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Navistar Alters Course

Truck Maker Expected to Retreat From Its Exhaust Technology

By BOB TITA

Navistar International Corp. NAV -4.51% is expected to disclose soon that it is backing away from the pollution-reduction technology for its engines that has weighed on the U.S. truck maker's sales and brought it into conflict with federal regulators, said people familiar with the company's plans.

The company plans to adopt the same process for treating diesel-engine emissions used by its rivals in an attempt to reverse falling truck sales and regulatory uncertainty that has caused its stock price to collapse and made the company the subject of takeover speculation.

Getty Images

Commercial trucks at a Navistar plant in Wakarusa, Ind.

In 4 p.m. trading Monday on the New York Stock Exchange, Navistar shares, which have fallen 28% this year, were down 4.5% at $27.09.

The company's plan marks a bold shift by its new president, Troy Clarke, to revive Navistar's truck business, but analysts caution the change in strategy could take six to nine months to implement.

Navistar produces heavy and medium-duty trucks, school buses, specialty commercial trucks and military vehicles and engines for these vehicles.

The company's North American diesel vehicles have long used an exhaust-treatment process called exhaust-gas recirculation, or EGR.

The system is cheaper than selective catalytic reduction, or SCR, used by all of its rivals, but Navistar has had trouble meeting strict emission standards introduced by the Environment Protection Agency in 2010.

The company, which is based in Lisle, Ill., is expected to announce that it will buy SCR components and install them on its own engines, said a person familiar with its intentions.

The plan maintains Navistar's goal of featuring its own engines in its trucks, preserving the company's investments in engine production capacity and truck dealers' revenue from the sale of replacement parts.

Navistar's market value has fallen by more then half over the past year as truck buyers became wary of the company's engines.

Two straight quarters of unexpected losses caused by warranty claims on the company's 13-liter engines have added to the market's anxiety about its trucks.

But the new engine strategy also carries risks. The EPA would have to certify Navistar's engines as complying with the agency's 2010 requirement for an ultra-low level of smog-causing nitrogen oxide.

Navistar faces additional development and engineering costs at a time when the company has been rapidly burning through cash and losing market share.

The change also will require lead time. The EPA certification process can take two to three months to complete following months in-house performance testing by a manufacturer to accumulate data for the EPA to evaluate. It isn't known how much development or testing Navistar has already completed on engines equipped with SCR.

"It's going to take some time, but you're going with a known strategy," said J.B. Groh, an analyst with D.A. Davidson & Co. "Now we don't have the uncertainty surrounding" the engine strategy.

Navistar Chairman and Chief Executive Daniel Ustian bet that the company could use EGR to reach the EPA standard. By offering trucks with the less expensive EGR system, Mr. Ustian hoped Navistar could grab market share from its competitors that opted for the more-expensive SCR system.

Mr. Ustian and the company's senior management team have repeatedly expressed disdain for SCR, especially its requirement that truck operators maintain an on-board reservoir of urea fluid.

"Without a doubt, our solution is the simplest," said Jack Allen, president of Navistar's North American truck business, during a presentation to analysts in February. "It's the most customer-friendly without any of the cost, without the maintenance or without the hassle of SCR."

But the Navistar's inability to win EPA certification for its EGR-equipped engines has been the downfall of Mr. Ustian's engine strategy. Navistar so far has come up short in repeated attempts to persuade the EPA to sign off on its engines, ratcheting up an already frosty relationship between the company and the agency. Without EPA certification or a temporary alternative from the agency, Navistar runs the risks having no engines to sell.

"The EGR strategy is a dead end, with associated bankruptcy risk," said Wells Fargo WFC +0.33% senior analyst Andrew Casey in a recent note to investors.

People familiar with the company say Navistar's Mr. Clarke, a former General Motors Corp. executive, has been trying to repair relations with the EPA and the California Air Resources Board, which sets vehicle-emissions standards for California and about 10 other states. Navistar has been at odds with the agencies for the past three years, repeatedly accusing them of showing preferential treatment to truck makers that use SCR.

"Navistar is committed to providing its customers the EPA-compliant trucks and is continuing its dialogue with the EPA," a spokeswoman for the company said.

Since the start of 2010, Navistar has been relying on previously required pollution credits to offset the company's lack of compliance on the nitrogen-oxide standard. When Navistar's supply of credits dwindled early this year, the EPA gave it the option of paying fines on its engines. But a federal appeals court recently found that the EPA violated its procedures when it established the fines on an emergency basis.

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