

American Axle & Manufacturing



STRENGTH

in motion

2007 ANNUAL REPORT

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2007
Annual Report

PROFILE

AAM is a world leader in the manufacture, engineering, design and validation of driveline and drivetrain systems and related components and modules, chassis systems and metal-formed products for trucks, sport utility vehicles, passenger cars and crossover utility vehicles. In addition to locations in the United States (Michigan, New York, Ohio and Indiana), AAM also has offices or facilities in Brazil, China, Germany, India, Japan, Luxembourg, Mexico, Poland, South Korea and the United Kingdom.

STRENGTH

in motion

“As we face the realities of a continually and structurally changing global automotive industry, we do so as a more mobile, agile, versatile and competitive American Axle & Manufacturing.”

— Richard E. Dauch, AAM Co-Founder, Chairman of the Board & Chief Executive Officer

Financial Summary

| | 2007 | 2006 |
|---------------------------------------|--------------------------------------|------------|
| | (In millions, except per share data) | |
| Statement of income data | | |
| Net sales | \$ 3,248.2 | \$ 3,191.7 |
| Gross profit (loss) | 278.4 | (128.6) |
| Operating income (loss) | 75.6 | (326.0) |
| Net income (loss) | 37.0 | (222.5) |
| Diluted earnings (loss) per share | \$ 0.70 | \$ (4.42) |
| Balance sheet data | | |
| Cash and cash equivalents | \$ 343.6 | \$ 13.5 |
| Total assets | 2,914.7 | 2,597.5 |
| Total long-term debt | 858.1 | 672.2 |
| Stockholders' equity | 890.7 | 813.7 |
| Statement of cash flows data | | |
| Cash provided by operating activities | \$ 367.9 | \$ 185.7 |
| Capital expenditures | 186.5 | 286.6 |
| Dividends paid | 31.8 | 31.0 |



LETTER

to Our Stockholders

The year 2007 was a transformational year for American Axle & Manufacturing (AAM). Our company made significant advances in customer diversity, geographic diversity, product portfolio expansion and served market growth as we improved our balance sheet. We expanded our role as a global player as we continued to resize, restructure and recover from the rapid and unprecedented structural transformation of the U.S. domestic automotive industry.

AAM returned to profitability in 2007, demonstrating our company's ability to turn adversity into opportunity. In the midst of this transformation, restructuring and ongoing globalization, we delivered profitable global growth and long-term value to our customers, shareholders and stakeholders. We are focused on our long-term strategic goals and our commitment to achieving sustainable global market cost competitiveness and adequate profitability.

The Changing Global Automotive Industry

The global automotive industry today is healthy and growing, but it is also structurally changing, with approximately 95% of all automotive industry growth occurring outside of the U.S.

The U.S. domestic automotive industry continues to be challenged by customer demand for global market pricing, ongoing escalation of the domestic cost structure and intense competition from offshore and transplant OEMs and OE suppliers. Underutilization of industry capacity, existing manpower and other factors made 2007 a year of labor transformation, as highlighted by the Detroit Three's unprecedented and historic agreements with the UAW.

Financial Recovery in Challenging Times

AAM's continued emphasis on productivity gains, process efficiencies and structural cost reductions enabled us to meet our financial recovery objectives in 2007. We reported net sales of \$3.25 billion and generated approximately \$150 million of positive free cash flow. As a result, we reduced net debt levels, strengthened our balance sheet and enhanced shareholder value.

Our solid cash flow helps support R&D expenditures needed to stay competitive and maintain leadership in our product lines.

Other financial results for 2007 included:

- Profitable results with net earnings of \$37.0 million
- Diluted earnings per share of \$0.70
- Net debt to capital ratio of 36.6%

Restructuring and Resizing Yield Results

To meet the realities of the demanding global automotive market, AAM continued the efforts that it began in 2006 to restructure, resize and recover.

A series of Supplemental New Hire Agreements and attrition programs helped us transition a portion of our workforce to a more competitive cost structure and resulted in structural cost reductions exceeding \$100 million annually. On January 11, 2007, we announced that approximately 1,500 associates had agreed to participate in AAM's special attrition program (SAP) offered to all UAW associates at our master agreement facilities.

Also during 2007, approximately 100 associates elected to participate in the voluntary separation incentive program (VSIP) offered to the IAM (International Association of Machinists). In addition, AAM eliminated approximately 300 U.S. salary positions through a salaried

retirement incentive program (SRIP), a salaried reduction in force program (SRIF) and normal attrition.

On December 12, 2007, we began labor negotiations with the UAW on a collective bargaining agreement covering AAM's original master agreement facilities. The goal of these ongoing negotiations is to achieve market cost competitiveness and operational flexibility at all locations.

On December 23, 2007, we idled production at our Buffalo Gear, Axle & Linkage facility. This was the result of decreased U.S. mid-size light truck production and diminishing future orders. On January 17, 2008, AAM announced that 558 UAW represented associates agreed to participate in AAM's Buffalo Separation Program (BSP).

We also continued our efforts to rationalize our installed capacity and redistribute manpower at our global manufacturing plants and other operational locations. These efforts included redeploying machinery and equipment to support adjusted capacity needs, and consolidating our Detroit site operations.

A Strong New Business Backlog

AAM's continued emphasis on product innovation, superior engineering and design, world-class quality and warranty performance, as well as flawless launch performance is attracting significant additional business from new customers resulting in the expansion of our global market.

In 2007, AAM's new and incremental business backlog increased by 50%—from about \$800 million to an estimated \$1.3 billion for the years 2008 through 2012. Approximately 60% of this business launches in the 2008, 2009 and 2010 calendar years. The remainder will launch in 2011 and 2012.



Richard E. Dauch *Co-Founder, Chairman of the Board & Chief Executive Officer*

AAM recognized early on the potential for growth in the all-wheel-drive (AWD) segment of the market. With supporting purchase orders, the company has moved quickly from development to production with products such as multi-piece driveshafts and independent rear drive axles (IRDAs). Approximately half of our new and incremental business backlog supports rear-wheel-drive (RWD) and AWD passenger car and crossover utility vehicle (CUV) applications. This backlog includes 10 AWD/RWD programs with four customers in North America, South America, Asia, Europe and Australia.

The new business includes first-time awards from Volkswagen AG to supply the rear driveline system for a global light vehicle program launching in 2009. We also earned important new business from Chery Automobile Co., Ltd., a Chinese OEM, to produce rear-drive modules (RDMs) for a 2010 model-year CUV. In addition, AAM has earned an order from Mahindra International Limited (MIL) to provide driving heads in India for a commercial vehicle program. MIL is a joint venture involving Mahindra & Mahindra Limited from India and International Truck & Engine Corporation (ITEC) from the U.S.

Beginning in 2008, light vehicle axles for Tata Motors will be produced at the AAM Sona Axle facility located in Pantnagar, India.

In 2007, we secured the successor business for GM's next generation full-size pick-up and SUV programs. Sales of driveline components relating to GM's full-size-pick-ups and SUVs represent more than half of AAM's annual sales.

Launching AAM Products Around the World

AAM product launches in 2007 reflected our growing product, customer and geographic diversification:

- We successfully completed the launch of GM's full-size pick-up truck platform—with the same flawless, world-class quality, performance and on-time delivery as the SUV portion of the platform, completed in 2006.
- Our Changshu, China facility successfully launched production of rear-drive modules for the Beijing Benz DaimlerChrysler (BBDC) 300C sedan and the SsangYong Motors Chairman sedan to be produced in Seoul, South Korea.
- Our Guanajuato, Mexico facility successfully completed the launch

of the first high-volume application of AAM's patented, electronically-controlled SmartBar™ stabilizer system for the 2007 Jeep® Wrangler Rubicon.

- We ramped up the volume for production of metal-formed products to support Nissan and Toyota products through AAM customers Hino, Jatco and Koyo.

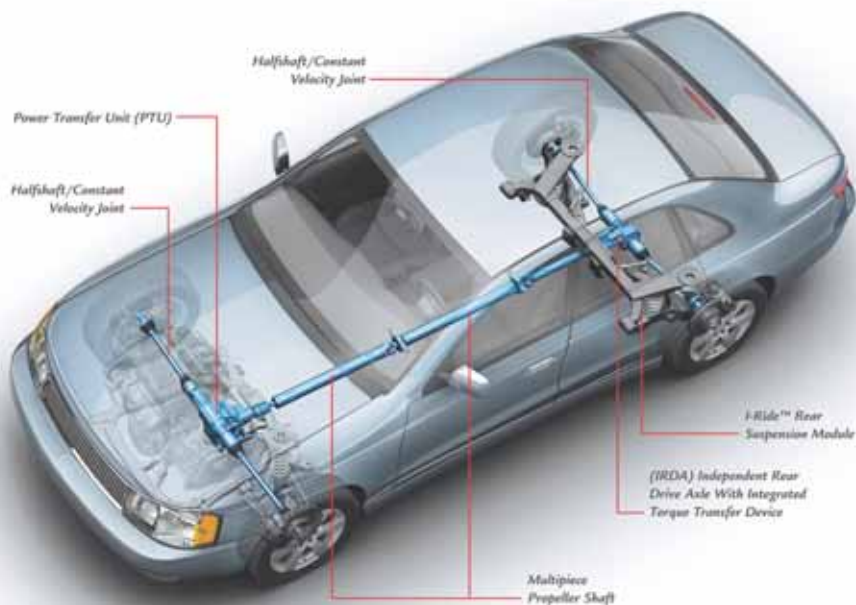
A Growing Global Presence

Becoming a selectively global Tier One automotive supplier has been a key AAM initiative since 1994. Since then, we have grown from our five original North American manufacturing facilities to 29 locations across four continents.

AAM currently has multiple facilities undergoing construction, expansion or renovation globally, including:

Oxford Forge Inc. in Oxford, Michigan, which became the newest addition to our Metal Formed Products Division (MFPD), and will be launching ring gear and axle shaft production in early 2008.

AAM de Mexico which saw its seventh expansion in six years, as it moves closer to becoming AAM's largest operating subsidiary with sales expected to hit \$1 billion in 2008.



AAM Products for All-Wheel-Drive Passenger Cars and Crossover Vehicles

AAM do Brasil which introduced gear manufacturing, to be followed by full axle assembly in preparation for becoming a full driveline and drivetrain manufacturing facility by 2010.

Changshu Manufacturing which is adding gear manufacturing in 2008 as it moves toward becoming a full-fledged axle facility. Also, a new assembly line is being installed to accommodate the production of RDMs for Chery Automobile Co.

AAM Sona Axle Private Limited which was formed as a joint venture with Sona Koyo Steering Systems Limited. This new company, headquartered in Pune, India, will manufacture and sell light truck, passenger car and SUV axle assemblies for the India market. Its new greenfield manufacturing facility in Pantnagar, India is expected to launch in 2008 with the production of light vehicle axles for Tata Motors.

AAM Future Expansions — Plans for 2008 include the construction of a new AAM facility in southwestern India. This facility will launch in 2009 and focus on commercial axle production. MIL will be AAM's first customer in this facility. In addition, AAM will construct a new regional manufacturing facility in Rayong, Thailand to support a major global OEM beginning in the 2010 model year.

24-hour Engineering Provides Global Customer Support

A competitive advantage for AAM as we expand our global footprint is the ability to provide our customers with critical engineering and technical support, wherever they are located throughout the world—7 days a week, 24 hours a day, 365 days a year.

We have grown from our first Technical Center in Rochester Hills, Michigan in 1995 to 10 engineering centers and offices in nine countries. Our global engineering staff includes more than 800 engineers. These centers support the core capabilities of our Rochester Hills Technical Center, which include design, development, validation, materials and vehicle NVH (noise, vibration and harshness) analysis and road load simulation.

In 2007, we added staff at our Pune, India business office to strengthen our sales, engineering and sourcing presence in the region. We also opened a new technical office staffed with AAM engineers in Fort Wayne, Indiana.

Through ongoing investment and expansion, such as new all-wheel-drive dynamometers at our Rochester Hills Technical Center, AAM technology continues to meet and exceed global requirements for durability, quality, reliability and NVH.

Innovative Products for the World Market

As we compete on an increasingly global playing field, AAM continues the critical design, expansion and modernization of our product portfolio. Our focus is on vehicle safety, performance, fuel economy and energy efficiency through improvements in mass reduction, packaging and continued durability, quality and reliability (DQR).

Our new line of AWD systems is designed to meet shifting consumer buying habits. We have secured purchase orders for AAM power transfer units (PTUs), IRDAs, torque transfer devices (TTDs), transfer cases and other products that will fit into a multiplicity of crossover and multi-activity-type vehicles.

We continue to integrate electronics into our product offerings, such as our TracRite® differentials, transfer cases and TTDs.

As we position AAM for sustainable and profitable growth in the AWD market, we continue to offer technological innovations—such as steerable, independent rear suspension modules—for full-size SUV and light truck segments.

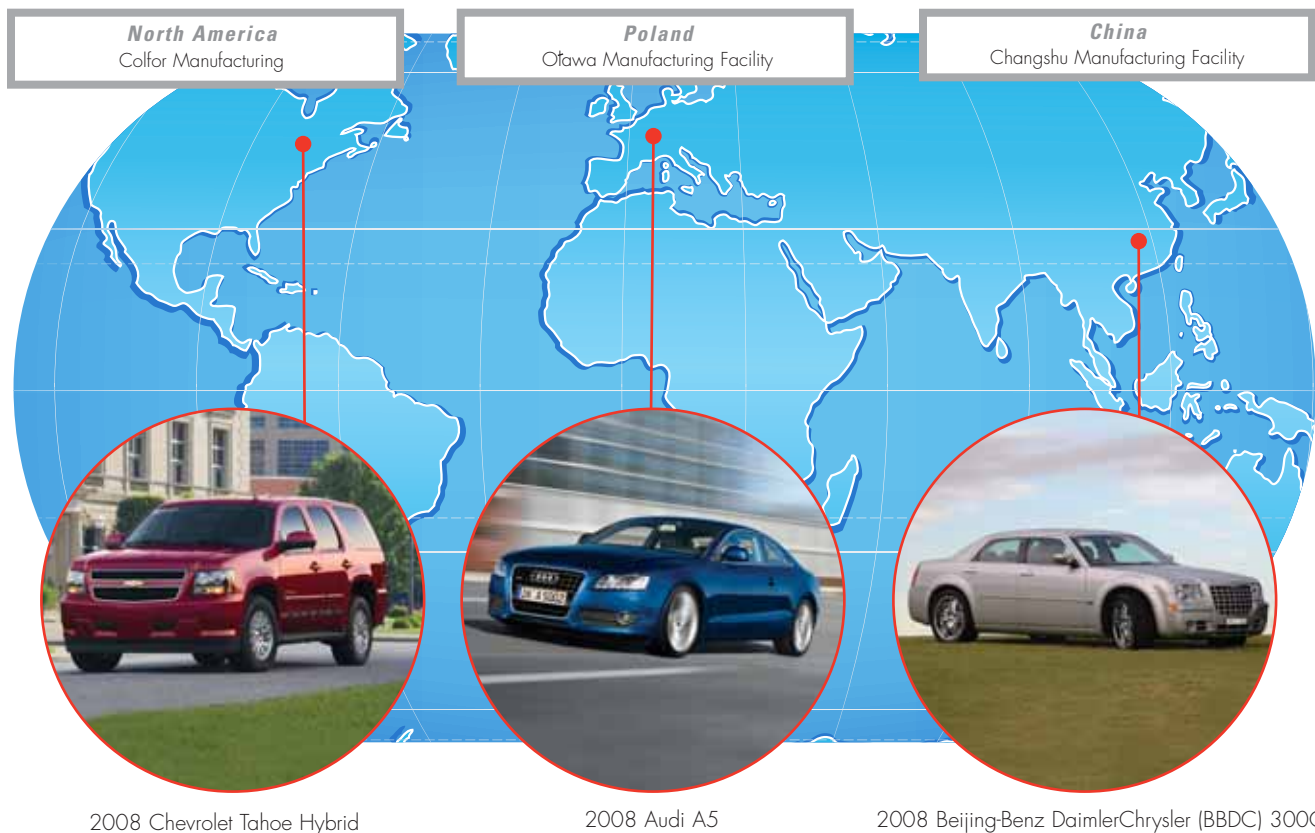
AAM is also currently developing high-efficiency axle technology for several awarded programs. The focus is on improving vehicle fuel economy through reduced friction and more efficient power transfer. We are targeting pick-up truck, SUV, CUV and passenger car markets for the use of AAM's new high-efficiency independent rear-drive and beam axle applications.

AAM continues to explore hybrid electric vehicle technologies, utilizing an electric all-wheel-drive (eAWD) system for checking vehicle dynamics capabilities.

Operational Excellence

AAM has achieved world-class Six Sigma quality on a global scale for multiple months. Six Sigma represents exceptional quality achieved through the elimination of defects by systematically improving processes, and through the contributions of our workforce. We continue to meet AAM's standard of excellence in our warranty and productivity performance.

We continue to standardize AAM best practices and introduce them into our



new regional manufacturing and engineering facilities throughout the world. Implementing “lean” initiatives and improving productivity continued to be vital priorities in 2007. We expanded the use of timed delivery/pickup schedules, called tugger systems, to more quickly and efficiently bring materials from supplier to operators’ fingertips. This program also greatly enhanced workplace ergonomics. Other lean activities in use at our state-of-the-art AAM facilities around the world include integrated pull systems, value stream mapping and highly flexible manufacturing processes.

Our purchasing and supplier development activities are becoming increasingly global. We are exploring new ways to procure materials cost effectively while ensuring continuity of high quality supply. AAM utilizes a total landed cost approach to ensure that quality, cost and logistics are taken into account in selecting our global supply chain partners.

The Right Team with the Right Plan

AAM is evolving daily on a global basis. With a strong leadership team

and a highly skilled workforce, we are taking advantage of new opportunities and getting the job done with positive results. Our approach to globalization combines a firm proactive strategy for profitable growth with flexibility in our human resources, operations, make/buy decisions and our overall business thinking. We are changing the way we conduct our business as we continue to focus on serving our customers and maintaining our market competitiveness. At the same time, our commitment remains as intense as ever to deliver operational and financial performance and value to the global automotive industry and our shareholders.

New Opportunities Will Take Us into the Future

AAM has the leadership team, financial strength, engineering capabilities, innovative products and global manufacturing footprint for continued profitable global growth and diversification in 2008 and beyond. We will continue to precisely execute our game plan on a global basis, leveraging our world-wide capability and capacity. We will keep an eye on strategic opportunities for joint ventures,

acquisitions, additional customers and expanded market presence.

The recent automotive industry restructuring and globalization offer significant opportunities—and challenges—for our company. As we face the realities of a continually and structurally changing global automotive industry, we do so as a more mobile, agile, versatile and competitive American Axle & Manufacturing.

I would like to thank all AAM shareholders for their vital ongoing support and confidence as we go through this critical period of transitioning AAM to a truly global company.

I am also extremely proud of our accomplished and committed leadership, governance and workforce. They understand the importance of global change as a reality. They lead it, live it and thrive on it.

Richard E. Dauch
Co-Founder, Chairman of the Board &
Chief Executive Officer

Letter from

t h e C h i e f O p e r a t i n g O f f i c e r



David C. Dauch
Executive Vice President &
Chief Operating Officer

As AAM moves forward, we are continually and aggressively planning, developing and improving our day-to-day operations. We have a firm strategy and business plan in place for achieving continued profitable global growth, while staying true to our core principles.

Underlying our efforts in 2008 and beyond are two key objectives: reducing our cost structure and increasing diversification.

A Market Competitive Cost Structure

As AAM competes on an increasingly global scale, we are doing more with less. Our sights are set on being the lowest

cost/highest quality manufacturer that consistently meets our customers' desired product features, content and value. To become truly "market competitive" in the regions in which we operate, we are continuing to improve our overall market-based cost structure in key areas such as labor, materials, manufacturing, sourcing and logistics.

AAM is extending its global footprint. We are leveraging design, engineering and product development resources, sales, IT systems, procurement and manufacturing operations, while fully utilizing our global capability. Leveraging our global assets enables us to cost-effectively and time-effectively develop products for all regions.

Increasing Diversification

As part of our strategy for profitable global growth, AAM is driving increased diversification in our customer base, sales, products, geographic footprint, served markets and workforce.

Broadening our customer base includes both deepening our long-standing relationship with General Motors and developing relationships with new customers around the world.

Going forward, we expect to reduce our concentration of business with GM in North America from our current 78% to approximately 50% in the next decade. At the same time, we will grow our support of GM operations in other parts of the world, including South America, Europe,



“Successful in transforming AAM

into a standalone, autonomous, industry-leading automotive supplier, we are now realizing our vision of becoming a profitable, viable, sustainable and truly global company. Through it all, our solid foundational principles have served us well. Teamwork; integrity in people, products and financial performance; customer focus; and advanced technology in product, processes and systems differentiate us in today’s fiercely competitive world market.”

— David C. Dauch

Asia, Africa and Australia. AAM will support both pick-up/SUV programs and global all-wheel-drive (AWD) passenger car/crossover vehicle programs for GM. By 2012, we estimate that passenger car and crossover utility vehicle (CUV) applications will constitute approximately 25% of AAM’s total sales to GM.

AAM’s new business backlog continues to diversify in terms of market and geography. Approximately 75% of our current new business backlog will be manufactured outside of the U.S. Fifty percent represents AWD/rear-wheel-drive (RWD) products for passenger cars and CUVs.

We continue to expand and diversify our product portfolio to gain entry into high-growth OEMs, regions and vehicle segments. Our portfolio increasingly reflects our efforts to be the premier global driveline and drivetrain supplier for multiple segments, including: passenger car, crossover vehicle, RWD truck, SUV and commercial vehicles. New drivetrain products include power transfer units for AWD and front-wheel-drive (FWD)-based vehicle applications; transfer cases and transmission differentials for four-wheel-drive (4WD)/AWD RWD-based vehicle applications; and high-precision gears and shafts for six-speed transmissions for light trucks, SUVs and passenger car applications.

The expansion of our product portfolio has tripled the size of AAM’s served market—from \$8 billion North American RWD driveline market to \$27 billion global AWD/RWD drivetrain market.

Structuring the Business for a Global Market

To drive greater profitability for AAM, we are making a major shift by focusing on individual business units. This will facilitate the quick decision-making so critical in today’s ultra-competitive, fast-changing global automotive market.

This new approach will also allow us to focus more keenly on daily performance, profitability and accountability, with the added advantage of reinforcing the entrepreneurial spirit at AAM.

New business units will include: Global Driveline Operations, including full-frame (truck and SUV) and unibody/passenger car (AWD/RWD); Global Metal Formed Product Operations; Global Driveshaft & Halfshaft Operations; and Commercial Vehicle Operations.

Balanced Growth

AAM expects organic growth in the next five years to increase our topline revenue from \$3.25 billion to in excess of \$4 billion. This will be balanced with strategic growth in the form of possible mergers and acquisitions, joint ventures

or technical alliances focused on expanding our core businesses, geographic locations and markets. Potential future geographic expansion includes Russia, South Africa and South America (Colombia, Ecuador, Venezuela).

Remaining True to AAM’s Founding Principles

A crucial factor in AAM’s success in coming years is an organizational structure, culture and environment that enables our associates to profitably operate multiple businesses serving diverse markets and customers on a global scale.

We will continue to focus on the core values that have served us well. First and foremost are: a respect for people; a passion for AAM and commitment to our responsibilities; and providing industry-leading products. Equally important are delivering the highest performance in program launches, quality/warranty and supply chain management; as well as operational excellence, continuous supply and providing solid financial returns to our shareholders.

David C. Dauch
Executive Vice President &
Chief Operating Officer

Manufacturing New Opportunities

in the Global Marketplace

“Global expansion



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Redesigning and expanding our product portfolio for the global automotive market

AAM's past success has been built on products for the light truck, SUV and four-wheel-drive (4WD) vehicle markets. Today, we are developing an expanded product portfolio for emerging market segments, such as all-wheel-drive (AWD) systems for passenger cars, crossover utility vehicles (CUVs) and multi-activity vehicles.

- a. *AAM is supplying the independent rear drive axle (IRDA) and torque transfer device (TTD) assemblies for the 2008 Saab 9-3 passenger car for the European market.*
- b. *Integrated oil pan (IOP) front axles and IRDAs for South Korean-based SsangYong Motors' Kyron are produced at AAM's Changshu Manufacturing facility in China.*
- c. *AAM is the exclusive driveline supplier for General Motor's full-size pick-ups and SUVs, including the 2007 Chevrolet Silverado which was named Motor Trend's 2007 Truck of the Year.*
- d. *AAM supplies both front and rear axles and front and rear driveshafts for the Dodge Ram Heavy Duty pick-up. AAM also supplies the Smartbar™ (electronic disconnecting stabilizer bar) for the Dodge Ram Power Wagon and Jeep® Wrangler Rubicon models.*
- e. *Beginning in 2008, AAM will produce enhanced rear axles and driveshafts, including six-speed transmission components for GM's full-size SUVs and pick-ups, including the GMC Yukon Denali standard and hybrid versions.*
- f. *AAM's Albion Automotive facilities produce rear beam axles and front axles for commercial vehicles such as the DAF LF series truck. Coming soon: Driving heads for commercial truck axles for Mahindra International Limited (MIL) to be produced at a future AAM site in India, beginning in*

was AAM's goal in 2007.

I am proud to say that we achieved that objective with growth in Eastern Europe, India and China, with plans for a new facility in Thailand. This means we are now able to support our customers around the world. In 2008, AAM's driveline operations will focus on flawless product launches, lean metrics, overall equipment effectiveness, improved quality and the continued development of our workforce."



— Curt S. Howell
**Vice President,
Global Driveline Operations**

On the move globally, profitably

AAM continues its focus on reducing costs, improving efficiency and increasing return on capital investment at all of our existing facilities. We have set our sights on finding new ways to expand capacity at these existing locations. Our growing Mexican operations—both Guanajuato Gear & Axle and Guanajuato Forge—are a prime example of this success.

In AAM's quest for profitable global growth, establishing facilities in market cost competitive countries such as Mexico, Brazil, India, China, Thailand and Poland can save as much as 15% to 20% in materials and labor costs.

Expanding business in new markets

Approximately 50% of AAM's new business backlog for the next several years consists of orders for products for AWD passenger cars and CUVs. As a percentage of our sales, we expect these segments to grow from 4% today to 20% by 2011. At the same time, by



AAM's new Oxford Forge Inc., on a reclaimed brownfield site in Oxford, Michigan, is launching ring gear and axle shaft manufacturing in early 2008. The facility will serve customers on the open market as well as AAM's driveline operations.

2012, 25% of AAM's sales to our largest customer, General Motors, will be in the passenger car and CUV segments.

Forging flexibility is paying off

AAM's Global Metal Formed Product Operations is winning new business and enhancing profitability and sustainability by focusing on value added initiatives such as assembly and machining capabilities.

In 2007, our Colfor/Minerva facility became the first AAM facility to produce machined transmission components. Production of sophisticated six-speed automatic transmission components for General Motors and BMW is one example of how AAM is making the transition from driveline to drivetrain products.

"The Global Metal Formed Product Operations underwent a significant makeover and made good progress in 2007. Our strategy: To add value and become the most market cost competitive forger in the world."

— Norm Willemse
**Vice President, Global Metal Formed
Product Operations**

Being a Flexible, Smart

and Competitive Manufacturer

“Being a successful global manufacturer today



“One-piece flow” welding utilized at the Detroit Manufacturing Complex (above) improves welding of tube flanges and brackets and replaces four, stand alone batch processes. This new system provides projection weld technology that is 40% more labor-efficient than traditional arc welding. Other benefits: Improved output, increased OEE (Original Equipment Effectiveness) and significant cost savings.

Detroit Manufacturing Complex associates Heather Lindell Klish – Value Stream Manager, Bruce LaFrance – Tugger Driver, and Ben Hogan – Production Supervisor are employing lean initiatives such as this “tugger” system—a timed delivery/pickup schedule for transporting materials to manufacturing cells or line-side flow racks. Inventory is tugged throughout the manufacturing facility in a series of small trailers.

requires tremendous flexibility

in overall business thinking. In the manufacturing and engineering disciplines, AAM is making significant changes, replacing traditional practices with methods that make us competitive as we expand globally. The idea is to produce more and do things better using fewer resources. That's what we are doing to challenge the global competition."

— John J. Bellanti
**Group Vice President, Manufacturing
Services, Capital Planning &
Cost Estimating**



A global market competitive mindset

From our World Headquarters to our manufacturing facilities to our R&D centers, AAM is adopting new ways of thinking, engaging our workforce and leveraging our resources to achieve our global manufacturing and financial objectives. With the right balance of lean manufacturing initiatives and product, process and systems technology, we are providing our customers around the world with the highest quality, advanced products and services in an efficient and timely manner at a fair, market-competitive price.

Flexibility in our processes

In 2007, AAM introduced a number of initiatives in our manufacturing operations that are delivering significant time and cost savings, including:

- Developing turnkey machining operations internally. We now purchase standard off-the-shelf machinery, do our own fixture design, tooling and gauging; then source the individual components to our facilities in market cost competitive regions. The result: A reduction of 30% to 50% in initial capital expense over our traditional sourcing methods.
- Replacing older, dedicated equipment with flexible manufacturing cells. Benefits include: greater operating efficiency, less cash tied to inventory, easier identification of waste in processes and improved uptime.
- The designs can be built in-house by our own labor in our market cost competitive facilities or outsourced to assembly line builders or metal fabricators in low cost regions.

- Identifying and benchmarking qualified equipment suppliers in low cost countries, such as China, India and South Korea, which can potentially reduce initial capital costs by as much as 30% to 50%.

Making operational excellence a global AAM standard

At AAM, we are continually seeking new techniques to improve the delicate balance of man, material and machine in our manufacturing facilities. This approach is reinforcing our reputation as a world-class manufacturer as we grow our global presence. Through solid teamwork and ongoing workshops, our lean initiatives and innovative processes are becoming standard practice at AAM facilities around the world. Our Changshu, China manufacturing facility is a good example. From start of production in December 2006 through 2007, Changshu associates produced more than 20,000 independent rear drive axles (IRDAs), with zero PPM (discrepant parts per million), 100% on-time shipments, and zero absenteeism—an AAM record!



**Award-winning
manufacturing—AAM's
Guanajuato Forge and Guanajuato
Gear & Axle facilities have been
recognized for lean
manufacturing excellence
with the "gold" and "silver"
Shingo Prize for Excellence in
Manufacturing, Region
Centro de Mexico.**

World-Class AAM

Engineering and Technology

“AAM’s innovative product



Glen Steyer, Executive Director Engineering Systems, with David Schankin, Manager NVH Engineering, reviewing binaural listening equipment in a new AWD prototype vehicle.

Minimizing noise, vibration and harshness—Associates at the Technical Center’s NVH Lab prepare a vehicle for testing in the NVH full vehicle semi-anechoic chamber.

technology is our lifeblood.



It is the detail that differentiates us. As we continue to grow our global presence, the challenge is to fully understand the environments our products are used in. That is key to utilizing the right technologies to obtain the desired performance and cost characteristics for each market."

— Yogendra N. Rahangdale
Vice Chairman

World-class testing and validation

As we develop products for new markets, AAM is staying in step with escalating global requirements for durability, quality, reliability (DQR) and noise, vibration and harshness (NVH). Our advanced testing and validation technology—including state-of-the-art dynamometers, a road load simulator and materials testing equipment—enables us to determine the best ways our components relate to the entire engineered system of the vehicle. The payoff: A 20% year-over-year improvement in warranty performance for our customers.

Adding value through electronic enhancements

AAM's sizeable investment in R&D—over \$650 million to date—includes the development of electronically-controlled products and systems, with a focus on improved fuel efficiency and enhanced vehicle safety and performance. Today, over 80% of AAM products incorporate electronic controls, including products for light vehicles, all-wheel-drive (AWD) applications and the growing crossover utility vehicle (CUV) segment.



State-of-the-art durability testing—Inspecting a rear drive module on AAM's newest durability dynamometer are (top left) Scott Jacob, Manager, Test Engineering; (top right) Jim Downs, Director, Advanced Engineering; and AAM lab technicians (from bottom left) Kirk Evans, Timothy Barber and Mike LaGrow.

Some key AAM products featuring electronic enhancements include:

- Electronic torque transfer devices (TTDs), which serve as an electronic/hydraulic system for automatically activating AWD capabilities in multiple applications.
- SmartBar™—We continue to investigate new applications and business opportunities for our patented electronically actuated SmartBar™ electronic stabilizer system, in addition to the Dodge Ram Power Wagon and Jeep® Wrangler Rubicon.

AAM engineering expertise— around the clock, around the world

Since opening our flagship Technical Center in Rochester Hills, Michigan in 1995, AAM has expanded our engineering and technical expertise to support AAM customers in multiple time zones, with a presence throughout the world including: Trollhatten, Sweden; Seoul, South Korea; Bad Homburg, Germany; Tokyo, Japan; Shanghai, China; Pune, India; and Sydney, Australia.

In 2007, we opened a new engineering center in Fort Wayne, Indiana. In 2008, we will be opening a new business office in São Paulo, Brazil which will provide engineering and technical support to AAM's customers in South America.

Pursuing Environmental Excellence

Doing Our Part



“AAM focuses on reducing our environmental impact

by embracing and employing the concepts of ISO 14001. We ensure continuous improvement and minimization of the impact of our facilities on the environment by implementing processes such as dry cutting, water-based painting and oil recovery and reuse.”

— Mark Williams
Manager, Environmental Services

AAM Environmental Initiatives

- Expand our focus on improvements of our environmental management system, following the standards set by ISO 14001.
- Implement global environmental standards to identify and minimize environmental impact in AAM's new international facilities, even when not required by local laws.
- Implement AAM's policies for reporting, data management, auditing, communications and waste management for all new and existing facilities.
- Report energy savings and other key manufacturing metrics at each AAM location, to identify areas of improvement.
- Implement an environmental performance “scorecard” that tracks and reports waste, wastewater and emissions including greenhouse gases.
- Monitor power consumption on a real-time basis at all AAM facilities—which in 2007 reduced energy usage by more than 130,000 MMBTUs, equivalent to more than 20,000 tons of carbon dioxide emissions.

- Conduct internal and external energy audits on compressed air usage, power factor improvement, process heating and pump efficiency to reduce energy waste and greenhouse gas generation.
- Reduce waste-to-landfill impact at facilities, with the ultimate goal of zero landfill of waste materials.
- Incorporate environmental impact reviews, including safety and energy, in AAM's 2008 Capital Expenditure review and approval process.
- Conduct a pilot Total Waste Management Program at the Detroit Manufacturing Complex in 2008 with a world-class waste management partner to pursue alternative waste management methods.

Greening Guanajuato

(above) AAM associates and their families at our Guanajuato facilities celebrated the second annual “Ecology Journey” by planting 700 trees throughout the complex. The plantings are part of an initiative to “green up” the site, which is located in a part of Mexico where trees are sparse.

The “greening” of AAM facilities starts from the ground up



Planned pollution control

Through careful planning and state-of-the-art pollution control equipment, our building addition in Minerva, Ohio was completed successfully without negative impact to the surrounding farming community.



Saving trees in Brazil

AAM do Brasil's site master plan in Araucária was designed to avoid cutting down any endangered trees, and to include nature trails for associates' use.



S.P.I.R.I.T

Save Resources

Prevent Pollution

Improve Continuously

Recycle Waste

Implement Effective Policies

Train Associates

Being a good neighbor

Surrounded by farmland and situated on a former garlic field, our Guanajuato Manufacturing Complex has earned a reputation as an environmentally friendly neighbor. The complex's extensive landscaping is completely irrigated with recycled waste water.



Changshu conserves energy

The Changshu facility's natural gas fired absorption system is less costly, easier to maintain and produces less greenhouse gas emissions than electric-powered centrifugal chillers. The front of the building faces south to take greatest advantage of the natural light.



“Our philosophy begins with doing what is environmentally right, which often exceeds the common practices and legal requirements of the countries in which we are operating—from simple initiatives such as establishing tobacco-free sites to detailed site and resource use plans that include purifying wastewater for reuse in irrigation systems.”

— David Sibley
Executive Director, Facilities Engineering

AAM's Environmental Philosophy

Forward-thinking, Award-winning

From day one as a company, starting with the extensive transformation of our Detroit complex and the surrounding community, AAM has been committed to protecting the environment at our operations around the world. Our proactive environmental efforts and strong compliance record are winning us recognition in the U.S. and internationally.

Our Detroit Manufacturing Complex has received the State of Michigan Clean Corporate Citizen (C3) award and is also a Michigan Business Pollution Prevention Partner (MBP3). The C3 award acknowledges our proactive environmental efforts, including an environmental management system, the practice of pollution prevention and a strong environmental compliance record.

Our Guanajuato Manufacturing Complex has received the gold award for environmental performance from the Mexican Federal Attorney General's Office of Protection to the

Environment (PROFEPA). AAM has been asked by PROFEPA to submit the Guanajuato facilities for a repeat award in 2008.

Some AAM green guidelines

- Leave as much of the natural setting (trees, local vegetation, natural matter) intact as possible.
- Orient the building on the property to take best advantage of natural ventilation, shade and lighting.
- Choose a site relatively close to public transportation, so associates can get to work without having to drive.
- Strive for low light pollution by keeping exterior lighting trapped within the site.
- Incorporate skylights wherever possible to make maximum use of natural light.
- Choose low-energy climate control methods, including compressors that utilize non-CFC-type refrigerant.
- Utilize locally available building materials wherever possible.
- In hot climates, paint building exteriors white to reflect heat.
- Incorporate local vegetation into landscaping.
- Recycle materials from initial facility construction through startup and ongoing manufacturing operations.
- Prohibit processes that have potentially high environmental impact, such as plating, solvent-based painting and the use of chlorinated solvents.
- Support the prohibition of highly toxic materials, such as lead, hexavalent chromium, mercury and CFCs.
- Prohibit the use of certain highly toxic materials, such as lead, hexavalent chromium, mercury and cadmium.
- Adopt global performance-based standards to reduce waste and emissions.

Green construction for AAM World Headquarters

Triple-glazed windows help reduce heat gain from the heavily glassed design of the AAM World Headquarters building in Detroit, Michigan.





American Axle & Manufacturing

2007 FINANCIALS

AAM | Financials

Management's Discussion and Analysis

OVERVIEW

American Axle & Manufacturing Holdings, Inc. (Holdings) and its subsidiaries (collectively, we, our, us or AAM) is a Tier I supplier to the automotive industry. We manufacture, engineer, design and validate driveline and drivetrain systems and related components and chassis modules for trucks, sport utility vehicles (SUVs), passenger cars and crossover utility vehicles. Driveline and drivetrain systems include components that transfer power from the transmission and deliver it to the drive wheels. Our driveline, drivetrain and related products include axles, chassis modules, driveshafts, power transfer units, transfer cases, chassis and steering components, driving heads, crankshafts, transmission parts and metal-formed products.

We are the principal supplier of driveline components to General Motors Corporation (GM) for its rear-wheel drive (RWD) light trucks and SUVs manufactured in North America, supplying substantially all of GM's rear axle and front four-wheel drive and all-wheel drive (4WD/AWD) axle requirements for these vehicle platforms. Sales to GM were approximately 78% of our total net sales in 2007, 76% in 2006 and 78% in 2005.

We are the sole-source supplier to GM for certain axles and other driveline products for the life of each GM vehicle program covered by a Lifetime Program Contract (LPC). Substantially all of our sales to GM are made pursuant to the LPCs. The LPCs have terms equal to the lives of the relevant vehicle programs or their respective derivatives,

which typically run 6 to 10 years, and require us to remain competitive with respect to technology, design and quality. We have been successful in competing, and we will continue to compete, for future GM business upon the expiration of the LPCs.

We are also the principal supplier of driveline system products for the Chrysler Group's heavy-duty Dodge Ram full-size pickup trucks (Dodge Ram program) and its derivatives. Sales to Chrysler LLC (Chrysler) were 12% of our total net sales in 2007, 14% in 2006 and 13% in 2005.

In addition to GM and Chrysler, we supply driveline systems and other related components to PACCAR Inc., Ford Motor Company (Ford), SsangYong Motor Company, Harley-Davidson and other original equipment manufacturers (OEMs) and Tier I supplier companies such as The Timken Company, Jatco Ltd., Koyo Machine Industries Co., Ltd. and Hino Motors, Ltd. Our net sales to customers other than GM were \$712.3 million in 2007 as compared to \$758.5 million in 2006 and \$754.4 million in 2005.

In 2007, we continued ongoing restructuring efforts to address the structural change occurring in the domestic automotive market. We further reduced our workforce and redeployed assets to support capacity utilization initiatives. In December 2007, we idled production at our Buffalo Gear, Axle & Linkage (Buffalo) facility in New York. The impact of these ongoing restructuring actions resulted in productivity gains and structural cost reductions and are discussed in the section entitled "Results of Operations."

INDUSTRY TRENDS AND COMPETITION

There are a number of significant trends affecting the highly competitive automotive industry. The industry is global with an increased emphasis on new consumer markets, geographically diverse production facilities and supplier consolidation. Advancing technology and product development are critical to attracting and retaining business. Pricing pressures are significant. U.S. manufacturing costs, including labor and certain raw materials, have escalated. These factors have caused significant financial distress in the U.S. domestic supply base. As a result, OEMs and suppliers are aggressively developing strategies to reduce costs, which include restructuring U.S. operations, producing in low cost regions and sourcing on a global basis. The driveline and drivetrain systems segment of the industry in which we compete reflects these trends, and we expect them to continue.

GLOBAL AUTOMOTIVE PRODUCTION The trend toward globalization of automotive production continues to intensify in regions such as Asia (particularly China, India, South Korea and Thailand), South America and Eastern Europe. The growth rate of automotive production in these regions is expected to continue to outpace the traditional automotive production centers such as North America, Western Europe and Japan. In addition to our recent construction of production facilities in China and Poland, we continue to expand our existing facilities in Mexico and Brazil. We also have offices in India, China and South Korea to support these growing markets. We expect our activity in these markets to increase significantly over the next several years.

In 2007, AAM and Sona Koyo Steering Systems Limited formed a joint venture to operate in the Indian market. AAM Sona Axle Private Limited will be headquartered in Pune, India and will manufacture and sell light truck, passenger car and SUV axle assemblies.

CHANGE IN CONSUMER DEMAND AND PRODUCT MIX

In the U.S., consumer demand for full-frame light trucks and SUV-type vehicles continues to shift to passenger cars and crossover vehicles with smaller displacement engines and higher fuel economy. A significant portion of our revenue stream is tied to full-size and mid-size SUVs. When demand softens for these products, our revenue streams are impacted. Our research and development (R&D) efforts have led to new business awards for products that support AWD and RWD passenger cars and crossover vehicles. These efforts position us to compete as this product mix shift continues. AAM's new and incremental business backlog includes awards for new products supporting passenger car and crossover vehicle programs that represent future annual sales of approximately \$600 million by 2012.

DECLINING U.S. DOMESTIC OEM MARKET SHARE

Competition from offshore and transplant OEMs continues to intensify, resulting in the decline of U.S. market share for U.S. domestic OEMs and a decrease in their domestic vehicle production levels by approximately 7% in 2007 as compared to 2006. Since approximately 90% of our 2007 revenue was derived from net sales to GM and Chrysler, this continuing trend is significant for us. We continue to aggressively pursue business with other OEMs.

FINANCIAL DISTRESS OF U.S. DOMESTIC SUPPLY BASE

The declining market share of the U.S. domestic OEMs has resulted in the under-utilization of production capacity for them and their suppliers. Steel and metallic material prices are volatile, and higher energy and fuel costs have exacerbated the financial pressure on the industry. Over the past few years, many automotive suppliers have filed for bankruptcy protection. The declining market share of the U.S. domestic OEMs caused by global competition has created a major structural change in the U.S. domestic automotive industry. As a result of these pressures, the U.S. domestic OEMs and their suppliers, including AAM, have undertaken wide-scale domestic capacity reduction initiatives, workforce reductions and other restructuring actions to reduce costs.

SUPPLY BASE CONSOLIDATION The OEMs have continued to reduce their supply base, preferring stronger relationships with a smaller number of suppliers capable of designing, engineering, testing, validating and manufacturing systems and modules on a global basis. The trend is to move away from regional suppliers and toward suppliers that can serve global markets in a cost efficient manner. The financial strength of a supplier is also an important factor in sourcing decisions as the OEMs work to protect their continuity of supply. We believe our engineering capabilities, global manufacturing footprint and financial resources position us well in this environment.

Supply base consolidation is not limited to Tier I suppliers. The competitive pressures of the automotive industry have forced the consolidation of our supply base as well. We have expanded our global purchasing and supplier development activities in order to procure materials cost-effectively while ensuring continuity of high quality supply.

PRICE PRESSURE Year-over-year price reductions are a common competitive practice in the automotive industry. The majority of our products are sold under long-term contracts with prices scheduled at the time the contracts are established. Certain contracts require us to reduce our prices in subsequent years, and most of our contracts allow us to

adjust prices for engineering changes. We do not believe that the price reductions we have committed to our customers will have a material adverse impact on our future operating results because we intend to offset such price reductions through continued cost reductions and other productivity initiatives.

INCREASING ELECTRONIC INTEGRATION The electronic content of vehicles continues to expand, largely driven by consumer demand for greater vehicle performance, functionality and affordable convenience options. This demand is a result of increased communication abilities in vehicles as well as increasingly stringent regulatory standards for energy efficiency, emissions reduction and increased safety. As electronics continue to become more reliable and affordable, we expect this trend to continue. The increased use of electronics provides greater flexibility in vehicles and enables the OEMs to better control vehicle stability, fuel efficiency and safety while improving the overall driving experience. Suppliers with enhanced capability in electronic integration have increased opportunities to improve their value added position with the OEMs through better pricing and more sourcing opportunities.

We are continuing to invest in the development of advanced products focused on vehicle safety and performance leveraging electronics and technology. We have increased our focus on electronics by investing in product development that is consistent with market demand.

STEEL AND OTHER METALLIC MATERIAL PRICING In recent years, worldwide commodity market conditions have resulted in higher steel and other metallic material prices. We are focused on mitigating the impact of this trend through commercial agreements with our customers, strategic sourcing arrangements with suppliers and technology advancements that require less costly metallic content in the manufacturing of our products.

Nearly all of our sales contracts with our largest customers provide price adjustment provisions for metal market price fluctuations. We do not have metal market price provisions with all of our customers for all of the parts that we sell. We also have agreed to share in the risk of metal market price fluctuations in certain contracts.

OEM EXTENSION OF WARRANTY PROGRAMS GM, Chrysler and Ford have extended standard warranty programs to their customers. This trend will put additional pressure on the need for robust quality systems throughout the supply chain. This trend may also increase warranty related expenditures for the supply base. In our 14 year history, we have experienced negligible warranty charges from our customers due to our contractual arrangements and improvements we have made in the quality, warranty, reliability and durability performance of our products. Consequently, we do not expect warranty obligations will have a material adverse impact on our future operating results.

RESULTS OF OPERATIONS

NET SALES Net sales were \$3,248.2 million in 2007 as compared to \$3,191.7 million in 2006 and \$3,387.3 million in 2005.

Our sales in 2007, as compared to 2006, reflect substantially similar customer production volumes for the major full-size truck and SUV programs we currently support for GM and Chrysler and a decrease of approximately 11% in products supporting GM's mid-size light truck and SUV programs.

Our content-per-vehicle (as measured by the dollar value of our products supporting GM's North American light truck platforms and the Dodge Ram program) was \$1,293 in 2007 versus \$1,225 in 2006 and \$1,201 in 2005. New

AAM content appearing on GM's full-size pickup trucks was the primary driver of content growth in 2007.

The decreases in net sales resulting from lower GM light truck production volumes in 2007 and 2006 were partially offset by metal market price adjustments.

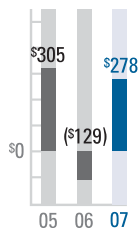
Our 4WD/AWD penetration rate was 63.6% in 2007 as compared to 61.9% in 2006 and 63.7% in 2005. We define 4WD/AWD penetration as the total number of front axles we produce divided by the total number of rear axles we produce for the vehicle programs on which we sell product. The higher penetration rate in 2007 as compared to 2006 is reflected in the increase in content-per-vehicle.

In 2007 and 2006, we recorded special charges, asset impairments and other non-recurring operating costs that we do not consider indicative of our ongoing operating activities. The following table details these charges (in millions):

| | 2007 | 2006 |
|---|---------|----------|
| Buffalo separation program | \$ 56.2 | \$ - |
| Redeployment of assets | 14.0 | - |
| IAM voluntary separation incentive programs | 7.8 | - |
| Salaried workforce reductions | 1.7 | 7.5 |
| Special attrition program | - | 141.1 |
| Supplemental unemployment benefits | - | 27.1 |
| Environmental obligations | - | 2.5 |
| Restructuring accrual adjustments and other | (2.9) | 3.2 |
| Total charges | \$ 76.8 | \$ 181.4 |
| Asset impairments | \$ 11.6 | \$ 196.5 |

GROSS PROFIT (LOSS) Gross profit (loss) was a profit of \$278.4 million in 2007 as compared to a loss of \$128.6 million in 2006 and a profit of \$304.7 million in 2005. Gross margin was 8.6% in 2007 as compared to negative 4.0% in 2006 and 9.0% in 2005. The increase in gross profit and gross margin in

Gross Profit (Loss) (in millions)



2007 as compared to 2006 reflects the impact of higher sales, productivity gains and structural cost reductions resulting from attrition programs and other ongoing restructuring actions.

Gross profit in 2007 and 2006 also reflects the impact of significant charges. These charges are discussed below:

Buffalo Separation Program In September 2007, we offered the Buffalo Separation Program (BSP) to all hourly associates represented by the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) at our Buffalo facility. This voluntary separation program offered retirement or buyout incentives to approximately 650 eligible hourly associates. Approximately 560 associates participated in this separation program. We recorded a charge of \$56.2 million as a result of this program. This charge includes \$42.3 million related to postemployment costs and \$13.9 million for the curtailment of certain pension and other postretirement benefits and related special termination benefits.

Redeployment of assets In order to realign our production capacity with revised current and future production schedules, we performed significant asset redeployment actions in 2007. The costs related to these redeployment actions include those to remove, ship, reinstall and prepare the redeployed assets for production. In 2007, we incurred \$14.0 million in charges related to the redeployment of assets to support capacity utilization initiatives.

IAM voluntary separation incentive programs We offered voluntary separation incentive programs (VSIP) to approximately 200 associates represented by the International Association of Machinists (IAM) at our Tonawanda, New York and Detroit, Michigan facilities in 2007. Approximately 90 associates participated in this attrition program. We recorded a charge of \$7.8 million as a result of this program. This charge includes \$7.4 million related to postemployment costs and \$0.4 million for the curtailment of certain pension and other postretirement benefits and related special termination benefits.

Salaried workforce reductions In 2006, we approved a plan to reduce our salaried workforce during 2007. These employees are provided postemployment benefits based on our layoff severance program and a special transition program. In 2007 and 2006, we have recorded charges for this involuntary separation to cost of sales of \$1.7 million and \$3.5 million, respectively. In 2007, this charge included \$3.3 million for postemployment benefits and a \$1.6 million gain related to the curtailment of certain pension and other postretirement benefits.

In 2006, we offered a salaried retirement incentive program to eligible salaried associates in the U.S. to voluntarily retire. As a result of 67 associates participating in this program, we recorded a charge to cost of sales of \$2.7 million in 2006.

Special Attrition Program and supplemental unemployment benefits In the third quarter of 2006, we signed a supplemental new hire agreement with the UAW that reduced our total labor cost (including benefits) for new hire associates. In conjunction with this agreement, we offered the Special Attrition Program (SAP) to approximately 6,000 UAW represented associates at AAM's master agreement facilities in the fourth quarter of 2006. This program was designed to reduce our workforce. Approximately 1,500 associates participated in this attrition program. We recorded a charge of \$141.1 million as a result of this program. This charge included \$131.4 million related to postemployment costs and \$9.7 million for the curtailment of certain pension and other postretirement benefits and related special termination benefits.

In the third quarter of 2006, we recorded a charge of \$91.2 million relating to supplemental unemployment benefits (SUB) estimated to be payable to UAW associates who were expected to be permanently idled through the end of the current collective bargaining agreement that expires on February 25, 2008. The results of the SAP reduced the number of employees expected to be permanently idled. Therefore, we revised our estimate of SUB to be paid pursuant to the current agreement and reduced this liability to \$13.2 million at December 31, 2006.

In 2007, we expensed \$10.3 million of supplemental unemployment benefits and other related benefit costs for associates on layoff as compared to \$77.1 million in 2006 and \$53.0 million in 2005.

Environmental obligations In 2006, based on the impairment and redeployment of assets and determination of certain assets as permanently idled, the methods and timing of the settlement of certain environmental obligations related to our Buffalo facility became reasonably estimable. Based on management's best estimate of these obligations, we recorded a charge of \$2.5 million.

Restructuring accrual adjustments and other We recorded a reduction to cost of sales for restructuring accrual adjustments and other of \$2.9 million in 2007. This primarily relates to the update of previously estimated postemployment benefit accruals based on actual results.

In 2006, we also recorded a charge to cost of sales of \$3.2 million related principally to postemployment benefits for associates in our European operations.

Asset impairments We recorded asset impairment charges of \$11.6 million in 2007 and \$196.5 million in 2006 associated with idling a portion of our production capacity in the U.S. dedicated to the mid-size light truck product range and other capacity reduction initiatives. The charge in 2007 includes a \$5.9 million reduction of the net book value of certain assets at our Buffalo facility, which was production idled in the fourth quarter of 2007. This charge also includes a \$5.7 million write-off of assets previously classified as held for sale. The charge in 2006 related to the write-off of assets to be disposed of that became permanently idled in 2006, the reduction of the net book value of certain assets located at our Buffalo facility to their estimated fair value, the write down of assets classified as held for sale to their estimated net realizable value and the write down of certain machine repair parts classified as indirect inventory.

In addition to these charges, the decrease in gross profit in 2006 as compared to 2005 reflects lower production volumes and increases in non-cash expenses related to depreciation and amortization, pension and other postretirement benefit costs and stock-based compensation costs. Partially offsetting the impact of these items on gross profit were ongoing productivity improvements, including material cost reductions and the favorable impact of additional metal market agreements in 2006. In addition, we recorded a \$3.3 million curtailment gain in 2006 to cost of sales for amendments to our salaried defined benefit pension and other postretirement benefit plans.

Our gross profit in 2005 reflects the impact of a voluntary separation program, whereby participating hourly associates received lump-sum payments to voluntarily terminate their employment with AAM. We recognized a pre-tax charge of \$17.3 million in 2005 related to this program.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

(SG&A) SG&A (including R&D) was \$202.8 million in 2007 as compared to \$197.4 million in 2006 and \$199.6 million in 2005. SG&A as a percentage of net sales was 6.2% in 2007 and 2006 and 5.9% in 2005.

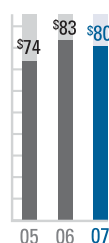


SG&A in 2007 reflects higher incentive compensation accruals and stock-based compensation expense due to increased profitability and stock price appreciation.

Included in SG&A in 2006 is a charge of \$1.3 million related to our salaried workforce reductions, which is discussed in Gross Profit (Loss). Also included in SG&A in 2006 is a \$3.2 million curtailment gain for amendments to our salaried defined benefit pension and other postretirement benefit plans.

R&D In 2007, R&D spending was \$80.4 million as compared to \$83.2 million in 2006 and \$73.6 million in 2005. The focus of

R&D
(in millions)



our investment is to develop innovative driveline and drivetrain systems and related components for trucks, passenger cars, SUVs and crossover utility vehicles in the global marketplace. Product development in this area includes power transfer units, transfer cases, driveline and transmission differentials, multipiece driveshafts, independent rear drive axles and independent front drive axles. We continue to focus on electronic integration in our existing products. We also continue to support the development of hybrid vehicle systems. Our efforts in these areas have resulted in the development of prototypes and various configurations of these driveline systems for several OEMs throughout the world.

OPERATING INCOME (LOSS) Operating income (loss) was income of \$75.6 million in 2007 as compared to a loss of \$326.0 million in 2006 and income of \$105.1 million in 2005. Operating margin was 2.3% in 2007 as compared to a margin of negative 10.2% in 2006 and 3.1% in 2005. The changes in operating income and operating margin in 2007, 2006 and 2005 were due to the factors discussed in Gross Profit (Loss) and SG&A.

INTEREST EXPENSE Interest expense was \$61.6 million in 2007, \$39.0 million in 2006 and \$27.9 million in 2005. Interest expense increased in 2007 as compared to 2006 and in 2006 as compared to 2005 due to higher average outstanding borrowings and higher average interest rates.

INTEREST INCOME Interest income was \$9.3 million in 2007, \$0.2 million in 2006 and \$0.7 million in 2005. Interest income increased in 2007 because of higher cash and cash equivalent balances in 2007 as compared to 2006 and 2005.

OTHER INCOME (EXPENSE) Following are the components of Other Income (Expense) for 2007, 2006 and 2005:

Debt refinancing and redemption costs We expensed \$5.5 million of unamortized debt issuance costs and prepayment premiums in 2007 related to the voluntary prepayment of our Term Loan due 2010. We had been amortizing the debt issuance costs over the expected life of the borrowing. This compares to the \$2.7 million of unamortized debt issuance costs that were expensed in 2006 related to the cash conversion of a portion of our 2.00% Convertible Notes due 2024.

Other, net Other, net, which includes the net effect of foreign exchange gains and losses, was an expense of \$0.2 million in 2007, income of \$12.0 million in 2006 and income of \$2.1 million in 2005. In 2006, this included a net gain of \$10.1 million related to the resolution of various legal proceedings and claims.

INCOME TAX EXPENSE (BENEFIT) Income tax expense (benefit) was a benefit of \$19.4 million in 2007 as compared to a benefit of \$133.0 million in 2006 and expense of \$24.0 million in 2005. Our effective income tax rate was a benefit of 110.7% in 2007 compared to a benefit of 37.4% in 2006 and an expense of 30.0% in 2005. The change in the 2007 tax rate as compared to 2006 and 2005 is primarily the result of recognizing the deferred income tax benefit of current year losses in the U.S. and the tax rate impact of an increase in foreign source income, which carries a lower overall effective tax rate than U.S. income. In 2007, the change in the effective tax rate also reflects the impact of tax deductions on a smaller base of income (loss) before income taxes.

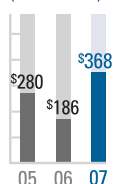
NET INCOME (LOSS) AND EARNINGS (LOSS) PER SHARE (EPS) Net income (loss) was income of \$37.0 million in 2007 as compared to a loss of \$222.5 million in 2006 and income of \$56.0 million in 2005. Diluted earnings (loss) were earnings of \$0.70 per share in 2007 as compared to a loss of \$4.42 per share in 2006 and earnings of \$1.10 per share in 2005. Net Income (Loss) and EPS were primarily impacted by the factors discussed in Gross Profit (Loss), SG&A, Interest Expense, Other Income (Expense) and Income Tax Expense (Benefit).

LIQUIDITY AND CAPITAL RESOURCES

Our primary liquidity needs are to fund capital expenditures, debt service obligations, working capital investments and our quarterly cash dividend program. We also need to fund ongoing attrition programs and may need to fund additional restructuring actions, including potential events related to the expiration of the current collective bargaining agreement with the UAW. We believe that operating cash flow and borrowings under our Revolving Credit Facility will be sufficient to meet these needs in the foreseeable future.

OPERATING ACTIVITIES Net cash provided by operating activities was \$367.9 million in 2007 as compared to \$185.7 million in 2006 and \$280.4 million in 2005. Significant factors impacting our 2007 operating cash flow as compared to 2006 were:

Net Cash
Provided by
Operating
Activities
(in millions)



- higher net income;
- increased collections from customers;
- lower cash payments related to restructuring actions;
- receipt of customer payments to implement customer capacity programs;
- lower operating lease payments; and
- lower tax payments.

Restructuring actions In 2007 and 2006, we paid \$80.9 million and \$105.3 million, respectively, related to restructuring actions. Notwithstanding potential additional future actions, we expect to make payments in 2008 of approximately \$21 million for these restructuring programs.

Deferred income taxes Net deferred income tax assets increased in 2007 due to the liability recorded for future postretirement costs, the recognition of research and experimentation credits and a reduction in our overall deferred tax liabilities. A significant portion of our tax credits will result in carryforward credits, the benefit of which is reflected on our balance sheet as a deferred tax asset on December 31, 2007.

Our deferred tax asset valuation allowances were \$42.3 million at year-end 2007, \$39.0 million at year-end 2006 and \$31.2 million at year-end 2005. The majority of our allowances relate to foreign net operating losses and capital allowance carryforwards. Although these carryforwards do not expire, we considered prior operating results and future plans, as well as the utilization period of other temporary differences, in determining the amount of our valuation allowances.

Pension and other postretirement benefits We contributed \$19.9 million to our pension trusts in 2007 as compared to \$9.1 million in 2006 and \$34.7 million in 2005. This funding compares to our annual pension expense of \$35.0 million in 2007, \$52.1 million in 2006 and \$41.3 million in 2005. We currently estimate our regulatory pension funding requirements in 2008 to be less than \$5 million.

Our cash outlay for other postretirement benefit obligations was \$9.0 million in 2007, \$4.7 million in 2006 and \$3.5 million in 2005. This compares to our annual postretirement benefit expense of \$50.3 million in 2007, \$69.2 million in 2006 and \$70.1 million in 2005. We expect our cash outlay for other postretirement benefit obligations in 2008 to be between \$5 million and \$10 million.

Accounts receivable Accounts receivable at year-end 2007 were \$264.0 million as compared to \$327.6 million at year-end 2006 and \$328.0 million at year-end 2005. Accounts receivable were impacted by reduced sales in the fourth quarter of 2007 as compared to the fourth quarter of 2006 and more timely billing and collection of metal market price adjustments.

Our accounts receivable allowances were \$2.2 million at year-end 2007, \$1.2 million at year-end 2006 and \$3.1 million at year-end 2005.

Inventories At year-end 2007, inventories were \$229.0 million as compared to \$198.4 million at year-end 2006 and \$207.2 million at year-end 2005. The increase in inventory in 2007 as compared to 2006 relates to an increase in business activity at our foreign locations as well as actions supporting our redeployment of assets in 2007.

Our inventory valuation allowances were \$40.3 million at year-end 2007, \$34.7 million at year-end 2006 and \$20.3 million at year-end 2005. The change in our inventory valuation allowances in 2006 as compared to 2005 was due to increased reserves for indirect inventories, primarily resulting from the idling and impairment of certain machinery and equipment. We monitor and adjust our allowance as necessary to recognize as an asset only those quantities that we can reasonably estimate will be used.

INVESTING ACTIVITIES Capital expenditures were \$186.5 million in 2007, \$286.6 million in 2006 and \$305.7 million in 2005. In 2007, our capital spending supported our

Capital
Expenditures
(in millions)



asset redeployment actions, customer capacity programs, the future launch of passenger car and crossover vehicle programs within our new business backlog and the continued development of our facilities in China and Poland.

We expect our capital spending in 2008 to be in the range of \$190 million to \$200 million. We expect to have expenditures in 2008 that will continue to support the

expansion of our global manufacturing footprint. We currently have eight major manufacturing facility expansions in process in Brazil, India, Mexico, Poland, Thailand and the U.S.

FINANCING ACTIVITIES Net cash provided by financing activities was \$148.3 million in 2007 as compared to \$147.3 million in 2006 and \$14.8 million in 2005. Total debt outstanding was \$858.1 million at year-end 2007, \$672.2 million at year-end 2006 and \$489.2 million at year-end 2005. Total debt outstanding increased by \$185.9 million at year-end 2007 as compared to year-end 2006 primarily due to the issuance of the 7.875% Notes in the first quarter of 2007. The increase in debt is also reflected in the increase in our cash balance from \$13.5 million at December 31, 2006 to \$343.6 million at December 31, 2007.

Revolving Credit Facility Our Revolving Credit Facility bears interest at rates based on LIBOR or an alternate base rate, plus an applicable margin, and runs through April 2010. At December 31, 2007, \$571.7 million was available under the Revolving Credit Facility, which reflected a reduction of \$28.3 million for standby letters of credit issued against the facility.

The Revolving Credit Facility provides back-up liquidity for our foreign credit facilities and uncommitted lines of credit. We intend to use the availability of long-term financing under the Revolving Credit Facility to refinance any current maturities related to such debt agreements that are not otherwise refinanced on a long-term basis in their respective markets. Accordingly, we have classified \$40.3 million of current maturities as long-term debt.

7.875% Notes In the first quarter of 2007, we issued \$300.0 million of 7.875% senior unsecured notes due 2017. Net proceeds from these notes were used for general corporate purposes, including payment of amounts outstanding under our Revolving Credit Facility. In 2007, we paid debt issuance costs of \$5.2 million related to the 7.875% Notes.

2.00% Convertible Notes In 2006, the 2.00% senior convertible notes due 2024 became convertible into cash under terms of the indenture. A total of \$147.3 million of the notes was converted into cash in 2006 and \$2.7 million of the notes remain outstanding as of December 31, 2007. We had been amortizing fees and expenses associated with the 2.00% Convertible Notes over the expected life of the notes. As a result of these conversions, we expensed the proportional amount of unamortized debt issuance costs in 2006, which totaled \$2.7 million.

Term Loan Due 2012 On June 14, 2007, we entered into a \$250.0 million senior unsecured term loan that matures in June 2012. Borrowings under the Term Loan due 2012 bear interest payable at rates based on LIBOR or an alternate base rate, plus an applicable margin. Proceeds from this borrowing were used for general corporate purposes, including the payment of amounts outstanding under the senior unsecured term loan scheduled to mature in April 2010. In 2007, we paid \$2.3 million in debt issuance costs related to the Term Loan due 2012.

Term Loan Due 2010 In 2006, we entered into a \$250.0 million senior unsecured term loan due in April 2010. Proceeds from this financing were used for general corporate purposes and to finance payments related to the cash conversion of the 2.00% Convertible Notes. On June 28, 2007, we voluntarily prepaid the amounts outstanding under our Term Loan due 2010. Upon repayment, we expensed \$3.0 million of unamortized debt issuance costs and \$2.5 million of prepayment premiums. We had been amortizing the debt issuance costs over the expected life of the borrowing.

The weighted-average interest rate of our total debt outstanding was 8.1%, 6.8% and 5.0% during 2007, 2006 and 2005, respectively.

Credit ratings Our current credit ratings and (outlook) are BB (Negative), Ba3 (Stable) and BB (Stable) with Standard & Poors Rating Services, Moody's Investors Services and Fitch Ratings, respectively.

Dividend program On an annualized basis, our dividend payout equates to \$0.60 per share. We paid \$31.8 million, \$31.0 million and \$30.4 million to stockholders of record under the quarterly cash dividend program during 2007, 2006 and 2005, respectively.

Off-balance sheet arrangements Our off-balance sheet financing relates principally to operating leases for certain facilities and manufacturing machinery and equipment. We lease certain machinery and equipment under operating leases with various expiration dates. Pursuant to these operating leases, we have the option to purchase the underlying machinery and equipment on specified dates. In 2006, we renewed and amended equipment leases of \$33.6 million, elected to exercise our purchase option for \$71.8 million of assets and entered into sale-leaseback transactions amounting to \$34.8 million. Remaining lease repurchase options are \$42.7 million through 2012.

Contractual obligations The following table summarizes payments due on our contractual obligations as of December 31, 2007:

| | Total | Payments due by period | | | |
|--|------------|------------------------|-----------|-----------|----------|
| | | <1 year | 1-3 years | 3-5 years | >5 years |
| | | (in millions) | | | |
| Long-term debt | \$ 849.2 | \$ 39.6 | \$ 1.9 | \$ 257.9 | \$ 549.8 |
| Interest obligations | 397.9 | 60.3 | 116.5 | 104.4 | 116.7 |
| Capital lease obligations | 8.9 | 0.7 | 1.4 | 1.2 | 5.6 |
| Operating leases ⁽¹⁾ | 73.4 | 17.9 | 31.8 | 23.0 | 0.7 |
| Purchase obligations ⁽²⁾ | 158.4 | 142.6 | 15.8 | - | - |
| Other long-term liabilities ⁽³⁾ | 525.3 | 32.3 | 100.3 | 97.6 | 295.1 |
| Total | \$ 2,013.1 | \$ 293.4 | \$ 267.7 | \$ 484.1 | \$ 967.9 |

(1) Operating leases include all lease payments through the end of the contractual lease terms, including elections for repurchase options, and exclude any non-exercised purchase options on such leased equipment.

(2) Purchase obligations represent our obligated purchase commitments for capital expenditures.

(3) Other long-term liabilities represent our pension and postretirement obligations that were actuarially determined through 2017 and unrecognized income tax benefits.

MARKET RISK

Our business and financial results are affected by fluctuations in world financial markets, including interest rates and currency exchange rates. Our hedging policy has been developed to manage these risks to an acceptable level based on management's judgment of the appropriate trade-off between risk, opportunity and cost. We do not hold financial instruments for trading or speculative purposes.

CURRENCY EXCHANGE RISK Because a majority of our business is denominated in U.S. dollars, we do not currently have significant exposures relating to currency exchange risk. From time to time, we use foreign currency forward contracts to reduce the effects of fluctuations in exchange rates, primarily relating to the Mexican Peso, Euro, Pound Sterling, Brazilian Real and Canadian Dollar. At December 31, 2007, we had currency forward contracts with a notional amount of \$41.8 million outstanding. Our significant functional currency transactional exposures relate to the Mexican Peso and

Brazilian Real. The estimated maximum adverse effect related to the transactional exposures from a hypothetical 10% weakening of the U.S. dollar relative to these currencies for 2008 is approximately \$6 million.

Future business operations and opportunities, including the expansion of our business outside North America, may further increase the risk that cash flows resulting from these activities may be adversely affected by changes in currency exchange rates. If and when appropriate, we intend to manage these risks by utilizing local currency funding for these expansions and various types of foreign exchange contracts.

INTEREST RATE RISK We are exposed to variable interest rates on certain credit facilities. From time to time, we use interest rate hedging to reduce the effects of fluctuations in market interest rates. We have designated interest rate swaps as effective cash flow hedges of the related debt and reflect the net cost of such agreements as an adjustment to interest expense over the lives of the debt agreements. We have hedged a portion of our interest rate risk by entering into an interest rate swap with a notional amount of \$200.0 million. This notional amount reduces to \$100.0 million in December 2008 and expires in April 2010. This interest rate swap converts variable rate financing based on 3-month LIBOR into fixed U.S. dollar rates. The pre-tax earnings and cash flow impact of a one-percentage-point increase in interest rates (approximately 13% of our weighted-average interest rate at December 31, 2007) on our long-term debt outstanding at December 31, 2007 would be approximately \$1.0 million on an annualized basis.

CYCLICALITY AND SEASONALITY

Our operations are cyclical because they are directly related to worldwide automotive production, which is itself cyclical and dependent on general economic conditions and other factors. Our business is also moderately seasonal as our major OEM customers historically have a two-week shutdown of operations in July and an approximate one-week shutdown in December. In addition, our OEM customers have historically incurred lower production rates in the third quarter as model changes enter production. Accordingly, our third quarter and fourth quarter results may reflect these trends.

LEGAL PROCEEDINGS

We are involved in various legal proceedings incidental to our business. Although the outcome of these matters cannot be predicted with certainty, we do not believe that any of these matters, individually or in the aggregate, will have a material adverse effect on our financial condition, results of operations or cash flows.

We are subject to various federal, state, local and foreign environmental and occupational safety and health laws,

regulations and ordinances, including those regulating air emissions, water discharge, waste management and environmental cleanup. We closely monitor our environmental conditions to ensure that we are in compliance with applicable laws, regulations and ordinances. GM has agreed to indemnify and hold us harmless against certain environmental conditions existing prior to our asset purchase from GM on March 1, 1994. GM's indemnification obligations terminated on March 1, 2004 with respect to any new claims that we may have against GM. We have made, and will continue to make, capital and other expenditures to comply with environmental requirements, including recurring administrative costs. Such expenditures were not significant in 2007, 2006 and 2005.

EFFECT OF NEW ACCOUNTING STANDARDS

In December 2004, the FASB issued Statement No. 123(R) (SFAS 123R), *"Share-Based Payment."* SFAS 123R replaced FASB Statement No. 123, *"Accounting for Stock-Based Compensation,"* and superseded APB Opinion No. 25, *"Accounting for Stock Issued to Employees."* The revised statement requires that the compensation cost relating to share-based payment transactions be recognized in financial statements and measured on the fair value of the equity or liability instruments issued. We adopted SFAS 123R on January 1, 2006.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48 (FIN 48), *"Accounting for Uncertainty in Income Taxes."* FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *"Accounting for Income Taxes."* This interpretation prescribes a "more likely than not" recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The impact of adopting FIN 48 was not material.

In September 2006, the FASB issued Statement No. 158 (SFAS 158), *"Employers Accounting for Defined Benefit Pension and Other Postretirement Plans."* This statement amended FASB Statement Nos. 87, 88, 106 and 132R. We adopted the balance sheet recognition provisions of SFAS 158 on December 31, 2006. The effective date for plan assets and benefit obligations to be measured as of the date of the fiscal year-end statement of financial position is January 1, 2008. We elected to early adopt the measurement date provisions on January 1, 2007. As a result, we recorded a transition adjustment of \$12.0 million in the first quarter of 2007 to the opening retained earnings balance related to the net periodic benefit cost for the period between September 30, 2006 and January 1, 2007.

In September 2006, the FASB issued Statement No. 157 (SFAS 157), *"Fair Value Measurements."* This statement clarifies the definition of fair value and establishes a fair value hierarchy. SFAS 157 is effective for us on January 1, 2008. We do not expect the impact of adoption to be material.

In February 2007, the FASB issued Statement No. 159 (SFAS 159), *"The Fair Value Option for Financial Assets and Financial Liabilities."* This statement permits entities to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 is effective for us on January 1, 2008. We do not expect the impact of adoption to be material.

CRITICAL ACCOUNTING POLICIES

In order to prepare consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP), we are required to make estimates and assumptions that affect the reported amounts and disclosures in our consolidated financial statements. These estimates are subject to an inherent degree of uncertainty and actual results could differ from our estimates.

Other items in our consolidated financial statements require estimation. In our judgment, they are not as critical as those disclosed herein. We have discussed and reviewed our critical accounting policies disclosure with the Audit Committee of our Board of Directors.

PENSION AND OTHER POSTRETIREMENT BENEFITS In calculating our liabilities and expenses related to pension and other postretirement benefits, we make several important assumptions, including the discount rate, expected long-term rates of return on plan assets and rates of increase in health care costs and compensation.

The discount rates used in the valuation of our U.S. pension and other postretirement benefit obligations are based on an actuarial review of a hypothetical portfolio of long-term, high quality corporate bonds matched against the expected payment stream for each of our plans. In 2007, the discount rates determined on that basis ranged from 6.30% to 6.60% for the valuation of our pension benefit obligations, and 6.35% to 6.55% for the valuation of our other postretirement benefit obligations. The discount rate used in the valuation of our non-U.S. pension obligation is based on a review of long-term bonds, in consideration of the average duration of plan liabilities. In 2007, the discount rate determined on that basis was 5.70%.

The expected long-term rates of return on our plan assets were 8.50% and 6.50% for our U.S. and non-U.S. plans, respectively, in 2007. We developed these rates of return assumptions based on a review of long-term historical returns

and future capital market expectations for the asset classes represented within our portfolio. The asset allocation for our plans is developed in consideration of the demographics of the plan participants and expected payment stream of the liability. Our investment policy allocates 65-70% of the plans' assets to equity securities, depending on the plan, with the remainder invested in fixed income securities and cash. The rates of increase in compensation and health care costs are based on current market conditions, inflationary expectations and historical information.

All of our assumptions are developed in consultation with our actuarial service providers. While we believe that we have selected reasonable assumptions for the valuation of our pension and other postretirement benefits obligations at year-end 2007, actual trends could result in materially different valuations.

The effect on our pension plans of a 0.5% decrease in both the discount rate and expected return on assets is shown below as of December 31, 2007, our valuation date.

| | Discount Rate | Expected Return on Assets |
|--------------------------|------------------|---------------------------------|
| | (in millions) | |
| Decline in funded status | \$ 37.3 | N/A |
| Increase in 2007 expense | \$ 8.6 | \$ 1.9 |

No changes in benefit levels and no changes in the amortization of gains or losses have been assumed.

For 2008, we assumed a weighted average annual increase in the per-capita cost of covered healthcare benefits of 8.6%. The rate is assumed to decrease gradually to 5% for 2014 and remain at that level thereafter. A 0.5% decrease in the discount rate for our other postretirement benefits would have increased total service and interest cost in 2007 and the postretirement obligation at December 31, 2007 by \$4.3 million and \$44.2 million, respectively. A 1.0% increase in the assumed health care trend rate would have increased total service and interest cost in 2007 and the postretirement obligation at December 31, 2007 by \$11.6 million and \$84.6 million, respectively.

POSTEMPLOYMENT BENEFITS As part of our operations, we pay postemployment benefits to associates who are temporarily or permanently on layoff. These benefits received prior to retirement may relate to a pre-existing plan or a one-time termination plan. Annual net postemployment benefits expense under our benefit plans and the related liabilities are accrued as service is rendered for those obligations that accumulate or vest and when the liability is probable and can be reasonably estimated. Obligations that do not accumulate or vest are recorded when

payment of the benefits is probable and the amounts can be reasonably estimated. Due to the complexities inherent in estimating these obligations, our actual costs could differ materially. Accordingly, we will continue to review our expected liability and make adjustments as necessary.

In the third quarter of 2006, we recorded a \$91.2 million charge for SUB estimated to be payable to the UAW associates who were expected to be permanently idled through the end of the current collective bargaining agreement that expires in February 2008. In prior periods, the cost of SUB and related benefits paid to associates on layoff was expensed as incurred. In the third quarter of 2006, several factors contributed to a condition in which future SUB costs became both probable and reasonably estimable.

In the fourth quarter of 2006, we paid \$101.2 million of postemployment benefits related to participation in the SAP. The participation in the SAP reduced the number of associates that we expected to be permanently idled. Therefore, we revised our estimate of SUB to be paid pursuant to the current agreement and reduced this liability to \$13.2 million as of December 31, 2006. In 2007, we paid \$11.3 million of this accrual and adjusted our estimate of SUB costs to be paid to such associates through February 25, 2008. At December 31, 2007, the accrual for SUB was \$4.7 million.

ENVIRONMENTAL OBLIGATIONS Due to the nature of our operations, we have legal obligations to perform asset retirement activities pursuant to federal, state and local environmental requirements. The process of estimating environmental liabilities is complex. Significant uncertainty may exist related to the timing and method of the settlement of these obligations. Therefore, these liabilities are not reasonably estimable until a triggering event occurs that allows us to estimate a range and assess the probabilities of potential settlement dates and the potential methods of settlement.

In 2006, based on the impairment and redeployment of assets and determination of certain assets as permanently idled, the methods and timing of certain environmental liabilities related to our Buffalo facility were reasonably estimable. Based on management's best estimate of the costs, we recorded a charge of \$2.5 million.

In 2007, we paid \$0.3 million of environmental costs related to this accrual. At year-end 2007, the remaining liability related to this obligation was \$2.2 million. In the future, we will update our estimated costs and potential settlement dates and methods and their associated probabilities based on current information. Any update may change our best estimate and could result in a material adjustment to this liability.

ACCOUNTS RECEIVABLE ALLOWANCES The scope of our relationships with certain customers, such as GM and Chrysler, is complex and, from time to time, we identify differences in our valuation of receivables due from these customers. Differences in the quantity of parts processed as received by customers and the quantity of parts shipped by AAM is one major type of such difference. Price differences can also arise when we and our customer agree on a price change but the customer's pricing database does not accurately reflect the commercial agreement. In these instances, revenue is fixed and determinable, but payment could fall outside our normal payment terms as we work through the process of resolving these differences.

Substantially all of our transactions with customers occur within the parameters of a purchase order which makes our selling prices fixed and determinable. We sometimes enter into non-routine agreements outside the original scope of the purchase order. These agreements may be temporary and often have payment terms that are different than our normal terms. We recognize the revenue or cost recovery from such arrangements in accordance with the commercial agreement.

We track the aging of uncollected billings and adjust our accounts receivable allowances on a quarterly basis as necessary based on our evaluation of the probability of collection. The adjustments we have made due to the write-off of uncollectible amounts have been negligible.

While we believe that we have made an appropriate valuation of our accounts receivable due from GM, Chrysler and other customers for accounting purposes, unforeseen changes in our ability to enforce commercial agreements or collect aged receivables may result in actual collections that differ materially from current estimates.

VALUATION OF INDIRECT INVENTORIES As part of our strategy to control our investment in working capital and manage the risk of excess and obsolete inventory, we generally do not maintain large balances of productive raw materials, work-in-process or finished goods inventories. Instead, we utilize lean manufacturing techniques and coordinate our daily production activities to meet our daily customer delivery requirements. The ability to address plant maintenance issues on a real-time basis is a critical element of our ability to pursue such an operational strategy. Our machinery and equipment may run for long periods of time without disruption and suddenly fail to operate as intended.

In addition, certain repair parts required to address such maintenance requirements may be difficult or cost prohibitive to source on a real-time basis.

To facilitate our continuous preventive maintenance strategies and to protect against costly disruptions in operations due to machine downtime, we carry a significant investment in inherently slow-moving machine repair parts and other maintenance materials and supplies. At December 31, 2007, such indirect inventories comprised approximately 38% of our total net inventories. For inventory valuation purposes, we evaluate our usage of such slow-moving inventory on a quarterly basis by part number and adjust our inventory valuation allowances as necessary to recognize as an asset only those quantities that we can reasonably estimate will be used. We have used the same approach in 2007 and 2006 to evaluate the adequacy of our indirect inventory valuation allowances.

In 2006, as a result of asset impairments of certain machinery and equipment and related machine repair parts, we recorded a \$9.4 million increase to our indirect inventory reserve.

While we believe that we have made an appropriate valuation of such inventories for accounting purposes, unforeseen changes in inventory usage requirements, manufacturing processes, maintenance and repair techniques, or inventory control may result in actual usage of such inventories that differ materially from current estimates.

ESTIMATED USEFUL LIVES FOR DEPRECIATION At December 31, 2007, approximately 82% of our capitalized investment in property, plant and equipment, or \$2.4 billion, was related to machinery and equipment used in support of our manufacturing operations. The selection of appropriate useful life estimates for such machinery and equipment is a critical element of our ability to properly match the cost of such assets with the operating profits and cash flow generated by their use. We currently depreciate machinery and equipment on the straight-line method using composite useful life estimates up to 12 years. We monitor useful life estimates on a periodic basis and adjust our estimates if necessary.

While we believe that the useful life estimates currently being used for depreciation purposes reasonably approximate the period of time we will use such assets in our operations, unforeseen changes in product design and technology standards or cost, quality and delivery requirements may result in actual useful lives that differ materially from the current estimates.

IMPAIRMENT OF LONG-LIVED ASSETS Long-lived assets, excluding goodwill, to be held and used are reviewed for impairment whenever adverse events or changes in circumstances indicate a possible impairment. An impairment loss is recognized when the long-lived assets' carrying value exceeds the fair value. If business conditions or other factors cause the profitability and estimated cash flows to be generated from an asset to decline, we may be required to record impairment charges at that time. Long-lived assets held for sale are recorded at the lower of their carrying amount or fair value less cost to sell. Significant judgments and estimates used by management when evaluating long-lived assets for impairment include:

- An assessment as to whether an adverse event or circumstance has triggered the need for an impairment review;
- Undiscounted future cash flows generated by the assets; and
- Determination of fair value when an impairment is deemed to exist.

In 2006, we recorded expense of \$39.4 million for assets to be disposed that were identified as permanently idled. In addition, we recorded expense of \$142.0 million for the reduction of the net book value required to state certain "held for use" long-lived assets to their estimated fair value and reduced the remaining useful lives of certain of these assets. Certain other long-lived assets classified as "held for sale" were written down to their estimated net realizable value based on estimated market prices. We recorded an expense of \$5.7 million for these assets. As a result of the asset impairments relating to machinery and equipment, certain machine repair parts classified as indirect inventory were also impaired. We recorded an expense of \$9.4 million related to the write down of their net book value to their estimated net realizable value at year-end 2006.

In 2007, we reviewed the estimates made in 2006 related to the impairment of long-lived assets. We recorded an additional impairment charge of \$11.6 million in 2007. This included a \$5.9 million charge for the reduction of net book value required to state certain assets to their estimated fair value. The remaining \$5.7 million impairment charge relates to the write-off of assets previously classified as "held for sale."

Management believes that the estimates of future cash flows and fair value assumptions are reasonable; however, changes in assumptions underlying these estimates could affect the evaluations.

VALUATION OF DEFERRED TAX ASSETS AND OTHER TAX LIABILITIES Because we operate in many different geographic locations, including several foreign, state and local tax jurisdictions, the evaluation of our ability to use all recognized deferred tax assets is complex.

We are required to estimate whether recoverability of our deferred tax assets is more likely than not, based on forecasts of taxable income in the related tax jurisdictions. In this estimate, we use historical results, projected future operating results based upon approved business plans, eligible carry-forward periods, tax planning opportunities and other relevant considerations. This includes the consideration of tax law changes, a history of profitability and the uncertainty of future projected profitability.

Our deferred tax asset valuation allowances at December 31, 2007 and 2006 are principally related to foreign net operating losses and capital allowance carry forwards. Although these carry forwards do not expire, we consider prior operating results and future plans, as well as the utilization period of other temporary differences in determining the amount of our valuation allowances. In 2007 and 2006, we utilized a portion of such tax benefits.

While we believe we have made appropriate valuations of our deferred tax assets, unforeseen changes in tax legislation, regulatory activities, audit results, operating results, financing strategies, organization structure and other related matters may result in material changes in our deferred tax asset valuation allowances or our tax liabilities.

To the extent our uncertain tax positions do not meet the "more likely than not" threshold, we have derecognized such positions. To the extent our uncertain tax positions meet the "more likely than not" threshold, we have measured and recorded the highest probable benefit, and have established appropriate reserves for benefits that exceed the amount likely to be defended upon examination.



FORWARD-LOOKING INFORMATION

Certain statements in this MD&A and elsewhere in this Annual Report are forward-looking in nature and relate to trends and events that may affect our future financial position and operating results. Such statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The terms "will," "expect," "anticipate," "intend," "project" and similar words or expressions are intended to identify forward-looking statements. These statements speak only as of the date of this Annual Report. The statements are based on our current expectations, are inherently uncertain, are subject to risks and should be viewed with caution. Actual results and experience may differ materially from the forward-looking statements as a result of many factors, including, but not limited to:

- reduced purchases of our products by GM, Chrysler or other customers;
- reduced demand for our customers' products (particularly light trucks and SUVs produced by GM and Chrysler);
- our ability and our suppliers' ability to maintain satisfactory labor relations and avoid work stoppages;
- our ability to achieve cost reductions through ongoing restructuring actions;
- our ability to improve our U.S. labor cost structure;
- additional restructuring actions that may occur;
- our ability to achieve the level of cost reductions required to sustain global cost competitiveness;
- our ability to consummate and integrate acquisitions;
- supply shortages or price increases in raw materials, utilities or other operating supplies;
- our ability or our customers' and suppliers' ability to successfully launch new product programs on a timely basis;
- our ability to realize the expected revenues from our new and incremental business backlog;
- our customers' and their suppliers' ability to maintain satisfactory labor relations and avoid work stoppages;
- our ability to attract new customers and programs for new products;
- our ability to develop and produce new products that reflect the market demand;
- our ability to respond to changes in technology, increased competition or pricing pressures;
- adverse changes in laws, government regulations or market conditions including increases in fuel prices affecting our products or our customers' products (such as the Corporate Average Fuel Economy regulations);
- adverse changes in the economic conditions or political stability of our principal markets (particularly North America, Europe, South America and Asia);
- liabilities arising from warranty claims, product liability and legal proceedings to which we are or may become a party or claims against us or our products;
- changes in liabilities arising from pension and other postretirement benefit obligations;
- risks of noncompliance with environmental regulations or risks of environmental issues that could result in unforeseen costs at our facilities;
- availability of financing for working capital, capital expenditures, R&D or other general corporate purposes, including our ability to comply with financial covenants;
- our ability to attract and retain key associates;
- other unanticipated events and conditions that may hinder our ability to compete.

It is not possible to foresee or identify all such factors and we make no commitment to update any forward-looking statement or to disclose any facts, events or circumstances after the date hereof that may affect the accuracy of any forward-looking statement.

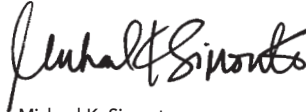
MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

We are responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. In making this assessment, we used the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment, we believe that as of December 31, 2007, our internal control over financial reporting is effective based on those criteria.



Richard E. Dauch
Co-Founder, Chairman of the Board &
Chief Executive Officer
February 20, 2008



Michael K. Simonte
Group Vice President – Finance &
Chief Financial Officer
(also in the capacity of Chief Accounting Officer)
February 20, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of American Axle & Manufacturing Holdings, Inc.:

We have audited the accompanying consolidated balance sheets of American Axle & Manufacturing Holdings, Inc. and subsidiaries (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. We also have audited the Company's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Axle & Manufacturing Holdings, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in Notes 1, 6 and 8, on January 1, 2006 the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payments*, on December 31, 2006 adopted the balance sheet provisions of SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* and on January 1, 2007 adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* and the measurement date provisions of SFAS No. 158.



Deloitte & Touche LLP
Detroit, Michigan
February 20, 2008

Consolidated Statements of Operations

Year Ended December 31,

(in millions, except per share data)

| | 2007 | 2006 | 2005 |
|--|------------|------------|------------|
| Net sales | \$ 3,248.2 | \$ 3,191.7 | \$ 3,387.3 |
| Cost of goods sold | 2,969.8 | 3,320.3 | 3,082.6 |
| Gross profit (loss) | 278.4 | (128.6) | 304.7 |
| Selling, general and administrative expenses | 202.8 | 197.4 | 199.6 |
| Operating income (loss) | 75.6 | (326.0) | 105.1 |
| Interest expense | (61.6) | (39.0) | (27.9) |
| Interest income | 9.3 | 0.2 | 0.7 |
| Other income (expense) | | | |
| Debt refinancing and redemption costs | (5.5) | (2.7) | - |
| Other, net | (0.2) | 12.0 | 2.1 |
| Income (loss) before income taxes | 17.6 | (355.5) | 80.0 |
| Income tax expense (benefit) | (19.4) | (133.0) | 24.0 |
| Net income (loss) | \$ 37.0 | \$ (222.5) | \$ 56.0 |
| Basic earnings (loss) per share | \$ 0.72 | \$ (4.42) | \$ 1.12 |
| Diluted earnings (loss) per share | \$ 0.70 | \$ (4.42) | \$ 1.10 |

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

December 31,

(in millions, except per share data)

| | 2007 | 2006 |
|---|------------|------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 343.6 | \$ 13.5 |
| Accounts receivable, net of allowances of \$2.2 million in 2007 and \$1.2 million in 2006 | 264.0 | 327.6 |
| Inventories, net | 229.0 | 198.4 |
| Prepaid expenses and other | 73.4 | 69.2 |
| Deferred income taxes | 24.6 | 30.7 |
| Total current assets | 934.6 | 639.4 |
| Property, plant and equipment, net | 1,696.2 | 1,731.7 |
| Deferred income taxes | 78.7 | 35.7 |
| Goodwill | 147.8 | 147.8 |
| Other assets and deferred charges | 57.4 | 42.9 |
| Total assets | \$ 2,914.7 | \$ 2,597.5 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 313.8 | \$ 316.4 |
| Trade payable program liability | - | 12.5 |
| Accrued compensation and benefits | 126.6 | 156.3 |
| Other accrued expenses | 71.2 | 56.1 |
| Total current liabilities | 511.6 | 541.3 |
| Long-term debt | 858.1 | 672.2 |
| Deferred income taxes | 6.6 | 6.8 |
| Postretirement benefits and other long-term liabilities | 647.7 | 563.5 |
| Total liabilities | 2,024.0 | 1,783.8 |
| Stockholders' equity | | |
| Series A junior participating preferred stock, par value \$0.01 per share; 0.1 million shares authorized; no shares outstanding in 2007 or 2006 | - | - |
| Preferred stock, par value \$0.01 per share; 10.0 million shares authorized; no shares outstanding in 2007 or 2006 | - | - |
| Common stock, par value \$0.01 per share; 150.0 million shares authorized; 56.7 million and 55.6 million shares issued and outstanding in 2007 and 2006, respectively | 0.6 | 0.6 |
| Series common stock, par value \$0.01 per share; 40.0 million shares authorized; no shares outstanding in 2007 or 2006 | - | - |
| Paid-in capital | 416.3 | 381.7 |
| Retained earnings | 583.2 | 590.0 |
| Treasury stock at cost, 5.2 million and 5.1 million shares in 2007 and 2006, respectively | (173.8) | (171.8) |
| Accumulated other comprehensive income (loss), net of tax | | |
| Defined benefit plans | 33.5 | (0.8) |
| Foreign currency translation adjustments | 34.2 | 15.5 |
| Unrecognized loss on derivatives | (3.3) | (1.5) |
| Total stockholders' equity | 890.7 | 813.7 |
| Total liabilities and stockholders' equity | \$ 2,914.7 | \$ 2,597.5 |

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Year Ended December 31,

(in millions)

| | 2007 | 2006 | 2005 |
|--|----------|------------|---------|
| Operating activities | | | |
| Net income (loss) | \$ 37.0 | \$ (222.5) | \$ 56.0 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Asset impairment | 11.6 | 196.5 | - |
| Depreciation and amortization | 229.4 | 206.0 | 185.1 |
| Deferred income taxes | (47.4) | (184.0) | (1.1) |
| Stock-based compensation | 18.4 | 10.2 | 5.6 |
| Pensions and other postretirement benefits, net of contributions | 53.3 | 114.8 | 72.0 |
| Loss on retirement of equipment | 8.5 | 6.3 | 7.0 |
| Debt refinancing and redemption costs | 5.5 | 2.7 | - |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | 64.9 | 2.9 | 6.5 |
| Inventories | (28.4) | 1.1 | (10.6) |
| Accounts payable and accrued expenses | (5.2) | 43.7 | (32.2) |
| Other assets and liabilities | 20.3 | 8.0 | (7.9) |
| Net cash provided by operating activities | 367.9 | 185.7 | 280.4 |
| Investing activities | | | |
| Purchases of property, plant and equipment | (186.5) | (286.6) | (305.7) |
| Purchase buyouts of leased equipment | - | (71.8) | - |
| Proceeds from sale-leasebacks | - | 34.8 | - |
| Net cash used in investing activities | (186.5) | (323.6) | (305.7) |
| Financing activities | | | |
| Net borrowings (repayments) under revolving credit facilities | (130.8) | 67.2 | 49.0 |
| Proceeds from issuance of long-term debt | 556.1 | 261.6 | - |
| Conversion of 2.00% Notes | - | (147.3) | - |
| Payment of Term Loan due 2010 | (252.5) | - | - |
| Payments of other long-term debt and capital lease obligations | (0.5) | (1.0) | (8.4) |
| Debt issuance costs | (7.5) | (4.4) | - |
| Employee stock option exercises | 13.5 | 1.3 | 4.6 |
| Tax benefit on stock option exercises | 3.8 | 1.0 | - |
| Dividends paid | (31.8) | (31.0) | (30.4) |
| Purchase of treasury stock | (2.0) | (0.1) | - |
| Net cash provided by financing activities | 148.3 | 147.3 | 14.8 |
| Effect of exchange rate changes on cash | 0.4 | 0.4 | (0.2) |
| Net increase (decrease) in cash and cash equivalents | 330.1 | 9.8 | (10.7) |
| Cash and cash equivalents at beginning of year | 13.5 | 3.7 | 14.4 |
| Cash and cash equivalents at end of year | \$ 343.6 | \$ 13.5 | \$ 3.7 |
| Supplemental cash flow information | | | |
| Interest paid | \$ 58.1 | \$ 44.8 | \$ 31.3 |
| Income taxes paid, net of refunds | \$ 20.6 | \$ 49.4 | \$ 35.7 |

See accompanying notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(in millions)

| | Common Stock | | Paid-in Capital | Retained Earnings | Treasury Stock | Unearned Compensation | Accumulated Other Comprehensive | Comprehensive |
|--|-----------------------|---------------|--------------------|----------------------|-------------------|--------------------------|---------------------------------------|-------------------|
| | Shares Outstanding | Par Value | | | | | Income (Loss) | Income (Loss) |
| Balance at January 1, 2005 | 49.7 | \$ 0.5 | \$ 357.6 | \$ 817.9 | \$(171.7) | \$ - | \$ (48.8) | |
| Net income | | | | 56.0 | | | | \$ 56.0 |
| Gain on derivatives, net | | | | | | | (0.1) | (0.1) |
| Foreign currency translation, net | | | | | | | 6.1 | 6.1 |
| Minimum pension liability adjustment, net | | | | | | | (5.5) | (5.5) |
| Comprehensive income | | | | | | | | <u>\$ 56.5</u> |
| Exercise of stock options, including tax benefit | 0.6 | | 28.0 | | | | | |
| Dividends paid | | | | (30.4) | | | | |
| Stock-based compensation expense | | | | | | 5.6 | | |
| Restricted stock awards | | | | | | (20.4) | | |
| Balance at December 31, 2005 | <u>50.3</u> | <u>0.5</u> | <u>385.6</u> | <u>843.5</u> | <u>(171.7)</u> | <u>(14.8)</u> | <u>(48.3)</u> | |
| Net loss | | | | (222.5) | | | | \$ (222.5) |
| Loss on derivatives, net | | | | | | | (1.9) | (1.9) |
| Foreign currency translation, net | | | | | | | 11.6 | 11.6 |
| Minimum pension liability adjustment, net | | | | | | | 37.0 | 37.0 |
| SFAS 158 transition adjustment, net | | | | | | | | |
| Minimum pension liability | | | | | | | 15.6 | |
| Net prior service credit | | | | | | | 10.8 | |
| Net actuarial loss | | | | | | | (11.6) | |
| Comprehensive loss | | | | | | | | <u>\$ (175.8)</u> |
| Reclassification of unearned compensation | | | (14.8) | | | 14.8 | | |
| Exercise of stock options including tax benefit | 0.2 | 0.1 | 2.2 | | | | | |
| Dividends paid | | | | (31.0) | | | | |
| Stock-based compensation expense | | | 8.7 | | | | | |
| Purchase of treasury stock | | | | | (0.1) | | | |
| Balance at December 31, 2006 | <u>50.5</u> | <u>0.6</u> | <u>381.7</u> | <u>590.0</u> | <u>(171.8)</u> | <u>-</u> | <u>13.2</u> | |
| Net income | | | | 37.0 | | | | \$ 37.0 |
| Loss on derivatives, net | | | | | | | (1.8) | (1.8) |
| Foreign currency translation, net | | | | | | | 18.7 | 18.7 |
| SFAS 158 transition adjustment, net | | | | (12.0) | | | | |
| Defined benefit plans, net | | | | | | | | |
| Net prior service adjustments | | | | | | | (0.6) | (0.6) |
| Net actuarial adjustments | | | | | | | 34.9 | 34.9 |
| Comprehensive income | | | | | | | | <u>\$ 88.2</u> |
| Exercise of stock options and vesting of restricted stock, including tax benefit | 1.1 | | 18.9 | | | | | |
| Dividends paid | | | | (31.8) | | | | |
| Stock-based compensation expense | | | 15.7 | | | | | |
| Purchase of treasury stock | | | | | (2.0) | | | |
| Balance at December 31, 2007 | <u>51.6</u> | <u>\$ 0.6</u> | <u>\$ 416.3</u> | <u>\$ 583.2</u> | <u>(173.8)</u> | <u>\$ -</u> | <u>\$ 64.4</u> | |

See accompanying notes to consolidated financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION American Axle & Manufacturing Holdings, Inc. (Holdings) and its subsidiaries (collectively, we, our, us or AAM) is a Tier I supplier to the automotive industry. We manufacture, engineer, design and validate driveline and drivetrain systems and related components and chassis modules for trucks, sport utility vehicles (SUVs), passenger cars and crossover utility vehicles. Driveline and drivetrain systems include components that transfer power from the transmission and deliver it to the drive wheels. Our driveline, drivetrain and related products include axles, chassis modules, driveshafts, power transfer units, transfer cases, chassis and steering components, driving heads, crankshafts, transmission parts and metal-formed products. In addition to locations in the United States (U.S.) (Michigan, New York, Ohio and Indiana), we also have offices or facilities in Brazil, China, England, Germany, India, Japan, Luxembourg, Mexico, Poland, Scotland and South Korea.

PRINCIPLES OF CONSOLIDATION We include the accounts of Holdings and its subsidiaries in our consolidated financial statements. We eliminate the effects of all intercompany transactions, balances and profits in our consolidation.

REVENUE RECOGNITION We recognize revenue when products are shipped to our customers and title transfers under standard commercial terms or when realizable in accordance with our commercial agreements. If we are uncertain as to whether we will be successful collecting a balance in accordance with our understanding of a commercial agreement, we do not recognize the revenue or cost recovery until such time as the uncertainty is removed.

RESEARCH AND DEVELOPMENT (R&D) COSTS We expense R&D as incurred. R&D spending was \$80.4 million, \$83.2 million and \$73.6 million in 2007, 2006 and 2005, respectively.

CASH AND CASH EQUIVALENTS Cash and cash equivalents include all of our cash balances and highly liquid investments with a maturity of 90 days or less at the time of purchase.

ACCOUNTS RECEIVABLE The majority of our accounts receivable are due from original equipment manufacturers in the automotive industry. Credit is extended based on the evaluation of our customers' financial condition and is reviewed on an ongoing basis. Trade accounts receivable are generally due on average within 50 days from the date of shipment and are past due when payment is not received within the stated terms. Amounts due from customers are stated net of allowances for doubtful accounts. We determine our allowances by considering factors such as the length of time accounts are past due, our previous loss history, the customer's ability to pay its obligation to us and the condition of the general economy and the industry as a whole. We write-off accounts receivable when they become uncollectible.

CUSTOMER TOOLING AND PRE-PRODUCTION COSTS RELATED TO LONG-TERM SUPPLY ARRANGEMENTS

Engineering, R&D, and other pre-production design and development costs for products sold on long-term supply arrangements are expensed as incurred unless we have a contractual guarantee for reimbursement from the customer. Costs for tooling used to make products sold on long-term supply arrangements for which we have either title to the assets or the non-cancelable right to use the assets during the term of the supply arrangement are capitalized in property, plant and equipment. Capitalized items and customer receipts specifically related to a supply arrangement are amortized over the shorter of the term of the arrangement or over the estimated useful lives of the related assets.

INVENTORIES We state our inventories at the lower of cost or market. The cost of our U.S. inventories is determined principally using the last-in, first-out method (LIFO), which represents approximately 25% of our total gross inventories in 2007 and 2006. The cost of our foreign and indirect inventories is determined principally using the first-in, first-out method (FIFO). We classify indirect inventories, which include perishable tooling, machine repair parts and other materials consumed in the manufacturing process but not incorporated into our finished products, as raw materials. When we determine that our gross inventories exceed usage requirements, or if inventories become obsolete or otherwise not saleable, we record a provision for such loss as a component of our inventory accounts. Inventories consist of the following:

| | 2007 | 2006 |
|------------------------------------|---------------|----------|
| | (in millions) | |
| Raw materials and work-in-progress | \$ 230.5 | \$ 220.6 |
| Finished goods | 52.6 | 26.3 |
| Gross inventories | 283.1 | 246.9 |
| LIFO reserve | (13.8) | (13.8) |
| Other inventory valuation reserves | (40.3) | (34.7) |
| Inventories, net | \$ 229.0 | \$ 198.4 |

PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment consists of the following:

| | Estimated Useful Lives | 2007 | 2006 |
|---|------------------------|---------------|------------|
| | (Years) | (in millions) | |
| Land | - | \$ 25.6 | \$ 28.8 |
| Land improvements | 10 - 15 | 18.1 | 18.8 |
| Buildings and building improvements | 15 - 40 | 414.4 | 373.5 |
| Machinery and equipment | 3 - 12 | 2,410.4 | 2,314.2 |
| Construction in progress | - | 83.2 | 124.6 |
| | | 2,951.7 | 2,859.9 |
| Accumulated depreciation and amortization | | (1,255.5) | (1,128.2) |
| Property, plant and equipment, net | | \$ 1,696.2 | \$ 1,731.7 |

We state property, plant and equipment at cost. Construction in progress includes costs incurred for the construction of buildings and building improvements, and machinery and equipment in process. Repair and maintenance costs that do not extend the useful life or otherwise improve the utility of the asset beyond its useful state are expensed in the period incurred.

We record depreciation and tooling amortization on the straight-line method over the estimated useful lives of the depreciable assets. Depreciation and tooling amortization amounted to \$220.6 million, \$195.6 million and \$158.3 million in 2007, 2006 and 2005, respectively.

IMPAIRMENT OF LONG-LIVED ASSETS We evaluate the carrying value of long-lived assets and long-lived assets to be disposed for potential impairment on an ongoing basis in accordance with FASB Statement No. 144, *"Accounting for the Impairment or Disposal of Long-Lived Assets."* We consider projected future undiscounted cash flows, trends and other circumstances in making such estimates and evaluations. If an impairment is deemed to exist, the carrying amount of the asset is adjusted based on its fair value. Recoverability of assets "held for use" is determined by comparing the forecasted undiscounted cash flows of the operations to which the assets relate to their carrying amount. When the carrying value of an asset group exceeds its fair value and is therefore nonrecoverable, those assets are written down to fair value. Fair value is determined based on a cash flow analysis performed using management estimates. See Note 2 – Restructuring Actions for detail on our 2007 and 2006 asset impairments.

GOODWILL We record goodwill when the purchase price of acquired businesses exceeds the value of their identifiable net tangible and intangible assets acquired. We periodically evaluate goodwill for impairment in accordance with FASB Statement No. 142, *"Goodwill and Other Intangibles."* We completed our annual impairment tests as of December 31, 2007 and 2006 and concluded that there was no impairment of our goodwill. Goodwill is our only significant intangible asset.

DEFERRED CONTRACT COSTS Lump-sum payments totaling \$37.5 million (including applicable payroll taxes) were made in the first half of 2004 in accordance with new collective bargaining agreements with unions that represent our hourly associates at six of our locations in the U.S. These lump-sum payments relate to the future service of our hourly workforce. Through 2007, we expensed \$36.2 million of these payments, which represented amounts earned in relation to the agreements in addition to \$6.4 million, \$8.0 million and \$7.1 million paid in lieu of base wage increases in 2007, 2006 and 2005, respectively. The remaining \$1.3 million will be amortized in 2008.

TRADE PAYABLE PROGRAM LIABILITY In 2007, we terminated our supplier payment program through which suppliers could elect for a designated finance company to advance payment on their invoices due from us. Our agreement with the finance company called for us to share in the discount fees charged to the suppliers by the finance company for any advance payments made through this program. The fees collected in association with this program were negligible for 2007, 2006 and 2005. As of December 31, 2007, there was no outstanding balance under this program.

STOCK-BASED COMPENSATION Prior to January 1, 2006, as permitted by FASB Statement No. 123 (SFAS 123), *"Accounting for Stock-Based Compensation,"* we accounted for our employee stock options in accordance with APB Opinion No. 25, *"Accounting for Stock Issued to Employees,"* and related interpretations. Although it is our practice to grant options with no intrinsic value, we measured compensation cost as the excess, if any, of the market price of our common stock at the date of grant over the amount our associates must pay to acquire the stock.

Effective January 1, 2006, we adopted FASB Statement No. 123(R) (SFAS 123R), *"Share-Based Payment."* We adopted the fair value recognition provisions of SFAS 123R using the modified prospective transition method and, therefore, did not restate the prior periods' results. Under this transition method, stock-based compensation expense for the first quarter of 2006 included compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. We recognize these compensation costs net of a forfeiture rate and recognize the compensation costs for only those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the vesting term. We estimate the forfeiture rate based on our historical experience.

As part of the prospective adoption of SFAS 123R, we classified our tax benefit from stock option exercises as a financing activity on the statement of cash flows for the years ended December 31, 2007 and 2006. Tax benefits from the exercise of stock options in 2005 were \$3.6 million. In addition, we elected the alternative transition method for calculating the beginning balance of the APIC pool as described by FASB Staff Position 123R-3, *"Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards."*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table illustrates the effect on net income after tax and net income per common share as if we had applied the fair value recognition provisions of SFAS 123 to stock-based compensation during the year ended December 31, 2005:

| | 2005 (in millions, except per share data) |
|--|---|
| Net income, as reported | \$ 56.0 |
| Deduct: Total employee stock option expense determined under the fair value method, net of tax | (22.3) |
| Pro forma net income | \$ 33.7 |
| Basic EPS, as reported | \$ 1.12 |
| Basic EPS, pro forma | \$ 0.67 |
| Diluted EPS, as reported | \$ 1.10 |
| Diluted EPS, pro forma | \$ 0.67 |

DERIVATIVES We account for derivatives under FASB Statement No. 133 (SFAS 133), *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted. SFAS 133 requires us to recognize all derivatives on the balance sheet at fair value. If a derivative qualifies under SFAS 133 as a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value, and changes in the fair value of derivatives that do not qualify as hedges, are immediately recognized in earnings.

2. RESTRUCTURING ACTIONS

In 2006, we took certain restructuring actions to realign and resize our production capacity and cost structure to current and projected operational and market requirements. In connection with these restructuring actions, we incurred charges for one-time termination benefits, asset impairments and environmental obligations of \$340.7 million.

In 2007, we incurred charges in cost of sales for ongoing restructuring actions. In addition, we continue to make payments related to the charges incurred in 2006. A summary of this activity for 2007 and 2006 is shown below (in millions):

| | One-time Termination Benefits | Redeployment of Assets | Asset Impairments | Environmental Obligations | Total |
|---|----------------------------------|---------------------------|----------------------|------------------------------|----------|
| Charges | \$ 141.7 | \$ - | \$ 196.5 | \$ 2.5 | \$ 340.7 |
| Cash utilization | (105.3) | - | - | - | (105.3) |
| Non-cash utilization | - | - | (196.5) | - | (196.5) |
| Accrual as of December 31, 2006 | \$ 36.4 | \$ - | \$ - | \$ 2.5 | \$ 38.9 |
| Charges | 53.1 | 14.0 | 11.6 | - | 78.7 |
| Cash utilization | (66.6) | (14.0) | - | (0.3) | (80.9) |
| Non-cash utilization and accrual adjustments | (2.6) | - | (11.6) | - | (14.2) |
| Accrual as of December 31, 2007 | \$ 20.3 | \$ - | \$ - | \$ 2.2 | \$ 22.5 |

CURRENCY TRANSLATION We translate the assets and liabilities of our foreign subsidiaries to U.S. dollars at end-of-period exchange rates. We translate the income statement elements of our foreign subsidiaries to U.S. dollars at average-period exchange rates. We report the effect of translation for our foreign subsidiaries that use the local currency as their functional currency as a separate component of stockholders' equity. Gains and losses resulting from the remeasurement of assets and liabilities of our foreign subsidiaries that use the U.S. dollar as their functional currency are reported in current period income. We also report any gains and losses arising from transactions denominated in a currency other than our functional currency in current period income.

USE OF ESTIMATES In order to prepare consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP), we are required to make estimates and assumptions that affect the reported amounts and disclosures in our consolidated financial statements. Actual results could differ from those estimates.

EFFECT OF NEW ACCOUNTING STANDARDS In September 2006, the FASB issued Statement No. 157 (SFAS 157), *Fair Value Measurements*. This statement clarifies the definition of fair value and establishes a fair value hierarchy. SFAS 157 is effective for us on January 1, 2008. We do not expect the impact of adoption to be material.

In February 2007, the FASB issued Statement No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities*. This statement permits entities to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 is effective for us on January 1, 2008. We do not expect the impact of adoption to be material.

ONE-TIME TERMINATION BENEFITS In the third quarter of 2007, we offered the Buffalo Separation Program (BSP) to all hourly associates represented by the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) at our Buffalo Gear, Axle & Linkage (Buffalo) facility in New York. This voluntary separation program offered retirement or buyout incentives to approximately 650 eligible hourly associates. We recorded expense in 2007 of \$42.3 million for the one-time termination benefits of this program and we paid \$33.3 million of these costs as of December 31, 2007.

In 2007, approximately 90 associates represented by the International Association of Machinists (IAM) at our Tonawanda, New York and Detroit, Michigan facilities participated in a voluntary separation incentive program (VSIP) and elected to terminate employment with AAM. We recorded expense of \$7.4 million for the estimated postemployment costs of these VSIPs in 2007 and we paid \$6.7 million of these costs as of December 31, 2007.

The remaining one-time termination benefit charges of \$3.4 million recorded in 2007 related to service earned in the period for estimated transition payments to certain salaried associates who terminated employment on or around December 31, 2007. We recorded \$0.6 million in 2006 for the proportional amount of expense for service related to these payments as of December 31, 2006. We paid \$1.0 million of these transition payments in 2007.

In the fourth quarter of 2006, we offered a Special Attrition Program (SAP) to approximately 6,000 UAW represented associates at AAM's master agreement facilities. This program was designed to reduce our workforce. In 2006, approximately 1,500 associates participated in this attrition program. We recorded expense in 2006 of \$131.4 million for the estimated postemployment costs of this program. We paid \$23.7 million of these costs in 2007 and \$101.2 million in 2006.

In 2006, we also offered a salaried retirement incentive program to eligible salaried associates in the U.S. As a result of 67 associates participating in this program, we recorded expense of \$3.7 million in 2006. We paid \$1.5 million of these costs in 2007 and \$2.1 million in 2006.

In 2006, we approved a plan to reduce the salaried workforce in 2007. These associates will be provided postemployment benefits within the terms of our Layoff Severance Program (LSP), which determines an employee's benefit based on current salary and prior service levels. Based on the approval of this action and the terms of the LSP, this liability was probable and estimable as of December 31, 2006. We recorded expense of \$3.2 million for this involuntary separation program. We paid \$0.3 million of this obligation in 2007.

We also recorded a charge to cost of sales of \$2.8 million in 2006 related to postemployment benefits payable to associates

in our European operations. We paid \$0.1 million of this obligation in 2007 and \$2.0 million in 2006.

We expect to make approximately \$17 million in payments related to the remaining restructuring accrual of \$22.5 million in 2008. We will continue to make payments related to this accrual through 2012.

In 2005, we recognized a pre-tax charge of \$17.3 million related to a voluntary separation program whereby hourly associates received lump-sum payments to voluntarily terminate their employment with AAM.

REDEPLOYMENT OF ASSETS In addition to the one-time termination benefits, we have also incurred charges related to the redeployment of assets to support capacity utilization initiatives. For the year ended December 31, 2007, we have expensed and paid \$14.0 million related to these actions.

ASSET IMPAIRMENTS In 2007, we recorded an asset impairment charge of \$11.6 million. The charge includes a \$5.9 million reduction of the net book value of certain assets at our Buffalo facility, which was production idled in the fourth quarter of 2007. This charge also includes a \$5.7 million write-off of the remaining net book value of assets previously classified as held for sale.

In 2006, we recorded asset impairment charges of \$196.5 million associated with plans to idle a portion of our production capacity in the U.S. dedicated to the mid-size light truck product range and other capacity reduction initiatives. These plans resulted in the identification of assets to be disposed that became permanently idled. We recorded expense of \$39.4 million related to the disposal or idling of these assets. In addition, we performed an impairment assessment in 2006 of certain "held for use" assets located at our Buffalo facility due to impairment indicators such as permanent declines in production volumes of mid-size SUVs and changes in the extent these long-lived assets will be used. Based on this analysis, we recorded an additional expense of \$142.0 million and reduced the remaining useful lives of certain of these assets. This represents the reduction in net book value required to state these assets at their estimated fair value. Certain other long-lived assets classified as "held for sale" were written down to their estimated net realizable value based on quoted market prices. We recorded expense of \$5.7 million for these assets. The remaining net book value of the held for sale assets of \$5.6 million was classified as other assets and deferred charges on our consolidated balance sheet as of December 31, 2006.

As a result of the asset impairments relating to our machinery and equipment, certain machine repair parts classified as indirect inventory were impaired. We recorded a charge of \$9.4 million related to the write down of their net book value to the estimated net realizable value at year-end 2006.

ENVIRONMENTAL OBLIGATIONS In 2006, based on the determination of certain assets as permanently idled, the settlement methods and timing of environmental obligations related to our Buffalo facility were reasonably estimable. Based on management's best estimate of the costs, we recorded a charge of \$2.5 million. In 2007, we made payments of \$0.3 million related to this accrual. As of December 31, 2007, the accrual for this liability was \$2.2 million.

3. LONG-TERM DEBT AND LEASE OBLIGATIONS

Long-term debt consists of the following:

| | 2007 | 2006 |
|------------------------------|-----------------|-----------------|
| | (in millions) | |
| Revolving credit facility | \$ - | \$ 100.0 |
| 7.875% Notes | 300.0 | - |
| 5.25% Notes, net of discount | 249.8 | 249.8 |
| 2.00% Convertible Notes | 2.7 | 2.7 |
| Term Loan due 2012 | 250.0 | - |
| Term Loan due 2010 | - | 250.0 |
| Uncommitted lines of credit | - | 33.5 |
| Foreign credit facilities | 46.7 | 33.7 |
| Capital lease obligations | 8.9 | 2.5 |
| Long-term debt | <u>\$ 858.1</u> | <u>\$ 672.2</u> |

REVOLVING CREDIT FACILITY Our Revolving Credit Facility bears interest at rates based on LIBOR or an alternate base rate, plus an applicable margin, which runs until April 2010. At December 31, 2007, \$571.7 million was available under the Revolving Credit Facility, which reflected a reduction of \$28.3 million for standby letters of credit issued against the facility.

The Revolving Credit Facility provides back-up liquidity for our foreign credit facilities and uncommitted lines of credit. We intend to use the availability of long-term financing under the Revolving Credit Facility to refinance any current maturities related to such debt agreements that are not otherwise refinanced on a long-term basis in their respective markets. Accordingly, we have classified \$40.3 of current maturities as long-term debt.

7.875% NOTES In the first quarter of 2007, we issued \$300.0 million of 7.875% senior unsecured notes due 2017. Net proceeds from these notes were used for general corporate purposes, including payment of amounts outstanding under our Revolving Credit Facility. In 2007, we paid debt issuance costs of \$5.2 million related to the 7.875% Notes.

5.25% NOTES The 5.25% Notes are senior unsecured obligations due February 2014.

2.00% CONVERTIBLE NOTES In 2006, the 2.00% senior convertible notes due 2024 became convertible into cash under terms of the indenture. A total of \$147.3 million of the notes was converted into cash in 2006 and \$2.7 million of the notes remain outstanding as of December 31, 2007. We had been amortizing fees and expenses associated with the 2.00% Convertible Notes over the expected life of the notes. As a result of these conversions, we expensed the proportional amount of unamortized debt issuance costs in 2006, which totaled \$2.7 million.

TERM LOAN DUE 2012 On June 14, 2007, we entered into a \$250.0 million senior unsecured term loan that matures in June 2012. Borrowings under the Term Loan due 2012 bear interest payable at rates based on LIBOR or an alternate base rate, plus an applicable margin. Proceeds from this borrowing were used for general corporate purposes, including the payment of amounts outstanding under the senior unsecured term loan scheduled to mature in April 2010. In 2007, we paid \$2.3 million in debt issuance costs related to the Term Loan due 2012.

TERM LOAN DUE 2010 In 2006, we entered into a \$250.0 million senior unsecured term loan due in April 2010. Proceeds from this financing were used for general corporate purposes and to finance payments related to the cash conversion of the 2.00% Convertible Notes. On June 28, 2007, we voluntarily prepaid the amounts outstanding under our Term Loan due 2010. Upon repayment, we expensed \$3.0 million of unamortized debt issuance costs and \$2.5 million of prepayment premiums. We had been amortizing the debt issuance costs over the expected life of the borrowing.

LEASES We lease certain facilities, machinery and equipment under capital leases expiring at various dates. In 2007, we entered into a capital lease of \$6.7 million related to a lease renewal for one of our U.S. manufacturing facilities. The gross asset cost of our capital leases was \$16.1 million at December 31, 2007 and \$9.4 million at December 31, 2006. The net book value included in property, plant and equipment, net on the balance sheet was \$8.9 million and \$2.8 million at December 31, 2007 and 2006, respectively. The weighted-average interest rate on these capital lease obligations at December 31, 2007 was 8.5%.

We also lease certain facilities, machinery and equipment under operating leases expiring at various dates. Pursuant to these operating leases, we have the option to purchase the underlying machinery and equipment on specified dates. In 2006, we renewed and amended equipment leases totaling \$33.6 million, elected to exercise our purchase option for \$71.8 million of assets and entered into sale-leaseback transactions totalling \$34.8 million. These transactions did not result in a significant loss or deferred gain. Existing lease repurchase options are \$42.7 million through 2012. Future minimum payments under noncancelable operating leases are as follows: \$17.9 million in 2008, \$16.3 million in 2009, \$15.5 million in 2010, \$13.5 million in 2011, \$9.5 million in 2012 and \$0.7 million thereafter. Our total expense relating to operating leases was \$18.8 million, \$28.0 million and \$32.2 million in 2007, 2006 and 2005, respectively.

UNCOMMITTED LINES OF CREDIT In 2007, we had access to \$60.0 million of uncommitted bank lines of credit. At December 31, 2007, there was no balance outstanding under such uncommitted bank lines of credit.

FOREIGN CREDIT FACILITIES We utilize local currency credit facilities to finance the operations of certain foreign subsidiaries. These credit facilities, some of which are guaranteed by Holdings and/or AAM, Inc., expire at various dates through December 2011. At December 31, 2007, \$46.7 million was outstanding under these facilities and an additional \$109.9 million was available.

DEBT COVENANTS The Revolving Credit Facility contains operating covenants which, among other things, require us to comply with a leverage ratio and maintain a minimum level of net worth. Our ability to incur certain types of liens and amounts of indebtedness, merge into another company or sell all or substantially all of our assets is also limited by the Revolving Credit Facility and Term Loan due 2012.

DEBT MATURITIES Aggregate maturities of long-term debt are as follows (in millions):

| | |
|------------|----------|
| 2008 | \$ 40.3 |
| 2009 | 0.7 |
| 2010 | 2.6 |
| 2011 | 8.1 |
| 2012 | 251.0 |
| Thereafter | 555.4 |
| Total | \$ 858.1 |

INTEREST EXPENSE AND INTEREST INCOME Interest expense was \$61.6 million in 2007, \$39.0 million in 2006 and \$27.9 million in 2005. Interest expense increased in 2007 as compared to 2006 and in 2006 as compared to 2005 due to higher average outstanding borrowings and higher average interest rates.

Interest income was \$9.3 million in 2007, \$0.2 million in 2006 and \$0.7 million in 2005. Interest income increased in 2007 because of higher cash and cash equivalent balances in 2007 as compared to 2006 and 2005. We capitalized interest of \$6.4 million in 2007, \$7.2 million in 2006 and \$5.7 million in 2005. The weighted-average interest rate of our long-term debt outstanding at December 31, 2007 was 7.8% as compared to 8.0% and 4.7% at December 31, 2006 and 2005, respectively.

4. DERIVATIVES AND RISK MANAGEMENT

DERIVATIVE FINANCIAL INSTRUMENTS In the normal course of business, we are exposed to market risk associated with changes in foreign currency exchange rates and interest rates. To manage a portion of these inherent risks, we purchase certain types of derivative financial instruments, from time to time, based on management's judgment of the trade-off between risk, opportunity and cost. We do not hold or issue derivative financial instruments for trading or speculative purposes.

CURRENCY FORWARD CONTRACTS Because a majority of our business is denominated in U.S. dollars, we do not currently have significant exposures relating to currency exchange risk. From time to time, we use foreign currency forward contracts to reduce the effects of fluctuations in exchange rates, primarily relating to the Mexican Peso, Euro, Pound Sterling, Brazilian Real and Canadian Dollar. We had currency forward contracts with a

notional amount of \$41.8 million and \$33.5 million outstanding at December 31, 2007 and 2006, respectively.

INTEREST RATE SWAPS We are exposed to variable interest rates on certain credit facilities. From time to time, we use interest rate hedging to reduce the effects of fluctuations in market interest rates. We have hedged a portion of the interest rate risk by entering into an interest rate swap with a notional amount of \$200.0 million as of December 31, 2007. This notional amount reduces to \$100.0 million in December 2008 and expires in April 2010. This interest rate swap converts variable rate financing based on 3-month LIBOR into fixed U.S. dollar rates. The fair value of our interest rate swap was a liability of \$5.8 million and \$3.3 million at December 31, 2007 and 2006, respectively.

We have designated interest rate swaps as effective cash flow hedges of the related debt and reflect the net cost of such agreements as an adjustment to interest expense over the lives of the debt agreements. The ineffective portion of any such hedge is included in current earnings. The impact of hedge ineffectiveness was not significant in any of the periods presented.

FAIR VALUE OF FINANCIAL INSTRUMENTS The carrying value of our cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximates their fair values due to the short-term maturities of these assets and liabilities. The carrying value of our borrowings under the foreign credit facilities approximates their fair value due to the frequent resetting of the interest rates. At December 31, 2007, we have estimated the fair value of the Term Loan due 2012, 7.875% Notes and 5.25% Notes, using available market information, to be \$232.5 million, \$271.5 million and \$210.0 million, respectively.

CONCENTRATIONS OF CREDIT RISK In the normal course of business, we provide credit to customers in the automotive industry. We periodically evaluate the creditworthiness of our customers and we maintain reserves for potential credit losses, which, when realized, have been within the range of our allowances for doubtful accounts. When appropriate, we also diversify the concentration of invested cash among different financial institutions and we monitor the selection of counter parties to other financial instruments to avoid unnecessary concentrations of credit risk.

Sales to General Motors Corporation (GM) were approximately 78%, 76% and 78% of our total net sales in 2007, 2006 and 2005, respectively. Accounts receivable due from GM were \$179.3 million at year-end 2007 and \$200.6 million at year-end 2006. Sales to Chrysler LLC (Chrysler) were approximately 12% of our total net sales in 2007, 14% in 2006 and 13% in 2005. Accounts receivable due from Chrysler were \$40.1 million at year-end 2007 and \$82.6 million at year-end 2006. No other single customer accounted for more than 10% of our consolidated net sales in any year presented.

5. STOCKHOLDER RIGHTS PLAN

In September 2003, our Board of Directors adopted a Stockholder Rights Plan (the Rights Plan) and declared a dividend of one preferred share purchase right for each outstanding share of common stock for stockholders of record on September 25, 2003. The Rights Plan provides a reasonable means of safeguarding the interests of all stockholders against unsolicited takeover attempts at a price not reflective of the company's fair value. The Rights Plan is designed to give the Board of Directors sufficient time to evaluate and respond to an unsolicited take over attempt and to encourage anyone or group considering such action to negotiate first with the Board of Directors.

In July 2006, the Nominating/Corporate Governance Committee of the Board of Directors conducted an independent evaluation of the Rights Plan and concluded that it would be in the best interest of AAM and its shareholders to maintain the Rights Plan as adopted in September 2003, without modification.

6. EMPLOYEE BENEFIT PLANS

PENSION AND OTHER POSTRETIREMENT DEFINED BENEFIT PLANS We sponsor various qualified and non-qualified defined benefit pension plans for our eligible associates. We also maintain hourly and salaried benefit plans that provide postretirement medical, dental, vision and life insurance benefits (OPEB) to our eligible retirees and their dependents in the U.S. We also provide benefits under collective bargaining agreements to a majority of our hourly associates.

In September 2006, the FASB issued Statement No. 158 (SFAS 158), *"Employers Accounting for Defined Benefit Pension and Other Postretirement Plans."* This statement amended FASB Statement Nos. 87, 88, 106 and 132R. This statement requires companies to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and obligations that determine its funded status as of the end of the fiscal year and recognize changes in the funded status of a defined benefit postretirement plan in other comprehensive income in the year in which the changes occur.

We adopted the balance sheet provision of SFAS 158 at December 31, 2006. We adopted the measurement date provision of SFAS 158 as of January 1, 2007. As a result of the adoption of the measurement date provision, we recorded a net transition adjustment of \$12.0 million in the first quarter of 2007 to the opening retained earnings balance related to the net periodic benefit cost for the period between September 30, 2006 and January 1, 2007.

Actuarial valuations of our benefit plans were made as of December 31, 2007 and September 30, 2006. The principal weighted-average assumptions used in the valuation of our U.S. and non-U.S. plans appear in the following table. The U.S. discount rates are based on an actuarial review of a hypothetical portfolio of long-term, high quality corporate bonds matched against the expected payment stream for each of our plans. The non-U.S. discount rate is based on a review of long-term bonds, in consideration of the average duration of plan liabilities. The assumptions for expected return on plan assets are based on a review of long-term historical returns and future capital market expectations for the asset classes represented within our portfolios. The rates of increase in compensation and health care costs are based on current market conditions, inflationary expectations and historical information.

| | Pension Benefits | | | | | | Other Postretirement Benefits | | |
|--------------------------------|------------------|----------|-------|----------|-------|----------|-------------------------------|-------|-------|
| | 2007 | | 2006 | | 2005 | | 2007 | 2006 | 2005 |
| | U.S. | Non-U.S. | U.S. | Non-U.S. | U.S. | Non-U.S. | | | |
| Discount rate | 6.45% | 5.70% | 6.05% | 5.00% | 5.80% | 5.00% | 6.55% | 6.10% | 5.90% |
| Expected return on plan assets | 8.50% | 6.50% | 8.50% | 7.50% | 8.00% | 8.00% | N/A | N/A | N/A |
| Rate of compensation increase | 3.75% | 3.80% | 3.75% | 3.25% | 4.25% | 3.25% | 3.75% | 3.75% | 4.25% |

The weighted-average asset allocations of our pension plan assets at December 31, 2007 and September 30, 2006 appear in the following table. The asset allocation for our plans is developed in consideration of the demographics of the plan participants and expected payment stream of the benefit obligation.

| | U.S. | | | Non-U.S. | | |
|-------------------------|--------|--------|-------------------|----------|--------|-------------------|
| | 2007 | 2006 | Target Allocation | 2007 | 2006 | Target Allocation |
| Equity securities | 71.0% | 70.8% | 65% - 70% | 73.0% | 72.0% | 65% - 70% |
| Fixed income securities | 25.5% | 29.1% | 30% - 35% | 26.0% | 27.0% | 30% - 35% |
| Cash | 3.5% | 0.1% | 0% - 5% | 1.0% | 1.0% | 0% - 5% |
| Total | 100.0% | 100.0% | | 100.0% | 100.0% | |

The accumulated benefit obligation for all defined benefit pension plans was \$589.9 million and \$549.4 million at December 31, 2007 and September 30, 2006, respectively. The following table summarizes the changes in benefit obligations and plan assets and reconciles the funded status of the benefit plans to the net benefit plan liability:

| | Pension Benefits | | Other Postretirement Benefits | |
|--|------------------|-----------|-------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | (in millions) | |
| Change in benefit obligation | | | | |
| Benefit obligation at beginning of year | \$ 555.3 | \$ 561.6 | \$ 411.7 | \$ 505.1 |
| Service cost | 21.4 | 33.0 | 25.3 | 40.2 |
| Interest cost | 34.9 | 33.7 | 28.5 | 31.7 |
| Plan amendments | - | (1.3) | - | (26.2) |
| Actuarial (gain) loss | (39.1) | (48.8) | (41.5) | (71.7) |
| SFAS 158 transition adjustment | 28.1 | - | 29.9 | - |
| Participant contributions | 1.4 | 1.7 | - | - |
| Special termination benefits | 16.1 | 5.4 | 16.9 | 0.9 |
| Curtailments | (5.1) | (28.7) | (16.9) | (64.0) |
| Benefit payments | (19.2) | (13.5) | (9.0) | (4.3) |
| Currency fluctuations | 2.2 | 12.2 | - | - |
| Net change | 40.7 | (6.3) | 33.2 | (93.4) |
| Benefit obligation at end of year | 596.0 | 555.3 | 444.9 | 411.7 |
| Change in plan assets | | | | |
| Fair value of plan assets at beginning of year | 460.2 | 412.7 | - | - |
| Actual return on plan assets | 24.7 | 39.0 | - | - |
| SFAS 158 transition adjustment | 27.9 | - | - | - |
| Employer contributions | 19.9 | 11.6 | 9.0 | 4.3 |
| Participant contributions | 1.4 | 1.7 | - | - |
| Benefit payments | (19.2) | (13.5) | (9.0) | (4.3) |
| Currency fluctuations | 1.6 | 8.7 | - | - |
| Net change | 56.3 | 47.5 | - | - |
| Fair value of plan assets at end of year | 516.5 | 460.2 | - | - |
| Funded status – U.S. plans at December 31, 2007 and September 30, 2006 | (63.1) | (67.4) | (444.9) | (411.7) |
| Funded status – Non-U.S. plan at December 31, 2007 and September 30, 2006 | (16.4) | (27.7) | - | - |
| Fourth quarter contribution | - | 3.0 | - | 1.2 |
| Net liability at December 31 | \$ (79.5) | \$ (92.1) | \$ (444.9) | \$ (410.5) |

Amounts recognized in our balance sheets are as follows:

| | Pension Benefits | | Other Postretirement Benefits | |
|------------------------------|------------------|-----------|-------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | (in millions) | |
| Noncurrent assets | \$ 13.3 | \$ 8.7 | \$ - | \$ - |
| Current liabilities | (1.2) | (25.0) | (7.8) | (6.5) |
| Noncurrent liabilities | (91.6) | (75.8) | (437.1) | (404.0) |
| Net liability at December 31 | \$ (79.5) | \$ (92.1) | \$ (444.9) | \$ (410.5) |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Amounts recognized in accumulated other comprehensive (income) loss in 2007 and 2006 consists of:

| | Pension Benefits | | Other Postretirement Benefits | |
|---|------------------|-----------|-------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | (in millions) | |
| Minimum pension liability adjustment, including SFAS 158 transition | \$ - | \$ (84.6) | \$ - | \$ - |
| Net actuarial (gain) loss | (33.8) | 33.4 | (25.2) | (11.2) |
| Net prior service (credit) cost | (5.2) | 20.3 | 5.8 | (37.1) |
| Total amount recognized | \$ (39.0) | \$ (30.9) | \$ (19.4) | \$ (48.3) |

The components of net periodic benefit cost are as follows:

| | Pension Benefits | | | Other Postretirement Benefits | | |
|---------------------------------------|------------------|---------|---------|-------------------------------|---------|---------|
| | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| | (in millions) | | | (in millions) | | |
| Net Periodic Benefit Cost | | | | | | |
| Service cost | \$ 21.4 | \$ 33.0 | \$ 32.7 | \$ 25.3 | \$ 40.2 | \$ 38.1 |
| Interest cost | 34.9 | 33.7 | 31.3 | 28.5 | 31.7 | 28.9 |
| Expected asset return | (38.3) | (32.0) | (30.3) | - | N/A | N/A |
| Amortized actuarial loss | 1.5 | 5.0 | 4.5 | - | 5.2 | 3.9 |
| Amortized prior service cost (credit) | 2.3 | 3.0 | 3.1 | (3.0) | (1.7) | (0.8) |
| Special termination benefits | 16.1 | 5.4 | - | 16.9 | 0.9 | - |
| Curtailments | (2.9) | 4.0 | - | (17.4) | (7.1) | - |
| Net periodic benefit cost | \$ 35.0 | \$ 52.1 | \$ 41.3 | \$ 50.3 | \$ 69.2 | \$ 70.1 |

The estimated net actuarial loss and prior service cost for the defined benefit pension plans that is expected to be amortized from accumulated other comprehensive income into net periodic benefit cost in 2008 are \$0.9 million and \$2.1 million, respectively. The estimated net actuarial loss and prior service credit for the other defined benefit postretirement plans that is expected to be amortized from accumulated other comprehensive income into net periodic benefit cost in 2008 is \$0.2 million and \$2.8 million, respectively.

For measurement purposes, a weighted average annual increase in the per-capita cost of covered health care benefits of 8.6% was assumed for 2008. The rate was assumed to decrease gradually to 5.0% by 2014 and to remain at that level thereafter. Health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1.0% increase in the assumed health care cost trend rate would have increased total service and interest cost in 2007 and the postretirement obligation at December 31, 2007 by \$11.6 million and \$84.6 million, respectively. A 1.0% decrease in the assumed health care cost trend rate would have decreased total service and interest cost in 2007 and the postretirement obligation at December 31, 2007 by \$8.9 million and \$65.8 million, respectively.

The expected future pension and postretirement benefits to be paid for each of the next five years and in the aggregate for the succeeding five years thereafter are as follows: \$32.3 million in 2008; \$37.8 million in 2009; \$41.3 million in 2010; \$44.8 million in 2011; \$48.5 million in 2012 and \$295.1 million in 2013 through 2017. These amounts were estimated using the same

assumptions to measure our 2007 year-end pension and postretirement benefit obligation and include an estimate of future employee service.

CONTRIBUTIONS We currently estimate our regulatory pension funding requirements in 2008 to be less than \$5 million. We expect our cash outlay for other postretirement benefit obligations to be between \$5 million and \$10 million in 2008.

ATTRITION AND SEPARATION PROGRAMS In 2007, as a result of the BSP, the funded status of certain U.S. hourly defined benefit pension and OPEB plans was remeasured as of November 15, 2007. In connection with this remeasurement, we recorded net expense of \$13.9 million for the curtailment of certain pension and other postretirement benefits and related special termination benefits. In addition, we recorded expense of \$0.4 million in 2007 for special termination benefits related to the participation in two voluntary separation incentive programs offered to IAM represented associates. We also recorded a curtailment gain of \$1.6 million related to the salaried workforce reductions that occurred in 2007.

In 2006, as a result of the SAP, the funded status of certain U.S. hourly defined benefit pension and OPEB plans was remeasured as of December 7, 2006. In connection with this remeasurement, we recorded net expense of \$9.7 million for the curtailment of certain pension and other postretirement benefits and related special termination benefits.

See Note 2 – Restructuring Actions for more detail on these attrition and separation programs.

AMENDMENTS TO SALARIED PENSION AND OPEB PLANS

In 2006, we amended our U.S. salaried defined benefit pension and OPEB plans. Depending on the plan, these amendments became effective on December 31, 2006 or January 1, 2007. Under the amended defined benefit pension plans, benefits for active participants as of December 31, 2006 who will be eligible for early or normal retirement on or before December 1, 2011 will be frozen on December 31, 2011. Pension benefits for all other active salaried participants in the U.S. defined benefit pension plans were frozen on December 31, 2006. Under the amended salaried OPEB plan, future benefits for associates hired prior to January 1, 2002 who retire after December 1, 2007 have been reduced or eliminated.

These amendments resulted in a curtailment of certain benefits under our salaried defined benefit pension and OPEB plans. As a result of the curtailment, the funded status of our U.S. salaried defined benefit pension and OPEB plans was remeasured as of August 1, 2006. We recognized a net curtailment gain of \$6.5 million in 2006 as a result of the amendments.

DEFINED CONTRIBUTION PLANS Most of our U.S. associates are eligible to participate in voluntary savings plans. As of December 31, 2006, our maximum match was 50% of salaried associates contributions up to 6% of their eligible salary. In 2007, our maximum match increased to 50% of salaried associates' contribution up to 10% of their eligible salary. Matching contributions amounted to \$3.7 million in 2007, \$3.1 million in 2006 and \$2.6 million in 2005. Our common stock is an investment option for our participants under these plans.

Also in 2007, participants in the salaried retirement programs whose benefits were frozen on December 31, 2006 and new U.S. salaried associates hired in 2007 received an additional annual retirement contribution between 3% to 5% of eligible salary, depending on years of service. We made related contributions of \$3.2 million in 2007.

DEFERRED COMPENSATION PLAN Certain U.S. associates are eligible to participate in a non-qualified deferred compensation plan. Payments of \$1.9 million and \$1.0 million have been made in 2007 and 2006, respectively, to eligible associates that have elected distributions. At December 31, 2007 and 2006, our deferred compensation liability was \$14.2 million and \$14.5 million, respectively. We recognized \$1.4 million, \$1.3 million and \$0.9 million of expense related to this deferred compensation plan in 2007, 2006 and 2005, respectively.

SEVERANCE OBLIGATIONS AND OTHER POSTEMPLOYMENT BENEFITS In 2006, we recorded a \$91.2 million charge to cost of sales relating to supplemental unemployment benefits (SUB) estimated to be payable to UAW represented associates who were expected to be permanently idled through the end of the

current collective bargaining agreement that expires in February 2008. The collective bargaining agreement between AAM and the UAW contains a SUB provision, pursuant to which we are required to pay eligible idled workers certain benefits. In prior periods, the cost of SUB and related benefits paid to associates on layoff was expensed as incurred. In the third quarter of 2006, several factors contributed to a condition in which future SUB costs became both probable and reasonably estimable. These factors include the conclusion of mid-contract negotiations with the UAW regarding SUB, the approval of a supplemental new hire agreement with the UAW, the agreement with the UAW to offer the SAP, plant loading decisions affecting current and future production programs and revised production schedules by both GM and Chrysler on major AAM platforms. The participation in the SAP of approximately 1,500 associates reduced the number of associates that we expected to be permanently idled. Therefore, we revised our estimate of SUB to be paid pursuant to the current agreement and reduced this liability to \$13.2 million as of December 31, 2006.

In 2007, we paid \$11.3 million of this accrual and adjusted our estimate of SUB costs to be paid to such workers through February 25, 2008. At December 31, 2007, the accrual for SUB was \$4.7 million.

7. STOCK-BASED COMPENSATION

At December 31, 2007, we have stock-based compensation outstanding under two stock compensation plans approved by our stockholders. Under these plans, a total of 19.1 million shares have been authorized for issuance to our directors, officers and certain other associates in the form of options, nonvested stock or other awards that are based on the value of our common stock. Shares available for future grants at December 31, 2007 were 2.5 million.

STOCK OPTIONS Under the terms of the Plans, stock options are granted at the market price of the stock on the grant date. The contractual term of outstanding stock options ranges from 10 to 12 years. We issue new shares to satisfy stock-based awards.

Effective December 31, 2005, we accelerated the vesting of approximately 1.8 million "out of the money" stock options, all of which became immediately exercisable in full. The acceleration was intended to eliminate future compensation expense with respect to the "out of the money" stock options that we would otherwise have recognized upon our adoption of SFAS 123R on January 1, 2006. Stock options granted subsequent to December 31, 2005 become exercisable one-third after one year from the date of grant, an additional one-third after two years and in full after three years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes activity relating to our stock options:

| | Weighted-Average | | | Weighted-Average | |
|----------------------------------|--------------------------------------|--------------------------|----------------------------------|--------------------------------------|--------------------------|
| | Number of Shares | Exercise Price Per Share | | Number of Shares | Exercise Price Per Share |
| | (in millions, except per share data) | | | (in millions, except per share data) | |
| Outstanding at January 1, 2005 | 7.3 | \$ 21.82 | Exercisable at December 31, 2005 | 6.8 | \$22.96 |
| Granted | 0.3 | 26.24 | Exercisable at December 31, 2006 | 6.4 | \$23.51 |
| Exercised | (0.6) | 7.70 | Exercisable at December 31, 2007 | 5.5 | \$24.40 |
| Canceled | (0.2) | 29.22 | | | |
| Outstanding at December 31, 2005 | 6.8 | \$ 23.00 | | | |
| Granted | 0.3 | 15.58 | | | |
| Exercised | (0.2) | 5.42 | | | |
| Canceled | (0.1) | 28.39 | | | |
| Outstanding at December 31, 2006 | 6.8 | \$ 23.10 | | | |
| Granted | 0.3 | 26.02 | | | |
| Exercised | (0.9) | 15.25 | | | |
| Canceled | (0.1) | 32.76 | | | |
| Outstanding at December 31, 2007 | 6.1 | \$ 24.16 | | | |

As of December 31, 2007, unrecognized compensation cost related to nonvested stock options totaled \$1.6 million. The weighted average period over which this cost is expected to be recognized is approximately two years. The total intrinsic value of options outstanding and exercisable as of December 31, 2007 was \$11.5 million and \$10.8 million, respectively. The total intrinsic value of stock options exercised in 2007 and 2006 was \$10.8 million and \$3.0 million, respectively.

The following is a summary of the range of exercise prices for stock options that are outstanding and exercisable at December 31, 2007:

| Range of exercise prices | Outstanding Stock Options | Weighted-Average Exercise Price Per Share | Weighted-Average Contractual Life | Number of Stock Options Exercisable | Weighted-Average Exercise Price Per Share |
|--------------------------|--------------------------------------|---|-----------------------------------|--------------------------------------|---|
| | (in millions, except per share data) | | (in years) | (in millions, except per share data) | |
| \$4.26 | 0.3 | \$ 4.26 | 1.8 | 0.3 | \$ 4.26 |
| \$8.85 | 0.5 | 8.85 | 3.3 | 0.5 | 8.85 |
| \$9.15 - \$15.58 | 0.9 | 15.29 | 4.5 | 0.6 | 14.50 |
| \$18.40 - \$23.73 | 1.3 | 23.66 | 5.1 | 1.3 | 23.68 |
| \$24.13 - \$28.45 | 1.7 | 24.98 | 5.6 | 1.4 | 24.75 |
| \$32.13 - \$40.83 | 1.4 | 38.56 | 6.1 | 1.4 | 38.56 |
| | 6.1 | \$24.16 | 5.1 | 5.5 | \$24.40 |

We estimated the fair value of our employee stock options on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

| | 2007 | 2006 | 2005 |
|--|----------|---------|----------|
| Expected volatility | 44.26% | 41.31% | 41.64% |
| Risk-free interest rate | 4.46% | 4.78% | 4.36% |
| Dividend yield | 2.30% | 3.70% | 2.25% |
| Expected life of options | 8 years | 7 years | 7 years |
| Weighted-average grant-date fair value | \$ 11.13 | \$ 5.33 | \$ 10.50 |

Expected volatility was based on the daily changes in our historical common stock prices over the expected life of the award. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of the grant corresponding to the expected life of the options. Our dividend yield is based on historical dividend payments. The expected life of options is based on historical stock option exercise patterns and the terms of the options.

OTHER STOCK-BASED COMPENSATION We also awarded performance accelerated restricted stock and restricted stock units (PARS and RSUs, respectively) under our 1999 Stock Incentive Plan. Prior to the adoption of SFAS 123R, the total amount of compensation expense associated with the PARS was recorded as unearned compensation and was presented as a separate component of stockholders' equity. In 2006, as required by SFAS 123R, the remaining unearned compensation was eliminated against paid-in-capital. The total amount of compensation expense associated with the RSUs is recorded as an accrued liability when incurred. The PARS and RSUs vest over three to five years contingent upon the satisfaction of future financial performance targets specified by the plan. The unearned compensation is expensed over the expected vesting period.

The following table summarizes activity relating to our PARS and RSUs:

| | Weighted-Average Grant Date Fair | |
|----------------------------------|--------------------------------------|-------------------------|
| | Number of Shares/Units | Value per Share/Unit |
| | (in millions, except per share data) | |
| Outstanding at January 1, 2005 | - | - |
| Granted | 1.0 | \$ 25.14 |
| Vested | - | - |
| Canceled | * | \$ 26.68 |
| Outstanding at December 31, 2005 | 1.0 | 25.11 |
| Granted | 0.9 | \$ 15.80 |
| Vested | * | 26.68 |
| Canceled | (0.1) | \$ 21.42 |
| Outstanding at December 31, 2006 | 1.8 | \$ 20.46 |
| Granted | 0.9 | 26.07 |
| Vested | (0.2) | 22.78 |
| Canceled | (0.2) | 21.90 |
| Outstanding at December 31, 2007 | 2.3 | \$ 22.33 |

* Activity for the period was less than 100,000 shares

As of December 31, 2007, unrecognized compensation cost related to nonvested PARS and RSUs totaled \$21.4 million. The weighted average period over which this cost is expected to be recognized is approximately two years. In 2007 and 2006, the total fair market value of PARS and RSUs vested was \$5.5 million and \$0.6 million, respectively.

8. INCOME TAXES

Income (loss) before income taxes for U.S. and non-U.S. operations was as follows:

| | 2007 | 2006 | 2005 |
|---------------------|---------------|------------|---------|
| | (in millions) | | |
| U.S. income (loss) | \$ (55.1) | \$ (422.7) | \$ 53.2 |
| Non-U.S. income | 72.7 | 67.2 | 26.8 |
| Total income (loss) | | | |
| before income taxes | \$ 17.6 | \$ (355.5) | \$ 80.0 |

The following is a summary of the components of our provisions for income taxes:

| | 2007 | 2006 | 2005 |
|---------------------------------------|---------------|------------|---------|
| | (in millions) | | |
| Current | | | |
| Federal | \$ 11.1 | \$ 21.1 | \$ 5.9 |
| Other state and local | 0.9 | (2.5) | 4.5 |
| Foreign | 6.1 | 20.7 | 14.7 |
| Total current | 18.1 | 39.3 | 25.1 |
| Deferred | | | |
| Federal | (32.6) | (162.2) | (1.3) |
| Other state and local | 0.6 | (6.0) | (1.6) |
| Foreign | (5.5) | (4.1) | 1.8 |
| Total deferred | (37.5) | (172.3) | (1.1) |
| Total income tax expense (benefit) | \$ (19.4) | \$ (133.0) | \$ 24.0 |

The following is a reconciliation of our provision for income taxes to the expected amounts using statutory rates:

| | 2007 | 2006 | 2005 |
|---------------------------|----------|-------|-------|
| Federal statutory | 35.0% | 35.0% | 35.0% |
| Foreign income taxes | (129.6) | (2.9) | (1.9) |
| State and local | 6.6 | 2.1 | 1.8 |
| Federal tax credits | (29.8) | 3.8 | (5.3) |
| Other | 7.1 | (0.6) | 0.4 |
| Effective income tax rate | (110.7)% | 37.4% | 30.0% |

The change in the 2007 tax rate as compared to 2006 and 2005 is primarily the result of recognizing the deferred income tax benefit of current year losses in the U.S. and the tax rate impact of an increase in foreign source income, which carries a lower overall effective tax rate than U.S. income. In 2007, the change in the effective tax rate also reflects the impact of tax deductions on a smaller base of income (loss) before income taxes.

The following is a summary of the significant components of our deferred tax assets and liabilities:

| | 2007 | 2006 |
|--|---------------|----------|
| | (in millions) | |
| Current deferred tax assets | | |
| Employee benefits | \$ 18.7 | \$ 29.6 |
| Inventory | 6.6 | 5.2 |
| Prepaid taxes and other | 6.5 | 5.1 |
| Valuation allowance | (2.9) | (2.3) |
| Total current deferred tax assets | 28.9 | 37.6 |
| Current deferred tax liabilities | | |
| Inventory and other | (4.3) | (6.9) |
| Current deferred tax asset, net | \$ 24.6 | \$ 30.7 |
| Noncurrent deferred tax assets | | |
| Employee benefits | \$ 221.8 | \$ 203.6 |
| NOL carryforwards | 32.1 | 23.8 |
| Tax credit carryforwards | 30.7 | 25.1 |
| Capital allowance carryforwards | 27.2 | 12.6 |
| Fixed assets | - | 6.5 |
| Capitalized expenditures | 28.6 | - |
| Other | 12.9 | 9.0 |
| Valuation allowances | (39.4) | (36.7) |
| Noncurrent deferred tax assets, net | 313.9 | 243.9 |
| Noncurrent deferred tax liabilities | | |
| Fixed assets and other | (241.8) | (215.0) |
| Noncurrent deferred tax asset net | \$ 72.1 | \$ 28.9 |

Noncurrent deferred tax assets and liabilities recognized in our balance sheets are as follows:

| | 2007 | 2006 |
|---------------------------------------|---------------|---------|
| | (in millions) | |
| U.S. federal deferred tax asset, net | \$ 60.5 | \$ 23.5 |
| Other foreign deferred tax asset, net | 11.6 | 5.4 |
| Noncurrent deferred tax asset, net | \$ 72.1 | \$ 28.9 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The deferred income tax assets and liabilities summarized above reflect the impact of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the basis of such assets and liabilities as measured by tax laws. At year-end 2007 and 2006, our net noncurrent foreign deferred tax asset was primarily attributable to timing differences related to the pension liability for our foreign operations. At year-end 2007, our net noncurrent U.S. federal deferred tax asset was principally comprised of the timing difference of employee benefits not yet deductible for tax purposes and other tax credit carryforwards offset by the impact of accelerated tax depreciation.

Our deferred tax asset valuation allowances at December 31, 2007 and 2006 are principally related to foreign net operating losses and capital allowance carryforwards. Although these carryforwards do not expire, we considered prior operating results and future plans, as well as the utilization period of other temporary differences, in determining the amount of our valuation allowances. In 2007 and 2006, we realized a portion of such tax benefits.

We are required to estimate whether recoverability of our deferred tax assets is more likely than not, based on forecasts of taxable income in the related tax jurisdictions. In this estimate, we use historical results, projected future operating results based upon approved business plans, eligible carry-forward periods, tax planning opportunities and other relevant considerations. This includes the consideration of tax law changes, a history of profitability and the uncertainty of future projected profitability.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This interpretation prescribes a "more likely than not" recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The impact of adopting FIN 48 was not material.

To the extent our uncertain tax positions do not meet the "more likely than not" threshold, we have derecognized such positions. To the extent our uncertain tax positions meet the "more likely than not" threshold, we have measured and recorded the highest probable benefit, and have established appropriate reserves for benefits that exceed the amount likely to be defended upon examination.

A reconciliation of the beginning and ending amounts of unrecognized tax benefits are as follows:

| | Unrecognized Tax Benefits | Interest and Penalties |
|--|------------------------------|------------------------------|
| | (in millions) | |
| Balance at January 1, 2007 | \$ 27.7 | \$ 1.0 |
| Increase in prior year tax positions | 5.1 | 1.3 |
| Decrease in prior year tax positions | (2.1) | - |
| Increase in current year tax positions | 3.3 | - |
| Statute of limitations release | (2.8) | (0.4) |
| Settlement | - | (0.1) |
| Balance at December 31, 2007 | \$ 31.2 | \$ 1.8 |

At December 31, 2007, we had \$31.2 million of net unrecognized income tax benefits. Included in the balance at December 31, 2007 is \$5.7 million for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

We recognize interest and penalties related to unrecognized tax benefits in income tax expense. During the year ended December 31, 2007, we recognized \$1.0 million of interest and penalties in income tax expense. We had \$1.8 million and \$1.0 million for the payment of interest and penalties accrued at December 31, 2007 and 2006, respectively.

We file income tax returns in the U.S. federal jurisdiction, as well as various states and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2002. The Internal Revenue Service (IRS) commenced an examination of our U.S. income tax returns for 2004 and 2005 in the first quarter of 2007. At this time, we are also under audit in several foreign jurisdictions.

Based on the status of the IRS audit and audits outside the U.S. and the protocol of finalizing audits by the relevant tax authorities, it is not possible to estimate the impact of changes, if any, to previously recorded uncertain tax positions. However, as of December 31, 2007, the IRS and other foreign tax authorities have proposed certain adjustments to our taxable income that would impact its liability for unrecognized tax benefits. Although it is not possible to predict the timing of the conclusion of all ongoing audits with accuracy, we anticipate that the current U.S. IRS audit will be complete by the end of 2008. It is reasonably possible that a reduction in the unrecognized tax benefits may occur; however, quantification of an estimated range cannot be made at this time.

9. EARNINGS (LOSS) PER SHARE (EPS)

The following table sets forth the computation of our basic and diluted EPS:

| | 2007 | 2006 | 2005 |
|--|--------------------------------------|-----------|---------|
| | (in millions, except per share data) | | |
| Numerator | | | |
| Net income (loss) | \$ 37.0 | \$(222.5) | \$ 56.0 |
| Denominators | | | |
| Basic shares outstanding – | | | |
| Weighted-average shares outstanding | 51.1 | 50.4 | 50.1 |
| Effect of dilutive securities – | | | |
| Dilutive stock-based compensation | 1.6 | - | 1.0 |
| Diluted shares outstanding – | | | |
| Adjusted weighted-average shares after assumed conversions | 52.7 | 50.4 | 51.1 |
| Basic EPS | \$ 0.72 | \$ (4.42) | \$ 1.12 |
| Diluted EPS | \$ 0.70 | \$ (4.42) | \$ 1.10 |

Basic and diluted loss per share in 2006 is the same because the effect of 1.0 million potentially dilutive shares would have been antidilutive.

Certain exercisable stock options were excluded in the computations of diluted EPS because the exercise price of these options was greater than the average annual market prices. The number of stock options outstanding excluded in the calculation of diluted EPS was 1.9 million at year-end 2007, 4.7 million at year-end 2006 and 4.7 million at year-end 2005. The ranges of exercise prices related to these excluded exercisable stock options were \$26.02 – \$40.83 at year-end 2007, \$19.54 – \$40.83 at year-end 2006 and \$23.73 – \$40.83 at year-end 2005.

10. COMMITMENTS AND CONTINGENCIES

PURCHASE COMMITMENTS Obligated purchase commitments for capital expenditures were approximately \$158.4 million at December 31, 2007 and \$97.1 million at December 31, 2006.

LEGAL PROCEEDINGS We are involved in various legal proceedings incidental to our business. Although the outcome of these matters cannot be predicted with certainty, we do not believe that any of these matters, individually or in the aggregate, will have a material adverse effect on our financial condition, results of operations or cash flows.

ENVIRONMENTAL OBLIGATIONS We are subject to various federal, state, local and foreign environmental and occupational safety and health laws, regulations and

ordinances, including those regulating air emissions, water discharge, waste management and environmental cleanup. We will continue to closely monitor our environmental conditions to ensure that we are in compliance with all laws, regulations and ordinances. GM has agreed to indemnify and hold us harmless against certain environmental conditions existing prior to our purchase of the assets from GM on March 1, 1994. GM's indemnification obligations terminated on March 1, 2004 with respect to any new claims that we may have against GM. We have made, and will continue to make, capital and other expenditures to comply with environmental requirements, including recurring administrative costs. Such expenditures were not significant during 2007, 2006 and 2005.

Due to the nature of our operations, we have legal obligations to perform asset retirement activities pursuant to federal, state, and local environmental requirements. The process of estimating environmental liabilities is complex. Significant uncertainty may exist related to the timing and method of the settlement of these obligations. Therefore, these liabilities are not reasonably estimable until a triggering event occurs that allows us to estimate a range and assess the probabilities of potential settlement dates and the potential methods of settlement. As of December 31, 2007, we have a liability of \$2.2 million for environmental obligations related to our Buffalo facility.

In the future, we will update our estimated costs and potential settlement dates and methods and their associated probabilities based on available information. Any update may change our estimate and could result in a material adjustment to this liability.

PRODUCT WARRANTIES We record a liability for estimated warranty obligations at the dates our products are sold. Our estimated warranty obligations for products sold are based on management estimates. For products and customers with actual warranty payment experience, we estimate warranty costs principally based on past claims history. For certain products and customers, actual warranty payment experience does not exist or is not mature. In these cases, we estimate our costs based on our contractual arrangements with individual customers, existing customer warranty programs, sales history and internal and external warranty data. The following table provides a reconciliation of changes in the product warranty liability as of December 31:

| | 2007 | 2006 |
|--|---------------|--------|
| | (in millions) | |
| Beginning balance | \$ 3.9 | \$ 2.2 |
| Accruals | 4.1 | 3.1 |
| Settlements | (1.2) | (1.6) |
| Foreign currency translation and other | - | 0.2 |
| Ending balance | \$ 6.8 | \$ 3.9 |

11. SEGMENT AND GEOGRAPHIC INFORMATION

We operate in one reportable segment: the manufacture, engineer, design and validate driveline systems and related components and chassis modules for trucks, SUVs, passenger cars and crossover utility vehicles. Financial information relating to our operations by geographic area is presented in the following table. Net sales are attributed to countries based upon location of customer. Long-lived assets exclude deferred income taxes.

| | 2007 | 2006 | 2005 |
|--------------------------|------------|---------------|------------|
| | | (in millions) | |
| Net sales | | | |
| United States | \$ 2,069.0 | \$ 2,199.3 | \$ 2,323.6 |
| Canada | 385.3 | 259.2 | 316.8 |
| Mexico and South America | 666.4 | 597.9 | 614.6 |
| Europe and other | 127.5 | 135.3 | 132.3 |
| Total net sales | \$ 3,248.2 | \$ 3,191.7 | \$ 3,387.3 |
| Long-lived assets | | | |
| United States | \$ 1,294.9 | \$ 1,429.3 | \$ 1,603.0 |
| Other | 606.5 | 528.8 | 459.2 |
| Total long-lived assets | \$ 1,901.4 | \$ 1,958.1 | \$ 2,062.2 |

12. UNAUDITED QUARTERLY FINANCIAL DATA

| | March 31 | June 30 | September 30 | December 31 | Full Year |
|----------------------------------|--------------------------------------|----------|--------------|-------------|------------|
| | (in millions, except per share data) | | | | |
| 2007 | | | | | |
| Net sales | \$ 802.2 | \$ 916.5 | \$ 774.3 | \$ 755.2 | \$ 3,248.2 |
| Gross profit (loss) | 84.8 | 113.1 | 80.7 | (0.2) | 278.4 |
| Net income (loss) ⁽¹⁾ | 15.4 | 34.0 | 13.1 | (25.5) | 37.0 |
| Basic EPS ⁽²⁾ | \$ 0.30 | \$ 0.67 | \$ 0.26 | \$ (0.50) | \$ 0.72 |
| Diluted EPS ⁽²⁾ | \$ 0.30 | \$ 0.64 | \$ 0.25 | \$ (0.50) | \$ 0.70 |
| 2006 | | | | | |
| Net sales | \$ 834.8 | \$ 874.6 | \$ 701.2 | \$ 781.1 | \$ 3,191.7 |
| Gross profit (loss) | 63.5 | 89.9 | (62.0) | (220.0) | (128.6) |
| Net income (loss) ⁽¹⁾ | 8.6 | 20.4 | (62.9) | (188.6) | (222.5) |
| Basic EPS ⁽²⁾ | \$ 0.17 | \$ 0.41 | \$ (1.25) | \$ (3.74) | \$ (4.42) |
| Diluted EPS ⁽²⁾ | \$ 0.17 | \$ 0.40 | \$ (1.25) | \$ (3.74) | \$ (4.42) |

⁽¹⁾ Net loss in the fourth quarter of 2007 and 2006 includes the charges discussed in Note 2 – Restructuring Actions.

⁽²⁾ Full year basic and diluted EPS will not necessarily agree to the sum of the four quarters because each quarter is a separate calculation.

13. SUPPLEMENTAL GUARANTOR CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Holdings has no significant asset other than its 100% ownership in AAM, Inc. and no direct subsidiaries other than AAM, Inc. Holdings fully and unconditionally guarantees the 7.875% Notes and 5.25% Notes, which are senior unsecured obligations of AAM, Inc. The 2.00% Convertible Notes are senior unsecured obligations of Holdings and are fully and unconditionally guaranteed by AAM, Inc.

The following Condensed Consolidating Financial Statements are included in lieu of providing separate financial statements for Holdings and AAM, Inc. These Condensed Consolidating Financial Statements are prepared under the equity method of accounting whereby the investments in subsidiaries are recorded at cost and adjusted for the parent's share of the subsidiaries' cumulative results of operations, capital contributions and distributions, and other equity changes.

Condensed Consolidating Statements of Operations

(in millions)

2007

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|--|----------|------------|------------|-----------|--------------|
| Net sales | | | | | |
| External | \$ - | \$ 2,174.2 | \$ 1,074.0 | \$ - | \$ 3,248.2 |
| Intercompany | - | 54.1 | 98.7 | (152.8) | - |
| Total net sales | - | 2,228.3 | 1,172.7 | (152.8) | 3,248.2 |
| Cost of goods sold | - | 2,089.3 | 1,025.7 | (145.2) | 2,969.8 |
| Gross profit | - | 139.0 | 147.0 | (7.6) | 278.4 |
| Selling, general and administrative expenses | - | 194.8 | 15.6 | (7.6) | 202.8 |
| Operating income (loss) | - | (55.8) | 131.4 | - | 75.6 |
| Net interest expense | - | (47.7) | (4.6) | - | (52.3) |
| Other expense | - | (5.4) | (0.3) | - | (5.7) |
| Income (loss) before income taxes | - | (108.9) | 126.5 | - | 17.6 |
| Income tax expense (benefit) | - | (40.8) | 21.4 | - | (19.4) |
| Earnings from equity in subsidiaries | 37.0 | 61.1 | - | (98.1) | - |
| Net income (loss) before royalties and dividends | 37.0 | (7.0) | 105.1 | (98.1) | 37.0 |
| Royalties and dividends | - | 44.0 | (44.0) | - | - |
| Net income after royalties and dividends | \$ 37.0 | \$ 37.0 | \$ 61.1 | \$ (98.1) | \$ 37.0 |

2006

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|--|------------|------------|------------|----------|--------------|
| Net sales | | | | | |
| External | \$ - | \$ 2,173.4 | \$ 1,018.3 | \$ - | \$ 3,191.7 |
| Intercompany | - | 36.0 | 81.8 | (117.8) | - |
| Total net sales | - | 2,209.4 | 1,100.1 | (117.8) | 3,191.7 |
| Cost of goods sold | - | 2,441.5 | 990.9 | (112.1) | 3,320.3 |
| Gross profit (loss) | - | (232.1) | 109.2 | (5.7) | (128.6) |
| Selling, general and administrative expenses | - | 190.6 | 12.5 | (5.7) | 197.4 |
| Operating income (loss) | - | (422.7) | 96.7 | - | (326.0) |
| Net interest expense | - | (23.2) | (15.6) | - | (38.8) |
| Other income | - | 6.4 | 2.9 | - | 9.3 |
| Income (loss) before income taxes | - | (439.5) | 84.0 | - | (355.5) |
| Income tax benefit | - | (128.3) | (4.7) | - | (133.0) |
| Earnings (loss) from equity in subsidiaries | (222.5) | 48.5 | - | 174.0 | - |
| Net income (loss) before royalties and dividends | (222.5) | (262.7) | 88.7 | 174.0 | (222.5) |
| Royalties and dividends | - | 40.2 | (40.2) | - | - |
| Net income (loss) after royalties and dividends | \$ (222.5) | \$ (222.5) | \$ 48.5 | \$ 174.0 | \$ (222.5) |

2005

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|--|----------|------------|------------|-----------|--------------|
| Net sales | | | | | |
| External | \$ - | \$ 2,516.6 | \$ 870.7 | \$ - | \$ 3,387.3 |
| Intercompany | - | 37.2 | 83.0 | (120.2) | - |
| Total net sales | - | 2,553.8 | 953.7 | (120.2) | 3,387.3 |
| Cost of goods sold | - | 2,340.5 | 862.4 | (120.3) | 3,082.6 |
| Gross profit | - | 213.3 | 91.3 | 0.1 | 304.7 |
| Selling, general and administrative expenses | - | 182.2 | 17.3 | 0.1 | 199.6 |
| Operating income | - | 31.1 | 74.0 | - | 105.1 |
| Net interest expense | - | (4.7) | (22.5) | - | (27.2) |
| Other income (expense) | - | 2.8 | (0.7) | - | 2.1 |
| Income before income taxes | - | 29.2 | 50.8 | - | 80.0 |
| Income tax expense | - | 13.5 | 10.5 | - | 24.0 |
| Earnings from equity in subsidiaries | 56.0 | 7.3 | - | (63.3) | - |
| Net income before royalties and dividends | 56.0 | 23.0 | 40.3 | (63.3) | 56.0 |
| Royalties and dividends | - | 33.0 | (33.0) | - | - |
| Net income after royalties and dividends | \$ 56.0 | \$ 56.0 | \$ 7.3 | \$ (63.3) | \$ 56.0 |

Condensed Consolidating Balance Sheets

(in millions)

2007

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|---|------------|------------|------------|--------------|--------------|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ - | \$ 223.5 | \$ 120.1 | \$ - | \$ 343.6 |
| Accounts receivable, net | - | 141.3 | 122.7 | - | 264.0 |
| Inventories, net | - | 109.6 | 119.4 | - | 229.0 |
| Other current assets | - | 28.4 | 69.6 | - | 98.0 |
| Total current assets | - | 502.8 | 431.8 | - | 934.6 |
| Property, plant and equipment, net | - | 959.8 | 736.4 | - | 1,696.2 |
| Goodwill | - | - | 147.8 | - | 147.8 |
| Other assets and deferred charges | - | 121.8 | 14.3 | - | 136.1 |
| Investment in subsidiaries | 1,181.8 | 763.7 | - | (1,945.5) | - |
| Total assets | \$ 1,181.8 | \$ 2,348.1 | \$ 1,330.3 | \$ (1,945.5) | \$ 2,914.7 |
| Liabilities and stockholders' equity | | | | | |
| Current liabilities | | | | | |
| Accounts payable | \$ - | \$ 174.9 | \$ 138.9 | \$ - | \$ 313.8 |
| Other accrued expenses | - | 144.3 | 53.5 | - | 197.8 |
| Total current liabilities | - | 319.2 | 192.4 | - | 511.6 |
| Intercompany payable (receivable) | 288.4 | (516.0) | 227.6 | - | - |
| Long-term debt | 2.7 | 799.8 | 55.6 | - | 858.1 |
| Other long-term liabilities | - | 563.3 | 91.0 | - | 654.3 |
| Total liabilities | 291.1 | 1,166.3 | 566.6 | - | 2,024.0 |
| Stockholders' equity | 890.7 | 1,181.8 | 763.7 | (1,945.5) | 890.7 |
| Total liabilities and stockholders' equity | \$ 1,181.8 | \$ 2,348.1 | \$ 1,330.3 | \$ (1,945.5) | \$ 2,914.7 |

2006

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|---|------------|------------|------------|--------------|--------------|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ - | \$ 0.5 | \$ 13.0 | \$ - | \$ 13.5 |
| Accounts receivable, net | - | 181.0 | 146.6 | - | 327.6 |
| Inventories, net | - | 110.4 | 88.0 | - | 198.4 |
| Other current assets | - | 62.9 | 37.0 | - | 99.9 |
| Total current assets | - | 354.8 | 284.6 | - | 639.4 |
| Property, plant and equipment, net | - | 1,075.2 | 656.5 | - | 1,731.7 |
| Goodwill | - | - | 147.8 | - | 147.8 |
| Other assets and deferred charges | - | 17.2 | 61.4 | - | 78.6 |
| Investment in subsidiaries | 1,043.4 | 676.1 | 69.9 | (1,789.4) | - |
| Total assets | \$ 1,043.4 | \$ 2,123.3 | \$ 1,220.2 | \$ (1,789.4) | \$ 2,597.5 |
| Liabilities and stockholders' equity | | | | | |
| Current liabilities | | | | | |
| Accounts payable | \$ - | \$ 201.6 | \$ 127.3 | \$ - | \$ 328.9 |
| Other accrued expenses | - | 173.6 | 38.8 | - | 212.4 |
| Total current liabilities | - | 375.2 | 166.1 | - | 541.3 |
| Intercompany payable (receivable) | 240.2 | (451.0) | 210.8 | - | - |
| Long-term debt | 2.7 | 633.2 | 36.3 | - | 672.2 |
| Other long-term liabilities | - | 508.0 | 62.3 | - | 570.3 |
| Total liabilities | 242.9 | 1,065.4 | 475.5 | - | 1,783.8 |
| Stockholders' equity | 800.5 | 1,057.9 | 744.7 | (1,789.4) | 813.7 |
| Total liabilities and stockholders' equity | \$ 1,043.4 | \$ 2,123.3 | \$ 1,220.2 | \$ (1,789.4) | \$ 2,597.5 |

Condensed Consolidating Statements of Cash Flows

(in millions)

2007

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|--|----------|----------|------------|-------|--------------|
| Operating activities | | | | | |
| Net cash provided by operating activities | \$ - | \$ 136.4 | \$ 231.7 | \$ - | \$ 367.9 |
| Investing activities | | | | | |
| Purchases of property, plant and equipment | - | (51.6) | (134.9) | - | (186.5) |
| Net cash used in investing activities | - | (51.6) | (134.9) | - | (186.5) |
| Financing activities | | | | | |
| Net debt activity | - | 164.0 | 8.3 | - | 172.3 |
| Intercompany activity | 33.8 | (35.4) | 1.6 | - | - |
| Debt issuance costs | - | (7.5) | - | - | (7.5) |
| Payment of dividends | (31.8) | - | - | - | (31.8) |
| Proceeds from stock option exercises, including tax benefit | - | 17.3 | - | - | 17.3 |
| Purchase of treasury stock | (2.0) | - | - | - | (2.0) |
| Net cash provided by financing activities | - | 138.4 | 9.9 | - | 148.3 |
| Effect of exchange rate changes on cash | - | - | 0.4 | - | 0.4 |
| Net increase in cash and cash equivalents | - | 223.0 | 107.1 | - | 330.1 |
| Cash and cash equivalents at beginning of period | - | 0.5 | 13.0 | - | 13.5 |
| Cash and cash equivalents at end of period | \$ - | \$ 223.5 | \$ 120.1 | \$ - | \$ 343.6 |

2006

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|--|----------|-------------|------------|-------|--------------|
| Operating activities | | | | | |
| Net cash provided by (used in) operating activities | \$ - | \$ (121 .2) | \$ 306.9 | \$ - | \$ 185.7 |
| Investing activities | | | | | |
| Purchases of property, plant and equipment | - | (162.8) | (123.8) | - | (286.6) |
| Purchase buyouts of leased equipment, net of proceeds | - | (37.0) | - | - | (37.0) |
| Net cash used in investing activities | - | (199.8) | (123.8) | - | (323.6) |
| Financing activities | | | | | |
| Net debt activity | (147.3) | 312.1 | 15.7 | - | 180.5 |
| Intercompany activity | 178.3 | 11.4 | (189.7) | - | - |
| Debt issuance costs | - | (4.4) | - | - | (4.4) |
| Payment of dividends | (31.0) | - | - | - | (31.0) |
| Proceeds from stock option exercises, including tax benefit | - | 2.3 | - | - | 2.3 |
| Purchase of treasury stock | - | (0.1) | - | - | (0.1) |
| Net cash provided by (used in) financing activities | - | 321.3 | (174.0) | - | 147.3 |
| Effect of exchange rate changes on cash | - | - | 0.4 | - | 0.4 |
| Net increase in cash and cash equivalents | - | 0.3 | 9.5 | - | 9.8 |
| Cash and cash equivalents at beginning of period | - | 0.2 | 3.5 | - | 3.7 |
| Cash and cash equivalents at end of period | \$ - | \$ 0.5 | \$ 13.0 | \$ - | \$ 13.5 |

2005

| | Holdings | AAM Inc. | All Others | Elims | Consolidated |
|--|----------|----------|------------|-------|--------------|
| Operating activities | | | | | |
| Net cash provided by operating activities | \$ - | \$ 70.4 | \$ 210.0 | \$ - | \$ 280.4 |
| Investing activities | | | | | |
| Purchases of property, plant and equipment | - | (198.7) | (107.0) | - | (305.7) |
| Net cash used in investing activities | - | (198.7) | (107.0) | - | (305.7) |
| Financing activities | | | | | |
| Net debt activity | - | 70.4 | (29.8) | - | 40.6 |
| Intercompany activity | 30.4 | 42.1 | (72.5) | - | - |
| Debt issuance costs | - | - | - | - | - |
| Payment of dividends | (30.4) | - | - | - | (30.4) |
| Proceeds from stock option exercises, including tax benefit | - | 4.6 | - | - | 4.6 |
| Purchase of treasury stock | - | - | - | - | - |
| Net cash provided by (used in) financing activities | - | 117.1 | (102.3) | - | 14.8 |
| Effect of exchange rate changes on cash | - | - | (0.2) | - | (0.2) |
| Net increase (decrease) in cash and cash equivalents | - | (11.2) | 0.5 | - | (10.7) |
| Cash and cash equivalents at beginning of period | - | 11.4 | 3.0 | - | 14.4 |
| Cash and cash equivalents at end of period | \$ - | \$ 0.2 | \$ 3.5 | \$ - | \$ 3.7 |

BOARD OF DIRECTORS

| | |
|--|---|
| Richard E. Dauch | Co-Founder, Chairman of the Board & Chief Executive Officer American Axle & Manufacturing Holdings, Inc. |
| John A. Casesa | Managing Partner Casesa Shapiro Group LLC |
| Elizabeth A. Chappell | President & Chief Executive Officer Detroit Economic Club |
| Forest J. Farmer | Chairman, Chief Executive Officer & President The Farmer Group |
| Richard C. Lappin | Chairman & Chief Executive Officer Clear Sky Power |
| William P. Miller II | Senior Investment Officer Ohio Public Employees Retirement System |
| Larry K. Switzer | Retired Chief Executive Officer Danka PLC |
| Thomas K. Walker | Chairman & Chief Executive Officer Lackawanna Acquisition Corporation |
| Dr. Henry T. Yang | Chancellor & Professor of Mechanical Engineering University of California – Santa Barbara |
| Audit Committee | William P. Miller II (chairman), Larry K. Switzer, Thomas K. Walker |
| Compensation Committee | Forest J. Farmer (chairman), Elizabeth A. Chappell, Thomas K. Walker, John A. Casesa |
| Executive Committee | Richard E. Dauch (chairman), Forest J. Farmer, Thomas K. Walker |
| Nominating/Corporate Governance Committee | Thomas K. Walker (chairman), Forest J. Farmer, Richard C. Lappin |
| Technology Committee | Dr. Henry T. Yang (chairman), Richard C. Lappin, William P. Miller II, Thomas K. Walker |

Board of Directors information as of February 18, 2008

OFFICERS

| | |
|-------------------------|--|
| Richard E. Dauch* | Co-Founder, Chairman of the Board & Chief Executive Officer |
| Yogendra N. Rahangdale* | Vice Chairman |
| David C. Dauch* | Executive Vice President & Chief Operating Officer |
| John J. Bellanti** | Group Vice President – Manufacturing Services, Capital Planning & Cost Estimating |
| Michael K. Simonte* | Group Vice President – Finance & Chief Financial Officer |
| Michael C. Flynn** | Vice President – Global Procurement & Supply Chain Management |
| Curt S. Howell** | Vice President – Global Driveline Operations |
| John E. Jerge** | Vice President – Human Resources |
| Patrick S. Lancaster* | Vice President, Chief Administrative Officer & Secretary |
| Allan R. Monich** | Vice President – Quality Assurance & Customer Satisfaction |
| Steven J. Proctor** | Vice President – Sales & Marketing |
| Alberto L. Satine** | Vice President – Strategic & Business Development |
| Abdallah F. Shanti** | Vice President – Information Technology, Electronic Product Integration & Chief Information Officer |
| Kevin M. Smith** | Vice President – Mexico |
| John S. Sofia** | Vice President – Product Engineering, Commercial Vehicle Operations & Chief Technology Officer |
| Norman Willemse** | Vice President – Global Metal Formed Product Operations |

* Executive Officer of American Axle & Manufacturing Holdings, Inc. and American Axle & Manufacturing, Inc.

** Executive Officer of American Axle & Manufacturing, Inc.

Officers information as of February 18, 2008

Five Year Financial Summary

Year Ended December 31,

(in millions, except per share data)

| | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|------------------------|---------------------------|------------|----------------------|------------|
| Statement of operations data | | | | | |
| Net sales | \$ 3,248.2 | \$ 3,191.7 | \$ 3,387.3 | \$ 3,599.6 | \$ 3,682.7 |
| Gross profit (loss) | 278.4 | (128.6) | 304.7 | 474.5 | 540.3 |
| Selling, general and administrative expenses | 202.8 | 197.4 | 199.6 | 189.7 | 194.0 |
| Operating income (loss) | 75.6 | (326.0) | 105.1 | 284.8 | 346.3 |
| Net interest expense | (52.3) | (38.8) | (27.2) | (25.5) | (46.8) |
| Net income (loss) | 37.0 ^{(a)(b)} | (222.5) ^{(a)(b)} | 56.0 | 159.5 ^(b) | 197.1 |
| Diluted earnings (loss) per share | \$ 0.70 | \$ (4.42) | \$ 1.10 | \$ 2.98 | \$ 3.70 |
| Diluted shares outstanding | 52.7 | 50.4 | 51.1 | 53.5 | 53.3 |
| Balance sheet data | | | | | |
| Cash and cash equivalents | \$ 343.6 | \$ 13.5 | \$ 3.7 | \$ 14.4 | \$ 12.4 |
| Total assets | 2,914.7 | 2,597.5 | 2,666.6 | 2,538.8 | 2,398.7 |
| Total long-term debt | 858.1 | 672.2 | 489.2 | 448.0 | 449.7 |
| Stockholders' equity | 890.7 | 813.7 | 994.8 | 955.5 | 954.7 |
| Dividends declared per share | \$ 0.60 | \$ 0.60 | \$ 0.60 | \$ 0.45 | \$ - |
| Statement of cash flows data | | | | | |
| Cash provided by operating activities | \$ 367.9 | \$ 185.7 | \$ 280.4 | \$ 453.2 | \$ 496.9 |
| Cash used in investing activities | (186.5) | (323.6) | (305.7) | (240.2) | (232.1) |
| Cash provided by (used in) financing activities | 148.3 | 147.3 | 14.8 | (211.3) | (262.6) |
| Dividends paid | (31.8) | (31.0) | (30.4) | (23.0) | - |
| Other data | | | | | |
| Depreciation and amortization | \$ 229.4 | \$ 206.0 | \$ 185.1 | \$ 171.1 | \$ 163.1 |
| Capital expenditures | 186.5 | 286.6 | 305.7 | 240.2 | 229.1 |
| Buyouts of sale-leasebacks | - | 71.8 | - | - | 3.0 |

^(a) Includes special charges, asset impairments and other non-recurring operating costs of \$58.7 million in 2007 and \$248.2 million in 2006, net of tax, related to restructuring actions.

^(b) Includes charges of \$3.5 million in 2007, \$1.8 million in 2006 and \$15.9 million in 2004, net of tax, related to debt refinancing and redemption costs.

STOCKHOLDERS' INFORMATION

AMERICAN AXLE & MANUFACTURING HOLDINGS, INC.

One Dauch Drive
 Detroit, Michigan 48211-1198
 Telephone: (313) 758-2000
 Internet: www.aam.com

FORM 10-K ANNUAL REPORT

AAM's Form 10-K annual report for 2007, filed with the Securities and Exchange Commission, is available on our website or from:

American Axle & Manufacturing Holdings, Inc.
 Investor Relations ■ One Dauch Drive ■ Detroit, Michigan 48211-1198
 Telephone: (313) 758-4823

CORPORATE NEWS RELEASES

Corporate news releases are available on our website at www.aam.com.

ANNUAL MEETING OF STOCKHOLDERS

The 2008 Annual Meeting of Stockholders will be held on April 24, 2008, at 3:00 p.m. at:

AAM World Headquarters
 One Dauch Drive
 Detroit, Michigan 48211-1198

EQUITY SECURITIES

American Axle & Manufacturing Holdings, Inc.
 Common Stock Transfer Agent ■ Computershare Trust Company, N.A.
 P.O. Box 43069 ■ Providence, RI 02940-3069

Telephone: (877) 282-1168
 (Inside the United States)

Telephone: (781) 575-2879
 (Outside the United States)

Telephone: (800) 952-9245
 (TDD/TTY for hearing impaired)

Internet: www.computershare.com

CERTIFICATIONS REGARDING PUBLIC DISCLOSURES & LISTING STANDARDS

AAM has filed with the Securities and Exchange Commission as exhibits 31.1 and 31.2 to its Form 10-K for the year ended December 31, 2007, the certification required by Section 302 of the Sarbanes-Oxley Act of 2002 regarding the quality of the company's public disclosure. In addition, the annual certification of the Chief Executive Officer regarding compliance by AAM with the corporate governance listing standards of the NYSE was submitted without qualification to the NYSE following the April 2007 Annual Meeting of Stockholders.

STOCKHOLDERS

As of February 18, 2008, there were 430 stockholders of record.

NON-GAAP RECONCILIATION - NET DEBT TO CAPITAL

| | December 31, 2007 | December 31, 2006 | December 31, 2005 |
|------------------------------------|----------------------|----------------------|----------------------|
| | | (in millions) | |
| Total debt | \$ 858.1 | \$ 672.2 | \$ 489.2 |
| Less: Cash and cash equivalents | 343.6 | 13.5 | 3.7 |
| Net debt | 514.5 | 658.7 | 485.5 |
| Add: Stockholders' equity | 890.7 | 813.7 | 994.8 |
| Invested capital | \$ 1,405.2 | \$ 1,472.4 | \$ 1,480.3 |
| Net debt to capital ⁽¹⁾ | 36.6% | 44.7% | 32.8% |

⁽¹⁾ Net debt to capital is equal to net debt divided by invested capital.

We believe that net debt to capital is a meaningful measure of financial condition as it is commonly utilized by management, investors and creditors to assess relative capital structure risk.

NON-GAAP RECONCILIATION - FREE CASH FLOW

| | Net Operating Cash Flow and Free Cash Flow Twelve months ended December 31, | | |
|--|--|---------------|-----------|
| | 2007 | 2006 | 2005 |
| | | (in millions) | |
| Net cash flow provided by operating activities | \$ 367.9 | \$ 185.7 | \$ 280.4 |
| Less: Purchases of property, plant and equipment | (186.5) | (286.6) | (305.7) |
| Net operating cash flow | 181.4 | (100.9) | (25.3) |
| Less: Dividends paid | 31.8 | 31.0 | 30.4 |
| Free cash flow | \$ 149.6 | \$ (131.9) | \$ (55.7) |

We believe net operating cash flow and free cash flow are meaningful measures as they are commonly utilized by management and investors to assess our ability to generate cash flow from business operations to repay debt and return capital to our stockholders. Net operating cash flow is also a key metric used in our calculation of incentive compensation.

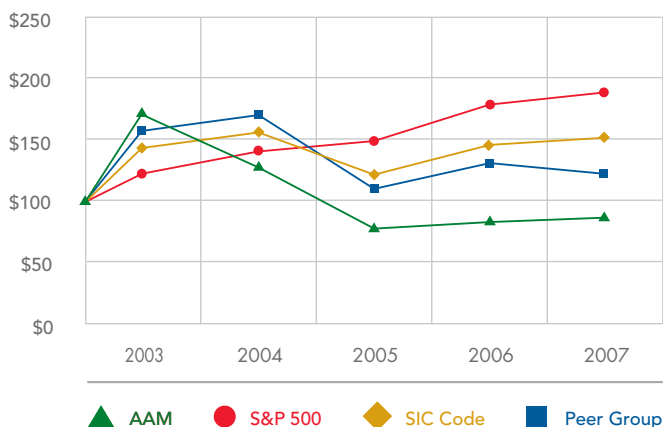
MARKET DATA

Prices are the quarterly and full-year high and low closing sales prices for our common stock as reported by the New York Stock Exchange. Ticker symbol: AXL.

| | High | Low |
|----------------|----------|----------|
| 2007 | | |
| First Quarter | \$ 28.16 | \$ 17.38 |
| Second Quarter | 30.01 | 26.76 |
| Third Quarter | 30.59 | 21.55 |
| Fourth Quarter | 27.91 | 18.62 |
| Full Year | 30.59 | 17.38 |
| 2006 | | |
| First Quarter | \$ 21.01 | \$ 15.33 |
| Second Quarter | 20.04 | 15.80 |
| Third Quarter | 17.67 | 14.77 |
| Fourth Quarter | 20.07 | 16.99 |
| Full Year | 21.01 | 14.77 |

STOCK PERFORMANCE

Comparison of cumulative total return of AAM with the cumulative total return of our competitor peer group (ArvinMeritor Inc., Autoliv Inc., Borg Warner Inc., Dura Automotive Systems Inc., Dana Corporation, Delphi Corporation, Lear Corporation, Magna International Inc., Tenneco Automotive Inc. and Visteon Corporation) and the Standard & Poor's 500 Composite Index assuming \$100 invested on December 31, 2002 and the reinvestment of dividends from December 31, 2002 through December 31, 2007. Collins & Aikman Corporation and Tower Automotive Inc. ceased trading in 2007 and have been removed from the peer group comparison. The closing price of AXL as of December 31, 2007 was \$18.62.





Technical, Business and Manufacturing Locations

NORTH AMERICA

Indiana

Fort Wayne Engineering Office

Michigan

Detroit Manufacturing Complex

Detroit South Campus

MSP Industries

Oxford Forge

Technical Center

Three Rivers Driveline

World Headquarters

New York

Buffalo Gear, Axle & Linkage

Cheektowaga Machining

Tonawanda Forge

Ohio

Colfor Manufacturing

Malvern, Ohio

Minerva, Ohio

Salem, Ohio

Mexico

Guanajuato Gear & Axle

Guanajuato Forge

SOUTH AMERICA

Brazil

AAM do Brasil

South American Business Office

ASIA

China

Changshu Manufacturing Facility

China Business Office

India

India Business Office &
Engineering Center

AAM Sona Axle Private Ltd.

Japan

Japan Business Office

South Korea

Korea Business Office &
Engineering Center

EUROPE

Germany

AAM European Headquarters &
Engineering Center

Luxembourg

AAM Luxembourg S.à r.l.

Poland

Otawa Manufacturing Facility

United Kingdom

Albion Automotive

Glasgow, Scotland

Lancashire, England



STRENGTH

in motion