

FEDERAL-MOGUL CORPORATION



PEOPLE
SERVING
CUSTOMERS
THROUGH
MANUFACTURING
MASTERY

1998 ANNUAL REPORT



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Shareowner/Media Information
Inside Back Cover

FELPRO

WAGNER
Brake Products

National
Oil Seals

MADE

WAGNER

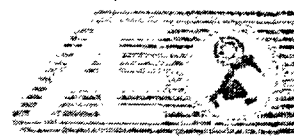
WAGNER

WAGNER

CHAMPION

GLYCO

FELPRO





STOCKING THE BEST GOODS OBTAINABLE

Founded in 1899, the Muzzy-Lyon Company — later to become Federal-Mogul — was a mill supply business. The founders rented a four-story building on Woodward Avenue close to the Detroit River in the heart of the burgeoning automotive industry.



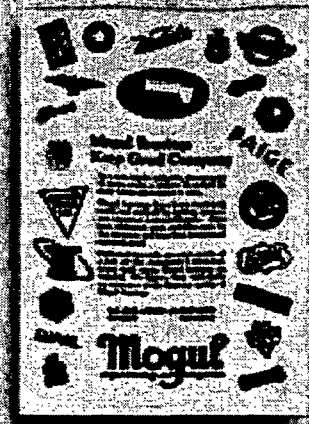
J. HOWARD MUZZY, Co-FOUNDER

After 14 years of working for a mill supply business, J. Howard Muzzy co-founded a company of his own in 1899 — Muzzy-Lyon. Born in 1865 in the rural town of Romeo, Michigan, north of Detroit, he would prove to be a very shrewd businessman.

EDWARD F. LYON, Co-FOUNDER

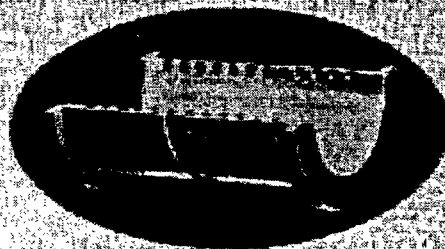
Edward F. Lyon had been Muzzy's assistant and a traveling salesman before the two teamed up to start their own company. He was a renowned salesman of babbitt metal and die-cast bearings for Muzzy and Lyon, but financial woes led him to sell his share of the company in 1912.





HIGH MOGUL OF ALL BABBITT METALS

Seeking a specialty to increase sales, Muzzy and Lyon experimented with formulations of babbitt metal, used to make bearings for automobiles, farm machinery and locomotives. They developed two different formulas, one of which they trade-named Mogul.



MOGUL BEARINGS KEEP GOOD COMPANY

This Mogul bearing resembled a split cylinder. In the early 1900s, Mogul bearings were standard in automobile gasoline engines built by Rolls-Royce, Stutz, Hudson and many other early car makers.

MOLDING METALS

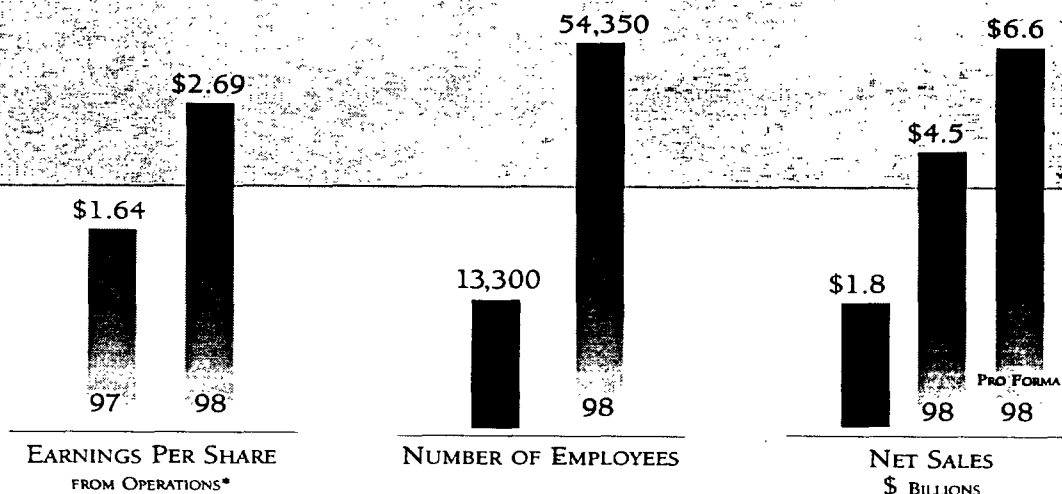
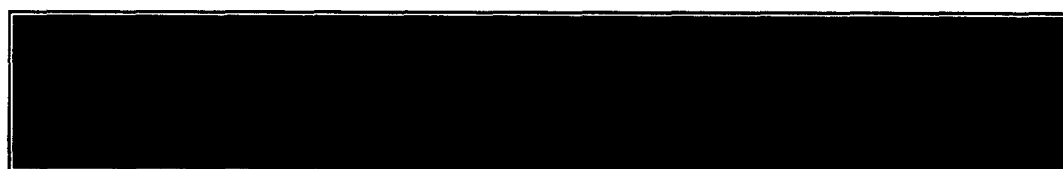
A factory worker pours molten metal at the Mogul Metal Company, a subsidiary company formed by Muzzy and Lyon to produce the two formulations they had developed — hard metals backed with tin-based alloys, each suited to particular bearing load and speed requirements — that were the basis of their metal bearings.



FINANCIAL HIGHLIGHTS

(Dollars in millions, except per share amounts)

Financial Information	1998	1997	1996
Net sales	\$4,468.7	\$1,806.6	\$2,032.7
Operating earnings (loss)	\$ 386.6	\$ 140.2	\$ (180.1)
Net earnings (loss)	\$ 53.7	\$ 69.4	\$ (206.3)
EBITDA	\$ 579.3	\$ 181.7	\$ (122.4)
Operating cash flow	\$ 325.5	\$ 215.7	\$ 149.0
Working capital	\$1,686.3	\$ 382.3	\$ 505.6
Total assets	\$9,940.1	\$1,802.1	\$1,455.2
Total debt/capital	57%	24%	61%
Capital expenditures	\$ 228.5	\$ 49.7	\$ 54.2
Economic value added	13	(18)	(121)
Number of employees	54,350	13,300	15,700
Common Stock Information	1998	1997	1996
Price per share as of year end	\$ 59 1/2	\$ 40 1/2	\$ 22
Net earnings (loss) per share assuming dilution	\$ 0.96	\$ 1.61	\$ (6.20)
Weighted average shares outstanding (millions, diluted)	53.7	41.9	34.7



* 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 reversals of the acquired inventory fair market value writeups.



LETTER TO SHAREOWNERS

TO OUR SHAREOWNERS:

1998 was a year of unprecedented growth and accomplishment for Federal-Mogul. We started the year as a \$1.8 billion supplier of components and finished as a \$6.6 billion industry-leading supplier of automotive systems and modules. Through the acquisition of ten very good companies, we created a stronger Federal-Mogul that provides the quality, technology and value our customers need with results that benefit our shareowners.

Our success is the result of the sustained professional effort put forth by the Federal-Mogul employee team whose hard work was often times heroic. Every day they consistently delivered on our goals and I am very proud of their team effort.

When we started 1998, we outlined three mandates:

- Continue to deliver solid financial results each quarter;
- Grow through acquisitions that deliver on our goals; and
- Integrate our acquisitions to create a consolidated, united operation.

FINANCIAL PERFORMANCE

We continued our strong financial performance in 1998 building on the solid results we delivered in 1997.

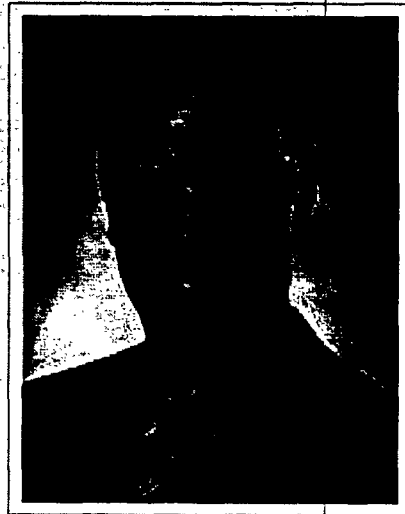
In 1998, your team:

- Generated \$13 million in operating EVA;
- Delivered earnings per share from operations of \$2.69, up 64% from 1997;
- Generated \$167 million in cash flow from operations after capital expenditures; and
- Achieved \$51 million in synergy savings from acquisitions.

The stock market recognized our efforts as our stock price increased 47% by year end, outperforming other similar automotive suppliers. We were also honored by Stern Stewart & Co. for achieving the best EVA improvement in absolute dollars and as a percentage of capital in the auto parts industry. This was particularly noteworthy, as 1998 was the first time in over a decade that Federal-Mogul reported to its shareowners returns in excess of our cost of capital.

Since the beginning of 1998, we:

- Completed a \$600 million equity offering and \$1 billion global bond offering to support the T&N and Fel-Pro acquisitions;
- Completed a \$780 million equity offering and \$1 billion global bond offering to support the Cooper acquisition;
- Completed the FTC-required divestiture of T&N's thinwall bearing business for \$430 million;
- Syndicated \$2 billion in bank facilities to provide bridge financing for acquisitions; and
- Increased our revolving credit facilities to \$1 billion.



THE
UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT
WASHINGTON, D. C. 20246



1907 GRAY MOTOR CAR

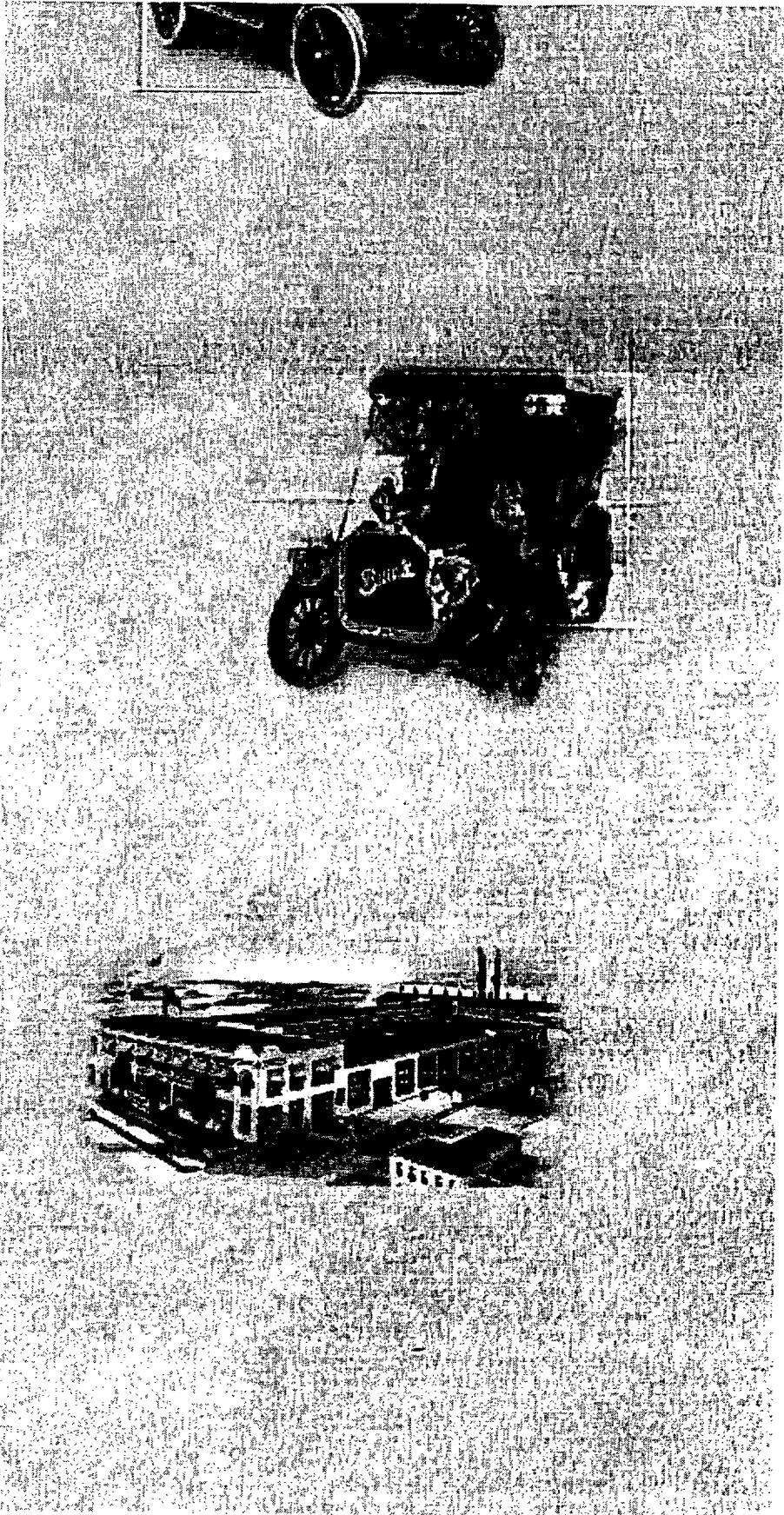
This Gray Motor Car Company 1907 car was the first to use Mogul die-cast bearings. Muzzy and Lyon foresaw the need for bearings in standard sizes and shapes and made their second important breakthrough by developing a method for producing die-cast bearings — experimenting with an old printer's typesetting machine.

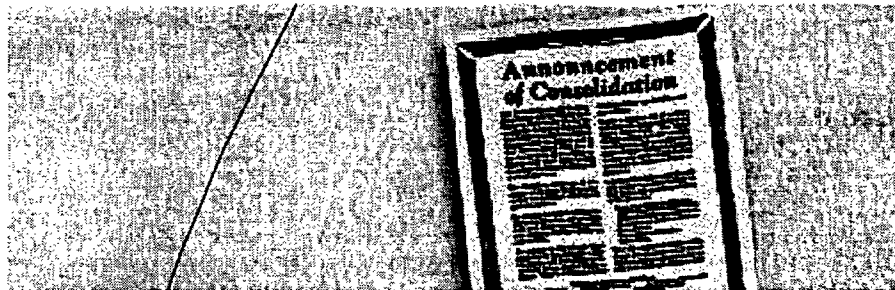
MODEL 10 BUICK

A 1910 order for 10,000 connecting rods for use in this Model 10 Buick was a high point for the business, which took off around 1913 when sales of bronze-backed, babbitt-lined bearings necessitated expansion of the Larned plant.

MOVING UP TO SHOEMAKER ROAD

The Muzzy-Lyon Company moved into this 36,000-square foot plant in 1922 — a bigger, more modern facility close to the majority of auto plants. 1923 saw record profits.





COMPETITORS BECOME PARTNERS

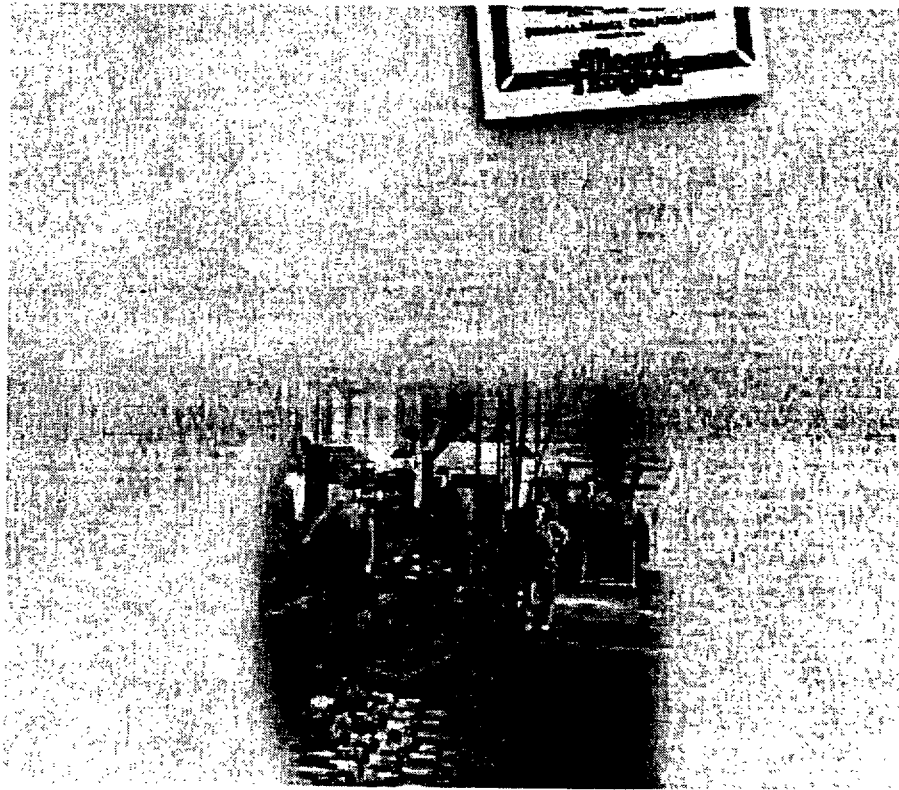
Numerous automotive trade publications carried this announcement of the merger of Muzzy-Lyon and Federal Bearing and Bushing. The name Federal-Mogul combined the two companies' trademarked products — hyphenated so neither would be perceived as more important than the other.

TARGETING THE AFTERMARKET

Federal-Mogul went into the replacement parts business with the purchase in 1924 of the failing Douglas Dahlin Company of St. Louis. Like this service center in Portland, Oregon, 16 branches opened around the country in the 1920s.

SON SUCCEEDS

The founder's oldest son, H. Gray Muzzy, was Federal-Mogul's first vice president and became president in 1926. Under his guidance the company established a Research Division in 1929 and purchased the Pacific Metal Bearing Company in San Francisco in 1930.





GROWTH PERFORMANCE

1998 was an extraordinary year of growth for Federal-Mogul. We completed ten acquisitions and strengthened our product offering and services to customers around the world. Three acquisitions were sizable: T&N, Fel-Pro and the automotive businesses of Cooper Industries.

We developed and we follow a very disciplined acquisition process that has strategic and financial hurdles that must be met in order to go forward. The strategic hurdles were developed to better serve our customers by:

- Expanding our core product lines into systems and modules to enhance value;
- Expanding globally to follow and serve original equipment customers; and
- Globally expanding our aftermarket parts manufacturing in those same regions.

The financial hurdles are:

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

The acquisitions of 1998 cleared these hurdles and have positioned us with totally new growth platforms. We've come a long way toward building a very solid foundation for future growth, especially when taking into consideration we are:

- The first to offer a complete Power Cylinder System;
- A leader in total engine and transmission sealing;
- The world leader in friction products;
- The North American leader in passenger car lighting;
- The developer of a revolutionary Twin Disc braking system;
- A technical leader in the development of alloys, powdered metals, and advanced sealing materials; and
- An aftermarket powerhouse offering strong brand names such as Fel-Pro®, Moog®, Champion®, ANCO®, Wagner®, Ferodo® and National®.

Federal-Mogul is the global leader in some very substantial consolidating sectors of the automobile industry. We are well positioned to capitalize on the major industry trends of: OEM outsourcing, supplier consolidation, systems and modules, and globalization.

INTEGRATION PROGRESS

We have a good, robust process for integrating our acquisitions. Our integration process is detailed and thorough beginning at the due diligence phase, enabling us to act quickly once we have acquired a company. With our 1998 acquisitions, we are on schedule with our integration actions, including:

- Closing manufacturing facilities in Hamburg, Germany and Salisbury and Ringwood, England;
- Closing aftermarket distribution facilities in Chapel-en-le-Frith, England and Burscheid, Germany;
- Downsized a manufacturing facility in Bridgwater, England;
- Downsizing a French friction facility;
- Closed FP Diesel warehouse in Florida and cylinder liner facility in South Africa;
- Restructured Mexican sealing operations;
- Closed T&N's U.S. headquarters and downsized T&N's U.K. headquarters;
- Consolidated marketing departments and sales forces;
- Closed five sales offices;
- Consolidating raw material sourcing;
- Sold piston facility in Argentina;
- Commenced restructuring of European aftermarket facilities; and
- Announced closure of structural bearings operations in Ilminster, England.

ALIGNMENT AND PRIORITIES

Alignment to our purpose and core values is a key factor to our success. Every member of the Federal-Mogul team operates by these values:

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

Our core values are our enduring tenets, and they are never compromised.

We have also committed to continuous improvement in our quality, health and safety, and productivity through the implementation of our constraint management process.

QUALITY

We are driving the organization to a target of zero defects. Our customers require defect-free quality not only in the product, but also in their entire interaction from order to delivery. Although our plants have recorded significant reductions in defects and several are running defect-free, we have not concentrated



EQUI-POISE PROPELLER

Federal-Mogul introduced this new-formula bronze propeller in 1931, called the Equi-Poise, capable of withstanding the tremendous twisting force of powerful racing engines. Research Division advances would help the company throughout the 1930s.

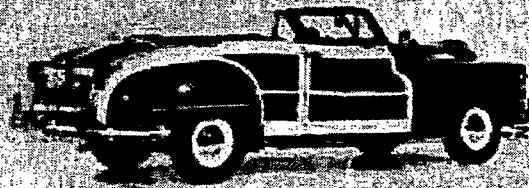
ALLOY DEVELOPED TO BEAR HEAVY LOADS

This large bearing for use in heavily loaded engines is made of C-S 50, a cadmium-based alloy developed by Federal-Mogul researchers, introduced in 1934. By 1935, C-S 50 bearings were used on the connecting rods of all Ford Motor Company cars.

FEDERAL-MOGUL GIVES ALLIES EXTRA PUNCH

During World War II, Federal-Mogul ads often featured stories about battles won with equipment that used the company's products. In 1941, Federal-Mogul was the largest manufacturer of motorboat propellers in the world.





PENT-UP DEMAND SPURS POST-WAR CAR SALES

After years of pent-up demand fueled by six years of halted production, passenger car sales soared when automakers rolled out the first new models in 1947.

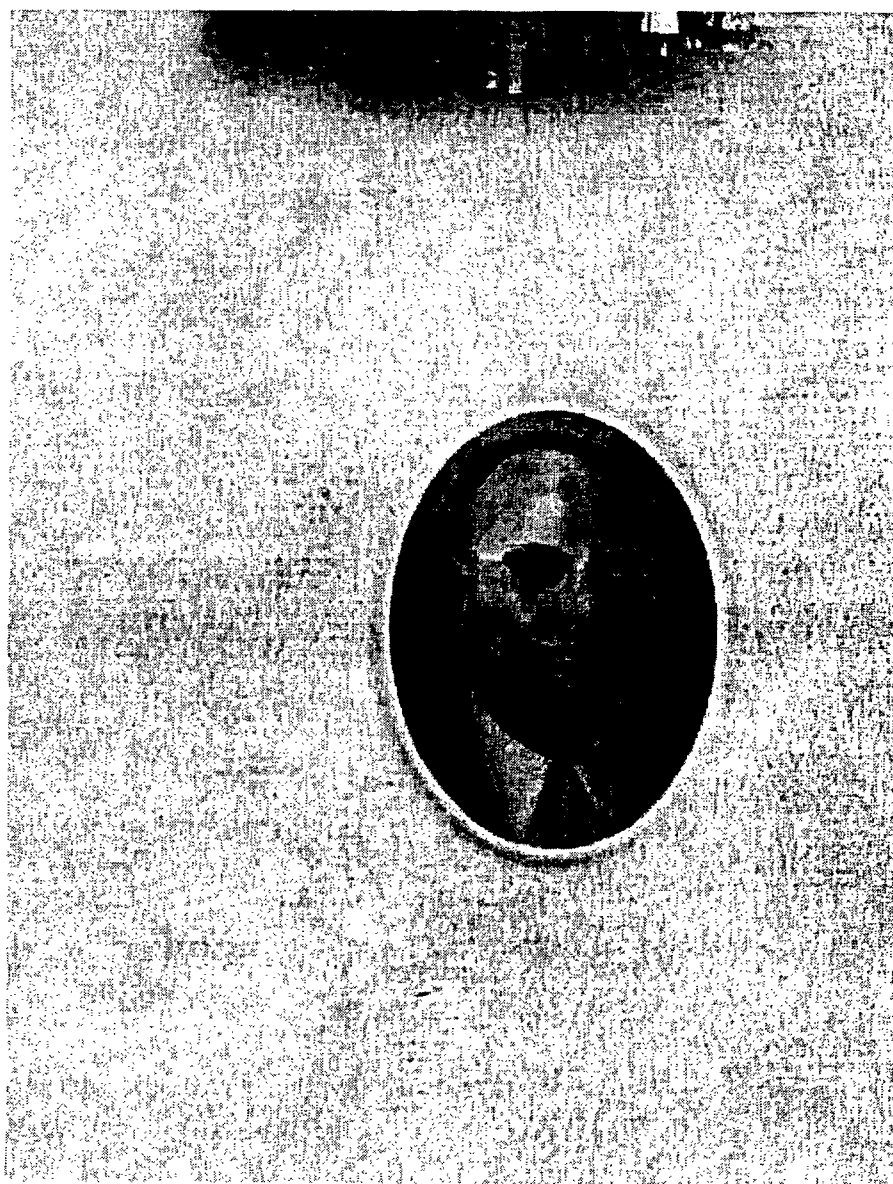


AT 50, COMPANY GLOBAL

This ceremony at the Coldwater service center celebrated Federal-Mogul's fiftieth anniversary in 1949. Successfully converting the company to post-war civilian production included doing business in 75 countries.

NEW DECADE, NEW PRESIDENT

Guy S. Peppiatt was elected president in 1950, when H. Gray Muzzy stepped down. Peppiatt embarked on a program of aggressive acquisitions.



enough energy on the broader drive to zero defects in our business. We will be launching several initiatives in this area in 1999.

HEALTH AND SAFETY

The health and safety of our employees is a high priority. The prevention of work-related injuries and illnesses is not a program but a way of life at Federal-Mogul. I am a firm believer that a great health and safety record is a sign of a well-managed plant. We have a number of facilities operating at several million direct labor hours with no loss-time accidents such as the Boaz, Alabama friction facility (5 million hours) and the Liberty, South Carolina ignition plant (3 million hours).

PRODUCTIVITY IMPROVEMENT

As part of our acquisition integration, we have been implementing our signature constraint management process to eliminate waste and embedded costs. For example, our newly acquired gasket manufacturing operation in Athens, Alabama has already reduced work-in-process inventory by 25%. The inventory reduction has resulted in 10% more floor space available for manufacturing capacity. In Athens, as well as in our other acquired facilities, this implementation effort is still in its infancy and we are encouraged by its success.

OUR CHALLENGE

In 1999, we celebrate a century of people serving customers through manufacturing mastery. Many celebrations of this accomplishment around the world reflect on our proud heritage that we seek to re-establish as the cornerstone of our success for the future.

With the substantial size and breadth of the company, we are very fortunate to acquire a person with the skills and experience of Gordon Ulsh to take over the operating structure of the company. Gordon is a seasoned automotive executive who began working in the auto industry with Ford in engineering and manufacturing, and most recently with Cooper Industries, rising to lead their entire automotive business. His experience is perfect for our operating needs and his personality fits very well into our culture of being driven towards mastery.

I continue to be very excited about our prospects for the future. Our growth formula is working well. We've established ourselves as the leading consolidator in the powertrain and sealing area and we have a good, proven formula for growth, which we will work to accelerate in the coming months.

Thank you for your continued support and encouragement.


Dick Shell

Chairman and Chief Executive Officer



PRODUCT SEGMENTATION

GENERAL PRODUCTS

43%

39%

18%

POWERTRAIN
SYSTEMS

SEALING
SYSTEMS

GEOGRAPHIC SEGMENTATION

OTHER

7%

34%

59%

EUROPE

NORTH
AMERICA

GENERAL MOTORS
FORD
DAIMLERCHRYSLER
NAPA
FIAT
PSA
CARQUEST
AUTO VALUE
CUMMINS
RENAULT



BELDEN

SPEED-PRO.

**FEDERAL
MOGUL**



National
Oil Seals



▲ Payen



FERODO

Bentley Harris

Signal-Stat[®]
Lighting and Safety Products

Carter



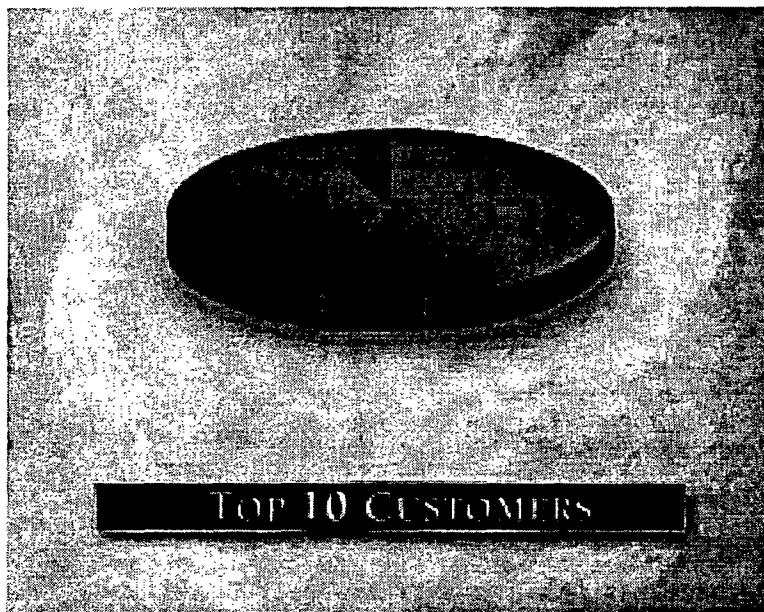


CHAMPION

PowerPath.

GLYCO







PRECISION
steering joint

BLAZER

WAGNER
Brake Products

WAGNER
STEERING JOINTS

ZANXX

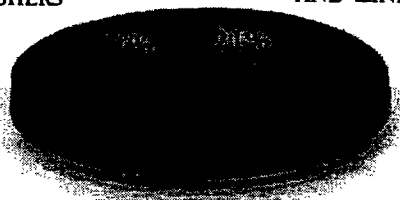
POWERTRAIN SYSTEMS

POWER CYLINDER SYSTEMS
ENGINE BEARINGS
PISTONS
PISTON PINS
PISTON RINGS
PISTON LINERS
CONNECTING RODS
BUSHINGS
WASHERS
SPARK PLUGS
IGNITION WIRES AND CABLES
IGNITION COILS
CERAMIC INSULATORS

ENGINE BEARINGS,
BUSHINGS AND
WASHERS

PISTON RINGS
AND LINERS

OTHER



PISTONS
AND PINS

IGNITION
PRODUCTS

EUROPE

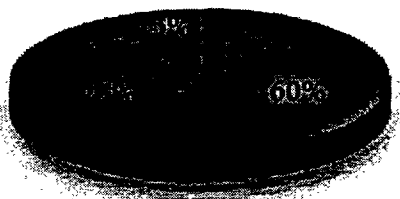
NORTH AMERICA

SEALING SYSTEMS

TOTAL ENGINE SEALING
TOTAL TRANSMISSION SEALING
TOTAL AXLE SEALING
CYLINDER HEAD GASKETS
ANCILLARY GASKETS
DYNAMIC SEALS
BONDED PISTONS
WIPER PRODUCTS
HEAT SHIELDS
NOISE AND VIBRATION
SEALING SYSTEMS

WIPER PRODUCTS

OTHER



DYNAMIC
SEALS

GASKETS

EUROPE

NORTH AMERICA

GENERAL PRODUCTS

CAMSHAFTS
BRAKE AND FRICTION PRODUCTS
CHASSIS PRODUCTS
DRIVELINE PRODUCTS
FUEL SYSTEM COMPONENTS
LIGHTING PRODUCTS
SINTERED PRODUCTS
SYSTEMS PROTECTION
PRODUCTS

OTHER

CHASSIS

OTHER



LIGHTING

CAMSHAFTS

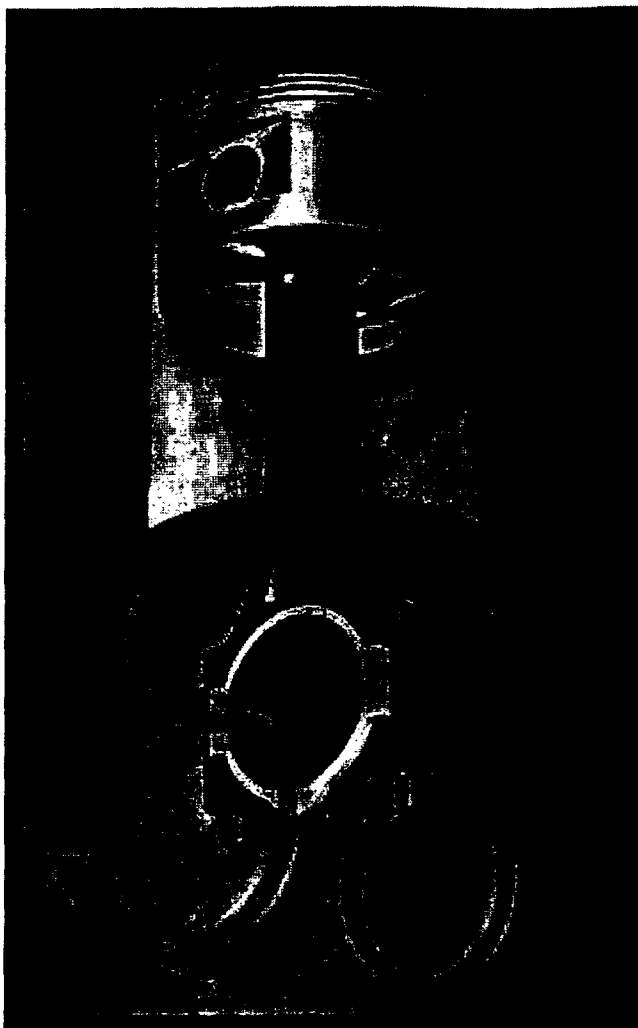
SINTERED
PRODUCTS

BRAKE
AND FRICTION

SYSTEMS
PROTECTION

EUROPE

NORTH AMERICA



A STROKE OF GENIUS

Powertrain Systems' comprehensive expertise in pistons, piston rings, connecting rods, bearings and cylinder liners come together in the Power Cylinder System — a totally integrated system that's lighter, more durable, less costly, and easier to install than conventionally assembled products.

The Power Cylinder System represents the synergy inherent in our unique set of skills: core competencies in materials, alloy development, surface technology and advanced design analysis; comprehensive research and development capabilities; extensive program management skills and manufacturing mastery.

AS PLASMA, CHROME AND CKS; WET/DRY LINERS AND LARGE BEARINGS, CONNECTING RODS AND IGNITION SYSTEM COMPONENTS, INCLUDING SPARK PLUGS. THESE PRODUCTS ARE SUPPLIED FROM MORE THAN 55 LOCATIONS IN 16 COUNTRIES.

POWERTRAIN SYSTEMS TAILORS OUR PRODUCTS AND SERVICES TO MATCH EACH CUSTOMER'S REQUIREMENTS. FROM MANUFACTURING AND ASSEMBLING PARTS TO DESIGNING ENTIRE NEW SYSTEMS, WE HAVE THE FLEXIBILITY, SKILLS AND RESOURCES TO RESPOND TO OUR CUSTOMERS' EVOLVING NEEDS.

POWERTRAIN SYSTEMS

POWERTRAIN SYSTEMS — GREATER THAN THE SUM OF THE PARTS

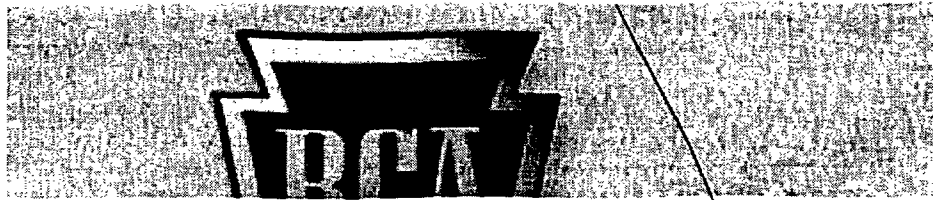
POWERTRAIN SYSTEMS LEVERAGES OUR STRENGTH AS A LEADING MANUFACTURER OF HIGH-QUALITY PARTS AND COMPONENTS WITH NEW PRODUCT DEVELOPMENT AND SELECTIVE ACQUISITIONS, WHICH FURTHER INCREASE OUR CAPABILITIES. AS A RESULT, POWERTRAIN SYSTEMS IS A SYSTEMS SUPPLIER TO A GROWING NUMBER OF AUTOMOTIVE, INDUSTRIAL AND COMMERCIAL CUSTOMERS WORLDWIDE.

MAJOR PRODUCTS INCLUDE ALUMINUM, ARTICULATED AND COMPOSITE PISTONS AND TAPER/CHAMFER PINS; ENGINE BEARINGS, BUSHINGS AND WASHERS; TWO- AND THREE-PIECE CAST IRON AND STEEL PISTON RINGS FEATURING COMPLEX COATINGS SUCH



DURABLE SPUTTER BEARING SAVES MONEY OVER THE LONG HAUL

Powertrain Systems sets a new standard for bearing performance with the Sputter Bearing — a bearing with a vacuum-deposited aluminum and tin coating, which enables it to withstand high engine loads and pressures. The Sputter Bearing's unsurpassed durability lowers costs over the product life cycle.



BEARINGS THAT ROLL

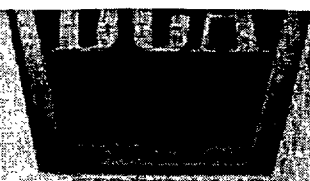
The company added ball bearing products to its line with the acquisition of the Bearings Company of America (BCA) in 1953. Sales jumped almost 1,400 percent in a single year.

BIGGEST MERGER OF THE '50s

In 1955, Federal-Mogul took a bold step forward, merging with Bower Roller Bearing Company, more than doubling the employment roster to 62,000 people. Federal-Mogul-Bower had three manufacturing divisions.

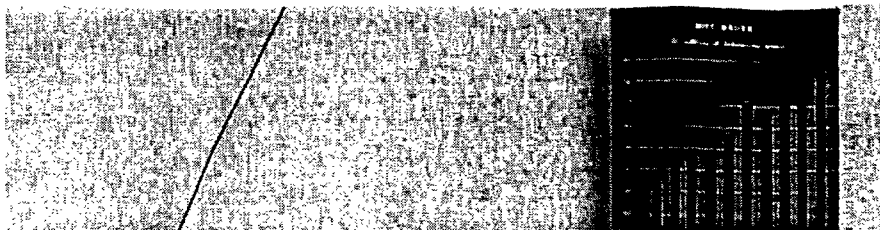
SEALING ANOTHER DEAL

Within months of the Federal-Mogul-Bower merger, the company acquired National Motor Bearing Company, adding seals, shims and rubber parts to its product line. "Sealver Dollars," pictured here, reminded people to replace old oil seals.



BOWER
ROLLER BEARING CO.
Detroit, Michigan





WORLD RENOWNED AUTO SUPPLIER

In 1956, Federal-Mogul-Bower debuted on the Fortune 500 list of top U.S. corporations at the 350th position. The three acquisitions of the early 50s forever changed the Detroit-based company.

FEDERAL-MOGUL MANUFACTURES OVERSEAS

The introduction of import vehicles like the low-priced Volkswagen Beetle made domestic cars no longer the only game in town. Anticipating the trend toward imports, Federal-Mogul-Bower built its first overseas manufacturing plants in 1959.

AEROSPACE BUSINESS TAKES OFF

NASA's Saturn launch vehicle was equipped with a propellant ducting system designed and developed by Arrowhead Products, acquired by Federal-Mogul-Bower — an example of the company's diversification strategy aimed at minimizing its dependence on the auto industry.



ARTIFICIAL INTELLIGENCE PRODUCES REAL QUALITY AND PRODUCTIVITY GAINS

A Powertrain Systems' pilot manufacturing process is producing connecting rod bearings using a state-of-the-art computerized system, which controls every aspect of operations. From the loading of raw materials to the output of final product, the system's sophisticated artificial intelligence functions continuously direct and monitor activities, doubling productivity while achieving zero-defect quality levels.

SYSTEM SOLUTIONS SUPPORTED BY TOTAL PROGRAM MANAGEMENT

Powertrain Systems helps maximize value by working closely with our customers' engineering staffs beginning early in the development process. With a thorough understanding of the operating parameters of specific applications, we explore various material, design and process configurations to optimize a system solution.

Depending on our customers' needs, dedicated teams of Powertrain Systems specialists are assigned to work on-site with customers' program staffs, sharing our extensive expertise in all aspects of design, development, testing and production. Our program management capabilities include total responsibility for the design of interfaces as well as components, and for all assembly, packaging, logistics and warranty management issues.

Our relentless customer focus guides our efforts to develop innovative technological responses. And our vertical integration gives us the control necessary to develop, manage and deliver increasingly sophisticated services.

The results are integrated systems such as our Power Cylinder Systems — ready-to-install units comprised of pistons, piston rings, connecting rods, pins and bearings that outperform conventional assemblies in terms of development time, overall cost, and other characteristics. We can even supply the Champion® ignition source best suited to the power cylinder's characteristics. Benefits like these reinforce our perspective that our real value to customers lies in understanding the complex relationships between the many parts that make up a system.

Our four research and development centers in the United States and Europe use the world's most advanced analytical, testing and design technologies to develop Power Cylinder

Systems and other custom products and processes that unlock the synergy of system solutions.

Our highly integrated manufacturing techniques incorporate many proprietary machine tools and processes that enable us to deliver these innovative solutions; on time and on cost, with the quality and performance levels our customers need to compete and win in today's marketplace.

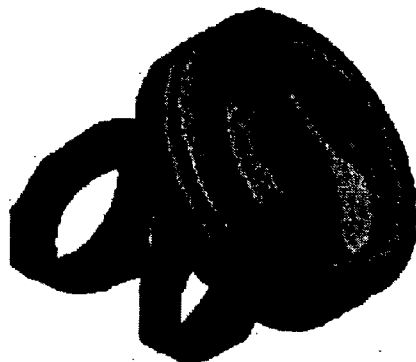
AFTERMARKET ADVANTAGES

Powertrain Systems' extensive global sales and distribution network supplies replacement parts to the automotive, heavy-duty and industrial aftermarket, providing recognized, high-quality brands preferred by installers. Our world-class line-up of products includes such leading brand names as Champion®, AE Goetze®, Glyco® and SPEED-PRO®.

In every region and distribution channel, our overriding goal is to provide fast, accurate shipment of products to meet customers' expectations of consistent timely delivery performance. Building on our brand strengths and integrated global distribution capabilities are teams of engineers who oversee the aftermarket applications of our powertrain products.

These specialists work closely with customers to tailor our growing product line to meet their requirements. The result is uniquely differentiated aftermarket products whose superior quality and ease of installation builds customer preference.

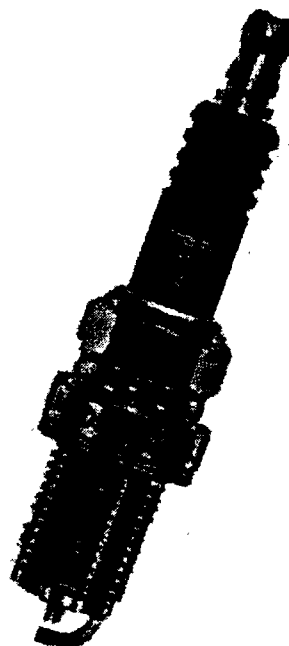
The world doesn't go to work without a little spark, and Champion® is the undisputed heavyweight when it comes to ignition product recognition for world-wide markets. Champion® is poised to offer vehicle manufacturers the spark plugs, ignition wires and coils they need to keep their products moving without fail.



INSIDE INFORMATION VERIFIES LIVE ENGINE DYNAMICS

Powertrain Systems developed a unique procedure for measuring what's happening inside a cylinder when an engine is running — an industry first that generated valuable data for engineers working to optimize system performance.

The results of the live test were compared to the predictions generated by software modeling and analysis tools, allowing engineers to more precisely calibrate the tools to improve their accuracy and reliability.

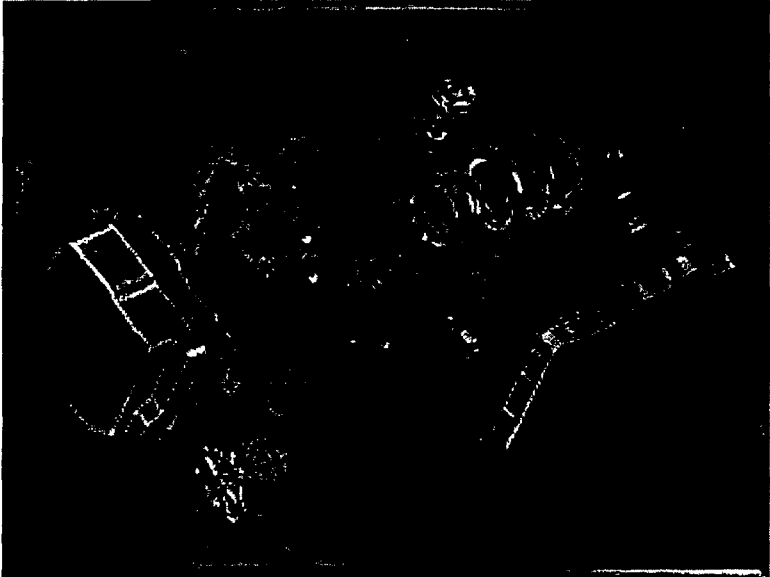




SEALING SYSTEMS

SEALING SYSTEMS

DELIVERS TOTAL SEALING SOLUTIONS



THE SEALING SYSTEMS GROUP OFFERS A PRODUCT PORTFOLIO THAT IS UNRIVALED IN BREADTH AND QUALITY, ENABLING US TO BE THE AUTOMOTIVE INDUSTRY'S FIRST TRUE SUPPLIER OF TOTAL SEALING SYSTEMS.

WITH 30 MANUFACTURING FACILITIES IN 12 COUNTRIES, SEALING SYSTEMS IS THE LEADING SUPPLIER FOR MANY MAJOR AUTOMOTIVE, HEAVY-DUTY DIESEL AND INDUSTRIAL MANUFACTURERS WORLDWIDE. MAJOR PRODUCTS INCLUDE MULTI-LAYER STEEL, GRAPHITE AND EDGE-MOLDED METALPLATE

THE SINGLE SOURCE FOR MULTIPLE SEALING REQUIREMENTS

With our extensive line of dynamic seals, gaskets and sealing modules and global manufacturing capabilities, Sealing Systems truly offers customers one-stop-shopping when it comes to sealing an entire engine, transmission or axle.

Our systems approach and program management capabilities streamline the integration of our full array of sealing products. This approach creates engineering efficiencies that ultimately provide higher total delivered system value and performance.

GASKETS, A FULL RANGE OF DYNAMIC SEALS, BONDED PISTONS FOR TRANSMISSIONS AND WIPER PRODUCTS.

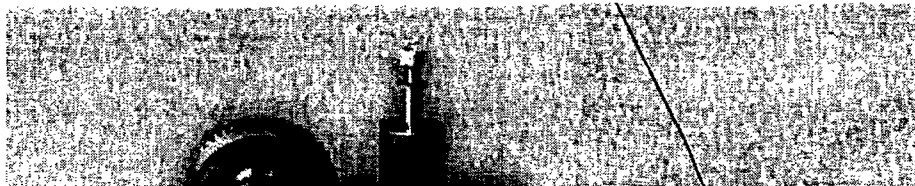
OUR TALENTED AND EXPERIENCED ENGINEERING TEAMS, COMBINED WITH OUR VERTICAL INTEGRATION IN MANY PHASES OF GASKET AND SEAL MANUFACTURING, GIVE US THE ABILITY TO DESIGN, DEVELOP AND DELIVER TOTAL SYSTEM SOLUTIONS FOR CUSTOMERS.

MANAGING THE SYNERGY OF SYSTEMS

More North American automotive and heavy-duty customers are seeking to place complete responsibility for an entire engine program on one supplier — and Sealing Systems is taking up the challenge. Our capabilities include providing comprehensive program and warranty management services as a Tier 1 provider of sealing systems, in addition to providing the correct designs for the application.

Using the latest technologies and analytical tools, we optimize solutions for specific applications based on operating parameters and performance requirements, both for original equipment and aftermarket concerns.





INVESTING IN CORE COMPETENCIES

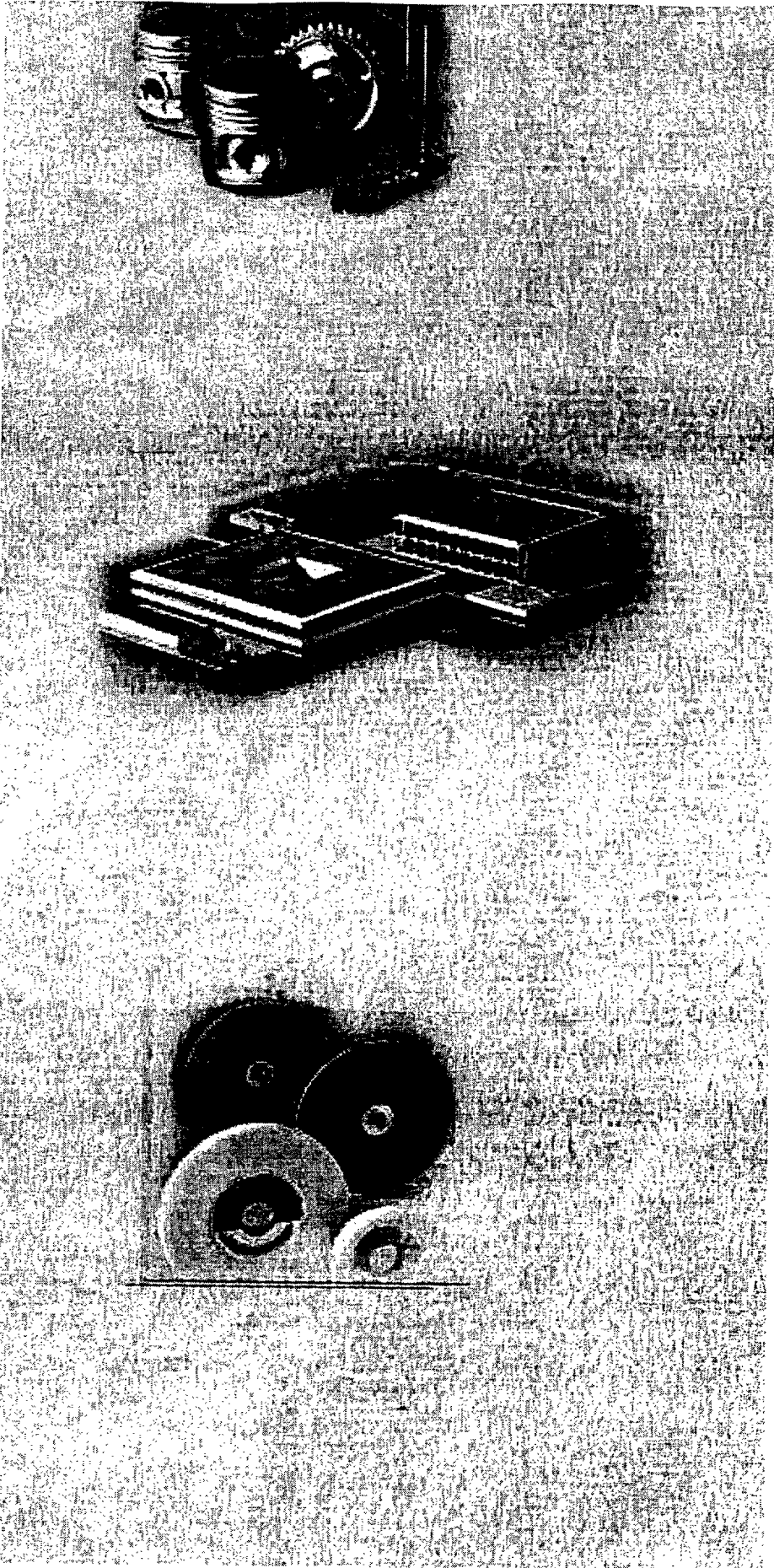
The company also continued to develop its core competencies, merging with Sterling Aluminum Products, a supplier of pistons and valves, among many other engine components, and acquiring Haller, Inc. of Northville, Michigan, a powdered metal parts manufacturer.

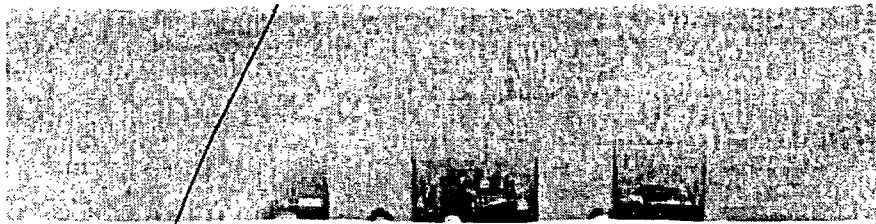
NAME CHANGES, NEW HEADQUARTERS BUILT

The company became Federal-Mogul again in 1965, and corporate staffs were consolidated in 1966 into a newly built, 148,000-square foot complex in Southfield, Michigan, which also housed divisional management teams. 1966 sales topped \$241 million; the worldwide workforce stood at 12,422.

MANAGEMENT PUSHES DIVERSIFICATION

These abrasive grinding and diamond cutting wheels were products produced by the National Grinding Wheel Company, Inc. of North Tonawanda, New York, acquired by Federal-Mogul in 1967 as part of an aggressive diversification strategy.





BENDIX TAKEOVER BID CAUSES MANAGEMENT CHANGE

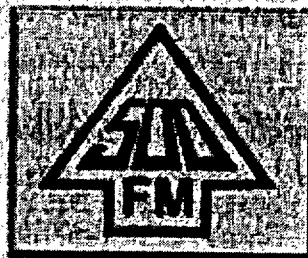
1960s' purchases of diversified companies proved unpopular with Federal-Mogul's board of directors. After an unsuccessful takeover attempt by Bendix Corporation in 1968, the board prompted a change in management, tapping insider Sam MacArthur as president.

WORLD'S FIRST HIGH-VOLUME HOT-FORGED PARTS

In 1972, Federal-Mogul boosted its metal powders operation with Sinta Forge — a revolutionary process that used heat and pressure to convert metal powder into formed parts. More than one million automatic transmission parts were made with the new process in the first year.

FM GROWTH GOAL

Company management announced an aggressive 5-year sales growth plan — called FM 500 — to achieve \$500 million in yearly sales by 1976. Annual sales in 1972 when the program was launched were close to \$290 million.



SERVING THE AFTERMARKET FROM THE CUSTOMER'S POINT OF VIEW

Installing an oil seal is one thing in the controlled, ergonomically correct environment of the assembly line. However, we recognize that aftermarket customers often tackle the job in less than ideal conditions — such as from underneath the vehicle. Therefore, our aftermarket oil seals include a patented hole lock device that aligns and holds the oil seal in position, speeding installation and ensuring correct alignment between the engine and oil pan. Attention to detail like this is a hallmark of Sealing Systems' commitment to our aftermarket customers.

Customers benefit from our knowledge of the best practices for mating surfaces before the design is finalized, greatly reducing total implementation time and cost. This is the approach Sealing Systems is using to provide the total engine sealing package for DaimlerChrysler's new 5.7L RAM engine, which will contain approximately 25 different applications including gaskets, dynamic seals and sealing modules.

TECHNOLOGY DRIVES DEVELOPMENT

Sealing Systems' portfolio of analytical, computer-based tools streamline the design and development process. For example, our "Bookshelf" is a searchable database that contains information about our entire range of designs, materials and processes. Engineers access the bookshelf to quickly determine whether existing solutions will fit a customer's specific application, greatly reducing the up-front investment in time and resources for many programs.

The system can also produce a complete "menu" of recommended analytical, benchmark and live testing procedures for a given application. Additional tests are added depending on customer requirements, with all knowledge gained added to the system to inform future projects.

Finite Element Analysis and Verified Predictive Analysis are among many tools that enable Sealing Systems' engineers to accurately predict how effectively products and processes will behave in real-world conditions. This allows us to reduce the number of iterations and to "freeze" designs and processes faster — critical capabilities that help customers achieve accelerated ramp-up schedules.

In addition, there are verified bench tests that duplicate the results of expensive dynamometer testing at significantly reduced time and cost. Sealing Systems has access to more than one hundred dynamometers when these tests are required.

EXPLORING FUTURE FUNCTIONALITY

Integrating several parts into one module — such as bonding dynamic oil seals directly to oil pans — is one way we're seeking to increase functionality for customers. The integrated oil pan modules could mean fewer parts to store, move and handle at assembly, while assuring precise alignment of the seal and mating surfaces.

Wherever possible, Sealing Systems is tapping the synergy of other products and groups to create new value-added solutions for customers.

AFTERMARKET ADVANTAGES

Sealing Systems' full aftermarket product offering is supported by our excellent service, making us the recognized leader in all of our product categories. Our well-known brand names include Fel-Pro®, Payen® and AE Goetze® gaskets, Mather® seals, Unipiston® bonded pistons, and ANCO® wipers.

Our proactive approach to customer service includes dedicated aftermarket engineers who tear down and analyze engines once their warranty period has expired. Their findings fuel development of differentiated products that address the most difficult sealing applications — in many cases resulting in products that exceed original equipment specifications.

PROGRAM MANAGEMENT CAPABILITIES STREAMLINE PLANNING AND EXECUTION

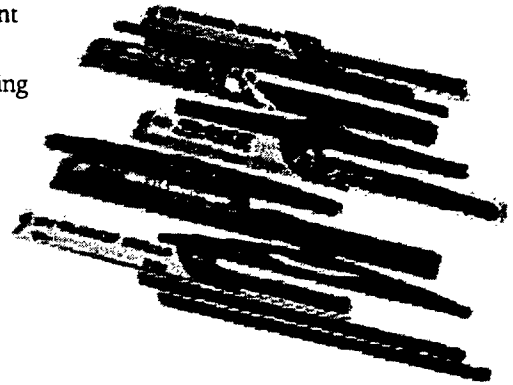
Our program management services include placing a dedicated team on the customer's project team. We provide input on all of the engine design parameters to assure the best marriage between the engine and our sealing products.

The Sealing Systems team are headed by Project Managers, experienced individuals who understand how engines and seals interact, what analytical tools and bench tests are available and appropriate and how material and design issues affect the manufacturing process.

Cross-functional teams at Sealing Systems headquarters support the activities of the core team at the customer's location.

Senior Management Review Committees meet regularly with the product teams to assess project status and to allocate additional resources as needed to achieve quality, cost and time objectives.

The Sealing Systems teams also take responsibility for supply chain management and management of actual production and delivery.





GENERAL PRODUCTS

GENERAL PRODUCTS OFFERS INDUSTRY-LEADING PRODUCT LINE-UP

GENERAL PRODUCTS IS COMPRISED OF SOME OF THE INDUSTRY'S LEADING ENGINEERING AND MANUFACTURING TEAMS, PRINCIPALLY SERVING THE AUTOMOTIVE AND COMMERCIAL VEHICLE MARKETS. THROUGH NEW PRODUCT DEVELOPMENT ACTIVITIES AND SELECTIVE ACQUISITION OF STRATEGIC CORPORATIONS THAT COMPLEMENT OUR



NEW LOW-COST, LIGHTWEIGHT BRAKING SYSTEM STOPS TRAFFIC

Starting with a clean sheet of paper, our engineers explored the trade-offs of various design, material and process combinations to arrive at a revolutionary braking system that delivers new levels of function and value for customers.

The "twin disc" brake system is significantly lighter and less costly than conventional braking components, and may also offer reduced noise and vibration levels.

CAPABILITIES, GENERAL PRODUCTS HAS ESTABLISHED A LEADERSHIP POSITION IN A VARIETY OF PRODUCT GROUPS AND MARKETS WORLDWIDE.

PRODUCTS FOR ORIGINAL EQUIPMENT MANUFACTURERS AND THE AFTER-MARKET INCLUDE CAMSHAFTS, CHASSIS PRODUCTS, BRAKE AND FRICTION PRODUCTS, FUEL SYSTEM COMPONENTS, HEAT TRANSFER PRODUCTS, LIGHTING PRODUCTS, SINTERED METAL COMPONENTS AND SYSTEMS PROTECTION. THESE ARE SUPPLIED FROM 86 MANUFACTURING LOCATIONS IN 17 COUNTRIES.

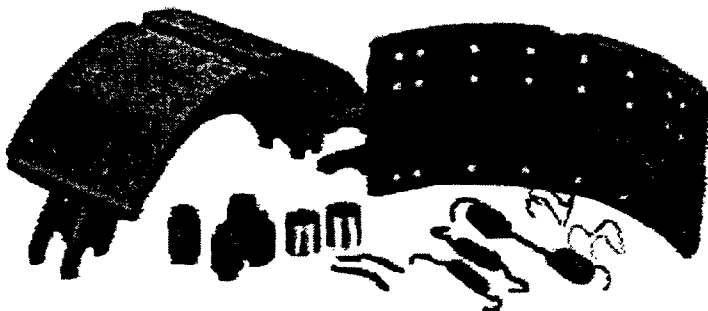
CAMSHAFTS

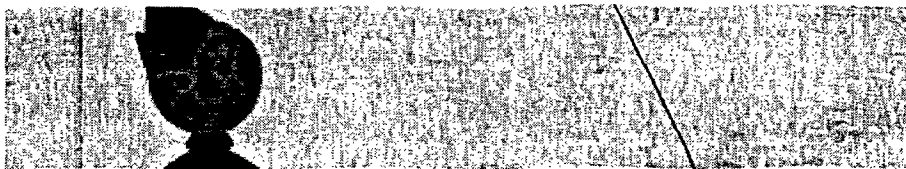
General Products is the world's number-one independent supplier of camshafts, with extensive design and manufacturing capabilities in all three major camshaft technologies — cast, machined and assembled.

Building on our strengths in a variety of cast iron and machined steel camshaft capabilities, General Products is also developing breakthrough materials and processes that can produce assembled camshafts, which require little or no machining.

BRAKE AND FRICTION PRODUCTS

Federal-Mogul enhances its position as the world's number-one friction manufacturer with expanded brake capabilities that offer expertise in virtually all related parts and components. Brake and friction products include disc brake pads, drum brakes, brake linings, wheels and master cylinders, calipers and rotors. This deep vertical integration, combined with our flair for innovation, are resulting in "step change" inventions like the "twin disc" brake, a revolutionary idea that reflects our creative approach to traditional design and engineering challenges.





THE IMPORTANCE OF AFTERMARKET

Service Sam, a 1960s sales promotion character, put Federal-Mogul's name before consumers in service stations, reminding them to service their car's wheels. The company's aftermarket target, however, was the parts buyers who dealt with the service/distribution centers.

THE VELVET HAMMER: FROM OFFICE BOY TO CHAIRMAN

An office boy in 1942 who delivered mail and cleaned spittoons, Tom Russell rose to executive vice president at age 45. Enormously popular as president, he was nicknamed the "velvet hammer," for his charm while driving uncompromising bargains. Chairman and CEO in the 1970s, he focused on the aftermarket, helping the company through two recessions.

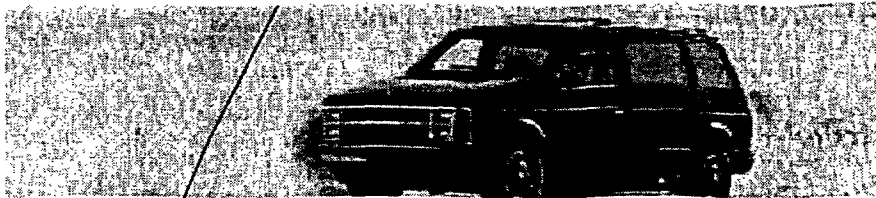
SUPERIOR CUSTOMER SERVICE

In 1982, the company launched a customer service hotline that offered customers quick access to late-breaking product information in addition to technical assistance and compatibility issues.

1987 THE \$1 BILLION YEAR

Everything seemed to be going the right way when Federal-Mogul's sales broke the \$1 billion mark in 1987 and earnings reached \$3.24 per share.





OEMs SQUEEZE SUPPLIERS

The economic downturn of the late 1980s and foreign competition caused U.S. big-three automakers to seek constant cost reductions from suppliers like Federal-Mogul. Margins fell on OE products, and aftermarket sales looked more attractive to new management.

FEDERAL-MOGUL TRIES RETAILING IN EMERGING COUNTRIES

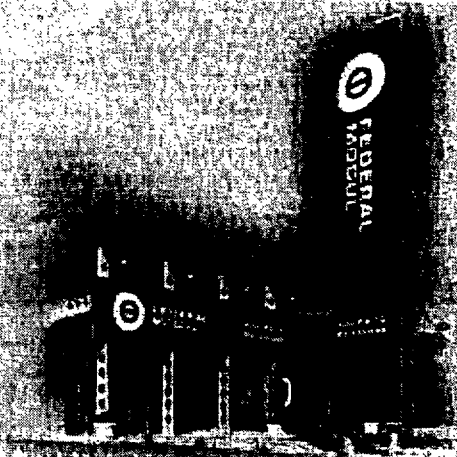
Federal-Mogul's extensive line of automotive replacement parts was sold in overseas retail stores as a move to increase profit margins.

MANUFACTURING MASTERY RESTORED

Dick Snell, named chairman and chief executive officer in late 1996, returns the company to manufacturing mastery.

A RETURN TO ROOTS SPURS GROWTH GOAL

Federal-Mogul announces restructuring, a return to its manufacturing roots and a growth strategy based on systems and modules, expanding global manufacturing presence to follow OEMs, and expanding global aftermarket sales.



SINTERED PRODUCTS

Federal-Mogul's expertise in powder metal technology continues to translate into revolutionary new products and processes. Heavy-duty valve seats and guides, camshaft lobes, transmission components and various engine gears and sprockets are among the high-strength, high-density products made possible through our expertise in powder metallurgy. It is this expertise that has made Federal-Mogul the world leader in passenger car valve guides and seats.

Technical developments in single-press, single-sinter techniques and green machining are assisting in the production of novel cost-effective components that will support our efforts to provide new customer solutions both directly and through our supply of systems.

SYSTEMS PROTECTION

As the market leader in Systems Protection products, General Products offers a comprehensive line of sleeving products, which are used to protect wire harnesses, hoses, tubing and cables. These products serve to solve thermal, mechanical/abrasion and acoustic problems. New products such as our reflective convolute are among recent customer-driven innovations that meet the demands posed by today's smaller engine compartments, hotter operating temperatures and the growing use of sensitive electronics.

CHASSIS PRODUCTS, FUEL SYSTEM COMPONENTS AND LIGHTING PRODUCTS

General Products is number one in the U.S. aftermarket in select chassis and driveline products, which include steering and suspension parts, coil springs and universal joints.



ASSEMBLED CAMSHAFT TECHNOLOGY REDUCES MACHINING COSTS BY HALF

General Products is combining its expertise in powdered metals and camshafts to create mechanically bonded assembled camshafts using powder metal lobes.

The process reduces machining costs by approximately 50 percent while producing a light, strong camshaft with optimized friction and wear characteristics. Engineers are currently developing the next generation of tubular assemblies with the aim of eliminating machining altogether.

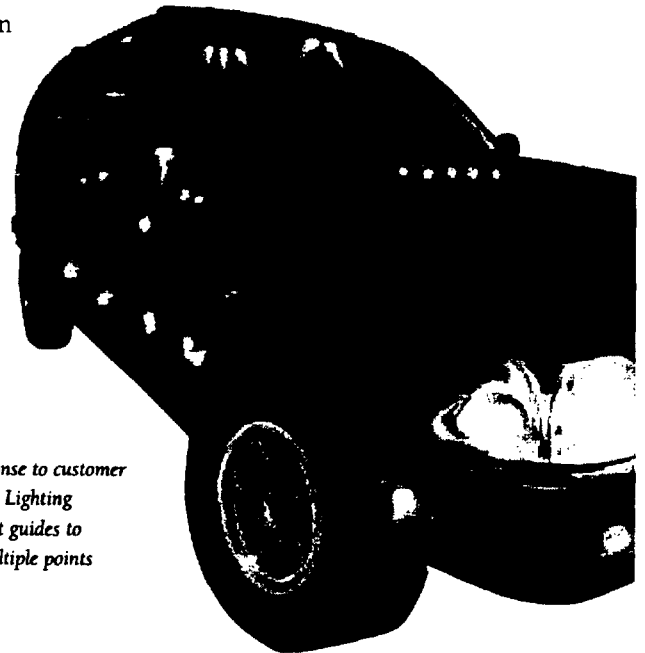
General Products is also the U.S. aftermarket's leading manufacturer of Fuel System components. These products, designed for automotive, diesel and marine applications, include fuel pumps, fuel delivery modules and hanger assemblies.

Our lighting products group offers bumper-to-bumper capabilities in a broad range of exterior vehicular lighting, as well as innovative interior lighting solutions.

AFTERMARKET ADVANTAGES

General Product's line-up of exceptionally strong brand names include Wagner/Abex brakes and friction, Ferodo friction, Wagner/Blazer lighting and Moog chassis — allowing us to provide our aftermarket customers with a wide selection of products that are highly regarded in the marketplace.

Our expanding product offering also brings efficiencies to our operations that benefit customers, while our global manufacturing and distribution capabilities ensure responsive service and industry-leading fill rates.



BRIGHT LIGHT, BIG IDEA

Another technology-driven response to customer requirements is our Distributive Lighting System, which uses die-cast light guides to direct light from one bulb to multiple points throughout a vehicle interior.

OUR LEADERSHIP TEAM



From left are: John C. Pope, Paul Scott Lewis, Roderick M. Hills, Robert S. Miller Jr., Sir Geoffrey Whalen, Richard A. Snell, Antonio Madero and John J. Fannon.

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 of the United States, bringing Federal-Mogul a strong balance of business viewpoints and international perspectives. All directors are shareowners and collectively, the board owns and holds options to purchase 720,482 shares.

John J. Fannon, 65, is the retired vice chairman of Simpson Paper Company and a business consultant. He joined the board of directors in 1986.

Roderick M. Hills, 68, is chairman of Hills Enterprises, Ltd., and a partner in Hills and Sterns. He joined the board of directors in 1977.

Paul Scott Lewis, 62, is chairman of Terranova Foods plc. He joined the board of directors in 1998.

Antonio Madero, 61, is founder, chairman of the board and chief executive officer of SANLUIS Corporación S.A. de C.V. He joined the Federal-Mogul board in 1994.

Robert S. Miller Jr., 57, is chairman of the board of Waste Management, Inc. He joined the board in 1993.

John C. Pope, 50, is chairman of the board of MotivePower Industries, Inc. He joined Federal-Mogul's board in 1987.

Richard A. Snell, 57, is chairman and chief executive officer of Federal-Mogul. He joined the board of directors in 1996.

Sir Geoffrey Whalen, C.B.E., 63, is retired managing director and deputy chairman of Peugeot Motor Company plc. He joined the board of directors in 1998.

BOARD COMMITTEES

Audit Committee

John C. Pope, chairman

Roderick M. Hills

Paul Scott Lewis

Antonio Madero

Robert S. Miller Jr.

Compensation Committee

John J. Fannon, chairman

Antonio Madero

John C. Pope

Sir Geoffrey Whalen

Governance and Nominating Committee

Roderick M. Hills, chairman

John J. Fannon

Paul Scott Lewis

Antonio Madero

Robert S. Miller Jr.

John C. Pope

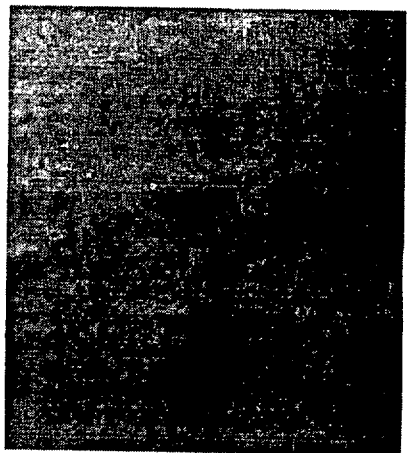
Sir Geoffrey Whalen

Pension Committee

Robert S. Miller Jr., chairman

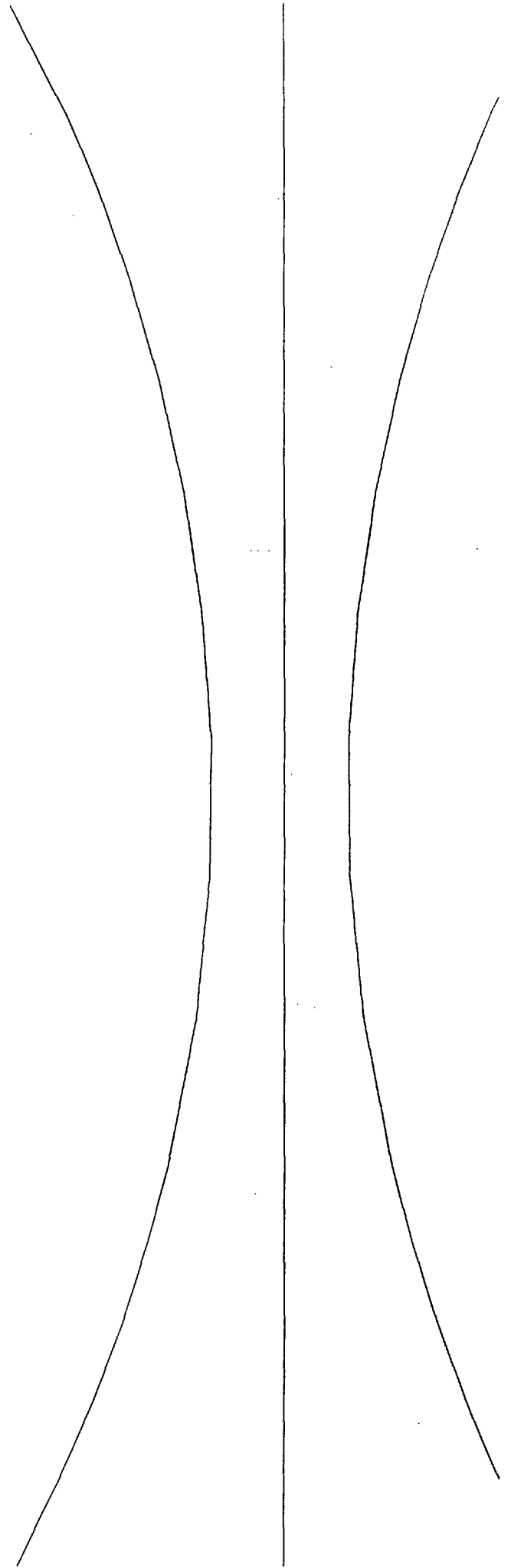
John J. Fannon

Roderick M. Hills



H. MICHAEL SEKYRA
1942 - 1998

Dr.





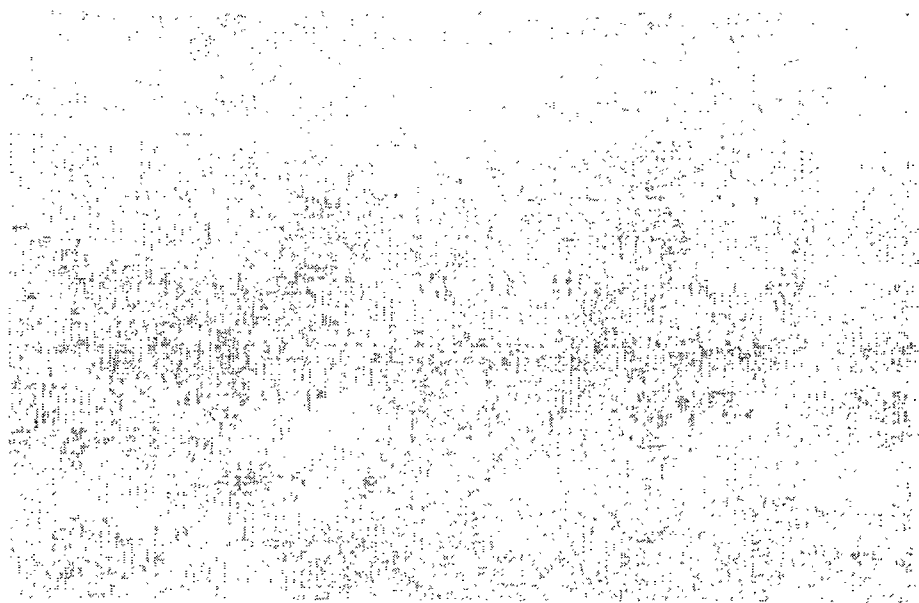
*ugo Michael Sekyra, a member of
Federal-Mogul's Board of Directors since 1991,
passed away in December 1998 at age 56.*

*Sekyra was chairman of the supervisory board of
Bohler Uddeholm AG and recently served as chairman
and chief executive officer of C.H. CHEM, a.s. He was
previously chairman and chief executive officer of
Austrian Industries AG. A native of Austria, Sekyra
was born in Mannersdorf and earned his Doctor of
Law degree from the University of Vienna.*

*Sekyra sat on the compensation, nominating and
pension committees.*

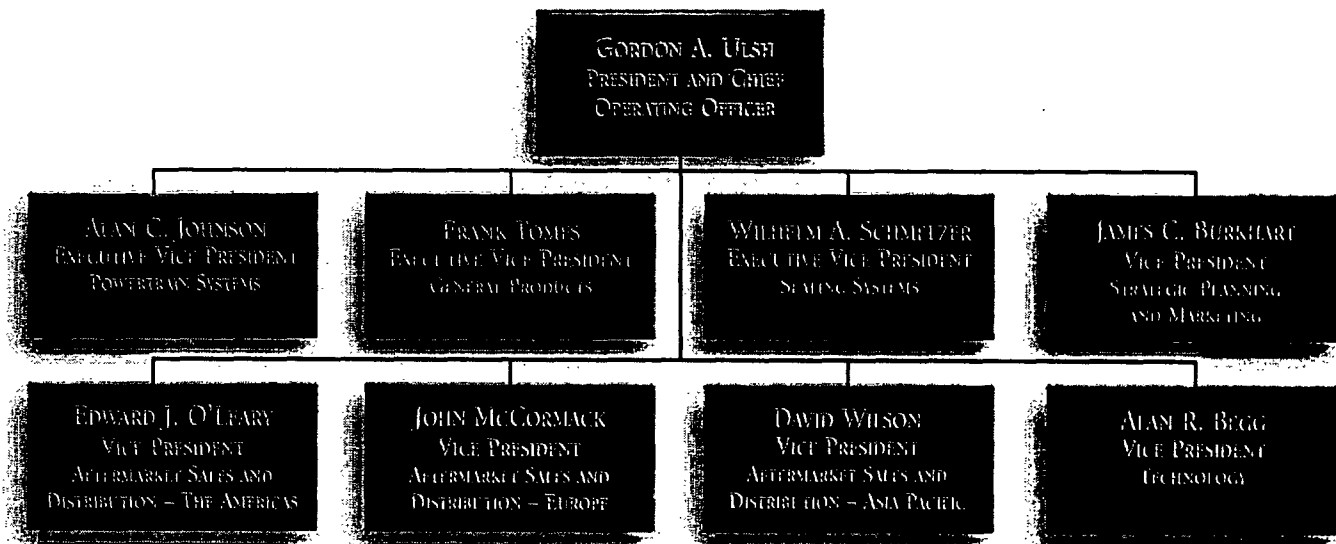
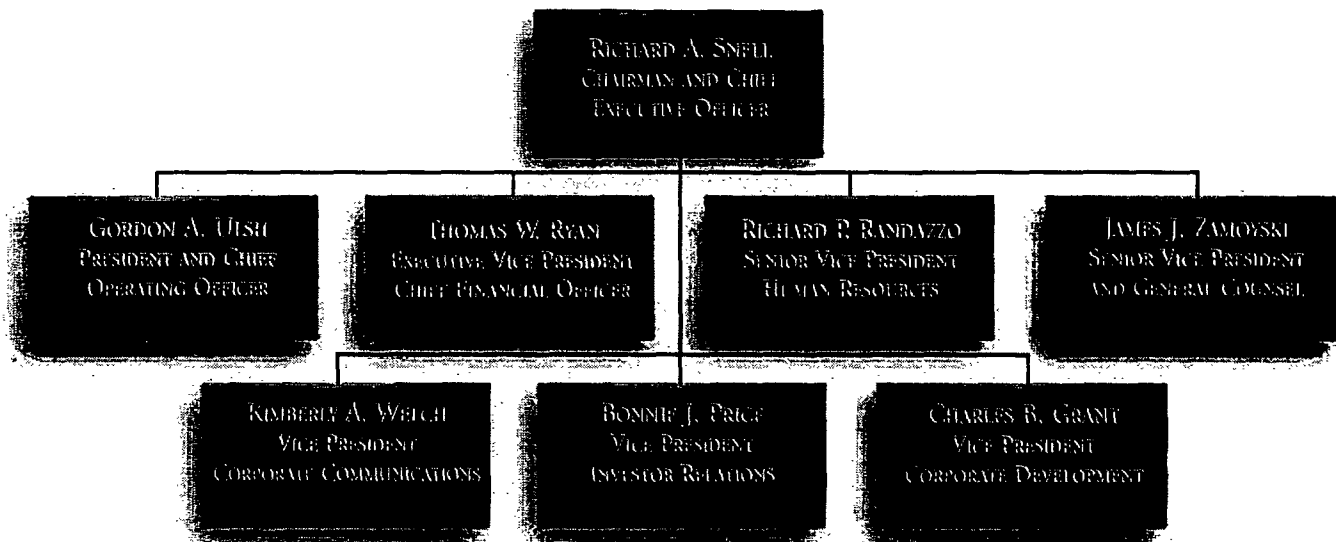
*"Michael was an important catalyst for change and
was fundamental to our recent successes," said Dick
Snell, chairman and chief executive officer. "His global
experience and insight has been a strong influence
on our strategic plans. Michael will be sincerely
missed as a friend and advisor."*





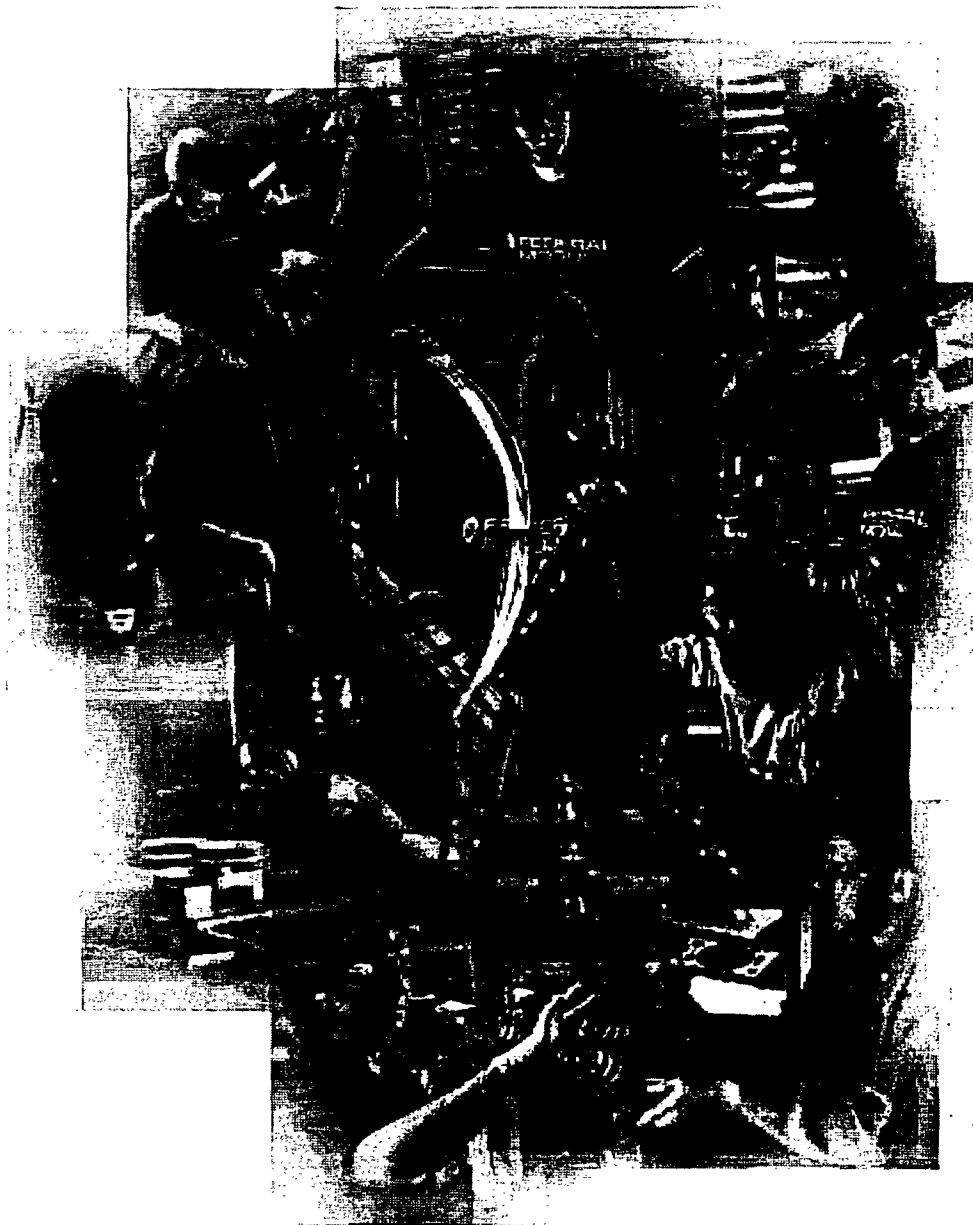


OUR MANAGEMENT TEAM



PURPOSE AND CORE VALUES

PEOPLE SERVING CUSTOMERS
THROUGH MANUFACTURING MASTERY



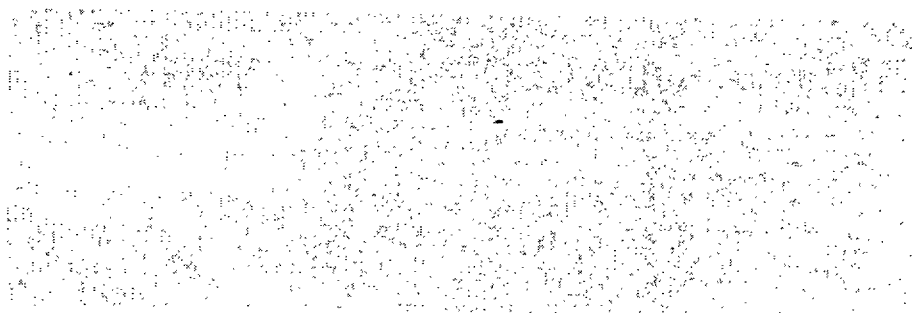
WE ARE A TEAM FIRST.

WE RESPECT, TRUST AND HELP EACH OTHER.

WE ACT WITH INTEGRITY.

WE ARE DRIVEN TO MASTERY IN ALL WE DO.

WE CELEBRATE OUR SUCCESS.





1998 FINANCIAL

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	NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
	MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING
	REPORT OF INDEPENDENT AUDITORS

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 or contemplated or implied by such statements.

**FORWARD-LOOKING
STATEMENTS**

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Consolidated Statement of Operations Data

	1998	1997	1996	1995	1994
	(Millions of Dollars, Except Per Share Amounts)				
Net sales	\$ 4,468.7	\$ 1,806.6	\$ 2,032.7	\$ 1,999.8	\$ 1,889.5
Costs and expenses	(4,266.9) ⁽¹⁾	(1,703.7) ⁽²⁾	(2,258.0) ⁽³⁾	(2,000.7) ⁽⁴⁾	(1,795.5)
Other expense	(16.3)	(3.4)	(3.4)	(2.4)	(2.5)
Income tax (expense) benefit	(93.6)	(27.5)	22.4	(2.5)	(31.8)
Net earnings (loss) before extraordinary items	91.9	72.0	(206.3)	(5.8)	59.7
Extraordinary items — loss on early retirement of debt, net of applicable income tax benefit	(38.2)	(2.6)	—	—	—
Net earnings (loss)	\$ 53.7	\$ 69.4	\$ (206.3)	\$ (5.8)	\$ 59.7
Common Share Summary (Diluted)					
Average shares and equivalents outstanding (in thousands)	53,748	41,854	34,659	34,642	41,800
Earnings (loss) per share:					
Before extraordinary items	\$ 1.67	\$ 1.67	\$ (6.20)	\$ (.42)	\$ 1.38
Extraordinary items — loss on early retirement of debt, net of applicable income tax benefit	(.71)	(.06)	—	—	—
Net earnings (loss) per share	\$.96	\$ 1.61	\$ (6.20)	\$ (.42)	\$ 1.38
Dividends declared per share	\$.1275	\$.48	\$.48	\$.48	\$.48
Consolidated Balance Sheet Data					
Total assets	\$ 9,940.1	\$ 1,802.1	\$ 1,455.2	\$ 1,701.1	\$ 1,481.7
Short-term debt ⁽⁵⁾	211.0	28.6	280.1	111.9	74.0
Long-term debt	3,130.7	273.1	209.6	481.5	319.4
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely convertible subordinated debentures of the Company	575.0	575.0	—	—	—
Shareholders' equity	1,986.2	369.3	318.5	550.3	588.5
Other Financial Information					
Net cash provided from (used by) operating activities	\$ 325.5	\$ 215.7	\$ 149.0	\$ (34.7)	\$ 24.3
Expenditures for property, plant, equipment and other long-term assets	228.5	49.7	54.2	78.5	74.9
Depreciation and amortization expense	228.0	51.5	61.9	59.2	54.6

(1) 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.

(2) 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.

(3) 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.

(4) 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.

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

OVERVIEW

Federal-Mogul is a leading global manufacturer and distributor of a broad range of vehicular components for automobiles and light trucks, heavy-duty trucks, farm and construction vehicles and industrial products. The Company's principal customers include many of the world's major original equipment (OE) manufacturers of such vehicles and industrial products. The Company also manufactures and supplies its products and related parts to the aftermarket.

ACQUISITIONS

In 1998, the Company acquired T&N plc (T&N), the automotive division of Cooper Industries, Inc. (Cooper Automotive), Fel-Pro, Incorporated and certain affiliated entities, which constitute the operating businesses of the Fel-Pro group of companies (Fel-Pro), and various other acquisitions. For certain acquisitions, principally Cooper Automotive, the purchase price allocation may be adjusted as further information becomes available. Goodwill recognized in connection with these transactions, which were accounted for as purchases, is being amortized on a straight-line basis over 40 years.

T&N

In March 1998, the Company acquired T&N, a manufacturer 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.

T&N manufactures and supplies high technology engineered automotive components and industrial materials. In 1997, T&N had sales of approximately £1.8 billion (\$2.9 billion at the 1997 average exchange rate) with about 80% of such sales relating to the global automotive industry. At the time of its acquisition, T&N's major product lines consisted of piston products, bearings, friction products, composites and camshafts (incorporating sintered products) and sealing products servicing OE customers and the aftermarket. T&N operated in approximately 200 locations in 24 countries, employed over 28,000 people worldwide and served customers globally. T&N's operations included technical centers in the United Kingdom, Germany and North America.

Cooper Automotive

In October 1998, the Company acquired Cooper Automotive, headquartered in St. Louis, Missouri, for initial consideration of approximately \$1.9 billion. Cooper Automotive is a leading supplier of aftermarket parts for repair and maintenance and serves OE automobile manufacturers worldwide. In 1997, Cooper Automotive had sales of approximately \$1.9 billion. At the time of the acquisition, Cooper Automotive's principal products consisted of brakes and friction, lighting, chassis parts, ignition and wiper blades. Cooper Automotive employed approximately 14,500 employees in 63 locations.

Fel-Pro

In February 1998, the Company acquired Fel-Pro, a privately owned gasket manufacturer headquartered in Skokie, Illinois, for total consideration of approximately \$722 million, which included 1,030,325.6 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 for the North American aftermarket and the OE heavy-duty market. In 1997, Fel-Pro had sales of approximately \$500 million. At the time of the acquisition, Fel-Pro's primary product lines consisted of gaskets, heavy-duty diesel engine products, diesel products, high performance gaskets and other equipment and chemical products. Fel-Pro employed approximately 2,700 employees in 16 locations.

Other Acquisitions

During 1998, the Company acquired other complementary businesses and increased its ownership in certain joint ventures in order to expand its manufacturing and distribution capabilities. In the first quarter of 1998, the Company increased its ownership to 100% in its Summerton, South Carolina gasket manufacturing plant and also increased its ownership in KFM Bearing Company Ltd., a Korean joint venture with Kukje Special Metal Co., from 30% to 87%. In addition, the Company acquired Bimet, a Polish manufacturer of engine bearings, bushings and related products. During the fourth quarter of 1998, the Company acquired Tri-Way Machine Limited, a Canadian manufacturer of machining systems for the metal-cutting industry and Glöckler Dichtsysteme Günter Hemmrich GmbH, a manufacturer of rubber sealing components and acoustic decoupling for valve covers, intake manifolds and oil pans. Additionally, the Company increased its ownership from 50.6% to 100% in T&N Holdings Limited located in South Africa.

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 provide for \$180.0 million and \$36.8 million in severance and exit costs, respectively, and were recorded as a component of goodwill in the purchase price allocation.

The components of the integration plan include: closure of certain manufacturing facilities worldwide; relocation of highly manual manufacturing product lines to lower cost regions or 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. An anticipated result of the integration plan and the restructuring will be a reduction of approximately 5,300 full-time employees.

The Company paid \$61.6 million related to these rationalization reserves in 1998.

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.

On December 18, 1998, the Company completed the sale of 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 also expects to realize 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.

RESULTS OF OPERATIONS

Net Sales

Sales by operating segment were:

	1998	1997	1996
	(Millions of Dollars)		
Powertrain Systems	\$1,883	\$ 782	\$ 739
Sealing Systems	925	333	295
General Products	1,636	577	665
Divested Activities	25	115	334
Total Sales	\$4,469	\$1,807	\$2,033

Powertrain Systems sales increased 141% from 1997 to 1998 primarily due to the acquisitions of T&N and Cooper Automotive. Excluding the impact of these and other acquisitions, sales decreased 3% due to lower aftermarket sales and the impact of foreign exchange rate fluctuations, partially offset by certain original equipment volume increases. Sales in the aftermarket were impacted by an overall decrease in the engine parts market size due to improved original equipment quality, and the bankruptcy of a major customer in North America.

Sealing Systems sales increased 178% from 1997 to 1998 primarily due to the acquisitions of T&N, Cooper Automotive and Fel-Pro. Taking out the impact of these acquisitions, sales were essentially flat. Original equipment sales increased slightly due to certain model volume increases while aftermarket sales decreased primarily due to the bankruptcy of a major customer in North America.

General Products sales increased 184% from 1997 to 1998 primarily due to the acquisitions of T&N and Cooper Automotive. Excluding the impact of these acquisitions, sales decreased 4% primarily due to the impact of foreign exchange rates and the bankruptcy of a major customer in the North American aftermarket, slightly offset by certain original equipment volume increases.

Operational EBIT

The accounting policies of the business segments are consistent with those described in Note 1, "Accounting Policies." Operational EBIT is defined as

Operational Earnings before certain nonrecurring items (such as certain purchase accounting adjustments and integration costs associated with new acquisitions), interest and income taxes.

	1998	1997	1996
	(Millions of Dollars)		
Powertrain Systems	\$223	\$ 68	\$ 75
Sealing Systems	133	26	9
General Products	154	44	31
Divested Activities	(8)	1	(22)
Operational EBIT	\$502	\$139	\$ 93

Operational EBIT in Powertrain Systems increased 228% 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 Federal-Mogul's constraint management programs across the combined companies.

Sealing Systems 1998 operational EBIT rose 412% as compared to 1997 due to higher sales, reduced administrative costs and material sourcing savings as a result of the acquisitions.

General Products operational EBIT in 1998 increased 250% versus 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 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.

Restructuring Charges (Credits)

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 result 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. The Company anticipates that the actions related to the 1998 restructuring plan will be substantially completed in 1999.

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.

Primarily as a result of the amendments to the 1996 restructuring plan, (refer to Note 4, "Restructuring Charges"), the Company's 1997 operating results were increased by \$23.1 million for the reversal of previously recognized 1996 and 1995 restructuring charges. Offsetting this reversal was a \$22.0 million charge for new 1997 restructuring programs. The net impact on 1997 operations, as a result of the restructuring activities, was a credit of \$1.1 million. The 1997 charge includes \$3.1 million for exiting

certain European aftermarket product lines and the related employment reductions, \$6.8 million for termination of certain European administrative and support personnel, \$7.5 million for additional exit and severance costs related to the Puerto Rican retail operations, \$2.6 million for consolidation and reconfiguration of the North American aftermarket service branch network and \$2.0 million for other actions. The Company's 1997 progress and actual implementation of the 1996 restructuring plan resulted in 1997 operating results being increased by \$20.8 million for severance and \$1.4 million of exit and consolidation costs being reversed.

In the fourth quarter of 1996, the Company recognized a restructuring charge of \$57.6 million for costs associated with employee severance, exit and consolidation costs for 132 international retail operations and 30 wholesale aftermarket operations, rationalization of European manufacturing operations, consolidation of lighting products, consolidation or closure of certain North American warehouse facilities, consolidation of customer support functions in the United States and streamlining of administrative and operational staff functions worldwide. The charge consists of \$22.7 million for the sale of 132 international retail aftermarket and 30 wholesale aftermarket operations, \$14.7 million for corporate employee severance costs, \$7.7 million for the rationalization of European manufacturing operations, \$5.3 million for consolidation or closure of certain North American warehouse facilities, \$2.8 million for consolidation of customer support functions in the United States, \$2.5 million for closure of the Leiters Ford facility and \$1.9 million for other miscellaneous actions, including the consolidation of the European aftermarket management function into the European manufacturing headquarters.

Reengineering and Other Related Charges (Credits)

In 1996, the Company initiated an extensive effort to strategically review its businesses and focus on its competencies of manufacturing, engineering and distribution. As a result of this process, the Company recognized a charge of \$11.4 million for professional fees and personnel costs related to the strategic review of the Company and changes in management and related costs. Operating results for 1997 include a credit of \$1.6 million relating to the reversal of certain 1996 reengineering and other related charges, as the actual costs were less than the initial estimates.

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

In 1998, the Company decided to sell its subsidiary, Bertolotti Pietro e Figli, S.r.l. (Bertolotti), an Italian aftermarket operation. The carrying value of Bertolotti's long-lived assets was reduced to fair value based on estimates of selling values, less costs to sell, calculated using multiples of earnings similar to recent automotive industry transactions in Italy. The Company recognized a \$20.0 million charge primarily associated with the write-down of Bertolotti's assets to the estimated fair value.

Also in 1998, the Company recognized a \$1.0 million benefit associated with the sale of certain international retail assets previously written down to their realized fair value.

In 1997, the Company recognized a charge of \$2.4 million to write down certain long-lived assets of the international retail aftermarket to fair value. These assets were sold in 1998 for approximately their adjusted value and no gain or loss was recorded.

During 1996, management designed a restructuring plan to aggressively improve the Company's cost structure, streamline operations and divest the Company of underperforming assets. As part of this plan, the Company decided to sell 132 international retail aftermarket operations, sell or restructure 30 wholesale aftermarket operations and consolidate a North American manufacturing operation. The carrying value of assets held for sale was reduced to fair value based on estimates of selling values less costs to sell. Selling values used to determine the fair value of assets held for sale were determined using market prices (i.e., valuation multiples) of comparable companies from other 1996 transactions. The resulting adjustment of \$148.5 million to reduce assets held for sale to fair value was recorded in the fourth quarter of 1996. The Company has substantially completed the 1996 restructuring plan, selling its South Africa, Australia, Chile and Puerto Rico retail operations during 1997 and 1998. Also in 1996, based upon the final sale, the Company recognized an additional write-down of \$2.8 million to the net asset value of the United States ball bearings operations.

Integration Costs

The Company recognized \$22.4 million of integration costs in 1998 in connection with the previously discussed acquisitions. These expenses included 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.

Interest Expense

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 expense decreased \$11.1 million in 1997 to \$33.3 million. The decrease was primarily due to a \$188 million reduction of debt which resulted from improvements in working capital and the sale of the South African and Australian businesses.

Interest Income

The increase in interest income of \$3.5 million in 1998 to \$10.6 million and the increase of \$4.2 million in 1997 are 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.

International Currency Exchange Losses

International currency exchange losses increased to \$4.7 million in 1998 due primarily to the weakening of the Mexican peso. The decrease of \$3.1 million from 1996 to 1997 is due to the 1997 sale of the Turkish operation and a devalued Venezuelan bolivar.

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 have 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."

Other Expense, net

The increase in other expense, net, of \$12.9 million in 1998 to \$16.3 million is due to the expense related to the Company-obligated mandatorily redeemable preferred securities, issued in December 1997, partially offset by an increase in earnings from equity investments acquired in the T&N acquisition and a gain on the divestiture of its minority interest in G. Brüss GmbH & Co. KG.

Income Taxes

The effective tax rate for 1998 was 50.5% compared to 27.6% in 1997. This difference was primarily due to non-deductible goodwill, the one-time charge for purchased in-process research and development and foreign tax rate differences. The effective tax rate on the loss in 1996 was 9.8% due to losses in foreign countries where no tax benefit was recorded.

At December 31, 1998, the Company had deferred tax assets, net of a \$66.2 million valuation allowance, of \$894.0 million and deferred tax liabilities of \$842.5 million. The valuation allowance reserve increased from \$44.4 million in 1997 to \$66.2 million in 1998 due to valuation allowances recorded on net operating loss carryforwards acquired with the acquisitions of T&N, Cooper Automotive and Fel-Pro. Future reductions to these valuation allowances, if any, will be applied to reduce goodwill related to the respective acquisitions.

The net deferred tax asset of \$51.5 million included deferred tax assets of \$429.1 million for asbestos liabilities and \$165.2 million for postemployment benefit obligations and deferred tax liabilities of \$379.4 million and \$326.2 million for fixed asset and intangible asset basis differences, respectively. The Company expects to realize the assets and liabilities related to these items over the next 40 years.

Extraordinary Items

The Company incurred extraordinary losses on the early retirement of debt of \$38.2 million and \$2.6 million, net of related tax benefits, in 1998 and 1997, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Provided from Operating Activities

Cash flow provided from operating activities was \$325.5 million in 1998. Cash flow was generated primarily from operations, a decrease in inventories of \$55.9 million and a decrease in accounts receivable of

\$37.5 million. Partially offsetting these items were payments against the asbestos liability of \$89.2 million and restructuring and rationalization payments of \$78.0 million.

Cash Flow Used by Investing Activities

Cash flow used by investing activities was primarily related to the acquisitions of T&N, Cooper Automotive and Fel-Pro, net of proceeds from sales of the T&N Bearings Business and the Fel-Pro Chemical Business. The Company expects to pay approximately \$50 million in taxes related to the sale of the T&N Bearings Business during the first quarter of 1999. In addition, capital expenditures of \$228.5 million were made for property, plant and equipment to implement process improvements, information technology, replacement of existing machinery and equipment and introductions of new products. Capital expenditures are expected to be approximately \$300 million in 1999.

The Cooper Automotive purchase agreement includes a price adjustment based upon acquired net assets, as defined in the agreement, as of the acquisition date. The Company anticipates that an additional cash payment of approximately \$100 million will be paid in 1999.

Cash Flow Provided from Financing Activities

Cash flow provided from financing activities was primarily from debt issued to fund the acquisitions of T&N, Cooper Automotive and Fel-Pro and the issuance of common stock, partially offset by principal payments on long-term debt. The Company had total debt of \$3,341.7 million at December 31, 1998 compared to \$301.7 million at December 31, 1997.

At December 31, 1998, the Company had \$400 million available under its revolving credit facility expiring on December 31, 2003. As of December 31, 1998, there were no borrowings outstanding against this facility.

The Company entered into Senior Credit Agreements in connection with its acquisitions of T&N and Cooper Automotive totaling \$4.625 billion and a Senior Subordinated Credit Agreement in connection with its acquisition of T&N of \$500 million in 1998. The Senior Credit Agreements had \$1.894 billion outstanding at December 31, 1998 with maturities ranging from 1999 through 2005. There were no borrowings outstanding against the Senior Subordinated Credit Agreement at December 31, 1998.

The Company issued 26.75 million shares of common stock, including 2.1 million shares which were converted to Series E Preferred Stock, in two equity offerings in 1998 generating proceeds of \$1.373 billion. Proceeds were used to repay borrowings under the Senior Credit Agreements and Senior Subordinated Credit Agreement.

The Company issued \$1.0 billion of bonds with maturities ranging from six to twelve years, a weighted-average yield of 7.76% and a weighted-average coupon of 7.73% in 1998, and \$1.0 billion in bonds with maturities ranging from seven to ten years, a weighted-average yield of 7.53% and a weighted-average coupon of 7.45% in January 1999. Proceeds from these transactions were used to repay borrowings under the Senior Credit Agreements. As a result of the 1999 transaction, the Company will recognize an extraordinary charge in the first quarter of 1999 of approximately \$8 million, net of tax, related to early extinguishment of debt.

On February 24, 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. As a result of these transactions, the Company will recognize an extraordinary charge in the first quarter of 1999 of approximately \$15 million, net of tax, related to the early extinguishment of debt.

The Company believes that 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 of T&N's United States subsidiaries (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 to property damage litigation in the United States based upon asbestos products allegedly installed in buildings. 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 expenditure which may arise therefrom. As of December 31, 1998, the Company has provided approximately \$1.3 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.

As of December 31, 1998, the T&N Companies had approximately 105,000 claims pending. During 1998, approximately 85,000 new claims were filed and 54,000 claims were settled, dismissed or otherwise resolved. In addition to the pending cases above, the T&N Companies have approximately 41,000 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.

As of December 31, 1998, T&N is one of a large number of defendants named in three pending property damage cases pending in two jurisdictions. Provision has been made in the asbestos reserve for anticipated expenditures in relation to such cases.

The \$1.3 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, 1998, the \$1.3 billion total provision is comprised of approximately \$460 million related to

known claims and approximately \$840 million related to IBNR claims.

In arriving at the IBNR provision, assumptions have been made regarding the total number of claims which it is anticipated may 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.

The T&N Companies have appointed the Center for Claims Resolution (CCR) as their exclusive representative in relation to all asbestos-related personal injury claims made against the T&N Companies in the United States. The CCR provides to its 20 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 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.

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 amount 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 Company's reserve for claims filed after June 30, 1996 approximates 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 T&N's asbestos-related claims, given the nature and complexity of the factors affecting the estimated liability, the actual liability may differ. No absolute assurances can be given that T&N 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 T&N Companies reserves will be reevaluated periodically as additional information becomes available.

Federal-Mogul, Fel-Pro and Cooper Automotive Asbestos Litigation

The Company also is one of a large number of defendants in a number of lawsuits brought by claimants alleging injury due to exposure to asbestos. Fel-Pro has been named as a defendant in a number of product liability cases involving asbestos, primarily involving gasket or packing products sold to ship owners. In addition, subsidiaries of Cooper Automotive have been named as defendants in a number of product liability cases involving asbestos, primarily involving friction products. The Company is defending

all such claims vigorously and believes that it, Fel-Pro and the Cooper Automotive subsidiaries 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, Fel-Pro and the Cooper Automotive subsidiaries as of December 31, 1998, will not have a material effect on the Company's financial position. At December 31, 1998, approximately \$20 million in related reserves have been provided in respect of the possible uninsured portion of the expenditures on asbestos claims pending against the Company, Fel-Pro and the Cooper Automotive subsidiaries.

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 and legal reserve was approximately \$50 million at December 31, 1998 and \$11 million at December 31, 1997. The majority of the 1998 increase is attributable to the acquisitions of T&N and Cooper Automotive. 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 consists 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 income statements 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, 1998, the Company's net assets (defined as current assets less current liabilities) subject to foreign currency translation risk are \$146.8 million. The potential decrease in net assets from a hypothetical 10% adverse change in quoted foreign currency exchange rates would be approximately \$14.7 million.

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 monitors 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.

The Company has 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 has 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.

The Company has 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 are 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. Some 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.

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. The net unrealized losses at December 31, 1998 for commodity contracts were \$1.4 million.

OTHER MATTERS**Year 2000 Costs**

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. The Company has established a team that has completed an awareness program and assessment project to address the Year 2000 issue including information technology (IT) and non-IT systems. In addition, the Board of Directors has received status reports related to the Company's progress in addressing the Year 2000 issue. The Company has determined that it will be required to modify or replace portions of its software so that its computer systems will properly utilize dates beyond December 31, 1999. The Company has initiated remediation and testing, and is implementing the action plan to address the Year 2000 issue and estimates that the majority of testing will be completed by the end of the first quarter of 1999. A number of independent third-party reviews have been performed and others are planned. The Company presently believes that with modifications to existing software and

Interest Rate Sensitivity
Principal Amount by Expected Maturity
(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%	—	—	—	—	—	—	—

conversions to new software, the Year 2000 issue can be mitigated. However, if such modifications and conversions are not made, or are not completed in a timely manner, the Year 2000 issue could cause production interruptions that could have a material impact on the operations of the Company. The Company has initiated development of contingency plans and will continue to do so throughout the program.

The Company has initiated formal communications with a substantial majority of its significant suppliers and large customers to determine their plans to address the Year 2000 issue. While the Company expects a successful resolution of all issues, there can be no guarantee that the systems of other companies on which the Company's systems rely will be converted in a timely manner, or that a failure to convert by a supplier or customer, or a conversion that is incompatible with the Company's systems, would not have a material adverse effect on the Company. The Company has determined it has no exposure to contingencies related to the Year 2000 issue for the products it has sold.

The Company has contracts in place with external resources and has allocated internal resources to reprogram or replace, and test the hardware and software for Year 2000 modifications. The total cost of the Year 2000 project is estimated to be \$25 million and is being funded through operating cash flows. These estimates have been verified by independent third-party audit. Of the total project cost, approximately \$10 million is attributable to the purchase of new hardware and software which will be capitalized. Maintenance and repair of existing systems to be expensed as incurred is expected to be approximately \$15 million. As of December 31, 1998, the Company has incurred and expensed approximately \$8 million and capitalized approximately \$3 million.

The costs of the project and the date which the Company plans to complete the Year 2000 modifications are based on management's best estimates, which were derived utilizing numerous assumptions of future events including the continued availability of certain resources, third-party modification plans and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those plans. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes and similar uncertainties.

Management of the Company believes it has an effective program in place to resolve the Year 2000 issue in a timely manner. As noted above, the Company has not yet completed all necessary phases of the Year 2000 program. In the event that the Company does not complete any additional

phases, the Company would be unable to take customer orders, manufacture and ship products, invoice customers or collect payments. In addition, disruptions in the economy generally resulting from Year 2000 issues could also materially adversely affect the Company. The Company could be subject to litigation for computer systems product failure, for example, equipment shutdown or failure to properly date business records. The amount of potential liability and lost revenue cannot be reasonably estimated at this time.

The Company has contingency plans for certain critical applications and is working on such plans for others. These contingency plans involve, among other actions, manual workarounds, increasing inventories, and adjusting staffing strategies.

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.

Effect of Accounting Pronouncements

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 is 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 unamortized balance of start-up costs will be written off as a cumulative effect of an accounting change of approximately \$13 million, net of tax, as of January 1, 1999.

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The Company expects to adopt the new statement effective January 1, 2000. The statement requires the Company to recognize all derivatives on the balance sheet at fair value. The Company does not anticipate that the adoption of this statement will have a significant effect on its results of operations or financial condition.

Year Ended December 31			
	1998	1997	1996
	(Millions of Dollars, Except Per Share Amounts)		
Net sales	\$4,468.7	\$1,806.6	\$2,032.7
Cost of products sold	3,290.2	1,381.8	1,660.5
Gross margin	1,178.5	424.8	372.2
Selling, general and administrative expenses	640.8	276.0	320.0
Amortization	83.8	8.9	12.0
Purchased in-process research and development charge	18.6	—	—
Restructuring charges (credits)	7.3	(1.1)	57.6
Reengineering and other related charges (credits)	—	(1.6)	11.4
Adjustment of assets held for sale and other long-lived assets to fair value	19.0	2.4	151.3
Integration costs	22.4	—	—
Interest expense	204.0	33.3	44.4
Interest income	(10.6)	(7.1)	(2.9)
International currency exchange losses	4.7	0.6	3.7
Net (gain) loss on British pound currency option and forward contract	(13.3)	10.5	—
Other expense, net	16.3	3.4	3.4
Earnings (loss) before income taxes and extraordinary items	185.5	99.5	(228.7)
Income tax expense (benefit)	93.6	27.5	(22.4)
Net earnings (loss) before extraordinary items	91.9	72.0	(206.3)
Extraordinary items — loss on early retirement of debt, net of applicable income tax benefit	38.2	2.6	—
Net earnings (loss)	53.7	69.4	(206.3)
Preferred dividends	3.6	5.5	8.7
Net Earnings (Loss) Available to Common Shareholders	\$ 50.1	\$ 63.9	\$ (215.0)
Earnings (Loss) Per Common Share:			
Income (loss) before extraordinary items	\$ 1.84	\$ 1.81	\$ (6.20)
Extraordinary items	(.80)	(.07)	—
Net Earnings (Loss) Per Common Share	\$ 1.04	\$ 1.74	\$ (6.20)
Earnings (Loss) Per Common Share Assuming Dilution:			
Income (loss) before extraordinary items	\$ 1.67	\$ 1.67	\$ (6.20)
Extraordinary items	(.71)	(.06)	—
Net Earnings (Loss) Per Common Share Assuming Dilution	\$.96	\$ 1.61	\$ (6.20)

See accompanying Notes to Consolidated Financial Statements.



	December 31	
	1998	1997
	(Millions of Dollars)	
ASSETS		
Cash and equivalents	\$ 77.2	\$ 541.4
Accounts receivable	1,025.0	158.9
Investment in accounts receivable securitization	91.1	48.7
Inventories	1,068.6	277.0
Prepaid expenses and income tax benefits	337.7	113.2
Total Current Assets	2,599.6	1,139.2
Property, plant and equipment	2,477.5	313.9
Goodwill	3,398.4	143.8
Other intangible assets	886.4	48.4
Other noncurrent assets	578.2	156.8
Total Assets	\$9,940.1	\$1,802.1
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-term debt, including current portion of long-term debt	\$ 211.0	\$ 28.6
Accounts payable	498.4	102.3
Accrued compensation	200.3	36.8
Restructuring and rationalization reserves	178.9	33.9
Current portion of asbestos liability	125.0	—
Income taxes payable	142.2	10.2
Other accrued liabilities	673.7	117.8
Total Current Liabilities	2,029.5	329.6
Long-term debt	3,130.7	273.1
Long-term portion of asbestos liability	1,176.7	—
Postemployment benefits	677.0	190.9
Other accrued liabilities	327.0	50.6
Minority interest in consolidated subsidiaries	38.0	13.6
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	44.4	49.0
Series E preferred stock	132.7	—
Common stock	336.8	201.0
Additional paid-in capital	1,665.8	332.6
Accumulated deficit	(69.9)	(123.6)
Unearned ESOP compensation	(15.1)	(21.8)
Accumulated other comprehensive income	(106.0)	(65.7)
Other	(2.5)	(2.2)
Total Shareholders' Equity	1,986.2	369.3
Total Liabilities and Shareholders' Equity	\$9,940.1	\$1,802.1

(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.

	Year Ended December 31		
	1998	1997	1996
	(Millions of Dollars)		
Cash Provided From (Used By) Operating Activities			
Net earnings (loss)	\$ 53.7	\$ 69.4	\$(206.3)
Adjustments to reconcile net earnings (loss) to net cash provided from operating activities:			
Depreciation and amortization	228.0	51.5	61.9
Purchased in-process research and development charge	18.6	—	—
Restructuring charges (credits)	7.3	(1.1)	57.6
Reengineering and other related charges (credits)	—	(1.6)	11.4
Adjustment of assets held for sale and other long-lived assets to fair value	19.0	2.4	151.3
Loss on early retirement of debt	58.1	4.1	—
Vesting of restricted stock	0.7	9.0	0.4
Postemployment benefits	10.9	(7.7)	(2.0)
Decrease in accounts receivable	37.5	7.6	46.5
Decrease in inventories	55.9	59.9	54.5
Increase (decrease) in accounts payable	5.4	(19.5)	(25.5)
Increase (decrease) in current liabilities and other	(2.4)	67.9	16.8
Payments against restructuring and rationalization reserves	(78.0)	(26.2)	(17.6)
Payments against asbestos liability	(89.2)	—	—
Net Cash Provided From Operating Activities	325.5	215.7	149.0
Cash Provided From (Used By) Investing Activities			
Expenditures for property, plant and equipment and other long-term assets	(228.5)	(49.7)	(54.2)
Proceeds from sale of business investments	53.4	73.6	42.0
Proceeds from sale of options	39.1	—	—
Businesses acquisitions, net of cash acquired	(4,225.2)	(30.5)	(0.3)
Other	—	1.1	—
Net Cash Used By Investing Activities	(4,361.2)	(5.5)	(12.5)
Cash Provided From (Used By) Financing Activities			
Issuance of common stock	1,382.2	14.2	0.6
Proceeds from issuance of long-term debt	6,197.5	179.6	—
Principal payments on long-term debt	(3,927.6)	(127.4)	(29.4)
Increase (decrease) in short-term debt	0.5	(235.8)	(61.4)
Fees paid for debt issuance and other securities	(76.6)	(42.8)	—
Fees for early retirement of debt	(27.4)	(4.1)	—
Investment in accounts receivable securitization	42.6	(31.8)	—
Issuance of Company-obligated mandatorily redeemable preferred securities	—	575.0	—
Dividends	(10.4)	(24.8)	(26.9)
Other	(9.3)	(4.0)	(5.7)
Net Cash Provided From (Used By) Financing Activities	3,571.5	298.1	(122.8)
Increase (Decrease) in Cash and Equivalents	(464.2)	508.3	13.7
Cash and equivalents at beginning of year	541.4	33.1	19.4
Cash and Equivalents at End of Year	\$ 77.2	\$ 541.4	\$ 33.1

See accompanying Notes to Consolidated Financial Statements.

(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 December 31, 1995	\$56.8	\$ 76.6	\$175.2	\$ 280.8	\$ 40.2	\$(34.3)	\$(37.3)	\$(7.7)	\$ 550.3
Net loss					(206.3)				(206.3)
Currency translation							(4.3)		(4.3)
Other							1.5		1.5
Total Comprehensive Income									\$ (209.1)
Issuance of stock			0.5	1.3				(1.2)	0.6
Retirement of Series C ESOP preferred stock	(3.7)								(3.7)
Amortization of unearned ESOP compensation						5.9			5.9
Dividends					(26.9)				(26.9)
Preferred dividend tax benefits				1.4					1.4
Balance at December 31, 1996	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

See accompanying Notes to Consolidated Financial Statements.

1. Accounting Policies

Organization: Headquartered in Southfield, Michigan, Federal-Mogul is a global manufacturer and distributor of a broad range of vehicular components for automobiles and light trucks, heavy-duty trucks, farm and construction vehicles and industrial products. The Company's principal customers include many of the world's major 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. Inter-company 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 53% and 55% of the inventory at December 31, 1998 and 1997, respectively. The remaining inventories are costed using the first-in, first-out (FIFO) method. If inventories had been valued at current cost, amounts reported at December 31 would have been increased by \$39.0 million in 1998 and \$44.5 million in 1997.

Inventory quantity reductions resulting in liquidations of certain LIFO inventory layers increased net earnings by \$3.4 million, \$3.2 million and \$3.1 million (\$.06, \$.08 and \$.09 per diluted share) in 1998, 1997 and 1996, respectively.

At December 31, inventories consisted of the following:

	1998	1997
	(Millions of Dollars)	
Finished products	\$ 737.9	\$254.6
Work-in-process	147.1	21.8
Raw materials	208.5	15.7
	1,093.5	292.1
Reserve for inventory valuation	(24.9)	(15.1)
	<u>\$1,068.6</u>	<u>\$277.0</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	1998	1997
		(Millions of Dollars)	
Goodwill	40 years	\$3,481.8	\$163.8
Accumulated amortization		(83.4)	(20.0)
Total Goodwill		<u>\$3,398.4</u>	<u>\$143.8</u>
Trademarks	40 years	\$ 417.6	\$ 56.5
Developed technology	12-30 years	390.1	—
Assembled workforce	15 years	88.1	—
Other	5-20 years	39.9	20.8
		935.7	77.3
Accumulated amortization		(49.3)	(28.9)
Total Other Intangible Assets		<u>\$ 886.4</u>	<u>\$ 48.4</u>

Intangible assets are periodically reviewed for impairment based on an assessment of future cash flows, or fair value for assets held for sale, to ensure that they are appropriately valued. Intangible assets are amortized on a straight-line basis over their estimated useful lives. Impairment charges recorded in 1998, 1997 and 1996 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 \$80.5 million, \$13.1 million and \$14.4 million for 1998, 1997 and 1996, respectively.

Costs associated with advertising and promotion are expensed as incurred. Advertising and promotion expense was \$45.9 million, \$31.8 million and \$34.0 million for 1998, 1997 and 1996, 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.

Effect of Accounting Pronouncements: In April 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 is 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 unamortized balance of start-up costs will be written off as a cumulative effect of an accounting change of approximately \$13 million, net of tax, as of January 1, 1999.

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The Company expects to adopt the new statement effective January 1, 2000. The statement requires the Company to recognize all derivatives on the balance sheet at fair value. The Company does not anticipate that the adoption of this statement will have a significant effect on its results of operations or financial condition.

Environmental Liabilities: The Company recognizes environmental liabilities when a loss is probable and estimable. Such liabilities are generally not subject to insurance coverage. Each environmental obligation is estimated by engineering and legal specialists within the Company based on current law and existing technologies. 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 20, "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: Incremental direct costs associated with integrating material acquisitions 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.

Derivative Financial Instruments: The Company uses 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, 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 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.

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 1998.

2. Acquisitions of Businesses

T&N

In March 1998, the Company acquired T&N plc (T&N), a manufacturer 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.

In connection with the acquisition of T&N, the Company entered into a \$2.675 billion floating rate Senior Credit Agreement (consisting of a \$2.275 billion term loan facility and a \$400 million revolving loan facility) and a \$500 million floating rate Senior Subordinated Credit Agreement.

In addition, the Company funded a portion of the T&N acquisition through the December 1997 sale of 11.5 million shares of Company-

obligated mandatorily redeemable preferred securities (generating gross proceeds of \$575 million) by Federal-Mogul Financing Trust, a wholly owned subsidiary of the Company.

T&N manufactures and supplies high technology engineered automotive components and industrial materials. In 1997, T&N had sales of approximately £1.8 billion (\$2.9 billion at the 1997 average exchange rate) with about 80% of such sales relating to the global automotive industry. At the time of its acquisition, T&N's major product lines consisted of piston products, bearings, friction products, composites and camshafts (incorporating sintered products) and sealing products servicing OE customers and the aftermarket. T&N operated in approximately 200 locations in 24 countries, employed over 28,000 people worldwide and served customers globally. T&N's operations included technical centers in the United Kingdom, Germany and North America.

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 includes a price adjustment based upon acquired net assets, as defined in the agreement, as of the acquisition date. The Company anticipates additional cash payments of approximately \$100 million will be paid.

Cooper Automotive is a leading supplier of aftermarket parts for repair and maintenance and serves OE automobile manufacturers worldwide. In 1997, Cooper Automotive had sales of approximately \$1.9 billion. At the time of the acquisition, Cooper Automotive's principal products consisted of brakes and friction, lighting, chassis parts, ignition and wiper blades. Cooper Automotive employed approximately 14,500 employees in 63 locations.

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 1,030,325.6 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 for the North American aftermarket and OE heavy-duty market. In 1997, Fel-Pro had sales of approximately \$500 million. At the time of the acquisition, Fel-Pro's primary product lines consisted of gaskets, heavy-duty diesel engine products, diesel products, high performance gaskets and other equipment and chemical products. Fel-Pro employed approximately 2,700 employees in 16 locations.

The 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 statement of operations for the

year ended December 31, 1998 includes 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 the acquisition dates.

In connection with the acquisition of Cooper Automotive, the Company is in the process of having valuations of acquired property, plant and equipment and identifiable intangible assets completed. The related purchase price allocation will be finalized when such valuations and the final purchase price adjustment are completed in 1999.

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 provide for \$180.0 million and \$36.8 million in severance and exit costs, respectively, and were recorded as a component of goodwill in the purchase price allocation.

The components of the integration plan include: closure of certain manufacturing facilities worldwide; relocation of highly manual manufacturing product lines to lower cost regions or 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. An anticipated result of the integration plan and the restructuring will be a reduction of approximately 5,300 full-time employees.

The Company paid \$61.6 million related to these rationalization reserves in 1998.

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.

On December 18, 1998, the Company completed the sale of 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 also expects to realize additional net proceeds of approximately \$13 million from the collection of receivables of the business sold. Prior to the sale of the T&N Bearing 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)

Other Acquisitions

During 1998, the Company acquired other complementary businesses and increased its ownership in certain joint ventures in order to expand its manufacturing and distribution capabilities. In the first quarter of 1998, the Company increased its ownership to 100% in its Summerton, South Carolina gasket manufacturing plant and also increased its ownership in KFM Bearing Company Ltd. (KFM), a Korean joint venture with Kukje Special Metal Co., from 30% to 87%. In addition, the Company acquired Bimet, a Polish manufacturer of engine bearings, bushings and related products. During the fourth quarter of 1998, the Company acquired Tri-Way Machine Limited (Tri-Way), a Canadian manufacturer of machining systems for the metal-cutting industry and Glöckler Dichtsysteme Günter Hemmrich GmbH (Glöckler), a manufacturer of rubber sealing components and acoustic decoupling for valve covers, intake manifolds and oil pans. Additionally, the Company increased its ownership from 50.6% to 100% in T&N Holdings Limited located in South Africa.

The Summerton, KFM, Bimet, Tri-Way, Glöckler, and T&N Holdings Limited transactions have been accounted for as purchases and, accordingly, the total consideration was allocated to the acquired assets and assumed liabilities based on its estimated fair values as of the acquisition dates. The total cash consideration paid for these acquisitions approximated \$93 million. The consolidated statement of operations for the year ended December 31, 1998 includes the operating results of the acquired businesses from the applicable date of acquisition.

3. Sales of Businesses

Divestitures

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 (refer to Note 2, "Acquisitions of Businesses"). 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.

During 1996, the Company received \$42.0 million in net cash proceeds from the sale of its United States ball bearings and electrical products manufacturing operations.

Except for the sales of Bruss and the electrical products manufacturing operations, sales of businesses in 1998, 1997 and 1996 relate to assets previously adjusted to fair value (refer to Note 7, "Adjustment of Assets Held for Sale and Other Long-Lived Assets to Fair Value"). Accordingly, no gain or loss was recognized on the date of sale related to these transactions. In addition, no gain or loss was recognized related to the sale of the electrical products manufacturing operations.

4. Restructuring Charges

The following is a summary of restructuring charges and related activity for 1996, 1997 and 1998 (in millions of dollars):

	1995 Restructuring Provision		1996 Restructuring Provision		1997 Restructuring Provision		1998 Restructuring Provision		Total
	Severance	Exit	Severance	Exit	Severance	Exit	Severance	Exit	
Balance of restructuring reserves at December 31, 1995	\$3.9	\$6.8	—	—					\$10.7
1996 restructuring charge	—	—	\$42.8	\$14.8					57.6
Payments against restructuring reserves	(3.9)	(3.4)	(4.8)	(1.0)					(13.1)
Balance of restructuring reserves at December 31, 1996	—	3.4	38.0	13.8					55.2
1997 restructuring charge	—	—	—	—	\$16.7	\$5.3			22.0
Adjustment to restructuring reserves	—	(.9)	(20.8)	(1.4)	—	—			(23.1)
1997 restructuring charges (net)	—	(.9)	(20.8)	(1.4)	16.7	5.3			(1.1)
Payments against restructuring reserves	—	(1.7)	(11.6)	(3.7)	(0.1)	—			(17.1)
Balance of restructuring reserves at December 31, 1997	—	0.8	5.6	8.7	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	—	(0.8)	(1.1)	(5.0)	(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

The Company's total restructuring reserves at December 31, 1998 of \$27.9 million include \$4.2 million of severance, which was anticipated to be paid over the next two years, and was classified as noncurrent other accrued liabilities in the balance sheet.

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 result from planned terminations of approximately 1,800 employees 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 work-force reduction policies and certain foreign governmental regulations. The Company anticipates that the actions related to the 1998 restructuring plan will be substantially completed in 1999.

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 result from the planned 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.

As of December 31, 1998, employee severance actions related to the 1997 charges resulted in the termination of approximately 200 employees.

1996 Restructuring Provision

Primarily due to the anticipated T&N and Fel-Pro transactions (refer to Note 2, "Acquisitions of Businesses"), the Company elected not to fully implement the following actions under the 1996 restructuring plan:

- Reductions to the operational and administrative staff were not made to the extent originally planned.
- Reconfiguration of the North American distribution network was altered to accommodate the planned integration of T&N and Fel-Pro aftermarket operations.
- Relocation of certain European manufacturing product lines to lower cost areas within Europe and related workforce reductions did not take place. Management of the Company decided not to pursue this action, primarily in anticipation of the integration of future acquisitions.

Primarily as a result of actions not fully implemented under the 1996 restructuring plan, the Company's 1997 operating results were increased by \$23.1 million for the reversal of previously recognized 1996 and 1995 restructuring charges.

As of December 31, 1998, employee severance costs related to the 1996 charge have resulted in the termination of approximately 700 employees, primarily in the international retail aftermarket and wholesale aftermarket operations, the North American distribution business and a closed manufacturing operation.

Exit costs for 1996 principally include lease termination costs of international retail aftermarket stores and certain international wholesale aftermarket operations, the consolidation of certain North American distribution facilities and the closing of a North American manufacturing operation.

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 have been reflected in the results of

operations in the fourth quarter of 1997. At December 31, 1997, the Company 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."

6. Debt

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

	1998	1997
	(Millions of Dollars)	
Senior Credit Agreements	\$1,893.6	\$ —
Notes due 2004 - 7.5%, issued in 1998	249.5	—
Notes due 2006 - 7.75%, issued in 1998	399.9	—
Notes due 2010 - 7.875%, issued in 1998	349.2	—
Medium-term notes - due between 1999 and 2005, average rate of 8.4%, issued in 1994 and 1995	125.0	125.0
Senior notes - due in 2007, rate of 8.8%, issued in 1997	124.7	124.6
ESOP obligation - due in 1999 and 2000, average rate of 7.19%	14.7	21.9
Other	82.6	11.8
	3,239.2	283.3
Less current maturities included in short-term debt	108.5	10.2
	<u>\$3,130.7</u>	<u>\$273.1</u>

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 outstanding under these Senior Credit Agreements as of December 31, 1998 which are due from 1999 to 2005 with an average interest rate of 7.33%.

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 12, "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 inter-company 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 22, "Audited 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.

In June 1997, the Company entered into a new \$350 million multicurrency revolving credit facility, with a consortium of international banks, which matures in June 2002 which was subsequently replaced by the \$400 million multicurrency revolving credit facility related to the T&N acquisition. As of December 31, 1998 and 1997, there were no borrowings outstanding against the multicurrency revolving credit facility. The weighted average interest rate for the Company's short-term debt was approximately 7.75% and 9.9% as of December 31, 1998 and 1997, respectively.

On February 24, 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. As a result of these transactions, the Company will recognize an extraordinary charge in the first quarter of 1999 of approximately \$15 million, net of tax, related to the early extinguishment of debt.

Aggregate maturities of long-term debt for each of the years following 1999 are, in millions: 2000 — \$475.1; 2001 — \$139.1; 2002 — \$126.7; 2003 — \$139.7 and thereafter \$2,250.1.

Interest paid in 1998, 1997 and 1996 was \$173.4 million, \$30.7 million and \$43.5 million, respectively.

7. Adjustment of Assets Held For Sale and Other Long-Lived Assets to Fair Value

In 1998, the Company decided to sell its subsidiary, Bertolotti Pietro e Figli, S.r.l. (Bertolotti), an Italian aftermarket operation. The carrying value of Bertolotti's long-lived assets was reduced to fair value based on estimates of selling values, less costs to sell, calculated using multiples of earnings

similar to recent automotive industry transactions in Italy. The Company recognized a \$20.0 million first quarter charge primarily associated with the write-down of Bertolotti's assets to the estimated fair value.

Also in 1998, the Company recognized a \$1.0 million benefit associated with the sale of certain international retail assets previously written down to their realized fair value.

In 1997, the Company recognized a charge of \$2.4 million to write down certain long-lived assets of the international retail aftermarket to fair value. These assets were sold in 1998 for approximately their adjusted value and no gain or loss was recorded.

During 1996, management designed a restructuring plan to aggressively improve the Company's cost structure, streamline operations and divest the Company of underperforming assets. As part of this plan, the Company decided to sell 132 international retail aftermarket operations, sell or restructure 30 wholesale aftermarket operations and consolidate a North American manufacturing operation. The carrying value of assets held for sale was reduced to fair value based on estimates of selling values less costs to sell. Selling values used to determine the fair value of assets held for sale were determined using market prices (i.e., valuation multiples) of comparable companies from other 1996 transactions. The resulting adjustment of \$148.5 million to reduce assets held for sale to fair value was recorded in the fourth quarter of 1996. The Company has substantially completed the 1996 restructuring plan, selling its South Africa, Australia, Chile and Puerto Rico retail operations during 1997 and 1998. Also in 1996, based upon the final sale, the Company recognized an additional write-down of \$2.8 million to the net asset value of the United States ball bearings operations.

8. Reengineering and Other Related Charges (Credits)

In 1996, the Company initiated an extensive effort to strategically review its businesses and focus on its competencies of manufacturing, engineering and distribution. As a result of this process, the Company recognized a charge of \$11.4 million for professional fees and personnel costs related to the strategic review of the Company and changes in management and related costs. Operating results for 1997 include a credit of \$1.6 million relating to the reversal of certain 1996 reengineering and other related charges, as the actual costs were less than the initial estimates.

9. Changes in Accounting Estimates

In 1996, the Company made certain changes in accounting estimates totaling \$51 million (\$34 million after tax, \$.98 per share) attributable to 1996 events and new information becoming available. The changes in accounting estimates included increasing the provision for customer incentive programs and related sales initiatives by \$18 million, increasing the provision for excess and obsolete inventory by \$13 million, increasing the provision for bad debts by \$3 million, increasing the provision for environmental and legal matters by \$9 million and increasing various other provisions by approximately \$8 million.

10. 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, 1998, the Company has foreign exchange forward contracts principally for British pound exposures relating to the United States dollar and the South African rand totaling a notional amount of \$127 million. At December 31, 1998, there was an unrealized loss of \$9.1 million related to foreign exchange contracts. The Company did not have foreign exchange forward contracts or currency option contracts at December 31, 1997.

The Company enters into copper 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. Under the agreements, the Company was committed to purchase 7.3 million pounds of copper. The net unrealized loss on these firm purchase commitments was \$0.8 million at December 31, 1998. In addition, in 1998, the Company had also entered into aluminum and nickel contracts as a hedge to offset the effects of price changes. The net unrealized losses at December 31, 1998 were \$0.4 million and \$0.2 million for aluminum and nickel contracts, respectively.

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.

Interest Rate Locks

The Company had \$300 million of interest rate locks outstanding as of December 31, 1998 with an unrealized loss of \$0.9 million. These interest rate locks were entered into as a hedge in anticipation of the bond issuance of \$1.0 billion in January 1999 (refer to Note 23, "Subsequent Events").

Accounts Receivable Securitization

During 1998, the Company replaced an existing accounts receivable securitization program with a new program which provides up to \$150 million of financing. 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 \$105.8 million and \$63.2 million at December 31, 1998 and 1997, 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 \$60.4 million and \$18.7 million at December 31, 1998 and 1997, 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 were \$3,130.7 million and \$3,166.3 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.

11. Property, Plant and Equipment

Property, plant and equipment are stated at cost and include expenditures which 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, 1998, 1997 and 1996, was \$144.2 million, \$42.6 million and \$49.8 million, respectively.

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

	Estimated Useful Life	1998	1997
		(Millions of Dollars)	
Land	—	\$ 139.4	\$ 29.1
Buildings and building improvements	24-40 years	560.1	124.0
Machinery and equipment	3-12 years	2,097.6	363.4
		2,797.1	516.5
Accumulated depreciation		(319.6)	(202.6)
		\$2,477.5	\$ 313.9

Future minimum payments under noncancelable operating leases with initial or remaining terms of more than one year are, in millions: 1999 — \$52.9; 2000 — \$40.3; 2001 — \$33.6; 2002 — \$27.2; 2003 — \$24.0 and thereafter \$73.8. Future minimum lease payments have been reduced by approximately \$29.2 million for amounts to be received under sublease agreements.

Total rental expense under operating leases was \$46.5 million in 1998, \$29.1 million in 1997 and \$33.8 million in 1996, exclusive of property taxes, insurance and other occupancy costs generally payable by the Company.

12. 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 67,233,216 shares, 40,196,603 shares and 35,130,359 shares were outstanding at December 31, 1998, 1997 and 1996, respectively.

In February 1998, in connection with the Fel-Pro acquisition, the Company issued 1,030,325.6 shares Series E Stock with an imputed value of \$225 million. The shares of Series E Stock are exchangeable into shares of the Company's common stock at a rate of five shares of common stock per share of Series E Stock. Subsequently, in conjunction with the June 1998 common stock offering described below, the Company converted 422,581 shares of Series E Stock into approximately 2.1 million shares of common stock.

In February 1999, all outstanding shares of the Company's Series E Stock were exchanged into the Company's common stock (refer to Note 23, "Subsequent Events").

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 "Acquisitions").

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 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 Company's ESOP covers substantially all domestic salaried employees and allocates Series C ESOP Convertible Preferred Stock to eligible employees based on their contributions to the Salaried Employees' Investment Program. There were 724,644, 762,939 and 835,898 shares of Series C ESOP preferred stock outstanding at December 31, 1998, 1997 and 1996, respectively. The Series C ESOP preferred shares pay dividends at a rate of 7.5%. The Company repurchased and retired 38,295 Series C ESOP preferred shares valued at \$4.6 million during 1998 and 72,959 Series C ESOP preferred shares valued at \$4.1 million during 1997, all of which represent plan distributions or fund transfers for participants of the plan.

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. The Series C ESOP preferred stock may be issued only to a trustee acting on behalf of an employee stock ownership plan or other employee benefit plan of the Company. These shares are automatically converted into shares of common stock in the event of any transfer to any

person other than the plan trustee. The Series C ESOP preferred stock is redeemable, in whole or in part, at the option of the Company.

The charge to operations for the cost of the ESOP was \$5.2 million in 1998, \$5.2 million in 1997 and \$4.2 million in 1996. The Company made cash contributions to the plan of \$8.2 million in 1998 and \$8.1 million in 1997 and 1996, including preferred stock dividends of \$3.6 million in 1998, \$3.8 million in 1997 and \$4.1 million in 1996. 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 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, 1998 and December 31, 1997. Any repurchase of the ESOP shares is strictly at the option of the Company.

In 1988, the Company's Board of Directors authorized the distribution of one Preferred Share Purchase Right (Right) for each outstanding share of common stock of the Company. Each Right entitles shareholders to buy one-half of one-hundredth of a share of a new series of preferred stock at a price of \$70. These Rights will expire on April 30, 1999, after which they will be replaced by Rights authorized under a new Shareholder Rights Plan adopted by the Board of Directors in February of 1999. Under the new plan, each Right will entitle shareholders to buy one-one thousandth of a share of a newly created Series F preferred stock at a price of \$250.

As distributed, the Rights trade together with the common stock of the Company. They may be exercised or traded separately only after the earlier to occur of (i) ten days following a public announcement that a person or group of persons has obtained the right to acquire 10% or more of the outstanding common stock of the Company (20% in the case of certain institutional investors), or (ii) ten business days (or such later date as may be determined by action of the Board of Directors) following the commencement or announcement of an intent to make a tender offer or exchange offer which would result in beneficial ownership by a person or group of persons of 10% or more of the Company's outstanding common stock. Additionally, if the Company is acquired in a merger or other business combination, each Right will entitle its holder to purchase, at the Right's exercise price, shares of the acquiring Company's common stock (or stock of the Company if it is the surviving corporation) having a market value of twice the Right's exercise price.

The Rights may be redeemed at the option of the Board of Directors for \$.01 per Right at any time before a person or group of persons acquires 10% or more of the Company's common stock. The Board may amend the Rights at any time without shareholder approval. The Rights will expire by their terms on April 30, 2009.

13. 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.

14. Accumulated Other Comprehensive Income

The components of other comprehensive income are as follows:

	Currency Translation	Other	Total
	(Millions of Dollars)		
Balance at December 31, 1996	\$ (38.2)	\$(1.9)	\$ (40.1)
Current period change	(27.4)	1.8	(25.6)
Balance at December 31, 1997	(65.6)	(0.1)	(65.7)
Current period change	(36.7)	(3.6)	(40.3)
Balance at December 31, 1998	\$(102.3)	\$(3.7)	\$(106.0)

The earnings associated with the Company's investment in its foreign subsidiaries are considered to be permanently invested and no provision for United States Federal and state income taxes on those earnings or translation adjustments have been provided.

15. Earnings Per Share

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

	1998	1997	1996
Numerator:			
Net earnings (loss) after extraordinary items	\$ 53.7	\$ 69.4	\$ (206.3)
Extraordinary items — loss on early retirement of debt net of applicable tax benefit	38.2	2.6	—
Net earnings (loss) before extraordinary items	91.9	72.0	(206.3)
Series C preferred dividend requirement	(2.3)	(2.4)	(2.5)
Series D preferred dividend requirement	—	(3.1)	(6.2)
Series E preferred dividend requirement	(1.3)	—	—
Numerator for basic earnings per share — income (loss) available to common shareholders before extraordinary items	\$ 88.3	\$ 66.5	\$ (215.0)
Effect of dilutive securities:			
Series C preferred dividend requirement	2.3	2.4	—
Series D preferred dividend requirement	—	3.1	—
Series E preferred dividend requirement	1.3	—	—
Additional required ESOP contribution	(2.1)	(1.9)	—
Numerator for diluted earnings per share — income (loss) available to common shareholders after assumed conversions, before extraordinary item	\$ 89.8	\$ 70.1	\$ (215.0)
Numerator for basic earnings per share — income (loss) available to common shareholders after extraordinary item	\$ 50.1	\$ 63.9	\$ (215.0)
Numerator for diluted earnings per share — income (loss) available to common shareholders after extraordinary item	\$ 51.6	\$ 67.5	\$ (215.0)
Denominator:			
Denominator for basic earnings per share — weighted average shares	48.1	36.6	34.7
Effect of dilutive securities:			
Dilutive stock options outstanding	0.8	0.4	—
Nonvested stock	0.1	0.3	—
Conversion of Series C preferred stock	1.5	1.6	—
Conversion of Series D preferred stock	—	3.0	—
Conversion of Series E preferred stock	3.2	—	—
Dilutive potential common shares	5.6	5.3	—
Denominator for dilutive earnings per share — adjusted weighted average shares and assumed conversions	53.7	41.9	34.7
Basic earnings (loss) per share before extraordinary items	\$ 1.84	\$ 1.81	\$ (6.20)
Basic earnings (loss) per share after extraordinary items	\$ 1.04	\$ 1.74	\$ (6.20)
Diluted earnings (loss) per share before extraordinary items	\$ 1.67	\$ 1.67	\$ (6.20)
Diluted earnings (loss) per share after extraordinary items	\$ 0.96	\$ 1.61	\$ (6.20)

For additional disclosures regarding the Series C, Series D and Series E preferred stock, the employee stock options and nonvested stock shares, refer to Note 12, "Capital Stock and Preferred Share Purchase Rights," and Note 16, "Incentive Stock Plans".

Convertible preferred securities (refer to Note 13, "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.

16. 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, 1998, there were 2,752,952 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 \$0.7 million, \$9.0 million and \$0.4 million in 1998, 1997 and 1996, 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 (Statement 123) *Accounting for Stock Based Compensation*, the Company's net earnings (loss), in millions, and earnings (loss) per share would have been adjusted to the pro forma amounts indicated below:

	1998	1997	1996
Net earnings (loss) as reported	\$ 53.7	\$ 69.4	\$ (206.3)
Pro forma	\$ 48.3	\$ 70.7	\$ (207.1)
Basic earnings (loss) per share as reported	\$ 1.04	\$ 1.74	\$ (6.20)
Pro forma	\$ 0.93	\$ 1.78	\$ (6.22)
Diluted earnings (loss) per share as reported	\$ 0.96	\$ 1.61	\$ (6.20)
Pro forma	\$ 0.86	\$ 1.64	\$ (6.22)

Pro forma information regarding net income and earnings per share is required by Statement 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 1998, 1997 and 1996, respectively: risk-free interest rates of 6.5%; dividend yields of 0.2%, 1.5% and 2.3%; volatility factors of the expected market price of the Company's common stock of 30.1%, 27.2% and 11.2% 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.

Since the above pro forma disclosures of results are required to consider only grants awarded in 1995 and thereafter, the pro forma effects during this initial phase-in period may not be representative of the effects on the reported results for future years.

The weighted-average fair value and the total number (in millions) of options granted was \$22.36, \$9.99 and \$3.34, and 1.1, 0.9 and 0.3 for 1998, 1997 and 1996, respectively. The weighted-average fair value and total number (in millions) of nonvested stock awards granted was \$53.52, \$24.47 and \$18.90 and 0.1, 0.1 and 0.2 for 1998, 1997 and 1996, respectively. All options and stock awards that are not vested at December 31, 1998, 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 December 31, 1995	2.6	\$ 22.02
Options/stock granted	.5	22.08
Options exercised	—	—
Options/stock lapsed or canceled	(.6)	22.32
Outstanding at December 31, 1996	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 exercisable at December 31, 1998	0.6	\$ 30.11
Options exercisable at December 31, 1997	0.9	\$ 23.07
Options exercisable at December 31, 1996	1.3	\$ 22.50

The following is a summary of the range of exercise prices for stock options that are outstanding and the amount of nonvested stock awards at December 31, 1998:

Range	Outstanding Awards	Weighted-Average Price	Remaining Life
Options:			
\$15.69 – \$23.50	0.5	\$21.79	3 years
\$23.51 – \$35.25	0.7	\$28.16	3 years
\$35.26 – \$52.87	0.4	\$42.12	5 years
\$52.88 – \$70.69	1.1	\$59.32	5 years
Nonvested stock	0.1		
Total	2.8		

17. Postemployment Benefits

The Company sponsors several defined benefit pension plans (Pension Benefits) and health care and life insurance benefits (Other Benefits) for certain employees 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		
	1998	1997	1996	1998	1997	1996	1998	1997	1996
Service cost	\$16.4	\$ 7.8	\$ 9.0	\$ 4.4	\$ 2.5	\$ 2.8	\$ 26.7	\$ 0.3	\$ 0.4
Interest cost	29.9	14.0	15.0	19.2	10.5	10.8	100.7	1.9	2.5
Expected return on plan assets	(48.1)	(24.2)	(24.3)	—	—	—	(123.6)	—	—
Net amortization and deferral	(4.3)	(4.2)	(3.2)	(0.6)	(0.5)	(0.5)	—	—	—
Curtailment loss (gains)	1.6	—	3.7	—	—	(7.5)	—	—	—
Net periodic (benefit) cost	<u>\$ (4.5)</u>	<u>\$ (6.6)</u>	<u>\$ 0.2</u>	<u>\$ 23.0</u>	<u>\$ 12.5</u>	<u>\$ 5.6</u>	<u>\$ 3.8</u>	<u>\$ 2.2</u>	<u>\$ 2.9</u>

Change in benefit obligation:
(Millions of Dollars)

	United States Plans				International Plans	
	Pension Benefits		Other Benefits		Pension Benefits	
	1998	1997	1998	1997	1998	1997
Benefit obligation at beginning of year	\$197.2	\$211.1	\$150.4	\$150.8	\$ 26.6	\$ 34.5
Service cost	16.4	7.8	4.4	2.5	26.7	0.3
Interest cost	29.9	14.0	19.2	10.5	100.7	1.9
Acquisitions	496.7	—	297.3	—	1,834.3	—
Company contributions	—	—	—	—	13.3	—
Benefits paid	(26.0)	(20.6)	(15.0)	(8.2)	(124.3)	(1.7)
Plan amendments	9.9	—	—	—	—	—
Actuarial gains and losses and changes in actuarial assumptions	4.8	—	12.6	(5.2)	161.3	(3.5)
Settlements and curtailments	(11.4)	(15.1)	—	—	—	(4.9)
Benefit obligation at end of year	<u>\$ 717.5</u>	<u>\$ 197.2</u>	<u>\$ 468.9</u>	<u>\$ 150.4</u>	<u>\$ 2,038.6</u>	<u>\$ 26.6</u>

Change in plan assets:
(Millions of Dollars)

	United States Plans				International Plans	
	Pension Benefits		Other Benefits		Pension Benefits	
	1998	1997	1998	1997	1998	1997
Fair value of plan assets at beginning of year	\$293.7	\$262.6	\$ —	\$ —	\$ —	\$ —
Actual return on plan assets	25.3	61.8	—	—	157.6	—
Acquisitions	487.1	—	—	—	1,918.4	—
Company contributions	7.9	5.0	—	—	21.4	—
Benefits paid	(26.0)	(20.6)	—	—	(124.3)	1.7
Settlements and curtailments	(12.6)	(15.1)	—	—	—	(1.7)
Fair value of plan assets at end of year	<u>\$ 775.4</u>	<u>\$ 293.7</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,973.1</u>	<u>\$ —</u>
Funded status of the plan	\$ 57.9	\$ 96.5	\$ (468.9)	\$ (150.4)	\$ (65.5)	\$ (26.6)
Unrecognized net asset at transition	0.3	(2.0)	—	—	—	—
Unrecognized net actuarial (gain) loss	(30.1)	(60.3)	8.9	(3.8)	129.6	—
Unrecognized prior service cost	17.6	9.7	(2.9)	(3.5)	—	2.8
Prepaid (accrued) benefit cost	<u>\$ 45.7</u>	<u>\$ 43.9</u>	<u>\$ (462.9)</u>	<u>\$ (157.7)</u>	<u>\$ 64.1</u>	<u>\$ (23.8)</u>

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

	United States Plans				International Plans	
	Pension Benefits		Other Benefits		Pension Benefits	
	1998	1997	1998	1997	1998	1997
Discount rate	7.25%	7.5%	7.25%	7.5%	5.5-6%	6.5%
Expected return on plan assets	10%	10%	—	—	7.5%	—
Rate of compensation increase	4.25-5%	4.5%	—	—	2.5-3.9%	2.5%

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

United States Plans			International Plans		
	1998	1997		1998	1997
Projected benefit obligation	\$138.1	\$56.4	Projected benefit obligation	\$180.0	\$26.6
Accumulated benefit obligation	137.9	55.5	Accumulated benefit obligation	171.0	26.6
Fair value of plan assets	126.6	49.9	Fair value of plan assets	—	—

Amounts recognized in the balance sheet consist of:

	Pension Benefits		Other Benefits	
	1998	1997	1998	1997
Prepaid (accrued) benefit cost	\$109.8	\$20.1	\$ (462.9)	\$ (157.7)
Accrued benefit liability	(12.7)	(1.3)	—	—
Intangible asset	7.3	1.1	—	—
Accumulated other comprehensive income	3.4	0.1	—	—
Net amount recognized	<u>\$107.8</u>	<u>\$20.0</u>	<u>\$ (462.9)</u>	<u>\$ (157.7)</u>

At December 31, 1998, the assumed annual health care cost trend used in measuring the APBO approximated 7.1% in 1998, declining to 6.7% in 1999 and to an ultimate annual rate of 5.5% estimated to be achieved in 2009. Increasing the assumed cost trend rate by 1% each year would have increased the APBO by approximately 11.5% and 8.3% at December 31, 1998 and 1997, respectively. Aggregate service and interest costs would have increased by approximately 13.3% for 1998 and 9.4% for 1997 and 1996.

18. 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 (loss) before income taxes and extraordinary items consisted of the following:

	1998	1997	1996
	(Millions of Dollars)		
Domestic	\$ (73.4)	\$ 50.1	\$ (88.3)
International	258.9	49.4	(140.4)
	<u>\$185.5</u>	<u>\$99.5</u>	<u>\$(228.7)</u>

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

	1998	1997	1996
	(Millions of Dollars)		
Current:			
Federal	\$ (12.1)	\$ 9.6	\$ (4.0)
State and local	10.0	0.2	2.3
International	65.4	6.6	6.3
Total current	<u>63.3</u>	<u>16.4</u>	<u>4.6</u>
Deferred:			
Federal	33.0	6.1	(25.2)
State and local	2.1	0.7	(1.8)
International	(4.8)	4.3	—
Total deferred	<u>30.3</u>	<u>11.1</u>	<u>(27.0)</u>
	<u>\$ 93.6</u>	<u>\$ 27.5</u>	<u>\$ (22.4)</u>

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

	1998	1997	1996
	(Millions of Dollars)		
Income taxes (tax benefits)			
at United States statutory rate	\$64.9	\$34.9	\$(80.1)
Tax effect from:			
State income taxes	7.9	0.8	0.7
Foreign operations, net of foreign tax credits	5.6	(2.7)	55.9
Sale of international retail/wholesale operations	(11.5)	(6.8)	—
Goodwill amortization	19.7	—	—
Purchased in-process research and development	6.5	—	—
Tax credits and other	0.5	1.3	1.1
	<u>\$93.6</u>	<u>\$27.5</u>	<u>\$(22.4)</u>

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

	1998	1997	1996
	(Millions of Dollars)		
Income tax expense (benefit)	\$ 93.6	\$ 27.5	\$(22.4)
Extraordinary items	(19.8)	(1.5)	—
T&N Bearings Divestiture	56.1	—	—
Allocated to equity:			
Currency translation	15.3	(3.6)	(4.9)
Preferred dividends	(1.2)	(1.3)	(1.5)
Incentive stock plans	(3.9)	(3.4)	—
Investment securities	—	(0.6)	0.8
Other	0.2	1.2	0.7
	<u>\$140.3</u>	<u>\$18.3</u>	<u>\$(27.3)</u>

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

	1998	1997
	(Millions of Dollars)	
Deferred tax assets:		
Asbestos	\$429.1	\$ —
Postemployment benefits	165.2	58.2
Net operating loss carryforwards of international subsidiaries	121.5	45.0
Restructuring reserves	98.8	—
Inventory basis	34.2	10.3
Allowance for doubtful accounts	15.2	11.3
Other temporary differences	96.2	52.0
Total deferred tax assets	<u>960.2</u>	<u>176.8</u>
Valuation allowance for deferred tax assets	(66.2)	(44.4)
Net deferred tax assets	<u>894.0</u>	<u>132.4</u>
Deferred tax liabilities:		
Fixed asset basis differences	(379.4)	(50.5)
Intangible asset basis differences	(326.2)	—
Deferred gains	(130.0)	—
Pension	(6.9)	(17.3)
Total deferred tax liabilities	<u>(842.5)</u>	<u>(67.8)</u>
	<u>\$ 51.5</u>	<u>\$64.6</u>

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

	1998	1997
	(Millions of Dollars)	
Assets:		
Prepaid expenses and income tax benefits	\$187.3	\$46.6
Noncurrent assets	—	26.7
Liabilities:		
Other current accrued liabilities	—	(4.2)
Other long-term accrued liabilities	(135.8)	(4.5)
	<u>\$ 51.5</u>	<u>\$64.6</u>

Income taxes paid in 1998, 1997 and 1996 were \$34.7 million, \$2.6 million and \$6.7 million, respectively.

Undistributed earnings of the Company's international subsidiaries amounted to approximately \$229 million at December 31, 1998 and \$77 million at December 31, 1997. Since these earnings are considered by the Company to be permanently reinvested, no taxes were provided in 1998 or 1997. 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, 1998, the Company has \$159 million in net operating loss carryforwards in the United Kingdom and Germany with no expiration date or valuation allowance. Also, the Company has \$174 million of additional foreign net operating loss carryforwards with a full valuation allowance and various expiration dates. Included in the previous amounts are \$145 million of net operating loss carryforwards acquired with the purchases of T&N, Cooper Automotive and Fel-Pro. A valuation allowance was recorded on \$64 million of these purchased net operating loss carryforwards, thereby increasing the balance in the valuation allowance reserve for 1998. The reduction in these valuation allowances, if any, will be applied to reduce goodwill related to the respective acquisitions.

19. Operations By Industry Segment and Geographic Area

In 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131 (Statement 131), *Disclosures about Segments of an Enterprise and Related Information*, for the year ended December 31, 1998. Statement 131 established standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports issued to stockholders. It also established standards for related disclosures about products, services and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the Company, in deciding how to allocate resources and in assessing performance.

The Company operates in three fundamental business segments (excluding Divested Activities): Powertrain Systems, Sealing Systems and General Products.

Powertrain Systems, which consist of internal engine components directly involved in creating a vehicle's movement. These components consist primarily of engine bearings, bushings, pistons, piston pins, rings, liners and ignition products.

Sealing Systems, which provide for the encapsulation of fluids and gases from the engine, transmission and axle and also prevent external objects from entering the systems. They consist of dynamic seals (found between components that move in relation to one another) and gaskets (located between components that are static in relation to one another).

General Products, which consist of the Company's remaining product lines, primarily camshafts, sintered products (engine components made from

powdered metal), chassis components and systems protection products (used for shielding against heat, noise, abrasion and stone impingement) and friction products.

Divested Activities include the historical operating results and assets of aftermarket operations in South Africa, Australia, Chile and its heavy wall bearing operations in Germany and Brazil which were sold or closed in 1997. During 1996, the Company divested its United States ball bearings and electrical products manufacturing operations. In addition, the Company divested its minority interest in G. Bruss GmbH & Co. (refer to Note 3, "Sales of Businesses").

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, as defined as Operational Earnings before certain nonrecurring items (such as certain purchase accounting adjustments and integration costs associated with new acquisitions), interest and income taxes. Pursuant to Statement 131, Operational EBIT for each segment is shown below, as it is most consistent with the measurement principles used in measuring the corresponding amounts in the consolidated financial statements.

	1998	1997	1996
	(Millions of Dollars)		
Net Sales:			
Powertrain Systems	\$ 1,883	\$ 782	\$ 739
Sealing Systems	925	333	295
General Products	1,636	577	665
Divested Activities	25	115	334
Total	\$ 4,469	\$ 1,807	\$ 2,033

	1998	1997	1996
	(Millions of Dollars)		
Operational EBIT:			
Powertrain Systems	\$ 223	\$ 68	\$ 75
Sealing Systems	133	26	9
General Products	154	44	31
Divested Activities	(8)	1	(22)
Total	\$ 502	\$ 139	\$ 93

	1998	1997	1996
	(Millions of Dollars)		
Reconciliation:			
Total segments operational EBIT	\$ 502	\$ 139	\$ 93
Net interest and other financing costs	(233)	(29)	(39)
Restructuring, impairment and other special charges	(20)	(10)	(283)
Acquisition related costs	(63)	—	—
Earnings (loss) before income taxes and extraordinary item	\$ 186	\$ 100	\$ (229)

	1998	1997	1996
	(Millions of Dollars)		
Assets:			
Powertrain Systems	\$3,590	\$ 786	\$ 608
Sealing Systems	1,640	382	243
General Products	4,687	508	456
Divested Activities	23	126	148
Total	\$9,940	\$1,802	\$1,455

	1998	1997	1996
	(Millions of Dollars)		
Capital Expenditures:			
Powertrain Systems	\$ 116	\$ 28	\$ 25
Sealing Systems	33	13	10
General Products	80	9	10
Divested Activities	—	—	9
Total	\$ 229	\$ 50	\$ 54

	1998	1997	1996
	(Millions of Dollars)		
Depreciation and Amortization:			
Powertrain Systems	\$ 104	\$ 28	\$ 27
Sealing Systems	43	11	10
General Products	81	12	14
Divested Activities	—	1	11
Total	\$ 228	\$ 52	\$ 62

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		
	1998	1997	1996	1998	1997	1996
	(Millions of Dollars)					
United States	\$2,345	\$1,111	\$1,177	\$1,422	\$166	\$169
Mexico	124	87	73	30	7	7
Canada	76	58	57	39	1	1
Total North America	2,545	1,256	1,307	1,491	174	177
United Kingdom	516	21	18	312	9	11
Germany	478	126	175	318	105	127
France	327	33	35	113	9	10
Italy	200	71	81	77	9	11
Other Europe	188	117	122	62	3	4
Total Europe	1,709	368	431	882	135	163
Rest of World	215	183	295	104	5	10
Total	\$4,469	\$1,807	\$2,033	\$2,477	\$314	\$350

20. Litigation and Environmental Matters

T&N Asbestos Litigation

In the United States, the Company's United Kingdom subsidiary, T&N Ltd., and two of T&N's United States subsidiaries (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 to property damage litigation in the United States based upon asbestos products allegedly installed in buildings. 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 expenditure which may arise therefrom. As of December 31, 1998, the Company has provided approximately \$1.3 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.

As of December 31, 1998, the T&N Companies had approximately 105,000 claims pending. During 1998, approximately 85,000 new claims were filed and 54,000 claims were settled, dismissed or otherwise resolved. In addition to the pending cases above, the T&N Companies have approximately

41,000 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.

As of December 31, 1998, T&N is one of a large number of defendants named in three pending property damage cases pending in two jurisdictions. Provision has been made in the asbestos reserve for anticipated expenditures in relation to such cases.

The \$1.3 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, 1998, the \$1.3 billion total provision is comprised of approximately \$460 million related to known claims and approximately \$840 million related to IBNR claims.

In arriving at the IBNR provision, assumptions have been made regarding the total number of claims which it is anticipated may 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.

The T&N Companies have appointed the Center for Claims Resolution (CCR) as their exclusive representative in relation to all asbestos-related personal injury claims made against the T&N Companies in the United States. The CCR provides to its 20 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 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.

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 amount 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 Company's reserve for claims filed after June 30, 1996, approximates to 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 T&N's asbestos-related claims, given the nature and complexity of the factors affecting the estimated liability, the actual liability may differ. No absolute assurances can be given that T&N 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 T&N Companies reserves will be reevaluated periodically as additional information becomes available.

Federal-Mogul, Fel-Pro and Cooper Automotive Asbestos Litigation

The Company also is one of a large number of defendants in a number of lawsuits brought by claimants alleging injury due to exposure to asbestos. Fel-Pro has been named as a defendant in a number of product liability cases involving asbestos, primarily involving gasket or packing products sold to ship owners. In addition, subsidiaries of Cooper Automotive have been named as defendants in a number of product liability cases involving asbestos, primarily involving friction products. The Company is defending all such claims vigorously and believes that it, Fel-Pro and the Cooper Automotive subsidiaries 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, Fel-Pro and the Cooper Automotive subsidiaries as of December 31, 1998, will not have a material effect on the Company's financial position. At December 31, 1998, approximately \$20 million in related reserves have been provided in respect of the possible uninsured portion of the expenditures on asbestos claims pending against the Company, Fel-Pro and the Cooper Automotive subsidiaries.

Other

The Company is involved in various other legal actions and claims, directly and through its subsidiaries (including T&N Limited and Fel-Pro). After taking into consideration legal counsel's evaluation of such actions, management is of the opinion that its outcomes are not reasonably likely to have a material adverse affect on the Company's financial position, operating results or cash flows.

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 and legal reserve was approximately \$50 million at December 31, 1998 and \$11 million at December 31, 1997. The majority of the 1998 increase is attributable to the acquisitions of T&N and Cooper Automotive. Management believes that such accruals will be adequate to cover the Company's estimated liability for its exposure in respect of such matters.

21. Quarterly Financial Data (Unaudited)

	First ⁽¹⁾	Second ⁽²⁾	Third ⁽³⁾	Fourth ⁽⁴⁾	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 item - loss on early retirement of debt, net of tax benefit	—	(31.3)	—	(6.9)	(38.2)
Net earnings (loss)	(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	
	First	Second ⁽⁵⁾	Third	Fourth ⁽⁶⁾	Year
	(Millions of Dollars, Except Per Share Amounts)				
Year ended December 31, 1997:					
Net sales	\$485.6	\$ 481.8	\$ 424.2	\$ 415.0	\$1,806.6
Gross margin	112.1	115.3	102.8	94.6	424.8
Net earnings before extraordinary item	13.9	28.5	17.4	12.2	72.0
Extraordinary item - loss on early retirement of debt, net of tax benefit	—	(2.6)	—	—	(2.6)
Net earnings	13.9	25.9	17.4	12.2	69.4
Diluted earnings per share	.32	.61	.40	.28	1.61
Stock price					
High	\$26.75	\$ 35.38	\$ 39.94	\$ 47.63	
Low	\$21.63	\$ 24.50	\$ 32.75	\$ 36.75	

Dividends on the capital stock of the Company are payable at the discretion of the Company's Board of Directors. In May 1998, the Board of Directors reduced the quarterly dividend from \$.12 per share and subsequently declared cash dividends payable in the second, third and fourth quarters of 1998 in the amount of \$.0025 per share of common stock. The Company, consistent with its growth strategy, intends to retain future earnings in the business and therefore anticipates paying dividends at a comparable level in the foreseeable future.

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

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

(3) Includes \$9.0 million of integration costs and a \$6.6 million restructuring credit

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

(5) Includes an income tax benefit of \$6.8 million related to the sales of the South African and Australian businesses.

(6) Includes \$1.1 million for a net restructuring credit, a \$2.4 million charge for adjustment of assets held for sale 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.

22. Audited Consolidating Condensed Financial Information of Guarantor Subsidiaries

Certain subsidiaries of the Company (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 \$1.0 billion of bonds on June 25, 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, 1998 Form 10-K, filed with the Securities and Exchange Commission.

23. Subsequent Events

On January 7, 1999, the Company announced that it has agreed to acquire the piston division of Alcan Deutschland GmbH in Germany, a subsidiary of Alcan Aluminum Limited in Canada. Alcan's piston division manufactures high quality pistons for passenger cars and commercial vehicles under the highly regarded Nural brand name. The piston division employs approximately 1,100 people at its manufacturing facility in Nuremberg, Germany with annual sales in excess of \$150 million.

On January 14, 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 will recognize an extraordinary charge in the first quarter of 1999 of approximately \$8 million, net of tax, related to early extinguishment of debt.

On January 20, 1999, the Company completed its acquisition of two camshaft machining plants from Crane Technologies Group Inc. to expand the capacity of its automotive products lines. The two plants located in Orland, Indiana and Jackson, Michigan employ approximately 230 people and have annual sales of approximately \$36 million.

On February 24, 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.

As a result of these transactions, the Company will recognize an extraordinary charge in the first quarter of 1999 of approximately \$15 million, net of tax, related to early extinguishment of debt.

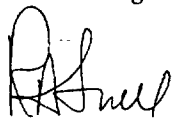
On February 24, 1999, all outstanding shares of the Company's Series E Stock were exchanged into shares of the Company's common stock. Each of the 607,745 remaining shares of the Series E Stock were exchanged into five shares of the Company's common stock.

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 four 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



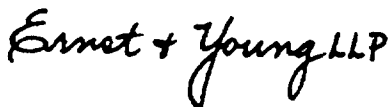
Tom Ryan
Executive Vice President and
Chief Financial Officer

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, 1998 and 1997, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. 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 generally accepted auditing standards. 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, 1998 and 1997, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.



Detroit, Michigan
February 3, 1999,
except for Note 23, as to which
the date is February 24, 1999

SHAREOWNER INFORMATION

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 10:30 a.m. on Wednesday, April 21, 1999 at Federal-Mogul World Headquarters.

Stock Listing

New York Stock Exchange
Ticker Symbol: FMO

Investor Relations

Investors and security analysts should contact:
Bonnie J. Price
Vice President - Investor Relations
Telephone: (248) 354-8847 Fax: (248) 354-7769
E-mail: Bonnie_Price@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 Security 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 1998 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 Shareholder 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, 1998, the company had 67,450,799 shares of common stock outstanding owned by 8,463 shareholders of record. Management estimates there are an additional 12,000 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 Dividend Reinvestment Department
P.O. Box 11260, Church Street Station
New York, New York 10277-0760 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 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
4Q 1997	47 5/8	36 3/4	40 1/2
3Q 1997	39 15/16	32 3/4	37 1/8
2Q 1997	35 3/8	24 1/2	35
1Q 1997	26 3/4	21 5/8	24 5/8

MEDIA INFORMATION

Journalists and media representatives should contact:

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Vice President - Corporate Communications
Federal-Mogul Corporation
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Southfield, Michigan 48034 USA
Telephone: (248) 354-1916
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E-mail: Kim_Welch@fmo.com

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People serving
customers through
manufacturing mastery.

Core Values

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.

Federal-Mogul Corporation
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<http://www.federal-mogul.com>

We
celebrate
our
success.

