BORGWARNER INC
Form 10-Q
April 26, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

QUARTERLY REPORT

(Mark One)

_X_ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2007
OR
___ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ____________ to ____________

Commission file number: 1-12162

BORGWARNER INC.
(Exact name of registrant as specified in its charter)

Delaware	13-3404508
State or other jurisdiction of Incorporation or organization	(I.R.S. Employer Identification No.)

3850 Hamlin Road, Auburn Hills, Michigan 48326
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (248) 754-9200

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **YES _X_ NO ___**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer_X_ Accelerated Filer___ Non-Accelerated Filer___

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES ___ NO _X_

On March 31, 2007, the registrant had 58,027,699 shares of Common Stock outstanding.

BORGWARNER INC.
FORM 10-Q
THREE MONTHS ENDED MARCH 31, 2007

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PART I. FINANCIAL INFORMATION

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(millions of dollars)

	March 31, 2007 (Unaudited)	December 31, 2006
ASSETS		
Cash	$ 118.1	$ 123.3
Marketable securities	58.0	59.1
Receivables	795.4	744.0
Inventories	425.0	386.9
Deferred income taxes	36.9	33.7
Prepayments and other current assets	101.1	90.5
Total current assets	1,534.5	1,437.5
Property, plant & equipment, net	1,460.6	1,460.7
Investments & advances	215.8	198.0
Goodwill	1,090.5	1,086.5
Other non-current assets	403.9	401.3
Total other assets	1,710.2	1,685.8
Total assets	$ 4,705.3	$ 4,584.0
LIABILITIES AND STOCKHOLDERS' EQUITY		
Notes payable	$ 113.4	$ 151.7
Accounts payable and accrued expenses	899.5	843.4
Income taxes payable	39.5	39.7
Total current liabilities	1,052.4	1,034.8
Long-term debt	581.6	569.4
Other non-current liabilities:		
Retirement-related liabilities	664.8	660.9
Other	302.2	281.4
Total other non-current liabilities	967.0	942.3
Minority interest in consolidated subsidiaries	152.4	162.1
Common stock	0.6	0.6
Capital in excess of par value	895.6	871.1
Retained earnings	1,096.1	1,064.1
Accumulated other comprehensive loss	(40.3)	(60.3)
Treasury stock	(0.1)	(0.1)
Total stockholders' equity	1,951.9	1,875.4
Total liabilities and stockholders' equity	$ 4,705.3	$ 4,584.0

See accompanying Notes to Condensed Consolidated Financial Statements

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(millions of dollars, except share and per share data)

	Three Months Ended March 31,	
	2007	**2006**
Net sales	$ 1,277.8	$ 1,155.2
Cost of sales	1,061.9	931.9
Gross profit	215.9	223.3
Selling, general and administrative expenses	126.7	129.5
Other income	(0.7)	(0.5)
Operating income	89.9	94.3
Equity in affiliates' earnings, net of tax	(9.2)	(10.0)
Interest expense and finance charges	8.9	9.4
Earnings before income taxes and minority interest	90.2	94.9
Provision for income taxes	24.4	26.6
Minority interest, net of tax	7.4	7.0
Net earnings	$ 58.4	$ 61.3
Earnings per share - basic	$ 1.01	$ 1.07
Earnings per share - diluted	$ 1.00	$ 1.06
Weighted average shares outstanding (thousands):		
Basic	57,916	57,181
Diluted	58,619	57,758
Dividends declared per share	$ 0.17	$ 0.16

See accompanying Notes to Condensed Consolidated Financial Statements

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(millions of dollars)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
OPERATING		
Net earnings	$ 58.4	$ 61.3
Adjustments to reconcile net earnings to net cash flows from operations:		
Non-cash charges (credits) to operations:		
Depreciation and tooling amortization	60.2	57.9
Amortization of intangible assets and other	4.1	3.2
Stock option compensation expense	4.2	2.9
Deferred income tax benefit	(7.0)	(2.6)
Equity in affiliates' earnings, net of dividends received, minority interest and other	6.8	2.5
Net earnings adjusted for non-cash charges (credits) to operations	126.7	125.2
Changes in assets and liabilities:		
Receivables	(45.3)	(67.3)
Inventories	(35.3)	(4.3)
Prepayments and other current assets	(12.2)	3.7
Accounts payable and accrued expenses	49.9	(0.3)
Income taxes payable	(0.5)	3.0
Other non-current assets and liabilities	(0.7)	(11.9)
Net cash provided by operating activities	82.6	48.1
INVESTING		
Capital expenditures, including tooling outlays	(58.3)	(70.3)
Net proceeds from asset disposals	2.1	1.1
Purchases of marketable securities	(12.5)	(24.1)
Proceeds from sales of marketable securities	14.4	-
Net cash used in investing activities	(54.3)	(93.3)
FINANCING		
Net decrease in notes payable	(39.7)	(36.8)
Additions to long-term debt	20.0	125.6
Repayments of long-term debt	(7.5)	(54.3)
Proceeds from stock options exercised	13.1	2.4
Dividends paid to BorgWarner stockholders	(9.8)	(9.1)
Dividends paid to minority shareholders	(10.9)	(9.1)
Net cash (used in) provided by financing activities	(34.8)	18.7
Effect of exchange rate changes on cash	1.3	(6.4)
Net decrease in cash	(5.2)	(32.9)
Cash at beginning of year	123.3	89.7
Cash at end of period	$ 118.1	$ 56.8
SUPPLEMENTAL CASH FLOW INFORMATION		
Net cash paid during the period for:		

Interest	$	11.8	$	11.0
Income taxes		27.4		21.9
Non-cash financing transactions:				
Issuance of common stock for stock performance plans		2.3		2.7

See accompanying Notes to Condensed Consolidated Financial Statements

BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) Basis of Presentation

The accompanying Condensed Consolidated Financial Statements of BorgWarner Inc. and Consolidated Subsidiaries (the "Company") have been prepared in accordance with the instructions to Form 10-Q under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The statements are unaudited but include all adjustments, consisting only of recurring items, except as noted, which the Company considers necessary for a fair presentation of the information set forth herein. The December 31, 2006 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP"). The results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the entire year.

(2) Research and Development

The following table presents the Company's gross and net expenditures on research and development ("R&D") activities:

(Millions) Three months ended March 31,		**2007**		**2006**
Gross R&D expenditures	$	60.5	$	53.5
Customer reimbursements		(9.6)		(7.5)
Net R&D expenditures	$	50.9	$	46.0

The Company's net R&D expenditures are included in the selling, general and administrative expenses of the Condensed Consolidated Statements of Operations. Customer reimbursements are netted against gross R&D expenditures upon billing of services performed. The Company has contracts with several customers at the Company's various R&D locations. No such contract exceeded $6 million in any of the periods presented.

(3) Income Taxes

The Company's provision for income taxes is based upon an estimated annual tax rate for the year applied to federal, state and foreign income. The projected effective tax rate of 27.0% for 2007 differs from the U.S. statutory rate primarily due to foreign rates, which differ from those in the U.S., the realization of certain business tax credits including R&D and foreign tax credits and favorable permanent differences between book and tax treatment for items, including equity in affiliates' earnings and a Medicare prescription drug benefit. This rate is expected to be greater than the full year 2006 effective tax rate of 12.0% because the 2006 rate included the release of tax accrual accounts upon conclusion of certain tax audits, the tax effects of dispositions and adjustments to various tax accounts, including changes in tax laws.

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a $16.6 million reduction to the January 1, 2007 balance of retained earnings.

At January 1, 2007, the balance of gross unrecognized tax benefits is $50.5 million. Included in the balance at January 1, 2007 are $43.1 million of tax positions that are permanent in nature and, if recognized, would reduce the effective tax rate. However, the Company's federal, certain state and certain non-U.S. income tax returns are currently under various stages of audit by applicable tax authorities and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year. It is not possible to reasonably estimate any possible change in the unrecognized tax benefits within the next 12 months.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. The Company is no longer subject to income tax examinations by tax authorities in its major tax jurisdictions as follows:

Tax Jurisdiction	Years No Longer Subject to Audit
U.S. federal	2001 and prior
Brazil	2000 and prior
France	2002 and prior
Germany	2002 and prior
Hungary	2004 and prior
Italy	2000 and prior
Japan	2002 and prior
South Korea	2004 and prior
United Kingdom	2003 and prior

In certain tax jurisdictions the Company may have more than one taxpayer. The table above reflects the status of the major taxpayers in each major tax jurisdiction.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. The Company had $5.3 million accrued at January 1, 2007 for the payment of any such interest and penalties.

(4) Marketable Securities

As of March 31, 2007 and December 31, 2006, the Company held $58.0 million and $59.1 million, respectively, of highly liquid investments in marketable securities, primarily bank notes. The securities are carried at fair value with the unrealized gain or loss, net of tax, reported in other comprehensive income. As of March 31, 2007 and December 31, 2006, $44.2 million and $45.5 million of the contractual maturities are within one to five years and $13.8 million and $13.6 million are due beyond five years, respectively. The Company does not intend to hold these investments until maturity; rather, they are available to support current operations if needed.

(5) Sales of Receivables

The Company securitizes and sells certain receivables through third party financial institutions without recourse. The amount sold can vary each month based on the amount of underlying receivables. At both March 31, 2007 and 2006, the Company had sold $50 million of receivables under a Receivables Transfer Agreement for face value without recourse. During both of the three-month periods ended March 31, 2007 and 2006, total cash proceeds from sales of accounts receivable were $150 million. The Company paid servicing fees related to these receivables of $0.7 million and $0.6 million for the three months ended March 31, 2007 and 2006, respectively. These amounts are recorded in interest expense and finance charges in the Condensed Consolidated Statements of Operations.

(6) Inventories

Inventories are valued at the lower of cost or market. The cost of U.S. inventories is determined by the last-in, first-out ("LIFO") method, while the operations outside the U.S. use the first-in, first-out ("FIFO") or average-cost methods. Inventories consisted of the following:

(Millions)	March 31, 2007	December 31, 2006
Raw material and supplies	$ 215.2	$ 207.4
Work in progress	108.1	100.0
Finished goods	115.3	91.9
FIFO inventories	438.6	399.3
LIFO reserve	(13.6)	(12.4)
Net inventories	$ 425.0	$ 386.9

(7) Property, plant & equipment

(Millions)	March 31, 2007	December 31, 2006
Land and buildings	$ 551.3	$ 552.3
Machinery and equipment	1,695.0	1,687.8
Capital leases	1.1	1.1
Construction in progress	125.8	112.8
Total property, plant & equipment	2,373.2	2,354.0
Less accumulated depreciation	(1,006.2)	(988.4)
	1,367.0	1,365.6
Tooling, net of amortization	93.6	95.1
Property, plant & equipment - net	$ 1,460.6	$ 1,460.7

Interest costs capitalized during the three-month periods ended March 31, 2007 and March 31, 2006 were $2.0 million and $1.7 million, respectively.

As of March 31, 2007 and December 31, 2006, accounts payable of $28.4 million and $36.0 million, respectively, were related to property, plant and equipment purchases.

As of March 31, 2007 and December 31, 2006, specific assets of $21.5 million and $21.3 million, respectively, were pledged as collateral under certain of the Company's long-term debt agreements.

(8) Product Warranty

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

(Millions)	Three months ended March 31, 2007	2006
Beginning balance	$ 60.0	$ 44.0
Provision	24.9	5.6
Payments	(5.6)	(6.8)
Currency translation	0.5	1.7
Ending balance	$ 79.8	$ 44.5

Contained within the provision recognized in the three months ended March 31, 2007 is approximately $14 million for a warranty-related issue surrounding a product, built during a 15-month period in 2004 and 2005, that is no longer in production.

(9) Notes Payable and Long-Term Debt

Following is a summary of notes payable and long-term debt. The weighted average interest rate on all borrowings outstanding as of March 31, 2007 and December 31, 2006 was 4.9%.

(Millions)	March 31, 2007		December 31, 2006	
December 31,	Current	Long-Term	Current	Long-Term
Bank borrowings and other	$ 70.0	$ 15.6	$ 131.8	$ 5.9
Term loans due through 2013 (at an average rate of 2.6% in 2007 and 3.0% in 2006)	43.4	25.8	19.9	23.1
5.75% Senior Notes due 11/01/16, net of unamortized discount (a)	-	149.1	-	149.0
6.50% Senior Notes due 02/15/09, net of unamortized discount (a)	-	136.4	-	136.4
8.00% Senior Notes due 10/01/19, net of unamortized discount (a)	-	133.9	-	133.9
7.125% Senior Notes due 02/15/29, net of unamortized discount	-	119.2	-	119.2
Carrying amount of notes payable and long-term debt	113.4	580.0	151.7	567.5

Impact of derivatives on debt		-		1.6		-		1.9
Total notes payable and long-term debt	$	113.4	$	581.6	$	151.7	$	569.4

(a) The Company entered into several interest rate swaps, which have the effect of converting $325.0 million of these fixed rate notes to variable rates as of March 31, 2007 and December 31, 2006. The weighted average effective inerest rates for these borrowings, including the effects of outstanding swaps as noted in Note 10, were 4.6% and 4.5% as of March 31, 2007 and December 31, 2006, respectively.

The Company has a multi-currency revolving credit facility, which provides for borrowings up to $600 million through July 2009. At March 31, 2007, $10.0 million of borrowings under the facility were outstanding. At December 31, 2006, there were no borrowings outstanding under the facility. The credit agreement is subject to the usual terms and conditions applied by banks to an investment grade company. The Company was in compliance with all covenants at March 31, 2007 and expects to be compliant in future periods. The Company had outstanding letters of credit of $25.8 million at March 31, 2007 and $27.0 million at December 31, 2006. The letters of credit typically act as a guarantee of payment to certain third parties in accordance with specified terms and conditions.

As of March 31, 2007 and December 31, 2006, the estimated fair values of the Company's senior unsecured notes totaled $572.8 million and $572.7 million, respectively. The estimated fair values were $34.2 million higher at March 31, 2007 and December 31, 2006 than their respective carrying values. Fair market values are developed by the use of estimates obtained from brokers and other appropriate valuation techniques based on information available as of year-end. The fair value estimates do not necessarily reflect the values the Company could realize in the current markets.

(10) Financial Instruments

The Company's financial instruments include cash, marketable securities, trade receivables, trade payables, and notes payable. Due to the short-term nature of these instruments, the book value approximates fair value. The Company's financial instruments also include long-term debt, interest rate and currency swaps, commodity swap contracts, and foreign currency forward contracts. All derivative contracts are placed with counterparties that have a credit rating of "A-" or better.

The Company manages its interest rate risk by balancing its exposure to fixed and variable rates while attempting to minimize its interest costs. The Company selectively uses interest rate swaps to reduce market value risk associated with changes in interest rates (fair value hedges). The Company also selectively uses cross-currency swaps to hedge the foreign currency exposure associated with our net investment in certain foreign operations (net investment hedges).

A summary of these instruments outstanding at March 31, 2007 follows (currency in millions):

	Hedge Type		Notional Amount	Maturity (a)
Interest rate swaps				
Fixed to floating	Fair value	$	100	February 15, 2009
Fixed to floating	Fair value	$	150	November 1, 2016
Fixed to floating	Fair value	$	75	October 1, 2019
Cross currency swap				
Floating $ to floating €	Net Investment	$	100	February 15, 2009
Floating $ to floating ¥	Net Investment	$	150	November 1, 2016
Floating $ to floating €	Net Investment	$	75	October 1, 2019

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

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Effectiveness for interest rate and cross currency swaps is assessed at the inception of the hedging relationship. If specified criteria for the assumption of effectiveness are not met at hedge inception, effectiveness is assessed quarterly. Ineffectiveness is measured quarterly and results are recognized in earnings.

The interest rate swaps that are fair value hedges were determined to be exempt from ongoing tests of their effectiveness as hedges at the time of the hedge inception. This determination was made based upon the fact that the swaps matched the underlying debt terms for the following factors: notional amount, fixed interest rate, interest settlement dates, and maturity date. Additionally, the fair value of the swap was zero at the time of inception, the variable rate is based on a benchmark, with no floor or ceiling, and the interest bearing liability is not pre-payable at a price other than its fair value.

As of March 31, 2007, the fair values of the fixed to floating interest rate swaps were recorded as a current asset of $1.7 million and a current liability of $(0.1) million. As of December 31, 2006, the fair values of the fixed to floating interest rate swaps were recorded as a non-current asset of $1.9 million. No hedge ineffectiveness was recognized in relation to fixed to floating swaps. Fair values are based on quoted market prices for contracts with similar maturities.

As of March 31, 2007, the fair values of the cross currency swaps were recorded as a non-current asset of $0.3 million and a non-current liability of $(7.8) million. As of December 31, 2006, the fair values of the cross currency swaps were recorded as a non-current asset of $1.7 million and a non-current liability of $(5.5) million. Hedge ineffectiveness of $0.9 million was recognized as of March 31, 2007 in relation to cross currency swaps. Fair values are based on quoted market prices for contracts with similar maturities.

The Company also entered into certain commodity derivative instruments to protect against commodity price changes related to forecasted raw material and supplies purchases. The primary purpose of the commodity price hedging activities is to manage the volatility associated with these forecasted purchases. The Company primarily utilizes forward and option contracts, which are designated as cash flow hedges. As of March 31, 2007, the Company had forward and option commodity contracts with a total notional value of $41.0 million. As of March 31, 2007, the Company was holding commodity derivatives with positive and negative fair market values of $3.2 million and $(0.5) million, respectively ($3.0 million gains and ($0.2) million losses mature in less than one year). To the extent that derivative instruments are deemed to be effective as defined by FAS 133, gains and losses arising from these contracts are deferred in other comprehensive income. Such gains and losses will be reclassified into income as the underlying operating transactions are realized. Gains and losses not qualifying for deferral treatment have been credited/charged to income as they are recognized. As of December 31, 2006, the Company had forward and option commodity contracts with a total notional value of $19.1 million. The fair market values of the forward contracts were negative ($2.0) million ($(1.9) million losses maturing in less than one year). Losses not qualifying for deferral associated with these contracts for March 31, 2007 were negligible. At December 31, 2006, losses not qualifying for deferral were $(0.1) million.

The Company uses foreign exchange forward and option contracts to protect against exchange rate movements for forecasted cash flows for purchases, operating expenses or sales transactions designated in currencies other than the functional currency of the operating unit. Most contracts mature in less than one year, however certain long-term commitments are covered by forward currency arrangements to protect against currency risk through 2009. Foreign currency contracts require the Company, at a future date, to either buy or sell foreign currency in exchange for the operating units' local currency. At March 31, 2007, contracts were outstanding to buy or sell U.S. Dollars, Euros, British Pounds Sterling, South Korean Won,

Japanese Yen and Hungarian Forints. To the extent that derivative instruments are deemed to be effective as defined by FAS 133, gains and losses arising from these contracts are deferred in other comprehensive income. Such gains and losses will be reclassified into income as the underlying operating transactions are realized. Any gains or losses not qualifying for deferral are credited/charged to income as they are recognized. As of March 31, 2007, the Company was holding foreign exchange derivatives with a positive market value of $4.4 million ($3.1 million maturing in less than one year). Derivative contracts with negative value amounted to $(0.6) million ($(0.5) million maturing in less than one year). As of December 31, 2006, the Company was holding foreign exchange derivatives with a positive market value of $5.1 million ($4.5 million maturing in less than one year). Derivatives contracts with negative value amounted to $(0.1) million (all maturing in less than one year). Losses not qualifying for deferral associated with these contracts as of March 31, 2007 were negligible. As of December 31, 2006, gains not qualifying for deferral amounted to $0.7 million.

(11) Retirement Benefit Plans

The Company has a number of defined benefit pension plans and other post employment benefit plans covering eligible salaried and hourly employees. The other post employment benefits plans, which provide medical and life insurance benefits, are unfunded plans. The estimated contributions to pension plans for 2007 range from $10 to $20 million, of which $2.6 million has been contributed through the first three months of the year. The components of net periodic benefit cost recorded in the Company's Condensed Consolidated Statements of Operations, are as follows:

(Millions)	**Pension benefits**				**Other post employment benefits**	
	2007		**2006**			
Three months ended March 31,	US	Non-US	US	Non-US	**2007**	**2006**
Components of net periodic benefit cost:						
Service cost	$ 0.5	$ 3.0	$ 0.7	$ 3.2	$ 1.6	$ 3.2
Interest cost	4.4	4.0	4.2	3.5	7.5	8.9
Expected return on plan assets	(7.4)	(3.1)	(7.2)	(2.8)	-	-
Amortization of unrecognized transition obligation	-	-	-	0.1	-	-
Amortization of unrecognized prior service cost (benefit)	-	-				