

TO OUR SHAREOWNERS:

1999 was our year to celebrate a century of people serving customers through manufacturing mastery. Your team diligently worked to integrate 13 acquisitions since 1997, making Federal-Mogul a global technology leader in powertrain systems and brake systems. Innovative technology resulting from these acquisitions underscored many new product launches for our customers around the world. We increased sales revenue by 3.5 times and operating profit by 6 times. We have built a solid foundation for the next century, making operational excellence our highest priority.

1999 FINANCIAL RESULTS

Federal-Mogul had record earnings from operations of \$4.04 per share, a 50 percent increase from the \$2.69 per share in 1998. Earnings per share from operations exclude integration costs, extraordinary and other non-recurring items. Including these items, Federal-Mogul earned \$3.16 per share compared to \$.96 in 1998.

For 1999, Federal-Mogul had record sales of \$6,488 million, compared to \$4,469 million in 1998, a 45 percent increase. The company generated \$167 million in free cash flow from operations in 1999, an improvement of \$100 million over 1998. Over the past two years, after having expended more than \$600 million for capital investments and nearly \$500 million on restructuring, integration and asbestos payments, our operations still generated cash of well over \$200 million.

Even though tremendous acquisition, restructuring, consolidation and integration activities have marked the past two years, our key credit ratios have continued to improve. As a result, our borrowing costs under our bank credit agreements have recently been reduced by 25 basis points.

Despite the dedicated attention that we had to give to the consolidation and integration of our acquisitions, the financial performance of our company has steadily improved. The fourth quarter of 1999 marked the twelfth consecutive quarter of increased year-over-year earnings per share.

OPERATIONAL EXCELLENCE

We have dedicated the coming year to operational excellence. Our focus will be in three areas — customer delight, becoming the low-cost provider in all product categories, and substantially reducing our invested capital base.

GROWTH STRATEGY

We have both a solid financial foundation and a sound strategy for long-term growth. We follow a very disciplined acquisition process that has strategic and financial hurdles that must be met.

The strategic hurdles were developed to better serve our customers by:

- Expanding our product lines into systems and modules to enhance value;
- Expanding globally to follow and serve original equipment customers; and
- Leveraging our global manufacturing base into local aftermarkets.

The financial hurdles are:

- EVA positive;
- Cash positive;
- Accretive to earnings in the near term; and
- Maintenance of a strong balance sheet with the appropriate combination of equity and debt with an investment grade objective.

OUR FUTURE

We will maintain and grow our position as a global leader in the automotive industry with our focus on operational excellence in the year 2000 and beyond — keeping relentless focus on the customer, being the low-cost provider of our value package, and reducing our invested capital base. I can assure you that our entire organization is on the same page and committed to these imperatives.

We're starting our second hundred years, clearly a company on the move delivering value.



Dick Snell
Chairman and Chief Executive Officer



**People serving customers
through manufacturing mastery.**

- ☐ We are a team first.
- ☐ We respect, trust and help each other.
- ☐ We act with integrity.
- ☐ We are driven toward mastery in all we do.
- ☐ We **CELEBRATE** our success.

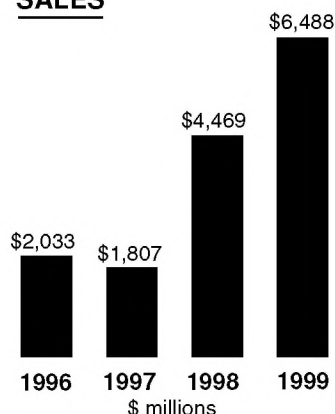
(Dollars in millions, except per share amounts)

Financial Information	1999	1998	1997	1996
Net sales	\$ 6,487.5	\$ 4,468.7	\$ 1,806.6	\$ 2,032.7
Earnings before interest and taxes (EBIT)	\$ 749.1	\$ 398.8	\$ 127.2	\$ (187.2)
Net earnings (loss)	\$ 243.2	\$ 53.7	\$ 69.4	\$ (206.3)
Earnings before interest, taxes, depreciation and amortization (EBITDA)	\$ 1,104.0	\$ 626.8	\$ 178.7	\$ (125.3)
Operating cash flow	\$ 562.4	\$ 325.5	\$ 215.7	\$ 149.0
Working capital	\$ 1,008.5	\$ 1,686.3	\$ 382.3	\$ 505.6
Total assets	\$ 9,945.2	\$ 9,940.1	\$ 1,802.1	\$ 1,455.2
Total debt/capital	58%	57%	24%	61%
Capital expenditures	\$ 395.2	\$ 228.5	\$ 49.7	\$ 54.2
Economic value added	\$ (15)	\$ 13	\$ (18)	\$ (121)
Number of employees	50,400	54,350	13,300	15,700
Common Stock Information	1999	1998	1997	1996
Price per share as of year-end	\$ 20 ¹ / ₈	\$ 59 ¹ / ₂	\$ 40 ¹ / ₂	\$ 22
Net earnings (loss) per share assuming dilution	\$ 3.16	\$ 0.96	\$ 1.61	\$ (6.20)
Weighted average shares outstanding (millions, diluted)	84.2	53.7	41.9	34.7

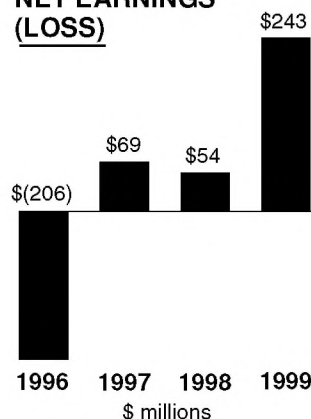
Forward-Looking Statements

This annual report contains forward-looking statements relating to, among other things, the combination of the Company's business with those of T&N, Cooper Automotive, Fel-Pro and the ability to achieve operating improvements, conditions in the automotive components industry, and certain regional and global economic conditions. Consequently, actual events and results may vary significantly from those included in, contemplated or implied by such statements.

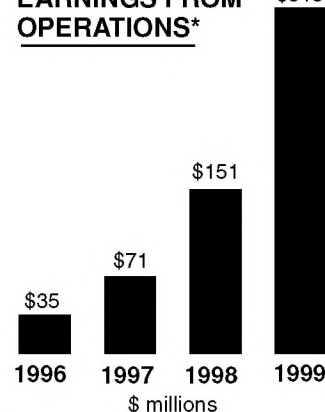
SALES



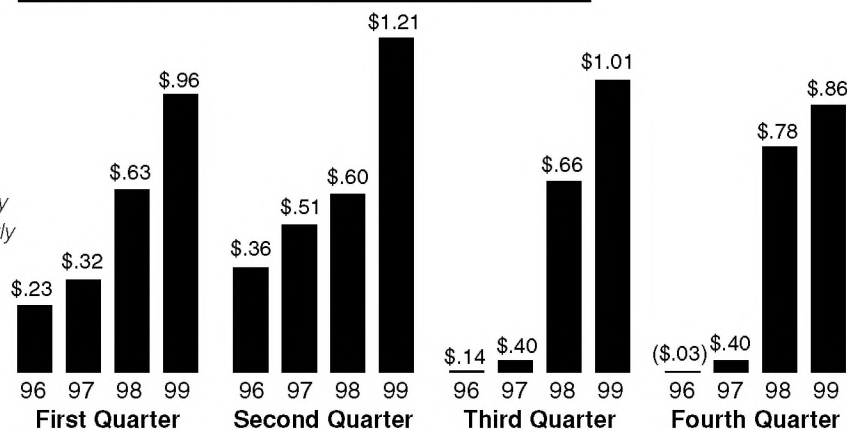
NET EARNINGS (LOSS)



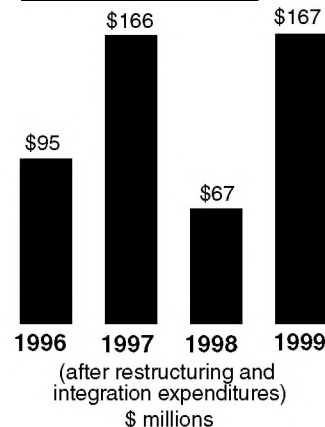
EARNINGS FROM OPERATIONS*



EARNINGS PER SHARE FROM OPERATIONS*



FREE CASH FLOW**



* Excludes restructuring, purchased-in-process research and development, reengineering, adjustment of assets held for sale to fair value, integration costs, net loss (gain) on British pound currency option and forward contract, extraordinary items and the impact of the acquired inventory fair market value writeups.

** Operating cash flow less capital expenditures, and for 1998, cash received of \$30.6 million relating to the British pound currency option and forward contract.

FIVE-YEAR FINANCIAL SUMMARY

	1999	1998	1997	1996	1995
	(Millions of Dollars, Except Per Share Amounts)				
Consolidated Statement of Operations Data					
Net sales	\$ 6,487.5	\$ 4,468.7	\$ 1,806.6	\$ 2,032.7	\$ 1,999.8
Costs and expenses	(6,006.2)(1)	(4,266.9)(2)	(1,703.7)(3)	(2,258.0)(4)	(2,000.7)(5)
Other expense	(21.4)	(16.3)	(3.4)	(3.4)	(2.4)
Income tax (expense) benefit	(180.9)	(93.6)	(27.5)	22.4	(2.5)
Net earnings (loss) before extraordinary items and net effect of cumulative effect of change in accounting principle	279.0	91.9	72.0	(206.3)	(5.8)
Extraordinary items — loss on early retirement of debt, net of applicable income tax benefits	(23.1)	(38.2)	(2.6)	—	—
Cumulative effect of change in accounting for costs of start-up activities, net of applicable income tax benefit	(12.7)	—	—	—	—
Net earnings (loss)	\$ 243.2	\$ 53.7	\$ 69.4	\$ (206.3)	\$ (5.8)
Common Share Summary (Diluted)					
Average shares and equivalents outstanding (in thousands)	84,206	53,748	41,854	34,659	34,642
Earnings (loss) per share:					
Before extraordinary items and cumulative effect of a change in accounting principle	\$ 3.59	\$ 1.67	\$ 1.67	\$ (6.20)	\$ (.42)
Extraordinary items — loss on early retirement of debt, net of applicable income tax benefits	(.28)	(.71)	(.06)	—	—
Cumulative effect of change in accounting for costs of start-up activities, net of applicable income tax benefit	(.15)	—	—	—	—
Net earnings (loss) per share	\$ 3.16	\$.96	\$ 1.61	\$ (6.20)	\$ (.42)
Dividends declared per share	\$.01	\$.1275	\$.48	\$.48	\$.48
Consolidated Balance Sheet Data					
Total assets	\$ 9,945.2	\$ 9,940.1	\$ 1,802.1	\$ 1,455.2	\$ 1,701.1
Short-term debt(6)	190.8	211.0	28.6	280.1	111.9
Long-term debt	3,020.0	3,130.7	273.1	209.6	481.5
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely convertible subordinated debentures of the Company	575.0	575.0	575.0	—	—
Shareholders' equity	2,075.2	1,986.2	369.3	318.5	550.3
Other Financial Information					
Net cash provided from (used by) operating activities	\$ 562.4	\$ 325.5	\$ 215.7	\$ 149.0	\$ (34.7)
Expenditures for property, plant, equipment and other long-term assets	395.2	228.5	49.7	54.2	78.5
Depreciation and amortization expense	354.9	228.0	51.5	61.9	59.2

(1) Includes a \$46.9 million charge for integration costs and a \$7.9 million charge for adjustment of assets held for sale and other long-lived assets to fair value.

(2) Includes a \$7.3 million net restructuring charge, a \$19.0 million net charge for adjustment of assets held for sale and other long-lived assets to fair value, an \$18.6 million charge for purchased in-process research and development, a \$22.4 million charge for integration costs and a \$13.3 million net gain related to the British pound currency option and forward contract.

(3) Includes a \$1.1 million net restructuring credit, a \$2.4 million charge for adjustment of assets held for sale and other long-lived assets to fair value, a \$1.6 million credit for reengineering and other

related charges, and a \$10.5 million charge related to the British pound currency option and forward contract.

(4) Includes a \$57.6 million restructuring charge, a \$151.3 million charge for adjustment of assets held for sale and other long-lived assets to fair value, and \$11.4 million relating to reengineering and other related charges.

(5) Includes a \$26.9 million restructuring charge, a \$51.8 million charge for adjustment of assets held for sale and other long-lived assets to fair value, and \$13.9 million relating to reengineering and other related charges.

(6) Includes current maturities of long-term debt (see Note 6 to the consolidated financial statements).

OVERVIEW

Federal-Mogul Corporation is an automotive parts manufacturer providing innovative solutions and systems to global customers in the automotive, small engine, heavy-duty, and industrial markets. The Company manufactures engine bearings, sealing systems, fuel systems, lighting products, pistons, ignition, brake, friction and chassis products. The Company's principal customers include many of the world's original equipment ("OE") manufacturers of such vehicles and industrial products. The Company also manufactures and supplies its products and related parts to the aftermarket.

RESULTS OF OPERATIONS**Net Sales**

Sales by operating segment were:

	1999	1998	1997
	(Millions of Dollars)		
Powertrain Systems	\$ 2,459	\$ 2,107	\$ 782
Sealing Systems, Visibility and Systems Protection Products	1,887	1,252	333
Brake, Chassis, Ignition and Fuel Products	2,123	1,036	577
Divested Activities	19	74	115
Total Sales	\$ 6,488	\$ 4,469	\$ 1,807

Powertrain Systems

Sales increased 17% from 1998 to 1999 primarily due to the full year effect of the 1998 acquisitions of T&N and Triway, the 1999 acquisitions of Alcan and Crane and higher North American OE sales. These increases were partially offset by the impact of foreign exchange rates, lower European OE sales due mainly to softness in the U.K. markets and lower aftermarket sales due to an overall decrease in the engine parts market size due to improved OE quality.

Sales increased 169% from 1997 to 1998 primarily due to the acquisition of T&N and certain OE volume increases, partially offset by lower aftermarket sales and the impact of foreign exchange rates. Sales in the aftermarket were impacted by an overall decrease in the engine parts market size due to improved OE quality, and the bankruptcy of a major customer in the North American aftermarket.

Sealing Systems, Visibility and Systems Protection Products

Sales increased 51% from 1998 to 1999 primarily due to the full year effect of the 1998 acquisitions of Cooper Automotive, T&N and Fel-Pro and higher North American OE sales. These increases were partially offset by the impact of foreign exchange rates and lower European sales.

Sales increased 276% from 1997 to 1998 primarily due to the acquisitions of Cooper Automotive, T&N and Fel-Pro and OE sales increases due to certain model volume increases. These increases were partially offset by aftermarket sales decreases primarily due to the bankruptcy of a major customer in the North American aftermarket.

Brake, Chassis, Ignition and Fuel Products

Sales increased 105% from 1998 to 1999 primarily due to the full year effect of the 1998 acquisitions of Cooper Automotive and T&N and higher North American OE sales. These increases were partially offset by the loss of certain domestic aftermarket business and the impact of foreign exchange rates.

Sales increased 80% from 1997 to 1998 primarily due to the acquisitions of T&N and Cooper Automotive and certain OE volume increases. These increases were partially offset by the impact of foreign exchange rates and the bankruptcy of a major customer in the North American aftermarket.

Operational EBIT

The accounting policies of the business segments are consistent with those described in Note 1, "Accounting Policies." Operational EBIT is defined as earnings before interest, income taxes, extraordinary items and certain nonrecurring items such as certain acquisition-related adjustments and integration costs associated with new acquisitions.

	1999	1998	1997
	(Millions of Dollars)		
Powertrain Systems	\$ 262	\$ 248	\$ 68
Sealing Systems, Visibility and Systems Protection Products	297	154	26
Brake, Chassis, Ignition and Fuel Products	277	104	44
Divested Activities	(1)	(4)	1
Operational EBIT	\$ 835	\$ 502	\$ 139

Powertrain Systems

Operational EBIT increased 6% in 1999 from 1998. This increase was due to higher OE sales from the full year effect of the 1998 acquisitions of T&N and Triway, the 1999 acquisitions of Alcan and Crane, reduced administrative costs, material sourcing savings and other synergies as a result of the acquisitions. This increase was partially offset by productivity issues in the camshaft operations and lower aftermarket sales. Operational EBIT increased 265% in 1998 from 1997 due to the increase in sales noted above, as well as the streamlining of product engineering costs and the implementation of the Company's constraint management programs across the combined companies.

Sealing Systems, Visibility and Systems Protection Products

Operational EBIT increased 93% in 1999 from 1998. This increase was due to higher sales from the full year effect of the 1998 acquisitions of Cooper Automotive and T&N and reduced administrative costs and material sourcing savings as a result of the acquisitions. Operational EBIT increased 492% in 1998 from 1997 due to higher sales, reduced administrative costs and material sourcing savings as a result of the acquisitions.

Brake, Chassis, Ignition and Fuel Products

Operational EBIT increased 166% in 1999 from 1998. This increase was due to higher sales from the full year effect of the 1998 acquisitions of Cooper Automotive and T&N, reduced administrative costs and material sourcing savings as a result of the acquisitions. These increases were partially offset by the loss of certain aftermarket customers. Operational EBIT increased 136% in 1998 from 1997 due to increased sales, material sourcing savings and implementation of constraint management practices as a result of the acquisitions.

Purchased In-Process Research and Development Charge

In connection with the T&N acquisition, the Company recognized an \$18.6 million charge in the first quarter of 1998 associated with the estimated fair value of purchased in-process research and development for which technological feasibility had not been established and the in-process technology had no future alternative uses.

Rationalization of Acquired Businesses

In connection with the T&N, Cooper Automotive and Fel-Pro acquisitions in 1998 the Company recognized \$216.8 million as acquired liabilities related to the rationalization and integration of acquired businesses. The rationalization reserves provided for \$180.0 million in relocation and severance costs and \$36.8 million in exit costs, and were recorded as a component of goodwill in the purchase price allocation.

The components of the integration plan included: closure of certain manufacturing facilities worldwide; relocation of highly manual manufacturing product lines to more suitable locations; consolidation of overlapping manufacturing, technical and sales facilities and joint ventures; consolidation of overlapping aftermarket warehouses; consolidation of aftermarket marketing and customer support functions; and streamlining of administrative, sales, marketing and product engineering staffs worldwide.

The Company paid \$72.2 million and \$61.6 million related to these rationalization reserves in 1999 and 1998, respectively. Also during 1999, the Company made adjustments to reduce the rationalization reserves, with an offsetting amount to goodwill, by \$47.9 million. These adjustments related to the finalization of rationalization plans. As of December 31, 1999, remaining rationalization reserves were \$30.3 million, primarily relating to the closure of several Powertrain Systems facilities in Europe and the consolidation of aftermarket warehouses in Europe. These costs are expected to be paid in 2000.

Restructuring Charges (Credits)

In 1999, the Company recognized \$13.2 million of restructuring charges related to severance and exit costs. Employee severance costs of \$11.1 million resulted from planned terminations in certain European operations of the Company, employees at the Company's Milan, Michigan plant, and certain executive severances. The severance costs were based on the estimated amounts that will be paid to the affected employees pursuant to the Company's workforce reduction policies and certain foreign

governmental regulations. Total headcount reductions are expected to be approximately 250 employees. Exit costs of \$2.1 million were related to the closing of the Company's Milan plant and French bearing operations. These actions are expected to be primarily completed in 2000.

Also in 1999, the Company recognized \$13.2 million of reversals of restructuring charges recorded in previous years. These reversals resulted primarily from lower than expected employee severance costs principally associated with the reduction of the aftermarket sales force and consolidation of certain operations in the Americas. In 1999, the Company paid \$3.3 million relating to these reserves.

In 1998, as a result of the T&N, Cooper Automotive and Fel-Pro acquisitions, the Company recognized \$16.3 million of restructuring charges related to restructuring the Company's operations in place prior to these acquisitions. The restructuring charges were primarily for employee severance costs, which resulted from planned terminations in various business operations of the Company. The severance costs were based on the estimated amounts that will be paid to the affected employees pursuant to the Company's workforce reduction policies and certain foreign governmental regulations.

Also in 1998, the Company recognized restructuring credits of \$9.0 million for a reversal of charges recorded in previous years. The Company was able to sell, rather than liquidate, its retail operations in Puerto Rico, causing this reversal.

Adjustment of Assets Held for Sale and Other Long-Lived Assets to Fair Value

In 1999, the Company sold its subsidiary, Bertolotti Pietro e Figli, S.r.l. (Bertolotti), an Italian aftermarket operation. In 1998, the Company recognized a \$20.0 million charge primarily associated with the writedown of Bertolotti's assets to their estimated fair value. In 1999, the Company recognized an additional \$7.9 million loss associated with the writedown of Bertolotti's assets to their fair value resulting from the sale. Offsetting the loss was a tax benefit of \$7.9 million resulting from the sale.

Integration Costs

The Company recognized \$46.9 million and \$22.4 million of integration costs in 1999 and 1998, respectively, in connection with the acquisitions of T&N, Cooper Automotive and Fel-Pro. These expenses included one-time items such as brand integration, costs to pack and move productive inventory and fixed assets from one location to another, and costs to change the identity of entities acquired.

Interest Expense

Interest expense increased \$69.5 million in 1999 to \$273.5 million. The increase is primarily attributable to the full year effect of the issuance of new debt to finance the acquisitions of Cooper Automotive and other businesses, offset slightly by debt reductions from cash flow generated from operations and the Company's increased accounts receivable securitizations.

Interest expense increased \$170.7 million in 1998 to \$204.0 million due to debt financing of the T&N, Cooper Automotive, Fel-Pro and other acquisitions, offset slightly by debt reductions from cash flow generated from operations.

Interest Income

Interest income decreased \$6.0 million in 1999 to \$4.6 million in 1998. The decrease in interest income is due to the Company using the proceeds of the Company-obligated mandatorily redeemable preferred securities for the purchase of T&N and improved cash management.

Interest income increased \$3.5 million in 1998 to \$10.6 million due to interest earned on the proceeds of the December 1997 sale of Company-obligated mandatorily redeemable preferred securities, which were used in March 1998 to finance a portion of the T&N acquisition.

Net (Gain) Loss on British Pound Currency Option and Forward Contract

In the fourth quarter of 1997, in anticipation of the then pending T&N acquisition, the Company purchased a British pound currency option for \$28.1 million with a notional amount of \$2.5 billion. The cost of the option and its change in fair value has been reflected in the results of operations in the fourth quarter of 1997. At December 31, 1997, the Company had recognized a net loss of \$10.5 million on the transaction. In January 1998, the Company settled the option and recognized an additional loss of \$17.3 million.

Also in January 1998, in anticipation of the then pending T&N acquisition, the Company entered into a forward contract to purchase £1.5 billion for approximately \$2.45 billion. As a result of favorable fluctuations in the British pound/United States dollar exchange rate during the contract period, the Company recognized a \$30.6 million gain.

The Company entered into the above transactions to serve as economic hedges for the purchase of T&N. Such transactions, however, do not qualify for hedge accounting under GAAP, and therefore both the loss on the British pound currency option and the gain on the British pound forward contract are reflected in the consolidated statement of operations caption "Net (gain) loss on British pound currency option and forward contract."

Income Taxes

The effective tax rates for 1999, 1998 and 1997 were 39.3%, 50.5% and 27.6%, respectively. The decrease in 1999 was primarily due to the reduction in valuation allowances and the dilutive effect of the increase in pretax earnings on non-deductible goodwill. The Company reduced its valuation allowance related to deferred tax assets in 1999 as a result of regulatory approvals and other events establishing that it is more likely than not that certain deferred tax assets related to foreign tax attributes will be realized. Also, to the extent the Company utilized pre-acquisition net operating loss carryforwards during the year, the related valuation allowance was reduced with a corresponding reduction to goodwill.

The increase in 1998 was primarily due to non-deductible goodwill, a one-time charge for purchased in-process research and development and foreign tax rate differences.

Extraordinary Items

As a result of certain financing transactions (see Liquidity and Capital Resources), the Company incurred extraordinary losses on the early retirement of debt of \$23.1 million and \$38.2 million, net of related tax benefits of \$13.5 million and \$19.9 million, in 1999 and 1998, respectively.

Cumulative Effect of Change in Accounting Principle

In 1998, the American Institute of Certified Public Accountants issued Statement of Position (SOP) 98-5, *Reporting the Costs of Start-Up Activities*. SOP 98-5 was effective January 1, 1999 and requires that start-up costs capitalized prior to January 1, 1999 be written off and any future start-up costs be expensed as incurred. The Company adopted SOP 98-5 on January 1, 1999 and subsequently wrote off, as a cumulative effect of change in accounting principle, the unamortized balance of start-up costs totaling \$12.7 million, net of applicable income tax benefits of \$6.8 million, in the quarter ended March 31, 1999.

Effect of Accounting Pronouncements

In 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In June 1999, the effective date of SFAS No. 133 was delayed by one year to January 1, 2001. The statement requires the Company to recognize all derivatives on the balance sheet at fair value. The effect of adoption of this statement on the Company's earnings or financial position has not been finalized.

In 1999, the Emerging Issues Task Force ("EITF") of the FASB reached consensus on issue No. 99-5, *Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements*. The EITF addresses the accounting for pre-production costs relating to design and development of production parts and tooling. The EITF is required to be applied beginning January 1, 2000. The Company does not believe the adoption of this pronouncement will have a material effect on the Company's financial position or financial operations as its current accounting practices are consistent with the pronouncement.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Provided from Operating Activities

Cash flow provided from operating activities was \$562.4 million in 1999. Cash flows were generated primarily from net earnings plus depreciation and amortization. Additional cash flow was generated primarily from an increase in accounts payable of \$149.7 million, a decrease in inventories of \$117.2 million, and certain non-recourse sales of foreign accounts receivables of \$115.0 million. These items were offset by payments related to restructuring and rationalization reserves of \$80.6 million and asbestos payments of \$178.2 million.

Cash Flow Used by Investing Activities

Cash flow used by investing activities was \$713.1 million in 1999. The Company used \$371.2 million to fund business acquisitions, including the piston division of Alcan, Crane and the final payments of \$154.9 million related to its 1998 acquisition of Cooper Automotive. Capital expenditures of \$395.2 million were to implement process improvements, increase manufacturing capacity, information technology, integration of acquired businesses and new product introductions.

Cash Flow Provided from Financing Activities

Cash flow provided from financing activities was \$138.0 million in 1999, primarily arising from proceeds of \$2,123.0 million from the issuance of long-term debt and \$304.3 million provided by the investment in accounts receivable securitization. This was offset primarily by principal payments on long-term debt of \$2,251.5 million.

In July 1999, the Company entered into a new \$450 million accounts receivable securitization agreement replacing the existing \$150 million agreement. The facility maturity date is June 28, 2000. Net proceeds were used to repay borrowings under the Senior Credit Agreement's multicurrency revolving credit facility.

In February 1999, the Company entered into a new \$1.75 billion Senior Credit Agreement at variable interest rates, which contains a \$1.0 billion multicurrency revolving credit facility and two term loan components. The revolving credit facility has a five-year maturity. The term loan components of \$400 million and \$350 million mature in five and six years, respectively. The proceeds of this Senior Credit Agreement were used to refinance the prior Senior Credit Agreements entered into in connection with the T&N and Cooper Automotive acquisitions as well as the \$400 million multicurrency revolving credit facility related to the T&N acquisition.

In January 1999, the Company issued \$1.0 billion of bonds with maturities ranging from seven to ten years, a weighted average yield of 7.53% and a weighted average coupon of 7.45%. Proceeds were used to repay borrowings under the Senior Credit Agreements.

The Company believes the cash flows from operations, together with borrowings available under the Company's multicurrency revolving credit facility will continue to be sufficient to meet its ongoing working capital requirements.

LITIGATION AND ENVIRONMENTAL MATTERS***T&N Asbestos Litigation***

In the United States, the Company's United Kingdom subsidiary, T&N Ltd., and two former United States subsidiaries of T&N, plc (the "T&N Companies") are among many defendants named in numerous court actions alleging personal injury resulting from exposure to asbestos or asbestos-containing products. T&N is also subject to asbestos-disease litigation, to a lesser extent, in the United Kingdom and France. Because of the slow onset of asbestos-related diseases, management anticipates that similar claims will be made in the future. It is not known how many such claims may be made nor the expenditures which may arise therefrom.

As of December 31, 1999, the T&N Companies had approximately 95,000 claims pending. During 1999, approximately 49,000 new

claims were filed and 60,000 claims were settled, dismissed or otherwise resolved. In addition to the pending cases above, the T&N Companies have approximately 64,000 claims that have been settled but will be paid over time. There are a number of factors that could impact the settlement costs into the future, including but not limited to: changes in legal environment; possible insolvency of co-defendants; and the establishment of an acceptable administrative (non-litigation) claims resolution mechanism.

The \$1.1 billion total provision held for the T&N Companies is comprised of an estimate for known claims (pending and settled but not paid) and possible future claims (IBNR). As of December 31, 1999, the \$1.1 billion total provision is comprised of approximately \$520 million related to known claims and approximately \$620 million related to IBNR claims.

In arriving at the IBNR provision for the T&N Companies, assumptions have been made regarding the total number of claims anticipated to be received in the future, the typical cost of settlement (which is sensitive to the industry in which the plaintiff claims exposure, the alleged disease type and the jurisdiction in which the action is being brought), the rate of receipt of claims and the timing of settlement and, in the United Kingdom, the level of subrogation claims brought by insurance companies.

T&N Ltd. has appointed the Center for Claims Resolution (CCR) as its exclusive representative in relation to all asbestos-related personal injury claims made against it in the United States. The CCR provides to its member companies a litigation defense, claims-handling and administration service in respect to United States asbestos-related disease claims. Pursuant to the CCR Producer Agreement, T&N Ltd. is entitled to appoint a representative as one of the five voting directors on the CCR's Board of Directors. Members of the CCR contribute towards indemnity payments in each claim in which the member is named. Contributions to such indemnity payments are calculated on a case by case basis according to sharing agreements among the CCR's members.

Effective January 18, 2000, the two United States subsidiaries withdrew from the CCR membership and appointed a law firm specializing in asbestos matters as their claims handling defense and administrative service provider. Indemnity and defense obligations incurred while members of the CCR will continue to be honored. This change is intended to create greater economic and defense efficiencies for the two companies.

In 1996, T&N purchased a £500 million (approximately \$845 million at the insurance agreement exchange rate of \$1.69/£) layer of insurance which will be triggered should the aggregate costs of claims filed after June 30, 1996, where the exposure occurred prior to that date, exceed £690 million (approximately \$1,166 million at the \$1.69/£ exchange rate). The initial reserve provided for the T&N Companies for claims filed after June 30, 1996 approximated the trigger point of the insurance. The Company has reviewed the financial viability and legal obligations of the three reinsurance companies involved and has concluded, at this time, that there is little risk of the reinsurers not being able to meet their obligation to pay, should the claims filed after June 30, 1996 exceed the £690 million trigger point.

While management believes that reserves are appropriate for anticipated losses arising from asbestos-related claims against the T&N Companies, given the nature and complexity of the factors affecting the estimated liability, the actual liability may differ. No absolute assurance can be given that the T&N Companies will not be subject to material additional liabilities and significant additional litigation relating to asbestos. In the possible, but unlikely event that such liabilities exceed the reserves recorded by the Company and the additional £500 million of insurance coverage, the Company's results of operations, business, liquidity and financial condition could be materially adversely affected. The reserve for the T&N Companies is re-evaluated periodically as additional information becomes available.

During 1999, T&N Ltd. was named in a complaint filed in the United States District Court for the Eastern District of Texas by Owens-Illinois alleging that T&N is liable to Owens-Illinois for Owens-Illinois' own indemnity and defense costs pertaining to asbestos-related personal injury claims. The Company believes it has meritorious defenses to the claim and has successfully defended against similar underlying claims in the past.

Cooper Automotive Asbestos Litigation

Former businesses of Cooper Automotive, primarily Abex and Wagner, are involved as defendants in numerous court actions in the United States alleging personal injury from exposure to asbestos or asbestos-containing products, mainly involving friction products. In 1998, the Company acquired the capital stock of a Cooper Automotive entity resulting in the assumption by a Company subsidiary of contractual liability, under certain circumstances, for all claims pending and to be filed in the future alleging exposure to certain Wagner automotive and industrial friction products and for all claims filed after August 29, 1998, alleging exposure to certain Abex (non-railroad and non-aircraft) friction products. As of December 31, 1999, Abex has approximately 10,500 claims pending and Wagner has approximately 13,700 claims pending. The Company has completed its assessment of the potential liability and related potential insurance recoveries related to the Cooper Automotive acquisition and has recorded a \$325.9 million insurance recoverable asset and a liability of the subsidiaries involved of approximately \$400 million. This is the Company's estimate, after taking into account legal counsel's evaluation related to amounts expected to be paid or reimbursed by insurers. In arriving at these provisions, certain assumptions have been made regarding the total number of claims which may be received in the future against these two entities and the average costs associated with such claims.

Abex maintained product liability insurance coverage for most of the time that it manufactured products that contained asbestos. The subsidiary of the Company that may be liable for the post-August 1998 asbestos claims against Abex has the benefit of that insurance. Abex has been in litigation since 1982 with the insurance carriers of its primary layer of liability concerning coverage for asbestos claims. Abex also has substantial excess layer liability insurance coverage which,

barring unforeseen insolvencies of excess carriers or other adverse events, should provide coverage for asbestos claims against Abex.

Wagner also maintained product liability insurance coverage for some of the time that it manufactured products that contained asbestos. The subsidiary of the Company that may be liable for asbestos claims against Wagner has the benefit of that insurance. Primary layer liability insurance coverage for asbestos claims against Wagner is the subject of an agreement with Wagner's solvent primary carriers. The agreement provides for partial reimbursement of indemnity and defense costs for Wagner asbestos claims until exhaustion of aggregate limits. Wagner also has substantial excess layer liability insurance coverage which, barring unforeseen insolvencies of excess carriers or other adverse events, should provide coverage for asbestos claims against Wagner.

The ultimate exposure of the Company's subsidiary with respect to claims against Abex and Wagner will depend upon the extent to which the insurance described above will be available to cover such claims, the amounts paid for indemnity and defense, changes in the legal environment and other factors. While the Company believes that the liability and receivable recorded for these claims are reasonable and appropriate, given the nature and complexity of factors affecting the estimated liability and potential insurance recovery, the actual liability and insurance recovery may differ. In the event that the actual liability net of insurance proceeds recovered exceeds the reserve net of insurance receivable recorded by the Company, the Company's results of operations, business, liquidity and financial condition could be materially adversely affected. The asbestos reserves for the businesses acquired as part of the Cooper Automotive acquisition will be re-evaluated periodically as additional information becomes available.

Federal-Mogul and Fel-Pro Asbestos Litigation

The Company also is sued in its own name as one of a large number of defendants in a number of lawsuits brought by claimants alleging injury due to exposure to asbestos. The Company's Fel-Pro subsidiary has been named as a defendant in a number of product liability cases involving asbestos, primarily involving gasket or packing products. The Company is defending all such claims vigorously and believes that it and Fel-Pro have substantial defenses to liability and adequate insurance coverage for defense and indemnity. While the outcome of litigation cannot be predicted with certainty, management believes that asbestos claims pending against the Company and Fel-Pro as of December 31, 1999, will not have a material effect on the Company's financial position.

Aggregate of Asbestos Liability

As of December 31, 1999, the Company has provided a total reserve for all of its subsidiaries and businesses with potential asbestos liability of approximately \$1.5 billion as its best estimate for future costs related to resolving asbestos claims. The Company estimates claims will be filed and paid in excess

of the next 20 years. This estimate is based in part on recent and historical claims experience, medical information and the current legal environment. The company has a corresponding receivable from certain insurance carriers of approximately \$325.9 million.

Environmental Matters

The Company is a defendant in lawsuits filed in various jurisdictions pursuant to the federal Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA) or other similar federal or state environmental laws which require responsible parties to pay for cleaning up contamination resulting from hazardous wastes which were discharged into the environment by them or by others to which they sent such wastes for disposition. In addition, the Company has been notified by the United States Environmental Protection Agency and various state agencies that it may be a potentially responsible party (PRP) under such law for the cost of cleaning up certain other hazardous waste storage or disposal facilities pursuant to CERCLA and other federal and state environmental laws. PRP designation requires the funding of site investigations and subsequent remedial activities. At most of the sites that are likely to be costliest to clean up, which are often current or former commercial waste disposal facilities to which numerous companies sent waste, the Company's exposure is expected to be limited. Despite the joint and several liability which might be imposed on the Company under CERCLA and some of the other laws pertaining to these sites, the Company's share of the total waste is usually quite small; the other companies which also sent wastes, often numbering in the hundreds or more, generally include large, solvent publicly owned companies; and in most such situations the government agencies and courts have imposed liability in some reasonable relationship to contribution of waste. In addition, the Company has identified certain present and former properties at which it may be responsible for cleaning up environmental contamination. The Company is actively seeking to resolve these matters. Although difficult to quantify based on the complexity of the issues, the Company has accrued the estimated cost associated with such matters based upon current available information from site investigations and consultants. The environmental reserve was approximately \$74.5 million at December 31, 1999, and \$50.0 million at December 31, 1998. The 1999 increase results from a number of factors, including retaining liabilities from the divestiture of the T&N Bearings Business. Management believes that such accruals will be adequate to cover the Company's estimated liability for its exposure in respect of such matters.

MARKET RISK

In the normal course of business, the Company is subject to market exposure from changes in foreign exchange rates, interest rates, and raw material prices. To manage a portion of these inherent risks, the Company purchases various derivative financial instruments and commodity futures contracts. The Company does not hold or issue derivative financial instruments for trading purposes.

Foreign Currency Risk

A substantial portion of the Company's operations consist of manufacturing and sales activities in foreign jurisdictions. The Company manufactures and sells its products in North America, Europe, South America, Africa and Asia. As a result, the Company's financial results could be significantly affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which the Company distributes its products. The Company's operating results are primarily exposed to changes in exchange rates between the United States dollar and European currencies.

As currency exchange rates change, translation of the statements of operation of the Company's international businesses into United States dollars affects year-over-year comparability of operating results. The Company does not generally hedge operating translation risks because cash flows from international operations are generally reinvested locally.

As of December 31, 1999 and 1998, the Company's net current assets (defined as current assets less current liabilities) subject to foreign currency translation risk were \$187.4 million and \$146.8 million, respectively. The potential decrease in net assets from a hypothetical 10% adverse change in quoted foreign currency exchange rates would be approximately \$18.7 million and \$14.7 million, respectively.

The sensitivity analysis presented assumes a parallel shift in foreign currency exchange rates. Exchange rates rarely move in the same direction. This assumption may overstate the impact of changing exchange rates on individual assets and liabilities denominated in a foreign currency.

The Company manages certain aspects of its foreign currency activities and larger transactions through the use of foreign currency options or forwards. The Company generally tries to utilize natural hedges within their foreign currency activities, including the matching of revenues and costs.

As of December 31, 1999, the Company had entered into foreign currency forward contracts to hedge the British pound against the United States dollar and the Euro against the United States dollar in the amount of \$41.3 million and \$45.1 million, respectively, with an average contract rate of \$1.62/£ and \$1.01/Euro. The Company had also entered into foreign currency forward contracts to hedge the British pound against the Euro, French franc and Italian lira in the amounts of \$28.4 million, \$25.7 million and \$41.8 million with average contract rates of 1.58 Euro/£, 10.06 franc/£, 2,982.93 lira/£, respectively. At December 31, 1999, the unrealized gains or losses on these contracts were not material.

As of December 31, 1999, the Company had also entered into foreign currency forward contracts to hedge foreign currency debt exposures from the British pound to the Australian dollar, Belgium franc, Czech koruna, Dutch guilder, Danish krone,

German mark, Irish punt, Japanese yen, South African rand and Spanish peseta whose notional amounts and related unrealized gains or losses were not material.

As of December 31, 1998, the Company had entered into foreign currency forward contracts to hedge the British pound against the United States dollar in the amount of \$66 million with an average contract rate of \$1.62/£ and an unrealized loss of \$3.5 million at December 31, 1998. The Company had also entered into foreign currency forward contracts to hedge the British pound against the South African rand in the amount of \$19 million with an average contract rate of 9.99 rand/£ and an unrealized loss of \$4.3 million at December 31, 1998.

As of December 31, 1998, the Company had also entered into foreign currency forward contracts to hedge foreign currency debt exposures from the British pound to the Australian dollar, Swiss franc, German mark, Danish krone, Spanish peseta, French franc, Hong Kong dollar, Italian lira, Japanese yen and

Swedish krona whose notional amounts and related unrealized gains or losses were not material.

All foreign currency forward contracts purchased will expire within the next twelve months.

Interest Rate Risk

The Company's variable interest expense is sensitive to changes in the general level of United States interest rates. Most of the Company's interest expense is fixed through long-term borrowings to mitigate the impact of such potential exposure. The following table provides information about the Company's financial instruments that are sensitive to changes in interest rates. The table presents principal cash flows and related weighted-average interest rates by expected maturity dates. Weighted-average variable rates are based upon spot rate observations as of the reporting date.

Interest Rate Sensitivity Principal Amount by Expected Maturity As of December 31, 1999 (Millions of Dollars)

	2000	2001	2002	2003	2004	Thereafter	Total	Fair Value at December 31, 1999
Liabilities								
Long-term debt, including current portion								
Fixed rate	\$ 33.0	\$ 44.8	\$ 5.8	\$ 20.9	\$ 250.5	\$1,885.0	\$2,240.0	\$ 2,040.0
Average interest rate	7.71%	7.70%	7.70%	7.68%	7.68%	7.69%	7.69%	
Variable rate	\$ 57.8	\$ 111.6	\$ 118.7	\$ 134.5	\$ 261.5	\$ 186.7	\$ 870.8	\$ 870.8
Average interest rate	7.32%	7.37%	7.38%	7.37%	7.36%	7.43%	7.37%	

Interest Rate Sensitivity Principal Amount by Expected Maturity As of December 31, 1998 (Millions of Dollars)

	1999	2000	2001	2002	2003	Thereafter	Total	Fair Value at December 31, 1998
Liabilities								
Long-term debt, including current portion								
Fixed rate	\$ 52.1	\$ 65.2	\$ 52.7	\$ 10.8	\$ 23.7	\$1,141.1	\$1,345.6	\$ 1,381.2
Average interest rate	7.80%	7.84%	7.88%	7.86%	7.86%	7.85%	7.85%	
Variable rate	\$ 56.4	\$ 409.9	\$ 86.4	\$ 115.9	\$ 116.0	\$1,109.0	\$1,893.6	\$ 1,893.6
Average interest rate	7.33%	7.33%	7.33%	7.33%	7.33%	7.33%	7.33%	

Rate sensitive derivative financial instruments

Interest rate locks purchased	\$ 300.0	—	—	—	—	—	\$ 300.0	\$ (0.9)
Average strike rate	4.69%	—	—	—	—	—	—	—
Forward rate	4.66%	—	—	—	—	—	—	—

Commodity Price Risk

The Company is dependent upon the supply of certain raw materials in the production process and has entered into firm purchase commitments for copper, aluminum and nickel. The Company uses forward contracts to hedge against the changes in certain specific commodity prices of the purchase commitments outstanding. As of December 31, 1999, the Company had net unrealized gains for commodity contracts of \$0.7 million. As of December 31, 1998, the Company had net unrealized losses for commodity contracts of \$1.4 million.

OTHER MATTERS***Impact of Year 2000***

In prior years, the Company discussed the nature and progress of its plans to become Year 2000 compliant. In late 1999, the Company completed its remediation and testing of systems.

As a result of those planning and implementation efforts, the Company experienced no significant disruptions in mission-critical information technology and non-information technology systems and believes those systems successfully responded to the Year 2000 date change. The Company is not aware of any material problems resulting from Year 2000 issues, either with its products, its internal systems, or the products and services of third parties. As of December 31, 1999, the Company incurred and expensed approximately \$12.1 million and capitalized \$7.7 million. Year 2000 program costs incurred during 2000 are not expected to be material and will be funded from operations. The Company will continue to monitor its mission-critical computer applications and those of its suppliers and vendors throughout 2000 to ensure that any latent Year 2000 matters that may arise are addressed promptly.

Euro Conversion

On January 1, 1999, certain member countries of the European Union irrevocably fixed the conversion rates between their national currencies and a common currency, the "Euro," which became their legal currency on that date. The participating countries' former national currencies continue to exist as denominations of the Euro until January 1, 2002. The Company has established a steering committee that is monitoring the business implications of conversion to the Euro, including the need to adapt internal systems to accommodate Euro-denominated transactions. The acquisition

of T&N has provided the Company with a strong knowledge base in which to assist with the conversion. While the Company is still in various stages of assessment and implementation, the Company does not expect the conversion to the Euro to have a material effect on its financial condition or results of operations.

Status of Lighting, Wiper and Fuel Businesses

During the third quarter of 1999, the Company announced plans to sell its lighting, wiper blade and fuel systems businesses. Accordingly, the Company accounted for these businesses as held for sale in its press release on February 2, 2000, and did not include pretax depreciation and amortization totaling \$5.2 million related to these businesses in its operating results at such time. Subsequent to the Company's February 2, 2000 press release relative to fourth quarter and total year financial results, the Company, in recognition of the market price available for the businesses held for sale and the continued profitability of these businesses, decided to retain its lighting, wiper blade and fuel systems businesses. As a result, the \$5.2 million of depreciation and amortization is reflected in the fourth quarter and total year 1999 financial results.

2000 Restructuring Program

On February 23, 2000, the Board of Directors of the Company approved a restructuring plan to reduce costs in the Company's aftermarket and OE businesses. Under the restructuring plan, the Company expects to incur restructuring charges of approximately \$100 million which it expects to incur over the next two years, the majority of which will be recognized in 2000 when specific actions are finalized. The Company will also incur an additional \$100 million in incremental expenses and capital expenditures associated with this plan that will be expensed or capitalized as incurred. The majority of these expenses will occur in 2000 with the remainder over the subsequent two years. As a result of this restructuring plan, the Company may also take a non-cash asset writedown of approximately \$35 million to adjust certain assets to their fair value. The Company anticipates recognizing the first of these charges in the first quarter of 2000. It is possible the Company may identify additional areas of potential improvements requiring further restructuring plans.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31		
	1999	1998	1997
	(Millions of Dollars, Except Per Share Amounts)		
Net sales	\$ 6,487.5	\$ 4,468.7	\$ 1,806.6
Cost of products sold	4,709.1	3,290.2	1,381.8
Gross margin	1,778.4	1,178.5	424.8
Selling, general and administrative expenses	848.9	640.8	276.0
Amortization of goodwill and other intangible assets	127.2	83.8	8.9
Purchased in-process research and development charge	—	18.6	—
Restructuring charges (credits)	—	7.3	(1.1)
Reengineering and other related credits	—	—	(1.6)
Adjustment of assets held for sale and other long-lived assets to fair value	7.9	19.0	2.4
Integration costs	46.9	22.4	—
Interest expense	273.5	204.0	33.3
Interest income	(4.6)	(10.6)	(7.1)
International currency exchange (gains) losses	(2.7)	4.7	0.6
Net (gain) loss on British pound currency option and forward contract	—	(13.3)	10.5
Other expense, net	21.4	16.3	3.4
Earnings before income taxes, extraordinary items and cumulative effect of change in accounting principle	459.9	185.5	99.5
Income tax expense	180.9	93.6	27.5
Earnings before extraordinary items and cumulative effect of change in accounting principle	279.0	91.9	72.0
Extraordinary items - loss on early retirement of debt, net of applicable income tax benefits	23.1	38.2	2.6
Cumulative effect of change in accounting for costs of start-up activities, net of applicable income tax benefit	12.7	—	—
Net earnings	243.2	53.7	69.4
Preferred dividends, net of related tax benefit	2.4	3.6	5.5
Net Earnings Available for Common Shareholders	\$ 240.8	\$ 50.1	\$ 63.9

Earnings Per Common Share:

Basic			
Earnings before extraordinary items and cumulative effect of change in accounting principle	\$ 3.96	\$ 1.84	\$ 1.81
Extraordinary items - loss on early retirement of debt, net of applicable income tax benefits	(.34)	(.80)	(.07)
Cumulative effect of change in accounting for costs of start-up activities, net of applicable income tax benefit	(.18)	—	—
Net Earnings Available for Common Shareholders	\$ 3.44	\$ 1.04	\$ 1.74
Diluted			
Earnings before extraordinary items and cumulative effect of change in accounting principle	\$ 3.59	\$ 1.67	\$ 1.67
Extraordinary items - loss on early retirement of debt, net of applicable income tax benefits	(.28)	(.71)	(.06)
Cumulative effect of change in accounting for costs of start-up activities, net of applicable income tax benefit	(.15)	—	—
Net Earnings Available for Common Shareholders	\$ 3.16	\$.96	\$ 1.61

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

	December 31	
	1999	1998
	(Millions of Dollars)	
ASSETS		
Cash and equivalents	\$ 64.5	\$ 77.2
Accounts receivable	514.6	1,025.0
Investment in accounts receivable securitization	232.2	91.1
Inventories	883.6	1,068.6
Prepaid expenses and income tax benefits	331.6	337.7
Total Current Assets	2,026.5	2,599.6
Property, plant and equipment, net	2,503.7	2,477.5
Goodwill	3,547.8	3,398.4
Other intangible assets	796.3	886.4
Asbestos-related insurance recoverable	325.9	—
Other noncurrent assets	745.0	578.2
Total Assets	<u>\$ 9,945.2</u>	<u>\$ 9,940.1</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-term debt, including current portion of long-term debt	\$ 190.8	\$ 211.0
Accounts payable	621.9	498.4
Accrued compensation	182.9	200.3
Restructuring and rationalization reserves	46.0	178.9
Current portion of asbestos liability	180.0	125.0
Income taxes payable	72.3	142.2
Other accrued liabilities	488.7	673.7
Total Current Liabilities	1,782.6	2,029.5
Long-term debt	3,020.0	3,130.7
Long-term portion of asbestos liability	1,335.3	1,176.7
Postemployment benefits	661.9	660.9
Other accrued liabilities	454.9	343.1
Minority interest in consolidated subsidiaries	40.3	38.0
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely convertible subordinated debentures of the Company(1)	575.0	575.0
Shareholders' Equity:		
Series C ESOP preferred stock	41.5	44.4
Series E preferred stock	—	132.7
Common stock	352.1	336.8
Additional paid-in capital	1,782.4	1,665.8
Retained earnings (accumulated deficit)	170.3	(69.9)
Unearned ESOP compensation	(7.9)	(15.1)
Accumulated other comprehensive income	(262.1)	(106.0)
Other	(1.1)	(2.5)
Total Shareholders' Equity	2,075.2	1,986.2
Total Liabilities and Shareholders' Equity	<u>\$ 9,945.2</u>	<u>\$ 9,940.1</u>

(1) The sole assets of the Trust are convertible subordinated debentures of Federal-Mogul with an aggregate principal amount of \$575.0 million, which bear interest at a rate of 7% per annum and mature on December 1, 2027. Upon repayment, the Company-obligated mandatorily redeemable preferred securities of subsidiary trust will be mandatorily redeemed.

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOW

	Year Ended December 31		
	1999	1998	1997
	(Millions of Dollars)		
Cash Provided From (Used By) Operating Activities			
Net earnings	\$ 243.2	\$ 53.7	\$ 69.4
Adjustments to reconcile net earnings to net cash provided from operating activities:			
Depreciation and amortization	354.9	228.0	51.5
Purchased in-process research and development charge	—	18.6	—
Restructuring charges (credits)	—	7.3	(1.1)
Reengineering and other related credits	—	—	(1.6)
Adjustment of assets held for sale and other long-lived assets to fair value	7.9	19.0	2.4
Loss on early retirement of debt	36.6	58.1	4.1
Cumulative effect of change in accounting principle	19.5	—	—
Vesting of restricted stock	1.4	0.7	9.0
Postemployment benefits	(18.8)	10.9	(7.7)
(Increase) decrease in accounts receivable	(33.4)	37.5	7.6
Decrease in inventories	117.2	55.9	59.9
Increase (decrease) in accounts payable	149.7	5.4	(19.5)
Increase (decrease) in current liabilities and other	(57.0)	(2.4)	67.9
Payments against restructuring and rationalization reserves	(80.6)	(78.0)	(26.2)
Payments against asbestos liability	(178.2)	(89.2)	—
Net Cash Provided From Operating Activities	562.4	325.5	215.7
Cash Provided From (Used By) Investing Activities			
Expenditures for property, plant and equipment and other long-term assets	(395.2)	(228.5)	(49.7)
Proceeds from sale of business investments	53.3	53.4	73.6
Proceeds from sale of options	—	39.1	—
Business acquisitions, net of cash acquired	(371.2)	(4,225.2)	(30.5)
Other	—	—	1.1
Net Cash Used By Investing Activities	(713.1)	(4,361.2)	(5.5)
Cash Provided From (Used By) Financing Activities			
Issuance of common stock	1.2	1,382.2	14.2
Proceeds from issuance of long-term debt	2,123.0	6,197.5	179.6
Principal payments on long-term debt	(2,251.5)	(3,927.6)	(127.4)
Increase (decrease) in short-term debt	(3.0)	0.5	(235.8)
Fees paid for debt issuance and other securities	(25.5)	(76.6)	(42.8)
Fees for early retirement of debt	—	(27.4)	(4.1)
Sale (repurchase) of accounts receivable under securitization	304.3	42.6	(31.8)
Issuance of Company-obligated mandatorily redeemable preferred securities	—	—	575.0
Dividends	(4.3)	(10.4)	(24.8)
Other	(6.2)	(9.3)	(4.0)
Net Cash Provided From Financing Activities	138.0	3,571.5	298.1
Increase (Decrease) in Cash and Equivalents	(12.7)	(464.2)	508.3
Cash and equivalents at beginning of year	77.2	541.4	33.1
Cash and Equivalents at End of Year	\$ 64.5	\$ 77.2	\$ 541.4

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Millions of Dollars)	Series C ESOP Preferred Stock	Series D & E Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Unearned ESOP Compensation	Accumulated Other Comprehensive Income	Other	Total
Balance at January 1, 1997	\$ 53.1	\$ 76.6	\$ 175.7	\$ 283.5	\$ (193.0)	\$ (28.4)	\$ (40.1)	\$ (8.9)	\$ 318.5
Net earnings					69.4				69.4
Currency translation							(27.4)		(27.4)
Other							1.8		1.8
Total Comprehensive Income									43.8
Conversion of Series D preferred stock		(76.6)	22.3	54.3					—
Issuance of stock			3.0	14.7				6.7	24.4
Retirement of Series C ESOP preferred stock	(4.1)								(4.1)
Amortization of unearned ESOP compensation						6.6			6.6
Dividends				(24.8)					(24.8)
Preferred dividend tax benefits				4.9					4.9
Balance at December 31, 1997	49.0	—	201.0	332.6	(123.6)	(21.8)	(65.7)	(2.2)	369.3
Net earnings					53.7				53.7
Currency translation							(36.7)		(36.7)
Other							(3.6)		(3.6)
Total Comprehensive Income									13.4
Issuance of Series E preferred stock		225.0							225.0
Issuance of stock		(92.3)	135.8	1,338.4				(0.3)	1,381.6
Retirement of Series C ESOP preferred stock	(4.6)								(4.6)
Amortization of unearned ESOP compensation						6.7			6.7
Dividends				(10.4)					(10.4)
Preferred dividend tax benefits				5.2					5.2
Balance at December 31, 1998	44.4	132.7	336.8	1,665.8	(69.9)	(15.1)	(106.0)	(2.5)	1,986.2
Net earnings					243.2				243.2
Currency translation							(149.7)		(149.7)
Other							(6.4)		(6.4)
Total Comprehensive Income									87.1
Conversion of Series E preferred stock		(132.7)	15.2	117.5					—
Issuance of stock, net			0.1	(1.1)				1.4	0.4
Retirement of Series C ESOP preferred stock	(2.9)								(2.9)
Amortization of unearned ESOP compensation						7.2			7.2
Dividends				(1.3)	(3.0)				(4.3)
Preferred dividend tax benefits				1.5					1.5
Balance at December 31, 1999	\$ 41.5	—	\$ 352.1	\$ 1,782.4	\$ 170.3	\$ (7.9)	\$ (262.1)	\$ (1.1)	\$ 2,075.2

See accompanying Notes to Consolidated Financial Statements.

1. ACCOUNTING POLICIES

Organization: Federal-Mogul is an automotive parts manufacturer providing innovative solutions and systems to global customers in the automotive, small engine, heavy-duty, and industrial markets. The Company manufactures engine bearings, sealing systems, fuel systems, lighting products, pistons, ignition, brake, friction and chassis products. The Company's principal customers include many of the world's original equipment ("OE") manufacturers of such vehicles and industrial products. The Company also manufactures and supplies its products and related parts to the aftermarket.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Cash and Equivalents: The Company considers all highly liquid investments with maturities of 90 days or less from the date of purchase to be cash equivalents.

Inventories: Inventories are stated at the lower of cost or market. Cost determined by the last-in, first-out (LIFO) method was used for 50% and 53% of the inventory at December 31, 1999 and 1998, respectively. The remaining inventories are recorded using the first-in, first-out (FIFO) method. If inventories had been valued at current cost, amounts reported would have been increased by \$45.0 million and \$39.0 million as of December 31, 1999 and 1998, respectively.

Inventory quantity reductions resulting in liquidations of certain LIFO inventory layers increased net earnings by \$3.2 million, \$3.4 million and \$3.2 million (\$.04, \$.06 and \$.08 per diluted share) in 1999, 1998 and 1997, respectively.

At December 31, inventories consisted of the following:

	1999	1998
	(Millions of Dollars)	
Finished products	\$ 638.9	\$ 737.9
Work-in-process	133.1	147.1
Raw materials	138.1	208.5
	910.1	1,093.5
Reserve for inventory valuation	(26.5)	(24.9)
	<u>\$ 883.6</u>	<u>\$ 1,068.6</u>

Goodwill and Other Intangible Assets: At December 31, goodwill and other intangible assets, which result principally from acquisitions, consisted of the following:

	Estimated Useful Life	1999	1998
		(Millions of Dollars)	
Goodwill	40 years	\$ 3,725.7	\$ 3,481.8
Accumulated amortization		(177.9)	(83.4)
Total Goodwill		<u>\$ 3,547.8</u>	<u>\$ 3,398.4</u>

	Estimated Useful Life	1999	1998
		(Millions of Dollars)	
Trademarks	40 years	\$ 415.7	\$ 417.6
Developed technology	12-30 years	368.1	390.1
Assembled workforce	15 years	76.9	88.1
Other	5-20 years	14.4	39.9
		875.1	935.7
Accumulated amortization		(78.8)	(49.3)
Total Other Intangible Assets		<u>\$ 796.3</u>	<u>\$ 886.4</u>

Intangible assets are periodically reviewed for impairment based on an assessment of future cash flows, or fair value for assets held for sale. Intangible assets are amortized on a straight-line basis over their estimated useful lives. Impairment charges recorded in 1999, 1998 and 1997 related primarily to assets held for sale.

Revenue Recognition: The Company recognizes revenue and estimated returns from product sales and the related customer incentive and warranty expense when goods are shipped to the customer.

Research and Development and Advertising Costs: The Company expenses research and development costs as incurred. Research and development expense was \$128.0 million, \$85.0 million and \$13.1 million for 1999, 1998 and 1997, respectively.

Costs associated with advertising and promotion are expensed as incurred. Advertising and promotion expense was \$59.8 million, \$45.9 million, \$31.8 million for 1999, 1998 and 1997, respectively.

Currency Translation: Exchange adjustments related to international currency transactions and translation adjustments for subsidiaries whose functional currency is the United States dollar (principally those located in highly inflationary economies) are reflected in the consolidated statements of operations. Translation adjustments of international subsidiaries for which the local currency is the functional currency are reflected in the consolidated financial statements as a component of accumulated other comprehensive income.

Environmental Liabilities: The Company recognizes environmental liabilities when a loss is probable and estimable. Such liabilities are generally not subject to insurance coverage. Engineering and legal specialists within the Company, based on current law and existing technologies, estimate each environmental obligation. Such estimates are based primarily upon the estimated cost of investigation and remediation required and the likelihood that other potentially responsible parties will be able to fulfill their commitments at the sites where the Company may be jointly and severally liable with such parties (refer to Note 16, "Litigation and Environmental Matters").

The Company regularly evaluates and revises its estimates for environmental obligations based on expenditures against established reserves and the availability of additional information.

Integration Costs: These are incremental direct costs associated with integrating material acquisitions and include such one-time items as brand integration, costs to pack and move productive inventory and fixed assets from one location to another, and costs to change the identity of entities acquired. Such costs are expensed as incurred.

Derivative Financial Instruments: The Company has used interest rate lock agreements to synthetically manage the interest rate characteristics of certain outstanding debt to a more desirable fixed rate basis or to limit the Company's exposure to rising interest rates, and uses forward foreign exchange contracts to minimize and lock the amount of currency payments for certain transactions that are denominated in certain foreign currencies, and forward contracts to hedge against the changes in certain specific commodity prices of the purchase commitments outstanding (collectively "derivative contracts").

Interest rate differentials to be paid or received as a result of settled interest rate lock agreements are accrued and recognized as an adjustment of interest expense related to the designated debt. Recorded amounts related to derivative contracts are included in other assets or liabilities. The fair values of interest rate lock agreements and forward contracts are not recognized in the financial statements.

Realized and unrealized gains or losses at the time of maturity, termination, sale or repayment of a derivative contract or designated item are recorded in a manner consistent with the original designation of the derivative in view of the nature of the termination, sale or repayment transaction. Amounts related to interest rate locks are deferred and amortized as an adjustment to interest expense over the original period of interest exposure, provided the designated liability continues to exist or is probable of occurring. Realized and unrealized changes in fair value of derivatives designated with items that no longer exist or are no longer probable of occurring are recorded as a component of the gain or loss arising from the disposition of the designated item.

Comprehensive Income: The Company displays comprehensive income in the Consolidated Statements of Shareholders' Equity. At December 31, 1999 and 1998, comprehensive income consisted of \$252.0 million and \$102.3 million of foreign currency translation adjustments, respectively, and \$10.1 million and \$3.7 million of other comprehensive income, primarily minimum pension funding, respectively.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications: Certain items in the prior year financial statements have been reclassified to conform with the presentation used in 1999.

Effect of Accounting Pronouncements: Effective January 1, 1999, the Company adopted AICPA Statement of Position (SOP) 98-5, *Reporting the Costs of Start-Up Activities*. SOP 98-5 requires that start-up costs capitalized prior to January 1, 1999 be written off and any future start-up costs be expensed as incurred. The unamortized balance of start-up costs written off as a cumulative effect of an accounting change was approximately \$12.7 million, net of tax.

The following table summarizes the pro forma net earnings and per share amounts for each period presented. Pro forma amounts assume the change in application of accounting principle was applied retroactively (unaudited):

	1999	1998	1997
Net earnings as reported	\$243.2	\$ 53.7	\$ 69.4
Pro forma	\$255.9	\$ 45.3	\$ 65.1
Basic earnings per share as reported	\$ 3.44	\$ 1.04	\$ 1.74
Pro forma	\$ 3.63	\$.87	\$ 1.62
Diluted earnings per share as reported	\$ 3.16	\$.96	\$ 1.61
Pro forma	\$ 3.31	\$.80	\$ 1.51

In 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In June 1999, the effective date of SFAS No. 133 was delayed by one year to January 1, 2001. The statement requires the Company to recognize all derivatives on the balance sheet at fair value. The effect of adoption of this statement on the Company's earnings or financial position has not been finalized.

In 1999, the Emerging Issues Task Force ("EITF") of the FASB reached consensus on issue No. 99-5, *Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements*. The EITF addresses the accounting for pre-production costs relating to design and development of production parts and tooling. The EITF is required to be applied beginning January 1, 2000. The Company does not believe the adoption of this pronouncement will have a material effect on the Company's financial position or financial operations as its current accounting practices are consistent with the pronouncement.

2. ACQUISITIONS OF BUSINESSES

1999 Acquisitions:

In January 1999, the Company completed its acquisition of the piston division of Alcan Deutschland GmbH (Alcan) in Germany, a subsidiary of Alcan Aluminum Ltd. in Canada. The division manufactures pistons for passenger cars and commercial vehicles under the Nural® brand name. The piston division employs approximately 1,100 people with 1998 annual sales of approximately \$150 million.

Also in January 1999, the Company completed its acquisition of certain manufacturing operations of Crane Technologies, Inc. (Crane) to increase its camshaft capacity. Its two plants, located in Orland, Indiana and Jackson, Michigan, employ approximately 230 people with 1998 annual sales of approximately \$36 million.

1998 Acquisitions:**T&N**

In March 1998, the Company acquired T&N plc (T&N), a manufacturer of high technology engineered automotive components and industrial materials, based in Manchester, England for consideration (including direct costs of the acquisition) of approximately \$2.4 billion. The Company also assumed cash of approximately \$185 million and debt of approximately \$745 million.

The Company recognized an \$18.6 million charge in the first quarter of 1998 associated with the estimated fair value of purchased in-process research and development for which technological feasibility had not been established and the in-process technology had no future alternative uses.

Cooper Automotive

In October 1998, the Company acquired the automotive division of Cooper Industries, Inc. (Cooper Automotive), headquartered in St. Louis, Missouri, for initial consideration of approximately \$1.9 billion. The Cooper Automotive purchase agreement included a price adjustment based upon acquired net assets, as defined in the agreement, under which, the Company made additional cash payments of \$154.9 million in 1999. Cooper is a leading supplier of aftermarket parts for repair and maintenance and serves OE automobile manufacturers worldwide.

Fel-Pro

In February 1998, the Company acquired Fel-Pro, Incorporated and certain affiliated entities which constitute the operating businesses of the Fel-Pro group of companies (Fel-Pro), a privately owned gasket manufacturer headquartered in Skokie, Illinois, for a total consideration of approximately \$722 million, which included 1,030,326 shares of Federal-Mogul Series E Stock with an imputed value of \$225 million and approximately \$497 million in cash. Fel-Pro is a leading gasket manufacturer in the North American aftermarket and OE heavy-duty market.

The Alcan, Crane, T&N, Cooper Automotive and Fel-Pro acquisitions have been accounted for as purchases and, accordingly, the total consideration was allocated to the acquired assets and assumed liabilities based on estimated fair values as of the acquisition dates. The consolidated statements of operations for the years ended December 31, 1999 and 1998 include the operating results of the acquired businesses, exclusive of the T&N Bearings Business and the Fel-Pro Chemical Business (refer to "Divestiture of Acquired Businesses" below) from their respective acquisition dates.

Rationalization of Acquired Businesses

In connection with the T&N, Cooper Automotive and Fel-Pro acquisitions in 1998, the Company recognized \$216.8 million as acquired liabilities related to the rationalization and integration of acquired businesses. The rationalization reserves provided for \$180.0 million in relocation and severance costs, and \$36.8 million in exit costs and were recorded as a component of goodwill in the purchase price allocation.

The components of the integration plan included: closure of certain manufacturing facilities worldwide; relocation of highly manual manufacturing product lines to more suitable locations; consolidation of overlapping manufacturing, technical and sales facilities and joint ventures; consolidation of overlapping aftermarket warehouses; consolidation of aftermarket marketing and customer support functions; and streamlining of administrative, sales, marketing and product engineering staffs worldwide.

The Company paid \$72.2 million and \$61.6 million related to these rationalization reserves in 1999 and 1998, respectively. Also during 1999, the Company made adjustments to reduce the rationalization reserves, with an offsetting amount to goodwill, by \$47.9 million. These adjustments related to the finalization of rationalization plans. As of December 31, 1999, remaining rationalization reserves were \$30.3 million, primarily relating to the closure of several Powertrain Systems facilities in Europe and the consolidation of aftermarket warehouses in Europe. These costs are expected to be paid in 2000.

Divestitures of Acquired Businesses

In connection with securing regulatory approvals for the acquisition of T&N, the Company executed an Agreement Containing Consent Order with the Federal Trade Commission on February 27, 1998. Pursuant to this agreement, the Company divested of the T&N Bearings Business and provided for independent management of those assets pending such divestiture. The agreement stipulated that the T&N Bearings Business be maintained as a viable, independent competitor of the Company and that the Company not attempt to direct the activities of, or exercise control over, the T&N Bearings Business or have contact with the T&N Bearings Business outside of normal business activities.

In December 1998, the Company sold the T&N Bearings Business, consisting of the Glacier Vandervell Bearings Group and the AE Clevite North American non-bearing aftermarket engine hard parts business, to Dana Corporation for \$430 million. These proceeds were subsequently used to pay down debt. Furthermore, the Company realized additional net proceeds of approximately \$13 million from the collection of receivables of the business sold. Prior to the sale of the T&N Bearings Business to Dana Corporation, a portion of the business was sold for approximately \$12 million in August 1998.

In July 1998, the Company sold the Fel-Pro Chemical Business to Loctite Corporation, a part of Henkel KGaA, a global specialist in applied chemistry headquartered in Dusseldorf, Germany, for \$57 million.

Operating results for the T&N Bearings and Fel-Pro Chemical Businesses (which include interest expense of \$30 million relating to the holding costs of the businesses) have been excluded from the consolidated statement of operations for the year ended December 31, 1998.

Pro Forma Results

The following unaudited pro forma financial information for the years ended December 31, 1998 and 1997 assume the T&N, Cooper Automotive and Fel-Pro acquisitions occurred as of the

beginning of the respective periods, after giving effect to certain adjustments, including the amortization of intangible assets, interest expense on acquisition debt, divestitures of the T&N Bearings Business and Fel-Pro Chemical Business, 1998 equity offerings and income tax effects. The pro forma results (in millions of dollars, except per share data) have been prepared for comparative purposes only and are not necessarily indicative of the results of operations which may occur in the future or that would have occurred had the acquisitions of T&N, Cooper Automotive and Fel-Pro been consummated on the dates indicated, nor are they necessarily indicative of the Company's future results of operations.

Unaudited Pro Forma Financial Information (Millions of Dollars, Except Per Share Amounts)

	Year Ended December 31	
	1998	1997
Net sales	\$ 6,444.1	\$ 6,644.7
Net earnings (loss)	\$ 152.0	\$ (4.9)
Earnings (loss) per share	\$ 2.12	\$ (.19)
Earnings (loss) per share assuming dilution	\$ 1.95	\$ (.19)

3. SALES OF BUSINESSES

In 1999, the Company sold its subsidiary, Bertolotti Pietro e Figli, S.r.l. (Bertolotti), an Italian aftermarket operation. In 1998, the Company recognized a \$20.0 million charge primarily associated

with the writedown of Bertolotti's assets to their estimated fair value. In 1999, the Company recognized an additional \$7.9 million loss associated with the writedown of Bertolotti's assets to their fair value resulting from the sale. Offsetting the loss was a tax benefit of \$7.9 million resulting from the sale.

Also during 1999, the Company sold its South African heat transfer business. The business had sales of approximately \$56 million in 1998 in four South African locations and employed approximately 1,200 people. The Company did not realize a significant gain or loss on this transaction.

In February 1998, the Company divested its minority interest in G. Bruss GmbH & Co. KG (Bruss), a German manufacturer of seals and gaskets. As part of the divestiture agreement the Company increased its ownership to 100% in its Summerton, South Carolina, gasket manufacturing plant. The Company received net proceeds of approximately \$46 million related to the divestiture agreement and recognized a gain on the divestiture of \$6.0 million. The gain on the divestiture is included as a component of other expense. In addition, the Company closed or sold substantially all its remaining retail aftermarket operations during 1998.

During 1997, the Company received \$73.6 million in net cash proceeds from the sale of its aftermarket operations in South Africa, Australia and Chile, and its heavy wall bearing operations in Germany and Brazil.

4. RESTRUCTURING CHARGES

The following is a summary of restructuring charges and related activity for 1997, 1998 and 1999 (in millions of dollars):

	1995 and 1996 Restructuring Provisions		1997 Restructuring Provision		1998 Restructuring Provision		1999 Restructuring Provision		Total
	Severance	Exit	Severance	Exit	Severance	Exit	Severance	Exit	
Balance of restructuring reserves at January 1, 1997	\$ 38.0	\$ 17.2							\$ 55.2
1997 restructuring charge	—	—	\$ 16.7	\$ 5.3					22.0
Adjustment to restructuring reserves	(20.8)	(2.3)	—	—					(23.1)
1997 restructuring charges (net)	(20.8)	(2.3)	16.7	5.3					(1.1)
Payments against restructuring reserves	(11.6)	(5.4)	(0.1)	—					(17.1)
Balance of restructuring reserves at December 31, 1997	5.6	9.5	16.6	5.3					37.0
1998 restructuring charges	—	—	—	—	\$ 16.0	\$ 0.3			16.3
Adjustment to restructuring reserves	—	(2.4)	(4.6)	(2.0)	—	—			(9.0)
1998 restructuring charges (net)	—	(2.4)	(4.6)	(2.0)	16.0	0.3			7.3
Payments against restructuring reserves	(1.1)	(5.8)	(6.1)	(0.1)	(3.3)	—			(16.4)
Balance of restructuring reserves at December 31, 1998	4.5	1.3	5.9	3.2	12.7	0.3			27.9
1999 restructuring charges	—	—	—	—	—	—	\$ 11.1	\$ 2.1	13.2
Adjustment to restructuring reserves	(0.9)	(0.6)	(3.1)	(2.3)	(6.1)	(0.2)	—	—	(13.2)
1999 restructuring charges (net)	(0.9)	(0.6)	(3.1)	(2.3)	(6.1)	(0.2)	11.1	2.1	—
Payments and charges against restructuring reserves	(3.6)	(0.7)	(2.8)	(0.9)	(0.8)	(0.1)	(3.1)	(0.2)	(12.2)
Balance of restructuring reserves at December 31, 1999	\$ —	\$ —	\$ —	\$ —	\$ 5.8	\$ —	\$ 8.0	\$ 1.9	\$ 15.7

1999 Restructuring Provision

In 1999, the Company recognized \$13.2 million of restructuring charges related to severance and exit costs. Employee severance costs of \$11.1 million resulted from planned terminations in certain European operations of the Company, employees at the Company's Milan, Michigan plant, and certain executive severances. The severance costs were based on the estimated amounts that will be paid to the affected employees pursuant to the Company's workforce reduction policies and certain foreign governmental regulations. Total headcount reductions are expected to be approximately 250 employees. Exit costs of \$2.1 million were related to the closing of the Company's Milan plant and French bearing operations. These actions are expected to be primarily completed in 2000.

Also in 1999, the Company recognized \$13.2 million reversals of restructuring charges recorded in previous years. These reversals resulted primarily from lower than expected employee severance costs principally associated with the reduction of the aftermarket sales force and consolidation of certain operations in the Americas.

1998 Restructuring Provision

In 1998, as a result of the T&N, Cooper Automotive and Fel-Pro acquisitions, the Company recognized \$16.3 million of restructuring charges related to restructuring the Company's operations in place prior to these acquisitions. Employee severance costs resulted from planned terminations of approximately 1,800 employees in various business operations of the Company. The severance costs were based on the estimated and actual amounts that will be paid to the affected employees pursuant to the Company's workforce reduction policies and certain foreign governmental regulations. The Company anticipates that the remaining actions related to the 1998 restructuring plan will be completed in 2000.

Also in 1998, the Company recognized restructuring credits of \$9.0 million for a reversal of charges recorded in previous years. The Company was able to sell, rather than liquidate, its retail operations in Puerto Rico causing this reversal.

1997 Restructuring Provision

Results of operations in 1997 include a \$22.0 million charge for 1997 severance and exit costs. The restructuring actions were designed to improve the Company's cost structure, streamline operations and divest the Company of underperforming assets.

Employee severance costs for 1997 resulted from the planned and actual termination of approximately 500 employees, in various business operations of the Company. The severance costs were based on the minimum levels that will be paid to the affected employees pursuant to the Company's workforce reduction policies and certain foreign governmental regulations.

Exit costs for 1997 principally include lease termination costs for certain North American distribution service branches and retail aftermarket operations in Puerto Rico, and the consolidation of certain European distribution, and North American and European manufacturing operations. The 1997 restructuring actions were completed during 1999.

5. BRITISH POUND CURRENCY OPTION AND FORWARD CONTRACT

In the fourth quarter of 1997, in anticipation of the then pending T&N acquisition, the Company purchased a British pound currency option for \$28.1 million with a notional amount of \$2.5 billion. The cost of the option and its change in fair value has been reflected in the results of operations in the fourth quarter of 1997. At December 31, 1997, the Company had recognized a net loss of \$10.5 million on the transaction. In January 1998, the Company settled the option and recognized an additional loss of \$17.3 million.

Also in January 1998, in anticipation of the then pending T&N acquisition, the Company entered into a forward contract to purchase £1.5 billion for approximately \$2.45 billion. As a result of favorable fluctuations in the British pound/United States dollar exchange rate during the contract period, the Company recognized a \$30.6 million gain.

The Company entered into the above transactions to serve as economic hedges for the purchase of T&N. Such transactions, however, did not qualify for hedge accounting under GAAP, and therefore both the loss on the British pound currency option and the gain on the British pound forward contract are reflected in the consolidated statement of operations caption "Net (gain) loss on British pound currency option and forward contract."

6. DEBT

Long-term debt at December 31 consists of the following:

	1999 (Millions of Dollars)	1998 (Millions of Dollars)
Senior Credit Agreements:		
Term loans	\$ 750.0	\$1,893.6
Multi-currency revolving credit facility	65.0	—
Notes due 2004 — 7.5%, issued in 1998	249.6	249.5
Notes due 2006 — 7.75%, issued in 1998	399.9	399.9
Notes due 2006 — 7.375%, issued in 1999	398.6	—
Notes due 2009 — 7.5%, issued in 1999	597.6	—
Notes due 2010 — 7.875%, issued in 1998	349.2	349.2
Medium-term notes — due between 2000 and 2005, average rate of 8.8%, issued in 1994 and 1995	104.0	125.0
Senior notes — due in 2007, rate of 8.8%, issued in 1997	124.7	124.7
ESOP obligation — due in 2000, average rate of 7.19%	7.9	14.7
Other	64.3	82.6
	<u>3,110.8</u>	<u>3,239.2</u>
Less current maturities included in short-term debt	90.8	108.5
	<u>\$3,020.0</u>	<u>\$3,130.7</u>

In February 1999, the Company entered into a new \$1.75 billion Senior Credit Agreement at variable interest rates, which contains a \$1.0 billion multicurrency revolving credit facility and two term loan components. The revolving credit facility has a five-year maturity. The term loan components of \$400 million

and \$350 million mature in five and six years, respectively. The proceeds of this Senior Credit Agreement were used to refinance the prior Senior Credit Agreements entered into in connection with the T&N and Cooper Automotive acquisitions as well as the \$400 million multi-currency revolving credit facility related to the T&N acquisition. As a result of these transactions, the Company recognized an extraordinary charge in the first quarter of 1999 of approximately \$14.6 million, net of tax, related to the early extinguishment of debt. The Company had \$815.0 million outstanding under these Senior Credit Agreements as of December 31, 1999, which were due from 2000 to 2005 with an average interest rate of 7.36%.

In January 1999, the Company issued \$1.0 billion of bonds with maturities ranging from seven to ten years, a weighted average yield of 7.53% and a weighted average coupon of 7.45%. Proceeds were used to repay borrowings under the Senior Credit Agreements. As a result of this transaction the Company recognized an extraordinary charge in the first quarter of 1999 of approximately \$8.5 million, net of tax, related to early extinguishment of debt.

In 1998, in connection with the acquisitions of T&N and Cooper Automotive, the Company entered into Senior Credit Agreements. The Company had \$1,893.6 million outstanding under these Senior Credit Agreements as of December 31, 1998, which were due from 1999 to 2005 with an average interest rate of 7.33%. These Agreements were replaced with the 1999 Senior Credit Agreements discussed above.

The proceeds from the 2004, 2006 and 2010 notes were used to repay amounts previously outstanding under the Senior Credit Agreements. Such repayments and other repayments resulting from the proceeds of equity offerings (refer to Note 9, "Capital Stock and Preferred Share Purchase Rights") and the early retirement of private placement debt assumed in the T&N acquisition and related make-whole payment resulted in the extraordinary loss on the early retirement of debt in 1998 of \$38.2 million, net of applicable income tax benefits of \$19.9 million.

The Company has pledged 100% of the capital stock of certain United States subsidiaries, 65% of capital stock of certain foreign subsidiaries and certain intercompany loans to secure the Senior Credit Agreements of the Company; certain of such pledges also extend to the Notes, Medium-term notes and Senior notes. In addition, certain subsidiaries of the Company have guaranteed the senior debt (refer to Note 18, "Consolidating Condensed Financial Information of Guarantor Subsidiaries").

The ESOP obligation represents the unpaid principal balance on an 11-year loan entered into by the Company's ESOP in 1989. Proceeds of the loan were used by the ESOP to purchase the Company's Series C ESOP preferred stock. Payment of principal and interest on the notes is unconditionally guaranteed by the Company, and therefore, the unpaid principal balance of the borrowing is classified as long-term debt. Company contributions and dividends on the preferred shares held by the ESOP are used

to meet semi-annual principal and interest obligations. The original ESOP obligation bore an annual interest rate of 11.5%. The obligation was refinanced on June 30, 1995 at a fixed interest rate of 7.2%. The ESOP obligation matures in December 2000.

The weighted average interest rate for the Company's short-term debt was approximately 7.42% and 7.75% as of December 31, 1999 and 1998, respectively.

Aggregate maturities of long-term debt for each of the years following 2000 are, in millions: 2001 — \$156.4; 2002 — \$124.5; 2003 — \$155.4; 2004 — \$512.0 and thereafter \$2,071.7.

Interest paid in 1999, 1998 and 1997 was \$240.3 million, \$173.4 million and \$30.7 million, respectively.

7. FINANCIAL INSTRUMENTS

Foreign Exchange Risk and Commodity Price Management

The Company is subject to exposure to market risks from changes in foreign exchange rates and raw material price fluctuations. Derivative financial instruments are utilized by the Company to reduce those risks. Except for the British pound currency option and forward contract discussed in Note 5, the Company does not hold or issue derivative financial instruments for trading purposes.

As of December 31, 1999, the Company has foreign exchange forward contracts principally for British pound exposures relating to the United States dollar, Euro, French franc and Italian lira. The Company also has foreign exchange forward contracts for United States dollar exposure relating to the Euro. At December 31, 1999, the unrealized gains or losses relating to these contracts were not material.

The Company enters into copper, aluminum and nickel contracts to hedge against the risk of price increases. These contracts are expected to offset the effects of price changes on the firm purchase commitments for copper, aluminum and nickel. Under the agreements, the Company was committed to purchase approximately 3.6, 6.4 and 0.5 million pounds of copper, aluminum, and nickels respectively. The net unrealized gain on these firm purchase commitments were not material.

Deferred gains and losses are included in other assets and liabilities and recognized in operations when the future purchase, sale or payment (in the case of the asbestos liability) occurs, or at the point in time when the purchase, sale or payment is no longer expected to occur.

Accounts Receivable Securitization

In July 1999, the Company entered into a new \$450 million accounts receivable securitization agreement replacing the existing \$150 million agreement. The facility maturity date is June 28, 2000. Net proceeds were used to repay borrowings under the Senior Credit Agreement's multicurrency revolving credit facility.

On an ongoing basis, the Company sells certain accounts receivable to Federal-Mogul Funding Corporation (FMFC), a wholly owned subsidiary of the Company, which then sells

such receivables, without recourse, to a financial conduit. Amounts excluded from the balance sheets under these arrangements were \$410.1 million and \$105.8 million at December 31, 1999 and 1998, respectively. The Company's retained interest in the accounts receivable sold to FMFC is included in the consolidated balance sheet caption "Investment in Accounts Receivable Securitization."

Concentrations of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of accounts receivable and cash investments. The Company's customer base includes virtually every significant global automotive manufacturer and a large number of distributors and installers of automotive aftermarket parts. The Company's credit evaluation process, reasonably short collection terms and the geographical dispersion of sales transactions help to mitigate any concentration of credit risk. The Company requires placement of investments in financial institutions evaluated as highly creditworthy.

The Company does not generally require collateral for its trade accounts receivable or those assets included in the investment in accounts receivable securitization. The allowance for doubtful accounts of \$69.3 million and \$60.4 million at December 31, 1999 and 1998, respectively, is based upon the expected collectibility of trade accounts receivable.

Fair Value of Financial Instruments

The carrying amounts of certain financial instruments such as cash and equivalents, accounts receivable, accounts payable and short-term debt approximate their fair values. The carrying amounts and estimated fair values of the Company's long-term debt, including the current portion, were \$3,110.8 million and \$2,910.8 million, respectively, at December 31, 1999. The carrying amounts and estimated fair values of the Company's long-term debt, including the current portion, were \$3,239.2 million and \$3,274.8 million, respectively, at December 31, 1998. The fair value of the long-term debt is estimated using discounted cash flow analysis and the Company's current incremental borrowing rates for similar types of arrangements.

8. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost and include expenditures that materially extend the useful lives of existing buildings, machinery and equipment.

Depreciation is computed principally by the straight-line method for financial reporting purposes and by accelerated methods for income tax purposes. Depreciation expense for the years ended December 31, 1999, 1998 and 1997, was \$221.4 million, \$144.2 million and \$42.6 million, respectively.

At December 31, property, plant and equipment consisted of the following:

	Estimated Useful Life	1999	1998
(Millions of Dollars)			
Land	—	\$ 145.7	\$ 139.4
Buildings and building improvements	24-40 years	496.1	560.1
Machinery and equipment	3-12 years	2,402.9	2,097.6
		3,044.7	2,797.1
Accumulated depreciation		(541.0)	(319.6)
		<u>\$ 2,503.7</u>	<u>\$ 2,477.5</u>

Future minimum payments under noncancelable operating leases with initial or remaining terms of more than one year are, in millions: 2000 — \$41.7; 2001 — \$33.1; 2002 — \$27.1; 2003 — \$21.6; 2004 — \$19.8 and thereafter \$45.2.

Total rental expense under operating leases was \$52.6 million in 1999, \$46.5 million in 1998 and \$29.1 million in 1997, exclusive of property taxes, insurance and other occupancy costs generally payable by the Company.

9. CAPITAL STOCK AND PREFERRED SHARE PURCHASE RIGHTS

The Company's articles of incorporation authorize the issuance of 260,000,000 shares of common stock, of which 70,422,525 shares, 67,233,216 shares and 40,196,603 shares were outstanding at December 31, 1999, 1998 and 1997, respectively.

In December 1998, the Company completed an equity offering of 14.1 million shares of common stock. The net proceeds from the sale of the common stock of \$781.2 million were used to reduce the Senior Credit Agreements associated with the acquisition of Cooper Automotive.

In June 1998, the Company issued 12.7 million shares of common stock, including 2.1 million shares which were converted from Series E Stock. The net proceeds from the sale of the common stock of \$592 million were used to prepay the entire outstanding principal amount under the Senior Subordinated Credit Agreement and partially repay the Senior Credit Agreement (refer to Note 2, "T&N" in "1998 Acquisitions").

In February 1998, in connection with the Fel-Pro acquisition, the Company issued 1,030,326 shares Series E Stock with an imputed value of \$225 million. The shares of Series E Stock were exchangeable into shares of the Company's common stock at a rate of five shares of common stock per share of Series E Stock. In conjunction with the June 1998 common stock offering described above, the Company converted 422,581 shares of Series E Stock into approximately 2.1 million shares of common stock. On February 24, 1999, the remaining 607,745 shares of the Company's Series E Stock were exchanged into shares of the Company's common stock.

In August 1997, the Company announced a call for the redemption of all its outstanding \$3.875 Series D Convertible Exchangeable Preferred Stock. These preferred stockholders elected to convert each preferred share into 2.778 shares of common stock. The Company issued 4.4 million shares of common stock in exchange for all the outstanding Series D Convertible Exchangeable Preferred Stock.

The Series C ESOP Convertible Preferred Stock shares of stock are used to fund a portion of the Company's matching contributions with in the Salaried Employees' Investment Program. The Series C ESOP preferred stock is convertible into shares of the Company's common stock at a rate of two shares of common stock for each share of preferred stock. There were 701,758, 724,644 and 762,939 shares of Series C ESOP preferred stock outstanding at December 31, 1999, 1998 and 1997, respectively. The Series C ESOP preferred shares pay dividends at a rate of 7.5%. The Company repurchased and retired 28,549, 38,295 and 72,959 Series C ESOP preferred shares valued at \$2.9 million, \$4.6 million and \$4.1 million during 1999, 1998 and 1997, respectively. All of the repurchases represent plan distributions or fund transfers for participants of the plan.

The charge to operations for the cost of the ESOP was \$5.5 million in 1999, \$5.2 million in 1998 and \$5.2 million in 1997. The Company made cash contributions to the plan of \$8.2 million in 1999, \$8.2 million in 1998 and \$8.1 million in 1997, including preferred stock dividends of \$3.4 million in 1999, \$3.6 million in 1998 and \$3.8 million in 1997. ESOP shares are released as principal and interest on the debt is paid. The ESOP Trust uses the preferred dividends not allocated to employees to make principal and interest payments on the debt. Compensation expense is measured based on the fair value of shares committed to be released to employees. Dividends on ESOP shares are treated as a reduction of retained earnings in the period declared. The number of allocated shares and suspense shares held by the ESOP were 621,088 and 80,670 at December 31, 1999, 563,995 and 160,649 at December 31, 1998, and 512,147 and 250,792 at December 31, 1997, respectively. There were no committed-to-be-released shares at December 31, 1999, 1998 and 1997. Any repurchase of the ESOP shares is strictly at the option of the Company.

The Company's common stock is subject to a Rights Agreement under which each share has attached to it a Right to purchase one one-hundredth of a share of a new series of Preferred Stock, at a price of \$250 per Right. In the event an entity acquires or attempts to acquire 10% (20% in the case of an institutional investor) or more of the then outstanding shares, each Right would entitle the holder to purchase a number of shares of common stock pursuant to a formula contained in the Agreement. These Rights will expire on April 30, 2009, but may be redeemed at a price of \$.01 per Right at any time prior to a public announcement that the above event has occurred. The Board may amend the Rights at any time without shareholder approval.

10. COMPANY-OBLIGATED MANDATORILY REDEEMABLE PREFERRED SECURITIES OF SUBSIDIARY TRUST HOLDING SOLELY CONVERTIBLE SUBORDINATED DEBENTURES OF THE COMPANY

In December 1997, the Company's wholly owned financing trust ("Affiliate") completed a \$575 million private issue of 11.5 million shares of 7.0% Trust Convertible Preferred Securities ("TCP Securities") with a liquidation value of \$50 per convertible security. The net proceeds from the TCP Securities were used to purchase an equal amount of 7.0% Convertible Junior Subordinate Debentures ("Debentures") of the Company. The TCP Securities represent an undivided interest in the Affiliate's assets, with a liquidation preference of \$50 per security.

Distributions on the TCP Securities are cumulative and will be paid quarterly in arrears at an annual rate of 7.0%, and are included in the consolidated statements of operations as a component of "Other Expense, Net." The Company has the option to defer payment of the distributions for an extension period of up to 20 consecutive quarters if the Company is in compliance with the terms of the TCP Securities.

The shares of the TCP Securities are convertible, at the option of the holder, into the Company's common stock at an equivalent conversion price of approximately \$51.50 per share, subject to adjustment in certain events. The TCP Securities and the Debentures will be redeemable, at the option of the Company, on or after December 6, 2000 at a redemption price, expressed as a percentage of principal which is added to accrued and unpaid interest. The redemption price range is from 104.2% on December 6, 2000 to 100.0% after December 1, 2007. All outstanding TCP Securities and Debentures are required to be redeemed by December 1, 2027.

11. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in millions, except per share data):

	1999	1998	1997
Numerator:			
Net earnings	\$ 243.2	\$ 53.7	\$ 69.4
Extraordinary items — loss on early retirement of debt, net of applicable tax benefits	23.1	38.2	2.6
Cumulative effect of change in accounting for costs of start-up activities, net of applicable income tax benefits	12.7	—	—
Earnings before extraordinary items and cumulative effect of change in accounting principle	279.0	91.9	72.0
Series C preferred dividend requirement	(2.2)	(2.3)	(2.4)
Series D preferred dividend requirement	—	—	(3.1)
Series E preferred dividend requirement	(0.2)	(1.3)	—
Numerator for basic earnings per share — income available to common shareholders before extraordinary items and cumulative effect of change in accounting principle	\$ 276.6	\$ 88.3	\$ 66.5
Effect of dilutive securities:			
Series C preferred dividend requirement	2.2	2.3	2.4
Series D preferred dividend requirement	—	—	3.1
Series E preferred dividend requirement	0.2	1.3	—
Minority interest — preferred securities of an affiliate	25.4	—	—
Additional required ESOP contribution	(2.2)	(2.1)	(1.9)
Numerator for diluted earnings per share — income available to common shareholders after assumed conversions, before extraordinary items and cumulative effect of change in accounting principle	\$ 302.2	\$ 89.8	\$ 70.1
Numerator for basic earnings per share — income available to common shareholders after extraordinary items and cumulative effect of change in accounting principle	\$ 240.8	\$ 50.1	\$ 63.9
Numerator for diluted earnings per share — income available to common shareholders after extraordinary items and cumulative effect of change in accounting principle	\$ 266.4	\$ 51.6	\$ 67.5
Denominator:			
Denominator for basic earnings per share — weighted average shares	69.8	48.1	36.6
Effect of dilutive securities:			
Dilutive stock options outstanding	0.5	0.8	0.4
Nonvested stock	0.1	0.1	0.3
Conversion of Series C preferred stock	1.4	1.5	1.6
Conversion of Series D preferred stock	—	—	3.0
Conversion of Series E preferred stock	0.5	3.2	—
Conversion of Company-obligated mandatorily redeemable preferred securities	11.2	—	—
Contingently issuable shares of common stock	0.7	—	—
Dilutive potential common shares	14.4	5.6	5.3
Denominator for diluted earnings per share — adjusted weighted average shares and assumed conversions	84.2	53.7	41.9
Basic earnings per share before extraordinary items and cumulative effect of change in accounting principle	\$ 3.96	\$ 1.84	\$ 1.81
Basic earnings per share after extraordinary items and cumulative effect of change in accounting principle	\$ 3.44	\$ 1.04	\$ 1.74
Diluted earnings per share before extraordinary items and cumulative effect of change in accounting principle	\$ 3.59	\$ 1.67	\$ 1.67
Diluted earnings per share after extraordinary items and cumulative effect of change in accounting principle	\$ 3.16	\$.96	\$ 1.61

For additional disclosures regarding the Series C, Series D and Series E preferred stock, the employee stock options and non-vested stock shares, refer to Note 9, "Capital Stock and Preferred Share Purchase Rights," and Note 12, "Incentive Stock Plans."

Convertible preferred securities (refer to Note 10, "Company-Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trust Holding Solely Convertible Subordinated Debentures of the Company") redeemable for 11.2 million shares of common stock were outstanding for 1998 and a portion of 1997 but were not included in the computation of diluted earnings per share because the effect would be antidilutive. These shares were dilutive in 1999 and therefore included in the computation of earnings per share.

12. INCENTIVE STOCK PLANS

The Company's shareholders adopted stock option plans in 1976 and 1984 and performance incentive stock plans in 1989 and 1997. These plans provide generally for awarding restricted shares or granting options to purchase shares of the Company's common stock. Restricted shares entitle employees to all the rights of common stock shareholders, subject to certain transfer restrictions and to forfeiture in the event that the conditions for their vesting are not met. Options entitle employees to purchase shares at an exercise price not less than 100% of the fair market value on the grant date and expire after a five- or ten-year period as determined by the Board of Directors.

Under the plans, awards vest from six months to five years after their date of grant, as determined by the Board of Directors at the time of grant. At December 31, 1999, there were 513,836 shares available for future grants under the plans.

In October 1997, the Company met certain share price performance criteria under the 1989 Long-Term Incentive Plan, which resulted in the recognition of \$5.4 million in compensation expense relating to the vesting of restricted stock awards. The total compensation cost that has been charged to operations for vesting of restricted stock awards was \$1.4 million, \$0.7 million and \$9.0 million in 1999, 1998 and 1997, respectively.

The Company has elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related interpretations in accounting for its employee stock awards. Accordingly, no compensation cost has been recognized for its stock option grants, as the exercise price of the Company's employee stock options equals the underlying stock price on the date of grant. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of Statement of Financial Accounting Standards No. 123 (SFAS 123) *Accounting for Stock Based Compensation*, the Company's net earnings, in millions, and earnings per share would have been adjusted to the pro forma amounts indicated below:

	1999	1998	1997
Net earnings as reported	\$ 243.2	\$ 53.7	\$ 69.4
Pro forma	\$ 230.3	\$ 48.3	\$ 70.7
Basic earnings per share as reported	\$ 3.44	\$ 1.04	\$ 1.74
Pro forma	\$ 3.27	\$.93	\$ 1.78
Diluted earnings per share as reported	\$ 3.16	\$.96	\$ 1.61
Pro forma	\$ 3.01	\$.86	\$ 1.64

Pro forma information regarding net income and earnings per share is required by SFAS 123 as if the Company had accounted for its employee stock options under the fair value method.

The fair value for options is estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 1999, 1998 and 1997, respectively: risk-free interest rates of 6.2%; dividend yields of 0.03%, 0.2% and 1.5%; volatility factors of the expected market price of the

Company's common stock of 48.0%, 30.1%, and 27.2% and a weighted average expected life of the option of five years. The fair value of nonvested stock awards is equal to the market price of the stock on the date of the grant.

The weighted-average fair value and the total number (in millions) of options granted was \$16.81, \$22.36 and \$9.99, and 2.7, 1.1 and 0.9 for 1999, 1998 and 1997, respectively. The weighted-average fair value and total number (in millions) of nonvested stock awards granted was \$53.52 and \$24.47 and 0.1 and 0.1 for 1998 and 1997, respectively. There were no stock awards granted in 1999. All options and stock awards that are not vested at December 31, 1999, vest solely on employees' rendering additional service.

The following table summarizes the activity relating to the Company's incentive stock plans:

	Number of Shares (In Millions)	Weighted-Average Price
Outstanding at January 1, 1997	2.5	\$ 22.03
Options/stock granted	1.0	31.74
Options exercised/stock vested	(1.0)	21.94
Options/stock lapsed or canceled	(0.3)	22.29
Outstanding at December 31, 1997	2.2	\$ 26.46
Options/stock granted	1.2	57.94
Options exercised/stock vested	(0.5)	21.85
Options/stock lapsed or canceled	(0.1)	31.49
Outstanding at December 31, 1998	2.8	\$ 40.50
Options granted	2.7	33.85
Options exercised/stock vested	(0.1)	25.98
Options/stock lapsed or canceled	(0.3)	41.86
Outstanding at December 31, 1999	5.1	\$ 37.14
Options exercisable at December 31, 1999	0.9	\$ 31.04
Options exercisable at December 31, 1998	0.6	\$ 30.11
Options exercisable at December 31, 1997	0.9	\$ 23.07

The following is a summary of the range of exercise prices for stock options that are outstanding and the amount of non-vested stock awards at December 31, 1999:

Range	Outstanding Awards (In Millions)	Weighted-Average Price	Remaining Life
Options:			
\$15.69-\$23.50	1.8	\$ 20.18	4 years
\$23.51-\$35.25	0.6	\$ 27.98	2 years
\$35.26-\$52.87	1.6	\$ 46.17	4 years
\$52.88-\$70.69	1.0	\$ 59.15	4 years
Nonvested stock	0.1		
Total	5.1		

13. POSTEMPLOYMENT BENEFITS

The Company sponsors several defined benefit pension plans (Pension Benefits) and health care and life insurance benefits (Other Benefits) for certain employees and retirees around the world. The Company funds the Pension Benefits based on the funding requirements of federal and international laws and regulations in advance of benefit payments and the Other Benefits as benefits are provided to the employees.

Components of net periodic benefit cost for the year ended December 31: (Millions of Dollars)

	United States Plans						International Plans		
	Pension Benefits			Other Benefits			Pension Benefits		
	1999	1998	1997	1999	1998	1997	1999	1998	1997
Service cost	\$ 26.4	\$ 16.4	\$ 7.8	\$ 4.7	\$ 4.4	\$ 2.5	\$ 26.8	\$ 26.7	\$ 0.3
Interest cost	51.0	29.9	14.0	31.0	19.2	10.5	112.0	100.7	1.9
Expected return on plan assets	(79.8)	(48.1)	(24.2)	—	—	—	(144.8)	(123.6)	—
Net amortization and deferral	(3.0)	(4.3)	(4.2)	(2.7)	(0.6)	(0.5)	9.2	—	—
Curtailment loss (gains)	0.1	1.6	—	(12.5)	—	—	(3.1)	—	—
Net periodic (benefit) cost	<u>\$ (5.3)</u>	<u>\$ (4.5)</u>	<u>\$ (6.6)</u>	<u>\$ 20.5</u>	<u>\$ 23.0</u>	<u>\$ 12.5</u>	<u>\$ 0.1</u>	<u>\$ 3.8</u>	<u>\$ 2.2</u>

Change in benefit obligation: (Millions of Dollars)

	United States Plans				International Plans	
	Pension Benefits		Other Benefits		Pension Benefits	
	1999	1998	1999	1998	1999	1998
Benefit obligation at beginning of year	\$ 717.5	\$ 197.2	\$ 468.9	\$ 150.4	\$ 2,099.3	\$ 26.6
Service cost	26.4	16.4	4.7	4.4	26.8	26.7
Interest cost	51.0	29.9	31.0	19.2	112.0	100.7
Acquisitions	—	496.7	2.9	297.3	(0.2)	1,895.0
Employee contributions	—	—	—	—	9.3	13.3
Benefits paid	(60.2)	(26.0)	(39.6)	(15.0)	(139.9)	(124.3)
Plan amendments	12.3	9.9	—	—	—	—
Actuarial (gains) and losses and changes in actuarial assumptions	(31.8)	4.8	(28.5)	12.6	19.8	161.3
Settlements and curtailments	—	(11.4)	(12.5)	—	(3.3)	—
Prior service cost	—	—	(2.0)	—	—	—
Currency translation adjustment	—	—	—	—	(63.6)	—
Benefit obligation at end of year	<u>\$ 715.2</u>	<u>\$ 717.5</u>	<u>\$ 424.9</u>	<u>\$ 468.9</u>	<u>\$ 2,060.2</u>	<u>\$ 2,099.3</u>

Change in plan assets: (Millions of Dollars)

	United States Plans				International Plans	
	Pension Benefits		Other Benefits		Pension Benefits	
	1999	1998	1999	1998	1999	1998
Fair value of plan assets at beginning of year	\$ 775.4	\$ 293.7	\$ —	\$ —	\$ 2,034.5	\$ —
Actual return on plan assets	83.9	25.3	—	—	325.3	157.6
Acquisitions	—	487.1	—	—	—	1,979.8
Company contributions	6.5	7.9	—	—	19.1	21.4
Benefits paid	(60.2)	(26.0)	—	—	(139.9)	(124.3)
Settlements and curtailments	—	(12.6)	—	—	—	—
Currency translation adjustment	—	—	—	—	(54.0)	—
Fair value of plan assets at end of year	<u>\$ 805.6</u>	<u>\$ 775.4</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,185.0</u>	<u>\$ 2,034.5</u>

Funded status of the plan	\$ 90.4	\$ 57.9	\$ (424.9)	\$ (468.9)	\$ 124.8	\$ (64.8)
Unrecognized net asset at transition	0.3	0.3	—	—	—	—
Unrecognized net actuarial (gain) loss	(60.9)	(30.1)	(19.5)	8.9	(46.3)	128.9
Unrecognized prior service cost	27.6	17.6	(2.4)	(2.9)	—	—
Prepaid (accrued) benefit cost	<u>\$ 57.4</u>	<u>\$ 45.7</u>	<u>\$ (446.8)</u>	<u>\$ (462.9)</u>	<u>\$ 78.5</u>	<u>\$ 64.1</u>

Weighted-average assumptions as of December 31: (Millions of Dollars)

	United States Plans				International Plans	
	Pension Benefits		Other Benefits		Pension Benefits	
	1999	1998	1999	1998	1999	1998
Discount rate	7.75%	7.25%	7.75%	7.25%	6.25-6.5%	5.5-6%
Expected return on plan assets	10%	10%	—	—	6.5-8.5%	7.5%
Rate of compensation increase	4-4.75%	4.25-5%	—	—	3-4.4%	2.5-3.9%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Amounts applicable to the Company's pension plans with accumulated benefit obligations in excess of plan assets are as follows:

	1999	1998
United States Plans		
Projected benefit obligation	\$ 362.8	\$ 138.1
Accumulated benefit obligation	359.1	137.9
Fair value of plan assets	336.8	126.6
International Plans		
Projected benefit obligation	\$ 157.4	\$ 180.0
Accumulated benefit obligation	156.9	171.0
Fair value of plan assets	0.2	—

Amounts recognized in the balance sheet consist of:

	Pension Benefits		Other Benefits	
	1999	1998	1999	1998
Prepaid (accrued) benefit cost	\$ 135.9	\$ 109.8	\$(446.8)	\$(462.9)
Accrued benefit liability	(20.5)	(12.7)	—	—
Intangible asset	7.2	7.3	—	—
Accumulated other comprehensive income	10.1	3.4	—	—
Net amount recognized	<u>\$ 132.7</u>	<u>\$ 107.8</u>	<u>\$(446.8)</u>	<u>\$(462.9)</u>

At December 31, 1999, the assumed annual health care cost trend used in measuring the APBO approximated 6.7% in 1999, declining to 6.5% in 2000 and to an ultimate annual rate of 5.5% estimated to be achieved in 2010. Increasing the assumed cost trend rate by 1% each year would have increased the APBO by approximately 9.5% and 11.5% at December 31, 1999 and 1998, respectively. Aggregate service and interest costs would have increased by approximately 10.4%, 13.3% and 9.4% for 1999, 1998 and 1997, respectively.

During 1999, the Company decided to curtail retiree healthcare benefits for approximately 4,000 employees. As a result, the Company reduced its postretirement liability and recognized a one-time benefit of approximately \$8.0 million, net of applicable taxes.

14. INCOME TAXES

Under the liability method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The components of earnings before income taxes, extraordinary items and cumulative effect changes consisted of the following:

	1999	1998	1997
	(Millions of Dollars)		
Domestic	\$ 237.8	\$ (73.4)	\$ 50.1
International	222.1	258.9	49.4
	<u>\$ 459.9</u>	<u>\$ 185.5</u>	<u>\$ 99.5</u>

Significant components of the provision for income taxes (tax benefit) are as follows:

	1999	1998	1997
	(Millions of Dollars)		
Current:			
Federal	\$ 49.3	\$ (12.1)	\$ 9.6
State and local	11.6	10.0	0.2
International	45.7	65.4	6.6
Total current	106.6	63.3	16.4
Deferred:			
Federal	29.2	33.0	6.1
State and local	(2.1)	2.1	0.7
International	47.2	(4.8)	4.3
Total deferred	74.3	30.3	11.1
	<u>\$ 180.9</u>	<u>\$ 93.6</u>	<u>\$ 27.5</u>

The reconciliation of income taxes computed at the United States federal statutory tax rate to income tax expense is:

	1999	1998	1997
	(Millions of Dollars)		
Income taxes at United States statutory rate	\$ 161.0	\$ 64.9	\$ 34.9
Tax effect from:			
State income taxes	9.5	7.9	0.8
Foreign operations, net of foreign tax credits	6.4	5.6	(2.7)
Sale of international retail/wholesale operations	(4.7)	(11.5)	(6.8)
Goodwill amortization	28.1	19.7	—
Purchased in-process research and development	—	6.5	—
Valuation allowance reductions	(21.4)	—	—
Tax credits and other	2.0	0.5	1.3
	<u>\$ 180.9</u>	<u>\$ 93.6</u>	<u>\$ 27.5</u>

The following table summarizes the Company's total provision for income taxes/(tax benefit) by component:

	1999	1998	1997
	(Millions of Dollars)		
Income tax expense	\$ 180.9	\$ 93.6	\$ 27.5
Extraordinary items and cumulative effect of change in accounting principle	(20.3)	(19.8)	(1.5)
T&N Bearings divestiture	—	56.1	—
Allocated to equity:			
Currency translation	—	15.3	(3.6)
Preferred dividends	(1.2)	(1.2)	(1.3)
Incentive stock plans	(0.3)	(3.9)	(3.4)
Investment securities	(0.1)	—	(0.6)
Pension	(4.5)	0.2	(0.9)
Other	—	—	2.1
	<u>\$ 154.5</u>	<u>\$ 140.3</u>	<u>\$ 18.3</u>

Significant components of the Company's deferred tax assets and liabilities as of December 31 are as follows:

	1999	1998
	(Millions of Dollars)	
Deferred tax assets:		
Asbestos	\$ 399.1	\$ 429.1
Postemployment benefits	178.2	165.2
Net operating loss carryforwards of		
international subsidiaries	103.0	110.9
Restructuring and rationalization reserves	20.9	98.8
Inventory basis	19.9	34.2
Allowance for doubtful accounts	25.6	15.2
Other temporary differences	105.5	117.6
Total deferred tax assets	852.2	971.0
Valuation allowance for deferred tax assets	(54.5)	(77.0)
Net deferred tax assets	797.7	894.0
Deferred tax liabilities:		
Fixed asset basis differences	(351.1)	(379.4)
Intangible asset basis differences	(289.5)	(326.2)
Deferred gains	(130.0)	(130.0)
Pension	(33.3)	(6.9)
Total deferred tax liabilities	(803.9)	(842.5)
	<u>\$ (6.2)</u>	<u>\$ 51.5</u>

Deferred tax assets and liabilities are recorded in the consolidated balance sheets as follows:

	1999	1998
	(Millions of Dollars)	
Assets:		
Prepaid expenses and income tax benefits	\$ 128.2	\$ 187.3
Other noncurrent assets	148.8	—
Liabilities:		
Other current accrued liabilities	(24.3)	—
Other long-term accrued liabilities	(258.9)	(135.8)
	<u>\$ (6.2)</u>	<u>\$ 51.5</u>

Income taxes paid in 1999, 1998 and 1997 were \$87.5 million, \$34.7 million and \$2.6 million, respectively.

The 1999 provision includes the estimated U.S. federal income tax effects of retained earnings of subsidiaries expected to be distributed to the Company. No provision was made with respect to \$417.3 million of undistributed earnings at December 31, 1999, since these earnings are considered by the Company to be permanently reinvested. Upon distribution of these earnings, the Company would be subject to United States income taxes and foreign withholding taxes. Determining the unrecognized deferred tax liability on the distribution of these earnings is not practicable as such liability, if any, is dependent on circumstances existing when remittance occurs.

At December 31, 1999, the Company has \$162 million in net operating loss carryforwards in the United Kingdom with no expiration date or valuation allowance. Also, the Company has \$155 million of additional foreign net operating loss carryforwards with a full valuation allowance and various expiration dates.

Included in the previous amounts are \$168 million of net operating loss carryforwards acquired with the purchases of T&N, Cooper Automotive and Fel-Pro. A valuation allowance was recorded on \$90 million of these purchased net operating loss carryforwards, and to the extent such benefits are ever realized, such benefits will be recorded as a reduction of goodwill.

15. OPERATIONS BY INDUSTRY SEGMENT AND GEOGRAPHIC AREA

During 1999, the Company reorganized its operating segments. Prior to the internal reorganization, the Company's three operating segments were Powertrain Systems, Sealing Systems and General Products. As a result of the Company's internal reorganization, integrated operations are conducted under three operating segments corresponding to major product areas: Powertrain Systems; Sealing Systems, Visibility and Systems Protection Products; and Brake, Chassis, Ignition and Fuel Products. The segment information to follow has been restated to reflect the internal reorganization changes announced in 1999.

Powertrain Systems Products are used primarily in automotive, light truck, heavy duty, industrial, marine, agricultural, power generation and small air-cooled engine applications. The primary products of this operating unit include camshafts, sintered products, engine bearings, large bearings, pistons, piston pins, rings, cylinder liners and connecting rods.

Sealing Systems, Visibility and Systems Protection Products are used in automotive, light truck, heavy-duty, agricultural, off-highway, marine, railroad, high-performance and industrial applications. The primary products of this operating unit include dynamic seals, gaskets, lighting products, wiper blades and systems protection products.

Brake, Chassis, Ignition and Fuel Products are used in automotive, light truck, heavy-duty, agricultural, off-highway, marine, and high-performance applications. The primary products of this operating unit include brake and friction products, chassis products, ignition products and fuel system components.

Divested Activities include the historical operating results and assets of aftermarket operations in South Africa, Australia, Chile and heavy wall bearing operations in Germany and Brazil which were sold or closed in 1997.

The accounting policies of the business segments are consistent with those described in the summary of significant accounting policies. The Company evaluates segmental performance based on several factors, including both Economic Value Added (EVA) and Operational EBIT. Operational EBIT is defined as earnings before interest, income taxes, extraordinary items and certain nonrecurring items such as certain acquisition-related adjustments and integration costs associated with new acquisitions. Operational EBIT for each segment is shown on the next page, as it is most consistent with the measurement principles used in measuring the corresponding amounts in the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	1999	1998	1997
	(Millions of Dollars)		
Net Sales:			
Powertrain Systems	\$2,459	\$2,107	\$ 782
Sealing Systems, Visibility and Systems Protection Products	1,887	1,252	333
Brake, Chassis, Ignition and Fuel Products	2,123	1,036	577
Divested Activities	19	74	115
Total	<u>\$6,488</u>	<u>\$4,469</u>	<u>\$1,807</u>

	1999	1998	1997
	(Millions of Dollars)		
Operational EBIT:			
Powertrain Systems	\$ 262	\$ 248	\$ 68
Sealing Systems, Visibility and Systems Protection Products	297	154	26
Brake, Chassis, Ignition and Fuel Products	277	104	44
Divested Activities	(1)	(4)	1
Total	<u>\$ 835</u>	<u>\$ 502</u>	<u>\$ 139</u>

	1999	1998	1997
	(Millions of Dollars)		
Reconciliation:			
Total segments operational EBIT	\$ 835	\$ 502	\$ 139
Net interest and other financing costs	(309)	(233)	(29)
Restructuring, impairment and other special charges	(8)	(20)	(10)
Acquisition-related costs	(58)	(63)	—
Earnings before income taxes, extraordinary items and cumulative effect of change in accounting principle	<u>\$ 460</u>	<u>\$ 186</u>	<u>\$ 100</u>

	1999	1998	1997
	(Millions of Dollars)		
Assets:			
Powertrain Systems	\$3,526	\$3,467	\$ 786
Sealing Systems, Visibility and Systems Protection Products	3,000	2,925	382
Brake, Chassis, Ignition and Fuel Products	3,419	3,471	508
Divested Activities	—	77	126
Total	<u>\$9,945</u>	<u>\$9,940</u>	<u>\$1,802</u>

	1999	1998	1997
	(Millions of Dollars)		
Capital Expenditures:			
Powertrain Systems	\$ 229	\$ 153	\$ 28
Sealing Systems, Visibility and Systems Protection Products	79	41	13
Brake, Chassis, Ignition and Fuel Products	87	35	9
Total	<u>\$ 395</u>	<u>\$ 229</u>	<u>\$ 50</u>

	1999	1998	1997
	(Millions of Dollars)		
Depreciation and Amortization:			
Powertrain Systems	\$ 151	\$ 115	\$ 28
Sealing Systems, Visibility and Systems Protection Products	94	50	11
Brake, Chassis, Ignition and Fuel Products	109	62	12
Divested Activities	1	1	1
Total	<u>\$ 355</u>	<u>\$ 228</u>	<u>\$ 52</u>

Included in the consolidated financial statements are amounts relating to geographic locations listed below. This geographic information is based on the location of Federal-Mogul operations.

	Net Sales			Net Property, Plant and Equipment		
	1999	1998	1997	1999	1998	1997
	(Millions of Dollars)					
United States	\$3,922	\$2,345	\$1,111	\$1,492	\$1,422	\$ 166
Mexico	153	124	87	28	30	7
Canada	162	76	58	43	39	1
Total North America	4,237	2,545	1,256	1,563	1,491	174
United Kingdom	533	516	21	305	312	9
Germany	630	478	126	344	318	105
France	303	327	33	79	113	9
Italy	252	200	71	77	77	9
Other Europe	295	188	117	55	62	3
Total Europe	2,013	1,709	368	860	882	135
Rest of World	238	215	183	81	104	5
Total	<u>\$6,488</u>	<u>\$4,469</u>	<u>\$1,807</u>	<u>\$2,504</u>	<u>\$2,477</u>	<u>\$ 314</u>

16. LITIGATION AND ENVIRONMENTAL MATTERS

T&N Asbestos Litigation

In the United States, the Company's United Kingdom subsidiary, T&N Ltd., and two former United States subsidiaries of T&N, plc (the "T&N Companies") are among many defendants named in numerous court actions alleging personal injury resulting from exposure to asbestos or asbestos-containing products. T&N is also subject to asbestos-disease litigation, to a lesser extent, in the United Kingdom and France. Because of the slow onset of asbestos-related diseases, management anticipates that similar claims will be made in the future. It is not known how many such claims may be made nor the expenditures which may arise therefrom.

As of December 31, 1999, the T&N Companies had approximately 95,000 claims pending. During 1999, approximately 49,000 new claims were filed and 60,000 claims were settled, dismissed or otherwise resolved. In addition to the pending cases above, the T&N Companies have approximately 64,000 claims that have been settled but will be paid over time. There are a number of factors that could impact the settlement costs into the future, including but not limited to: changes in legal environment; possible insolvency of co-defendants; and the establishment of an acceptable administrative (non-litigation) claims resolution mechanism.

The \$1.1 billion total provision held for the T&N Companies is comprised of an estimate for known claims (pending and settled but not paid) and possible future claims (IBNR). As of December 31, 1999, the \$1.1 billion total provision is comprised of approximately \$520 million related to known claims and approximately \$620 million related to IBNR claims.

In arriving at the IBNR provision for the T&N Companies, assumptions have been made regarding the total number of claims anticipated to be received in the future, the typical cost of settlement (which is sensitive to the industry in which the plaintiff claims exposure, the alleged disease type and the jurisdiction in which the action is being brought), the rate of receipt of claims and the timing of settlement and, in the United Kingdom, the level of subrogation claims brought by insurance companies.

T&N Ltd. has appointed the Center for Claims Resolution (CCR) as its exclusive representative in relation to all asbestos-related personal injury claims made against it in the United States.

The CCR provides to its member companies a litigation defense, claims-handling and administration service in respect to United States asbestos-related disease claims. Pursuant to the CCR Producer Agreement, T&N Ltd. is entitled to appoint a representative as one of the five voting directors on the CCR's Board of Directors. Members of the CCR contribute towards indemnity payments in each claim in which the member is named.

Contributions to such indemnity payments are calculated on a case by case basis according to sharing agreements among the CCR's members.

Effective January 18, 2000, the two United States subsidiaries withdrew from the CCR membership and appointed a law firm specializing in asbestos matters as their claims handling defense and administrative service provider. Indemnity and defense obligations incurred while members of the CCR will continue to be honored. This change is intended to create greater economic and defense efficiencies for the two companies.

In 1996, T&N purchased a £500 million (approximately \$845 million at the insurance agreement exchange rate of \$1.69/£) layer of insurance which will be triggered should the aggregate costs of claims filed after June 30, 1996, where the exposure occurred prior to that date, exceed £690 million (approximately \$1,166 million at the \$1.69/£ exchange rate). The initial reserve provided for the T&N Companies for claims filed after June 30, 1996 approximated the trigger point of the insurance. The Company has reviewed the financial viability and legal obligations of the three reinsurance companies involved and has concluded, at this time, that there is little risk of the reinsurers not being able to meet their obligation to pay, should the claims filed after June 30, 1996 exceed the £690 million trigger point.

While management believes that reserves are appropriate for anticipated losses arising from asbestos-related claims against the T&N Companies, given the nature and complexity of the factors affecting the estimated liability, the actual liability may differ. No absolute assurance can be given that the T&N Companies will not be subject to material additional liabilities

and significant additional litigation relating to asbestos. In the possible, but unlikely event that such liabilities exceed the reserves recorded by the Company and the additional £500 million of insurance coverage, the Company's results of operations, business, liquidity and financial condition could be materially adversely affected. The reserve for the T&N Companies is re-evaluated periodically as additional information becomes available.

During 1999, T&N Ltd. was named in a complaint filed in the United States District Court for the Eastern District of Texas by Owens-Illinois alleging that T&N is liable to Owens-Illinois for Owens-Illinois' own indemnity and defense costs pertaining to asbestos-related personal injury claims. The Company believes it has meritorious defenses to the claim and has successfully defended against similar underlying claims in the past.

Cooper Automotive Asbestos Litigation

Former businesses of Cooper Automotive, primarily Abex and Wagner, are involved as defendants in numerous court actions in the United States alleging personal injury from exposure to asbestos or asbestos-containing products, mainly involving friction products. In 1998, the Company acquired the capital stock of a Cooper Automotive entity resulting in the assumption by a Company subsidiary of contractual liability, under certain circumstances, for all claims pending and to be filed in the future alleging exposure to certain Wagner automotive and industrial friction products and for all claims filed after August 29, 1998, alleging exposure to certain Abex (non-railroad and non-aircraft) friction products. As of December 31, 1999, Abex has approximately 10,500 claims pending and Wagner has approximately 13,700 claims pending. The Company has completed its assessment of the potential liability and related potential insurance recoveries related to the Cooper Automotive acquisition and has recorded a \$325.9 million insurance recoverable asset and a liability of the subsidiaries involved of approximately \$400 million. This is the Company's estimate, after taking into account legal counsel's evaluation related to amounts expected to be paid or reimbursed by insurers. In arriving at these provisions, certain assumptions have been made regarding the total number of claims which may be received in the future against these two entities and the average costs associated with such claims.

Abex maintained product liability insurance coverage for most of the time that it manufactured products that contained asbestos. The subsidiary of the Company that may be liable for the post-August 1998 asbestos claims against Abex has the benefit of that insurance. Abex has been in litigation since 1982 with the insurance carriers of its primary layer of liability concerning coverage for asbestos claims. Abex also has substantial excess layer liability insurance coverage which, barring unforeseen insolvencies of excess carriers or other adverse events, should provide coverage for asbestos claims against Abex.

Wagner also maintained product liability insurance coverage for some of the time that it manufactured products that contained asbestos. The subsidiary of the Company that may be liable for asbestos claims against Wagner has the benefit of that insurance.

Primary layer liability insurance coverage for asbestos claims against Wagner is the subject of an agreement with Wagner's solvent primary carriers. The agreement provides for partial reimbursement of indemnity and defense costs for Wagner asbestos claims until exhaustion of aggregate limits. Wagner also has substantial excess layer liability insurance coverage which, barring unforeseen insolvencies of excess carriers or other adverse events, should provide coverage for asbestos claims against Wagner.

The ultimate exposure of the Company's subsidiary with respect to claims against Abex and Wagner will depend upon the extent to which the insurance described above will be available to cover such claims, the amounts paid for indemnity and defense, changes in the legal environment and other factors. While the Company believes that the liability and receivable recorded for these claims are reasonable and appropriate, given the nature and complexity of factors affecting the estimated liability and potential insurance recovery, the actual liability and insurance recovery may differ. In the event that the actual liability net of insurance proceeds recovered exceeds the reserve net of insurance receivable recorded by the Company, the Company's results of operations, business, liquidity and financial condition could be materially adversely affected. The asbestos reserves for the businesses acquired as part of the Cooper Automotive acquisition will be re-evaluated periodically as additional information becomes available.

Federal-Mogul and Fel-Pro Asbestos Litigation

The Company also is sued in its own name as one of a large number of defendants in a number of lawsuits brought by claimants alleging injury due to exposure to asbestos. The Company's Fel-Pro subsidiary has been named as a defendant in a number of product liability cases involving asbestos, primarily involving gasket or packing products. The Company is defending all such claims vigorously and believes that it and Fel-Pro have substantial defenses to liability and adequate insurance coverage for defense and indemnity. While the outcome of litigation cannot be predicted with certainty, management believes that asbestos claims pending against the Company and Fel-Pro as of December 31, 1999, will not have a material effect on the Company's financial position.

Aggregate of Asbestos Liability

As of December 31, 1999, the Company has provided a total reserve for all of its subsidiaries and businesses with potential asbestos liability of approximately \$1.5 billion as its best estimate for future costs related to resolving asbestos claims. The Company estimates claims will be filed and paid in excess of the next 20 years. This estimate is based in part on recent and historical claims experience, medical information and the current legal environment. The company has a corresponding receivable from certain insurance carriers of approximately \$325.9 million.

Environmental Matters

The Company is a defendant in lawsuits filed in various jurisdictions pursuant to the federal Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA) or other similar federal or state environmental laws which require responsible parties to pay for cleaning up contamination resulting from hazardous wastes which were discharged into the environment by them or by others to which they sent such wastes for disposition. In addition, the Company has been notified by the United States Environmental Protection Agency and various state agencies that it may be a potentially responsible party (PRP) under such law for the cost of cleaning up certain other hazardous waste storage or disposal facilities pursuant to CERCLA and other federal and state environmental laws. PRP designation requires the funding of site investigations and subsequent remedial activities. At most of the sites that are likely to be costliest to clean up, which are often current or former commercial waste disposal facilities to which numerous companies sent waste, the Company's exposure is expected to be limited. Despite the joint and several liability which might be imposed on the Company under CERCLA and some of the other laws pertaining to these sites, the Company's share of the total waste is usually quite small; the other companies which also sent wastes, often numbering in the hundreds or more, generally include large, solvent publicly owned companies; and in most such situations the government agencies and courts have imposed liability in some reasonable relationship to contribution of waste. In addition, the Company has identified certain present and former properties at which it may be responsible for cleaning up environmental contamination. The Company is actively seeking to resolve these matters. Although difficult to quantify based on the complexity of the issues, the Company has accrued the estimated cost associated with such matters based upon current available information from site investigations and consultants. The environmental reserve was approximately \$74.5 million at December 31, 1999, and \$50.0 million at December 31, 1998. The 1999 increase results from a number of factors, including retaining liabilities from the divestiture of the T&N Bearings Business. Management believes that such accruals will be adequate to cover the Company's estimated liability for its exposure in respect of such matters.

17. QUARTERLY FINANCIAL DATA (UNAUDITED)

	First(1)	Second(2)	Third(3)	Fourth(4)	Year
	(Millions of Dollars, Except Per Share Amounts)				
Year ended December 31, 1999:					
Net sales	\$ 1,642.2	\$ 1,687.1	\$ 1,583.9	\$ 1,574.3	\$ 6,487.5
Gross margin	449.5	482.6	441.2	405.1	1,778.4
Earnings before extraordinary items and cumulative effect of change in accounting principle	61.4	87.3	70.1	60.2	279.0
Extraordinary items — loss on early retirement of debt, net of applicable income tax benefits	23.1	—	—	—	23.1
Cumulative effect of change in accounting for costs of start-up activities, net of applicable income tax benefit	12.7	—	—	—	12.7
Net earnings	25.6	87.3	70.1	60.2	243.2
Diluted earnings per share	.38	1.11	.91	.79	3.16
Stock price					
High	\$ 64.88	\$ 53.81	\$ 55.00	\$ 29.13	
Low	\$ 40.63	\$ 41.94	\$ 23.38	\$ 17.56	
Dividend per share	\$.0025	\$.0025	\$.0025	\$.0025	

	First(5)	Second(6)	Third(7)	Fourth(8)	Year
	(Millions of Dollars, Except Per Share Amounts)				
Year ended December 31, 1998:					
Net sales	\$ 658.0	\$ 1,214.0	\$ 1,121.2	\$ 1,475.5	\$ 4,468.7
Gross margin	161.3	317.4	292.9	406.9	1,178.5
Net earnings before extraordinary items	(7.2)	28.4	34.6	36.1	91.9
Extraordinary items — loss on early retirement of debt, net of tax benefits	—	(31.3)	—	(6.9)	(38.2)
Net earnings	(7.2)	(2.9)	34.6	29.2	53.7
Diluted earnings per share	(.20)	(.07)	.58	.48	.96
Stock price					
High	\$ 54.37	\$ 69.25	\$ 72.00	\$ 63.00	
Low	\$ 39.00	\$ 52.62	\$ 46.62	\$ 33.00	
Dividend per share	\$.12	\$.0025	\$.0025	\$.0025	

(1) Includes \$10.1 million of integration costs.

(2) Includes \$13.3 million of integration costs.

(3) Includes \$13.2 million of integration costs, and a \$7.9 million charge for adjustment of assets held for sale and other long-lived assets to fair value.

(4) Includes \$10.3 million of integration costs.

(5) Includes \$1.0 million of integration costs, an \$18.6 million charge for purchased in-process research and development, a \$10.5 million restructuring charge, and a \$19.0 million net charge for an adjustment of assets held for sale and other long-lived assets to fair value.

(6) Includes \$3.7 million of integration costs.

(7) Includes \$9.0 million of integration costs, and a \$6.6 million restructuring credit.

(8) Includes \$8.7 million of integration costs, and a \$3.4 million net restructuring charge.

18. CONSOLIDATING CONDENSED FINANCIAL INFORMATION OF GUARANTOR SUBSIDIARIES

Certain subsidiaries of the Company (as listed below, collectively the "Guarantor Subsidiaries") have guaranteed fully and unconditionally, on a joint and several basis, the obligation to pay principal and interest under the Company's Senior Credit Agreement with the Chase Manhattan Bank, NA ("Chase"). The Company issued notes in 1998, which are guaranteed by the Guarantor Subsidiaries. The Guarantor Subsidiaries also guarantee the

Company's previously existing publicly registered Medium-term notes and Senior notes. The Company has included audited consolidating condensed financial statements based on the Company's understanding of the Securities and Exchange Commission's interpretation and application of Rule 3-10 of the Securities and Exchange Commission's Regulation S-X and Staff Accounting Bulletin 53 in its December 31, 1999 Form 10-K, filed with the Securities and Exchange Commission.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

To Our Shareholders:

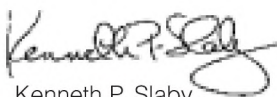
The management of Federal-Mogul has the responsibility for preparing the accompanying financial statements and for their integrity and objectivity. The financial statements were prepared in accordance with generally accepted accounting principles and include amounts based on the best estimates and judgments of management. Management also prepared the other financial information in this report and is responsible for its accuracy and consistency with the financial statements. Federal-Mogul has retained independent auditors, ratified by election by the shareholders, to audit the financial statements.

Federal-Mogul maintains internal accounting control systems which are adequate to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and which produce records adequate for preparation of financial information. The systems controls and compliance are reviewed by a program of internal audits. There are limits inherent in all systems of internal accounting control based on the recognition that the cost of such a system not exceed the benefits derived. We believe Federal-Mogul's system provides this appropriate balance.

The Audit Committee of the Board of Directors, comprised of five outside directors, performs an oversight role related to financial reporting. The Committee periodically meets jointly and separately with the independent auditors, internal auditors and management to review their activities and reports and to take any action appropriate to their findings. At all times, the independent auditors have the opportunity to meet with the Audit Committee, without management representatives present, to discuss matters related to their audit.



Dick Snell
Chairman and Chief Executive Officer



Kenneth P. Slaby
Vice President and Controller

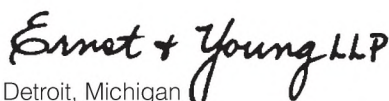
REPORT OF INDEPENDENT AUDITORS

To the Shareholders and Board of Directors, Federal-Mogul Corporation:

We have audited the accompanying consolidated balance sheets of Federal-Mogul Corporation and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Federal-Mogul Corporation and subsidiaries at December 31, 1999 and 1998, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.



Detroit, Michigan
February 16, 2000

BOARD OF DIRECTORS

Federal-Mogul's Board of Directors consists of eight members with impressive business experience and leadership. Seven directors are non-executives and three directors are citizens outside the United States, bringing Federal-Mogul a strong balance of business viewpoints and international perspectives. All directors are shareowners and collectively, own and hold options to purchase 1,038,142 shares.

John J. Fannon, 66
Retired Vice Chairman
Simpson Paper Company
Director since 1986

Roderick M. Hills, 69
Chairman, Hills Enterprises, Ltd.
Partner, Hills & Sterns
Director since 1977

Paul Scott Lewis, 63
Former Chairman, Terranova Foods, plc
Director since 1998

Antonio Madero, 62
Founder, Chairman, and Chief Executive Officer
SANLUIS Corporacion S.A. de C.V.
Director since 1994

Robert S. Miller Jr., 58
Former President, Reliance Group Holdings
Director since 1993

John C. Pope, 51
Chairman, PFI Group
Director since 1987

Richard A. Snell, 58
Chairman, Chief Executive Officer and President
Director since 1996

Sir Geoffrey Whalen, C.B.E., 64
Retired Managing Director and Deputy Chairman
Peugeot Motor Company plc
Director since 1998

CHAIRMAN OF THE BOARD

Richard A. Snell

AUDIT COMMITTEE

John C. Pope (Chair)
Roderick M. Hills
Paul Scott Lewis
Antonio Madero
Robert S. Miller Jr.

COMPENSATION COMMITTEE

John J. Fannon (Chair)
Paul Scott Lewis
Antonio Madero
John C. Pope
Sir Geoffrey Whalen

GOVERNANCE AND NOMINATING COMMITTEE

Roderick M. Hills (Chair)
John J. Fannon
Paul Scott Lewis
Antonio Madero
Robert S. Miller Jr.
John C. Pope
Sir Geoffrey Whalen

PENSION COMMITTEE

Robert S. Miller Jr. (Chair)
John J. Fannon
Roderick M. Hills
Sir Geoffrey Whalen

LEADERSHIP TEAM

Richard A. Snell
Chairman of the Board, Chief Executive Officer and President

Alan R. Begg
Vice President, Technology

James C. Burkhart
Vice President, Strategic Planning and Marketing

Robert F. Egan
Vice President, Aftermarket Sales - Americas

Steven C. Feeny
Vice President, Investor Relations

Charles B. Grant
Vice President, Corporate Development

David Krohn
Senior Vice President, Brake/Chassis/Ignition/Fuel

Bonnie J. Price
Vice President, Customer Service and Distribution

Richard P. Randazzo
Senior Vice President, Human Resources

David A. Bozynski
Chief Financial Officer

Wilhelm A. Schmelzer
Executive Vice President, Europe

Rick Streicher
Senior Vice President, Sealing Systems/Visibility/Systems Protection

Kimberly A. Welch
Vice President, Corporate Communications

Michael C. Verwilt
Senior Vice President, Powertrain Systems

James J. Zamoyski
Senior Vice President and General Counsel

WORLD HEADQUARTERS

Federal-Mogul Corporation
26555 Northwestern Highway
Southfield, Michigan 48034 USA
Telephone: (248) 354-7700
Fax: (248) 354-8950
Internet address: <http://www.federal-mogul.com>

ANNUAL MEETING

The annual meeting of shareholders will be held at 8:30 a.m. on Wednesday, April 19, 2000 at Federal-Mogul World Headquarters.

STOCK LISTING

New York Stock Exchange
Ticker Symbol: FMO

INVESTOR RELATIONS

Investors and security analysts should contact:
Steve Feeny
Vice President - Investor Relations
Telephone: (248) 354-8847 Fax: (248) 354-7769
E-mail: Steve_Feeny@fmo.com

INVESTOR SERVICES

The following information is available without charge to shareholders and other interested parties:

- Annual Report to Shareholders
- Form 10-K Annual Report and Form 10-Q Quarterly Reports filed with the Securities and Exchange Commission

To request these publications, please contact:
Kathy Fauls
Federal-Mogul Investor Relations
26555 Northwestern Highway
Southfield, Michigan 48034 USA
Telephone: (248) 354-7069
Toll-free number for U.S. calls: (800) 521-8607
E-mail: Kathy_Fauls@fmo.com

COMPANY NEWS ON-CALL (through PR Newswire®):
(800) 758-5804. Faxed news releases issued by Federal-Mogul are available in the U.S. and Canada by calling the above number and entering Federal-Mogul's code: 306225 followed by the caller's fax number.

ANNUAL REPORT ON THE INTERNET

The 1999 Federal-Mogul Annual Report is available on Federal-Mogul's World Wide Web site at <http://www.federal-mogul.com> under the Investor Relations section.

STOCK TRANSFER AGENT AND REGISTRAR

Federal-Mogul's transfer agent and registrar is The Bank of New York (BONY). General shareholder inquiries should be directed to:
BONY Investor Relations
Department 11-E
P.O. Box 11258
Church Street Station
New York, New York 10286-1258
[www: http://stock.bankofny.com](http://stock.bankofny.com)
E-mail: shareowner-svcs@bankofny.com

For transfer of stock ownership, address changes, or replacement of lost, stolen or destroyed certificates, please write:

BONY Receive & Deliver
Department - 11W
P.O. Box 11002
Church Street Station
New York, New York 10286-1002

INDEPENDENT AUDITORS

Ernst & Young LLP
Detroit, Michigan, USA

STOCK AND DIVIDEND INFORMATION

As of December 31, 1999, the company had 70,422,525 shares of common stock outstanding owned by 8,000 shareholders of record. Management estimates there are an additional 19,000 beneficial owners of the company's stock held in street name.

Quarterly dividends are customarily mailed to shareholders on or about the 10th of March, June, September and December.

DIVIDEND REINVESTMENT PLAN

Federal-Mogul's Dividend Reinvestment Plan (DRIP) provides shareholders the opportunity to purchase additional shares of the company's common stock for a minimal fee through automatic reinvestment of dividend and optional cash payments. Cash payments may range from a minimum of \$10 a month to a maximum of \$25,000 annually.

A detailed brochure and authorization form are available from:
BONY Investor Relations Department
P.O. Box 11258, Church Street Station
New York, New York 10286-1258 USA
Or call: BONY Shareholder Relations Department at (800) 524-4458 between 9 a.m. and 6 p.m. EST. When calling, please be prepared to give your account/tax identification number(s) and your name exactly as it appears on your stock certificate.

QUARTERLY STOCK PRICE INFORMATION

	High	Low	Close
4Q 1999	29 1/8	17 9/16	20 1/8
3Q 1999	55	23 3/8	27 9/16
2Q 1999	53 13/16	41 15/16	52
1Q 1999	64 7/8	40 5/8	42 3/4
4Q 1998	63	33	59 1/2
3Q 1998	72	46 5/8	46 3/4
2Q 1998	69 1/4	52 5/8	67 1/2
1Q 1998	54 3/8	39	53 3/16

MEDIA INFORMATION

Journalists and media representatives should contact:
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Vice President - Corporate Communications
Federal-Mogul Corporation
26555 Northwestern Highway
Southfield, Michigan 48034 USA
Telephone: (248) 354-1916
Fax: (248) 354-7999
E-mail: Kim_Welch@fmo.com