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

Dollars in millions

Selling, general and administrative expenses (SG&A) decreased $60 in 2000, slightly exceeding the $56 attributed to the net effect of divestitures and acquisitions. DCC increased its general and administrative expenses by $9 with higher depreciation on leased assets and expenses related to a real estate investment being the largest components. SG&A as a percentage of sales was 9.2% in 2000 and 9.1% in 1999.

Interest expense rose $44 or nearly 16% in 2000 as overall debt increased by almost 11%. Average short-term borrowings rose $452 to $1,614 and the average interest rate increased from 5.4% to 6.6%.

Our effective tax rate was 36.8% in 2000. We continue to benefit from tax credits generated by our leasing operations and from relatively low state and local tax rates.

Minority interest was unchanged in 2000. The minority interest in the gain recognized by Albarus S.A. on the sale of its interest in one of its affiliates was generally offset by the absence of the minority interest's participation in operating earnings.

We recorded $54 of equity in the earnings of our affiliates in 2000. Increased earnings at our affiliate in Mexico and expansion of the portion of leasing revenue earned on DCC's equity investments more than offset the $27 loss recorded in the fourth quarter at our 49%-owned affiliate in Venezuela.

Net income was $334 in 2000 versus $513 reported in 1999. Comparisons are made difficult by restructuring and other unusual items recorded in both years. In 1999 we recorded $165 of such charges net of the gain recorded in the AAG on the sale of Sierra. In 2000, we recorded $43 of restructuring and other unusual charges net of the gains recorded on several divestitures. Excluding these items, earnings would have been $377 in 2000 and $678 in 1999.

Unusual items in 2000 included net charges of $47 in ASG, $39 in AAG, $32 in EFMG and net credits of $27 in CVS and $16 in OHSG; a net gain of $32 was reflected in the Other category. In 1999, unusual charges were $59 in ASG, $40 in AAG, $3 in CVS, $34 in EFMG, $1 in OHSG and $28 in Other.

Market Trends

The light vehicle market in North America is difficult to project as we pass the midpoint in the first quarter of 2002. One uncertainty is the impact that the record incentives offered in the fourth quarter of 2001 will have on future retail sales volume. Absent broader economic recovery, demand may weaken in the first half of 2002. We remain conservative in projecting light vehicle production of 14.5 million units in North America in 2002. No improvement is anticipated in the light vehicular markets outside North America in 2002.

The automotive aftermarket continues to demonstrate strength at the retail level. As our customers resolve their consolidation and inventory reduction issues, which adversely affected our AAG sales inthe second half of 2001, we expect increased demand for our products in 2002. Combined with the effect of price increases implemented in recent months and others planned for this year, we expect the increase in demand to result in modest growth in our automotive aftermarket business during 2002.

Inventory levels in the heavy truck market declined by nearly 50% in 2001, while production for the year was down more than 40%. The inventory reduction was a prerequisite for the leveling out expected in this market. Although preliminary orders for heavy trucks reported for January 2002 were at their highest level in nearly two years, they represent relatively modest improvement on an historic scale. The new EPA standards governing diesel engine emissions that become effective in October 2002 could impact the timing of 2002 production if customers rush to buy units in advance of the new standards. This possibility may make it difficult for us to interpret the monthly volume of orders and production, but we expect North American heavy truck volume to approximate 130,000 units for the year.

We expect to benefit from net new business estimated at $405 for 2002 and approximately $6,000 through 2006, based on our review of the production projections of our OE customers. New business wins in 2001 included innovative products for Ford and General Motors, as well as for non-U.S.-based manufacturers, including BMW, Isuzu, Nissan, Toyota and Volkswagen. In the heavy truck market, key wins in 2001 included business with International and PACCAR.

Forward-Looking Information

Forward-looking statements in this report are indicated by words such as "anticipates," "expects," "believes," "intends," "plans," "estimates," "projects" and similar expressions. These statements represent our expectations based on current information and assumptions. Forward-looking statements are inherently subject to risks and uncertainties. Our actual results could differ materially from those which are anticipated or projected due to a number of factors, including national and international economic conditions (including additional adverse effects from terrorism or hostilities); the strength of the euro and other currencies relative to the U.S. dollar; the cyclical nature of the global vehicular industry; the performance of the global aftermarket sector; changes in business relationships with our major customers and in the timing, size and continuation of our customers' programs; the ability of our customers and suppliers to achieve their projected sales and production levels; competitive pressures on our sales and pricing; increases in production or material costs that cannot be recouped in product pricing; our ability to complete the sale of DCC's businesses and other divestitures as contemplated; and the success of our restructuring, cost reduction and cash management programs and of our long-term transformation strategy for the company.