automation Flexibility Bellwood, IL, USA

With the flexibility to run several products, the automated clutch assembly system developed by the Bellwood Team provides value-added assembly, integrated quality assurance and product tracking features. Machine flexibility benefits customers, enabling faster and more frequent product enhancements.



1880

Morse Equalizing Spring Company, forerunner of Morse Chain, is founded.

1901

Warner Gear is founded. First products are differentials.

1904

Borg & Beck is founded. Develops and manufactures smooth shifting, durable automotive clutches.

George and Earl Holley begin producing carburetors.

1909

First manual transmission is manufactured by Warner Gear.

Silent automobile chain for chain-driven front ends is developed for Cadillac.

1964

NSK-Warner joint venture is established with NSK Limited to supply the rapidly growing Japanese automotive industry.

1973

A modern, full-time four-wheel drive transfer case that incorporates Hy-Vo® chain and a torque-biasing differential is developed.

1983

Lightweight Maji-Band® brake band assembly is developed for automatic transmissions.

1993

We become a separate, independent company.

2000

The first application of computer-controlled all-wheel drive for passenger cars and crossover vehicles is introduced.

The first phases of major multi-year contracts with Ford and Honda for engine timing systems are launched.

2001

Fuel-efficient DualTronic™ transmission technology is selected for 2003 production by a major European automaker.

Contracts for four-wheel drive business are won with Honda and Kia; the first GM four-wheel drive production is announced.

2002

Company is organized into Engine and Drivetrain Groups to spur collaboration and growth.

Turbocharger technology advances create new business opportunities with VW/Audi, Peugeot, Ford and Renault.

2003

DualTronic™ transmission technology debuts on the Audi TT and VW Golf R32.

Demand for engine and four-wheel drive systems drive record results.

10-year anniversary

we are proud of our history of innovation

1928

Borg-Warner Corporation is formed. Founding companies included Borg & Beck, Marvel Carburetor, Warner Gear and Mechanics Universal Joint.

Morse Chain joins the next year.

1936

The Borg-Warner Indianapolis 500 Trophy makes its debut when it is presented to race winner Louis Meyer.

1940

Warner Gear begins manufacturing four-wheel drive transfer cases.

1950

A three-speed, automatically shifted transmission for passenger cars, the Ford-O-Matic, is introduced.

1952

Schwitzer turbocharger is introduced at Indy 500.

AG KK&K develops turbochargers in Germany.

1994

Morse Gemini™ chain system goes into production and overhead camshaft timing systems business is expanded for V6 and V8 engines.

Production of Torque-on-Demand® four-wheel drive transfer cases begins.

1996

Three automotive businesses are acquired from Coltec Industries, including Holley Automotive.

1997

Ownership interest in German turbocharger business is acquired.

NSK-Warner introduces carbon-impregnated friction materials for transmissions in all Lexus V8 models.

1998

Plastic air-induction modules are produced for Chrysler vehicles.

Front-wheel drive/four-wheel drive system is patented.

1999

Acquisitions expand turbocharger and cooling systems growth platforms.

Four new cross-business programs are launched. New concepts to automate transmissions are developed.

2004-2006

Fuel-efficient engine and drivetrain technology drives growth. \$1.3 billion in new business expected for 2004–2006.

*more
innovations
to come*

We celebrated our 10-year anniversary as a public company in 2003. A lot has changed since our first inventions for the emerging automotive industry. Tin Lizzies. Tail Fins. Turbo Technology. What hasn't changed is BorgWarner's passion for innovation. Every day, over 14,000 BorgWarner people continue on the journey to enhance the driving experience.



respect
for others

the power of
collaboration



we are
committed to our values

*passion for
excellence*

*personal
integrity*

*responsibility to our
communities*



While we've updated the words, our BorgWarner Beliefs embody those timeless qualities that have always characterized the people of BorgWarner and our daily dealings with each other, our customers and our communities.



Every day, millions of drivers throughout the world rely on BorgWarner

20
Locations



Americas

products. With a global reach nurtured by a local presence in 14 coun-

13
Locations



Asia

tries, we are addressing the universal needs for fuel efficiency, air quality

10
Locations



Europe

and vehicle reliability with solutions tailored to regional concerns.

we are

everywhere there are roads

Asheville, North Carolina Auburn Hills, Michigan Bellwood, Illinois Cadillac, Michigan Campinas, Brazil Cortland, New York Dixon, Illinois Fletcher, North Carolina Frankfort, Illinois
Guadalupe, Mexico Haverhill, Massachusetts Livonia, Michigan Lombard, Illinois Longview, Texas Marshall, Michigan Muncie, Indiana Sallisaw, Oklahoma Seneca, South Carolina
Simcoe, Ontario Tarrytown, New York Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio Tawawa, Ohio
Fukuoki City, Japan (JV) Mita, Osaka, Japan (JV) Nagasaki, Japan (JV) Nabari, Japan (JV) Ono, Osaka, Japan (JV) Saitama, Japan (JV) Taipei, Taiwan Arcore, Italy
Arnstadt, Germany Bradford, England Heidelberg, Germany Ketsch, Germany Kirchheimbolanden, Germany Margam, Wales Markdorf, Germany Oroszlany, Hungary Tulle, France

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 (OEM) of passenger cars, sport-utility vehicles, trucks and commercial transportation products. We operate manufacturing facilities serving customers in the Americas, Europe and Asia, and are an original equipment supplier to every major OEM in the world.

RESULTS OF OPERATIONS — 2003 VS. 2002 VS. 2001

BorgWarner reported net earnings for 2003 of \$174.9 million, or \$6.40 per diluted share. The Company's net loss in 2002 was \$119.1 million, or \$(4.44) per diluted share, which included an after-tax charge of \$269.0 million or \$10.02 per diluted share for the cumulative effect of an accounting change related to goodwill. The 2002 net earnings before cumulative effect of accounting change were \$149.9 million or \$5.58 per share. Net earnings in 2001 were \$66.4 million or \$2.51 per diluted share.

Overall, our sales increased 12.4% from 2002 and increased 16.1% from 2001 to 2002. The main causes of the sales increase in 2003 were increased demand for turbochargers, especially in Europe, increased volumes from new applications particularly in the four-wheel drive area, and the impact of currency. The sales increase in 2003 came in spite of a decrease in worldwide production, based upon data from Ward's Auto and LMC Automotive Services. As a comparison, worldwide light vehicle production decreased 1.6% in 2003 and increased by 2.3% in 2002. North American production decreased 3.0% in 2003 and increased by 5.7% in 2002. Japanese production decreased 0.7% in 2003 and increased by 3.8% in 2002. Western European production decreased 1.4% in 2003 and 1.5% in 2002. The effect of changing currency rates was also an impact in 2003. In 2003, the increase in the Euro and other currencies added \$161.9 million to sales and \$14.5 million to net income.

Earnings increased in 2003 due to increased volumes and applications, currency, lower interest rates, and a lower effective tax rate. The positive earnings before cumulative effect of accounting change comparison for 2002 to 2001 was due to increased sales, operating leverage, no goodwill amortization, lower interest expense, and a lower tax rate.

Our outlook for 2004 is positive. It is anticipated that North American auto production will be slightly better than 2003. Additionally, we have several newer applications that will be launching or ramping up during 2004. Sales are expected to grow assuming a flat to slightly positive global production rate, as well as the continuation of several trends: continued shift in Europe to diesel

engines, which utilize turbochargers; continued shift in Europe to automatic transmissions; continued popularity in the U.S. of four-wheel drive vehicles; and continued shift from timing belts to timing chains. Each of these trends is positive for the Company. Assuming no major changes to the above assumptions, the Company expects long-term growth rates in the target ranges of 8-11% for revenues and 12-15% in net income.

Results By Operating Segment

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," effective January 1, 2002. Accordingly, the segment EBIT table below only has goodwill amortization for the year 2001 in the amount of \$42.0 million. In 2003 and 2002, goodwill was not amortized pursuant to SFAS No. 142. See Note Fourteen to the Consolidated Financial Statements for further details on the Company's implementation of SFAS No. 142.

Net Sales

Year ended December 31,	millions of dollars		
	2003	2002	2001
Drivetrain	\$ 1,245.6	\$ 1,122.1	\$ 937.2
Engine	1,869.7	1,648.2	1,426.6
Divested operations and businesses held for sale	—	—	18.0
Inter-segment eliminations	(46.1)	(39.2)	(30.2)
Net sales	\$3,069.2	\$2,731.1	\$2,351.6

Earnings Before Interest and Taxes (EBIT)

Year ended December 31,	millions of dollars		
	2003	2002	2001
Drivetrain	\$ 98.4	\$ 99.9	\$ 70.1
Engine	239.6	215.9	142.7
Divested operations and businesses held for sale	—	—	(0.2)
Earnings before interest and taxes	\$338.0	\$315.8	\$212.6

The *Drivetrain* business' revenue increased 11.0% from 2002 to 2003, but EBIT declined 1.5% for the same period. The sales gains were due to four-wheel drive transfer case programs with General Motors, increased sales of the Company's Interactive Torque Management™ all-wheel drive systems to Honda and Hyundai, and steady demand for transmission components and systems, especially with increased automatic transmission adoption in Europe. These sales gains were offset by declines in European and North American automotive production. The decrease in EBIT was due to start-up costs for the Company's new DualTronic™ transmission product, including the opening of a new assembly facility in Europe. Profitability also suffered from a less favorable product mix and an increase in pension and retiree health care costs over the previous year.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The Drivetrain business' revenue increased 19.7% and EBIT increased 42.5% from 2001 to 2002. The increase in sales was due to increased transfer case volumes to Hyundai and Kia, as well as increased volumes of the Interactive Torque Management system application for the Acura MDX and Honda Pilot. Additionally, there were new transfer case applications for some GM vehicles. The transmission products portion of the business saw sales increases due to a combination of market conditions and new applications, both in North America and overseas. The EBIT increase was due to higher volumes and cost controls.

We expect moderate growth from this segment in 2004. We anticipate transfer case demand for four-wheel drive vehicles to remain strong. We also anticipate increased adoption of automatic transmissions in Europe, and the start of a sales ramp-up for our new DualTronic™ product. We anticipate a higher level of EBIT due to higher volumes and a lower impact of start-up costs.

The *Engine* business' 2003 revenue increased 13.4% over 2002 and EBIT increased 11.0% over the same period. This segment benefited from continued demand for the Company's turbochargers for European passenger cars and commercial vehicles. This growth offset the chain and emissions portions of the group, which experienced softness as a result of weaker auto production, particularly in North America. The EBIT was impacted by increased productivity and production in the turbocharger business, which translated into higher profitability. This was partially offset by start up costs for Variable Cam Timing systems, which will launch in 2004 and for new Korean operations.

The Engine business' sales increased 15.5% and EBIT increased 51.3% from 2001 to 2002. The primary factors for the sales increase were increased usage of turbochargers, particularly for European passenger cars; increased penetration into non-North America markets, and an overall increase in light vehicle production. The EBIT increase was due to higher volumes, better productivity, and no goodwill amortization in 2002, compared to approximately \$38 million in 2001. The EBIT increase would have been higher, except for royalty expenses related to the Honeywell agreement in 2002 discussed in more detail in the gross profit section below.

For 2004, we anticipate continued growth for this business. We anticipate further adoption of diesel engines in Europe, which will continue to increase demand for turbochargers. We expect our market share for European passenger car turbochargers will be flat to higher in 2004. We anticipate other portions of this group to be slightly up as well, due to anticipated small increases in production for North American light vehicles as well as medium and heavy trucks.

Divested operations and businesses held for sale includes the results of Fuel Systems, which was sold in 2001. This business did not fit our strategic goals, and

we believe our resources are better spent on our core technologies in highly engineered powertrain components and systems. The sale of the Fuel Systems business did not result in a significant gain or loss. Divested operations and businesses held for sale contributed sales of \$18.0 million and EBIT of \$(0.2) million in 2001.

Corporate is the difference between calculated total Company EBIT and the total from the segments and represents corporate headquarters expenses and expenses not directly attributable to the individual segments and is offset by equity in affiliate earnings. This net expense was \$48.0 million in 2003, \$44.3 million in 2002, and \$26.5 million in 2001. The main reasons for the increase from 2002 to 2003 is increased pension and post retirement health care costs for discontinued operations, which are recorded at the corporate level. The increase from 2001 to 2002 was due to a decrease in excess of earnings from pension assets over U.S. pension costs of \$5.3 million, and an increase in post-retirement health benefits for previously discontinued operations. Corporate headquarters expense was \$22.6 million in 2003, \$24.0 million in 2002, and \$20.5 million in 2001.

Our top ten customers accounted for approximately 77% of consolidated sales in 2003, 2002, and 2001. Ford continues to be our largest customer with 23% of consolidated sales in 2003, compared to 26% in 2002 and 30% in 2001. DaimlerChrysler, our second largest customer, represented 17% of consolidated sales in 2003, compared to 20% in 2002 and 21% in 2001; and General Motors accounted for 12% in 2003, 2002, and 2001. No other customer accounted for more than 10% of sales in any of the periods presented.

Over the past several years, our customers have continued to consolidate. While we have reduced our dependence on Ford and DaimlerChrysler, we have increased our sales to other global OEMs, bringing us more in line with customers' share of global vehicle market.

Other Factors Affecting Results of Operations

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

Year Ended December 31,	2003	2002	2001
Net sales	100.0%	100.0%	100.0%
Cost of sales	80.9	79.7	80.4
Gross profit	19.1	20.3	19.6
Selling, general and administrative expenses	10.3	11.1	10.6
Goodwill amortization	—	—	1.8
Non-recurring charges	—	—	1.2
Other, net	—	—	(0.1)
Operating income	8.8%	9.2%	6.1%

Gross Profit for 2003 was 19.1%, down from 20.3% in 2002 and the 19.6% in 2001. The decrease in gross profit in 2003 was due to several factors, including a change in sales mix and additional costs due to the ramp up of new programs. The impact of sales mix was due to stronger sales growth in some of our lower margin businesses such as turbochargers and transfer cases. Margins are lower in these businesses due to a higher percentage of purchased content for these products. Another mix impact in other businesses was a shift to more systems versus components. The margins on complete systems are typically lower than for a component. An example is in timing chains, where we are selling more complete timing systems, which increases revenue, but decreases the gross profit percentage. Another example was a lower percentage of aftermarket sales; these sales did not grow as quickly as our direct sales, and aftermarket sales typically carry a higher margin. The ramp-up of new programs also impacted gross margins, and includes new facilities in Europe and Korea. The increase from 2001 to 2002 was due mainly to higher volumes. We anticipate 2004 margins to be slightly higher than 2003 margins, as there should be a flattening out of the sales mix impact. Additionally, spending on new programs and facilities should increase at a slower rate than the projected sales increase.

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

The royalty agreement costs recognized under the agreement were \$13.5 million in 2002 and \$23.2 million in 2003. These costs were all recognized as part of cost of goods sold. It is anticipated that these costs will decrease in 2004 and be at minimal levels in 2005 and 2006 as the Company's primary customers are anticipated to convert to the Company's next generation VTG turbocharger beginning in mid-2004.

The combination of price reductions to customers and cost increases for material, labor, and overhead totaled approximately \$86 million in 2003, compared to \$75 million in 2002 and \$37 million in 2001. We were able to partially offset

the impact of these reductions by actively pursuing cost reductions from our suppliers, making changes in product design and by using process technology to remove cost and/or improve manufacturing capabilities.

Selling, general and administrative expenses (SG&A) as a percentage of sales decreased to 10.3% from 11.1% in 2002 and 10.6% in 2001. While SG&A spending in dollars increased slightly, we were able to slow that growth to a level below the growth in sales. We were able to do this through cost controls, and leveraging the existing infrastructure to support the increased sales.

Research and Development (R&D) is a major component of the Company's SG&A expenses. R & D spending was \$118.2 million or 3.9% of sales in 2003, compared to \$109.1 million or 4.0% of sales in 2002, and \$104.5 million or 4.4% of sales in 2001. We have continued to increase our absolute spending in R & D, although the growth rate has been somewhat lower than our sales growth rate. We 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 long-term target for R & D spending is approximately 4% of sales. We intend to maintain our commitment to R & D spending while continuing to focus on controlling other SG&A costs.

Goodwill amortization was zero in 2003 and 2002 and \$42.0 million in 2001. As discussed more fully in Note Fourteen to the Consolidated Financial Statements, the Company adopted the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," which discontinued the amortization of goodwill effective January 1, 2002.

Non-recurring charges were \$28.4 million in 2001. The 2001 non-recurring charges primarily include adjustments to the carrying value of certain assets and liabilities related to businesses acquired and disposed of over the past three years. Of the \$28.4 million of pretax charges in 2001, \$5.0 million represented non-cash charges. Approximately \$3.3 million was spent in 2001, \$8.4 million was transferred to environmental reserves in 2001, \$8.4 million was spent in 2002, and \$3.3 million was spent in 2003. The 2001 non-recurring charges included \$8.4 million of environmental remediation costs related to sold businesses and \$12.0 million of product quality costs for issues with products that were sold by acquired businesses prior to acquisition, all of which have been corrected in the currently produced products. The Company funded the total cash outlay of these actions from operations.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Components of the non-recurring charges are detailed in the following table and discussed further below.

	millions of dollars		
	Asset write-downs	Exit costs and other non- recurring charges	Total
Balance, January 1, 2001	\$ —	\$ —	\$ —
Provisions	5.0	23.4	28.4
Incurred	—	(11.7)	(11.7)
Non-cash write-offs	(5.0)	—	(5.0)
Balance, December 31, 2001	—	11.7	11.7
Provisions	—	—	—
Incurred	—	(8.4)	(8.4)
Non-cash write-offs	—	—	—
Balance, December 31, 2002	—	3.3	3.3
Provisions	—	—	—
Incurred	—	(3.3)	(3.3)
Non-cash write-offs	—	—	—
Balance, December 31, 2003	\$ —	\$ —	\$ —

Other, net decreased to \$0.1 million of income in 2003, from \$0.9 million of income in 2002 and \$2.1 million in 2001.

Equity in affiliate earnings, net of tax increased by \$0.6 million from 2002, and increased by \$4.6 million between 2002 and 2001. This line item is primarily driven by the results of our 50% owned Japanese joint venture, NSK-Warner. For more discussion of NSK-Warner, see Note 5 of the Consolidated Financial Statements.

Interest expense, net decreased by \$4.4 million in 2003 and decreased by \$10.1 million between 2002 and 2001. The decreases in 2003 and 2002 were due to lower interest rates as well as lower debt levels, as we used cash generated from operations to pay off debt. In 2003, our balance sheet debt decreased \$2.7 million, and we reduced the amount of securitized accounts receivable sold by \$40.0 million. In 2002, we paid down \$90.3 million of balance sheet debt and reduced the amount of securitized accounts receivable sold by \$30.0 million. We took advantage of lower interest rates through the use of interest rate swap arrangements described more fully in Note Seven to the Consolidated Financial Statements. At the end of 2003, the amount of debt with fixed interest rates was 44% of total debt, including the impact of the interest rate swaps.

The provision for income taxes resulted in an effective tax rate for 2003 of 28.5% compared with rates of 33.0% in 2002 and 36.1% for 2001. Our effective

tax rates have been lower than the standard federal and state tax rates due to the realization of certain R&D and foreign tax credits; foreign rates, which differ from those in the U.S.; and offset somewhat by non-deductible expenses. The decrease in rates is also a result of certain changes in the Company's legal structure. In 2004, we anticipate a small increase in the effective tax rate, due to a change in tax laws in certain countries in which the Company operates.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities of \$306.9 million was primarily used to fund \$172.0 million of capital expenditures, reduce accounts receivable financing by \$40.0 million, pay \$19.4 million of dividends to our shareholders, and increase cash and cash equivalents by \$76.5 million.

Operating Activities

Operating cash flow of \$306.9 million is \$45.5 million more than in 2002. The \$306.9 million consists of net income of \$174.9 million, non-cash charges of \$210.5 million and is offset by a \$78.5 million increase in net operating assets and liabilities. Non-cash charges are primarily comprised of \$161.3 million in depreciation and amortization.

Accounts receivable increased a total of \$122.8 million, of which \$32.4 million was due to currency. \$40.0 million of the increase was due to the reduction in securitized accounts receivable sold. The bulk of the remaining increase was due to higher business levels, particularly in Europe. Certain of our European customers tend to pay later than our North American customers. Additionally, one of our major North American customers made a one-time change in payment terms that had a net effect of adding several days to their payment terms.

Investing Activities

Net cash used in investing activities totaled \$228.2 million, compared with \$130.0 million in the prior year. Capital spending totaling \$172.0 million in 2003 was \$33.6 million higher than in 2002. The impact of foreign exchange rates year over year was \$12.0 million of the \$33.6 million increase. Approximately 60% of the 2003 spending was related to expansion, with the remainder for cost reduction and other purposes. Heading into 2004, we plan to continue to spend on capital to support the launch of our new applications and for cost reductions and productivity improvement projects. Our target for capital spending is to be approximately 5.5% of sales.

The 2003 investing uses of cash includes \$12.8 million of payments to resolve a valuation dispute regarding the value of the turbocharger business of Aktiengesellschaft Kühnle, Kopp & Kausch (AGKK&K). The valuation payment resulted from the settlement in 2003 of a lawsuit brought by certain minority shareholders of AGKK&K related to the automotive turbocharger business of AGKK&K, which the Company purchased from AGKK&K in 1998.

Since the settlement of the dispute, the Company has spent \$14.4 million to purchase additional shares of AGKK&K, an unconsolidated subsidiary of the Company, which has been recorded as an “Investment in Business Held for Sale” in the consolidated balance sheets. The Company also extended a formal tender offer to purchase all of the outstanding common and preferred shares of AGKK&K from the remaining shareholders.

Financing Activities and Liquidity

Stockholders’ equity increased by \$279.0 million in 2003. The increase was caused by net income of \$174.9 million along with currency translation adjustments of \$67.8 million, stock option exercises of \$39.3 million and stock issuances to retirement plans of \$12.9 million, offset by dividends of \$19.4 million, and purchase of treasury stock of \$2.5 million. In relation to the dollar, the currencies in foreign countries where we conduct business, particularly the Euro, strengthened, causing the currency translation component of other comprehensive income to increase in both 2003 and 2002.

Our total capitalization as of December 31, 2003 of \$1,904.4 million is comprised of short-term debt of \$10.0 million, long-term debt of \$634.0 million and stockholders’ equity of \$1,260.4 million. Capitalization at December 31, 2002 was \$1,628.1 million. During the year, we reduced our balance sheet debt to capital ratio to 33.8% from 39.9% in 2002.

The Company has a \$350 million revolving credit facility that extends until July 21, 2005. Additionally, we also have \$300 million available under a shelf registration statement on file with the Securities and Exchange Commission through which a variety of debt and/or equity instruments may be issued. The Company also has access to the commercial paper market through an accounts receivable securitization facility which is rolled over annually. From a credit quality perspective, we have an investment grade credit rating of BBB+ from Standard & Poor’s and Baa2 from Moody’s.

The Company’s significant contractual obligation payments at December 31, 2003, are as follows:

	millions of dollars				
	Total	2004	2005-2006	2007-2008	After 2008
Notes payable and long-term debt	\$ 646.8	\$ 10.0	\$ 195.0	\$ 12.4	\$ 429.4
Other postretirement benefits ^a	537.4	28.4	60.9	63.0	385.1
Non-cancelable operating leases	43.6	4.2	25.9	2.4	11.1
Minimum royalty payments ^b	17.5	16.0	1.5	—	—
Total	\$1,245.3	\$58.6	\$283.3	\$77.8	\$825.6

(a) Other postretirement benefits includes anticipated contributions to cover expected benefit payments for other postretirement defined benefit plans. Since the timing and amount of payments for pension plans is not certain for outgoing years, such payments have been excluded from this table. The Company expects to contribute a total of \$25 million to \$30 million into all pension plans during 2004. See Note Nine to the Consolidated Financial Statements for disclosures related to the Company’s pension and other postretirement benefits.

(b) The minimum royalty payments are related to the Honeywell Royalty Agreement discussed more fully in Note Thirteen to the Consolidated Financial Statements. The Company has other royalty agreements that are based on sales volumes. These royalty agreements do not have minimum royalty payments and are typically cancelable and have been excluded from the amounts in the table.

The Company does not have any long-term or fixed purchase obligations for inventories.

The Company has a credit agreement that contains numerous financial and operating covenants including, among others, covenants requiring the Company to maintain certain financial ratios and restricting its ability to incur additional indebtedness. The Company was in compliance with all covenants at December 31, 2003.

We believe that the combination of cash from operations, cash balances, and available credit facilities 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.

Off Balance Sheet Arrangements

As of December 31, 2003, 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, vehicles, and certain office equipment. The Company also has a lease obligation for production equipment at one of its facilities. The total future lease obligation for this production equipment at the end of 2003 was \$26.6 million. See Note Thirteen to the Consolidated Financial Statements for more information on operating leases, including future minimum payments.

The Company has guaranteed the residual values of the leased machinery and equipment. The guarantees extend through the maturity of the underlying lease, which is in 2005. In the event the Company exercised its option not to purchase the machinery and equipment, the Company has guaranteed a residual value of \$16.3 million. We do not believe we have any loss exposure due to this guarantee.

Pension and Other Postretirement Benefits

Generally, the Company's defined benefit pension plans are non-contributory. The Company's policy is to fund its pension plans in accordance with applicable U.S. and UK government regulations and to make additional contributions when management deems it appropriate. At December 31, 2003, all legal funding requirements had been met. The company contributed \$17.1 million to its pension plans in 2003 and \$11.7 million in 2002. The Company expects to contribute a total of \$25 million to \$30 million in 2004.

Funded status is derived by subtracting the value of the projected benefit obligation at December 31, 2003 from the end of year fair value of plan assets.

The funded status of the pension benefits deteriorated from \$(119.6) million at the end of 2002 to \$(142.2) million at the end of 2003. The decline was primarily due to actuarial losses of \$55.0 million and interest cost of \$28.0 million, offset by positive returns on plan assets of \$68.0 million and company contributions of \$17.1 million.

Other postretirement benefits primarily consist of postretirement health care benefits. The Company funds these benefits as retiree claims are incurred. Other post retirement benefits had a funded status of \$(537.4) million at the end of 2003, and \$(446.5) million at the end of 2002. The change was primarily due to actuarial losses of \$89.2 million.

A primary factor in the actuarial losses in all plans was a decline in the interest rate assumptions used to calculate the ending liabilities for each of the plans. The Company believes it will be able to fund the requirements of these plans through cash generated from operations or other sources for the foreseeable future.

OTHER MATTERS

Environmental/Contingencies

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 43 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

Based on information available to us, which in most cases, includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large, solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation costs; remediation alternatives; estimated legal fees; and other factors, we have established a reserve for indicated environmental liabilities with a balance at December 31, 2003 of approximately \$19.6 million. We expect this amount to be expended over the next three to five years.

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

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

The Company has been working with the Mississippi Department of Environmental Quality and Kuhlman Electric to investigate the extent of and remediate the contamination. The investigation revealed the presence of polychlorinated biphenyls (PCBs) in portions of the soil at the plant and neighboring areas. Clean-up began in 2000 and is continuing. Kuhlman Electric and others, including the Company, have been sued in several

related lawsuits that claim personal and property damage. We have moved to be dismissed from some of these lawsuits.

We believe that the reserve for environmental liabilities is sufficient to cover any potential liability associated with this matter. However, due to the nature of environmental liability matters, there can be no assurance that the actual amount of environmental liabilities will not exceed the amount reserved.

Critical Accounting Policies

The Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. 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. The significant accounting principles which management believes are the most important to aid in fully understanding our financial results are included below. Management also believes that all of the accounting policies are important to investors. Therefore, the Notes to the Consolidated Financial Statements provide a more detailed description of these and other accounting policies of the Company.

Revenue Recognition

The Company recognizes revenue upon shipment of product when title and risk of loss pass to the customer. 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.

Sales of Receivables

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. In the fourth quarter of 2003, the Company reduced the maximum size of the facility from \$90 million to \$50 million.

Impairment of Long-Lived Assets

The Company periodically reviews the carrying value of its long-lived assets held and used and assets to be disposed of, 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 estimates of such cash flows and fair value could affect the evaluations.

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 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.

Product Warranty

Provisions for estimated expenses related to product warranty are made at the time products are sold. These estimates are established using historical information about the nature, frequency, and average cost of warranty claims as related to the warranty provisions of our sales agreements with customers. We actively study trends of warranty claims and take action to improve product quality and minimize warranty claims. We believe that the warranty accrual is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the reserve.

Other Loss Reserves

The Company has numerous other loss exposures, such as environmental claims, workers' compensation claims, litigation, recoverability of assets, and loan and accounts receivable reserves. Establishing loss reserves for these matters requires the use of estimates and judgment in regards to the risk exposure and ultimate liability. We estimate losses under the programs using consistent and appropriate methods; however, changes to our assumptions could materially affect our recorded liabilities for loss.

Pension and Other Postretirement Benefits

The Company provides postretirement benefits to a substantial portion of its employees. Costs associated with postretirement benefits include pension and postretirement health care expenses for employees, retirees and surviving spouses and dependents. The Company's employee pension and postretirement 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's approach to establishing the discount rate is based upon corporate bond indices. In the United States, the discount rate assumption is based upon the Moody's Aa Corporate Bond Index as of December 31, 2003, rounded up or down to the nearest 25 basis points. Based on this approach, at December 31, 2003, the Company lowered the discount rate for its U.S. pension and other benefit plans to 6.00% from 6.75% at December 31, 2002. For the UK plans, the discount rate assumption is based on the iBoxx AA rated bonds, and rounded up or down to the nearest 25 basis points. At December 31, 2003, the discount rate used was 5.25%. For other locations, similar indices and methods are used.

The Company determines its expected return on plan asset assumptions by evaluating both historical returns as well as estimates of future returns. Specifically, the Company analyzed the average historical broad market returns for various periods of time over the past 100 years for equities and over a 30-year period for fixed income securities, and adjusted the computed amount for any expected changes in the long-term outlook for the equity and fixed income markets. The Company's expected return on assets was based on expected equity and fixed income returns weighted by the percentage of assets allocated to each plan. The Company's estimate of the long-term rate of return on assets for its U.S. pension is 8.75% for 2003 and 2002. The rate was 9.50% for 2001. The Company does not anticipate a change in the long-term rate of return on asset for pension benefits in 2004. For the UK plan, the expected return is based upon the relative weight of equity and debt investments, and the recent performance of those investments. The Company's estimate of the long-term rate of return on assets for its UK pension is 6.75% for 2003, 7.0% for 2002, and 6.5% for 2001.

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

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations." This standard requires that legally enforceable and unavoidable obligations related to asset retirements be recognized as an increase in the carrying amount of the related long-term asset when incurred. The Company adopted SFAS No. 143 on January 1, 2003. The adoption of this standard did not have any impact on the Company's results of operations, financial condition or cash flows.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company adopted SFAS No. 146 on January 1, 2003, which did not have a material impact on the Company's results of operations, financial position or cash flows.

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

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123." This Statement amends FASB Statement No. 123 to

provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and amends the disclosure requirements to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company adopted SFAS No. 148 January 1, 2003, and selected to continue to account for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting of Stock Issued to Employees." The Company has provided the required disclosure in Note One to the Consolidated Financial Statements.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities," which was revised in December 2003. FIN No. 46 requires that the assets, liabilities and results of the activity of variable interest entities be consolidated into the financial statements of the entity that has the controlling financial interest. FIN No. 46 also provides the framework for determining whether a variable interest entity should be consolidated based on voting interest or significant financial support provided to it. For the Company, this Interpretation, as revised, is effective January 1, 2004. The Company is in the process of evaluating the adoption of FIN No. 46 and the impacts on the Company's results of operations, financial position or cash flows.

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

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which amends and clarifies accounting and reporting for certain derivative instruments. The Company adopted this Statement effective July 1, 2003 and currently reports cash received from, or paid to, derivative contracts consistent with the underlying assets on its Statement of Cash Flow.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," which establishes standards for how an issuer classifies and measures

certain financial instruments with characteristics of both liabilities and equity. The Company adopted this Statement effective October 1, 2003. This Statement had no impact on the Company's results of operations, financial condition, and cash flows.

In January 2004, the FASB issued FASB Staff Position ("FSP") No. 106-1, "Accounting Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003." FSP No. 106-1 permits a sponsor to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2002 (the Act). The Act, signed into law in December, 2003, establishes a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Act introduces two new features to Medicare that must be considered when measuring accumulated postretirement benefit costs. The new features include a subsidy to the plan sponsors that is based on 28% of an individual beneficiary's annual prescription drug costs between \$250 and \$5,000 and an opportunity for a retiree to obtain a prescription drug benefit under Medicare. The Act is expected to reduce the Company's net postretirement benefit costs.

The Company has elected to defer the adoption of FSP No. 106-1 due to lack of specific accounting guidance. Therefore, the net post retirement benefit costs disclosed in the Consolidated Financial Statements do not reflect the impact of the Act on the plans. The deferral will continue to apply until specific authoritative accounting guidance for the federal subsidy is issued. Authoritative guidance on the accounting for the federal subsidy is pending and, when issued, could require information previously reported in the Company's Consolidated Financial Statements to change. The Company is currently investigating the impacts of FSP No. 106-1's initial recognition, measurement and disclosure provisions on its Consolidated Financial Statements.

Qualitative and Quantitative 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. We do not engage in any derivative instruments for purposes other than hedging specific 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. 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 2003 of approximately \$1.0 million, and \$0.5 million in 2002.

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, 2003, the net fair value of these instruments would increase by approximately \$26.8 million if interest rates decreased and would decrease by approximately \$24.5 million if interest rates increased. Our interest rate sensitivity analysis assumes a parallel shift in interest rate yield curves. The model, therefore, does not reflect the potential impact of changes in the relationship between short-term and long-term interest rates. Interest rate sensitivity at December 31, 2002, measured in a similar manner, was slightly greater than at December 31, 2003.

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 Euro, the British pound, the Canadian dollar, and the Japanese Yen. We mitigate our foreign currency exchange rate risk principally by establishing local production facilities in 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 \$184.0 million as of December 31, 2003 and \$152.0 million as of

December 31, 2002. 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. In the aggregate, our exposure related to such transactions was not material to our financial position, results of operations or cash flows in both 2003 and 2002.

Commodity Price Risk

Commodity price risk is the risk 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 automotive components. As of December 31, 2003, and 2002, we had contracts with a total notional value of \$1.1 and \$0.1 million, respectively.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

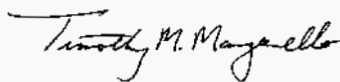
Statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations may contain forward-looking statements as contemplated by the 1995 Private Securities Litigation Reform Act that are based on management's current expectations, estimates and projections.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

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, independent auditors. Management has made available all the Company's financial records and related information deemed necessary by Deloitte & Touche LLP. Furthermore, management believes that all representations made by it to Deloitte & Touche LLP during its audit were valid and appropriate.

Management is responsible for maintaining a comprehensive system of internal control through its operations that provides reasonable assurance that assets are protected from improper use, that material errors are prevented or detected within a timely period and that records are sufficient to produce reliable financial reports. The system of internal control is supported by written policies and procedures that are updated by management as necessary. The system is reviewed and evaluated regularly by the Company's internal auditors as well as by the independent auditors in connection with their annual audit of the financial statements. The independent auditors conduct their evaluation in accordance with auditing standards generally accepted in the United States of America and perform such tests of transactions and balances as they deem necessary. Management considers the recommendations of its internal auditors and independent auditors concerning the Company's system of internal control and takes the necessary actions that are cost-effective in the circumstances. Management believes that, as of December 31, 2003, the Company's system of internal control was adequate to accomplish the objectives set forth in the first sentence of this paragraph.

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



Timothy M. Manganello
President and Chief Executive Officer



William C. Cline
Vice President and Controller

February 27, 2004

To The Board of Directors and Stockholders of BorgWarner Inc.:

We have audited the consolidated balance sheets of BorgWarner Inc. and Consolidated Subsidiaries (the "Company") as of December 31, 2003 and 2002, and the related consolidated statements of operations, cash flows, and stockholders' equity for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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 at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note Fourteen to the Consolidated Financial Statements, effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangibles," and accordingly, discontinued the amortization of goodwill to conform to the provisions of this standard. Note Fourteen provides transitional disclosures regarding the impact of the adoption of SFAS No. 142.

Deloitte & Touche LLP

Chicago, Illinois
February 27, 2004

Consolidated Statements of Operations

millions of dollars, except per share amounts

Year Ended December 31,	2003	2002	2001
Net sales	\$3,069.2	\$2,731.1	\$2,351.6
Cost of sales	2,482.5	2,176.5	1,890.8
Gross profit	586.7	554.6	460.8
Selling, general and administrative expenses	316.9	303.5	249.7
Goodwill amortization	—	—	42.0
Other, net	(0.1)	(0.9)	(2.1)
Non-recurring charges	—	—	28.4
Operating income	269.9	252.0	142.8
Equity in affiliate earnings, net of tax	(20.1)	(19.5)	(14.9)
Interest expense and finance charges	33.3	37.7	47.8
Earnings before income taxes	256.7	233.8	109.9
Provision for income taxes	73.2	77.2	39.7
Minority interest, net of tax	8.6	6.7	3.8
Net earnings before cumulative effect of accounting change	174.9	149.9	66.4
Cumulative effect of change in accounting principle, net of tax	—	(269.0)	—
Net earnings/(loss)	\$ 174.9	\$ (119.1)	\$ 66.4
Net earnings/(loss) per share – Basic			
Net earnings per share before cumulative effect of accounting change	\$ 6.46	\$ 5.63	\$ 2.52
Cumulative effect of accounting change	—	(10.10)	—
Net earnings/(loss) per share	\$ 6.46	\$ (4.47)	\$ 2.52
Net earnings/(loss) per share – Diluted			
Net earnings per share before cumulative effect of accounting change	\$ 6.40	\$ 5.58	\$ 2.51
Cumulative effect of accounting change	—	(10.02)	—
Net earnings/(loss) per share	\$ 6.40	\$ (4.44)	\$ 2.51
Average shares outstanding (thousands)			
Basic	27,058	26,625	26,315
Diluted	27,302	26,854	26,463

See Accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

BorgWarner Inc.
and Consolidated Subsidiaries

03

millions of dollars

December 31,	2003	2002
Assets		
Cash and cash equivalents	\$ 113.1	\$ 36.6
Receivables	414.9	292.1
Inventories	201.3	180.3
Deferred income taxes	32.8	25.5
Investment in business held for sale	32.0	14.2
Prepayments and other current assets	30.5	31.9
Total current assets	824.6	580.6
Land	42.3	40.6
Buildings	327.4	288.0
Machinery and equipment	1,216.0	1,060.0
Capital leases	2.8	2.7
Construction in progress	77.2	76.5
Total land and buildings	1,665.7	1,467.8
Less accumulated depreciation	680.4	572.9
Net property, plant and equipment	985.3	894.9
Tooling, net of amortization	90.5	82.0
Investments and advances	177.3	153.1
Goodwill	852.0	827.0
Deferred income taxes	—	37.1
Other noncurrent assets	109.2	108.2
Total other assets	1,229.0	1,207.4
Total assets	\$3,038.9	\$2,682.9
Liabilities and Stockholders' Equity		
Notes payable and current portion of long-term debt	\$ 10.0	\$ 14.4
Accounts payable and accrued expenses	460.3	435.6
Income taxes payable	—	1.2
Total current liabilities	470.3	451.2
Long-term debt	634.0	632.3
Long-term liabilities:		
Retirement-related liabilities	503.0	478.3
Other	154.0	125.2
Total long-term liabilities	657.0	603.5
Minority interest in consolidated subsidiaries	17.2	14.5
Commitments and contingencies	—	—
Capital stock:		
Preferred stock, \$.01 par value; authorized shares: 5,000,000; none issued	—	—
Common stock, \$.01 par value; authorized shares: 50,000,000; issued shares: 2003, 27,614,927 and 2002, 27,398,891; outstanding shares: 2003, 27,578,595; 2002, 26,580,004	0.3	0.3
Non-voting common stock, \$.01 par value; authorized shares: 25,000,000; none issued and outstanding	—	—
Capital in excess of par value	756.3	737.7
Retained earnings	491.3	335.8
Management shareholder notes	—	(2.0)
Accumulated other comprehensive income/(loss)	14.0	(54.5)
Common stock held in treasury, at cost: 2003, 36,332 shares; 2002, 818,887 shares	(1.5)	(35.9)
Total stockholders' equity	1,260.4	981.4
Total liabilities and stockholders' equity	\$3,038.9	\$2,682.9

See Accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

millions of dollars

Year Ended December 31,	2003	2002	2001
Operating			
Net earnings/(loss).....	\$ 174.9	\$(119.1)	\$ 66.4
Adjustments to reconcile net earnings/(loss) to net cash flows from operations:			
Non-cash charges (credits) to operations:			
Depreciation.....	124.5	108.1	104.2
Goodwill amortization.....	—	—	42.0
Amortization of tooling.....	36.8	29.3	23.7
Non-cash non-recurring charges.....	—	—	5.0
Cumulative effect of change in accounting principle, net of tax.....	—	269.0	—
Employee retirement benefits.....	12.9	20.8	19.8
Deferred income tax provision.....	40.0	30.4	3.1
Other, principally equity in affiliate earnings.....	(3.7)	(4.1)	(25.9)
Net earnings adjusted for non-cash charges.....	385.4	334.4	238.3
Changes in assets and liabilities, net of effects of divestitures:			
Increase in receivables.....	(90.4)	(67.4)	(48.6)
(Increase) decrease in inventories.....	(9.1)	(29.3)	10.1
(Increase) decrease in prepayments.....	7.3	(3.4)	0.1
Increase (decrease) in accounts payable and accrued expenses.....	(0.3)	(14.7)	23.0
Increase (decrease) in income taxes payable.....	(0.2)	14.1	(12.7)
Net change in other long-term assets and liabilities.....	14.2	27.7	27.6
Net cash provided by operating activities.....	306.9	261.4	237.8
Investing			
Capital expenditures.....	(172.0)	(138.4)	(140.9)
Tooling outlays, net of customer reimbursements.....	(42.4)	(27.7)	(42.0)
Net proceeds from asset disposals.....	8.0	12.3	6.5
Proceeds from sale of businesses.....	5.4	3.3	14.4
Tax refunds related to businesses sold.....	—	20.5	—
Payments for businesses acquired, net of cash acquired.....	(12.8)	—	(3.3)
Investment in business held for sale.....	(14.4)	—	—
Net cash used in investing activities.....	(228.2)	(130.0)	(165.3)
Financing			
Net decrease in notes payable.....	(5.5)	(22.8)	(16.5)
Additions to long-term debt.....	0.3	2.3	34.0
Reductions in long-term debt.....	(16.1)	(85.3)	(64.3)
Payments for purchase of treasury stock.....	(2.5)	(18.1)	(0.7)
Proceeds from stock options exercised.....	39.3	9.8	2.8
Dividends paid.....	(19.4)	(16.0)	(15.8)
Net cash used in financing activities.....	(3.9)	(130.1)	(60.5)
Effect of exchange rate changes on cash and cash equivalents.....	1.7	2.4	(0.5)
Net increase in cash and cash equivalents.....	76.5	3.7	11.5
Cash and cash equivalents at beginning of year.....	36.6	32.9	21.4
Cash and cash equivalents at end of year.....	\$ 113.1	\$ 36.6	\$ 32.9
Supplemental Cash Flow Information			
Net cash paid/(refunded) during the year for:			
Interest.....	\$ 34.5	\$ 39.5	\$ 50.2
Income taxes.....	24.4	(11.0)	28.1
Non-cash financing transactions:			
Issuance of common stock for Executive Stock Performance Plan.....	\$ 3.3	\$ 1.2	\$ 1.1

Consolidated Statements of Stockholders' Equity

BorgWarner Inc.
and Consolidated Subsidiaries

03

	millions of dollars								Comprehensive income/(loss)
	Number of Shares		Stockholders' Equity					Accumulated other comprehensive income/(loss)	
	Issued common stock	Common stock in treasury	Issued common stock	Capital in excess of par value	Treasury stock	Management shareholder notes	Retained earnings		
Balance, January 1, 2001	27,040,492	(815,209)	\$0.3	\$715.7	\$(33.3)	\$(2.5)	\$422.9	\$(16.0)	—
Purchase of treasury stock	—	(15,000)	—	—	(0.7)	—	—	—	—
Dividends declared	—	—	—	—	—	—	(15.8)	—	—
Management shareholder notes	—	—	—	—	—	0.5	—	—	—
Shares issued under stock option plans	—	129,550	—	—	5.3	—	(2.5)	—	—
Shares issued under executive stock plan	—	25,860	—	—	1.1	—	(0.1)	—	—
Kuhlman shares retired	(524)	—	—	—	—	—	—	—	—
Net income	—	—	—	—	—	—	66.4	—	\$ 66.4
Adjustment for minimum pension liability	—	—	—	—	—	—	—	(18.7)	(18.7)
Currency translation adjustment	—	—	—	—	—	—	—	(18.4)	(18.4)
Balance, December 31, 2001	27,039,968	(674,799)	\$0.3	\$715.7	\$(27.6)	\$(2.0)	\$470.9	\$(53.1)	\$ 29.3
Purchase of treasury stock	—	(385,000)	—	—	(18.1)	—	—	—	—
Dividends declared	—	—	—	—	—	—	(16.0)	—	—
Shares issued under stock option plans	—	217,632	—	0.9	8.9	—	—	—	—
Shares issued under executive stock plan	—	23,280	—	0.3	0.9	—	—	—	—
Shares issued under retirement savings plans	358,923	—	—	20.8	—	—	—	—	—
Net loss	—	—	—	—	—	—	(119.1)	—	\$ (119.1)
Adjustment for minimum pension liability	—	—	—	—	—	—	—	(42.3)	(42.3)
Currency translation adjustment	—	—	—	—	—	—	—	40.9	40.9
Balance, December 31, 2002	27,398,891	(818,887)	\$0.3	\$737.7	\$(35.9)	\$(2.0)	\$335.8	\$(54.5)	\$ (120.5)
Purchase of treasury stock	—	(41,930)	—	—	(2.5)	—	—	—	—
Dividends declared	—	—	—	—	—	—	(19.4)	—	—
Management shareholder notes	—	—	—	—	—	2.0	—	—	—
Shares issued under stock option plans	—	758,604	—	5.3	34.0	—	—	—	—
Shares issued under executive stock plan	—	65,881	—	0.4	2.9	—	—	—	—
Shares issued under retirement savings plans	216,036	—	—	12.9	—	—	—	—	—
Net income	—	—	—	—	—	—	174.9	—	\$ 174.9
Adjustment for minimum pension liability	—	—	—	—	—	—	—	0.7	0.7
Currency translation adjustment	—	—	—	—	—	—	—	67.8	67.8
Balance, December 31, 2003	27,614,927	(36,332)	\$0.3	\$756.3	\$(1.5)	\$ —	\$491.3	\$14.0	\$243.4

See Accompanying 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, trucks, commercial transportation products and industrial equipment. Our products fall into two reportable operating segments: Drivetrain and Engine.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following paragraphs briefly describe 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.

Principles of consolidation The consolidated financial statements include all significant majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior amounts have been reclassified to conform to the current year presentation.

Cash and cash equivalents Cash and cash equivalents are valued at cost, which approximates market. It is the Company’s policy to classify investments with original maturities of three months or less as cash and cash equivalents.

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. In the fourth quarter of 2003, the Company reduced the maximum size of the facility from \$90 million to \$50 million. During the year ended December 31, 2003, total cash proceeds from sales of accounts receivable were \$1,010.0 million, and the amount of receivables sold ranged from \$50 to \$90 million at any time during the year. The Company paid a servicing fee of \$1.3 million, \$2.5 million, and \$6.5 million in 2003, 2002, and 2001, respectively, related to these receivables. These amounts are recorded in interest

expense and finance charges in the Consolidated Statements of Operations. At December 31, 2003, the Company had sold \$50 million of receivables under a Receivables Transfer Agreement for face value without recourse. At December 31, 2002, the amount sold was \$90 million.

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) method. Inventory held by U.S. operations was \$97.1 million in 2003 and \$96.0 million in 2002. Such inventories, if valued at current cost instead of LIFO, would have been greater by \$3.6 million in both 2003 and 2002.

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.

Goodwill and other intangible assets The Company adopted SFAS No. 142, “Goodwill and Other Intangible Assets,” effective January 1, 2002. Under SFAS No. 142, goodwill is no longer amortized; however, it must be tested for impairment at least annually. Amortization continues to be recorded for other intangible assets with definite lives. See Note Fourteen for further details on the adoption of SFAS No. 142.

The Company had intangible assets with a cost of \$14.7 million, less accumulated amortization of \$8.7 million and \$7.6 million at December 31, 2003 and 2002, respectively. The intangible assets are being amortized on a straight-line basis over their legal lives, which range from 10 to 15 years. Annual amortization expense recognized was \$1.1 million in each of the years 2003, 2002, and 2001. The estimated future annual amortization expense for each of the successive years 2004 through 2008 is \$1.1 million.

Revenue recognition The Company recognizes revenue upon shipment of product when title and risk of loss pass to the customer. 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.

Financial instruments Financial instruments consist primarily of investments in cash, short-term securities, receivables and debt securities, and obligations under accounts payable, accrued expenses and debt instruments. The Company believes that the fair value of the financial instruments approximates the carrying value, except as noted in Note Six.

The Company received corporate bonds with a face value of \$30.3 million as partial consideration for the sales of Kuhlman Electric and Coleman Cable in 1999. These bonds were recorded at their fair market value of \$12.9 million using valuation techniques that considered cash flows discounted at current market rates and management's best estimates of credit quality. In 2001, the sale agreement with Coleman Cable was finalized, resulting in the exchange of the corporate bonds along with a purchase price receivable, for \$3 million in cash and a \$2 million note, which was collected in 2002. The fair value of the remaining Kuhlman Electric bonds was estimated to be \$8.8 million at December 31, 2003 and December 31, 2002. The contractual maturities of these bonds is October 2007.

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 in stockholders' equity.

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

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

	millions of dollars		
	2003	2002	2001
Beginning balance	\$23.7	\$ 19.5	\$16.5
Provisions	12.4	14.2	18.3
Payments	(7.4)	(10.0)	(15.3)
Ending balance	\$28.7	\$ 23.7	\$19.5

Classified in the Consolidated Balance Sheets as:

Accounts payable and accrued expenses	\$ 17.6	\$ 14.4	\$14.1
Other long-term liability	\$ 11.1	\$ 9.3	\$ 5.4

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. 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 derivative fair values are matched with the underlying transactions. The Company does not engage in any derivative instruments for purposes other than hedging specific risk.

Stock-based compensation SFAS No. 123, "Accounting for Stock-Based Compensation" and SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure," encourage, but do not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation in accordance with Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no compensation cost has been recognized for fixed stock options because the exercise prices of the stock options equal the market value of the Company's common stock at the date of grant. Further disclosure about the Company's stock compensation plans can be found in Note Ten. The following table illustrates the effect on the Company's net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provision of SFAS No. 123.

Notes to Consolidated Financial Statements

	millions of dollars, except per share amounts		
	2003	2002	2001
Net earnings/(loss), as reported	\$174.9	\$(119.1)	\$66.4
Add: Stock-based employee compensation expense included in net income, net of income tax	2.7	4.5	3.6
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of income tax	(7.7)	(10.7)	(7.8)
Pro forma net earnings/(loss)	<u>\$169.9</u>	<u>\$(125.3)</u>	<u>\$62.2</u>
Net earnings/(loss) per share:			
Basic – as reported	\$ 6.46	\$ (4.47)	\$ 2.52
Basic – pro forma	\$ 6.28	\$ (4.71)	\$ 2.36
Diluted – as reported	\$ 6.40	\$ (4.44)	\$ 2.51
Diluted – pro forma	\$ 6.22	\$ (4.67)	\$ 2.35

New accounting pronouncements In June 2001, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 143, “Accounting for Asset Retirement Obligations.” This standard requires that legally enforceable and unavoidable obligations related to asset retirements be recognized as an increase in the carrying amount of the related long-term asset when incurred. The Company adopted SFAS No. 143 on January 1, 2003. The adoption of this standard did not have any impact on the Company’s results of operations, financial condition or cash flows.

In June 2002, the FASB issued SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities.” This standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company adopted SFAS No. 146 on January 1, 2003, which did not have a material impact on the Company’s results of operations, financial position or cash flows.

In November 2002, the FASB issued Interpretation (“FIN”) No. 45 “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others,” which expands previously issued accounting guidance and disclosure requirements for certain guarantees.

FIN No. 45 requires the Company to recognize an initial liability for fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN No. 45 on January 1, 2003 did not have any impact on the Company’s financial position, operating results or liquidity and resulted in additional disclosures in the Company’s Consolidated Financial Statements.

In December 2002, the FASB issued SFAS No. 148, “Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123.” This Statement amends FASB Statement No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and amends the disclosure requirements to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company adopted SFAS No. 148 January 1, 2003, and selected to continue to account for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, “Accounting of Stock Issued to Employees.” The Company has provided the required disclosure in Note One to the Consolidated Financial Statements.

In January 2003, the FASB issued FIN No. 46, “Consolidation of Variable Interest Entities,” which was revised in December 2003. FIN No. 46 requires that the assets, liabilities and results of the activity of variable interest entities be consolidated into the financial statements of the entity that has the controlling financial interest. FIN No. 46 also provides the framework for determining whether a variable interest entity should be consolidated based on voting interest or significant financial support provided to it. For the Company, this Interpretation, as revised, is effective January 1, 2004. The Company is in the process of evaluating the adoption of FIN No. 46 and the impacts on the Company’s results of operations, financial position or cash flows.

In December 2003, the FASB issued a revised SFAS No. 132, “Employer’s Disclosures About Pensions and Other Postretirement Benefits.” SFAS No. 132 changes employers’ disclosures about pension plans and other post-retirement benefits and requires additional disclosures about assets, obligations, cash flows and net periodic benefit cost. The Statement is effective for annual and interim periods ended after December 15, 2003. The Company adopted SFAS No. 132 as of December 31, 2003, resulting in additional disclosures in the Company’s Consolidated Financial Statements. See Note Nine of the Notes to Consolidated Financial Statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which amends and clarifies accounting and reporting for certain derivative instruments. The Company adopted this Statement effective July 1, 2003 and currently reports cash received from, or paid to, derivative contracts consistent with the underlying assets on its Statement of Cash Flow.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The Company adopted this Statement effective October 1, 2003. This Statement had no impact on the Company's results of operations, financial condition, and cash flows.

In January 2004, the FASB issued FASB Staff Position ("FSP") No. 106-1, "Accounting Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003." FSP No.106-1 permits a sponsor to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2002 (the Act). The Act, signed into law in December, 2003, establishes a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Act introduces two new features to Medicare that must be considered when measuring accumulated postretirement benefit costs. The new features include a subsidy to the plan sponsors that is based on 28% of an individual beneficiary's annual prescription drug costs between \$250 and \$5,000 and an opportunity for a retiree to obtain a prescription drug benefit under Medicare. The Act is expected to reduce the Company's net postretirement benefit costs.

The Company has elected to defer the adoption of FSP No. 106-1 due to lack of specific accounting guidance. Therefore, the net post retirement benefit costs disclosed in the Consolidated Financial Statements do not reflect the impact of the Act on the plans. The deferral will continue to apply until specific authoritative accounting guidance for the federal subsidy is issued. Authoritative guidance on the accounting for the federal subsidy is pending and, when issued, could require information previously reported in the Company's Consolidated Financial Statements to change. The Company is currently investigating the impacts of FSP No. 106-1's initial recognition, measurement and disclosure provisions on its Consolidated Financial Statements.

NOTE 2 RESEARCH AND DEVELOPMENT COSTS

The Company spent approximately \$118.2 million, \$109.1 million, and \$104.5 million in 2003, 2002 and 2001, respectively, on research and development (R&D) activities included in selling, general, and administrative expenses in the Consolidated Statements of Operations. Not included in these amounts were customer-sponsored R&D activities of approximately \$22.3 million, \$14.2 million, and \$20.0 million in 2003, 2002, and 2001, respectively.

NOTE 3 OTHER INCOME

Items included in other income consist of:

Year Ended December 31,	millions of dollars		
	2003	2002	2001
Gains on sales of business	\$ 0.5	\$ —	\$ —
Interest income	0.8	1.7	1.4
Loss on asset disposals, net	(1.7)	(1.5)	(0.2)
Other	0.5	0.7	0.9
	\$ 0.1	\$ 0.9	\$ 2.1

NOTE 4 INCOME TAXES

Earnings before taxes and provision for taxes consist of:

	millions of dollars								
	2003			2002			2001		
	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total
Earnings before taxes	\$99.0	\$157.7	\$256.7	\$ 150.7	\$83.1	\$233.8	\$ 23.3	\$86.6	\$109.9
Income taxes:									
Current:									
Federal/foreign	\$18.5	\$13.1	\$31.6	\$ 11.1	\$10.6	\$21.7	\$ 9.8	\$24.7	\$34.5
State	1.6	—	1.6	3.1	—	3.1	2.1	—	2.1
	20.1	13.1	33.2	14.2	10.6	24.8	11.9	24.7	36.6
Deferred	18.5	21.5	40.0	44.8	7.6	52.4	2.0	1.1	3.1
Total income taxes	\$38.6	\$34.6	\$73.2	\$59.0	\$18.2	\$77.2	\$13.9	\$25.8	\$39.7

Notes to Consolidated Financial Statements

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		
	2003	2002	2001
Income taxes at U.S. statutory rate of 35%	\$ 89.8	\$ 81.8	\$ 38.5
Increases (decreases) resulting from:			
Income from non-U.S. sources	(16.0)	(6.8)	(0.1)
Business tax credits, net	(1.7)	(4.7)	(7.2)
Affiliate earnings	(7.0)	(6.8)	(5.2)
Non-temporary differences and other	8.1	13.7	13.7
Income taxes as reported	\$ 73.2	\$ 77.2	\$ 39.7

Following are the gross components of deferred tax assets and liabilities as of December 31, 2003 and 2002:

	millions of dollars	
Year Ended December 31,	2003	2002
Deferred tax assets — current:		
Foreign tax credits	\$ 7.1	\$ 8.4
Research and development credits	7.6	3.0
Employee related	5.8	5.5
Warranties	5.7	4.7
Other	6.6	3.9
Net deferred tax asset — current	\$ 32.8	\$ 25.5
Deferred tax assets — noncurrent:		
Pension and other postretirement benefits	\$ 90.4	\$ 90.3
Other comprehensive income	33.1	31.7
Employee related	8.7	10.1
Goodwill	13.9	26.0
Litigation and environmental	7.9	8.9
Other	1.0	5.1
	155.0	172.1
Deferred tax liabilities — noncurrent:		
Fixed assets	163.8	135.0
Net deferred tax asset/(liability) — noncurrent	\$ (8.8)	\$ 37.1

The foreign tax credits of \$5.4 million and \$1.7 million will expire in 2007 and 2008, respectively. The R&D tax credit carryforward of \$4.3 million and \$3.3 million will expire in 2022 and 2023, respectively.

No deferred income taxes have been provided on undistributed earnings of certain foreign subsidiaries totaling \$69.1 million and \$59.2 million in 2003 and 2002, respectively, as the amounts are essentially permanent in nature. Any such potential liability would be substantially offset by foreign tax credits with respect to such undistributed foreign earnings.

NOTE 5 BALANCE SHEET INFORMATION

Detailed balance sheet data are as follows:

	millions of dollars	
December 31,	2003	2002
Receivables:		
Customers	\$ 374.6	\$ 247.9
Other	46.0	49.3
Gross receivables	420.6	297.2
Less allowance for losses	5.7	5.1
Net receivables	\$ 414.9	\$ 292.1
Inventories:		
Raw material	\$ 95.5	\$ 85.3
Work in progress	65.1	57.6
Finished goods	40.7	37.4
Total inventories	\$ 201.3	\$ 180.3
Investments and advances:		
NSK-Warner	\$ 172.1	\$ 148.3
Other	5.2	4.8
Total investments and advances	\$ 177.3	\$ 153.1
Other noncurrent assets:		
Deferred pension assets	\$ 90.8	\$ 91.0
Other	18.4	17.2
Total other noncurrent assets	\$ 109.2	\$ 108.2
Accounts payable and accrued expenses:		
Trade payables	\$ 300.0	\$ 257.0
Payroll and related	63.7	70.9
Insurance	24.0	26.1
Warranties	17.6	14.4
Non-recurring charges	—	3.3
Other	55.0	63.9
Total accounts payable and accrued expenses	\$ 460.3	\$ 435.6
Other long-term liabilities:		
Environmental reserves	\$ 19.6	\$ 20.3
Deferred income taxes	8.8	—
Other	125.6	104.9
Total other long-term liabilities	\$ 154.0	\$ 125.2

Dividends and other payments received from affiliates accounted for under the equity method totaled \$9.7 million in 2003, \$8.4 million in 2002, and \$8.9 million in 2001.

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.

Following are summarized financial data for NSK-Warner, translated using the ending or periodic rates as of and for the years ended November 30, 2003, 2002 and 2001:

	millions of dollars		
	2003	2002	2001
Balance sheets:			
Current assets	\$210.7	\$176.0	\$125.3
Noncurrent assets	173.3	151.0	133.5
Current liabilities	108.8	85.2	62.9
Noncurrent liabilities	14.8	10.7	7.5
Statements of operations:			
Net sales	\$356.5	\$303.8	\$300.4
Gross profit	71.4	69.8	61.8
Net income	34.5	34.0	25.2

The equity of NSK-Warner as of November 30, 2003, was \$260.3 million and there was no debt.

NOTE 6 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 for 2003 and 2002 was 4.9% and 5.2%, respectively.

December 31,	millions of dollars			
	2003		2002	
	Current	Long-Term	Current	Long-Term
Bank borrowings and other	\$ 2.9	\$ 42.5	\$ 8.0	\$ 40.4
Term loans due through 2011 (at an average rate of 3.3% in 2003 and 3.1% in 2002; and 3.4% at December 31, 2003)	7.1	31.4	6.4	31.5
7% Senior Notes due 2006, net of unamortized discount (\$139 million converted to floating rate of 2.9% by interest rate swap at December 31, 2003)	—	139.4	—	139.3
6.5% Senior Notes due 2009, net of unamortized discount (\$100 million converted to floating rate of 3.3% by interest rate swap at December 31, 2003)	—	164.7	—	164.9
8% Senior Notes due 2019, net of unamortized discount (\$75 million converted to floating rate of 3.8% by interest rate swap at December 31, 2003)	—	133.9	—	134.2
7.125% Senior Notes due 2029, net of unamortized discount	—	122.1	—	122.0
Total notes payable and long-term debt	\$10.0	\$634.0	\$14.4	\$632.3

Annual principal payments required as of December 31, 2003 are as follows (in millions of dollars):

2004	\$ 10.0
2005	35.7
2006	159.3
2007	6.2
2008	6.2
after 2008	429.4
Total payments	646.8
Less: Unamortized discounts	(2.8)
Total	\$644.0

The Company has a revolving credit facility which provides for borrowings up to \$350 million through July, 2005. At December 31, 2003, there were no borrowings outstanding and no obligations under standby letters of credit under the facility. At December 31, 2002, there were no borrowings and \$7.1 million of obligations under standby letters of credit outstanding under the facility. The credit agreement contains numerous financial and operating covenants including, among others, covenants requiring the Company to maintain certain financial ratios and restricting its ability to incur additional indebtedness. The Company was in compliance with all covenants at December 31, 2003.

NOTE 7 FINANCIAL INSTRUMENTS

The Company's financial instruments include cash and cash equivalents, trade receivables payable, and notes payable. Due to the short-term nature of these instruments the book value approximates fair value. The Company's financial instruments also include long-term debt, interest rate and currency swaps, commodity forward and option contracts, and foreign currency forward contracts.

As of December 31, 2003 and 2002, the estimated fair values of the Company's senior unsecured notes totaled \$635.0 million and \$610.7 million, respectively. The estimated fair values were \$74.9 million higher in 2003, and \$50.3 million higher in 2002, 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.

The Company has entered into interest rate and currency swaps to manage interest rate and foreign currency risk. A summary of these instruments outstanding at December 31, 2003 follows (currency in millions):

	Hedge Type	Notional Amount	Interest Rates ^a		Floating Interest Rate Basis
			Receive	Pay	
Interest rate swaps^a					
Fixed to floating	Fair value	\$139	7.0%	2.9%	6 month LIBOR+1.7%
Fixed to floating	Fair value	\$100	6.5%	3.3%	6 month LIBOR+2.1%
Fixed to floating	Fair value	\$75	8.0%	3.8%	6 month LIBOR+2.6%
Cross currency swap (matures in 2006)					
Floating \$ to floating ¥	Investment	\$100	2.2%	—	6 mo. USD LIBOR+1.0%
		¥12,192	—	1.3%	6 mo. JPY LIBOR+1.2%

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

(b) Interest rates are as of December 31, 2003.

The ineffective portion of the swaps was not material. As of December 31, 2003, the fair value of the fixed to floating interest rate swaps was \$11.5 million. Cross currency swaps were recorded at their fair value of \$(4.2) million. Fair value is based on quoted market prices for contracts with similar maturities.

The Company also entered into certain commodity derivative instruments to protect against commodity price changes related to forecasted raw material and supplies purchases. The primary purpose of the commodity price hedging activities is to manage the volatility associated with these forecasted purchases. The Company primarily utilizes forward and option contracts with maturities of less than twelve months, which qualify as cash flow hedges. These instruments are intended to offset the effect of changes in commodity prices on forecasted purchases. As of December 31, 2003, the Company had forward and option commodity contracts with a total notional value of \$1.1 million and a favorable fair value of \$0.1 million. There were no material commodity contracts outstanding as of December 31, 2002. The net gain (loss) deferred in other comprehensive income which was \$0 million, net of tax as of December 31, 2003 and is anticipated to be reclassified into income in 2004 as the related inventories are sold. During 2003, 2002, and 2001, cash flow hedge ineffectiveness of these contracts were not material. All commodity forward contracts outstanding at December 31, 2003 will mature in 2004.

The Company uses foreign exchange forward contracts to hedge future purchases of materials consumed in the production process, and the receivables related to sales through December 2005. Foreign currency contracts require the Company, at a future date, to either buy or sell foreign currency in exchange for primarily U.S. dollars, Euros, and British Pound Sterling. Contracts outstanding as of December 31, 2003 will mature over the next two years and had net sales contract notional amounts of \$20.4 million and 66.8 million Euro and a fair value of \$0.3 million. Contracts outstanding as of December 31, 2002 had contract notional amounts of \$21.9 million and 3.0 million Euro and a favorable fair value of \$1.1 million. There was no net gain (loss) deferred in other comprehensive income as of December 31, 2003. Typically, this amount is reclassified into income as the related inventories are sold.

NOTE 8 NON-RECURRING CHARGES

Non-recurring charges of \$28.4 million were incurred in the fourth quarter of 2001. The charges primarily include adjustments to the carrying value of certain assets and liabilities related to businesses acquired and disposed of over the past three years. Of the \$28.4 million of pretax charges, \$5.0 million represented non-cash charges. Approximately \$3.3 million was spent in 2001, \$8.4 million was transferred to environmental reserves in 2001, \$8.4 million was spent in 2002, and \$3.3 million was spent in 2003. The Company funded the total cash outlay of these actions with cash flow from operations.

Components of the 2001 non-recurring charges are detailed in the following table and discussed further below.

millions of dollars			
	Asset write-downs	Exit costs and other non-recurring charges	Total
Balance, January 1, 2001	\$ —	\$ —	\$ —
Provisions	5.0	23.4	28.4
Incurred	—	(11.7)	(11.7)
Non-cash write-offs	(5.0)	—	(5.0)
Balance, December 31, 2001	\$ —	\$ 11.7	\$ 11.7
Provisions	—	—	—
Incurred	—	(8.4)	(8.4)
Non-cash write-offs	—	—	—
Balance, December 31, 2002	\$ —	\$ 3.3	\$ 3.3
Provisions	—	—	—
Incurred	—	(3.3)	(3.3)
Non-cash write-offs	—	—	—
Balance, December 31, 2003	\$ —	\$ —	\$ —

Exit costs and other non-recurring charges are primarily non-employee related exit costs for certain non-production facilities the Company has previously sold or no longer needs and non-recurring product quality related charges. The 2001 non-recurring charges include \$8.4 million of environmental remediation costs related to sold businesses and \$12.0 million of product quality costs for issues with products that were sold by acquired businesses prior to acquisition, all of which have been fixed in the currently produced products.

NOTE 9 RETIREMENT BENEFIT PLANS

The Company has a number of defined benefit pension plans and other postretirement benefit plans covering eligible salaried and hourly employees. The other postretirement benefit plans, which provide medical and life insurance benefits, are unfunded plans. The measurement date for all plans is December 31. The following provides a reconciliation of the plans' benefit obligations, plan assets, funded status and recognition in the Consolidated Balance Sheets.

	millions of dollars			
	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 443.1	\$ 385.7	\$ 446.5	\$ 407.1
Service cost	10.0	7.6	5.3	5.0
Interest cost	28.0	26.3	29.7	28.8
Plan participants' contributions	0.3	0.2	—	—
Amendments	—	—	—	(2.3)
Net actuarial loss	55.0	32.7	89.2	37.9
Currency translation adjustment	24.7	17.3	—	—
Curtailements	—	—	(0.8)	(0.5)
Benefits paid	(27.5)	(26.7)	(32.5)	(29.5)
Benefit obligation at end of year	\$ 533.6	\$ 443.1	\$ 537.4	\$ 446.5
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 323.5	\$ 358.2		
Actual return on plan assets	68.0	(27.7)		
Employer and other contributions	17.1	11.7		
Plan participants' contributions	0.3	0.2		
Currency translation adjustment	10.0	7.8		
Benefits paid	(27.5)	(26.7)		
Fair value of plan assets at end of year	\$ 391.4	\$ 323.5		
Reconciliation of funded status:				
Funded status (underfunded)	\$ (142.2)	\$ (119.6)	\$ (537.4)	\$ (446.5)
Unrecognized net actuarial loss	146.4	142.9	214.4	131.4
Unrecognized transition asset	0.2	(0.1)	—	—
Unrecognized prior service cost	9.4	11.1	(2.3)	(2.6)
Net amount recognized	\$ 13.8	\$ 34.3	\$ (325.3)	\$ (317.7)
Amounts recognized in the consolidated balance sheets:				
Prepaid benefit cost	\$ 81.7	\$ 80.3	\$ —	\$ —
Accrued benefit liability	(67.9)	(46.0)	(325.3)	(317.7)
Additional minimum liability	(103.3)	(106.0)	—	—
Intangible asset	9.1	10.7	—	—
Accumulated other comprehensive income	94.2	95.3	—	—
Net amount recognized	\$ 13.8	\$ 34.3	\$ (325.3)	\$ (317.7)
Total accumulated benefit obligation, end of year	\$ 511.1	\$ 427.1		

Notes to Consolidated Financial Statements

The funded status of pension plans included above with accumulated benefit obligations in excess of plan assets at December 31 is as follows:

	millions of dollars	
	2003	2002
Accumulated benefit obligation	\$418.1	\$343.8
Plan assets	270.0	216.7
Deficiency	\$148.1	\$127.1

The \$148.1 million deficiency in 2003 consists of \$56.7 million related to U.S. plans, \$30.0 million related to UK plans, \$55.5 million related to German plans, and \$5.9 million related to Japanese plans. The 2002 deficiency of \$127.1 million consists of \$60.7 million related to U.S. plans, \$25.0 million related to UK plans, and \$41.4 million related to German plans.

The Company's pension plan weighted average asset allocations at December 31, 2003 and 2002, and target allocations by asset category, are as follows:

	percent		
	2003	2002	Target Allocation
Cash & cash equivalents and other	3	5	0-10
Fixed income securities	33	41	30-45
Equity securities	64	54	50-70

The Company's investment strategy is to maintain actual asset weightings within a preset range of target allocations. The Company believes these ranges represent an appropriate risk profile for the planned benefit payments of the plans based on the timing of the estimated benefit payments. Within each asset category, separate portfolios are maintained for additional diversification. Investment managers are retained within each asset category to manage each portfolio against its benchmark. Each investment manager has appropriate investment guidelines. In addition, the entire portfolio is evaluated against a relevant peer group. The pension plans did not hold any Company securities as investments as of December 31, 2003 and 2002.

The Company expects to contribute a total of \$25 million to \$30 million into all of its pension plans during 2004.

millions of dollars

Year ended December 31,	Pension Benefits			Other Postretirement Benefits		
	2003	2002	2001	2003	2002	2001
Components of net periodic benefit cost:						
Service cost	\$10.0	\$ 7.6	\$ 7.1	\$ 5.3	\$ 5.0	\$ 4.4
Interest cost	28.0	26.3	25.0	29.7	28.8	25.0
Expected return on plan assets	(26.4)	(30.7)	(32.1)	—	—	—
Amortization of unrecognized transition asset	0.3	(0.2)	(0.1)	—	—	—
Amortization of unrecognized prior service cost	1.7	1.6	2.2	(0.2)	(0.1)	(0.1)
Amortization of unrecognized (gain)/loss	9.6	2.2	—	5.9	4.0	—
Settlement loss	—	—	0.1	—	—	—
Net periodic benefit cost	\$ 23.2	\$ 6.8	\$ 2.2	\$40.7	\$37.7	\$29.3

The Company's weighted-average assumptions used as of December 31, in determining the net periodic benefit cost and the benefit obligation liabilities shown above were as follows:

Year ended December 31,	percent					
	Pension Benefits			Other Postretirement Benefits		
	2003	2002	2001	2003	2002	2001
U.S. plans:						
Discount rate	6.00	6.75	7.25	6.00	6.75	7.25
Rate of compensation increase	3.5	4.5	4.5			
Expected return on plan assets	8.75	8.75	9.5			
Foreign plans:						
Discount rate	2.5-6.0	5.5-6.0	5.5-6.0			
Rate of compensation increase	0.0-4.0	2.5-4.0	2.5-4.0			
Expected return on plan assets	4.5-6.75	7.0	6.5			

The return on assets assumption was developed through analysis of historical market returns, current market conditions, target allocations among asset classes and past experience. Overall, it was projected that the funds could achieve an 8.75% net return over time, based upon the targeted asset allocation. This assumes no benefit from manager selection strategies.

The estimated future benefit payments for the pension and other post retirement benefits are as follows:

millions of dollars		
Year	Pension Benefits	Other Postretirement Benefits
2004	\$ 29.1	\$ 28.4
2005	29.3	30.1
2006	29.7	30.8
2007	30.2	31.3
2008	30.7	31.7
2009-2013	164.5	162.6

The weighted-average rate of increase in the per capita cost of covered health care benefits is projected to be 9.2% in 2004 decreasing to 4.5% by the year 2009. A one-percentage point change in the assumed health care cost trend would have the following effects:

	millions of dollars	
	One Percentage Point	
	Increase	Decrease
Effect on postretirement benefit obligation	\$68.8	\$(57.1)
Effect on total service and interest cost components	\$ 5.8	\$(4.7)

NOTE 10 STOCK INCENTIVE PLANS

Stock option plans Under the Company's 1993 Stock Incentive Plan, the Company may grant options to purchase shares of the Company's common stock at the fair market value on the date of grant. In 2000, the Company increased the number of shares available for grant by 1,200,000 to 2,700,000 shares. The options vest over periods up to three years and have a term of ten years from date of grant. As of December 31, 2003, there are 1,340,260 outstanding options under the 1993 Stock Incentive Plan. The plan expired as of December 31, 2003; therefore, there are no options available for future grants.

The Company accounts for stock options in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation cost has been recognized for fixed stock options because the exercise price of the stock options exceeded or equaled the market value of the Company's common stock at the date of grant.

A summary of the plan's shares under option at December 31, 2003, 2002 and 2001 follows:

	2003		2002		2001	
	Shares (thousands)	Weighted-average exercise price	Shares (thousands)	Weighted-average exercise price	Shares (thousands)	Weighted-average exercise price
Outstanding at beginning of year	1,825	\$46.57	1,493	\$44.67	1,248	\$41.22
Granted	341	65.47	616	50.67	442	47.99
Exercised	(759)	43.60	(217)	45.22	(129)	22.51
Forfeited	(67)	50.05	(67)	46.26	(68)	45.18
Outstanding at end of year	1,340	\$52.88	1,825	\$46.57	1,493	\$44.67
Options exercisable at year-end	277	\$45.15	594	\$45.21	423	\$46.81
Options available for future grants	0					

The following table summarizes information about stock options outstanding at December 31, 2003:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number outstanding (thousands)	Weighted-average remaining contractual life	Weighted-average exercise price	Number exercisable (thousands)	Weighted-average exercise price
\$22.50-42.25	116	5.8	\$36.07	112	\$35.95
\$48.28-53.13	842	7.9	50.08	102	49.56
\$53.88-66.08	382	8.8	64.13	63	54.28
\$22.50-66.08	1,340	8.0	\$52.88	277	\$45.15

The weighted average fair value at date of grant for options granted during 2003, 2002, and 2001 were \$23.81, \$20.26, and \$17.28, respectively, and were estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	2003	2002	2001
Risk-free interest rate	3.58%	4.34%	5.02%
Dividend yield	1.27%	1.32%	1.49%
Volatility factor	34.38%	33.66%	32.73%
Weighted average expected life	6.5 years	6.5 years	6.5 years

Executive stock performance plan The Company has an executive stock performance plan which provides payouts at the end of successive three-year periods based on the Company's performance in terms of total stockholder return relative to a peer group of automotive companies. Payouts earned are payable 40% in cash and 60% in the Company's common stock. For the three-year measurement periods ended December 31, 2003, 2002 and 2001, the amounts earned and expensed under the plan were \$2.7 million, \$4.5 million, and \$3.6 million, respectively. Under this plan, 65,881 shares, 23,280 shares, and 25,860 shares were issued in 2003, 2002 and 2001, respectively. Estimated shares issuable under the plan are included in the computation of diluted earnings per share as earned.

Earnings per share In calculating earnings per share, earnings are the same for the basic and diluted calculations. Shares increased for diluted earnings per share by 244,000, 229,000, and 148,000 for 2003, 2002 and 2001, respectively, due to the effects of stock options and shares issuable under the executive stock performance plan.

NOTE 11 OTHER COMPREHENSIVE INCOME

The tax effects of the components of other comprehensive income/(loss) in the Consolidated Statements of Stockholders' Equity are as follows:

Year ended December 31,	millions of dollars		
	2003	2002	2001
Foreign currency translation adjustment	\$68.8	\$ 55.9	\$(14.6)
Income taxes	(1.0)	(15.0)	(3.8)
Net foreign currency translation adjustment	67.8	40.9	(18.4)
Minimum pension liability adjustment	1.1	(65.4)	(29.7)
Income taxes	(0.4)	23.1	11.0
Net minimum pension liability adjustment	0.7	(42.3)	(18.7)
Other comprehensive income/(loss)	\$68.5	\$ (1.4)	\$(37.1)

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

Year ended December 31,	millions of dollars	
	2003	2002
Foreign currency translation adjustment	\$ 74.5	\$ 6.7
Minimum pension liability adjustment	(60.5)	(61.2)
Accumulated other comprehensive income/(loss)	\$ 14.0	\$(54.5)

NOTE 12 CONTINGENCIES

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 43 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

Based on information available to the Company, which in most cases, includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large, solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation costs; remediation alternatives; estimated legal fees; and other factors, the Company has established a reserve for indicated environmental liabilities with a balance at December 31, 2003 of approximately \$19.6 million. The Company expects this amount to be expended over the next three to five years.

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

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

The Company has been working with the Mississippi Department of Environmental Quality and Kuhlman Electric to investigate the extent of and remediate the contamination. The investigation revealed the presence of polychlorinated biphenyls (PCBs) in portions of the soil at the plant and neighboring areas. Clean-up began in 2000 and is continuing. Kuhlman Electric and others, including the Company, have been sued in several related lawsuits which claim personal and property damage. The Company has moved to be dismissed from some of these lawsuits.

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

NOTE 13 LEASES AND COMMITMENTS

Certain assets are leased under long-term operating leases. These include machinery and equipment at one plant, rent for the corporate headquarters, and a leased plane. Most leases contain renewal options for various periods. Leases generally require the Company to pay for insurance, taxes and maintenance of the leased property. The Company leases other equipment such as vehicles and certain office equipment under short-term leases. Total rent expense was \$13.4 million in 2003, \$11.4 million in 2002, and \$8.3 million in 2001. The Company does not have any material capital leases.

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

Future minimum operating lease payments at December 31, 2003 were as follows:

	millions of dollars
2004	\$ 4.2
2005	24.5
2006	1.4
2007	1.2
2008	1.2
After 2008	11.1
Total minimum lease payments	<u>\$ 43.6</u>

In June 2003, the Company entered into a royalty agreement with Honeywell International Inc. (“Honeywell”) to extend the Company’s right to produce certain variable turbine geometry (VTG) turbochargers under certain patents owned by Honeywell. The 2003 agreement extends the Company’s license to use these patents under a 2002 agreement with Honeywell, which resulted from the settlement of a patent dispute, and expired on June 30, 2003. The new agreement requires payments totaling \$29.1 million for minimum forecasted production of almost one million OEM and service production units over the period July 1, 2003 through December 31, 2006. The Company paid \$11.6 million towards this royalty in 2003. Future payments under the agreement are \$16.0 million in 2004 and \$1.5 million in 2005. The Company does not anticipate that it will produce affected VTG turbochargers in excess of the minimums under this agreement.

NOTE **14** GOODWILL

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142, effective January 1, 2002, specifies that goodwill and certain intangible assets will no longer be amortized but instead will be subject to periodic impairment testing. SFAS No. 142 also requires that, upon adoption, goodwill be allocated to the Company's reporting units and a two-step impairment analysis be performed.

The Company adopted SFAS No. 142 effective January 1, 2002. Under the transitional provisions of the SFAS, the Company allocated goodwill to its reporting units and performed the two-step impairment analysis. The fair value of the Company's businesses used in determination of the goodwill impairment was computed using the expected present value of associated future cash flows. As a result of this analysis, the Company determined that goodwill associated with its Cooling Systems and Air/Fluid Systems operating businesses was impaired due to fundamental changes in their served markets, particularly the medium and heavy truck markets, and weakness at a major customer. A resulting pre-tax charge of \$345 million, \$269 million after tax, was recorded. The impairment loss was recorded in the first quarter of 2002 as a cumulative effect of change in accounting principle. The changes in the carrying amount of goodwill for the twelve months ended December 31, 2003, are as follows:

	millions of dollars		
	Drivetrain	Engine	Total
Balance at January 1, 2002	\$ 133.7	\$ 1,026.9	\$ 1,160.6
Change in accounting principle	—	(345.0)	(345.0)
Translation adjustment	—	11.4	11.4
Balance at December 31, 2002	133.7	693.3	827.0
Contingent valuation payment on acquired business	—	12.8	12.8
Translation adjustment	0.6	11.6	12.2
Balance at December 31, 2003	\$ 134.3	\$ 717.7	\$ 852.0

Also as a result of the adoption of SFAS No. 142, the Company did not amortize goodwill in 2002. The following table provides adjusted net earnings/(loss) and earnings per share data for the years ended December 31, 2003, 2002, and 2001 as if goodwill had not been amortized during these periods:

	millions of dollars		
Year ended December 31,	2003	2002	2001
Reported net earnings before cumulative effect of change in accounting principle	\$ 174.9	\$ 149.9	\$ 66.4
Goodwill amortization, net of tax	—	—	26.5
Adjusted net earnings before cumulative effect of change in accounting principle	174.9	149.9	92.9
Cumulative effect of change in accounting principle, net of tax	—	(269.0)	—
Adjusted net earnings/(loss)	\$ 174.9	\$ (119.1)	\$ 92.9
<i>Basic earnings/(loss) per share:</i>			
Reported net earnings before cumulative effect of change in accounting principle	\$ 6.46	\$ 5.63	\$ 2.52
Goodwill amortization	—	—	1.00
Adjusted net earnings before cumulative effect of change in accounting principle	6.46	5.63	3.52
Cumulative effect of change in accounting principle, net of tax	—	(10.10)	—
Adjusted net earnings/(loss)	\$ 6.46	\$ (4.47)	\$ 3.52
<i>Diluted earnings/(loss) per share:</i>			
Reported net earnings before cumulative effect of change in accounting principle	\$ 6.40	\$ 5.58	\$ 2.51
Goodwill amortization	—	—	1.00
Adjusted net earnings before cumulative effect of accounting change	6.40	5.58	3.51
Cumulative effect of change in accounting principle, net of tax	—	(10.02)	—
Adjusted net earnings/(loss)	\$ 6.40	\$ (4.44)	\$ 3.51

NOTE **15** OPERATING SEGMENTS AND RELATED INFORMATION

For purposes of this footnote, the Company's business was comprised of two operating segments: Drivetrain and Engine. These reportable segments are strategic business units which are managed separately because each represents a specific grouping of automotive components and systems. The Company evaluates performance based on earnings before interest and taxes, which emphasizes realization of a satisfactory return on the total capital invested in each operating unit. Intersegment sales, which are not significant, are recorded at market prices. This footnote presents summary segment information.

Operating Segments

millions of dollars

	Sales			Earnings Before Interest and Taxes	Year End Assets	Depreciation/ Amortization	Long-Lived Asset Expenditures ^c
	Customers	Inter-segment	Net				
2003							
Drivetrain	\$ 1,245.5	\$ 0.1	\$ 1,245.6	\$ 98.4	\$ 778.8	\$ 60.1	\$ 66.4
Engine	1,823.7	46.0	1,869.7	239.6	1,925.1	93.8	133.3
Inter-segment eliminations	—	(46.1)	(46.1)	—	—	—	—
Total	3,069.2	—	3,069.2	338.0	2,703.9	153.9	199.7
Corporate	—	—	—	(48.0)	335.0 ^b	7.4	14.7
Consolidated	\$ 3,069.2	\$ —	\$ 3,069.2	\$ 290.0 ^d	\$ 3,038.9	\$ 161.3	\$ 214.4

	Sales			Earnings Before Interest and Taxes	Year End Assets	Depreciation/ Amortization	Long-Lived Asset Expenditures ^c
	Customers	Inter-segment	Net				
2002							
Drivetrain	\$ 1,122.1	\$ —	\$ 1,122.1	\$ 99.9	\$ 733.8	\$ 50.0	\$ 54.4
Engine	1,609.0	39.2	1,648.2	215.9	1,712.5	81.3	91.8
Inter-segment eliminations	—	(39.2)	(39.2)	—	—	—	—
Total	2,731.1	—	2,731.1	315.8	2,446.3	131.3	146.2
Corporate	—	—	—	(44.3)	236.6 ^b	6.1	19.9
Consolidated	\$ 2,731.1	\$ —	\$ 2,731.1	\$ 271.5 ^d	\$ 2,682.9	\$ 137.4	\$ 166.1

	Sales			Earnings Before Interest and Taxes	Year End Assets	Depreciation Amortization	Long-Lived Asset Expenditures ^c
	Customers	Inter-segment	Net				
2001							
Drivetrain	\$ 937.2	\$ —	\$ 937.2	\$ 70.1	\$ 647.8	\$ 52.1	\$ 66.0
Engine	1,396.4	30.2	1,426.6	142.7	1,937.0	115.4	106.5
Divested operations and businesses held for sale ^a	18.0	—	18.0	(0.2)	—	0.2	—
Inter-segment eliminations	—	(30.2)	(30.2)	—	—	—	—
Total	2,351.6	—	2,351.6	212.6	2,584.8	167.7	172.5
Corporate	—	—	—	(26.5)	186.1 ^b	2.2	10.4
Restructuring and other non-recurring charges	—	—	—	(28.4)	—	—	—
Consolidated	\$ 2,351.6	\$ —	\$ 2,351.6	\$ 157.7 ^d	\$ 2,770.9	\$ 169.9	\$ 182.9

(a) Fuel Systems was sold in 2001.

(b) Corporate assets, including equity in affiliates, are net of trade receivables sold to third parties, and include cash, marketable securities, deferred taxes and investments and advances.

(c) Long-lived asset expenditures includes capital spending and additions to non-perishable tooling, net of customer reimbursements.

(d) Earnings before interest and taxes above is net of interest expense and finance charges of \$33.3, \$37.7, and \$47.8 million in 2003, 2002 and 2001, respectively. Had these amounts been included in the table above, earnings before income taxes for the years 2003, 2002, and 2001 would be \$256.7, \$233.8, and \$109.9 million, respectively.

Notes to Consolidated Financial Statements

GEOGRAPHIC INFORMATION

No country outside the U.S., other than Germany, accounts for as much as 5% of consolidated net sales, attributing sales to the sources of the product rather than the location of the customer. For this purpose, the Company's 50% equity investment in NSK-Warner (see Note Five) amounting to \$172.1 million at December 31, 2003 is excluded from the definition of long-lived assets, as are goodwill and certain other noncurrent assets.

	millions of dollars					
	Net Sales			Long-Lived Assets		
	2003	2002	2001	2003	2002	2001
United States	\$1,889.2	\$1,859.1	\$1,687.4	\$ 636.9	\$643.0	\$638.5
Europe:						
Germany	637.7	453.4	347.5	234.6	182.3	148.5
Other Europe	314.0	236.0	162.2	114.7	72.4	64.4
Total Europe	951.7	689.4	509.7	349.3	254.7	212.9
Other foreign	228.3	182.6	154.5	89.6	80.8	75.5
Total	\$3,069.2	\$2,731.1	\$2,351.6	\$1,075.8	\$978.5	\$926.9

SALES TO MAJOR CUSTOMERS

Consolidated sales included sales to Ford Motor Company of approximately 23%, 26%, and 30%; to DaimlerChrysler of approximately 17%, 20%, and 21%; and to General Motors Corporation of approximately 12%, 12%, and 12% for the years ended December 31, 2003, 2002 and 2001, respectively. No other single customer accounted for more than 10% of consolidated sales in any year between 2001 and 2003. Such sales consisted of a variety of products to a variety of customer locations worldwide. Both of our operating segments had significant sales to all three of the customers listed above.

INTERIM FINANCIAL INFORMATION (UNAUDITED)

The following information includes all adjustments, as well as normal recurring items, that the Company considers necessary for a fair presentation of 2003 and 2002 interim results of operations. Certain 2003 and 2002 quarterly amounts have been reclassified to conform to the annual presentation.

Quarter Ended	millions of dollars, except per share amounts									
	2003					2002				
	March 31	June 30	Sept. 30	Dec. 31	Year 2003	March 31	June 30	Sept. 30	Dec. 31	Year 2002
Net sales	\$775.7	\$769.5	\$725.2	\$798.8	\$3,069.2	\$ 633.9	\$712.4	\$684.0	\$700.8	\$2,731.1
Cost of sales	624.2	622.8	595.9	639.7	2,482.5	504.2	561.4	556.1	554.8	2,176.5
Gross profit	151.5	146.7	129.3	159.1	586.7	129.7	151.0	127.9	146.0	554.6
Selling, general and administrative expenses	83.6	77.0	72.7	83.5	316.9	74.5	76.5	73.2	79.3	303.5
Other, net	—	0.1	0.1	(0.4)	(0.1)	(0.5)	0.1	(0.2)	(0.3)	(0.9)
Operating income	67.9	69.6	56.5	76.0	269.9	55.7	74.4	54.9	67.0	252.0
Equity in affiliate earnings, net of tax	(6.4)	(5.2)	(3.6)	(4.8)	(20.1)	(3.4)	(6.0)	(4.5)	(5.6)	(19.5)
Interest expense, net	9.0	8.7	8.1	7.5	33.3	9.8	9.5	9.3	9.1	37.7
Income before income taxes	65.3	66.1	52.0	73.3	256.7	49.3	70.9	50.1	63.5	233.8
Provision for income taxes	18.9	19.2	14.2	20.9	73.2	16.3	23.6	16.4	20.9	77.2
Minority interest, net of tax	2.2	2.1	1.9	2.4	8.6	1.5	1.6	1.8	1.8	6.7
Net earnings before cumulative effect of accounting change	\$ 44.2	\$ 44.8	\$ 35.9	\$ 50.0	\$ 174.9	\$ 31.5	\$ 45.7	\$ 31.9	\$ 40.8	\$ 149.9
Cumulative effect of accounting change ^a	—	—	—	—	—	(269.0)	—	—	—	(269.0)
Net earnings/(loss)	\$ 44.2	\$ 44.8	\$ 35.9	\$ 50.0	\$ 174.9	\$ (237.5)	\$ 45.7	\$ 31.9	\$ 40.8	\$ (119.1)
Net earnings/(loss) per share — Basic	\$ 1.66	\$ 1.66	\$ 1.32	\$ 1.82	\$ 6.46	\$ (8.98)	\$ 1.72	\$ 1.19	\$ 1.52	\$ (4.47)
Net earnings/(loss) per share — Diluted	\$ 1.65	\$ 1.65	\$ 1.30	\$ 1.80	\$ 6.40	\$ (8.90)	\$ 1.70	\$ 1.18	\$ 1.52	\$ (4.44)

(a) In 2002, the Company recorded a \$269.0 million after tax charge for cumulative effect of change in accounting principle related to goodwill. This charge was \$10.02 per diluted share.

millions of dollars, except per share data

Year Ended December 31,	2003	2002	2001	2000	1999
Statement of Operations Data					
Net sales	\$3,069.2	\$ 2,731.1	\$2,351.6	\$2,645.9	\$2,458.6
Cost of sales	2482.5	2,176.5	1,890.8	2,090.7	1,968.3
Gross profit	586.7	554.6	460.8	555.2	490.3
Selling, general and administrative expenses	316.9	303.5	249.7	258.7	214.8
Goodwill amortization	—	—	42.0	43.3	32.1
Other, net	(0.1)	(0.9)	(2.1)	(8.1)	(2.4)
Restructuring and other non-recurring charges	—	—	28.4 ^b	62.9 ^c	—
Operating income	269.9	252.0	142.8	198.4	245.8
Equity in affiliate earnings, net of tax	(20.1)	(19.5)	(14.9)	(15.7)	(11.7)
Interest expense, net	33.3	37.7	47.8	62.6	49.2
Income before income taxes	256.7	233.8	109.9	151.5	208.3
Provision for income taxes	73.2	77.2	39.7	54.8	74.7
Minority interest, net of tax	8.6	6.7	3.8	2.7	1.3
Net earnings before cumulative effect of accounting change	174.9	149.9	66.4	94.0	132.3
Cumulative effect of change in accounting principle, net of tax	—	(269.0) ^a	—	—	—
Net earnings/(loss)	\$ 174.9	\$ (119.1)	\$ 66.4	\$ 94.0	\$ 132.3
Net earnings/(loss) per share — Basic	\$ 6.46	\$ (4.47) ^a	\$ 2.52 ^b	\$ 3.56 ^c	\$ 5.10
Average shares outstanding (thousands) — Basic	27,058	26,625	26,315	26,391	25,948
Net earnings/(loss) per share — Diluted	\$ 6.40	\$ (4.44) ^a	\$ 2.51 ^b	\$ 3.54 ^c	\$ 5.07
Average shares outstanding (thousands) — Diluted	27,302	26,854	26,463	26,487	26,078
Cash dividend declared per share	\$ 0.72	\$ 0.63	\$ 0.60	\$ 0.60	\$ 0.60
Balance Sheet Data (at end of period)					
Total assets	\$ 3038.9	\$2,682.9	\$2,770.9	\$2,739.6	\$ 2,970.7
Total debt	644.0	646.7	737.0	794.8	980.3

(a) In 2002, upon the adoption of SFAS No. 142, the Company recorded a \$269.0 million after tax charge for cumulative effect of accounting principle related to goodwill. This charge was \$10.02 per diluted share.

(b) In 2001, the Company recorded \$28.4 million in non-recurring charges. Net of tax, this totaled \$19.0 million or \$0.72 per diluted share.

(c) In 2000, the Company recorded \$62.9 million in restructuring and other non-recurring charges. Net of tax, this totaled \$38.7 million or \$1.47 per diluted share.

Company Information

BorgWarner Inc.
200 South Michigan Avenue, Chicago, IL 60604
312-322-8500
www.bwauto.com

Stock Listing

Shares are listed and traded on the New York Stock Exchange.
Ticker symbol: **BWA**.

	High	Low
Fourth Quarter 2003	\$85.50	\$68.27
Third Quarter 2003	73.36	63.43
Second Quarter 2003	66.25	47.35
First Quarter 2003	55.39	43.31
Fourth Quarter 2002	\$ 53.65	\$ 38.38
Third Quarter 2002	62.73	47.89
Second Quarter 2002	68.95	55.48
First Quarter 2002	66.10	49.91

Dividends

The current dividend practice established by the directors is to declare regular quarterly dividends. The last such dividend of 25 cents per share of common stock was declared on November 14, 2003, payable February 17, 2004, to stockholders of record on February 2, 2004. The current practice is subject to review and change at the discretion of the Board of Directors.

Shareholder Services

Mellon Investor Services is the transfer agent, registrar and dividend dispersing agent for BorgWarner common stock.

Mellon Investor Services for BorgWarner
85 Challenger Road
Ridgefield Park, NJ 07660
www.melloninvestor.com

Communications concerning stock transfer, change of address, lost stock certificates or proxy statements for the annual meeting should be directed to Mellon Investor Services at 800-851-4229.

Dividend Reinvestment and Stock Purchase Plan

The BorgWarner Dividend Reinvestment and Stock Purchase Plan has been established so that anyone can make direct purchases of BorgWarner common stock and reinvest dividends. We pay the brokerage commissions on purchases. Questions about the plan can be directed to Mellon at 800-851-4229. To receive a prospectus and enrollment package, contact Mellon at 800-842-7629.

Annual Meeting of Stockholders

The 2004 annual meeting of stockholders will be held on Wednesday, April 21, 2004, beginning at 10:00 a.m. on the 19th floor of our headquarters at 200 South Michigan Avenue in Chicago.

Stockholders

As of December 31, 2003, there were 2,889 holders of record and an estimated 9,000 beneficial holders.

Investor Information

Visit www.bwauto.com for a wide range of company information. For investor information, including the following, click on Investor Information.

- BorgWarner News Releases
- BorgWarner Stock Quote
- Earnings Release Conference Call Calendar
- Webcasts
- Analyst Coverage
- Shareholder Services
- Corporate Governance
- BorgWarner In The News Articles
- Annual Reports
- Proxy Statement and Card
- Dividend Reinvestment/Stock Purchase Plan
- Financials and SEC Filings (including the Annual Report on Form 10K)
- Request Information Form

News Release Sign-up

At our Investor Information web page, you can sign up to receive BorgWarner's news releases. Here's how to sign up:

1. Go to www.bwauto.com
2. Click *Investor Information*
3. Click *News Release Sign-up* and follow the instructions

Investor Inquiries

Investors and securities analysts requiring financial reports, interviews or other information should contact Mary E. Brevard, Vice President of Investor Relations and Corporate Communications at BorgWarner headquarters, 312-322-8683. For copies of printed material, call our BorgWarner Investor Relations Hot Line at 312-322-8524.

Directors



Phyllis O. Bonanno (2)
President and Chief Executive Officer,
International Trade Solutions, Inc.



Dr. Andrew F. Brimmer (2)
President
Brimmer & Company, Inc.



William E. Butler (3,4)
Chairman and Chief Executive Officer,
Retired
Eaton Corporation



Jere A. Drummond (1,3,4)
Vice Chairman, Retired
BellSouth Corporation



Paul E. Glaske (3,4)
Chairman, President and
Chief Executive Officer, Retired
Blue Bird Corporation



Ivan W. Gorr (4)
Chairman and
Chief Executive Officer, Retired
Cooper Tire & Rubber Company



Timothy M. Manganello (1)
Chairman and Chief Executive Officer,
BorgWarner Inc.



Alexis P. Michas (1,2)
Managing Partner
Stonington Partners, Inc.



Ernest J. Novak, Jr. (2)
Managing Partner, Retired
Ernst and Young



John Rau (2,3)
President and Chief Executive Officer,
Miami Corporation

Committees of the Board

- 1 Executive Committee
- 2 Finance and Audit Committee
- 3 Compensation Committee
- 4 Corporate Governance Committee

Executive Officers

Timothy M. Manganello
Chairman and
Chief Executive Officer

John J. McGill
Vice President,
President and
General Manager,
TorqTransfer Systems

Alfred Weber
Vice President,
President and
General Manager,
Emissions/
Thermal Systems

F. Lee Wilson
Vice President,
President and
General Manager,
Turbo Systems

Roger J. Wood
Vice President,
President and
General Manager,
Morse TEC

Mary E. Brevard
Vice President,
Investor Relations
and Corporate
Communications

William C. Cline
Vice President
and Controller

Kimberly Dickens
Vice President,
Human Resources

Anthony D. Hensel
Vice President,
Business Development
and Acquisitions

Laurene H. Horiszny
Vice President,
General Counsel
and Secretary

Jeffrey L. Obermayer
Vice President
and Treasurer

Product Identification

Front Cover

ROW 1 DualTronic Transmission Control Module
Engine Timing System
13-54 4WD Transfer Case

ROW 2 Synchronizer Rings
Solenoid EGR Valve
Fan Clutch
Engine Timing System
Torque-On-Demand Clutch Pack Assembly

ROW 3 Interactive Torque Management II
Turbocharger BV50
44-11 4WD Transfer Case
Turbocharger K03
Air Flow System

ROW 4 DualTronic Modules in VW DSG
Binary Oil Pump
Turbocharger KP35
Diesel EGR

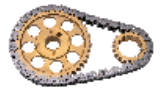
Back Cover

ROW 1 44-06 4WD Transfer Case
One-Way Clutch Assemblies
44-24 4WD Transfer Case
e-Booster
Electronic Throttle Body

ROW 2 Ring Fan with Viscous Fan Drive
Synchronizer Rings
Turbocharger K24
DualTronic Dual Clutch Module
Cam Phaser

ROW 3 Turbocharger S410V
Engine Timing System
Viscous Heater
VCT Cam Phaser with Variable Force Solenoid
High-Performance Engine Timing System

ROW 4 Transmission Control Module
Turbocharger with Electronic Actuator
Gemini Chain System
Transmission Band Assemblies
Interactive Torque Management I



200 South Michigan | Chicago, IL 60604

