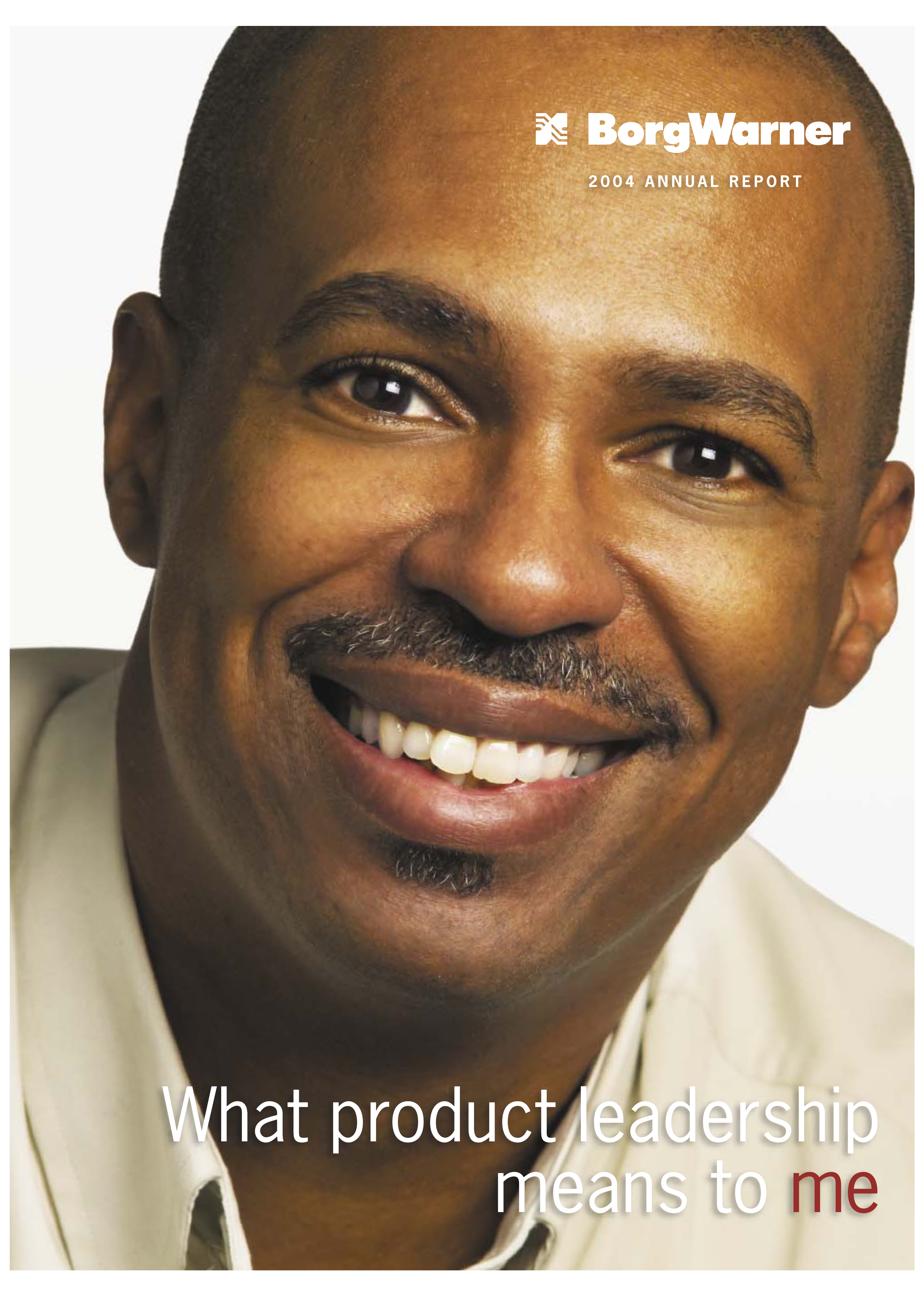
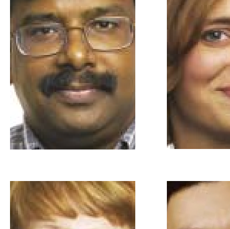
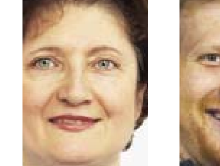
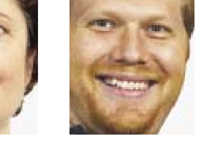
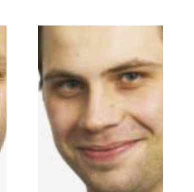

BorgWarner
2004 ANNUAL REPORT
What product leadership
means to me

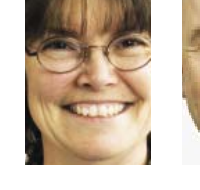
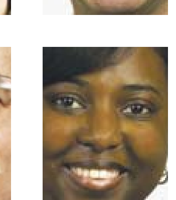
and me.

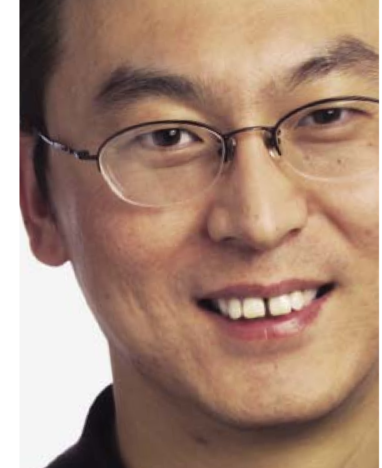
At BorgWarner, there are many definitions of PRODUCT LEADERSHIP — 17,127 to be exact.

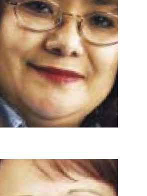
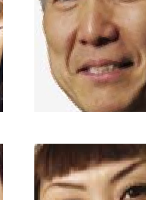
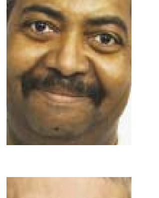


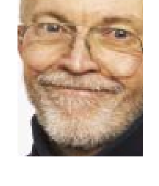





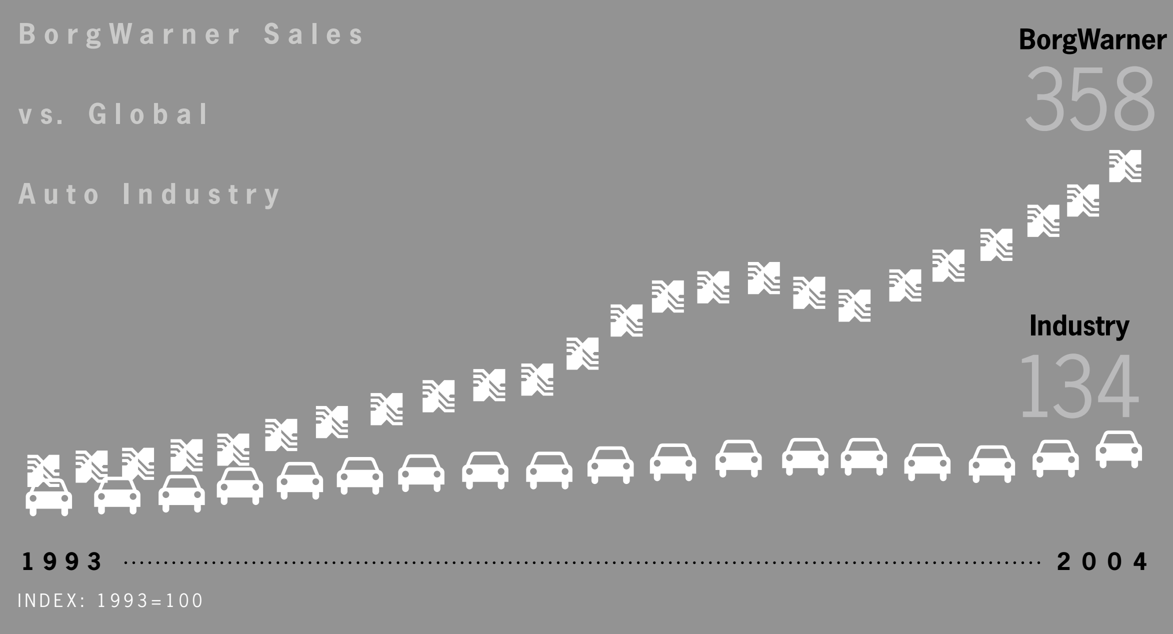







Product leadership means growing at a rate that is almost triple that of our industry.



04

Financial Highlights

millions of dollars, except per share data	2004	2003	% Change
Net sales	$3,525.3	$3,069.2	14.9%
Net earnings	218.3	174.9	24.8%
Net earnings per share — diluted	3.86	3.20	20.6%
Average number of shares outstanding — diluted (millions)	56.5	54.6	
Capital spending	204.9	172.0	19.1%
Research and development	123.1	118.2	4.1%
Cash and cash equivalents	229.7	113.1	103.1%
Debt	584.5	655.5	(10.8)%
Stockholders' equity	1,534.2	1,260.4	21.7%
Total stockholder return	29.5%	70.7%	

"Our technology, our customer diversity, our financial discipline and our staunch commitment to Product Leadership in every aspect of our business have built a foundation that continues to prove strong enough to support our ambitious growth plan. BorgWarner's record performance in 2004 affirms my view that there is no other automotive supplier better positioned for continued global growth."

FROM LEFT TO RIGHT:

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

Cynthia A. Niekamp
Vice President, President and General Manager TorqTransfer Systems

Robin J. Adams
Executive Vice President, Chief Financial Officer and Chief Administrative Officer

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

Timothy M. Manganello
Chairman and Chief Executive Officer

Mark A. Perlick
Vice President, President and General Manager Transmission Systems

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

BorgWarner's performance during 2004 distinguishes us from other auto systems suppliers as we continue to lay the groundwork for our global growth.

In an industry with little growth, our sales were up 15% to a record $3.5 billion. Earnings hit another record high. A stock split in May signaled our continued confidence in the future of the company. We increased our dividend for the third time in the past three years. By year-end, BorgWarner stock had chalked up 29 52-week highs.

Focused Growth

We have strengthened our Engine and Drivetrain focus with the creation of technology leadership positions in each group, the continued development of new products and the acquisition of a majority stake in Beru AG on January 4, 2005.

BORGWARNER PRODUCT LEADER

The Beru acquisition is expected to be accretive in 2005 and enhance our diesel and controls technology, as well as expand our customer base and geographic presence – all reasons we have previously cited for making acquisitions.

New business amounting to $1.4 billion is expected to come on stream over the next three years. About 66% is expected to be engine-related products such as turbochargers, engine timing systems, variable cam timing modules and emissions/thermal products. The other 34% is expected to be in transmission modules and all-wheel drive systems.

As a global business, we serve customers throughout the world. In addition to supporting the domestic automakers in North America, we have significantly diversified our customer base. Because of tremendous growth with customers like Honda, Hyundai/Kia and VW/Audi, our sales are well balanced. This strategic focus proves beneficial as market shares among the global automakers shift in favor of our faster growing customers.

We further enhanced our strong and talented management team with key appointments from within the company and by attracting exceptional outside talent. To help manage the complexities of our more global business, we strengthened the role of the CFO to include administration and created a new position for global supply chain management and emerging markets.

Our Board of Directors is actively engaged in guiding our business. I want to thank Bill Butler for his leadership and wise counsel as a board member since 1997. Bill retires from the board in April 2005. I also want to welcome David Brown, CEO of Owens Corning, as the newest member of the board. We look forward to his contributions.

Implementing Initiatives

Since becoming chief operating officer in 2002, and now as CEO, I have challenged our people to broaden the competitive gap between us and other suppliers in three key areas. These are quality and cost improvement, the use of electronic controls strategies, and harnessing the power of collaboration and teamwork – all with a focus on our vision of Product Leadership. I am proud of our achievements in each area. We are demonstrating that Product Leadership is everyone's job, and each employee has a role to play in the success of the company.

"Our strategic focus proves beneficial as market shares among the global automakers shift in favor of our faster growing customers."

GLOBAL

Our collaboration has led to better, more cost-efficient product launches, a successful move of our corporate headquarters to Auburn Hills, Michigan, an effective acquisition process and unprecedented quality and workplace safety results. In addition, we are leveraging our infrastructure within the Engine and Drivetrain groups on two Korean campuses and a single manufacturing campus in China.

Over the past few years, we have been building a robust and disciplined cost reduction process. This process touches all aspects of our business and was the reason we could manage through a situation as daunting as steep increases in steel and other raw materials costs in 2004. We operate in a very cost-competitive environment and must continually adjust our cost structure to the realities of our marketplace.

We have made progress in harnessing our expertise in mechanical functioning of engines and torque management through software controls strategies. This expertise is a major differentiator between BorgWarner and our competitors for most of our product lines. Computer control is the "brainpower" of the powertrain, and is the critical element of powertrains of the future. BorgWarner knows more about powertrains than any other supplier, but we need to make sure we are leveraging that expertise where it counts. Our acquisition of Beru shares will help us advance in this area.

Structuring for Future Growth

We are also focused on structuring ourselves for global growth. There is a difference between operating in multiple countries and being a truly global company. We realize that we must operate differently than we have in the past. Good examples are our expansions in China and Korea. At our new engine and drivetrain campuses in Korea, and in China, at our recently opened office in Shanghai and expanding Ningbo manufacturing compound, we are sharing space and support services. In the past, we would have established individual operations by product line.

Our new business model is reaching beyond emerging market opportunities to the rest of our business. We want to preserve the best of our entrepreneurial heritage while taking advantage of the benefits of common systems and processes, including information technology and supply chain management.

This report looks at those qualities that bring us together as BorgWarner people and that differentiate us from others in the industry: our continuing ability to supply innovative technology; our diversity – both in terms of our customer base and our geographic presence; our manufacturing excellence; and our financial discipline.

The auto industry expects to face another challenging year in 2005, with uncertainty about production, high commodity prices and shifting market shares among our customers. At BorgWarner, we will continue to manage through these issues with a focus on delivering the results our stockholders have come to expect.

"I have challenged our people to broaden the competitive gap between us and other suppliers in three key areas. These are quality and cost improvement, the use of electronic controls strategies, and harnessing the power of collaboration and teamwork – all with a focus on our vision of Product Leadership."

Timothy M. Manganello
Chairman and CEO

VISION & BELIEFS

BorgWarner Vision

BorgWarner is the recognized world leader in advanced products and technologies that satisfy customer needs in powertrain components and systems solutions.

BorgWarner Beliefs

- **Respect for Each Other**
- **The Power of Collaboration**
- **Passion for Excellence**
- **Personal Integrity**
- **Responsibility to Our Communities**

business profile

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 systems, boosting systems, air and noise management, cooling and controls is the foundation for this collaboration.

2004 Highlights

Strong demand boosted Engine Group sales 19% with an 18% increase in earnings before interest and taxes. The group continues to benefit from European and Asian automaker demand for turbochargers, timing systems and emission products, and from stronger commercial vehicle production in both Europe and North America. During the year, the group expanded its presence in Korea to manufacture engine timing systems for Hyundai's high-volume gasoline engines and formed a joint venture for the manufacture and sale of turbochargers. New business awards from Asian and European automakers expanded the group's customer base. The acquisition of a major stake in Beru in January 2005 further enhances the group.

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 and growth of "smart systems"
- 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 and reduce fuel consumption.

Beru Technologies World's leading supplier of diesel cold-start technology and a leading European supplier of ignition technology for gasoline vehicles. Electronics and sensing technology is focused on creating intelligent sensor products for various engine and vehicle functions.

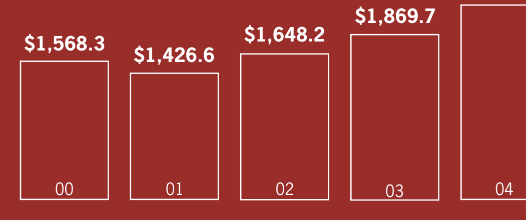
Production Plants and Technical Centers

Americas
Asheville, North Carolina ✦ ✳
Auburn Hills, Michigan ✳
Cadillac, Michigan ✦
Campinas, Brazil ✦
Civac-Jiutepec, Mexico ✦ ○
Cortland, New York ✦
Dixon, Illinois ✦
Fletcher, North Carolina ✦
Guadalajara, Mexico ✦
Ithaca, New York ✦
Marshall, Michigan ✳
Sallisaw, Oklahoma ✦
Simcoe, Ontario, Canada ✦
Water Valley, Mississippi ✦

Asia
Aoyama, Japan ✦
Changwon, South Korea ✦
Chennai, India ✦
Chennai, India (JV) ✦
Chungju-City, South Korea (JV) ✦ ○
Hitachinaka City, Japan (JV) ✦
Kakkalur, India (JV) ✦
Nabari City, Japan ✦ ✳
Ningbo, China (JV) ✦
Pune, India (JV) ✦ ○
Pyongtaek, South Korea ✦
Shihung-City, South Korea ✦ ○
Tainan Shien, Taiwan ✦

Europe
Arcore, Italy ✦ ✳
Biassono, Italy ✦ ○
Bretten, Germany ✦ ○
Bradford, England ✦
Chazelles, France ✦ ○
Diss, England ✦ ○
Kandel, Germany (JV) ✦ ○
Kirchheimbolanden, Germany ✦ ✳
La Ferté-Macé, France ✦ ○
Ludwigsburg, Germany ✦ ✳ ○
Markdorf, Germany ✦ ✳
Muggendorf, Germany ✦ ○
Neuhaus, Germany ✦ ○
Oroszlany, Hungary ✦
Rijswijk, Netherlands (JV) ✦ ○
Tiszakécske, Hungary ✦ ○
Tralee, Ireland ✦ ○
Vitoria, Spain ✦ ○

✦ PRODUCTION PLANTS
✳ TECHNICAL CENTERS
○ BERU LOCATIONS



Diesel Engine Timing

Our chain timing systems prolong engine life, increase fuel efficiency and reduce emissions in today's demanding new diesel applications.

Variable Cam Timing

Our patented variable cam timing system uses camshaft oscillation to achieve twice the emissions reduction and three times the fuel efficiency improvement in the federal EPA cycle than competitive technologies.

Secondary Air Pump

BorgWarner's air pump technology reduces hydrocarbon emissions by as much as 41%. Our air pumps are available in a full range of flow capabilities, are compact in size, and can be engine or vehicle mounted.

Air Flow Systems

Visctronic thermal management technology for engine cooling is a patented, revolutionary system which utilizes precision electronic controls to improve engine cooling and fuel economy in light, medium, heavy-duty and off-highway vehicles.

Beru Tire Pressure Monitoring Systems

Direct tire pressure monitoring systems measure temperature and pressure inside the tire and transmit the data to the driver. Legislation is mandating their use in North America for enhanced vehicle stability.

Gasoline Turbochargers

BorgWarner's boosting systems for gasoline engines, including new direct injected systems, provide power, pickup and real driver enjoyment with fuel economy improvement up to 15%.

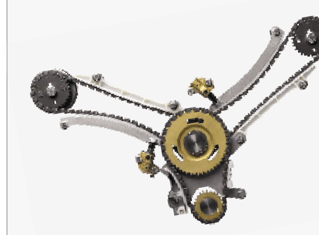
Exhaust Gas Recirculation

BorgWarner provides exhaust gas recirculation technology to support the most stringent emissions reductions. Our EGR valve offers a wide range of integration and high temperature solutions.

Diesel Turbochargers

Our boosting systems for diesel engines are key enabling technologies for modern, high-performing clean diesel engines. Advances include new variable geometry turbine designs and regulated two-stage devices.

Gasoline Engine Timing



We bring increased power and durability, noise reduction and more compact packaging to the growing market for both single and double overhead cam timing in gasoline engines.

Beru Diesel Cold-Start Technology

Glow plugs are a standard feature in modern passenger car diesels. With the Beru Instant Start System (ISS), diesel engines start more quickly and safely than ever before thanks to optimized glow plugs and an electronic controller which individually regulates each plug.

b u s i n e s s   p r o f i l e

drivetrain group

The Drivetrain Group harnesses our 100-year legacy as an industry innovator in transmission and four-wheel drive technology. The group is leveraging this understanding of powertrain clutching technology to develop interactive control systems and strategies for all types of torque management.

2004 Highlights

Sales were up 9% and earnings before interest and taxes improved 9% driven by demand for transmission and all-wheel drive systems, especially among Asian and European automakers. Productivity efforts helped to offset the impact of higher commodity pricing. Important new all-wheel drive business for both rear-wheel and front-wheel drive systems was won with two automakers in North America. In Europe, fuel-efficient DualTronic transmission technology was made available on five additional Volkswagen/Audi vehicles.

Growth Drivers and Opportunities

- Introduction of new automated (dual clutch) transmission systems for Europe and Asia
- Introduction of new generation five-, six- and seven-speed automatic transmissions
- Evolution from component to modular sourcing
- Increased consumer demand for automatic transmissions – Europe, Korea, China
- Subsystems for continuously variable transmissions (CVT)
- Substitution of modular wet starting clutches for torque converters
- Growing popularity of all-wheel drive passenger cars and crossover vehicles
- Application of electronically controlled torque management devices in all-wheel drive vehicles
- Expanded customer base in rear-wheel drive based all-wheel drive segment
- Increased global penetration of all-wheel drive
- Growing focus on improved shiftability within manual transmissions
- Emerging market for new generation Pre-emptive Torque Management (PTM)

Key Technologies

Transmission Products "Shift quality" components and systems including one-way clutches, transmission bands, friction plates and clutch pack assemblies; controls including transmission solenoids, control modules and integrated mechatronic control systems. BorgWarner is a trusted supplier to virtually every automatic transmission manufacturer in the world.

Torque Management Leading global designer and producer of torque distribution and management systems including rear-wheel four-wheel drive transfer cases, front-wheel all-wheel drive InterActive Torque Management (ITM) devices, electronic control units (ECU) and synchronizer systems. These systems enhance vehicle stability, drivability, shift quality and handling.

Production Plants and Technical Centers

Americas
Auburn Hills, Michigan ✳
Bellwood, Illinois ✦
Frankfort, Illinois ✦
Livonia, Michigan ✦
Addison, Illinois ✦
Longview, Texas ✦
Muncie, Indiana ✦
Seneca, South Carolina ✦

Asia
Beijing, China (JV) ✦
Eumsung, South Korea ✦
Eumsung, South Korea (JV) ✦
Fukuroi City, Japan (JV) ✦ ✳
Pune, India (JV) ✦
Sirsi, India (JV) ✦

Europe
Arnstadt, Germany ✦
Heidelberg, Germany ✦
Ketsch, Germany ✦ ✳
Margam, Wales ✦
Tulle, France ✦

✦ PRODUCTION PLANTS
✳ TECHNICAL CENTERS

SALES
millions of dollars

Year	Sales
00	$980.0
01	$937.2
02	$1,122.1
03	$1,245.6
04	$1,358.6

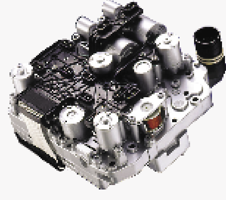
Clutch Products

Our broad line of clutch products assures smooth and efficient shifting, especially when combined with our friction elements. New clutch designs are especially critical in today's compact, six-speed automatic transmissions.

DualTronic Clutch Module

The system enables practical and efficient launch and shifting solutions for hybrid powertrains, new six-speed planetary transmissions, dual clutch transmissions and continuously variable transmissions.

Controls Modules



Advanced electrohydraulic control modules, transmission solenoids and mechatronic control systems help improve fuel economy and emissions and provide responsive, fun-to-drive vehicle performance.

Transfer Case

BorgWarner transfer cases reflect the trend toward smarter, more sophisticated algorithms and controls. Increasingly, automakers are leveraging 4x4 systems to augment vehicle handling and stability programs.

Synchronizers

Our synchronizers meet the demanding requirements of the modern transmission, whether manual, automated or dual clutch. These compact, high-performance systems generate much higher torque levels than conventional synchronizers.

Pre-emptive Torque Management

Our patented Pre-emptive Torque Management technology for premium all-wheel drive applications enhances vehicle traction, handling and stability, and provides high-torque accuracy using advanced, BorgWarner-developed controls.

InterActive Torque Management

Patented ITM technology electronically senses when a vehicle's front wheels slip, and transfers power to the rear wheels for better handling, stability and flexibility than that provided by passive, mechanical all-wheel drive systems.

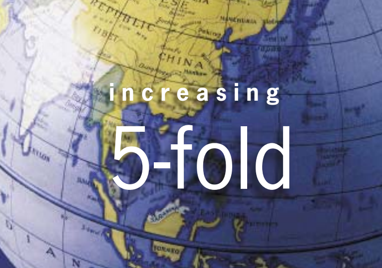
Friction Products

Added automatic transmission speeds, the shift from components to subsystems and clutch packs for all-wheel drive systems create demand for friction products. We supply "shift quality" components and systems to every automatic transmission maker.

PRODUCT LEADERSHIP You can see it in the eyes of our people. You can feel it in the air at each of our locations. You can even hear it. It's the sound that comes from hitting on all cylinders. That magic moment when all the pieces fall into place, the stars align and the spark of automotive *engine-uity* ignites. At BorgWarner, it's the result of a century of delivering innovation. It comes from every employee not only understanding that rich history, but embracing it. It motivates us to do a great job – and then do it even better the next time. On the following pages you will read of just a few examples of BorgWarner individuals who are pushing the envelope, walking the walk and making a real difference. To each of them, Product Leadership isn't a slogan, **IT'S A CALL TO ACTION.**

Freeman Shen

Country Manager
BorgWarner
Shanghai, China



Our sales in China, India and Korea are expected to increase about five-fold over the next five years from a small base today. As they build roads and cars for new drivers, these countries will be the fastest growing in the auto industry. As a global powertrain product leader, we are well positioned to take full advantage of this growth and that in other emerging markets.

"Our technology and reputation give us exciting opportunities in China."

Asian markets like China, India and Korea are the new growth frontiers for BorgWarner. We have been in China since 1993, India since 1995 and Korea since the late 1980s. While each country is unique, they share common needs. Our customers desire local engineering and manufacturing as they embrace new technologies for reduced emissions, fuel efficiency and driving comfort. Their goal is to meet European engine emissions requirements for both local and export markets and to produce transmissions that will please the most demanding customers anywhere in the world.

Local leaders like Freeman Shen, along with multi-national teams, are changing the way BorgWarner thinks and works as it structures for global growth. With BorgWarner for five years, previously heading the Emissions/Thermal operations in China, Freeman believes that our technology not only sets us apart, it allows us to attract good people needed to drive our growth.

In Korea, we are doing business from engine and drivetrain campuses. A common BorgWarner manufacturing campus in China is under construction and our Shanghai office opened in December 2004. We are starting small and proceeding cautiously. Synergies from sharing services as we enter or build our presence in emerging markets offer other opportunities for collaboration and cost savings. As we build our business in these areas, we are also developing local suppliers that can serve us around the world. Assuring quality is a top priority.

VCT Cam Phaser with Variable Force Solenoid

InterActive Torque Management 1

Turbocharger BV50

"We sustain our culture by integrating our vision into our daily work lives."

How does a lean, decentralized company like BorgWarner spur growth and make the most of its people and resources around the world? Through synergies, each business unit retains the best of its entrepreneurial spirit while sharing the benefits of common services like human resources, information technology, supply chain management and finance. Through collaboration, we want to create a BorgWarner that is more than just the sum of its parts.

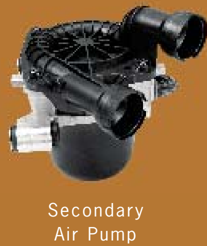
Support services people like Michelle Hartman are in the front lines of this effort.

One of a three-person team, she strives to provide her employee customers with more than they expect. Product leadership and its focus on safety and quality are not just slogans. People like Michelle integrate them into the fabric of daily life and decision making at BorgWarner, changing and shaping our culture to allow us to grow.

Every company has products and people, but it is the unique combination of these – the chemistry and the culture – that make one different from the other. Whether it's innovative approaches to sharing services or creating new ways to do business, people like Michelle help nurture the talent we need to succeed.

InterActive Torque Management 2

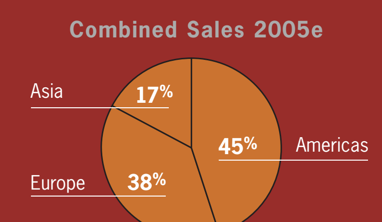
Binary Oil Pump



Secondary Air Pump

Collaboration and synergy are key focuses as we continue to grow faster than the auto industry by capitalizing on powertrain growth trends around the world. Our acquisition of the majority stake in Beru further expands our global breadth, especially in Europe. Beru expertise will also add depth to our Engine Group strategy for air management and improved combustion.

Combined Sales 2005e



Michelle Hartman

Human Resources Generalist
BorgWarner TorqTransfer Systems
Seneca, South Carolina, USA

Kunihiko Mishima

Engineering Supervisor
Morse TEC
Nagoya, Japan

Our understanding of powertrain function sets us apart from our competitors. Our expertise is showcased in intelligent all-wheel drive systems like those used by Hyundai, in our new transmission technology being rolled out by Volkswagen/Audi, and in variable cam timing that will be introduced by General Motors in 2006 models.

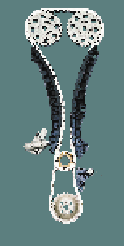
"Local support for automakers builds our global customer base."

In the past five years BorgWarner has won new business that gives it one of the broadest customer bases in the industry. This transition reflects years of work behind the scenes, building relationships and demonstrating and proving our technology to customers like Honda, Hyundai and VW/Audi. Kunihiko Mishima and his fellow engineers have been in the forefront of this endeavor, designing customized chain products for the needs of Japanese automakers as they develop more efficient engines that benefit from the durability of chain timing systems.

With global customers come global programs, like the family of four-cylinder gasoline engines produced by the Global Engine Alliance, a joint venture between Hyundai, DaimlerChrysler and Mitsubishi; or VW/Audi's gasoline 4-cylinder world engine to be built in China. Consistent quality and manufacturing of our engine products, coordinated with facilities in North America, Europe and Asia, are keys to earning this business. According to Kunihiko, it requires around-the-clock communications and sharing of technology and experience.

BorgWarner benefits from being a "local" company for our customers, wherever they may be. In Japan, our chain products business and our major joint venture for transmission products have operated in that country since the mid-1960s. We have been in Germany for over 50 years. This local presence, along with leading technology, continues to allow us to balance our sales growth with the shifting market shares of our customers.

Transmission Control Module



Engine Timing System

Air Flow System

"Technology must create value for our customers."

When it comes to industry leading products such as turbochargers, engineers like Uwe Muenkel know that technology alone is not enough. Product leadership means solving commercial problems, providing improved benefits and creating value for customers all at the same time. Whether they are developing new products like our regulated two-stage turbocharger for BMW or creating new applications from existing products, our engineers must blend innovation and speed to market with process and cost discipline.

This is an exciting time for Uwe and his colleagues. The pace of change in and around the powertrain is driving BorgWarner growth. We add value as a partner in the development of new engines and drivetrains for efficient power generation and torque management. The result is increased content for us, and better fuel economy and reduced emissions for our vehicle maker customers.

Uwe's ten years in the fast-growing turbocharger business have taught him that it takes more than technology to manage and drive growth. He and his colleagues face the challenge of developing the innovators of tomorrow while dealing with the relentless demands of customers. Within BorgWarner technical facilities around the world, seasoned engineers work to nurture those with less experience, allowing ideas to flourish. Our goal: to continuously reinvent ourselves.

Beru Instant Start System

Diesel Exhaust Gas Recirculation

Regulated Two-Stage Turbocharger

In the next ten years, worldwide diesel engine penetration is expected to grow 82%, from 11 million units to 19 million units. Europe will likely remain the largest diesel market with 31% growth, while diesel engines in Asia are expected to more than double. BorgWarner is expected to benefit from this growth through products like turbochargers, diesel exhaust gas recirculation valves and diesel cold start and ignition technologies from Beru.

Uwe Muenkel

Director of Passenger Car Research & Development

BorgWarner Turbo Systems
Kirchheimbolanden, Germany

Regina Dunagan

Team Leader
BorgWarner Transmission Systems
Bellwood, Illinois, USA

Like thousands of employees throughout BorgWarner's worldwide network of facilities, Regina Dunagan takes her job personally. Their commitment to continuous improvement translated into a 13% increase in sales per employee in 2004.

A team leader in a cell that makes clutch packs, Regina's top priority is assuring product quality. She knows that manufacturing is the backbone of the company's success and that product leadership means being the best at what we do. At the end of her day, she wants to know that she did her best, and that her fellow workers feel the same way.

In her 21 years with the company's transmission business, Regina has seen a lot of changes. The most dramatic is the move from manual assembly to the flexibility of today's automated processes. She works on products that move all over the world.

"My job is to deliver quality products. With me, it's personal."

Through training, new equipment and production optimization techniques, output of her plant has doubled over the past few years.

Manufacturing flexibility is key. In the competitive auto industry, productivity improvements need to outpace cost increases and low value-added manufacturing processes are outsourced. Our people know that better productivity helps secure the future of the company and that our compensation systems reward them for their success.

GOALS / BENCHMARKS

BorgWarner 2004 JAN FEB MAR

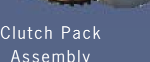
Safety

Cost Savings

Quality

%

A disciplined, robust process at BorgWarner tracks such critical metrics as cost, quality and safety. The process challenges each operation to account for, cover and neutralize all their costs, both on the positive and negative sides. This process addresses the need to offset increasing costs for commodities and employee welfare, and price pressures inherent in a competitive marketplace.



Clutch Pack Assembly

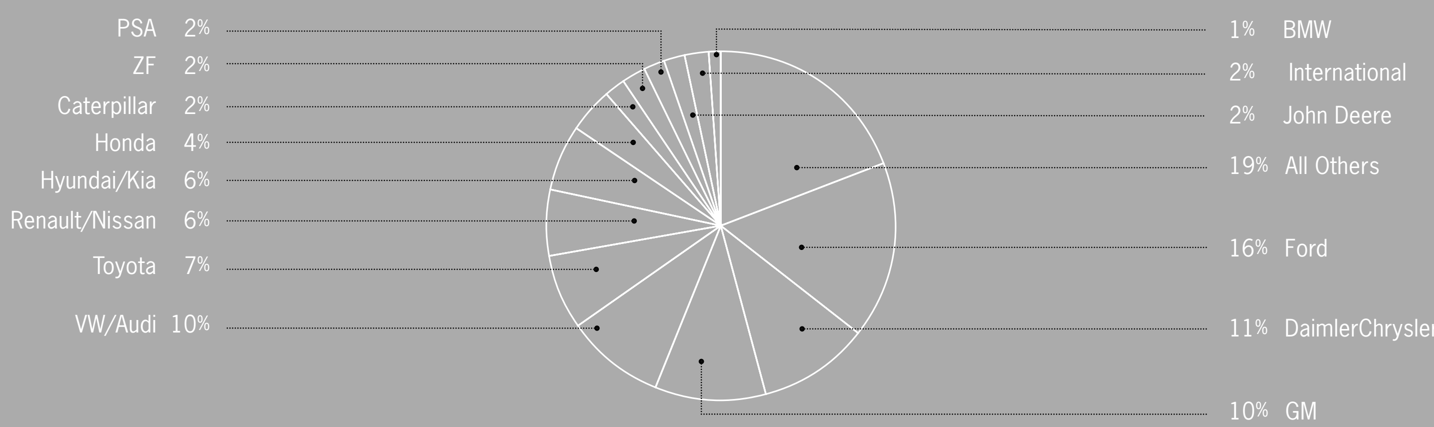
Gemini Chain System

4WD Transfer Case

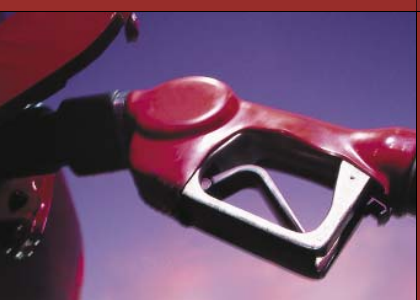
Drivetrain 2014

Demand for front-wheel all-wheel drive systems and six-speed automatic and dual clutch transmissions are expected to drive growth. The number of automated transmissions in Europe is expected to triple in ten years. Front-wheel all-wheel drive penetration could grow 34% in the next five years.

Customer Diversity
2005 Estimated Combined Sales*



* Includes Beru and NSK-Warner



Engine 2014

In the next ten years, gasoline engines are expected to experience 34% growth worldwide; diesel engine penetration is anticipated to grow 82%. The need for improved fuel economy and reduced emissions will drive growth.

INTRODUCTION

BorgWarner Inc. and Consolidated Subsidiaries (the Company) is a leading global supplier of highly engineered systems and components primarily for powertrain applications. Our products help improve vehicle performance, fuel efficiency, air quality and vehicle stability. They are manufactured and sold worldwide, primarily to original equipment manufacturers (OEMs) of light vehicles (i.e. passenger cars, sport-utility vehicles, vans and light-trucks). Our products are also manufactured and sold to OEMs of commercial trucks, buses and agricultural and off-highway vehicles. 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.

The Company's products fall into two reportable operating segments: Drivetrain and Engine. The Drivetrain segment is comprised of all-wheel drive transfer cases, torque management systems and components and systems for automatic transmissions. The Engine Segment is comprised of turbochargers, timing chain systems, air management, emissions and thermal systems.

Stock Split

On April 21, 2004 the Company's stockholders approved an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares of common stock from 50,000,000 to 150,000,000. The approval of the amendment allowed the Company to proceed with its two-for-one stock split on May 17, 2004 to stockholders of record on May 3, 2004. All prior year share and per share amounts disclosed in this document have been restated to reflect the two-for-one stock split.

Beru Transaction

On January 4, 2005, the Company acquired 62.2% of the outstanding shares of Beru Aktiengesellschaft (Beru), headquartered in Ludwigsburg, Germany, from the Carlyle Group and certain family shareholders. In conjunction with the acquisition, the Company launched a tender offer for the remaining outstanding shares of Beru. The tender offer period officially ended on January 24, 2005. Presently the Company holds 69.42% of the shares of Beru at a cost of approximately €415 million. Beru is a leading global automotive supplier of diesel cold starting technology (glow plugs and instant starting systems); gasoline ignition technology (spark plugs and ignition coils); and electronic and sensor technology (tire pressure sensors, diesel cabin heaters and selected sensors). Beginning in 2005, the Company will report the operating results of Beru within the Engine segment. The Company has not included a separate discussion of the Beru operations in the outlook for 2005, although many of the same factors that impact the Company's other operations can be expected to impact the business of Beru. In addition, the impact of Beru on the Company's future results will be affected by the allocation of the excess purchase price over the net book value of assets acquired between intangible assets and goodwill.

Overview

A summary of our operating results by segment for the years ended December 31, 2004, 2003 and 2002 is as follows:

millions of dollars, except per share data Year ended December 31,	**2004**	2003	2002
Drivetrain	**$106.9**	$98.4	$99.9
Engine	**281.7**	239.6	215.9
Segment earnings before interest and taxes	**388.6**	338.0	315.8
Corporate	**(50.3)**	(48.0)	(44.3)
Consolidated earnings before interest and taxes	**338.3**	290.0	271.5
Interest expense and finance charges	**29.7**	33.3	37.7
Earnings before income taxes	**308.6**	256.7	233.8
Provision for income taxes	**81.2**	73.2	77.2
Minority interest, net of tax	**9.1**	8.6	6.7
Net earnings before cumulative effect of accounting change	**218.3**	174.9	149.9
Cumulative effect of change in accounting principle, net of tax	**—**	—	(269.0)
Net earnings/(loss)	**$218.3**	$174.9	$(119.1)
Per share data – assuming dilution:			
Earnings per share before cumulative effect of accounting change	**$3.86**	$3.20	$2.79
Cumulative effect of accounting change	**—**	—	(5.01)
Earnings/(loss) per share	**$3.86**	$3.20	$(2.22)

A summary of major factors impacting the Company's net earnings for the years ended December 31, 2004 in comparison to 2003 and 2002 is as follows:

- Continued demand for our products in both Drivetrain and Engine segments.
- Continued results of our cost reduction programs, including containment of selling, general & administrative expenses, which helped to offset our commodity cost increases and start up costs incurred for our expansion in Korea and China.
- Lower interest expenses due to lower debt levels.
- Favorable currency impact of $11.0 million in 2004 and $14.5 million in 2003.

RESULTS OF OPERATIONS

Net Sales

The table below summarizes the overall worldwide global light vehicle production percentage changes for 2004 and 2003:

WORLDWIDE LIGHT VEHICLE YEAR OVER YEAR CHANGE IN PRODUCTION*

	2004	2003
North America	**(0.7)%**	(3.0)%
Europe	**5.0%**	1.4%
Japan and Korea	**3.9%**	(0.7)%
Total World-wide	**5.2%**	(1.6)%

*Data provided by CSM Worldwide.

BorgWarner Year Over Year Net Sales Change	**14.9%**	12.4%

Our net sales increase in 2004 and 2003 was strong compared to the estimated worldwide market production increase of approximately 5.2% in 2004 and decrease of (1.6)% in 2003. The Company's net sales increased 14.9% from 2003 and increased 12.4% from 2002 to 2003. The increase in 2004 was driven by both of our operating segments from higher demand for turbochargers, especially in Europe; new DualTronic™ transmissions; all-wheel drive systems; and timing chain systems in Asia and Europe. The effect of changing currency rates also had a positive impact on net sales and net earnings in 2004. The effect of non-U.S. currencies, primarily the Euro, U.K. Pound, Japanese Yen and Korean Won, added $114.0 million to net sales in 2004 and $161.9 million in 2003. The year over year increase in net sales excluding the favorable impact of currency was 11.1% in 2004 and 6.5% in 2003.

Consolidated net sales included sales to Ford Motor Company of approximately 21%, 23%, and 26%; to DaimlerChrysler of approximately 14%, 17%, and 20%; and to General Motors Corporation of approximately 10%, 12%, and 12% for the years ended December 31, 2004, 2003 and 2002, respectively. Sales to Volkswagen were approximately 10% in 2004. Both of our operating segments had significant sales to all four of the customers listed above. Such sales consisted of a variety of products to a variety of customer locations and regions. No other single customer accounted for more than 10% of consolidated sales in any year of the periods presented.

Over the past several years as our major customers have continued to consolidate, we have increased our sales to several other global OEMs, bringing us more in line with our customers' share of the global vehicle market. As a result, sales to Ford, DaimlerChrysler and General Motors have become a smaller percentage of total sales.

Our overall outlook for 2005 is positive. Sales are expected to grow in excess of a projected flat to slightly positive global production rate and we expect to benefit from the continuation of several trends: change in Europe to diesel engines, which utilize turbochargers and certain Beru products; shift in Europe to automatic transmissions; and the switch from timing belts to timing chains in Asia and Europe. Each of these trends is positive for the Company. Assuming no major changes to the above assumptions, the Company expects continued long-term sales and net earnings growth.

Results By Operating Segment

The following tables present net sales and earnings before interest and income taxes (EBIT) by segment for the years 2004, 2003 and 2002.

NET SALES

millions of dollars Year ended December 31,	2004	2003	2002
Drivetrain	**$1,358.6**	$1,245.6	$1,122.1
Engine	**2,217.0**	1,869.7	1,648.2
Inter-segment eliminations	**(50.3)**	(46.1)	(39.2)
Net sales	**$3,525.3**	$3,069.2	$2,731.1

EARNINGS BEFORE INTEREST AND TAXES (EBIT)

millions of dollars Year ended December 31,	2004	2003	2002
Drivetrain	**$106.9**	$ 98.4	$ 99.9
Engine	**281.7**	239.6	215.9
Segment earnings before interest and taxes	**388.6**	338.0	315.8
Corporate	**(50.3)**	(48.0)	(44.3)
Consolidated earnings before interest and taxes	**$338.3**	$290.0	$271.5
Interest expense and finance charges	**29.7**	33.3	37.7
Earnings before income taxes	**$308.6**	$256.7	$233.8

The **Drivetrain** segment net sales increased 9.1% from 2003 to 2004; EBIT increased 8.6% for the same period. The sales increase was the result of strong global demand for transmission components and all-wheel drive systems. The Company's new DualTronic™ transmission product continues to ramp-up volume in Europe. The increase in EBIT was due to increased volume and continued focus on cost reductions in our operations. These positive trends were offset by commodity price increases of approximately $20 million, which is primarily steel, and start up costs.

The Drivetrain segment net sales increased 11.0% from 2002 to 2003, but EBIT declined 1.5% for the same period. The sales gains were due to all-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 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.

In 2005, growth in the Drivetrain segment is expected to be flat as demand for traditional light-trucks will be about the same as in 2004. Sport-utility vehicles are expected to decline, while sales of front-wheel-drive based all-wheel-drive systems are expected to increase. Transmission products will benefit from increased penetration of automatic transmissions in Europe and Asia, and the continued ramp-up of DualTronic™ transmission modules in Europe.

The **Engine** segment 2004 net sales increased 18.6% over 2003 and EBIT increased 17.6% over the same period. This segment benefited from strong demand for the Company's turbochargers for European passenger cars and commercial vehicles. The segment EBIT was impacted by increased volume, productivity and positive currency impact, which offset commodity price increases of approximately $20 million and start up costs in Korea and China.

The Engine segment 2003 net sales 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 as well as continued growth of our timing chain and emissions products. 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.

For 2005, the Engine Group expects to deliver continued growth from further penetration of diesel engines in Europe, which will continue to boost demand for turbochargers and Beru technologies, and the launch of our first high-volume variable cam timing (VCT) system. Investments in Korea and China are expected to begin to contribute to results. This growth is expected to help offset anticipated weakness in North American light vehicle production.

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 includes equity in affiliate earnings. This net expense was $50.3 million in 2004, $48.0 million in 2003, and $44.3 million in 2002. The main reasons for the increase from 2003 to 2004 was an increase in our environmental spending related to the Crystal Springs, Mississippi site and the $3.7 million write down of a note relating to the sale of Kuhlman Electric Corporation, which were mostly offset by stronger equity earnings from NSK-Warner. The increase from 2002 to 2003 was due to higher pension and post retirement health care costs for discontinued operations, which are recorded at the corporate level.

Other Factors Affecting Results of Operations

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

Year Ended December 31,	2004	2003	2002
Net sales	**100.0%**	100.0%	100.0%
Cost of sales	**81.5**	80.9	79.7
Gross profit	**18.5**	19.1	20.3
Selling, general and administrative expenses	**9.6**	10.3	11.1
Other, net	**0.1**	—	—
Operating income	**8.8**	8.8	9.2
Equity in affiliate earnings, net of tax	**-0.8**	-0.7	-0.7
Interest expense and finance charges	**0.8**	1.1	1.4
Earnings before income taxes	**8.8**	8.4	8.5
Provision for income taxes	**2.3**	2.4	2.8
Minority interest, net of tax	**0.3**	0.3	0.2
Net earnings before cumulative effect of accounting change	**6.2%**	5.7%	5.5%

Gross Profit for 2004 was 18.5% down from 19.1% in 2003 and down from 20.3% in 2002. The decrease in gross profit in 2004 was due to several factors, including significant commodity price increases, including steel, a change in sales mix and geographic expansion. The geographic expansion includes new facilities in Europe and Asia for both operating segments. We anticipate 2005 margins to be impacted by the leveling off of commodity price increases, the continued shift from components to systems sales and continued results from our cost reduction initiatives.

Also impacting gross margins in 2004, 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 with a minimum royalty for shipments up to certain volume levels and a per unit royalty for any units sold above these stated amounts.

The royalty agreement costs recognized under the agreements were $14.2 million in 2004, $23.2 million in 2003 and $13.5 million in 2002. These costs were based on units shipped and were recorded in cost of goods sold. It is anticipated that these costs will be at minimal levels in 2005 and 2006 as the Company's primary customers have converted most of their requirements to the next generation VTG turbocharger.

Selling, general and administrative expenses (SG&A) as a percentage of net sales decreased to 9.6% from 10.3% in 2003 and 11.1% in 2002. While SG&A spending in dollars increased slightly, we were able to slow that growth to a level below the growth in sales through continued focus on 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 $123.1 million, or 3.5% of sales in 2004, compared to $118.2 million, or 3.9% of sales in 2003, and $109.1 million, or 4.0% of sales in 2002. We continue to increase our spending in R&D, although the growth rate has been somewhat lower than our sales growth rate. We also 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.

Other, net decreased to $(3.0) million of loss in 2004, from $0.1 million of income in 2003 and $0.9 million of income in 2002. The major item was losses from capital asset disposals of $3.5 million in 2004.

Equity in affiliates earnings, net of tax increased by $9.1 million from 2003, and by $0.6 million between 2003 and 2002. 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 $3.6 million in 2004 and decreased by $4.4 million between 2003 and 2002. The decreases in 2004 and 2003 were due to lower debt levels, as we used cash generated from operations to pay off debt. In 2004, our balance sheet debt decreased by $71.0 million. In 2003, our balance sheet debt decreased $2.7 million excluding the fair value adjustment for interest rate swaps, and we reduced the amount of securitized accounts receivable sold by $40.0 million. We took advantage of lower interest rates through the use of interest rate and cross-currency swap arrangements described more fully in Note 7 to the Consolidated Financial Statements.

The provision for income taxes resulted in an effective tax rate for 2004 of 26.3% compared with rates of 28.5% in 2003 and 33.0% for 2002. 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 by non-deductible expenses. In addition, the Company made an $11.4 million year-end adjustment to various tax accounts due to changes in circumstances related to various tax items, including changes in tax laws. The year-end adjustment resulted in a reduction in the U.S. effective tax rate for 2004. In 2005, we anticipate our tax rate to be approximately 30% to 31% based on our current mix of business.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities of $426.6 million was primarily used to fund $204.9 million of capital expenditures, $47.5 million of tooling, net of customer reimbursements, pay down long-term debt of $61.8 million, pay $27.9 million of dividends to our shareholders, and increase cash and cash equivalents by $116.6 million.

Operating Activities

Net cash provided by operating activities of $426.6 million is $119.7 million more than in 2003. The $426.6 million consists of net income of $218.3 million, increased for non-cash charges of $222.4 million and offset by a $17.3 million increase in net operating assets and liabilities. Non-cash charges are primarily comprised of $177.0 million in depreciation and amortization expense.

Accounts receivable increased a total of $84.2 million, of which $23.8 was due to currency. The remaining increase was due to higher business levels, particularly in Europe. Certain of our European customers tend to pay slower than our North American customers. Inventory increased by $22.1 million, but our inventory turns improved to 12.9 times from 12.3 times in 2003.

Investing Activities

Net cash used in investing activities totaled $257.2 million, compared with $228.2 million in the prior year. Capital spending totaling $204.9 million in 2004 was $32.9 million higher than in 2003. Approximately 60% of the 2004 capital spending was related to expansion, with the remainder for cost reduction and other purposes. Heading into 2005, 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 (AGK). The valuation payment resulted from the settlement in 2003 of a lawsuit brought by certain minority shareholders of AGK related to the automotive turbocharger business of AGK, which the Company purchased from AGK in 1998.

Since the settlement of the dispute, the Company extended a formal tender offer to purchase all of the outstanding common and preferred shares of AGK from the remaining shareholders. The Company spent $9.0 million in 2004 and $14.4 million in 2003 to purchase additional shares of AGK, an unconsolidated subsidiary of the Company, which has been recorded as an "Investment in business held for sale" in the Consolidated Balance Sheets. Effective February 17, 2005, the Company signed a Share Transfer Agreement (STA) with Turbo Group GmbH for the sale of its 95.42% interest in AGK. The STA will become effective no later than seven banking days after receipt of approval from both the German Federal Cartel Office and the Austrian Merger Control Authority. The transaction is anticipated to close before March 31, 2005. The estimated proceeds from the pending sale, net of closing costs are approximately €39.8 million.

Financing Activities and Liquidity

Stockholders' equity increased by $273.8 million in 2004. The increase was primarily caused by net income of $218.3 million, along with currency translation and hedge instruments adjustments of $28.4 million, stock option exercises of $14.4 million and stock issuances to retirement plans of $25.8 million. These factors were somewhat offset by dividend payments of $27.9 million. In relation to the U.S. Dollar, the currencies in foreign countries where we conduct business, particularly the Euro and Yen, strengthened, causing the currency translation component of other comprehensive income to increase in both 2004 and 2003.

Our total capitalization as of December 31, 2004 of $2,140.9 million is comprised of short-term debt of $16.5 million, long-term debt of $568.0 million, minority interest of $22.2 million and stockholders' equity of $1,534.2 million. Capitalization at December 31, 2003 was $1,934.2 million. During the year, we reduced our balance sheet debt to debt plus equity ratio to 27.3% from 34.2% in 2003.

The Company has a new revolving credit facility, which provides for borrowings up to $600 million through July 2009. The new facility effective July 22, 2004, replaced the Company's previous facility of $350 million. Additionally, we have $300 million available under a universal 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 a $50 million accounts receivable securitization facility, which is rolled over annually. From a credit quality perspective, we have an investment grade credit rating of A- from Standard & Poor's and Baa2 from Moody's.

The Company's significant contractual obligation payments at December 31, 2004, are as follows:

millions of dollars	Total	2005	2006-2007	2008-2009	After 2009
Other post retirement benefits excluding pensions[a]	$1,599.9	$ 30.8	$ 60.0	$ 61.5	$1,447.6
Notes payable and long-term debt	586.8	16.5	158.1	152.7	259.5
Projected minimum interest costs[b]	89.7	26.2	38.9	20.9	3.7
Non-cancelable operating leases	58.0	29.1	9.0	7.1	12.8
Minimum royalty payments[c]	1.5	1.5	—	—	—
Total	$2,335.9	$104.1	$266.0	$242.2	$1,723.6

(a) Other post retirement benefits (excluding pensions) include anticipated future payments to cover retiree medical and life insurance benefits. Since the timing and amount of payments for pension plans is not certain for future years, such payments have been excluded from this table. The Company expects to contribute a total of $20 million to $25 million into all pension plans during 2005. See Note 8 to the Consolidated Financial Statements for disclosures related to the Company's pension and other post retirement benefits.

(b) Projection is based upon an average debt portfolio interest rate of 5.00%. The calculation excludes the impact of the Beru transaction.

(c) The minimum royalty payments are related to the Honeywell royalty agreement discussed more fully in Note 12 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 cancellable 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 is subject to the usual terms and conditions applied by banks to an investment grade company. The Company was in compliance with all covenants at December 31, 2004.

We believe that the combination of cash from operations, cash balances, available credit facilities and the universal shelf registration will be sufficient to satisfy our cash needs for our current level of operations and our planned operations, including the acquisition of Beru, 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, 2004, the accounts receivable securitization facility was sized at $50 million and has been in place with its current funding partner since January 1994. This facility sells accounts receivable without recourse.

The Company has certain leases that are recorded as operating leases. Types of operating leases include leases on the headquarters facility, an airplane, vehicles, and certain office equipment. The Company also has a lease obligation for production equipment at one of it facilities. The total expected future cash outlays for all lease obligations at the end of 2004 is $58.0 million. See Note 12 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 production equipment. The guarantees extend through the maturity of the underlying lease, which is in 2005. In the event the Company exercises its option not to purchase the production equipment, the Company has guaranteed a residual value of $16.3 million. We do not believe we have any potential loss due to this guarantee.

Pension and Other Post Retirement Benefits

The Company's policy is to fund its defined benefit pension plans in accordance with applicable U.S., U.K., German and Japanese government regulations and to make additional contributions when management deems it appropriate. At December 31, 2004, all legal funding requirements had been met. The Company contributed $36.3 million to its pension plans in 2004 and $17.1 million in 2003. The Company expects to contribute a total of $20 million to $25 million in 2005.

The funded status of pension plans with accumulated benefit obligations in excess of plan assets improved from $(148.1) million at the end of 2003 to $(127.8) million at the end of 2004. The improvement was primarily due to positive returns on plan assets of $43.6 million and company contributions of $36.3 million, which were partially offset by interest costs of $28.8 million, service costs of $11.7 million and foreign currency translation of $9.7 million.

Other post retirement benefits primarily consist of post retirement health care benefits. The Company funds these benefits as retiree claims are incurred. Other post retirement benefits had an unfunded status of $(537.2) million at the end of 2004, and $(537.4) million at the end of 2003. The unfunded levels were relatively stable as increases in the liabilities related to a decline in the interest rate assumptions used to calculate the ending liabilities for each of the plans were offset by benefits of the new Medicare Part D plan enacted during 2004.

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

Contingencies

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

Environmental

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency and certain state environmental agencies and private parties as potentially responsible parties (PRPs) at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 39 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 and consulting costs; remediation alternatives; estimated legal fees; and other factors, we have established an accrual for indicated environmental liabilities with a balance at December 31, 2004 of approximately $25.7 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, the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities relating to the past operations of Kuhlman Electric. The liabilities at issue result from operations of Kuhlman Electric that pre-date the Company's acquisition of Kuhlman Electric's parent company, Kuhlman Corporation, in 1999. 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 numerous related lawsuits, in which multiple claimants allege personal injury and property damage. The Company has moved to be dismissed from some of these lawsuits. The first trial in these lawsuits is currently scheduled to begin in March 2005.

We believe that the accrual 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 accrued.

Product Liability

Like many other industrial companies who have historically operated in the United States, the Company (or parties the Company indemnifies) continues to be named as one of many defendants in asbestos-related personal injury actions. Management believes that the Company's involvement is limited because, in general, these claims relate to a few types of automotive friction products, manufactured many years ago that contained encapsulated asbestos. The nature of the fibers, the encapsulation and the manner of use lead the Company to believe that these products are highly unlikely to cause harm. At December 31, 2004, the Company had approximately 100,000 pending asbestos-related product liability claims. Of these outstanding claims, approximately 92,000 are pending in just three jurisdictions, where significant tort reform activities are underway. The Company's policy is to aggressively defend against these lawsuits and the Company has been successful in obtaining dismissal of many claims without any payment. The Company expects that the vast majority of the pending asbestos-related product liability claims where it is a defendant (or has an obligation to indemnify a defendant) will result in no payment being made by the Company or its insurers. In 2004 of the 4,062 claims settled, only 255 (6.3%) resulted in any payment being made to a claimant by or on behalf of the Company. In 2003 of the 4,664 claims settled, only 273 (5.9%) resulted in any payment being made to claimants. The settlement costs of these claims were paid by the insurance carriers, except for the $1.0 million in 2004 as described in the paragraph below. Based upon the encapsulated nature of the products, our experiences in aggressively defending and resolving claims in the past, and our significant insurance coverage with solvent carriers as of the date of this filing, management does not believe that asbestos-related product liability claims are likely to have a material adverse effect on the Company's results of operations, cash flows or financial condition.

Prior to June 2004, all claims were covered by the Company's primary layer insurance coverage, and these carriers administered, defended, settled and paid all claims under a funding agreement. In June 2004, the Company was notified by primary layer insurance

carriers of the exhaustion of their policy limits. This led the Company to access the next available layer of insurance coverage. Since June 2004, secondary layer insurers have paid asbestos-related litigation defense and settlement expenses pursuant to a funding agreement. Two secondary layer insurers are currently not participating in this arrangement until they are satisfied through an audit process, that the primary level of insurance is exhausted. The Company therefore paid $1.0 million in defense and settlement costs in late 2004 and expects to recover those amounts from either these insurers, or the primary layer insurers if the exhaustion audit shows that primary layer insurance is still available.

The Company's contractual relationship with the secondary layer carriers provides a change in circumstances and allows the Company to take a more direct role in defending and settling claims than with the primary carriers. Previously, the Company's arrangement utilized the primary layer insurance carriers' positions to defend and negotiate the settlements with periodic input from the Company.

At December 31, 2004, the Company recorded a liability of $40.8 million; with a related asset of $40.8 million to recognize the insurance proceeds receivable to the Company for estimated claim losses. For 2003, the comparable value of the insurance receivable and accrued liability was $41.6 million.

The amounts recorded in the Consolidated Balance Sheets are as follows:

millions of dollars	2004	2003
Assets:		
Prepayments and other current assets	**$13.5**	$13.7
Other non-current assets	**27.3**	27.9
Total insurance receivable	**$40.8**	$41.6
Liabilities:		
Accounts payable and accrued expenses	**$13.5**	$13.7
Long-term liabilities – other	**27.3**	27.9
Total accrued liability	**$40.8**	$41.6

The insurance receivable and accrued liability of $41.6 million in 2003 have been reclassified as outlined above and the reclassification is not material to the Company's Consolidated Financial Statements.

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

A declaratory judgment action was filed in January 2004 in the Circuit Court of Cook County, Illinois by Continental Casualty Company and related companies (CNA) against the Company and certain of its other historical general liability insurers. CNA provided the Company with both primary and additional layer insurance, and, in conjunction with other insurers, is currently defending and indemnifying the Company in all of its pending asbestos-related product liability claims. The lawsuit seeks to determine the extent of insurance coverage available to the Company including whether the available limits exhaust on a "per occurrence" or an "aggregate" basis, and to determine how the applicable coverage responsibilities should be apportioned. In addition to the primary insurance available for asbestos-related claims, the Company has substantial additional layers of insurance available for potential future asbestos-related product claims.

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

Critical Accounting Policies

The Consolidated Financial Statements are prepared in conformity with 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.

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. In the fourth quarter of 2002, the Company reduced the maximum size of the facility from $120 million to $90 million.

Impairment of Long-Lived Assets

The Company periodically reviews the carrying value of its long-lived assets, whether held for use or disposal, including other intangible assets, when events and circumstances warrant such a review. This review is performed using estimates of future cash flows. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value. Management believes that the estimates of future cash flows and fair value assumptions are reasonable; however, changes in assumptions underlying these estimates could affect the evaluations.

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. The goodwill impairment test was performed in November 2004, and no impairment was found. Amortization continues to be recorded for other intangible assets with definite lives.

Environmental Accrual

We work with outside experts to determine a range of potential liability for environmental sites. The ranges for each individual site are then aggregated into a loss range for the total accrued liability. Management's estimate of the loss range for 2004 is between $21.3 million and $69.9 million. We record an accrual at the most probable amount unless one cannot be determined; in which case we record the accrual at the low end of the range. At the end of 2004, our total accrued environmental liability was $25.7 million.

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 accrued liability.

Other Loss Accruals and Valuation Allowances

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

Pension and Other Post Retirement Benefits

The Company provides post retirement benefits to a substantial portion of its employees. Costs associated with post retirement benefits include pension and post retirement health care expenses for employees, retirees and surviving spouses and dependents. The Company's employee pension and post retirement heath 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, 2004, rounded up or down to the nearest 25 basis points. Based on this approach, at December 31, 2004, the Company lowered the discount rate for its U.S. pension and other benefit plans to 5.75% from 6.00% at December 31, 2003. For the U.K. plans, the discount rate assumption is based on the iBoxx AA rated bonds. At December 31, 2004, the discount rate used was 5.75%. 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 2004 and 2003, and 9.5% for 2002. The Company does not anticipate a change in the long-term rate of return on assets for pension benefits in 2005. For the U.K. 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 U.K. pension is 6.75% for 2004 and 2003, and 7.0% for 2002.

See Note 8 to the Consolidated Financial Statements for more information regarding costs and assumptions for employee retirement benefits.

Derivatives

The Company recognizes that certain normal business transactions generate risk. Example of risks include exposure to exchange 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 transactions 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 transactions for purposes other than hedging specific risks.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which was revised in December 2003. FIN No. 46R 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. 46R also provides the framework for determining whether a variable interest entity should be consolidated. For the Company, this Interpretation, as revised, was effective January 1, 2004. The Company has no variable interest entities required to be consolidated as a result of adopting FIN No. 46R.

In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (Medicare Act) introduced a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans. 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 106-1 permits a sponsor of a post retirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Act if there is insufficient data, time or guidance available to ensure appropriate accounting. The Company is a sponsor of post retirement health care plans that provide prescription benefits and, in accordance with the one-time election under FSP 106-1, elected to defer accounting for the Medicare Act. In May 2004, the FASB issued FSP 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," which supersedes FSP 106-1, to address the accounting and disclosure requirements related to the Medicare Act. This FSP was adopted by the Company beginning with its third quarter ended September 30, 2004. The effect of the adoption was to reduce the Company's 2004 post retirement benefits expense by $6.8 million.

In November 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs" which is an amendment of ARB No.43, Chapter 4. This statement provides clarification of accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. Generally, this statement requires that those items be recognized as current period charges. SFAS 151 will be effective for the Company on January 1, 2006. The Company is currently evaluating the impact that the adoption of SFAS 151 will have on its consolidated financial position, results of operations and cash flows.

In December 2004, the FASB issued FSP 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" (AJCA), and FSP 109-2 "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the AJCA." These two FSPs provide guidance on the application of the new provisions of the AJCA, which was signed into law on October 22, 2004.

The AJCA provides a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. In return, the AJCA provides for a two-year phase-out of the existing extra-territorial income exclusion (ETI) for foreign sales that was viewed to be inconsistent with international trade protocols by the European Union. Under the guidance in FSP 109-1, the deduction will be treated as a "special deduction" as described in SFAS 109. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the enactment date. Rather, the impact of this deduction will be reported in the period in which the deduction is claimed on our tax return. The Company expects the net effect of the phase out of the ETI and the phase in of this new deduction will not have a material impact on its effective tax rate.

FSP 109-2 provides guidance on the accounting for the deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. The Company may elect to apply this provision to qualifying earnings repatriations in 2005. Under the guidance set forth in FSP 109-2, the Company is allowed time beyond the financial reporting period of enactment to evaluate the effect of the AJCA on its plan for reinvestment or repatriation of foreign earnings. The Company has started an evaluation of the effects of the repatriation provision; however, the Company does not expect to be able to complete this evaluation until after the U.S. Congress or the Treasury Department provides additional clarifying language on key elements of the provision. The Company expects to complete its evaluation of the effects of the repatriation provision within a reasonable period of time following the publication of the additional clarifying language. The range of possible amounts that the Company is considering for repatriation under this provision is between zero and $74 million. The related range of income tax effects of such repatriation cannot be reasonably estimated until guidance is issued by Congress or the Treasury Department.

In December 2004, the FASB issued SFAS No. 123R, "Shared-Based Payment" which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Share-based payments include stock option grants and certain transactions under other Company stock plans. The Company grants options to

purchase common stock of the Company to some of its employees and directors under various plans at prices equal to the market value of the stock on the dates the options are granted. SFAS 123R will be effective for the Company beginning July 1, 2005. The Company is currently evaluating the impact that the adoption of SFAS 123R will have on its consolidated financial position, results of operations and cash flows.

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. The Company enters into derivative instruments only with high credit quality counterparties and diversifies its positions across such counterparties in order to reduce its exposure to credit losses. We do not engage in any derivative instruments for purposes other than hedging specific risks.

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

Interest Rate Risk

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. The Company manages its interest rate risk by balancing its exposure to fixed and variable rates while attempting to minimize its interest costs. The Company selectively uses interest rate swaps to reduce market value risk associated with changes in interest rates (fair value hedges). At the end of 2004, the amount of net debt with fixed interest rates was 62% of total debt, including the impact of the interest rate swaps. Our earnings exposure related to adverse movements in interest rates is primarily derived from outstanding floating rate debt instruments that are indexed to floating money market rates. A 10% increase or decrease in the average cost of our variable rate debt would result in a change in pre-tax interest expense for 2004 of approximately $1.3 million, and $1.0 million in 2003.

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, 2004, the net fair value of these instruments would increase by approximately $23.8 million if interest rates decreased and would decrease by approximately $21.9 million if interest rates increased. Our interest rate sensitivity analysis assumes a constant shift in interest rate yield curves. The model, therefore, does not reflect the potential impact of changes in the relationship between short-term and long-term interest rates. Interest rate sensitivity at December 31, 2003, measured in a similar manner, was slightly greater than at December 31, 2004.

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 Japanese Yen, the British Pound, the Hungarian Forint and the South Korean Won. 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 $324.6 million as of December 31, 2004 and $184.0 million as of December 31, 2003. 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 2004 and 2003.

Commodity Price Risk

Commodity price risk is the possibility that we will incur economic losses due to adverse changes in the cost of raw materials used in the production of our products. Commodity forward and option contracts are executed to offset our exposure to the potential change in prices mainly for various non-ferrous metals and natural gas consumption used in the manufacturing of automotive components. As of December 31, 2004, and 2003, we had contracts with a total notional value of $3.4 and $1.1 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, many of which are difficult to predict and generally beyond the control of the Company, which could cause actual results to differ materially from those 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, 2004. The Company does not undertake any obligation to update any forward-looking statement.

Management's Responsibility for Consolidated Financial Statements

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, 2004, the Company's system of internal control was effective 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
Chairman and
Chief Executive Officer

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

March 7, 2005

Report of Independent Registered Public Accounting Firm

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, 2004 and 2003, and the related consolidated statements of operations, cash flows, and stockholders' equity and comprehensive income for each of the three years in the period ended December 31, 2004. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of BorgWarner Inc. and Consolidated Subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 7, 2005 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Deloitte & Touche LLP

Detroit, Michigan

March 7, 2005

Consolidated Statements of Operations

millions of dollars, except per share amounts For the Year Ended December 31,	2004	2003	2002
Net sales	**$3,525.3**	$3,069.2	$2,731.1
Cost of sales	**2,874.2**	2,482.5	2,176.5
Gross profit	**651.1**	586.7	554.6
Selling, general and administrative expenses	**339.0**	316.9	303.5
Other, net	**3.0**	(0.1)	(0.9)
Operating income	**309.1**	269.9	252.0
Equity in affiliates earnings, net of tax	**(29.2)**	(20.1)	(19.5)
Interest expense and finance charges	**29.7**	33.3	37.7
Earnings before income taxes	**308.6**	256.7	233.8
Provision for income taxes	**81.2**	73.2	77.2
Minority interest, net of tax	**9.1**	8.6	6.7
Net earnings before cumulative effect of accounting change	**218.3**	174.9	149.9
Cumulative effect of change in accounting principle, net of tax	**—**	—	(269.0)
Net earnings/(loss)	**$ 218.3**	$ 174.9	$ (119.1)
Earnings/(loss) per share – basic:			
Earnings per share before cumulative effect of accounting change	**$ 3.91**	$ 3.23	$ 2.82
Cumulative effect of change in accounting principle	**—**	—	(5.05)
Earnings/(loss) per share – basic	**$ 3.91**	$ 3.23	$ (2.23)
Earnings/(loss) per share – diluted:			
Earnings per share before cumulative effect of accounting change	**$ 3.86**	$ 3.20	$ 2.79
Cumulative effect of change in accounting principle	**—**	—	(5.01)
Earnings/(loss) per share – diluted	**$ 3.86**	$ 3.20	$ (2.22)
Average shares outstanding (thousands):			
Basic	**55,872**	54,116	53,250
Diluted	**56,537**	54,604	53,708

See Accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

millions of dollars December 31,	2004	2003
ASSETS		
Cash and cash equivalents	**$ 229.7**	$ 113.1
Receivables	**499.1**	414.9
Inventories	**223.4**	201.3
Deferred income taxes	**22.6**	32.8
Investment in business held for sale	**44.2**	32.0
Prepayments and other current assets	**55.3**	44.2
Total current assets	**1,074.3**	838.3
Land	**45.0**	42.3
Buildings	**358.2**	327.4
Machinery and equipment	**1,352.3**	1,216.0
Capital leases	**1.1**	2.8
Construction in progress	**103.0**	77.2
	1,859.6	1,665.7
Less accumulated depreciation	**782.4**	680.4
Net property, plant and equipment	**1,077.2**	985.3
Tooling, net of amortization	**102.1**	90.5
Investments and advances	**193.7**	177.3
Goodwill	**860.8**	852.0
Other noncurrent assets	**221.0**	197.1
Total other assets	**1,377.6**	1,316.9
Total assets	**$3,529.1**	$3,140.5
LIABILITIES AND STOCKHOLDERS' EQUITY		
Notes payable and current portion of long-term debt	**$ 16.5**	$ 10.0
Accounts payable and accrued expenses	**608.0**	474.0
Income taxes payable	**39.3**	—
Total current liabilities	**663.8**	484.0
Long-term debt	**568.0**	645.5
Long-term liabilities:		
Retirement-related liabilities	**498.0**	503.0
Other	**242.9**	230.4
Total long-term liabilities	**740.9**	733.4
Minority interest in consolidated subsidiaries	**22.2**	17.2
Capital stock:		
Preferred stock, $0.01 par value; authorized shares: 5,000,000; none issued	**—**	—
Common stock, $0.01 par value; authorized shares: 150,000,000; issued shares: 2004, 56,361,167 and 2003, 55,229,854; outstanding shares: 2004, 56,357,183; 2003, 55,157,190	**0.6**	0.3
Non-voting common stock, $0.01 par value; authorized shares: 25,000,000; none issued and outstanding	**—**	—
Capital in excess of par value	**797.1**	756.3
Retained earnings	**681.4**	491.3
Accumulated other comprehensive income	**55.2**	14.0
Common stock held in treasury, at cost: 2004, 3,984 shares; 2003, 72,664 shares	**(0.1)**	(1.5)
Total stockholders' equity	**1,534.2**	1,260.4
Total liabilities and stockholders' equity	**$3,529.1**	$3,140.5

See Accompanying Notes to Consolidated Financial Statements.

millions of dollars For the Year Ended December 31,	2004	2003	2002
OPERATING			
Net earnings/(loss)	**$ 218.3**	$ 174.9	$(119.1)
Adjustments to reconcile net earnings/(loss) to net cash flows from operations:			
Non-cash charges (credits) to operations:			
Depreciation	**138.8**	124.5	108.1
Amortization of tooling	**38.2**	36.8	29.3
Cumulative effect of change in accounting principle, net of tax	**—**	—	269.0
Employee retirement benefits funded with common stock	**25.8**	12.9	20.8
Deferred income tax provision	**13.8**	40.0	30.4
Equity in affiliate earnings, net of dividends received, minority interest and other	**5.8**	(3.7)	(4.1)
Net earnings adjusted for non-cash charges	**440.7**	385.4	334.4
Changes in assets and liabilities, net of effects of divestitures:			
(Increase) in receivables	**(60.4)**	(90.4)	(67.4)
(Increase) in inventories	**(12.7)**	(9.1)	(29.3)
(Increase) decrease in prepayments	**(7.0)**	7.3	(3.4)
Increase (decrease) in accounts payable and accrued expenses	**113.1**	(0.3)	(14.7)
Increase (decrease) in income taxes payable	**36.0**	(0.2)	14.1
Net change in other long-term assets and liabilities	**(83.1)**	14.2	27.7
Net cash provided by operating activities	**426.6**	306.9	261.4
INVESTING			
Capital expenditures	**(204.9)**	(172.0)	(138.4)
Tooling outlays, net of customer reimbursements	**(47.5)**	(42.4)	(27.7)
Net proceeds from asset disposals	**4.2**	8.0	12.3
Proceeds from sale of businesses	**—**	5.4	3.3
Tax refunds related to businesses sold	**—**	—	20.5
Contingent valuation payment on acquired business	**—**	(12.8)	—
Investment in unconsolidated subsidiary	**(9.0)**	(14.4)	—
Net cash used in investing activities	**(257.2)**	(228.2)	(130.0)
FINANCING			
Net increase (decrease) in notes payable	**5.3**	(5.5)	(22.8)
Additions to long-term debt	**0.6**	0.3	2.3
Repayments of long-term debt	**(61.8)**	(16.1)	(85.3)
Payments for purchase of treasury stock	**—**	(2.5)	(18.1)
Proceeds from stock options exercised	**14.4**	39.3	9.8
Dividends paid	**(27.9)**	(19.4)	(16.0)
Net cash used in financing activities	**(69.4)**	(3.9)	(130.1)
Effect of exchange rate changes on cash and cash equivalents	**16.6**	1.7	2.4
Net increase in cash and cash equivalents	**116.6**	76.5	3.7
Cash and cash equivalents at beginning of year	**113.1**	36.6	32.9
Cash and cash equivalents at end of year	**$ 229.7**	$ 113.1	$ 36.6
SUPPLEMENTAL CASH FLOW INFORMATION			
Net cash paid/(refunded) during the year for:			
Interest	**$ 29.3**	$ 34.5	$ 39.5
Income taxes	**35.0**	24.4	(11.0)
Non-cash financing transactions:			
Issuance of common stock for Executive Stock Performance Plan	**$ 1.7**	$ 3.3	$ 1.2
Issuance of restricted common stock for non-employee directors	**0.3**	—	—

See Accompanying Notes to Consolidated Financial Statements.

	Number of shares		millions of dollars Stockholders' equity						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	Accumulated other comprehensive income/(loss)	
Balance, January 1, 2002	54,079,936	(1,349,598)	$0.3	$715.7	$(27.6)	$(2.0)	$470.9	$(53.1)	
Purchase of treasury stock	—	(770,000)	—	—	(18.1)	—	—	—	
Dividends declared	—	—	—	—	—	—	(16.0)	—	—
Shares issued under stock incentive plans	—	435,264	—	0.9	8.9	—	—	—	—
Shares issued under executive stock plan	—	46,560	—	0.3	0.9	—	—	—	—
Shares issued under retirement savings plans	717,846	—	—	20.8	—	—	—	—	—
Net loss	—	—	—	—	—	—	(119.1)	—	$(119.1)
Adjustment for minimum pension liability	—	—	—	—	—	—	—	(42.3)	(42.3)
Currency translation and hedge instruments adjustment	—	—	—	—	—	—	—	40.9	40.9
Balance, December 31, 2002	54,797,782	(1,637,774)	$0.3	$737.7	$(35.9)	$(2.0)	$335.8	$(54.5)	$(120.5)
Purchase of treasury stock	—	(83,860)	—	—	(2.5)	—	—	—	
Dividends declared	—	—	—	—	—	—	(19.4)	—	—
Management shareholder notes	—	—	—	—	—	2.0	—	—	—
Shares issued under stock incentive plans	—	1,517,208	—	5.3	34.0	—	—	—	—
Shares issued under executive stock plan	—	131,762	—	0.4	2.9	—	—	—	—
Shares issued under retirement savings plans	432,072	—	—	12.9	—	—	—	—	—
Net income	—	—	—	—	—	—	174.9	—	$ 174.9
Adjustment for minimum pension liability	—	—	—	—	—	—	—	0.7	0.7
Currency translation and hedge instruments adjustment	—	—	—	—	—	—	—	67.8	67.8
Balance, December 31, 2003	55,229,854	(72,664)	$0.3	$756.3	$ (1.5)	$ —	$491.3	$ 14.0	$ 243.4
Dividends declared	**—**	**—**	**—**	**—**	**—**	**—**	**(27.9)**	**—**	**—**
Stock split	**—**	**—**	**0.3**	**—**	**—**	**—**	**(0.3)**	**—**	**—**
Shares issued under stock incentive plans	**523,994**	**68,680**	**—**	**13.0**	**1.4**	**—**	**—**	**—**	**—**
Shares issued under executive stock plan	**41,252**	**—**	**—**	**1.7**	**—**	**—**	**—**	**—**	**—**
Restricted shares issued under stock incentive plan	**6,400**	**—**	**—**	**0.3**	**—**	**—**	**—**	**—**	**—**
Shares issued under retirement savings plans	**559,667**	**—**	**—**	**25.8**	**—**	**—**	**—**	**—**	**—**
Net income	**—**	**—**	**—**	**—**	**—**	**—**	**218.3**	**—**	**$ 218.3**
Adjustment for minimum pension liability	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**12.8**	**12.8**
Currency translation and hedge instruments adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**28.4**	**28.4**
BALANCE, DECEMBER 31, 2004	**56,361,167**	**(3,984)**	**$0.6**	**$797.1**	**$ (0.1)**	**$ —**	**$681.4**	**$ 55.2**	**$ 259.5**

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 the Company's significant accounting policies.

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

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

Cash and cash equivalents Cash and cash equivalents are valued at cost, which approximates fair market value. 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. In the fourth quarter of 2002, the Company reduced the maximum size of the facility from $120 million to $90 million.

During the year ended December 31, 2004, total cash proceeds from sales of accounts receivable were $600 million. The Company paid servicing fees of $0.9 million, $1.3 million, and $2.5 million in 2004, 2003, and 2002, respectively, related to these receivables. These amounts are recorded in interest expense and finance charges in the Consolidated Statements of Operations. At December 31, 2004 and 2003, the Company had sold $50 million of receivables under a Receivables Transfer Agreement for face value without recourse.

Inventories Inventories are valued at the lower of cost or market. Cost of U.S. inventories is determined by the last-in, first-out (LIFO) method, while the foreign operations use the first-in, first-out (FIFO) or average-cost methods. Inventory held by U.S. operations was $106.1 million in 2004 and $97.1 million in 2003. Such inventories, if valued at current cost instead of LIFO, would have been greater by $6.6 million in 2004 and $3.6 million in 2003.

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 Statement of Financial Accounting Standards (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. Under the transitional provisions of this statement, 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 Emissions/Thermal Systems business unit 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 pretax 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, 2002, 2003 and 2004, 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
Translation adjustment	0.3	8.5	8.8
Balance at December 31, 2004	**$134.6**	**$ 726.2**	**$ 860.8**

In the fourth quarter of each year, or when events and circumstances warrant such a review, the Company reviews the goodwill for all of its reporting units for impairment. 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. The goodwill impairment test was performed in November 2004. The results of that analysis did not indicate an impairment of the book value of the Company's goodwill.

The Company had intangible assets, primarily trade names, with a cost of $14.7 million, less accumulated amortization of $9.8 million and $8.7 million at December 31, 2004 and 2003, respectively. The intangible assets are being amortized on a straightline 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 2004, 2003, and 2002. The estimated future annual amortization expense for each of the successive years 2005 through 2008 is $1.2 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 and receivables, and obligations under accounts payable, and debt instruments. The Company believes that the fair value of the financial instruments approximates the carrying value, except as noted in Note 6.

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 estimated 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 renegotiated, 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 fully collected in 2002. During the first quarter of 2004 the Kuhlman Electric agreement was renegotiated whereby the Company received a payment of $2.5 million and a new note from Kuhlman Electric Corporation. The maturity of this new note is April 2012. The face value of the note is $4.5 million at December 31, 2004.

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 transactions for purposes other than hedging specific risks.

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 product quality and minimize warranty claims. Management believes that the warranty accrual is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the accrual. The accrual is represented in both 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	2004	2003	2002
Beginning balance	**$28.7**	$23.7	$ 19.5
Provisions	**10.2**	12.4	14.2
Payments	**(12.5)**	(7.4)	(10.0)
Ending balance	**$26.4**	$28.7	$ 23.7
Classified in the Consolidated Balance Sheets as:			
Accounts payable and accrued expenses	**$16.1**	$17.6	$ 14.4
Other long term liability	**$10.3**	$11.1	$ 9.3

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, which is the measurement date. Further disclosure about the Company's stock compensation plans can be found in Note 9. The following table illustrates the effect on the Company's net earnings/(loss) and net earnings/(loss) per share if the Company had applied the fair value recognition provision of SFAS No. 123.

millions of dollars, except per share data	2004	2003	2002
Net earnings/(loss), as reported	**$218.3**	$174.9	$(119.1)
Add: Stock-based employee compensation expense included in net income, net of income tax	**1.6**	2.7	4.5
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of income tax	**(7.7)**	(7.7)	(10.7)
Pro forma net earnings/(loss)	**$212.2**	$169.9	$(125.3)
Earnings/(loss) per share:			
Basic – as reported	**$ 3.91**	$ 3.23	$ (2.23)
Basic – pro forma	**$ 3.80**	$ 3.14	$ (2.36)
Diluted – as reported	**$ 3.86**	$ 3.20	$ (2.22)
Diluted – pro forma	**$ 3.75**	$ 3.11	$ (2.34)

New accounting pronouncements In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which was revised in December 2003. FIN No. 46R 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. 46R also provides the framework for determining whether a variable interest entity should be consolidated. For the Company, this Interpretation, as revised, was effective January 1, 2004. The Company has no variable interest entities required to be consolidated as a result of adopting FIN No. 46R.

In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (Medicare Act) introduced a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans. 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 106-1 permits a sponsor of a post retirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Act if there is insufficient data, time or guidance available to ensure appropriate accounting. The Company is a sponsor of post retirement health care plans that provide prescription benefits and, in accordance with the one-time election under FSP 106-1, elected to defer accounting for the Medicare Act. In May 2004, the FASB issued FSP No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," which supersedes FSP 106-1, to address the accounting and disclosure requirements related to the Medicare Act. The FSP was effective for the Company beginning with its third quarter ended September 30, 2004. The effect of the adoption was to reduce the Company's 2004 post retirement benefits expense by $6.8 million.

In November 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs" which is an amendment of ARB No.43, Chapter 4. This statement provides clarification of accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. Generally, this statement requires that those items be recognized as current period charges. SFAS 151 will be effective for the Company on January 1, 2006. The Company is currently evaluating the impact that the adoption of SFAS 151 will have on its consolidated financial position, results of operations and cash flows.

In December 2004, the FASB issued FSP 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" (AJCA), and FAS 109-2 "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the AJCA". These two FSPs provide guidance on the application of the new provisions of the AJCA, which was signed into law on October 22, 2004.

The AJCA provides a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. In return, the AJCA provides for a two-year phase-out of the existing extra-territorial income exclusion (ETI) for foreign sales that was viewed to be inconsistent with international trade protocols by the European Union. Under the guidance in FSP 109-1, the deduction will be treated as a "special deduction" as described in SFAS 109. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the enactment date. Rather, the impact of this deduction will be reported in the period in which the deduction is claimed on our tax return. The Company expects the net effect of the phase out of the ETI and the phase in of this new deduction will not have a material impact on its effective tax rate.

FSP 109-2 provides guidance on the accounting for the deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. The Company may elect to apply this provision to qualifying earnings repatriations in 2005. Under guidance set forth in FAS 109-2, the Company is allowed time beyond the financial reporting period of enactment to evaluate the effect of the AJCA on its plan for reinvestment or repatriation of foreign. The Company has started an evaluation of the effects of the repatriation provision; however, the Company does not expect to be able to complete this evaluation until after the U.S. Congress or the Treasury Department provides additional clarifying language on key elements of the provision. The Company expects to complete its evaluation of the effects of the repatriation provision within a reasonable period of time following the publication of the additional clarifying language. The range of possible amounts that the Company is considering for repatriation under this provision is between zero and $74 million. The related range of income tax effects of such repatriation cannot be reasonably estimated until guidance is issued by Congress or the Treasury Department.

In December 2004, the FASB issued SFAS No. 123R, "Shared-Based Payment" which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Share-based payments include stock option grants and certain transactions under other Company stock plans. The Company grants options to purchase common stock of the Company to some of its employees and directors under various plans at prices equal to the market value of the stock on the dates the options are granted. SFAS 123R will be effective for the Company beginning July 1, 2005. The Company is currently evaluating the impact that the adoption of SFAS 123R will have on its consolidated financial position, results of operations and cash flows.

Reclassification Certain prior period amounts have been reclassified to conform to the current year's presentation and are not material to the Company's Consolidated Financial Statements.

NOTE 2
RESEARCH AND DEVELOPMENT COSTS

The Company spent approximately $123.1 million, $118.2 million, and $109.1 million in 2004, 2003 and 2002, respectively, on research and development (R&D) activities. R&D costs are included primarily in the selling, general, and administrative expenses of the Consolidated Statements of Operations. Not included in these amounts were customer-sponsored R&D activities of approximately $31.8 million, $22.3 million, and $14.2 million in 2004, 2003, and 2002, respectively.

NOTE 3
OTHER INCOME

Items included in other income consist of:

millions of dollars Year Ended December 31,	**2004**	2003	2002
Gain on sale of business	**$ —**	$ 0.5	$ —
Interest income	**0.7**	0.8	1.7
Loss on asset disposals, net	**(3.5)**	(1.7)	(1.5)
Other	**(0.2)**	0.5	0.7
	$(3.0)	$ 0.1	$0.9

NOTE 4
INCOME TAXES

Earnings before income taxes and the provision for income taxes are presented in the following table. The earnings before income taxes amounts for 2003 and 2002 have been presented to conform to the 2004 U.S. versus non-U.S. presentation.

	2004			2003			2002		
millions of dollars	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total
Earnings before taxes	**$117.8**	**$190.8**	**$308.6**	$120.5	$136.2	$256.7	$163.7	$70.1	$233.8
Provision for income taxes:									
Current:									
Federal/foreign	**1.4**	**63.8**	**65.2**	18.5	13.1	31.6	11.1	10.6	21.7
State	**2.2**	**—**	**2.2**	1.6	—	1.6	3.1	—	3.1
	3.6	**63.8**	**67.4**	20.1	13.1	33.2	14.2	10.6	24.8
Deferred	**11.1**	**2.7**	**13.8**	18.5	21.5	40.0	44.8	7.6	52.4
Total provision for income taxes	**$ 14.7**	**$ 66.5**	**$ 81.2**	$ 38.6	$ 34.6	$ 73.2	$ 59.0	$18.2	$ 77.2
Effective tax rate	**12.4%**	**34.9%**	**26.3%**	32.0%	25.4%	28.5%	36.0%	26.0%	33.0%

The provision for income taxes resulted in an effective tax rate for 2004 of 26.3% compared with rates of 28.5% in 2003 and 33.0% in 2002. 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 by non-deductible expenses. In addition, the Company made an $11.4 million year-end adjustment to various tax accounts due to changes in circumstances related to various tax items, including changes in tax laws. The year-end adjustment resulted in a reduction in the U.S. effective tax rate for 2004.

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	**2004**	2003	2002
Income taxes at U.S. statutory rate of 35%	**$108.0**	$ 89.8	$81.8
Increases (decreases) resulting from:			
Income from non-U.S. sources including withholding taxes	**3.6**	(8.5)	(2.2)
Business tax credits, net	**(6.2)**	(6.3)	(4.7)
Affiliate earnings	**(10.2)**	(7.0)	(6.8)
Non-temporary differences and other	**(14.0)**	5.2	9.1
Provision for income taxes as reported	**$ 81.2**	$ 73.2	$77.2

Following are the gross components of deferred tax assets and liabilities as of December 31, 2004 and 2003:

millions of dollars	2004	2003
Current deferred tax assets:		
Foreign tax credits	**$ 9.0**	$ 7.1
Research and development credits	**6.0**	7.6
Employee related	**5.1**	5.8
Warranties	**—**	5.7
Other	**2.5**	6.6
Total current deferred tax assets	**$ 22.6**	$ 32.8
Non-current deferred tax assets:		
Pension and other post retirement benefits	**$ 92.1**	$ 90.4
Other comprehensive income	**36.3**	33.1
Employee related	**9.0**	8.7
Goodwill	**3.5**	13.9
Litigation and environmental	**9.2**	7.9
Warranties	**7.7**	—
Foreign tax credits	**2.6**	—
Research and development credits	**4.9**	—
Other	**5.3**	1.0
Non-current deferred tax assets	**$ 170.6**	$ 155.0
Non-current deferred tax liabilities:		
Fixed assets	**$(163.4)**	$(163.8)
Lease obligation – production equipment	**(9.0)**	—
Other	**(7.0)**	—
Non-current deferred tax liabilities	**$(179.4)**	$(163.8)
Net deferred tax asset (current and non-current)	**$ 13.8**	$ 24.0

The deferred tax assets (current and non-current) and liabilities recognized in the Company's Consolidated Balance Sheets are as follows:

millions of dollars	2004	2003
Deferred income taxes – current assets	**$ 22.6**	$ 32.8
Other non-current assets	**51.8**	48.5
Other long-term liabilities	**(60.6)**	(57.3)
Net deferred tax asset (current and non-current)	**$ 13.8**	$ 24.0

The other non-current assets are primarily comprised of amounts from the U.S., France and Korea. The other long-term liabilities are primarily comprised of amounts from Germany, Italy, U.K., Japan, and Canada. The non-current deferred tax asset in 2003 of $48.5 million was previously presented as a reduction of the non-current deferred tax liability; this amount has been reclassified to other non-current assets on the 2003 Consolidated Balance Sheets and the reclassification is not material to the Company's Consolidated Financial Statements.

The foreign tax credits will expire beginning in 2012 through 2014. The R&D tax credits will expire beginning in 2022 through 2024. The company also has deferred tax assets for minimum tax credits of $3.2 million, which can be carried forward indefinitely.

No deferred income taxes have been provided on the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries or foreign corporate joint ventures totaling $353.9 million in 2004, as these amounts are essentially permanent in nature. The excess amount will become taxable on a repatriation of assets or sale or liquidation of the investment. It is not practicable to determine the unrecognized deferred tax liability on the excess amount because the actual tax liability on the excess amount, if any, is dependent on circumstances existing when remittance occurs.

NOTE 5
BALANCE SHEET INFORMATION

Detailed balance sheet data are as follows:

millions of dollars December 31,	2004	2003
Receivables:		
Customers	**$453.9**	$374.6
Other	**56.1**	46.0
Gross receivables	**510.0**	420.6
Less allowance for losses	**10.9**	5.7
Net receivables	**$499.1**	$414.9
Inventories:		
Raw material	**$104.6**	$95.5
Work in progress	**69.8**	65.1
Finished goods	**49.0**	40.7
Total inventories	**$223.4**	$201.3
Investments and advances:		
NSK-Warner	**$188.2**	$172.1
Other	**5.5**	5.2
Total investments and advances	**$193.7**	$177.3
Other non-current assets:		
Deferred pension assets	**$113.1**	$90.8
Product liability insurance receivable	**27.3**	27.9
Deferred income taxes, net	**51.8**	48.5
Other	**28.8**	29.9
Total other non-current assets	**$221.0**	$197.1
Accounts payable and accrued expenses:		
Trade payables	**$390.6**	$300.0
Payroll and related	**74.5**	63.7
Insurance	**25.2**	24.0
Warranties	**16.1**	17.6
Product liability accrual	**13.5**	13.7
Other	**88.1**	55.0
Total accounts payable and accrued expenses	**$608.0**	$474.0
Other long-term liabilities:		
Environmental accruals	**$ 25.7**	$ 19.6
Warranties	**10.3**	11.1
Deferred income taxes, net	**60.6**	57.3
Product liability accrual	**27.3**	27.9
Other	**119.0**	114.5
Total other long-term liabilities	**$242.9**	$230.4

NSK-Warner

The Company has a 50% interest in NSK-Warner, a joint venture based in Japan that manufactures automatic transmission components. The Company's share of the earnings or losses reported by NSK-Warner is accounted for using the equity method of accounting. NSK-Warner has a fiscal year-end of March 31. The Company's equity in the earnings of NSK-Warner consists of the 12 months ended November 30 so as to reflect earnings on as current a basis as is reasonably feasible. NSK-Warner is the joint venture partner with a 40% interest in the Drivetrain Group's Korean subsidiary, BorgWarner Transmission Systems Korea Inc. Dividends received from NSK-Warner were $23.9 million in 2004, $9.7 million in 2003, and $8.4 million in 2002.

Following are summarized financial data for NSK-Warner, translated using the ending or periodic rates as of and for the years ended November 30, 2004, 2003 and 2002 (unaudited):

millions of dollars	2004	2003	2002
Balance sheets:			
Current assets	**$242.3**	$210.7	$176.0
Non-current assets	**180.7**	173.3	151.0
Current liabilities	**126.2**	108.8	85.2
Non-current liabilities	**18.5**	14.8	10.7
Statements of operations:			
Net sales	**$443.5**	$356.5	$303.8
Gross profit	**97.3**	71.4	69.8
Net income	**52.6**	34.5	34.0

The equity of NSK-Warner as of November 30, 2004, was $278.3 million, there was no debt and their cash and securities were $92.4 million.

Purchases from NSK-Warner for the years ended December 31, 2004, 2003 and 2002 were $19.9 million, $16.9 million and $15.1 million, respectively.

Investment in business held for sale

The Company's investment in Aktiengesellschaft Kühnle, Kopp & Kausch (AGK), an unconsolidated subsidiary of the Company, has been recorded in "Investment in business held for sale" in the Consolidated Balance Sheets. Effective February 17, 2005, the Company signed a Share Transfer Agreement (STA) for the sale of its 95.42% interest in AGK with Turbo Group GmbH. The STA will become effective no later than seven (7) banking days after receipt of approval from both the German Federal Cartel Office and the Austrian merger control authority. The transaction is anticipated to close before March 31, 2005. The proceeds, net of closing costs, are expected to be approximately €39.8 million. The investment is carried on a cost basis, with dividends received from AGK applied against the carrying value of the asset.

Following is summarized balance sheet data as of September 30, 2004 and 2003 for AGK (unaudited), which is the latest available. The assets and liabilities reported in Euros were translated using the respective year-end exchange rate:

millions of dollars	2004	2003
Current assets	**$132.3**	$79.9
Non-current assets	**65.7**	57.9
Current liabilities	**79.7**	43.7
Non-current liabilities	**54.0**	41.6

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 2004 and 2003 was 5.1% and 4.9%, respectively.

millions of dollars December 31,	2004 Current	2004 Long-Term	2003 Current	2003 Long-Term
Bank borrowings and other	**$ 9.2**	**$ 6.1**	$ 2.9	$ 42.5
Term loans due through 2011 (at an average rate of 3.3% in 2004 and 3.3% in 2003)	**7.3**	**26.9**	7.1	31.4
7% Senior Notes due 2006, net of unamortized discount ($139 million converted to floating rate of 4.5% by interest rate swap at December 31, 2004)	**—**	**139.0**	—	139.4
6.5% Senior Notes due 2009, net of unamortized discount ($100 million converted to floating rate of 5.2% by interest rate swap at December 31, 2004)	**—**	**136.1**	—	164.7
8% Senior Notes due 2019, net of unamortized discount ($75 million converted to floating rate of 5.4% by interest rate swap at December 31, 2004)	**—**	**133.9**	—	133.9
7.125% Senior Notes due 2029, net of unamortized discount	**—**	**119.1**	—	122.1
Carrying amount of notes payable and long-term debt	**16. 5**	**561.1**	10.0	634.0
Impact of derivatives on debt[a]	**—**	**6.9**	—	11.5
Total notes payable and long-term debt	**$16.5**	**$568.0**	$10.0	$645.5

(a) The $11.5 million impact of derivatives on debt from the interest rate swaps as of December 31, 2003 has been reclassified to long-term debt with a corresponding non-current asset. The reclassification is not material to the Company's Consolidated Financial Statements.

Annual principal payments required as of December 31, 2004 are as follows (in millions of dollars):

2005	$ 16.5
2006	151.4
2007	6.7
2008	6.7
2009	146.0
after 2009	259.5
Total payments	586.8
Less: Unamortized discounts	(2.3)
Total	$584.5

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

NOTE 7
FINANCIAL INSTRUMENTS

The Company's financial instruments include cash and cash equivalents, trade receivables, trade payables 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 swap contracts, and foreign currency forward contracts.

As of December 31, 2004 and 2003, the estimated fair values of the Company's senior unsecured notes totaled $589.0 million and $635.0 million, respectively. The estimated fair values were $60.9 million higher in 2004, and $74.9 million higher in 2003, 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 manages its interest rate risk by balancing its exposure to fixed and variable rates while attempting to minimize its interest costs. The Company selectively uses interest rate swaps to reduce market value risk associated with changes in interest rates (fair value hedges). We also selectively use cross-currency swaps to hedge the foreign currency exposure associated with our net investment in certain foreign operations (net investment hedges). A summary of these instruments outstanding at December 31, 2004 follows (currency in millions):

	Hedge Type	Notional Amount	Interest Rates[b] Receive	Interest Rates[b] Pay	Floating Interest Rate Basis
Interest rate swaps[a]					
Fixed to floating	Fair value	$139	7.0%	4.5%	6 month LIBOR+1.7%
Fixed to floating	Fair value	$100	6.5%	5.2%	6 month LIBOR+2.4%
Fixed to floating	Fair value	$ 75	8.0%	5.4%	6 month LIBOR+2.6%
Cross currency swap (matures in 2006)					
Floating $	Net investment	$125	4.2%	—	6 mo. USD LIBOR+1.4%
to floating ¥		¥14,930	—	1.7%	6 mo. JPY LIBOR+1.6%
Cross currency swap (matures in 2009)					
Floating $	Net investment	$75	5.4%	—	6 mo. USD LIBOR+2.6%
to floating €		€57	—	4.8%	6 mo. EURIBOR+2.6%
Cross currency swap (matures in 2019)					
Floating $	Net investment	$75	5.4%	—	6 mo. USD LIBOR+2.6%
to floating €		€61	—	4.8%	6 mo. EURIBOR+2.6%

(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, 2004.

As of December 31, 2004 and December 31, 2003, the fair value of the fixed to floating interest rate swaps was $6.9 million and $11.5 million, respectively and are recorded in the Company's Consolidated Balance Sheets as Other non-current assets with a corresponding adjustment to the carrying value of the hedged debt. The change in fair value of the swaps exactly offsets the change in fair value of the hedged debt with no net impact on earnings. The cross currency swaps were recorded at their fair value of $(33.1) at December 31, 2004 and $(4.2) million at December 31, 2003. Fair value is based on quoted market prices for contracts with similar maturities and the ineffective portion of all swaps was not significant.

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 utilizes forward and option contracts, which are designated as cash flow hedges. These instruments are intended to offset the effect of changes in commodity prices on forecasted purchases. As of December 31, 2004 the Company had commodity swap contracts with a total notional value of $3.4 million. The fair market value of the swap contracts was $0.4 million as of December 31, 2004, which is deferred in other comprehensive income and will be reclassified and matched into income as the underlying operating transactions are realized. As of December 31, 2003, the Company had commodity swap contracts with a total notional value of $1.1 million and a fair market value of $0.1 million as of December 31, 2003, which was deferred in other comprehensive income. During the twelve months ended December 31, 2004 and 2003, hedge ineffectiveness associated with these contracts was not significant.

The Company uses foreign exchange forward contracts to protect against exchange rate movements for forecasted cash flows for purchases, operating expenses or sales transactions designated in currencies other than the functional currency of the operating unit. Most contracts mature in less than one year, however certain long-term commitments are covered by forward currency arrangements to protect against currency risk through the second quarter of 2009. Foreign currency contracts require the Company, at a future date, to either buy or sell foreign currency in exchange for the operating units local currency. At December 31, 2004 contracts were outstanding to buy or sell U.S. Dollars, Euros, British Pounds Sterling, Canadian Dollars and Hungarian Forints. Gains and losses arising from these contracts are unrealized in other comprehensive income and will be reclassified and matched into income as the underlying operating transactions are realized. As of December 31, 2004 unrealized gains amounted to $8.8 million, ($4.2 million maturing in less than one year) and unrealized losses amounted to $(4.1) million ($(3.2) million maturing in less than one year). As of December 31, 2003 unrealized gains amounted to $3.6 million and unrealized losses amounted to $(3.3) million. Hedge ineffectiveness associated with these contracts during 2003 and 2004 was not significant.

NOTE 8
RETIREMENT BENEFIT PLANS

The Company has a number of defined benefit pension plans and other post retirement benefit plans covering eligible salaried and hourly employees. The other post retirement 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 2004 U.S.	Pension benefits 2004 Non-U.S.	Pension benefits 2003 U.S.	Pension benefits 2003 Non-U.S.	Other post retirement benefits 2004	Other post retirement benefits 2003
Change in projected benefit obligation:						
Projected benefit obligation at beginning of year	**$316.5**	**$217.1**	$283.2	$ 159.9	**$ 537.4**	$ 446.5
Service cost	**2.4**	**9.3**	2.5	7.5	**6.0**	5.3
Interest cost	**17.3**	**11.5**	18.5	9.5	**28.8**	29.7
Plan participants' contributions	**—**	**0.3**	—	0.3	**—**	—
Actuarial (gain)/loss	**(8.3)**	**12.2**	33.9	21.1	**(2.1)**	89.2
Currency translation	**—**	**17.9**	—	24.7	**—**	—
Curtailments	**—**	**—**	—	—	**—**	(0.8)
Benefits paid	**(22.6)**	**(8.1)**	(21.6)	(5.9)	**(32.9)**	(32.5)
Projected benefit obligation at end of year	**$305.3**	**$260.2**	$316.5	$ 217.1	**$ 537.2**	$ 537.4
Change in plan assets:						
Fair value of plan assets at beginning of year	**$288.0**	**$103.4**	$245.7	$ 77.8		
Actual return on plan assets	**34.7**	**8.9**	52.9	15.1		
Employer contribution	**24.3**	**12.0**	11.0	6.1		
Plan participants' contribution	**—**	**0.3**	—	0.3		
Currency translation	**—**	**8.2**	—	10.0		
Benefits paid	**(22.6)**	**(8.1)**	(21.6)	(5.9)		
Fair value of plan assets at end of year	**$324.4**	**$124.7**	$288.0	$ 103.4		
Funded status:						
Funded status at end of year	**$ 19.1**	**$(135.5)**	$ (28.5)	$(113.7)	**$(537.2)**	$(537.4)
Unrecognized net actuarial (gain) loss	**79.1**	**57.2**	101.2	45.2	**203.7**	214.4
Unrecognized transition obligation (asset)	**—**	**—**	—	0.2	**—**	—
Unrecognized prior service cost	**7.5**	**0.3**	9.0	0.4	**(2.1)**	(2.3)
Net amount recognized	**$105.7**	**$ (78.0)**	$ 81.7	$ (67.9)	**$(335.6)**	$(325.3)
Amounts recognized in the Consolidated Balance Sheets consist of:						
Prepaid benefit cost	**$105.7**	**$ —**	$ 81.7	$ —	**$ —**	$ —
Accrued benefit liability	**—**	**(78.0)**	—	(67.9)	**(335.6)**	(325.3)
Additional minimum liability	**(63.2)**	**(21.2)**	(80.5)	(22.8)	**—**	—
Intangible asset	**7.2**	**0.2**	8.7	0.4	**—**	—
Accumulated reduction in stockholders equity	**56.0**	**21.0**	71.8	22.4	**—**	—
Net amount recognized	**$105.7**	**$ (78.0)**	$ 81.7	$ (67.9)	**$(335.6)**	$(325.3)
Total accumulated benefit obligation for all plans	**$301.8**	**$229.6**	$316.2	$ 194.9		

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	2004	2003
Accumulated benefit obligation	**$(449.7)**	$(418.1)
Plan assets	**(321.9)**	(270.0)
Deficiency	**$(127.8)**	$(148.1)
Pension deficiency by country:		
United States	**$ (19.4)**	$ (56.7)
United Kingdom	**(29.0)**	(30.0)
Germany	**(72.5)**	(55.5)
Japan	**(6.9)**	(5.9)
Total pension deficiency	**$(127.8)**	$(148.1)

The weighted average asset allocations of the Company's funded pension plans at December 31, 2004 and 2003, and target allocations by asset category, are as follows:

percent	2004	2003	Target Allocation
Cash, real estate and other	**7%**	4%	0-15%
Fixed income securities	**33**	33	30-45
Equity securities	**60**	63	50-70
	100%	100%	

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, 2004 and 2003.

The Company expects to contribute a total of $20 million to $25 million into all of its pension plans during 2005. The Company's net periodic pension benefit cost was $16.7 million in 2004, $23.2 million in 2003 and $6.8 million in 2002. See table below for a breakout between U.S. and non-U.S. plans.

millions of dollars For the Year Ended December 31,	Pension benefits 2004 U.S.	2004 Non-U.S.	2003 U.S.	2003 Non-U.S.	2002 U.S.	2002 Non-U.S.	Other post retirement benefits 2004	2003	2002
Components of net periodic benefit cost:									
Service cost	**$ 2.4**	**$ 9.3**	$ 2.5	$ 7.5	$ 2.1	$ 5.5	**$ 6.0**	$ 5.3	$ 5.0
Interest cost	**17.3**	**11.5**	18.5	9.5	18.8	7.5	**28.8**	29.7	28.8
Expected return on plan assets	**(26.1)**	**(7.3)**	(20.7)	(5.7)	(25.5)	(5.4)	**—**	—	—
Amortization of unrecognized transition obligation	**—**	**0.3**	—	0.3	—	(0.1)	**—**	—	—
Amortization of unrecognized prior service cost	**1.5**	**0.2**	1.5	0.2	1.5	0.2	**(0.2)**	(0.2)	(0.1)
Amortization of unrecognized loss	**5.2**	**2.4**	7.8	1.8	2.1	0.1	**8.6**	5.9	4.0
Net periodic benefit cost/(benefit)	**$ 0.3**	**$16.4**	$ 9.6	$13.6	$ (1.0)	$ 7.8	**$43.2**	$40.7	$37.7

The Company's weighted-average assumptions used to determine the benefit obligations for our defined benefit pension and other post retirement plans as of December 31, 2004 and 2003 were as follows:

percents	2004	2003
U.S. plans		
Discount rate	**5.75**	6.00
Rate of compensation increase	**3.50**	3.50
Non-U.S. plans		
Discount rate	**5.04**	5.49
Rate of compensation increase	**3.36**	3.40

The Company's weighted-average assumptions used to determine the net periodic benefit cost (income) for our defined benefit pension and other post retirement benefit plans for the three years ended December 31, 2004 were as follows:

percents	2004	2003	2002
U.S. plans			
Discount rate	**6.00**	6.75	7.25
Rate of compensation increase	**3.50**	4.50	4.50
Expected return on plan assets	**8.75**	8.75	9.50
Non-U.S. plans			
Discount rate	**5.49**	5.45	5.46
Rate of compensation increase	**3.40**	3.36	3.39
Expected return on plan assets	**6.62**	6.82	6.43

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 U.S. 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 post retirement benefits
2005	$ 31.5	$ 30.8
2006	31.7	29.7
2007	32.0	30.3
2008	32.4	30.8
2009	33.1	30.7
2010–2014	175.7	162.3

The weighted-average rate of increase in the per capita cost of covered health care benefits is projected to be 8.0% in 2005 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	One percentage point decrease
Effect on post retirement benefit obligation	$70.0	$(55.7)
Effect on total service and interest cost components	$ 5.7	$ (4.5)

NOTE 9
STOCK INCENTIVE PLANS

Under the Company's 1993 Stock Incentive Plan, the Company granted options to purchase shares of the Company's common stock at the fair market value on the date of grant. 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 were no options available for future grants under the 1993 plan. The 1993 plan expired at the end of 2003 and was replaced by the Company's 2004 Stock Incentive Plan. Under the 2004 Stock Incentive Plan, the numbers of shares available for grant are 2,700,000. As of December 31, 2004, there are 2,990,205 outstanding options under the 1993 and 2004 Stock Incentive Plans. On July 28, 2004, the Company issued a total of 6,400 restricted shares of common stock to its non-employee directors under the 2004 Stock Incentive Plan.

The Company accounts for stock options in accordance with APB 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, which is the measurement date.

A summary of the plan's shares under option at December 31, 2004, 2003 and 2002 follows:

	2004 Shares (thousands)	2004 Weighted-average exercise price	2003 Shares (thousands)	2003 Weighted-average exercise price	2002 Shares (thousands)	2002 Weighted-average exercise price
Outstanding at beginning of year	**2,680**	**$26.44**	3,650	$23.29	2,986	$22.34
Granted	**1,063**	**44.56**	682	32.74	1,232	25.34
Exercised	**(593)**	**24.22**	(1,518)	21.80	(434)	22.61
Forfeited	**(160)**	**26.74**	(134)	25.03	(134)	23.13
Outstanding at end of year	**2,990**	**$33.30**	2,680	$26.44	3,650	$23.29
Options exercisable at year-end	**793**	**$23.78**	554	$22.57	1,188	$22.61
Options available for future grants	**1,637**					

The following table summarizes information about stock options outstanding at December 31, 2004:

Range of exercise prices	Options outstanding: Number outstanding (thousands)	Weighted-average remaining contractual life	Weighted-average exercise price	Options exercisable: Number exercisable (thousands)	Weighted-average exercise price
$12.78-21.13	156	5.0	$18.31	156	$18.31
$24.14-26.56	1,106	7.1	25.14	575	24.90
$26.94-44.56	1,728	9.0	39.88	62	27.18
$12.78-44.56	2,990	8.1	$33.30	793	$23.78

The weighted average fair value at date of grant for options granted during 2004, 2003, and 2002 were $16.28, $11.91, and $10.13, respectively, and were estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	2004	2003	2002
Risk-free interest rate	**4.14%**	3.58%	4.34%
Dividend yield	**1.26%**	1.27%	1.32%
Volatility factor	**32.89%**	34.38%	33.66%
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 that provides payouts to members of senior management 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, 2004, 2003 and 2002, the amounts expensed under the plan and the related share issuances were as follows:

	2004	2003	2002
Expense ($ millions)	**$2.0**	$2.7	$ 4.5
Number of shares*	**48,569**	41,252	131,762

*Shares are issued in February of the following year.

Estimated shares issuable under the plan are included in the computation of diluted earnings per share as earned. Under the terms of the Executive Stock Performance Plan, the final three-year period for which awards have been granted was for the three-year period beginning January 1, 2004 and ending on December 31, 2006.

NOTE 10
OTHER COMPREHENSIVE INCOME

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

millions of dollars	2004	2003
Foreign currency translation adjustments, net	**$ 99.7**	$ 74.3
Market value of hedge instruments, net	**3.2**	0.2
Minimum pension liability adjustment, net	**(47.7)**	(60.5)
Accumulated other comprehensive income	**$ 55.2**	$ 14.0

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

millions of dollars	2004	2003	2002
Foreign currency translation adjustments	**$10.7**	$67.6	$ 55.9
Market value of hedge instruments	**4.7**	0.4	—
Income taxes	**13.0**	(0.2)	(15.0)
Net foreign currency translation and hedge instruments adjustment	**28.4**	67.8	40.9
Minimum pension liability adjustment	**17.2**	1.1	(65.4)
Income taxes	**(4.4)**	(0.4)	23.1
Net minimum pension liability adjustment	**12.8**	0.7	(42.3)
Other comprehensive income/(loss)	**$41.2**	$68.5	$ (1.4)

NOTE 11
CONTINGENCIES

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

Environmental The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency (EPA) and certain state environmental agencies and private parties as potentially responsible parties (PRPs) at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 39 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 and consulting 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, 2004 of approximately $25.7 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. The liabilities at issue result from operations of Kuhlman Electric that pre-date the Company's acquisition of Kuhlman Electric's parent company, Kuhlman Corporation, during 1999. 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 numerous related lawsuits, in which multiple claimants allege personal injury and property damage. The Company has moved to be dismissed from some of these lawsuits. The first trial in these lawsuits is currently scheduled to begin in March 2005.

The Company believes that the accrual 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 accrued.

Product Liability Like many other industrial companies who have historically operated in the United States, the Company (or parties the Company indemnifies) continues to be named as one of many defendants in asbestos-related personal injury actions. Management believes that the Company's involvement is limited because, in general, these claims relate to a few types of automotive friction products, manufactured many years ago that contained encapsulated asbestos. The nature of the fibers, the encapsulation and the manner of use lead the Company to believe that these products are highly unlikely to cause harm. At December 31, 2004, the Company had approximately 100,000 pending asbestos-related product liability claims. Of these outstanding claims, approximately 92,000 are pending in just three jurisdictions, where significant tort reform activities are underway. The Company's policy is to aggressively defend against these lawsuits and the Company has been successful in obtaining dismissal of many claims without any payment. The Company expects that the vast majority of the pending asbestos-related product liability claims where it is a defendant (or has an obligation to indemnify a defendant) will result in no payment being made by the Company or its insurers. In 2004 of the 4,062 claims settled, only 255 (6.3%) resulted in any payment being made to a claimant by or on behalf of the Company. In 2003 of the 4,664 claims settled, only 273 (5.9%) resulted in any payment being made to claimants. The settlement costs of these claims were paid by the insurance carriers, except for the $1.0 million in 2004 as described in the paragraph below. Based upon the encapsulated nature of the products, our experiences in aggressively defending and resolving claims in the past, and our significant insurance coverage with solvent carriers as of the date of this filing, management does not believe that asbestos-related product liability claims are likely to have a material adverse effect on the Company's results of operations, cash flows or financial condition.

Prior to June 2004, all claims were covered by the Company's primary layer insurance coverage, and these carriers administered, defended, settled and paid all claims under a funding agreement. In June 2004, the Company was notified by primary layer insurance carriers of the exhaustion of their policy limits. This led the Company to access the next available layer of insurance coverage. Since June 2004, secondary layer insurers have paid asbestos-related litigation defense and settlement expenses pursuant to a funding agreement. Two secondary layer insurers are currently not participating in this arrangement, until they are satisfied through an audit process, that the primary level of insurance is exhausted. The Company therefore paid $1.0 million in defense and settlement costs in late 2004 and expects to recover those amounts from either these insurers, or the primary layer insurers if the exhaustion audit shows that primary layer insurance is still available.

The Company's contractual relationship with the secondary layer carriers provides a change in circumstances and allows the Company to take a more direct role in defending and settling claims than with the primary carriers. Previously, the Company's arrangement utilized the primary layer insurance carriers' positions to defend and negotiate the settlements with periodic input from the Company.

At December 31, 2004, the Company recorded a liability of $40.8 million; with a related asset of $40.8 million to recognize the insurance proceeds receivable to the Company for estimated claim losses. For 2003, the comparable value of the insurance receivable and accrued liability is $41.6 million.

The amounts recorded in the Consolidated Balance Sheets are as follows:

millions of dollars	2004	2003
Assets:		
Prepayments and other current assets	**$13.5**	$13.7
Other non-current assets	**27.3**	27.9
Total insurance receivable	**$40.8**	$41.6
Liabilities:		
Accounts payable and accrued expenses	**$13.5**	$13.7
Long-term liabilities – other	**27.3**	27.9
Total accrued liability	**$40.8**	$41.6

The insurance receivable and accrued liability of $41.6 million in 2003 have been reclassified as outlined above and the reclassification is not material to the Company's Consolidated Financial Statements.

We cannot reasonably estimate possible losses, if any, in excess of those for which we have accrued, because we cannot predict how many additional claims may be brought against the Company (or parties the Company has an obligation to indemnify) in the future, the allegations in such claims, the possible outcomes, or the impact of tort reform legislation currently being considered at the State and Federal level.

A declaratory judgment action was filed in January 2004 in the Circuit Court of Cook County, Illinois by Continental Casualty Company and related companies (CNA) against the Company and certain of its other historical general liability insurers. CNA provided the Company with both primary and additional layer insurance, and, in conjunction with other insurers, is currently defending and indemnifying the Company in all of its pending asbestos-related product liability claims. The lawsuit seeks to determine the extent of insurance coverage available to the Company including whether the available limits exhaust on a "per occurrence" or an "aggregate" basis, and to determine how the applicable coverage responsibilities should be apportioned. In addition to the primary insurance available for asbestos-related claims, the Company has substantial additional layers of insurance available for potential future asbestos-related product claims.

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

NOTE 12
LEASES AND COMMITMENTS

Certain assets are leased under long-term operating leases. These include production equipment at one plant, rent for the corporate headquarters, and an airplane. 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 $18.0 million in 2004, $13.4 million in 2003, and $11.4 million in 2002. The Company does not have any material capital leases.

The Company has guaranteed the residual values of certain leased production 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 production 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, 2004 were as follows:

millions of dollars	
2005	$29.1
2006	4.7
2007	4.3
2008	3.8
2009	3.3
After 2009	12.8
Total minimum lease payments	$58.0

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

The royalty costs recognized under the agreements were $14.2 million in 2004, $23.2 million in 2003 and $13.5 million in 2002. These costs were all recognized as part of cost of goods sold. These costs will be at minimal levels in 2005 and 2006 as the Company's primary customers have converted most of their requirements to the next generation VTG turbocharger.

NOTE 13
STOCK SPLIT

On April 21, 2004 the Company's stockholders approved an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares of common stock from 50,000,000 to 150,000,000. The approval of the amendment allowed the Company to proceed with its two-for-one stock split on May 17, 2004 to stockholders of record on May 3, 2004. All prior year share and per share amounts disclosed in this document have been restated to reflect the two-for-one stock split.

NOTE 14
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 665,000, 488,000, and 458,000 for 2004, 2003 and 2002, respectively, due to the effects of stock options and shares issuable under the executive stock performance plan.

NOTE 15
SUBSEQUENT EVENT

On January 4, 2005, the Company acquired 62.2% of the outstanding shares of Beru Aktiengesellschaft (Beru), headquartered in Ludwigsburg, Germany, from the Carlyle Group and certain family shareholders. In conjunction with the acquisition, the Company launched a tender offer for the remaining outstanding shares of Beru. The tender offer period officially ended on January 24, 2005. Presently the Company holds 69.42% of the shares of Beru at a cost of approximately €415 million. Beru is a leading global automotive supplier of diesel cold starting technology (glow plugs and instant starting systems); gasoline ignition technology (spark plugs and ignition coils); and electronic and sensor technology (tire pressure sensors, diesel cabin heaters and selected sensors). Beginning in 2005, the Company will report Beru within the Engine segment. The Company has not included a separate discussion of the Beru operations in the outlook for 2005, although many of the same factors that impact the Company's other operations can be expected to impact the business of Beru. In addition, the impact of Beru on the Company's future results will be affected by the allocation of the excess purchase price over the net book value of assets acquired between intangible assets and goodwill.

NOTE 16
OPERATING SEGMENTS AND RELATED INFORMATION

The Company's business is 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 the operating segments' performance based upon return on invested capital. The return on invested capital is comprised of earnings before income and taxes and the average capital invested in each operating segment. Inter-segment sales, which are not significant, are recorded at market prices. This footnote presents summary segment information.

Operating Segments

millions of dollars	Net sales: Customers	Net sales: Inter-segment	Net sales: Net	Earnings before interest and taxes	Year end assets	Depr./amort.	Long-lived asset expenditures[b]
2004							
Drivetrain	**$1,358.6**	**$ —**	**$1,358.6**	**$106.9**	**$ 810.0**	**$ 66.1**	**$ 75.3**
Engine	**2,166.7**	**50.3**	**2,217.0**	**281.7**	**2,208.4**	**107.3**	**167.7**
Inter-segment eliminations	**—**	**(50.3)**	**(50.3)**	**—**	**—**	**—**	**—**
Total	**3,525.3**	**—**	**3,525.3**	**388.6**	**3,018.4**	**173.4**	**243.0**
Corporate	**—**	**—**	**—**	**(50.3)**	**510.7[a]**	**3.6**	**9.4**
Consolidated	**$3,525.3**	**$ —**	**$3,525.3**	**$338.3**	**$3,529.1**	**$177.0**	**$252.4**
Interest expense and finance charges				**29.7**			
Earnings before income taxes				**$308.6**			

millions of dollars	Net sales: Customers	Net sales: Inter-segment	Net sales: Net	Earnings before interest and taxes	Year end assets	Depr./amort.	Long-lived asset expenditures[b]
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)	436.6[a]	7.4	14.7
Consolidated	$3,069.2	$ —	$3,069.2	$290.0	$3,140.5	$161.3	$214.4
Interest expense and finance charges				33.3			
Earnings before income taxes				$256.7			

millions of dollars	Net sales: Customers	Net sales: Inter-segment	Net sales: Net	Earnings before interest and taxes	Year end assets	Depr./amort.	Long-lived asset expenditures[b]
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[a]	6.1	19.9
Consolidated	$2,731.1	$ —	$2,731.1	$271.5	$2,682.9	$137.4	$166.1
Interest expense and finance charges				37.7			
Earnings before income taxes				$233.8			

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

(b) Long-lived asset expenditures includes capital expenditures and tooling outlays, net of customer reimbursements.

Geographic Information

No country outside the U.S., other than Germany and the United Kingdom, 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. Also, the Company's 50% equity investment in NSK-Warner (see Note 5) amounting to $188.2 million at December 31, 2004 is excluded from the definition of long-lived assets, as are goodwill and certain other non-current assets.

millions of dollars	Net sales 2004	Net sales 2003	Net sales 2002	Long-lived assets 2004	Long-lived assets 2003	Long-lived assets 2002
United States	**$1,964.9**	$1,889.2	$1,859.1	**$ 637.1**	$ 636.9	$643.0
Europe:						
Germany	**834.1**	637.7	453.4	**278.7**	234.6	182.3
United Kingdom	**186.0**	146.3	129.1	**39.5**	36.4	28.1
Other Europe	**237.1**	167.7	106.9	**106.1**	78.3	44.3
Total Europe	**1,257.2**	951.7	689.4	**424.3**	349.3	254.7
Other foreign	**303.2**	228.3	182.6	**117.9**	89.6	80.8
Total	**$3,525.3**	$3,069.2	$2,731.1	**$1,179.3**	$1,075.8	$978.5

Sales to Major Customers

Consolidated sales included sales to Ford Motor Company of approximately 21%, 23%, and 26%; to DaimlerChrysler of approximately 14%, 17%, and 20%; and to General Motors Corporation of approximately 10%, 12%, and 12% for the years ended December 31, 2004, 2003 and 2002, respectively. Sales to Volkswagen were approximately 10% in 2004. Both of our operating segments had significant sales to all four of the customers listed above. Such sales consisted of a variety of products to a variety of customer locations and regions. No other single customer accounted for more than 10% of consolidated sales in any year of the periods presented.

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 2004 and 2003 interim results of operations. Certain 2004 and 2003 quarterly amounts have been reclassified to conform to the annual presentation.

millions of dollars, except per share amounts Quarter Ended,	2004 Mar-31	2004 Jun-30	2004 Sep-30	2004 Dec-31	Year 2004	2003 Mar-31	2003 Jun-30	2003 Sep-30	2003 Dec-31	Year 2003
Net sales	**$903.1**	**$893.2**	**$839.8**	**$889.2**	**$3,525.3**	$775.7	$769.5	$725.2	$798.8	$3,069.2
Cost of sales	**730.5**	**723.4**	**694.7**	**725.5**	**2,874.2**	624.2	622.8	595.9	639.7	2,482.5
Gross profit	**172.6**	**169.8**	**145.1**	**163.7**	**651.1**	151.5	146.7	129.3	159.1	586.7
Selling, general and administrative expenses	**94.7**	**87.8**	**77.4**	**79.1**	**339.0**	83.6	77.0	72.7	83.5	316.9
Other, net	**0.3**	**0.6**	**(0.5)**	**2.7**	**3.0**	—	0.1	0.1	(0.4)	(0.1)
Operating income	**77.6**	**81.4**	**68.2**	**81.9**	**309.1**	67.9	69.6	56.5	76.0	269.9
Equity in affiliate earnings, net of tax	**(6.5)**	**(8.4)**	**(6.2)**	**(8.1)**	**(29.2)**	(6.4)	(5.2)	(3.6)	(4.8)	(20.1)
Interest expense, net	**7.5**	**7.7**	**7.5**	**7.0**	**29.7**	9.0	8.7	8.1	7.5	33.3
Income before income taxes	**76.6**	**82.1**	**66.9**	**83.0**	**308.6**	65.3	66.1	52.0	73.3	256.7
Provision for income taxes	**22.9**	**24.6**	**20.1**	**13.5**	**81.2**	18.9	19.2	14.2	20.9	73.2
Minority interest, net of tax	**2.6**	**2.8**	**2.0**	**1.8**	**9.1**	2.2	2.1	1.9	2.4	8.6
Net earnings	**$ 51.1**	**$ 54.7**	**$ 44.8**	**$ 67.7**	**$ 218.3**	$ 44.2	$ 44.8	$ 35.9	$ 50.0	$ 174.9
Earnings/(loss) per share – basic	**$ 0.92**	**$ 0.98**	**$ 0.80**	**$ 1.20**	**$ 3.91**	$ 0.83	$ 0.83	$ 0.66	$ 0.91	$ 3.23
Earnings/(loss) per share – diluted	**$ 0.91**	**$ 0.97**	**$ 0.79**	**$ 1.19**	**$ 3.86**	$ 0.82	$ 0.83	$ 0.65	$ 0.90	$ 3.20

millions of dollars, except per share data For the Year Ended December 31,	2004	2003	2002	2001	2000
STATEMENT OF OPERATIONS DATA					
Net sales	**$3,525.3**	$3,069.2	$2,731.1	$2,351.6	$2,645.9
Cost of sales	**2,874.2**	2,482.5	2,176.5	1,890.8	2,090.7
Gross profit	**651.1**	586.7	554.6	460.8	555.2
Selling, general and administrative expenses	**339.0**	316.9	303.5	249.7	258.7
Goodwill amortization	**—**	—	—	42.0	43.3
Other, net	**3.0**	(0.1)	(0.9)	(2.1)	(8.1)
Restructuring and other non—recurring charges	**—**	—	—	28.4[b]	62.9[c]
Operating income	**309.1**	269.9	252.0	142.8	198.4
Equity in affiliate earnings, net of tax	**(29.2)**	(20.1)	(19.5)	(14.9)	(15.7)
Interest expense, net	**29.7**	33.3	37.7	47.8	62.6
Earnings before income taxes	**308.6**	256.7	233.8	109.9	151.5
Provision for income taxes	**81.2**	73.2	77.2	39.7	54.8
Minority interest, net of tax	**9.1**	8.6	6.7	3.8	2.7
Net earnings before cumulative effect of accounting change	**218.3**	174.9	149.9	66.4	94.0
Cumulative effect of change in accounting principle, net of tax	—	—	(269.0)[a]	—	—
Net earnings/(loss)	**$ 218.3**	$ 174.9	$ (119.1)	$ 66.4	$ 94.0
Earnings/(loss) per share — basic	**$ 3.91**	$ 3.23	$(2.23)[a]	$ 1.26[b]	$ 1.78[c]
Average shares outstanding (thousands) — basic	**55,872**	54,116	53,250	52,630	52,782
Earnings/(loss) per share — diluted	**$ 3.86**	$ 3.20	$ (2.22)[a]	$ 1.26[b]	$ 1.77[c]
Average shares outstanding (thousands) — diluted	**56,537**	54,604	53,708	52,926	52,974
Cash dividend declared per share	**$0.50**	$ 0.36	$ 0.30	$ 0.30	$ 0.30
BALANCE SHEET DATA (at end of period)					
Total assets	**$3,529.1**	$3,140.5	$2,682.9	$2,770.9	$2,739.6
Total debt	**584.5**	655.5	646.7	737.0	794.8

(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 $5.01 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 $0.36 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 $0.74 per diluted share.

Company Information

BorgWarner Inc.
World Headquarters
3850 Hamlin Road
Auburn Hills, MI 48326
248-754-9200
www.borgwarner.com

Stock Listing

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

	High	Low
Fourth Quarter 2004	**$54.68**	**$39.50**
Third Quarter 2004	**48.77**	**40.73**
Second Quarter 2004	**45.08**	**38.35**
First Quarter 2004	**49.32**	**39.84**
Fourth Quarter 2003	$ 42.75	$ 34.14
Third Quarter 2003	36.68	31.72
Second Quarter 2003	33.13	23.68
First Quarter 2003	27.70	21.66

Certifications

- BorgWarner filed as an exhibit to its Annual Report on Form 10-K the CEO and CFO certifications as required by Section 302 of the Sarbanes-Oxley Act.
- BorgWarner also submitted the required annual CEO certification to the NYSE.

Dividends

The current dividend practice established by the Board of Directors is to declare regular quarterly dividends. The last such dividend of 14 cents per share of common stock was declared on November 10, 2004, payable February 15, 2005, to stockholders of record on February 1, 2005. The current practice is subject to review and change at the discretion of the Board of Directors.

Stockholder 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 2005 annual meeting of stockholders will be held on Wednesday, April 27, 2005, beginning at 9:00 a.m. at the BorgWarner World Headquarters at 3850 Hamlin Road, Auburn Hills, Michigan.

Stockholders

As of December 31, 2004, there were 2,877 holders of record and an estimated 18,000 beneficial holders.

Investor Information

Visit www.borgwarner.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
- Stockholder 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 10-K)
- 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.borgwarner.com
2. Click Investor Information
3. Click News
4. 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 World Headquarters, 248-754-0882.

BorgWarner Inc. owns U.S. trademark registrations for: BorgWarner, [logo], BorgWarner, and Visctronic. BorgWarner owns the following trademarks: ITM, InterActive Torque Management, Pre-emptive Torque Management, Morse Gemini, DualTronic and Regulated Two-Stage Turbocharger (R2S).

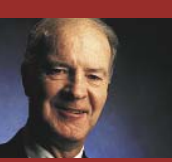
Directors

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

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

David T. Brown
President, Chief Executive Officer and Director
Owens Corning

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

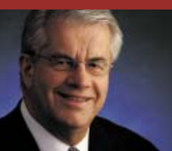


Jere A. Drummond (1,3,4)
Vice Chairman, Retired
BellSouth Corporation

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

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 as of March 2005

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

Robin J. Adams
Executive Vice President, Chief Financial Officer and Chief Administrative Officer

Cynthia A. Niekamp
Vice President, President and General Manager TorqTransfer Systems

Mark A. Perlick
Vice President, President and General Manager Transmission 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, Acquisition Coordination and Special Projects

Angela J. D'Aversa
Vice President, Human Resources

Jamal M. Farhat
Vice President and Chief Information Officer

Anthony D. Hensel
Vice President and Treasurer

Laurene H. Horiszny
Vice President, General Counsel and Secretary

John J. McGill
Vice President, Global Supply Chain and Champion of Emerging Market Utilization

Jeffrey L. Obermayer
Vice President and Controller

Christopher H. Vance
Vice President, Business Development and M&A

BorgWarner Inc.
World Headquarters
3850 Hamlin Road
Auburn Hills, MI 48326
www.borgwarner.com