

CUMMINS INC  
Form 10-Q  
October 31, 2012  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended September 30, 2012**

**Commission File Number 1-4949**

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**CUMMINS INC.**

(Exact name of registrant as specified in its charter)

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**Indiana**  
(State of Incorporation)

**35-0257090**  
(IRS Employer Identification No.)

**500 Jackson Street**  
**Box 3005**  
**Columbus, Indiana 47202-3005**  
(Address of principal executive offices)

**Telephone (812) 377-5000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of September 30, 2012, there were 190,065,999 shares of common stock outstanding with a par value of \$2.50 per share.

**Website Access to Company's Reports**

Cummins maintains an internet website at [www.cummins.com](http://www.cummins.com). Investors can obtain copies of our filings from this website free of charge as soon as reasonably practicable after they are electronically filed with, or furnished to the Securities and Exchange Commission.



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**CUMMINS INC. AND SUBSIDIARIES**

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Condensed Consolidated Financial Statements****CUMMINS INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

| In millions, except per share amounts                         | Three months ended    |                       | Nine months ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2012 | September 25,<br>2011 | September 30,<br>2012 | September 25,<br>2011 |
| <b>NET SALES</b> (a)  | \$ 4,118              | \$ 4,626              | \$ 13,042             | \$ 13,127             |
| Cost of sales   | 3,076                 | 3,438                 | 9,592                 | 9,779                 |
| <b>GROSS MARGIN</b>   | <b>1,042</b>          | <b>1,188</b>          | <b>3,450</b>          | <b>3,348</b>          |
| <b>OPERATING EXPENSES AND INCOME</b>                          |                       |                       |                       |                       |
| Selling, general and administrative expenses                  | 456                   | 489                   | 1,418                 | 1,341                 |
| Research, development and engineering expenses                | 186                   | 164                   | 554                   | 450                   |
| Equity, royalty and interest income from investees (Note 5)   | 94                    | 102                   | 302                   | 315                   |
| Gain on sale of businesses (Note 3)                           |                       |                       | 6                     | 68                    |
| Other operating income (expense), net                         | (1)                   | 2                     | 3                     | (4)                   |
| <b>OPERATING INCOME</b>                                       | <b>493</b>            | <b>639</b>            | <b>1,789</b>          | <b>1,936</b>          |
| Interest income   | 5                     | 9                     | 20                    | 25                    |
| Interest expense  | 9                     | 11                    | 25                    | 34                    |
| Other income (expense), net                                   | (2)                   | (8)                   | 14                    | (14)                  |
| <b>INCOME BEFORE INCOME TAXES</b>                             | <b>487</b>            | <b>629</b>            | <b>1,798</b>          | <b>1,913</b>          |
| Income tax expense (Note 7)                                   | 117                   | 157                   | 458                   | 539                   |
| <b>CONSOLIDATED NET INCOME</b>                                | <b>370</b>            | <b>472</b>            | <b>1,340</b>          | <b>1,374</b>          |
| Less: Net income attributable to noncontrolling interests     | 18                    | 20                    | 64                    | 74                    |
| <b>NET INCOME ATTRIBUTABLE TO CUMMINS INC.</b>                | <b>\$ 352</b>         | <b>\$ 452</b>         | <b>\$ 1,276</b>       | <b>\$ 1,300</b>       |
| <b>EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC.</b> |                       |                       |                       |                       |
| Basic   | \$ 1.87               | \$ 2.35               | \$ 6.73               | \$ 6.71               |
| Diluted   | \$ 1.86               | \$ 2.35               | \$ 6.72               | \$ 6.69               |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>                    |                       |                       |                       |                       |
| Basic   | 188.6                 | 192.1                 | 189.6                 | 193.8                 |
| Dilutive effect of stock compensation awards                  | 0.4                   | 0.6                   | 0.4                   | 0.6                   |
| Diluted   | 189.0                 | 192.7                 | 190.0                 | 194.4                 |
|   | \$ 0.50               | \$ 0.40               | \$ 1.30               | \$ 0.925              |

**CASH DIVIDENDS DECLARED PER COMMON  
SHARE**

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(a) Includes sales to nonconsolidated equity investees of \$579 million and \$1,870 million and \$640 million and \$1,874 million for the three and nine months ended September 30, 2012 and September 25, 2011, respectively.

*The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.*

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## CUMMINS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

| In millions   | Three months ended    |                       | Nine months ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2012 | September 25,<br>2011 | September 30,<br>2012 | September 25,<br>2011 |
| <b>CONSOLIDATED NET INCOME</b>  | \$ 370                | \$ 472                | \$ 1,340              | \$ 1,374              |
| Other comprehensive income (loss), net of tax                             |                       |                       |                       |                       |
| Foreign currency translation adjustments                                  | 131                   | (177)                 | 78                    | (123)                 |
| Unrealized gain (loss) on derivatives (Note 13)                           | 13                    | (19)                  | 24                    | (31)                  |
| Change in pension and other postretirement defined benefit plans          | 9                     | 7                     | 30                    | 40                    |
| Unrealized gain (loss) on marketable securities (Note 6)                  | 2                     | 1                     | 1                     | 1                     |
| Total other comprehensive income (loss), net of tax                       | 155                   | (188)                 | 133                   | (113)                 |
| <b>COMPREHENSIVE INCOME</b>   | <b>525</b>            | <b>284</b>            | <b>1,473</b>          | <b>1,261</b>          |
| Less: Comprehensive income (loss) attributable to noncontrolling interest | 35                    | (2)                   | 67                    | 52                    |
| <b>COMPREHENSIVE INCOME ATTRIBUTABLE TO CUMMINS INC.</b>                  | <b>\$ 490</b>         | <b>\$ 286</b>         | <b>\$ 1,406</b>       | <b>\$ 1,209</b>       |

*The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.*



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**CUMMINS INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

| In millions, except par value  | September 30,<br>2012 | December 31,<br>2011 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Current assets   |                       |                      |
| Cash and cash equivalents  | \$ 1,033              | \$ 1,484             |
| Marketable securities (Note 6)   | 239                   | 277                  |
| Total cash, cash equivalents and marketable securities                               | 1,272                 | 1,761                |
| Accounts and notes receivable, net   |                       |                      |
| Trade and other  | 2,266                 | 2,252                |
| Nonconsolidated equity investees   | 237                   | 274                  |
| Inventories (Note 9)   | 2,570                 | 2,141                |
| Prepaid expenses and other current assets  | 770                   | 663                  |
| Total current assets   | 7,115                 | 7,091                |
| Long-term assets   |                       |                      |
| Property, plant and equipment  | 5,691                 | 5,245                |
| Accumulated depreciation   | (3,134)               | (2,957)              |
| Property, plant and equipment, net   | 2,557                 | 2,288                |
| Investments and advances related to equity method investees                          | 962                   | 838                  |
| Goodwill (Note 10)   | 443                   | 339                  |
| Other intangible assets, net (Note 10)   | 365                   | 227                  |
| Other assets   | 972                   | 885                  |
| Total assets   | \$ 12,414             | \$ 11,668            |
| <b>LIABILITIES</b>   |                       |                      |
| Current liabilities  |                       |                      |
| Loans payable  | \$ 54                 | \$ 28                |
| Accounts payable (principally trade)   | 1,460                 | 1,546                |
| Current maturities of long-term debt (Note 12)                                       | 77                    | 97                   |
| Current portion of accrued product warranty (Note 11)                                | 406                   | 422                  |
| Accrued compensation, benefits and retirement costs                                  | 388                   | 511                  |
| Deferred revenue   | 208                   | 208                  |
| Taxes payable (including taxes on income)  | 172                   | 282                  |
| Other accrued expenses   | 544                   | 563                  |
| Total current liabilities  | 3,309                 | 3,657                |
| Long-term liabilities  |                       |                      |
| Long-term debt (Note 12)   | 670                   | 658                  |
| Postretirement benefits other than pensions  | 417                   | 432                  |
| Other liabilities and deferred revenue   | 1,184                 | 1,090                |
| Total liabilities  | 5,580                 | 5,837                |
| Commitments and contingencies (Note 14)  |                       |                      |
| <b>EQUITY</b>  |                       |                      |
| Cummins Inc. shareholders' equity  |                       |                      |
| Common stock, \$2.50 par value, 500 shares authorized, 222.4 and 222.2 shares issued | 2,046                 | 2,001                |
| Retained earnings  | 7,068                 | 6,038                |
| Treasury stock, at cost, 32.3 and 30.2 shares  | (1,809)               | (1,587)              |
| Common stock held by employee benefits trust, at cost, 1.6 and 1.8 shares            | (19)                  | (22)                 |

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|  |       |        |           |
|--|-------|--------|-----------|
| Accumulated other comprehensive loss       |       |        |           |
| Defined benefit postretirement plans       | (694) |        | (724)     |
| Other                                      | (114) |        | (214)     |
| Total accumulated other comprehensive loss | (808) |        | (938)     |
| Total Cummins Inc. shareholders' equity    | 6,478 |        | 5,492     |
| Noncontrolling interests                   | 356   |        | 339       |
| Total equity                               | 6,834 |        | 5,831     |
| Total liabilities and equity               | \$    | 12,414 | \$ 11,668 |

*The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.*

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## CUMMINS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| In millions   | Nine months ended     |                       |
|---|-----------------------|-----------------------|
|   | September 30,<br>2012 | September 25,<br>2011 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                       |                       |
| Consolidated net income   | \$ 1,340              | \$ 1,374              |
| Adjustments to reconcile consolidated net income to net cash provided by operating activities |                       |                       |
| Depreciation and amortization   | 262                   | 243                   |
| Gain on sale of businesses (Note 3)   | (6)                   | (68)                  |
| Gain on fair value adjustment for consolidated investee (Note 3)                              | (7)                   |                       |
| Deferred income taxes   | 91                    | 148                   |
| Equity in income of investees, net of dividends   | (51)                  | 7                     |
| Pension contributions in excess of expense (Note 4)   | (74)                  | (71)                  |
| Other post-retirement benefits payments in excess of expense (Note 4)                         | (16)                  | (10)                  |
| Stock-based compensation expense  | 29                    | 28                    |
| Excess tax benefits on stock-based awards   | (12)                  | (4)                   |
| Translation and hedging activities  | 16                    | (14)                  |
| Changes in current assets and liabilities, net of acquisitions and divestitures:              |                       |                       |
| Accounts and notes receivable   | 66                    | (469)                 |
| Inventories   | (367)                 | (367)                 |
| Other current assets  | (54)                  | (5)                   |
| Accounts payable  | (145)                 | 317                   |
| Accrued expenses  | (398)                 | 173                   |
| Changes in other liabilities and deferred revenue   | 154                   | 93                    |
| Other, net  | (41)                  | (7)                   |
| Net cash provided by operating activities   | 787                   | 1,368                 |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                       |                       |
| Capital expenditures  | (424)                 | (377)                 |
| Investments in internal use software  | (62)                  | (31)                  |
| Investments in and advances to equity investees   | (92)                  | (104)                 |
| Proceeds from sale of business, net of cash sold (Note 3)                                     | 10                    | 111                   |
| Acquisition of businesses, net of cash acquired (Note 3)                                      | (215)                 |                       |
| Investments in marketable securities acquisitions (Note 6)                                    | (433)                 | (538)                 |
| Investments in marketable securities liquidations (Note 6)                                    | 475                   | 572                   |
| Cash flows from derivatives not designated as hedges  | 13                    | 4                     |
| Other, net  | 9                     | 7                     |
| Net cash used in investing activities   | (719)                 | (356)                 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                       |                       |
| Proceeds from borrowings  | 64                    | 96                    |
| Payments on borrowings and capital lease obligations  | (120)                 | (174)                 |
| Net borrowings under short-term credit agreements   | 5                     | (5)                   |
| Distributions to noncontrolling interests   | (50)                  | (50)                  |
| Dividend payments on common stock   | (246)                 | (178)                 |
| Repurchases of common stock   | (231)                 | (546)                 |
| Excess tax benefits on stock-based awards   | 12                    | 4                     |
| Other, net  | 16                    | 13                    |
| Net cash used in financing activities   | (550)                 | (840)                 |

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|   |                 |                 |
|---|-----------------|-----------------|
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b> | <b>31</b>       | <b>(30)</b>     |
| Net increase (decrease) in cash and cash equivalents                | <b>(451)</b>    | 142             |
| Cash and cash equivalents at beginning of year                      | <b>1,484</b>    | 1,023           |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                   | <b>\$ 1,033</b> | <b>\$ 1,165</b> |

*The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.*

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## CUMMINS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)

| In millions                                 | Common<br>Stock | Additional<br>paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock | Common<br>Stock<br>Held in<br>Trust | Total<br>Cummins Inc.<br>Shareholders<br>Equity | Noncontrolling<br>Interests | Total<br>Equity |
|---|-----------------|----------------------------------|----------------------|---|-------------------|-------------------------------------|---|-----------------------------|-----------------|
| <b>BALANCE AT<br/>DECEMBER 31, 2010</b>     | \$ 554          | \$ 1,380                         | \$ 4,445             | \$ (720)                                      | \$ (964)          | \$ (25)                             | \$ 4,670  | \$ 326                      | \$ 4,996        |
| Net income                                  |                 |                                  | 1,300                |   |                   |                                     | 1,300   | 74                          | 1,374           |
| Other comprehensive<br>income (loss)        |                 |                                  |                      | (91)  |                   |                                     | (91)  | (22)                        | (113)           |
| Issuance of shares                          | 1               | 12                               |                      |   |                   |                                     | 13  |                             | 13              |
| Employee benefits trust<br>activity         |                 | 21                               |                      |   |                   | 3                                   | 24  |                             | 24              |
| Acquisition of shares                       |                 |                                  |                      |   | (546)             |                                     | (546)   |                             | (546)           |
| Cash dividends on<br>common stock           |                 |                                  | (178)                |   |                   |                                     | (178)   |                             | (178)           |
| Distribution to<br>noncontrolling interests |                 |                                  |                      |   |                   |                                     |   | (52)                        | (52)            |
| Stock option exercises                      |                 |                                  |                      |   | 5                 |                                     | 5   |                             | 5               |
| Other shareholder<br>transactions           |                 | 14                               |                      |   |                   |                                     | 14  | 7                           | 21              |
| <b>BALANCE AT<br/>SEPTEMBER 25, 2011</b>    | \$ 555          | \$ 1,427                         | \$ 5,567             | \$ (811)                                      | \$ (1,505)        | \$ (22)                             | \$ 5,211  | \$ 333                      | \$ 5,544        |
| <b>BALANCE AT<br/>DECEMBER 31, 2011</b>     | \$ 555          | \$ 1,446                         | \$ 6,038             | \$ (938)                                      | \$ (1,587)        | \$ (22)                             | \$ 5,492  | \$ 339                      | \$ 5,831        |
| Net income                                  |                 |                                  | 1,276                |   |                   |                                     | 1,276   | 64                          | 1,340           |
| Other comprehensive<br>income (loss)        |                 |                                  |                      | 130   |                   |                                     | 130   | 3                           | 133             |
| Issuance of shares                          | 1               | 5                                |                      |   |                   |                                     | 6   |                             | 6               |
| Employee benefits trust<br>activity         |                 | 22                               |                      |   |                   | 3                                   | 25  |                             | 25              |
| Acquisition of shares                       |                 |                                  |                      |   | (231)             |                                     | (231)   |                             | (231)           |
| Cash dividends on<br>common stock           |                 |                                  | (246)                |   |                   |                                     | (246)   |                             | (246)           |
| Distribution to<br>noncontrolling interests |                 |                                  |                      |   |                   |                                     |   | (71)                        | (71)            |
| Stock option exercises                      |                 |                                  |                      |   | 9                 |                                     | 9   |                             | 9               |
| Other shareholder<br>transactions           |                 | 17                               |                      |   |                   |                                     | 17  | 21                          | 38              |
| <b>BALANCE AT<br/>SEPTEMBER 30, 2012</b>    | \$ 556          | \$ 1,490                         | \$ 7,068             | \$ (808)(1)                                   | \$ (1,809)        | \$ (19)                             | \$ 6,478  | \$ 356                      | \$ 6,834        |

(1) Comprised of defined benefit postretirement plans of \$(694) million, foreign currency translation adjustments of \$(122) million, unrealized gain on derivatives of \$4 million and an unrealized gain on marketable securities of \$4 million.

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*The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.*

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**CUMMINS INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1. NATURE OF OPERATIONS**

Cummins Inc. ( Cummins, we, our or us ) is a leading global power provider that designs, manufactures, distributes and services diesel and natural gas engines, engine-related component products, including emission solutions, filtration, fuel systems and air handling systems, and power generation products, including electric power generation systems and related products. We were founded in 1919 as one of the first manufacturers of diesel engines and are headquartered in the United States (U.S.) in Columbus, Indiana. We sell our products to original equipment manufacturers (OEMs), distributors and other customers worldwide. We serve our customers through a network of more than 600 company-owned and independent distributor locations and approximately 6,500 dealer locations in more than 190 countries and territories.

**NOTE 2. BASIS OF PRESENTATION**

The unaudited *Condensed Consolidated Financial Statements* reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results of operations, financial position and cash flows. All such adjustments are of a normal recurring nature. The *Condensed Consolidated Financial Statements* have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted as permitted by such rules and regulations. Certain reclassifications have been made to prior period amounts to conform to the presentation of the current period condensed financial statements.

Our reporting period usually ends on the Sunday closest to the last day of the quarterly calendar period. The third quarters of 2012 and 2011 ended on September 30, and September 25, respectively. The interim periods for both 2012 and 2011 contain 13 weeks, while the nine month periods contained 39 weeks and 38 weeks, respectively. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts in the *Condensed Consolidated Financial Statements*. Significant estimates and assumptions in these *Condensed Consolidated Financial Statements* require the exercise of judgment and are used for, but not limited to, allowance for doubtful accounts, estimates of future cash flows and other assumptions associated with goodwill and long-lived asset impairment tests, useful lives for depreciation and amortization, warranty programs, determination of discount and other rate assumptions for pension and other postretirement benefit expenses, income taxes and deferred tax valuation allowances, lease classifications and contingencies. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates.

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In preparing our *Condensed Consolidated Financial Statements*, we evaluated subsequent events through the date our quarterly report was filed with the SEC.

The weighted-average diluted common shares outstanding exclude the anti-dilutive effect of certain stock options since such options had an exercise price in excess of the monthly average market value of our common stock. The options excluded from diluted earnings per share for the three and nine month periods ended September 30, 2012, and September 25, 2011, were as follows:

|                  | Three months ended    |                       | Nine months ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 30,<br>2012 | September 25,<br>2011 | September 30,<br>2012 | September 25,<br>2011 |
| Options excluded | <b>599,637</b>        | 285,937               | <b>412,318</b>        | 142,750               |

You should read these interim condensed financial statements in conjunction with the *Consolidated Financial Statements* included in our Annual Report on Form 10-K for the year ended December 31, 2011. Our interim period financial results for the three and nine month interim periods presented are not necessarily indicative of results to be expected for any other interim period or for the entire year. The year-end *Condensed Consolidated Balance Sheet* data was derived from audited financial statements, but does not include all disclosures required by GAAP.



Table of Contents**NOTE 3. ACQUISITIONS AND DIVESTITURES****Acquisitions**

In April 2012, we reached an agreement to acquire the doser technology and business assets from Hilite Germany GmbH (Hilite) in a cash transaction. Dosers are products that enable compliance with emission standards in certain aftertreatment systems and complement our current product offerings. The transaction was approved by German regulators in June and closed on July 18, 2012. The purchase price was \$176 million and is summarized below. There was no contingent consideration associated with this transaction. During the first nine months of 2012 we expensed approximately \$4 million of acquisition related costs.

The acquisition of Hilite was accounted for as a business combination, with the results of the acquired entity and the goodwill included in the Components operating segment in the third quarter of 2012. The majority of the purchase price was allocated to technology and customer related intangible assets and goodwill, most of which is expected to be fully deductible for tax purposes. We expect the Hilite acquisition to strengthen our aftertreatment product offerings. This acquisition enhances our technical capabilities and keeps us in a strong position to meet the needs of current customers and grow into new markets, especially as an increasing number of regions around the world adopt tougher emission standards.

Intangible assets by asset class, including weighted average amortization life, are as follows:

| Dollars in millions     | Purchase price allocation | Weighted average amortization life in years |
|-------------------------|---------------------------|---|
| Technology              | \$ 52                     | 10.6  |
| Customer                | 23                        | 4.5   |
| License arrangements    | 8                         | 6.0   |
| Total intangible assets | \$ 83                     | 8.5   |

The purchase price was allocated as follows:

| In millions          |        |
|----------------------|--------|
| Inventory            | \$ 5   |
| Fixed assets         | 5      |
| Intangible assets    | 83     |
| Goodwill             | 91     |
| Liabilities          | (8)    |
| Total purchase price | \$ 176 |

Net sales for Hilite were \$77 million for the 12 months ended December 31, 2011.

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In July 2012, we acquired an additional 45 percent interest in Cummins Central Power from the former principal for consideration of approximately \$20 million. The acquisition was accounted for as a business combination, with the results of the acquired entity included in the Distribution operating segment in the third quarter of 2012. Distribution segment results also included a \$7 million gain, as we were required to re-measure our pre-existing 35 percent ownership interest in Cummins Central Power to fair value in accordance with GAAP. Net sales for Cummins Central Power were \$209 million for the 12 months ended December 31, 2011.

### **Divestitures**

In the second quarter of 2011, we sold certain assets and liabilities of our exhaust business which manufactures exhaust products and select components for emission systems for a variety of applications not core to our other product offerings. This business was historically included in our Components segment. The sales price was \$123 million. We recognized a gain of \$68 million (\$37 million after-tax), which included a goodwill allocation of \$19 million. In the second quarter of 2012, we recorded an additional \$6 million gain (\$4 million after-tax) related to final purchase price adjustments for our 2011 divestitures. The gains have been excluded from segment results as they were not considered in our evaluation of operating results for the nine months ended September 30, 2012 and September 25, 2011.

Sales for this business were \$62 million, \$171 million and \$126 million in 2011 (through closing), 2010 and 2009, respectively. Operating results for this business were approximately \$9 million, \$22 million and \$11 million in 2011 (through closing), 2010 and 2009, respectively.

Table of Contents**NOTE 4. PENSION AND OTHER POSTRETIREMENT BENEFITS**

We sponsor funded and unfunded domestic and foreign defined benefit pension and other postretirement plans. Contributions to these plans were as follows:

| In millions  | Three months ended |                    | Nine months ended  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2012 | September 25, 2011 | September 30, 2012 | September 25, 2011 |
| Defined benefit pension and other postretirement plans |                    |                    |                    |                    |
| Voluntary pension                                      | \$ 34              | \$ 36              | \$ 107             | \$ 106             |
| Mandatory pension                                      | 4                  | 5                  | 15                 | 16                 |
| Defined benefit pension contributions                  | 38                 | 41                 | 122                | 122                |
| Other postretirement plans                             | 14                 | 4                  | 31                 | 22                 |
| Total defined benefit plans                            | \$ 52              | \$ 45              | \$ 153             | \$ 144             |
| Defined contribution pension plans                     | \$ 15              | \$ 20              | \$ 59              | \$ 57              |

We made \$122 million of pension contributions in the nine months ended September 30, 2012, and we anticipate making an additional \$8 million of contributions during the remainder of 2012. We paid \$31 million of claims and premiums for other postretirement benefits in the nine months ended September 30, 2012; payments for the remainder of 2012 are expected to be \$20 million. The \$130 million of contributions for the full year include voluntary contributions of approximately \$109 million. These contributions and payments may be made from trusts or company funds either to increase pension assets or to make direct benefit payments to plan participants.

The components of net periodic pension and other postretirement benefit cost under our plans consisted of the following:

| In millions                                 | Pension            |                    |                    |      |                    |                    | Other Postretirement Benefits |                    |
|---|--------------------|--------------------|--------------------|------|--------------------|--------------------|-------------------------------|--------------------|
|   | U.S. Plans         |                    | Non-U.S. Plans     |      |                    |                    |                               |                    |
|   | September 30, 2012 | September 25, 2011 | Three months ended |      | September 30, 2012 | September 25, 2011 | September 30, 2012            | September 25, 2011 |
| Service cost                                | \$ 15              | \$ 13              | \$ 5               | \$ 5 | \$                 | \$                 |                               |                    |
| Interest cost                               | 25                 | 27                 | 15                 | 15   | 6                  | 6                  |                               |                    |
| Expected return on plan assets              | (40)               | (38)               | (20)               | (19) |                    |                    |                               |                    |
| Amortization of prior service (credit) cost |                    |                    |                    | 1    | (1)                | (2)                |                               |                    |
| Recognized net actuarial loss               | 12                 | 10                 | 4                  | 3    |                    |                    |                               |                    |
| Net periodic benefit cost                   | \$ 12              | \$ 12              | \$ 4               | \$ 5 | \$ 5               | \$ 4               |                               |                    |

| In millions | Pension            |                    |                   |  |                    |                    | Other Postretirement Benefits |                    |
|-------------|--------------------|--------------------|-------------------|--|--------------------|--------------------|-------------------------------|--------------------|
|             | U.S. Plans         |                    | Non-U.S. Plans    |  |                    |                    |                               |                    |
|             | September 30, 2012 | September 25, 2011 | Nine months ended |  | September 30, 2012 | September 25, 2011 | September 30, 2012            | September 25, 2011 |
|             |                    |                    |                   |  |                    |                    |                               |                    |

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|   |    |              |    |       |    |             |    |      |    |                 |
|---|----|--------------|----|-------|----|-------------|----|------|----|-----------------|
| Service cost                                | \$ | <b>44</b>    | \$ | 39    | \$ | <b>16</b>   | \$ | 15   | \$ |                 |
| Interest cost                               |    | <b>77</b>    |    | 81    |    | <b>44</b>   |    | 45   |    | <b>16</b> 18    |
| Expected return on plan assets              |    | <b>(118)</b> |    | (114) |    | <b>(61)</b> |    | (56) |    |                 |
| Amortization of prior service (credit) cost |    |              |    |       |    |             |    | 2    |    | <b>(3)</b> (6)  |
| Recognized net actuarial loss               |    | <b>35</b>    |    | 30    |    | <b>11</b>   |    | 9    |    | <b>2</b>        |
| Net periodic benefit cost                   | \$ | <b>38</b>    | \$ | 36    | \$ | <b>10</b>   | \$ | 15   | \$ | <b>15</b> \$ 12 |

Table of Contents**NOTE 5. EQUITY, ROYALTY AND INTEREST INCOME FROM INVESTEEES**

Equity, royalty and interest income from investees included in our *Condensed Consolidated Statements of Income* for the interim reporting periods was as follows:

| In millions  | Three months ended    |                       | Nine months ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2012 | September 25,<br>2011 | September 30,<br>2012 | September 25,<br>2011 |
| <b>Distribution Entities</b>                       |                       |                       |                       |                       |
| North American distributors                        | \$ 37                 | \$ 35                 | \$ 115                | \$ 100                |
| Komatsu Cummins Chile, Ltda.                       | 9                     | 6                     | 20                    | 16                    |
| All other distributors                             |                       | 1                     | 3                     | 3                     |
| <b>Manufacturing Entities</b>                      |                       |                       |                       |                       |
| Chongqing Cummins Engine Company, Ltd.             | 14                    | 20                    | 49                    | 51                    |
| Dongfeng Cummins Engine Company, Ltd.              | 9                     | 15                    | 42                    | 64                    |
| Shanghai Fleetguard Filter Co., Ltd.               | 3                     | 4                     | 10                    | 12                    |
| Beijing Foton Cummins Engine Co., Ltd.             | 3                     | (2)                   | 3                     | (5)                   |
| Cummins Westport, Inc.                             | 2                     | 4                     | 11                    | 8                     |
| Valvoline Cummins, Ltd.                            | 2                     | 2                     | 6                     | 6                     |
| Tata Cummins, Ltd.                                 |                       | 2                     | 7                     | 9                     |
| Komatsu manufacturing alliances                    | (1)                   |                       | (1)                   | 1                     |
| All other manufacturers                            | 7                     | 7                     | 7                     | 19                    |
| Cummins share of net income                        | 85                    | 94                    | 272                   | 284                   |
| Royalty and interest income                        | 9                     | 8                     | 30                    | 31                    |
| Equity, royalty and interest income from investees | \$ 94                 | \$ 102                | \$ 302                | \$ 315                |

**NOTE 6. MARKETABLE SECURITIES**

A summary of marketable securities, all of which are classified as current, was as follows:

| In millions                         | Cost   | September 30, 2012              |                      | Cost   | December 31, 2011               |                      |
|-------------------------------------|--------|---------------------------------|----------------------|--------|---------------------------------|----------------------|
|                                     |        | Gross unrealized gains/(losses) | Estimated fair value |        | Gross unrealized gains/(losses) | Estimated fair value |
| Available-for-sale                  |        |                                 |                      |        |                                 |                      |
| Debt mutual funds                   | \$ 140 | \$ 3                            | \$ 143               | \$ 115 | \$ 2                            | \$ 117               |
| Bank debentures                     | 50     |                                 | 50                   | 82     |                                 | 82                   |
| Certificates of deposit             | 32     |                                 | 32                   | 66     |                                 | 66                   |
| Government debt securities-non-U.S. | 3      |                                 | 3                    | 3      |                                 | 3                    |
| Corporate debt securities           | 2      |                                 | 2                    | 2      |                                 | 2                    |
| Equity securities and other         |        | 9                               | 9                    |        | 7                               | 7                    |
|                                     | \$ 227 | \$ 12                           | \$ 239               | \$ 268 | \$ 9                            | \$ 277               |

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Total marketable securities

At September 30, 2012, the fair value of available-for-sale investments in debt securities by contractual maturity was as follows:

| <b>Maturity date</b> | <b>Fair value</b> |    |
|----------------------|-------------------|----|
| <b>In millions</b>   |                   |    |
| 1 year or less       | \$                | 29 |
| 1-5 years            |                   | 25 |
| 5-10 years           |                   | 1  |
| Total                | \$                | 55 |

Table of Contents**NOTE 7. INCOME TAXES**

Our effective tax rate for the year is expected to approximate 26.5 percent, absent any discrete period activity. Our tax rate is generally less than the 35 percent U.S. income tax rate primarily due to lower tax rates on foreign income. The tax rates for the three and nine month periods ended September 30, 2012, were 24.1 percent and 25.5 percent, respectively. These tax rates include a \$16 million tax benefit for third quarter discrete tax adjustments, \$6 million of which related to a dividend distribution of accumulated foreign income earned in prior years. These discrete tax adjustments also included a discrete tax benefit of \$13 million for prior year tax return true-up adjustments and a discrete tax charge of \$3 million related to the third quarter enactment of U.K. tax law changes.

The tax rates for the three and nine month periods ended September 25, 2011, were 25.0 percent and 28.2 percent, respectively, and included a net discrete income tax benefit of \$29 million (net of additional reserves for uncertain tax positions of \$39 million) related to prior year refund claims filed for additional research tax credits, additional foreign income and foreign tax credits, as well as other adjustments. This benefit also included discrete income tax charges of \$2 million for prior year tax return true-up adjustments and \$3 million related to the third quarter enactment of U.K. tax law changes in the three and nine month periods ended September 25, 2011. Additionally, the tax rate for the nine month period included a second quarter discrete income tax charge of \$4 million related to the enactment of state tax law changes in Indiana. The decrease in the 2012 effective tax rates versus the comparable periods in 2011 is due primarily to our assertion that income earned after 2011 by our China operations is permanently reinvested, as well as certain tax planning strategies implemented in our U.K. subsidiaries.

**NOTE 8. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The majority of the assets and liabilities we carry at fair value are available-for-sale (AFS) securities and derivatives. AFS securities are derived from level 1 or level 2 inputs. Derivative assets and liabilities are derived from level 2 inputs. The predominance of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. When material, we adjust the values of our derivative contracts for counter-party or our credit risk. There were no transfers into or out of levels 2 or 3 in the first nine months of 2012.

The following table summarizes our financial instruments recorded at fair value in our *Condensed Consolidated Balance Sheets* at September 30, 2012:

| In millions                          | Fair Value Measurements Using                                  |   |   | Total  |
|--------------------------------------|--|---|---|--------|
|                                      | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |        |
| Available-for-sale debt securities   |  |   |   |        |
| Debt mutual funds                    | \$ 78  | \$ 65   | \$  | \$ 143 |
| Bank debentures                      |  | 50  |   | 50     |
| Certificates of deposit              |  | 32  |   | 32     |
| Government debt securities-non-U.S.  |  | 3   |   | 3      |
| Corporate debt securities            |  | 2   |   | 2      |
| Available-for-sale equity securities |  |   |   |        |

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|                                    |    |    |    |     |    |        |
|------------------------------------|----|----|----|-----|----|--------|
| Financial services industry        |    | 9  |    |     |    | 9      |
| Derivative assets                  |    |    |    |     |    |        |
| Interest rate contracts            |    |    | 88 |     |    | 88     |
| Commodity swap contracts           |    |    | 6  |     |    | 6      |
| Foreign currency forward contracts |    |    | 5  |     |    | 5      |
| Commodity call option contracts    |    |    | 1  |     |    | 1      |
| Total assets                       | \$ | 87 | \$ | 252 | \$ | \$ 339 |
| Derivative liabilities             |    |    |    |     |    |        |
| Foreign currency forward contracts |    |    |    | 1   |    | 1      |
| Total liabilities                  | \$ |    | \$ | 1   | \$ | 1      |



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The following table summarizes our financial instruments recorded at fair value in our *Condensed Consolidated Balance Sheets* at December 31, 2011:

| In millions                                 | Fair Value Measurements Using                                  |   |   | Total  |
|---|--|---|---|--------|
|   | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |        |
| <b>Available-for-sale debt securities</b>   |  |   |   |        |
| Debt mutual funds                           | \$ 53  | \$ 64   | \$  | \$ 117 |
| Bank debentures                             |  | 82  |   | 82     |
| Certificates of deposit                     |  | 66  |   | 66     |
| Government debt securities-non-U.S.         |  | 3   |   | 3      |
| Corporate debt securities                   |  | 2   |   | 2      |
| <b>Available-for-sale equity securities</b> |  |   |   |        |
| Financial services industry                 | 7  |   |   | 7      |
| <b>Derivative assets</b>                    |  |   |   |        |
| Interest rate contracts                     |  | 82  |   | 82     |
| Total assets                                | \$ 60  | \$ 299  | \$  | \$ 359 |
| <b>Derivative liabilities</b>               |  |   |   |        |
| Commodity swap contracts                    |  | 22  |   | 22     |
| Foreign currency forward contracts          |  | 8   |   | 8      |
| Total liabilities                           | \$   | \$ 30   | \$  | \$ 30  |

The substantial majority of our assets were valued utilizing a market approach. A description of the valuation techniques and inputs used for our level 2 fair value measures are as follows:

*Debt mutual funds* Assets in level 2 consist of exchange traded mutual funds that lack sufficient trading volume to be classified at level 1. The fair value measure for these investments is the daily net asset value published on a regulated governmental website. Daily quoted prices are available from the issuing brokerage and are used on a test basis to corroborate this level 2 input.

*Bank debentures and Certificates of deposit* These investments provide us with a fixed rate of return and generally range in maturity from six months to three years. The counter-parties to these investments are reputable financial institutions with investment grade credit ratings. Since these instruments are not tradable and must be settled directly by Cummins with the respective financial institution, our fair value measure is the financial institutions' month-end statement.

*Government debt securities-non-U.S. and Corporate debt securities* The fair value measure for these securities are broker quotes received from reputable firms. These securities are infrequently traded on a national stock exchange and these values are used on a test basis to corroborate our level 2 input measure.

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*Foreign currency forward contracts* The fair value measure for these contracts are determined based on forward foreign exchange rates received from third-party pricing services. These rates are based upon market transactions and are periodically corroborated by comparing to third-party broker quotes.

*Commodity swap contracts* The fair value measure for these contracts are current spot market data adjusted for the appropriate current forward curves provided by external financial institutions. The current spot price is the most significant component of this valuation and is based upon market transactions. We use third-party pricing services for the spot price component of this valuation which is periodically corroborated by market data from broker quotes.

*Commodity call and put option contracts* We utilize the month-end statement from the issuing financial institution as our fair value measure for this investment. We corroborate this valuation through the use of a third-party pricing service for similar assets and liabilities.

*Interest rate contracts* We currently have only one interest rate contract. We utilize the month-end statement from the issuing financial institution as our fair value measure for this investment. We corroborate this valuation through the use of a third-party pricing service for similar assets and liabilities.

Table of Contents**Fair Value of Other Financial Instruments**

Based on borrowing rates currently available to us for bank loans with similar terms and average maturities, considering our risk premium, the fair value and carrying value of total debt, including current maturities, at September 30, 2012 and December 31, 2011, are set forth in the table below. The carrying values of all other receivables and liabilities approximated fair values (derived from level 2 inputs).

| In millions                  |    | September 30,<br>2012 |    | December 31,<br>2011 |
|------------------------------|----|-----------------------|----|----------------------|
| Fair value of total debt     | \$ | 957                   | \$ | 901                  |
| Carrying value of total debt |    | 801                   |    | 783                  |

**NOTE 9. INVENTORIES**

Inventories are stated at the lower of cost or market. Inventories included the following:

| In millions                       |    | September 30,<br>2012 |    | December 31,<br>2011 |
|-----------------------------------|----|-----------------------|----|----------------------|
| Finished products                 | \$ | 1,390                 | \$ | 1,220                |
| Work-in-process and raw materials |    | 1,292                 |    | 1,019                |
| Inventories at FIFO cost          |    | 2,682                 |    | 2,239                |
| Excess of FIFO over LIFO          |    | (112)                 |    | (98)                 |
| Total inventories                 | \$ | 2,570                 | \$ | 2,141                |

**NOTE 10. GOODWILL AND OTHER INTANGIBLE ASSETS**

A summary of the carrying amount of goodwill was as follows:

| In millions                       | Components | Distribution | Power<br>Generation | Engine | Total  |
|-----------------------------------|------------|--------------|---------------------|--------|--------|
| Goodwill at December 31,<br>2010  | \$ 338     | \$ 11        | \$ 12               | \$ 6   | \$ 367 |
| Divestitures                      | (25)       |              |                     |        | (25)   |
| Translation and other             | (2)        | (1)          |                     |        | (3)    |
| Goodwill at December 31,<br>2011  | 311        | 10           | 12                  | 6      | 339    |
| Acquisitions                      | 91         | 9            |                     |        | 100    |
| Translation and other             | 4          |              |                     |        | 4      |
| Goodwill at September 30,<br>2012 | \$ 406     | \$ 19        | \$ 12               | \$ 6   | \$ 443 |

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Intangible assets that have finite useful lives are amortized over their estimated useful lives. The following table summarizes our other intangible assets with finite lives that are subject to amortization:

| <b>In millions</b>                | <b>September 30,</b> |       | <b>December 31,</b> |       |
|-----------------------------------|----------------------|-------|---------------------|-------|
|                                   | <b>2012</b>          |       | <b>2011</b>         |       |
| Software                          | \$                   | 500   | \$                  | 409   |
| Less: Accumulated amortization    |                      | (231) |                     | (191) |
| Net software                      |                      | 269   |                     | 218   |
| Trademarks, patents and other     |                      | 138   |                     | 44    |
| Less: Accumulated amortization    |                      | (42)  |                     | (35)  |
| Net trademarks, patents and other |                      | 96    |                     | 9     |
| Total                             | \$                   | 365   | \$                  | 227   |

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Amortization expense for software and other intangibles totaled \$16 million and \$44 million and \$14 million and \$43 million for the three and nine months ended September 30, 2012 and September 25, 2011, respectively. Internal and external software costs (excluding those related to research, re-engineering and training), trademarks and patents are amortized generally over a 3 to 12-year period. The following table represents the projected amortization expense of our intangible assets, assuming no further acquisitions or dispositions.

| In millions                    | For the years ended |       |       |       |       |
|--------------------------------|---------------------|-------|-------|-------|-------|
|                                | 2013                | 2014  | 2015  | 2016  | 2017  |
| Projected amortization expense | \$ 80               | \$ 69 | \$ 66 | \$ 60 | \$ 33 |

**NOTE 11. PRODUCT WARRANTY LIABILITY**

We charge the estimated costs of warranty programs, other than product recalls, to income at the time products are shipped to customers. We use historical claims experience to develop the estimated liability. We review product recall programs on a quarterly basis and, if necessary, record a liability when we commit to an action, or when they become probable and estimable, which is reflected in the provision for warranties issued line. We also sell extended warranty coverage on several engines. The following is a tabular reconciliation of the product warranty liability, including the deferred revenue related to our extended warranty coverage and accrued recall programs:

| In millions   | Nine months ended     |                       |
|---|-----------------------|-----------------------|
|   | September 30,<br>2012 | September 25,<br>2011 |
| Balance, beginning of year                                      | \$ 1,014              | \$ 980                |
| Provision for warranties issued                                 | 320                   | 329                   |
| Deferred revenue on extended warranty contracts sold            | 154                   | 82                    |
| Payments  | (294)                 | (292)                 |
| Amortization of deferred revenue on extended warranty contracts | (77)                  | (71)                  |
| Changes in estimates for pre-existing warranties                | (36)                  | (4)                   |
| Foreign currency translation                                    | 2                     | (6)                   |
| Balance, end of period  | \$ 1,083              | \$ 1,018              |

Warranty related deferred revenue, supplier recovery receivables and the long-term portion of the warranty liability on our September 30, 2012, balance sheet were as follows:

| In millions  | September 30,<br>2012 |  | Balance Sheet Location                 |
|--|-----------------------|--|--|
|  |                       |  |  |
| Deferred revenue related to extended coverage programs |                       |  |  |
| Current portion  | \$ 106                |  | Deferred revenue                       |
| Long-term portion                                      | 284                   |  | Other liabilities and deferred revenue |
| Total  | \$ 390                |  |  |
| Receivables related to estimated supplier recoveries   |                       |  |  |
| Current portion  | \$ 6                  |  | Trade and other receivables            |
| Long-term portion                                      | 6                     |  | Other assets                           |
| Total  | \$ 12                 |  |  |
| Long-term portion of warranty liability                | \$ 287                |  | Other liabilities and deferred revenue |



Table of Contents**NOTE 12. DEBT**

A summary of long-term debt was as follows:

| In millions   | September 30,<br>2012 | December 31,<br>2011 |
|---|-----------------------|----------------------|
| Long-term debt  |                       |                      |
| Export financing loan, 4.5%, due 2012                       | \$                    | \$ 31                |
| Export financing loan, 4.5%, due 2013                       | 34                    | 44                   |
| Debentures, 6.75%, due 2027                                 | 58                    | 58                   |
| Debentures, 7.125%, due 2028                                | 250                   | 250                  |
| Debentures, 5.65%, due 2098 (effective interest rate 7.48%) | 165                   | 165                  |
| Other   | 119                   | 90                   |
|   | 626                   | 638                  |
| Unamortized discount  | (35)                  | (36)                 |
| Fair value adjustments due to hedge on indebtedness         | 88                    | 82                   |
| Capital leases  | 68                    | 71                   |
| Total long-term debt  | 747                   | 755                  |
| Less: Current maturities of long-term debt                  | (77)                  | (97)                 |
| Long-term debt  | \$ 670                | \$ 658               |

Principal payments required on long-term debt during the next five years are the following:

| In millions | Required Principal Payments |       |       |       |       |
|-------------|-----------------------------|-------|-------|-------|-------|
|             | 2012                        | 2013  | 2014  | 2015  | 2016  |
| Payment     | \$ 33                       | \$ 71 | \$ 31 | \$ 43 | \$ 14 |

**NOTE 13. DERIVATIVES**

We are exposed to financial risk resulting from volatility in foreign exchange rates, commodity prices and interest rates. This risk is closely monitored and managed through the use of financial derivative instruments including foreign currency forward contracts, commodity swap contracts, commodity zero-cost collars and interest rate swaps. As stated in our policies and procedures, financial derivatives are used expressly for hedging purposes, and under no circumstances are they used for speculative purposes. When material, we adjust the value of our derivative contracts for counter-party or our credit risk.

**Foreign Exchange Rates**

As a result of our international business presence, we are exposed to foreign currency exchange risks. We transact business in foreign currencies and, as a result, our income experiences some volatility related to movements in foreign currency exchange rates. To help manage our exposure

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to exchange rate volatility, we use foreign exchange forward contracts on a regular basis to hedge forecasted intercompany and third-party sales and purchases denominated in non-functional currencies. Our internal policy allows for managing anticipated foreign currency cash flows for up to one year. These foreign currency forward contracts are designated and qualify as foreign currency cash flow hedges under GAAP. The effective portion of the unrealized gain or loss on the forward contract is deferred and reported as a component of Accumulated other comprehensive loss (AOCL). When the hedged forecasted transaction (sale or purchase) occurs, the unrealized gain or loss is reclassified into income in the same line item associated with the hedged transaction in the same period or periods during which the hedged transaction affects income. The ineffective portion of the hedge, unrealized gain or loss, if any, is recognized in current income during the period of change. As of September 30, 2012, the amount we expect to reclassify from AOCL to income over the next year is an unrealized net gain of \$2 million. For the nine month periods ended September 30, 2012 and September 25, 2011, there were no circumstances that would have resulted in the discontinuance of a foreign currency cash flow hedge.

To minimize the income volatility resulting from the remeasurement of net monetary assets and payables denominated in a currency other than the functional currency, we enter into foreign currency forward contracts, which are considered economic hedges. The objective is to offset the gain or loss from remeasurement with the gain or loss from the fair market valuation of the forward contract. These derivative instruments are not designated as hedges under GAAP.



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The table below summarizes our outstanding foreign currency forward contracts. Only the U.S. dollar forward contracts are designated and qualify for hedge accounting as of each period presented below. The currencies in this table represent 95 percent and 98 percent of the notional amounts of contracts outstanding as of September 30, 2012 and December 31, 2011, respectively.

| Currency denomination        | Notional amount in millions |                      |
|------------------------------|-----------------------------|----------------------|
|                              | September 30,<br>2012       | December 31,<br>2011 |
| United States Dollar (USD)   | 147                         | 181                  |
| British Pound Sterling (GBP) | 240                         | 347                  |
| Euro (EUR)                   | 33                          | 47                   |
| Singapore Dollar (SGD)       | 8                           | 20                   |
| Indian Rupee (INR)           | 1,565                       | 1,701                |
| Japanese Yen (JPY)           | 1,788                       | 3,348                |
| Canadian Dollar (CAD)        | 52                          | 39                   |
| South Korea Won (KRW)        | 51,107                      | 36,833               |
| Chinese Renmimbi (CNY)       | 78                          | 61                   |

**Commodity Price Risk**

We are exposed to fluctuations in commodity prices due to contractual agreements with component suppliers. In order to protect ourselves against future price volatility and, consequently, fluctuations in gross margins, we periodically enter into commodity swap contracts with designated banks to fix the cost of certain raw material purchases with the objective of minimizing changes in inventory cost due to market price fluctuations. Certain commodity swap contracts are derivative contracts that are designated as cash flow hedges under GAAP. We also have commodity swap contracts that represent an economic hedge, but are not designated for hedge accounting and are marked to market through earnings. For those contracts that qualify for hedge accounting, the effective portion of the unrealized gain or loss is deferred and reported as a component of AOCL. When the hedged forecasted transaction (purchase) occurs, the unrealized gain or loss is reclassified into income in the same line item associated with the hedged transaction in the same period or periods during which the hedged transaction affects income. The ineffective portion of the hedge, if any, is recognized in current income in the period in which the ineffectiveness occurs. As of September 30, 2012, we expect to reclassify an unrealized net gain of \$1 million from AOCL to income over the next year. Our internal policy allows for managing these cash flow hedges for up to three years.

The following table summarizes our outstanding commodity swap contracts that were entered into to hedge the cost of certain raw material purchases:

| Dollars in millions<br>Commodity | September 30, 2012 |          |                    | December 31, 2011 |          |                    |
|----------------------------------|--------------------|----------|--------------------|-------------------|----------|--------------------|
|                                  | Notional Amount    | Quantity |                    | Notional Amount   | Quantity |                    |
|                                  |                    |          | <b>metric tons</b> |                   |          | <b>metric tons</b> |
| Copper                           | \$ 44              | 5,420    | (1)                | \$ 78             | 9,220    | (1)                |
|                                  |                    |          | <b>troy ounces</b> |                   |          | <b>troy ounces</b> |
| Platinum                         | 79                 | 50,631   | (2)                | 84                | 50,750   | (2)                |
|                                  |                    |          | <b>troy ounces</b> |                   |          | <b>troy ounces</b> |
| Palladium                        | 8                  | 12,687   | (2)                | 5                 | 7,141    | (2)                |

(1)A metric ton is a measurement of mass equal to 1,000 kilograms.

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(2)A troy ounce is a measurement of mass equal to approximately 31 grams.

In the third quarter of 2012 we began to use a combination of call and put option contracts for copper in net-zero-cost collar arrangements (zero-cost collars) that establish ceiling and floor prices for copper. These contracts are used strictly for hedging and not for speculative purposes. For these zero-cost collars, if the average price of the copper during the calculation period is within the call and put price, the call and put contracts expire at no cost to us. If the price falls below the floor, the counter-party to the collar receives the difference from us, and if the price rises above the ceiling, the counter-party pays the difference to us. We believe that these zero-cost collars will act as economic hedges; however we have chosen not to designate them as hedges for accounting purposes, therefore we present the calls and puts on a gross basis on our *Condensed Consolidated Balance Sheets*.

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The following table summarizes our outstanding commodity zero-cost collar contracts that were entered into to hedge the cost of copper purchases:

| Commodity           | September 30, 2012      |                                |
|---------------------|-------------------------|--------------------------------|
|                     | Average Floor<br>or Cap | Quantity in<br>metric tons (1) |
| Copper call options | \$ 8,192                | 2,000                          |
| Copper put options  | 6,702                   | 2,000                          |

(1) A metric ton is a measurement of mass equal to 1,000 kilograms.

### Interest Rate Risk

We are exposed to market risk from fluctuations in interest rates. We manage our exposure to interest rate fluctuations through the use of interest rate swaps. The objective of the swaps is to more effectively balance our borrowing costs and interest rate risk.

In November 2005, we entered into an interest rate swap to effectively convert our \$250 million debt issue, due in 2028, from a fixed rate of 7.125 percent to a floating rate based on a LIBOR spread. The terms of the swap mirror those of the debt, with interest paid semi-annually. This swap qualifies as a fair value hedge under GAAP. The gain or loss on this derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in current income as Interest expense. The following table summarizes these gains and losses for the three and nine month interim reporting periods presented below:

| In millions<br>Income Statement<br>Classification | Three months ended      |                              |                         |                              | Nine months ended       |                              |                         |                              |
|---|-------------------------|------------------------------|-------------------------|------------------------------|-------------------------|------------------------------|-------------------------|------------------------------|
|   | September 30, 2012      |                              | September 25, 2011      |                              | September 30, 2012      |                              | September 25, 2011      |                              |
|   | Gain/(Loss) on<br>Swaps | Gain/(Loss) on<br>Borrowings | Gain/(Loss) on<br>Swaps | Gain/(Loss) on<br>Borrowings | Gain/(Loss) on<br>Swaps | Gain/(Loss) on<br>Borrowings | Gain/(Loss) on<br>Swaps | Gain/(Loss) on<br>Borrowings |
| Interest expense                                  | \$ 1                    | \$ (1)                       | \$ 30                   | \$ (30)                      | \$ 6                    | \$ (6)                       | \$ 40                   | \$ (40)                      |

### Cash Flow Hedging

The following table summarizes the effect on our *Condensed Consolidated Statements of Income* for derivative instruments classified as cash flow hedges for the three and nine month interim reporting periods presented below. The table does not include amounts related to ineffectiveness as it was not material for the periods presented.

| In millions<br>Derivatives in Cash | Location of<br>Gain/(Loss)<br>Reclassified<br>into Income<br>(Effective<br>Portion) | Three months ended  |   | Nine months ended   |   |
|------------------------------------|---|---|---|---|---|
|                                    |   | Amount of Gain/(Loss)<br>Recognized in<br>AOCL on Derivative<br>(Effective Portion) | Amount of Gain/(Loss)<br>Reclassified from<br>AOCL into Income<br>(Effective Portion) | Amount of Gain/(Loss)<br>Recognized in<br>AOCL on Derivative<br>(Effective Portion) | Amount of Gain/(Loss)<br>Reclassified from<br>AOCL into Income<br>(Effective Portion) |



Table of Contents**Derivatives Not Designated as Hedging Instruments**

The following table summarizes the effect on our *Condensed Consolidated Statements of Income* for derivative instruments that are not classified as hedges for the three and nine month interim reporting periods presented below.

| In millions<br>Derivatives Not Designated as<br>Hedging Instruments | Location of Gain/(Loss)<br>Recognized in Income<br>on Derivatives | Three months ended<br>Amount of Gain/(Loss) Recognized in<br>Income on Derivatives |                       | Nine months ended<br>Amount of Gain/(Loss) Recognized in<br>Income on Derivatives |                       |
|---|---|--|-----------------------|---|-----------------------|
|   |   | September 30,<br>2012  | September 25,<br>2011 | September 30,<br>2012   | September 25,<br>2011 |
| Foreign currency forward contracts                                  | Cost of sales   | \$ (1)   | \$ 2                  | \$ (4)  | \$ (1)                |
| Foreign currency forward contracts                                  | Other income (expense), net                                       | 13   | (15)                  | 18  | (20)                  |
| Commodity swap contracts  | Cost of sales   | 2  |                       | 1   |                       |
| Commodity zero-cost collars   | Cost of sales   | 1  |                       | 1   |                       |

**Fair Value Amount and Location of Derivative Instruments**

The following tables summarize the location and fair value of derivative instruments on our *Condensed Consolidated Balance Sheets*:

| In millions   | Fair Value            |                      | Balance Sheet Location                    |
|---|-----------------------|----------------------|---|
|   | September 30,<br>2012 | December 31,<br>2011 |   |
| <b>Derivative Assets</b>                                |                       |                      |   |
| Derivatives designated as hedging instruments           |                       |                      |   |
| Interest rate contract                                  | \$ 88                 | \$ 82                | Other assets                              |
| Commodity swap contracts                                | 5                     |                      | Prepaid expenses and other current assets |
| Foreign currency forward contracts                      | 4                     |                      | Prepaid expenses and other current assets |
| Commodity swap contracts                                | 1                     |                      | Other assets                              |
| Total derivatives designated as hedging instruments     | 98                    | 82                   |   |
| Derivatives not designated as hedging instruments       |                       |                      |   |
| Foreign currency forward contracts                      | 1                     |                      | Prepaid expenses and other current assets |
| Commodity call option contracts                         | 1                     |                      | Other assets                              |
| Total derivatives not designated as hedging instruments | 2                     |                      |   |
| Total derivative assets                                 | \$ 100                | \$ 82                |   |

**Derivative Liabilities**

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| In millions  | Fair Value            |                      | Balance Sheet Location |
|--|-----------------------|----------------------|------------------------|
|  | September 30,<br>2012 | December 31,<br>2011 |                        |
| <b>Derivatives designated as hedging instruments</b>     |                       |                      |                        |
| Commodity swap contracts                                 | \$                    | \$ 16                | Other accrued expenses |
| Foreign currency forward contracts                       |                       | 7                    | Other accrued expenses |
| Total derivatives designated as hedging instruments      |                       | 23                   |                        |
| <b>Derivatives not designated as hedging instruments</b> |                       |                      |                        |
| Commodity swap contracts                                 |                       | 6                    | Other accrued expenses |
| Foreign currency forward contracts                       | 1                     | 1                    | Other accrued expenses |
| Total derivatives not designated as hedging instruments  | 1                     | 7                    |                        |
| Total derivative liabilities                             | \$ 1                  | \$ 30                |                        |

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**NOTE 14. COMMITMENTS AND CONTINGENCIES**

We are subject to numerous lawsuits and claims arising out of the ordinary course of our business, including actions related to product liability; personal injury; the use and performance of our products; warranty matters; patent, trademark or other intellectual property infringement; contractual liability; the conduct of our business; tax reporting in foreign jurisdictions; distributor termination; workplace safety; and environmental matters. We also have been identified as a potentially responsible party at multiple waste disposal sites under U.S. federal and related state environmental statutes and regulations and may have joint and several liability for any investigation and remediation costs incurred with respect to such sites. We have denied liability with respect to many of these lawsuits, claims and proceedings and are vigorously defending such lawsuits, claims and proceedings. We carry various forms of commercial, property and casualty, product liability and other forms of insurance; however, such insurance may not be applicable or adequate to cover the costs associated with a judgment against us with respect to these lawsuits, claims and proceedings. We do not believe that these lawsuits are material individually or in the aggregate. While we believe we have also established adequate accruals for our expected future liability with respect to pending lawsuits, claims and proceedings, where the nature and extent of any such liability can be reasonably estimated based upon then presently available information, there can be no assurance that the final resolution of any existing or future lawsuits, claims or proceedings will not have a material adverse effect on our business, results of operations, financial condition or cash flows.

We conduct significant business operations in Brazil that are subject to the Brazilian federal, state and local labor, social security, tax and customs laws. While we believe we comply with such laws, they are complex, subject to varying interpretations and we are often engaged in litigation regarding the application of these laws to particular circumstances.

**U.S. Distributor Commitments**

Our distribution agreements with independent and partially-owned distributors generally have a three-year term and are restricted to specified territories. Our distributors develop and maintain a network of dealers with which we have no direct relationship. Our distributors are permitted to sell other, noncompetitive products only with our consent. We license all of our distributors to use our name and logo in connection with the sale and service of our products, with no right to assign or sublicense the trademarks, except to authorized dealers, without our consent. Products are sold to the distributors at standard domestic or international distributor net prices, as applicable. Net prices are wholesale prices we establish to permit our distributors an adequate margin on their sales. Subject to local laws, we can generally refuse to renew these agreements upon expiration or terminate them upon written notice for inadequate sales, change in principal ownership and certain other reasons. Distributors also have the right to terminate the agreements upon 60-day notice without cause, or 30-day notice for cause. Upon termination or failure to renew, we are required to purchase the distributor's current inventory, signage and special tools, and may, at our option purchase other assets of the distributor, but are under no obligation to do so.

**Other Guarantees and Commitments**

In addition to the matters discussed above, from time to time we periodically enter into other guarantee arrangements, including guarantees of non-U.S. distributor financing, residual value guarantees on equipment leased under operating leases and other miscellaneous guarantees of third-party obligations. As of September 30, 2012, the maximum potential loss related to these other guarantees is summarized as follows (where the guarantee is in a foreign currency the amount below represents the amount in U.S. dollars at current exchange rates):

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|   |    |    |
|---|----|----|
| Cummins Olayan Energy Limited debt guarantee        | \$ | 18 |
| Xi'an Cummins Engine Company Limited debt guarantee |    | 7  |
| Residual value guarantees                           |    | 1  |
| Other debt guarantees                               |    | 3  |
| Maximum potential loss                              | \$ | 29 |

The amount of liabilities related to the above guarantees was \$8 million.

We have arrangements with certain suppliers that require us to purchase minimum volumes or be subject to monetary penalties. The penalty amounts are less than our purchase commitments and essentially allow the supplier to recover their tooling costs in most instances. As of September 30, 2012, if we were to stop purchasing from each of these suppliers, the aggregate amount of the penalty would be approximately \$102 million, of which \$98 million relates to a contract with an engine parts supplier that extends to 2016. We do not currently anticipate paying any penalties under these contracts. In addition, we also have a take or pay contract with an emission solutions business supplier requiring us to purchase approximately \$73 million annually from 2012 to 2018. These arrangements enable us to secure critical components.



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We have guarantees with certain customers that require us to satisfactorily honor contractual or regulatory obligations, or compensate for monetary losses related to nonperformance. These performance bonds and other performance-related guarantees were \$72 million at September 30, 2012.

**Indemnifications**

Periodically, we enter into various contractual arrangements where we agree to indemnify a third-party against certain types of losses. Common types of indemnifications include:

- product liability and license, patent or trademark indemnifications,
- asset sale agreements where we agree to indemnify the purchaser against future environmental exposures related to the asset sold and
- any contractual agreement where we agree to indemnify the counter-party for losses suffered as a result of a misrepresentation in the contract.

We regularly evaluate the probability of having to incur costs associated with these indemnifications and accrue for expected losses that are probable. Because the indemnifications are not related to specified known liabilities and due to their uncertain nature, we are unable to estimate the maximum amount of the potential loss associated with these indemnifications.

**Joint Venture Commitments**

As of September 30, 2012, we have committed to invest an additional \$36 million into existing joint ventures, of which \$19 million is expected to be funded in 2012.

**NOTE 15. OPERATING SEGMENTS**

Operating segments under GAAP are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Cummins chief operating decision-maker (CODM) is the Chief Executive Officer.

Our reportable operating segments consist of the following: Engine, Components, Power Generation and Distribution. This reporting structure is organized according to the products and markets each segment serves and allows management to focus its efforts on providing enhanced service to a wide range of customers. The Engine segment produces engines and parts for sale to customers in on-highway and various industrial markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as various industrial applications including construction, mining, agriculture, marine, oil and gas, rail and military equipment. The Components segment sells filtration products, exhaust aftertreatment systems, turbochargers and fuel systems. The Power Generation segment is an integrated provider of power systems. The segment sells engines, generator sets, alternators, power systems and services. The Distribution segment includes wholly-owned and partially-owned distributorships engaged in wholesaling engines, generator sets and service parts, as well as performing service and repair activities on our products and maintaining relationships with various OEMs throughout the world.

We use segment EBIT (defined as earnings before interest expense, income taxes and noncontrolling interests) as a primary basis for the CODM to evaluate the performance of each of our operating segments. Segment amounts exclude certain expenses not specifically identifiable to segments.

The accounting policies of our operating segments are the same as those applied in the *Condensed Consolidated Financial Statements*. We prepared the financial results of our operating segments on a basis that is consistent with the manner in which we internally disaggregate financial information to assist in making internal operating decisions. We have allocated certain common costs and expenses, primarily corporate functions, among segments differently than we would for stand-alone financial information prepared in accordance with GAAP. These include certain costs and expenses of shared services, such as information technology, human resources, legal and finance. We also do not allocate debt-related items, actuarial gains or losses, prior services costs or credits, changes in cash surrender value of corporate owned life insurance or income taxes to individual segments. Segment EBIT may not be consistent with measures used by other companies.

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Summarized financial information regarding our reportable operating segments for the three and nine month periods is shown in the table below:

| In millions  | Engine   | Components | Power Generation | Distribution | Non-segment Items(1) | Total     |
|--|----------|------------|------------------|--------------|----------------------|-----------|
| <b>Three months ended September 30, 2012</b>       |          |            |                  |              |                      |           |
| External sales                                     | \$ 2,131 | \$ 663     | \$ 526           | \$ 798       | \$                   | \$ 4,118  |
| Intersegment sales                                 | 396      | 275        | 288              | 3            | (962)                |           |
| Total sales  | 2,527    | 938        | 814              | 801          | (962)                | 4,118     |
| Depreciation and amortization(2)                   | 48       | 21         | 12               | 8            |                      | 89        |
| Research, development and engineering expenses     | 115      | 51         | 19               | 1            |                      | 186       |
| Equity, royalty and interest income from investees | 25       | 7          | 12               | 50           |                      | 94        |
| Interest income                                    | 2        | 1          | 2                |              |                      | 5         |
| Segment EBIT                                       | 239      | 89         | 73               | 99           | (4)                  | 496       |
| <b>Three months ended September 25, 2011</b>       |          |            |                  |              |                      |           |
| External sales                                     | \$ 2,539 | \$ 704     | \$ 604           | \$ 779       | \$                   | \$ 4,626  |
| Intersegment sales                                 | 416      | 311        | 270              | 4            | (1,001)              |           |
| Total sales  | 2,955    | 1,015      | 874              | 783          | (1,001)              | 4,626     |
| Depreciation and amortization(2)                   | 46       | 19         | 11               | 6            |                      | 82        |
| Research, development and engineering expenses     | 103      | 46         | 14               | 1            |                      | 164       |
| Equity, royalty and interest income from investees | 35       | 7          | 16               | 44           |                      | 102       |
| Interest income                                    | 5        | 1          | 2                | 1            |                      | 9         |
| Segment EBIT                                       | 349      | 113        | 92               | 104          | (18)                 | 640       |
| <b>Nine months ended September 30, 2012</b>        |          |            |                  |              |                      |           |
| External sales                                     | \$ 6,924 | \$ 2,147   | \$ 1,614         | \$ 2,357     | \$                   | \$ 13,042 |
| Intersegment sales                                 | 1,303    | 926        | 889              | 13           | (3,131)              |           |
| Total sales  | 8,227    | 3,073      | 2,503            | 2,370        | (3,131)              | 13,042    |
| Depreciation and amortization(2)                   | 142      | 59         | 34               | 23           |                      | 258       |
| Research, development and engineering expenses     | 341      | 153        | 56               | 4            |                      | 554       |
| Equity, royalty and interest income from investees | 100      | 23         | 32               | 147          |                      | 302       |
| Interest income                                    | 9        | 3          | 7                | 1            |                      | 20        |
| Segment EBIT                                       | 996      | 348        | 243              | 285          | (49)                 | 1,823     |
| <b>Nine months ended September 25, 2011</b>        |          |            |                  |              |                      |           |
| External sales                                     | \$ 7,021 | \$ 2,105   | \$ 1,810         | \$ 2,191     | \$                   | \$ 13,127 |
| Intersegment sales                                 | 1,225    | 866        | 768              | 19           | (2,878)              |           |
| Total sales  | 8,246    | 2,971      | 2,578            | 2,210        | (2,878)              | 13,127    |
| Depreciation and amortization(2)                   | 135      | 55         | 32               | 17           |                      | 239       |
|  | 285      | 126        | 37               | 2            |                      | 450       |

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Research, development and engineering expenses

|  |       |     |     |     |   |       |
|--|-------|-----|-----|-----|---|-------|
| Equity, royalty and interest income from investees | 126   | 24  | 37  | 128 |   | 315   |
| Interest income                                    | 14    | 3   | 6   | 2   |   | 25    |
| Segment EBIT                                       | 1,016 | 338 | 286 | 299 | 8 | 1,947 |

- 
- (1) Includes intersegment sales and profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the three months ended September 30, 2012 and September 25, 2011. The nine months ended September 30, 2012, include a \$6 million gain (\$4 million after-tax) related to adjustments from our 2011 divestitures. The nine months ended September 25, 2011, include a \$68 million gain (\$37 million after-tax) related to the sale of certain assets and liabilities of our exhaust business from the Components segment. The gains have been excluded from segment results as they were not considered in our evaluation of operating results for the corresponding periods. There were no other significant unallocated corporate expenses.
- (2) Depreciation and amortization as shown on a segment basis excludes the amortization of debt discount that is included in the *Condensed Consolidated Statements of Income* as Interest expense.

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A reconciliation of our segment information to the corresponding amounts in the *Condensed Consolidated Statements of Income* is shown in the table below:

| In millions                | Three months ended    |                       | Nine months ended     |                       |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                            | September 30,<br>2012 | September 25,<br>2011 | September 30,<br>2012 | September 25,<br>2011 |
| Segment EBIT               | \$ 496                | \$ 640                | \$ 1,823              | \$ 1,947              |
| Less: Interest expense     | 9                     | 11                    | 25                    | 34                    |
| Income before income taxes | \$ 487                | \$ 629                | \$ 1,798              | \$ 1,913              |

**NOTE 16. RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS****Accounting Pronouncements Recently Adopted**

In June 2011, the Financial Accounting Standards Board (FASB) amended its rules regarding the presentation of comprehensive income. The objective of this amendment is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Specifically, this amendment requires that all non-owner changes in shareholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In addition, the standard also requires disclosure of the location of reclassification adjustments between other comprehensive income and net income on the face of the financial statements. The new rules became effective for us beginning January 1, 2012. In December 2011, the FASB deferred certain aspects of this standard beyond the current effective date, specifically the provisions dealing with reclassification adjustments. Because the standard only impacts the display of comprehensive income and does not impact what is included in comprehensive income, the standard did not have a significant impact on our *Condensed Consolidated Financial Statements*.

In May 2011, the FASB amended its standards related to fair value measurements and disclosures. The objective of the amendment is to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards. Primarily this amendment changed the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements in addition to clarifying the Board's intent about the application of existing fair value measurement requirements. The new standard also requires additional disclosures related to fair value measurements categorized within Level 3 of the fair value hierarchy and requires disclosure of the categorization in the hierarchy for items which are not recorded at fair value but fair value is required to be disclosed. The new rules were effective for us beginning January 1, 2012. As of September 30, 2012, we had no fair value measurements categorized within Level 3. The only impact for us is the disclosure of the categorization in the fair value hierarchy for those items where fair value is only disclosed (primarily our debt obligations). Our disclosure related to the new standard is included in Note 8, FAIR VALUE OF FINANCIAL INSTRUMENTS, to the *Condensed Consolidated Financial Statements*.

**Accounting Pronouncements Issued But Not Yet Effective**

In July 2012, the FASB amended its rules regarding impairment testing of indefinite-lived intangible assets. The amendment reduces the cost and complexity of performing this impairment testing by simplifying how an entity tests those assets for impairment and improving consistency in impairment testing guidance by aligning it with the goodwill impairment testing model. The amendment permits an entity to assess qualitative

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factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for deciding whether it is necessary to perform the quantitative impairment test. The new standard is effective for us beginning January 1, 2013; however, the amendment will not impact us as we do not currently have any indefinite-lived intangible assets.

In December 2011, the FASB amended its standards related to offsetting assets and liabilities. This amendment requires entities to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement. This information will enable users of the financial statements to understand the effect of those arrangements on its financial position. The new rules will become effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. It is also required that the new disclosures are applied retrospectively for all comparative periods presented. We do not believe this amendment will have a significant impact on our *Consolidated Financial Statements*; however we are currently evaluating the potential impacts to our footnote disclosures.

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**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Cummins Inc. and its consolidated subsidiaries are hereinafter sometimes referred to as Cummins, we, our or us.

**CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION**

Certain parts of this quarterly report contain forward-looking statements intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. Forward-looking statements include those that are based on current expectations, estimates and projections about the industries in which we operate and management's beliefs and assumptions. Forward-looking statements are generally accompanied by words such as anticipates, expects, forecasts, intends, plans, believes, seeks, estimates, could, should or words of similar meaning. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which we refer to as future factors, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Some future factors that could cause our results to differ materially from the results discussed in such forward-looking statements are discussed below and shareholders, potential investors and other readers are urged to consider these future factors carefully in evaluating forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. Future factors that could affect the outcome of forward-looking statements include the following:

- general economic, business and financing conditions, including emerging markets;
- a slowdown in infrastructure development;
- increasingly stringent environmental laws and regulations;
- unpredictability in the adoption, implementation and enforcement of emission standards around the world;
- the actions of joint ventures and other investees that we do not directly control;
- changes in the outsourcing practices of significant customers;
- any significant problems in our new engine platforms;

- currency exchange rate changes;
- supply shortages and supplier financial risk;
- variability in material and commodity costs;
- product recalls and liability claims;
- competitor pricing activity;
- increasing global competition among our customers;
- global political and economic conditions;
- changes in taxation;
- the price and availability of energy;
- increasing our capacity and production at the appropriate pace;
- the development of new technologies;
- obtaining customers for our new light-duty diesel engine platform;
- new governmental actions, legislation and regulations;



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- the performance of our pension plan assets;
- labor relations;
- changes in accounting standards;
- our sales mix of products;
- protection and validity of our patent and other intellectual property rights;

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- technological implementation and cost/financial risks in our increasing use of large, multi-year contracts;
- the cyclical nature of some of our markets;
- the outcome of pending and future litigation and governmental proceedings;
- continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support our future business and
- other risk factors described in our Form 10-K, Part 1, Item IA under the caption Risk Factors.

Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements made herein are made only as of the date of this quarterly report and we undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

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**ORGANIZATION OF INFORMATION**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) was prepared to provide the reader with a view and perspective of our business through the eyes of management and should be read in conjunction with our *Consolidated Financial Statements* and accompanying *Notes to Consolidated Financial Statements* in the Financial Statements section of our 2011 Form 10-K. Our MD&A is presented in the following sections:

- Executive Summary and Financial Highlights
  
- Outlook
  
- Results of Operations
  
- Operating Segment Results
  
- Liquidity and Capital Resources
  
- Application of Critical Accounting Estimates
  
- Recently Adopted and Recently Issued Accounting Pronouncements

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**EXECUTIVE SUMMARY AND FINANCIAL HIGHLIGHTS**

We are a global power leader that designs, manufactures, distributes and services diesel and natural gas engines, engine-related component products, including emission solutions, filtration, fuel systems and air handling systems, and power generation products, including electronic power generation systems and related products. We sell our products to original equipment manufacturers (OEMs), distributors and other customers worldwide. We have long-standing relationships with many of the leading manufacturers in the markets we serve, including PACCAR Inc, Chrysler Group, LLC, Daimler Trucks North America, Ford Motor Company, Komatsu and Volvo AB. We serve our customers through a network of more than 600 company-owned and independent distributor locations and approximately 6,500 dealer locations in more than 190 countries and territories.

Our reportable operating segments consist of the following: Engine, Components, Power Generation and Distribution. This reporting structure is organized according to the products and markets each segment serves and allows management to focus its efforts on providing enhanced service to a wide range of customers. The Engine segment produces engines and parts for sale to customers in on-highway and various industrial markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as various industrial applications including construction, mining, agriculture, marine, oil and gas, rail and military equipment. The Components segment sells filtration products, exhaust aftertreatment systems, turbochargers and fuel systems. The Power Generation segment is an integrated provider of power systems. The segment sells engines, generator sets, alternators, power systems and services. The Distribution segment includes wholly-owned and partially-owned distributorships engaged in wholesaling engines, generator sets and service parts, as well as performing service and repair activities on our products and maintaining relationships with various OEMs throughout the world.

Our financial performance depends, in large part, on varying conditions in the markets we serve, particularly the on-highway, construction and general industrial markets. Demand in these markets tends to fluctuate in response to overall economic conditions and is particularly sensitive to changes in interest rate levels and our customers' access to credit. Our sales may also be impacted by OEM inventory levels and production schedules and stoppages. Economic downturns in markets we serve generally result in reductions in sales and pricing of our products. As a worldwide business, our operations are also affected by currency, political, economic and regulatory matters, including adoption and enforcement of environmental and emission standards, in the countries we serve. As part of our growth strategy, we invest in businesses in certain countries that carry high levels of these risks such as China, Brazil, India, Mexico, Russia and countries in the Middle East and Africa. At the same time, our geographic diversity and broad product and service offerings have helped limit the impact from a drop in demand in any one industry or customer or the economy of any single country on our consolidated results.

The global economy continued to slow throughout 2012. In the first nine months of 2012, we experienced declining demand in certain emerging markets including Brazil and China and a decline in India as the result of foreign currency fluctuations, which were mostly offset by growth in several end markets in North America. The off-highway construction markets in China have continued to deteriorate with shipments to construction markets down 69 percent. The on-highway medium-duty truck market in Brazil declined as the result of the 2011 pre-buy ahead of the new 2012 emission requirements and one of our customers replacing our B6.7 engine with a proprietary engine in 2012 contributing to international medium-duty truck shipments being down 18 percent. North American demand for heavy-duty on-highway products increased 21 percent while medium-duty truck shipments increased 20 percent in the first nine months of 2012 compared to the same period in 2011; although demand in both of these markets was lower in the third quarter of 2012 as compared to the same period in 2011. North American light-duty on-highway demand also improved with an increase in shipments to Chrysler of 42 percent in the first nine months of 2012 compared to the same period in 2011.

Slow growth in the U.S. economy and uncertainty driven by unresolved federal tax and budget issues is causing businesses to hold back on capital expenditures, thus impacting demand for truck and power generation equipment. The governments of China and India have controlled inflation through tight monetary policies in the form of rising interest rates and tightening access to credit, although both countries have begun

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easing these policies in response to reduced inflationary concerns. Brazil also began easing their monetary policies in the second half of 2012. Easing monetary policies could enhance our end markets; however, there likely would be a delay between when these policies are implemented and when our end markets respond, and we do not believe these policies will have a material positive impact on the remainder of 2012. The European economy remains uncertain with continued volatility in the Euro countries. Although we do not have any significant direct exposure to European sovereign debt, we generated approximately nine percent of our net sales from Euro zone countries in 2011 and approximately eight percent in the first nine months of 2012. As a result of a number of markets unexpectedly slowing in mid-2012, continued weak economic data in a number of regions and increasing levels of uncertainty regarding the direction of the global economy, we implemented a number of cost reduction initiatives in the third quarter of 2012. In October 2012, we announced actions necessary to respond strategically to the current environment by cutting costs while maintaining investments in key growth programs. Actions include a number of measures to reduce costs including planned work week reductions, shutdowns at some manufacturing facilities and some targeted workforce reductions. We expect to reduce our workforce by between 1,000 and 1,500 people by the end of the year.

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The following tables contain sales and earnings before interest expense, income taxes and noncontrolling interests (EBIT) results by operating segment for the three and nine months ended September 30, 2012 and September 25, 2011. Refer to the section titled Operating Segment Results for a more detailed discussion of net sales and EBIT by operating segment, including the reconciliation of segment EBIT to income before taxes.

| Operating Segments<br>In millions | September 30, 2012 |                     |               | Three months ended<br>September 25, 2011 |                     |               | Percent change<br>2012 vs. 2011 |              |
|-----------------------------------|--------------------|---------------------|---------------|--|---------------------|---------------|---------------------------------|--------------|
|                                   | Sales              | Percent<br>of Total | EBIT          | Sales                                    | Percent<br>of Total | EBIT          | Sales                           | EBIT         |
| Engine                            | \$ 2,527           | 61%                 | \$ 239        | \$ 2,955                                 | 64%                 | \$ 349        | (14)%                           | (32)%        |
| Components                        | 938                | 23%                 | 89            | 1,015                                    | 22%                 | 113           | (8)%                            | (21)%        |
| Power Generation                  | 814                | 20%                 | 73            | 874                                      | 19%                 | 92            | (7)%                            | (21)%        |
| Distribution                      | 801                | 19%                 | 99            | 783                                      | 17%                 | 104           | 2%                              | (5)%         |
| Intersegment<br>eliminations      | (962)              | (23)%               |               | (1,001)                                  | (22)%               |               | (4)%                            |              |
| Non-segment                       |                    |                     | (4)           |  |                     | (18)          |                                 | (78)%        |
| <b>Total</b>                      | <b>\$ 4,118</b>    | <b>100%</b>         | <b>\$ 496</b> | <b>\$ 4,626</b>                          | <b>100%</b>         | <b>\$ 640</b> | <b>(11)%</b>                    | <b>(23)%</b> |

Net income attributable to Cummins was \$352 million, or \$1.86 per diluted share, on sales of \$4.1 billion for the three month interim reporting period ended September 30, 2012, versus the comparable prior year period with net income attributable to Cummins of \$452 million, or \$2.35 per diluted share, on sales of \$4.6 billion. The decrease in income and earnings per share was driven by lower gross margins as lower volumes, particularly in the international construction, international medium-duty truck, North American heavy-duty truck and high-horsepower markets, were partially offset by a lower effective tax rate of 24.1 percent, which included \$16 million of favorable discrete items, versus the comparable prior year period of 25.0 percent, which included \$29 million of favorable discrete tax items.

| Operating Segments<br>In millions | September 30, 2012 |                     |                 | Nine months ended<br>September 25, 2011 |                     |                 | Percent change<br>2012 vs. 2011 |             |
|-----------------------------------|--------------------|---------------------|-----------------|---|---------------------|-----------------|---------------------------------|-------------|
|                                   | Sales              | Percent<br>of Total | EBIT            | Sales                                   | Percent<br>of Total | EBIT            | Sales                           | EBIT        |
| Engine                            | \$ 8,227           | 63%                 | \$ 996          | \$ 8,246                                | 63%                 | \$ 1,016        |                                 | (2)%        |
| Components                        | 3,073              | 24%                 | 348             | 2,971                                   | 22%                 | 338             | 3%                              | 3%          |
| Power Generation                  | 2,503              | 19%                 | 243             | 2,578                                   | 20%                 | 286             | (3)%                            | (15)%       |
| Distribution                      | 2,370              | 18%                 | 285             | 2,210                                   | 17%                 | 299             | 7%                              | (5)%        |
| Intersegment<br>eliminations      | (3,131)            | (24)%               |                 | (2,878)                                 | (22)%               |                 | 9%                              |             |
| Non-segment                       |                    |                     | (49)            |   |                     | 8               |                                 | NM          |
| <b>Total</b>                      | <b>\$ 13,042</b>   | <b>100%</b>         | <b>\$ 1,823</b> | <b>\$ 13,127</b>                        | <b>100%</b>         | <b>\$ 1,947</b> | <b>(1)%</b>                     | <b>(6)%</b> |

NM - not meaningful information.

Net income attributable to Cummins was \$ 1,276 million, or \$6.72 per diluted share, on sales of \$13.0 billion for the nine month interim reporting period ended September 30, 2012, versus the comparable prior year period with net income attributable to Cummins of \$ 1,300 million, or \$6.69 per diluted share, on sales of \$13.1 billion. The decrease in income was driven by higher operating expenses, lower gains on the disposition of certain assets and liabilities of our exhaust business and lower equity, royalty and interest income from investees, partially offset by improved gross margins and a lower effective tax rate of 25.5 percent versus 28.2 percent in the comparable prior year period. Diluted earnings per share for the nine months ended September 30, 2012, also benefited \$0.04 from lower shares due to the stock repurchase program.

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We generated \$ 787 million of operating cash flows for the nine months ended September 30, 2012, compared to \$ 1,368 million for the nine months ended September 25, 2011. Refer to the section titled "Operating Activities" in the "Liquidity and Capital Resources" section for a discussion of items impacting cash flows.

In February 2011, the Board of Directors authorized the acquisition of up to \$1 billion of our common stock. We repurchased \$231 million in the first nine months of 2012. Our debt to capital ratio (total capital defined as debt plus equity) at September 30, 2012, was 10.5 percent, compared to 11.8 percent at December 31, 2011. In October 2012, Fitch Ratings upgraded our ratings to "A" and changed our outlook to stable. In addition to the \$1.3 billion in cash and marketable securities on hand, we have access to our credit facilities, if necessary, to meet currently anticipated investment and funding needs.

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In July 2012, the Board of Directors authorized a dividend increase of 25 percent from \$0.40 per share to \$0.50 per share on a quarterly basis.

Our global pension plans, including our unfunded and non-qualified plans, were 98 percent funded at December 31, 2011. Our United States (U.S.) qualified plan, which represents approximately 60 percent of the worldwide pension obligation, was 103 percent funded and our United Kingdom (U.K.) plan was 106 percent funded. We expect to contribute \$130 million to our global pension plans in 2012.

In July 2012, we completed the acquisition of Hilite Germany GmbH (Hilite) in a cash transaction for \$176 million. We also acquired an additional 45 percent interest in Cummins Central Power for consideration of approximately \$20 million.

## **OUTLOOK**

### **Near-Term**

In the first six months of 2012, North American demand in heavy- and medium-duty truck markets remained strong; however, it began to soften in the third quarter.

We expect the following challenges to our business that may reduce our earnings potential in the remainder of 2012:

- Our North American heavy-duty truck market could continue to soften or experience further slowing.
  
- One of our Brazilian customers replaced our B6.7 engine with a proprietary engine in 2012, which is being partially offset by the 2012 launch of our ISF and 9 liter engines in new light-duty on-highway and medium-duty truck applications, respectively, with this same customer.
  
- Our 2012 engine sales in Brazil could be negatively impacted by excess Euro V channel inventory.
  
- The weakening economy in Brazil could continue to have adverse impacts on our other businesses.



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- Demand in certain industrial markets in China could remain low.
- The Indian Rupee could continue to depreciate in value, which would create additional pressure on earnings, while higher inflation could negatively impact sales, especially industrial sales.
- Demand in certain European markets could continue to decline due to economic uncertainty.
- Currency volatility could continue to put pressure on earnings.
- North American oil and gas markets could continue to decline.
- International mining markets could continue to decline.
- Strategic actions announced in October could have a net negative impact on fourth quarter results.

### **Long-Term**

We believe that, over the longer term, there will be economic improvements in most of our current markets and that our opportunities for long-term profitable growth will continue in the future as the result of the following four macroeconomic trends that will benefit our businesses:

- tightening emissions controls across the world;
- infrastructure needs in emerging markets;
- energy availability and cost issues and
- globalization of industries like ours.



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| In millions (except per share amounts)                                | Three months ended    |                       | Favorable/<br>(Unfavorable) |              | Nine months ended     |                       | Favorable/<br>(Unfavorable) |             |
|---|-----------------------|-----------------------|-----------------------------|--------------|-----------------------|-----------------------|-----------------------------|-------------|
|   | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent      | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent     |
| <b>NET SALES</b>  | \$ 4,118              | \$ 4,626              | \$ (508)                    | (11)%        | \$ 13,042             | \$ 13,127             | \$ (85)                     | (1)%        |
| Cost of sales   | 3,076                 | 3,438                 | 362                         | 11%          | 9,592                 | 9,779                 | 187                         | 2%          |
| <b>GROSS MARGIN</b>   | <b>1,042</b>          | <b>1,188</b>          | <b>(146)</b>                | <b>(12)%</b> | <b>3,450</b>          | <b>3,348</b>          | <b>102</b>                  | <b>3%</b>   |
| <b>OPERATING EXPENSES AND INCOME</b>                                  |                       |                       |                             |              |                       |                       |                             |             |
| Selling, general and administrative expenses                          | 456                   | 489                   | 33                          | 7%           | 1,418                 | 1,341                 | (77)                        | (6)%        |
| Research, development and engineering expenses                        | 186                   | 164                   | (22)                        | (13)%        | 554                   | 450                   | (104)                       | (23)%       |
| Equity, royalty and interest income from investees                    | 94                    | 102                   | (8)                         | (8)%         | 302                   | 315                   | (13)                        | (4)%        |
| Gain on sale of businesses  |                       |                       |                             |              | 6                     | 68                    | (62)                        | (91)%       |
| Other operating income (expense), net                                 | (1)                   | 2                     | (3)                         | NM           | 3                     | (4)                   | 7                           | NM          |
| <b>OPERATING INCOME</b>   | <b>493</b>            | <b>639</b>            | <b>(146)</b>                | <b>(23)%</b> | <b>1,789</b>          | <b>1,936</b>          | <b>(147)</b>                | <b>(8)%</b> |
| Interest income   | 5                     | 9                     | (4)                         | (44)%        | 20                    | 25                    | (5)                         | (20)%       |
| Interest expense  | 9                     | 11                    | 2                           | 18%          | 25                    | 34                    | 9                           | 26%         |
| Other income (expense), net   | (2)                   | (8)                   | 6                           | 75%          | 14                    | (14)                  | 28                          | NM          |
| <b>INCOME BEFORE INCOME TAXES</b>                                     | <b>487</b>            | <b>629</b>            | <b>(142)</b>                | <b>(23)%</b> | <b>1,798</b>          | <b>1,913</b>          | <b>(115)</b>                | <b>(6)%</b> |
| Income tax expense  | 117                   | 157                   | 40                          | 25%          | 458                   | 539                   | 81                          | 15%         |
| <b>CONSOLIDATED NET INCOME</b>  | <b>370</b>            | <b>472</b>            | <b>(102)</b>                | <b>(22)%</b> | <b>1,340</b>          | <b>1,374</b>          | <b>(34)</b>                 | <b>(2)%</b> |
| Less: Net income attributable to noncontrolling interests             | 18                    | 20                    | 2                           | 10%          | 64                    | 74                    | 10                          | 14%         |
| <b>NET INCOME ATTRIBUTABLE TO CUMMINS INC.</b>                        | <b>\$ 352</b>         | <b>\$ 452</b>         | <b>\$ (100)</b>             | <b>(22)%</b> | <b>\$ 1,276</b>       | <b>\$ 1,300</b>       | <b>\$ (24)</b>              | <b>(2)%</b> |
| <b>Diluted earnings per common share attributable to Cummins Inc.</b> | <b>\$ 1.86</b>        | <b>\$ 2.35</b>        | <b>\$ (0.49)</b>            | <b>(21)%</b> | <b>\$ 6.72</b>        | <b>\$ 6.69</b>        | <b>\$ 0.03</b>              |             |

| Percent of sales                               | Three months ended    |                       | Favorable/<br>(Unfavorable) |  | Nine months ended     |                       | Favorable/<br>(Unfavorable) |  |
|--|-----------------------|-----------------------|-----------------------------|--|-----------------------|-----------------------|-----------------------------|--|
|  | September 30,<br>2012 | September 25,<br>2011 | Percentage Points           |  | September 30,<br>2012 | September 25,<br>2011 | Percentage Points           |  |
| Gross margin                                   | 25.3%                 | 25.7%                 | (0.4)                       |  | 26.5%                 | 25.5%                 | 1.0                         |  |
| Selling, general and administrative expenses   | 11.1%                 | 10.6%                 | (0.5)                       |  | 10.9%                 | 10.2%                 | (0.7)                       |  |
| Research, development and engineering expenses | 4.5%                  | 3.5%                  | (1.0)                       |  | 4.2%                  | 3.4%                  | (0.8)                       |  |

**Net Sales**

Net sales for the three months ended September 30, 2012, decreased versus the comparable period in 2011. The decrease in sales by segment was primarily driven by the following:

- Foreign currency fluctuations unfavorably impacted sales.

- Engine segment sales decreased by 14 percent due to lower volumes in international construction markets, primarily in China, international medium-duty truck markets, especially in Brazil, and North American heavy-duty truck markets.
- Components segment sales, excluding acquisitions, decreased by ten percent due to decreased demand in the turbo technologies and filtration businesses and \$18 million of sales in the third quarter of 2011 related to assets sold during 2011.
- Power Generation segment sales decreased by seven percent due to unfavorable foreign currency fluctuations and lower volumes in the generator technologies, power systems and power solutions businesses, primarily in international markets.
- Distribution segment sales, excluding acquisitions, decreased by seven percent primarily due to unfavorable foreign currency fluctuations and lower volumes of both engine products in North America and global power generation products.

Net sales for the nine months ended September 30, 2012, decreased slightly versus the comparable period in 2011. The decrease in sales by segment was primarily driven by the following:

- Foreign currency fluctuations unfavorably impacted sales.

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- Power Generation segment sales decreased by three percent due to unfavorable foreign currency fluctuations and lower demand in the generator technologies and power solutions businesses, which were partially offset by growing demand in the power product business, especially in North America.
- Engine segment sales were down slightly as weakness in industrial demand, especially in international construction markets, and lower volumes in the Brazilian medium-duty truck market were offset by growth in the North American on-highway markets in the first half of the year, led by the heavy-duty business.

These decreases were partially offset by the following:

- Components segment sales, excluding acquisitions, increased by three percent due to higher demand in the emission solutions business primarily in North America and Brazil, partially offset by lower demand in the turbo technologies and filtration businesses and \$119 million of sales in the first nine months of 2011 related to assets sold in 2011.
- Distribution segment sales, excluding acquisitions, increased by three percent due to higher demand for parts and filtration products in North and Central America, increased power generation demand in East Asia and the South Pacific and higher service demand.

A more detailed discussion of sales by segment is presented in the OPERATING SEGMENT RESULTS section.

Sales to international markets based on location of customers for the three and nine month periods ended September 30, 2012, were 50 percent of total net sales for both periods, compared with 56 percent and 57 percent of total net sales, respectively, for the comparable periods in 2011.

**Gross Margin**

Gross margin decreased for the three months ended September 30, 2012, versus the comparable period in 2011, and decreased as a percentage of sales by 0.4 percentage points as lower volumes, unfavorable product mix and unfavorable foreign currency fluctuations were partially offset by lower material costs and improved price realization. Gross margin increased for the nine months ended September 30, 2012, versus the comparable period in 2011, and increased as a percentage of sales by 1.0 percentage points as improved price realization, lower material costs, lower warranty costs and favorable product mix were partially offset by unfavorable foreign currency fluctuations.

The provision for warranties issued as a percent of sales for the three and nine month periods ended September 30, 2012, were 2.0 percent and 2.3 percent, respectively, in 2012 compared to 1.9 percent and 2.3 percent, respectively, for the comparable periods in 2011. A more detailed discussion of margin by segment is presented in the OPERATING SEGMENT RESULTS section.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses for the three month period ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to reduced discretionary spending and lower compensation and related expenses of \$12 million. In the third quarter of 2012 we implemented a number of cost reduction initiatives to align our cost structure with the slowdown in demand at several of our key markets in the second half of the year. Lower compensation and related expenses were primarily due to reduced variable compensation accruals. Compensation and related expenses include salaries, fringe benefits and variable compensation.

Selling, general and administrative expenses for the nine month period ended September 30, 2012, increased versus the comparable period in 2011, primarily due to increased consulting of \$40 million and an increase of \$34 million in compensation and related expenses. Higher compensation expense was primarily due to increased headcount to support our strategic growth initiatives launched prior to a number of markets unexpectedly slowing in mid-2012.

**Research, Development and Engineering Expenses**

Research, development and engineering expenses for the three and nine month periods ended September 30, 2012, increased versus the comparable periods in 2011, primarily due to an increase of \$12 million and \$49 million, respectively, in compensation and related expenses and increased consulting of \$9 million and \$34 million, respectively. Higher compensation expense was primarily due to increased headcount to support our strategic growth initiatives. Compensation and related expenses include salaries, fringe benefits and variable compensation. Research activities continue to focus on development of new products to meet future emission standards around the world and improvements in fuel economy performance.

Table of Contents**Equity, Royalty and Interest Income From Investees**

Equity, royalty and interest income from investees for the three and nine month periods ended September 30, 2012, decreased versus the comparable periods in 2011, primarily due to the following:

| In millions  | Increase/(Decrease)                       |                   |
|--|---|-------------------|
|  | September 30, 2012 vs. September 25, 2011 |                   |
|  | Three months ended                        | Nine months ended |
| Dongfeng Cummins Engine Company, Ltd. (DCEC)       | \$ (6)                                    | \$ (22)           |
| Chongqing Cummins Engine Company, Ltd. (CCEC)      | (6)                                       | (2)               |
| Beijing Foton Cummins Engine Co., Ltd. (BFCEC)     | 5   | 8                 |
| North American distributors                        | 2   | 15                |
| Other equity income                                | (4)                                       | (11)              |
| Cummins share of net income                        | (9)                                       | (12)              |
| Royalty and interest income                        | 1   | (1)               |
| Equity, royalty and interest income from investees | \$ (8)                                    | \$ (13)           |

These overall decreases were primarily due to lower sales in China at DCEC and CCEC, which were partially offset by higher sales at BFCEC and growth in North America.

**Gain on Sale of Businesses**

In the second quarter of 2011, we sold certain assets and liabilities of our exhaust business which manufactures exhaust products and select components for emission systems for a variety of applications not core to our other product offerings. This business was historically included in our Components segment. The sales price was \$123 million. We recognized a gain of \$68 million (\$37 million after-tax), which included a goodwill allocation of \$19 million. In the second quarter of 2012, we recorded an additional \$6 million gain (\$4 million after-tax) related to final purchase price adjustments for our 2011 divestitures. The gains have been excluded from segment results as they were not considered in our evaluation of operating results for the nine months ended September 30, 2012 and September 25, 2011.

Sales for this business were \$62 million, \$171 million and \$126 million in 2011 (through closing), 2010 and 2009, respectively. Operating results for this business were approximately \$9 million, \$22 million and \$11 million in 2011 (through closing), 2010 and 2009, respectively.

**Other Operating Income (Expense), net**

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Other operating income (expense) was as follows:

| In millions                                 | Three months ended |               | September 25, |               | September 30, |               | September 25, |               |
|---|--------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
|   | September 30,      | September 25, | September 25, | September 25, | September 30, | September 30, | September 25, | September 25, |
|   | 2012               | 2011          | 2011          | 2011          | 2012          | 2012          | 2011          | 2011          |
| Amortization of intangible assets           | \$ (2)             | \$ (1)        | \$ (1)        | \$ (1)        | \$ (5)        | \$ (5)        | \$ (4)        | \$ (4)        |
| Royalty expense                             | (1)                | (1)           | (1)           | (1)           | (3)           | (3)           | (2)           | (2)           |
| Legal judgment                              |                    |               | 2             | 2             |               |               | (5)           | (5)           |
| Royalty income                              | 3                  | 3             | 3             | 3             | 11            | 11            | 9             | 9             |
| Other income (expense), net                 | (1)                | (1)           | (1)           | (1)           | (1)           | (1)           | (2)           | (2)           |
| Total other operating income (expense), net | \$ (1)             | \$ (1)        | \$ 2          | \$ 2          | \$ 3          | \$ 3          | \$ (4)        | \$ (4)        |

### Interest Income

Interest income for the three and nine month periods ended September 30, 2012, decreased versus the comparable periods in 2011, primarily due to lower average investment balances in 2012 compared to 2011.

### Interest Expense

Interest expense for the three and nine month periods ended September 30, 2012, decreased versus the comparable periods in 2011, primarily due to lower capitalized interest in 2011 and the termination of a capital lease in September of 2011.



Table of Contents**Other Income (Expense), net**

Other income (expense) was as follows:

| In millions  | Three months ended    |                       | Nine months ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2012 | September 25,<br>2011 | September 30,<br>2012 | September 25,<br>2011 |
| Foreign currency gains (losses), net                             | \$ (8)                | \$ (5)                | \$ (9)                | \$ (19)               |
| Change in cash surrender value of corporate owned life insurance | (7)                   | (3)                   | 3                     | 4                     |
| Bank charges   | (4)                   | (4)                   | (12)                  | (12)                  |
| Gain (loss) on marketable securities, net                        | 1                     |                       | 4                     |                       |
| Dividend income  | 2                     | 2                     | 5                     | 6                     |
| Gain on fair value adjustment for consolidated investee (1)      | 7                     |                       | 7                     |                       |
| Other, net   | 7                     | 2                     | 16                    | 7                     |
| Total other income (expense), net                                | \$ (2)                | \$ (8)                | \$ 14                 | \$ (14)               |

(1) See Note 3, ACQUISITIONS AND DIVESTITURES, to the *Condensed Consolidated Financial Statements* for further information.

**Income Tax Expense**

Our effective tax rate for the year is expected to approximate 26.5 percent, absent any discrete period activity. Our tax rate is generally less than the 35 percent U.S. income tax rate primarily due to lower tax rates on foreign income. The tax rates for the three and nine month periods ended September 30, 2012, were 24.1 percent and 25.5 percent, respectively. These tax rates include a \$16 million tax benefit for third quarter discrete tax adjustments, \$6 million of which related to a dividend distribution of accumulated foreign income earned in prior years. These discrete tax adjustments also included a discrete tax benefit of \$13 million for prior year tax return true-up adjustments and a discrete tax charge of \$3 million related to the third quarter enactment of U.K. tax law changes.

The tax rates for the three and nine month periods ended September 25, 2011, were 25.0 percent and 28.2 percent, respectively, and included a net discrete income tax benefit of \$29 million (net of additional reserves for uncertain tax positions of \$39 million) related to prior year refund claims filed for additional research tax credits, additional foreign income and foreign tax credits, as well as other adjustments. This benefit also included discrete income tax charges of \$2 million for prior year tax return true-up adjustments and \$3 million related to the third quarter enactment of U.K. tax law changes in the three and nine month periods ended September 25, 2011. Additionally, the tax rate for the nine month period included a second quarter discrete income tax charge of \$4 million related to the enactment of state tax law changes in Indiana. The decrease in the 2012 effective tax rates versus the comparable periods in 2011 is due primarily to our assertion that income earned after 2011 by our China operations is permanently reinvested, as well as certain tax planning strategies implemented in our U.K. subsidiaries.

**Noncontrolling Interests**

Noncontrolling interests eliminate the income or loss attributable to non-Cummins ownership interests in our consolidated entities. Noncontrolling interests in income of consolidated subsidiaries for the three month period ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to a decline of \$2 million at Cummins India Ltd., a publicly traded company on various exchanges in India. Noncontrolling interests in income of consolidated subsidiaries for the nine month period ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to a decline of \$5 million at Cummins India Ltd., \$3 million at Wuxi Cummins Turbo Technologies Co., Ltd. and \$3 million at Cummins Western Canada LP.

Table of Contents**Net Income Attributable to Cummins Inc. and Diluted Earnings Per Share Attributable to Cummins Inc.**

Net income and diluted earnings per share attributable to Cummins Inc. for the three months ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to lower volumes, particularly in the international construction, international medium-duty truck, North American heavy-duty truck and high-horsepower markets, higher research, development and engineering expenses, lower gross margin as a percentage of sales and lower equity, royalty and interest income from investees. These decreases were partially offset by lower selling, general and administrative expenses and a lower effective tax rate of 24.1 percent, which included \$16 million of favorable discrete items, versus the comparable prior year period of 25.0 percent, which included \$29 million of favorable discrete tax items.

Net income attributable to Cummins Inc. for the nine months ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to higher research, development and engineering expenses, lower volumes, particularly in the international construction and medium-duty truck markets, higher selling, general and administrative expenses, lower gains on the disposition of certain assets and liabilities of our exhaust business and lower equity, royalty and interest income from investees. These decreases were partially offset by improved gross margin as a percentage of sales and a lower effective tax rate of 25.5 percent versus 28.2 percent in the comparable prior year period. Diluted earnings per share attributable to Cummins Inc. for the nine months ended September 30, 2012, increased versus the comparable period in 2011, as a result of a \$0.04 per share benefit from lower shares due to the stock repurchase program.

**OPERATING SEGMENT RESULTS**

Our operating segments consist of the following: Engine, Components, Power Generation and Distribution. This reporting structure is organized according to the products and markets each segment serves. We use segment EBIT as the primary basis for the chief operating decision-maker to evaluate the performance of each operating segment.

Following is a discussion of operating results for each of our business segments.

**Engine Segment Results**

Financial data for the Engine segment was as follows:

| In millions                   | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|-------------------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                               | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| External sales                | \$ 2,131              | \$ 2,539              | \$ (408)                    | (16)%   | \$ 6,924              | \$ 7,021              | \$ (97)                     | (1)%    |
| Intersegment sales            | 396                   | 416                   | (20)                        | (5)%    | 1,303                 | 1,225                 | 78                          | 6%      |
| Total sales                   | 2,527                 | 2,955                 | (428)                       | (14)%   | 8,227                 | 8,246                 | (19)                        |         |
| Depreciation and amortization | 48                    | 46                    | (2)                         | (4)%    | 142                   | 135                   | (7)                         | (5)%    |
|                               | 115                   | 103                   | (12)                        | (12)%   | 341                   | 285                   | (56)                        | (20)%   |

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|  |            |     |       |       |            |       |      |       |
|--|------------|-----|-------|-------|------------|-------|------|-------|
| Research, development and engineering expenses     |            |     |       |       |            |       |      |       |
| Equity, royalty and interest income from investees | <b>25</b>  | 35  | (10)  | (29)% | <b>100</b> | 126   | (26) | (21)% |
| Interest income                                    | <b>2</b>   | 5   | (3)   | (60)% | <b>9</b>   | 14    | (5)  | (36)% |
| Segment EBIT                                       | <b>239</b> | 349 | (110) | (32)% | <b>996</b> | 1,016 | (20) | (2)%  |

|   | Percentage Points |       |  |       | Percentage Points |       |  |       |
|---|-------------------|-------|--|-------|-------------------|-------|--|-------|
| Segment EBIT as a percentage of total sales | <b>9.5%</b>       | 11.8% |  | (2.3) | <b>12.1%</b>      | 12.3% |  | (0.2) |

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Engine segment net sales by market were as follows:

| In millions               | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|---------------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                           | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| Heavy-duty truck          | \$ 656                | \$ 748                | \$ (92)                     | (12)%   | \$ 2,355              | \$ 1,926              | \$ 429                      | 22%     |
| Medium-duty truck and bus | 478                   | 640                   | (162)                       | (25)%   | 1,516                 | 1,722                 | (206)                       | (12)%   |
| Light-duty auto and RV    | 353                   | 271                   | 82                          | 30%     | 936                   | 877                   | 59                          | 7%      |
| Total on-highway          | 1,487                 | 1,659                 | (172)                       | (10)%   | 4,807                 | 4,525                 | 282                         | 6%      |
| Industrial                | 766                   | 977                   | (211)                       | (22)%   | 2,486                 | 2,820                 | (334)                       | (12)%   |
| Stationary power          | 274                   | 319                   | (45)                        | (14)%   | 934                   | 901                   | 33                          | 4%      |
| Total sales               | \$ 2,527              | \$ 2,955              | \$ (428)                    | (14)%   | \$ 8,227              | \$ 8,246              | \$ (19)                     |         |

Unit shipments by engine classification (including unit shipments to Power Generation) were as follows:

|                      | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|----------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                      | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| Midrange             | 113,000               | 130,600               | (17,600)                    | (13)%   | 332,000               | 371,300               | (39,300)                    | (11)%   |
| Heavy-duty           | 26,000                | 31,100                | (5,100)                     | (16)%   | 95,000                | 81,000                | 14,000                      | 17%     |
| High-horsepower      | 4,600                 | 5,600                 | (1,000)                     | (18)%   | 15,900                | 16,200                | (300)                       | (2)%    |
| Total unit shipments | 143,600               | 167,300               | (23,700)                    | (14)%   | 442,900               | 468,500               | (25,600)                    | (5)%    |

**Sales**

Engine segment sales for the three month period ended September 30, 2012, decreased versus the comparable period in 2011. The following were the primary drivers:

- Industrial market sales decreased primarily due to a 76 percent decline in construction engine shipments in China, a 65 percent decline in engine shipments to the North American oil and gas markets due to weakened natural gas prices and a 14 percent decrease in global mining engine market shipments, partially offset by a 12 percent increase in engine shipments in the North American construction market.
- Medium-duty truck and bus sales decreased primarily due to lower demand in the Brazilian truck market due to pre-buy activity in the second half of 2011 ahead of the implementation of Euro V emission regulations in the first quarter of 2012 and one of our customers replacing our B6.7 engine with a proprietary engine in 2012. The B6.7 engine replacement was partially offset by the 2012 launch of our ISF and 9 liter engines in new light-duty on-highway and medium-duty truck applications, respectively, with this same customer.
- Heavy-duty truck engine sales decreased primarily due to a 26 percent decline in North American heavy-duty truck engine shipments.

These decreases were partially offset by the following:

- Light-duty auto and RV sales increased primarily due to an 81 percent improvement in units shipped to Chrysler.

Total on-highway-related sales for the three month period ended September 30, 2012, were 59 percent of total engine segment sales, compared to 56 percent for the comparable period in 2011.

Engine segment sales for the nine month period ended September 30, 2012, decreased slightly versus the comparable period in 2011. The following were the primary drivers:

- Industrial market sales decreased primarily due to a 69 percent decline in construction engine shipments in China, and a 36 percent decline in engine shipments to the North American oil and gas markets due to weakened natural gas prices, which were partially offset by a 26 percent increase in engine shipments in the North American construction market.

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- Medium-duty truck and bus sales decreased primarily due to lower demand in the Brazilian truck market due to pre-buy activity in the second half of 2011 ahead of the implementation of Euro V emission regulations in the first quarter of 2012 and one of our customers replacing our B6.7 engine with a proprietary engine in 2012. The B6.7 engine replacement was partially offset by the 2012 launch of our ISF and 9 liter engines in new light-duty on-highway and medium-duty truck applications, respectively, with this same customer.

These decreases were offset by the following:

- Heavy-duty truck engine sales increased due to growth in North American on-highway markets in the first half of the year, primarily as a result of the replacement of aging fleets.
- Light-duty auto and RV sales increased primarily due to a 42 percent improvement in units shipped to Chrysler.

Total on-highway-related sales for the nine month period ended September 30, 2012, were 58 percent of total engine segment sales, compared to 55 percent for the comparable period in 2011.

**Segment EBIT**

Engine segment EBIT for the three months ended September 30, 2012, decreased versus the comparable period in 2011. Lower gross margin, higher research, development and engineering expenses and lower equity, royalty and interest income from investees were partially offset by lower selling, general and administrative expenses. Engine segment EBIT for the nine months ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to higher research, development and engineering expenses, lower equity, royalty and interest income from investees and higher selling, general and administrative expenses, which were mostly offset by higher gross margin. Changes in Engine segment EBIT and EBIT as a percentage of sales were as follows:

| In millions  | Three months ended<br>September 30, 2012 vs. September 25, 2011 |         |   |                                | Nine months ended<br>September 30, 2012 vs. September 25, 2011 |   |  |  |
|--|---|---------|---|--------------------------------|--|---|--|--|
|  | Favorable/(Unfavorable) Change                                  |         | Percentage point<br>change as a percent<br>of sales | Favorable/(Unfavorable) Change |  | Percentage point<br>change as a percent<br>of sales |  |  |
|  | Amount  | Percent |   | Amount                         | Percent  |   |  |  |
| Gross margin                                       | \$ (119)  | (19)%   | (1.1)   | \$ 62                          | 4%   | 0.8   |  |  |
| Selling, general and administrative expenses       | 22  | 10%     | (0.4)   | (22)                           | (4)%   | (0.3)   |  |  |
| Research, development and engineering expenses     | (12)  | (12)%   | (1.1)   | (56)                           | (20)%  | (0.6)   |  |  |
| Equity, royalty and interest income from investees | (10)  | (29)%   | (0.2)   | (26)                           | (21)%  | (0.3)   |  |  |

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The decrease in gross margin for the three month period ended September 30, 2012, versus the comparable period in 2011, was primarily due to lower volumes and unfavorable product mix, which were partially offset by improved price realization and lower material costs. The decrease in selling, general and administrative expenses for the three month period ended September 30, 2012, was primarily due to decreased variable compensation accruals and lower discretionary spending in the third quarter of 2012. The increase in research, development and engineering expenses was primarily due to new product development spending. The decrease in equity, royalty and interest income from investees was primarily due to weaker demand for on-highway products at DCEC, partially offset by higher volumes at BFCEC.

The increase in gross margin for the nine month period ended September 30, 2012, versus the comparable period in 2011, was primarily due to improved price realization, product mix and product coverage, which were partially offset by lower volumes. The increase in selling, general and administrative expenses was primarily due to increased headcount to support our strategic growth initiatives launched prior to a number of markets unexpectedly slowing in mid-2012, partially offset by decreased variable compensation accruals and lower consulting spending. The increase in research, development and engineering expenses was primarily due to new product development spending and increased headcount to support our strategic growth initiatives. The decrease in equity, royalty and interest income from investees was primarily due to weaker demand for on-highway products at DCEC.



Table of Contents**Components Segment Results**

Financial data for the Components segment was as follows:

| In millions  | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|--|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|  | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| External sales                                     | \$ 663                | \$ 704                | \$ (41)                     | (6)%    | \$ 2,147              | \$ 2,105              | \$ 42                       | 2%      |
| Intersegment sales                                 | 275                   | 311                   | (36)                        | (12)%   | 926                   | 866                   | 60                          | 7%      |
| Total sales  | 938                   | 1,015                 | (77)                        | (8)%    | 3,073                 | 2,971                 | 102                         | 3%      |
| Depreciation and amortization                      | 21                    | 19                    | (2)                         | (11)%   | 59                    | 55                    | (4)                         | (7)%    |
| Research, development and engineering expenses     | 51                    | 46                    | (5)                         | (11)%   | 153                   | 126                   | (27)                        | (21)%   |
| Equity, royalty and interest income from investees | 7                     | 7                     |                             |         | 23                    | 24                    | (1)                         | (4)%    |
| Interest income                                    | 1                     | 1                     |                             |         | 3                     | 3                     |                             |         |
| Segment EBIT                                       | 89                    | 113                   | (24)                        | (21)%   | 348                   | 338                   | 10                          | 3%      |
|  | Percentage Points     |                       |                             |         | Percentage Points     |                       |                             |         |
| Segment EBIT as a percentage of total sales        | 9.5%                  | 11.1%                 | (1.6)                       |         | 11.3%                 | 11.4%                 | (0.1)                       |         |

Sales for our Components segment by business were as follows:

| In millions              | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|--------------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                          | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| Emission solutions       | \$ 304                | \$ 306                | \$ (2)                      | (1)%    | \$ 1,057              | \$ 890                | \$ 167                      | 19%     |
| Acquisition              | 21                    |                       | 21                          | 100%    | 21                    |                       | 21                          | 100%    |
| Total emission solutions | 325                   | 306                   | 19                          | 6%      | 1,078                 | 890                   | 188                         | 21%     |
| Filtration               | 260                   | 288                   | (28)                        | (10)%   | 796                   | 830                   | (34)                        | (4)%    |
| Turbo technologies       | 257                   | 298                   | (41)                        | (14)%   | 852                   | 909                   | (57)                        | (6)%    |
| Fuel systems             | 96                    | 123                   | (27)                        | (22)%   | 347                   | 342                   | 5                           | 1%      |
| Total sales              | \$ 938                | \$ 1,015              | \$ (77)                     | (8)%    | \$ 3,073              | \$ 2,971              | \$ 102                      | 3%      |

**Acquisition**

In April 2012, we reached an agreement to acquire the doser technology and business assets from Hilite in a cash transaction. Dosers are products that enable compliance with emission standards in certain aftertreatment systems and complement our current product offerings. The transaction was approved by German regulators in June and closed on July 18, 2012. The purchase price was \$176 million. There was no contingent consideration associated with this transaction. During the first nine months of 2012 we expensed approximately \$4 million of acquisition related costs. See Note 3, ACQUISITIONS AND DIVESTITURES, to the *Condensed Consolidated Financial Statements* for more details.

**Excluding Acquisition**

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Selected financial information for our Components segment excluding the impact of an acquisition was as follows:

| In millions                  | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|------------------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                              | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| <b>Excluding acquisition</b> |                       |                       |                             |         |                       |                       |                             |         |
| Sales                        | \$ 917                | \$ 1,015              | \$ (98)                     | (10)%   | \$ 3,052              | \$ 2,971              | \$ 81                       | 3%      |
| EBIT                         | 91                    | 113                   | (22)                        | (19)%   | 350                   | 338                   | 12                          | 4%      |

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*Sales*

Components segment sales, excluding the acquisition, for the three month period ended September 30, 2012, decreased versus the comparable period in 2011. The following are the primary drivers:

- Turbo technologies business sales decreased primarily due to a decline in OEM sales in Europe, China and India, unfavorable foreign currency fluctuations and reduced aftermarket demand.
- Filtration business sales decreased primarily as a result of the disposition of certain assets and liabilities of our light-duty filtration business in the fourth quarter of 2011 and unfavorable foreign currency fluctuations. Disposition related sales were \$18 million in the third quarter of 2011.
- Fuel systems business sales decreased primarily due to lower demand in North American on-highway markets and reduced aftermarket demand.

Components segment sales, excluding the acquisition, for the nine month period ended September 30, 2012, increased versus the comparable period in 2011. The following are the primary drivers:

- Emission solutions business sales increased primarily due to higher demand in the North American on-highway market and new sales in the Brazilian on-highway market as the result of new emission requirements effective January 1, 2012, partially offset by lower sales due to the disposition of certain assets and liabilities of our exhaust business in the second quarter of 2011, lower price realization and unfavorable foreign currency fluctuations. Disposition related sales were \$55 million in the first nine months of 2011.

This increase was partially offset by the following:

- Turbo technologies business sales decreased primarily due to a decline in OEM sales in Europe and China, reduced aftermarket demand and unfavorable foreign currency fluctuations, which were partially offset by higher OEM demand in North America.
- Filtration business sales decreased primarily as a result of the disposition of certain assets and liabilities of our light-duty filtration business in the fourth quarter of 2011 and unfavorable foreign currency fluctuations. Disposition related sales were \$64 million in the first nine months of 2011. The decreases were partially offset by increased aftermarket demand.

*Segment EBIT*

Components segment EBIT for the three months ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to lower gross margin and higher research, development and engineering expenses, partially offset by lower selling, general and administrative expenses. Components segment EBIT for the nine months ended September 30, 2012, increased versus the comparable period in 2011, primarily due to higher gross margin, partially offset by higher research, development and engineering expenses and higher selling, general and administrative expenses. Changes in Components segment EBIT and EBIT as a percentage of sales were as follows:

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| In millions  | Three months ended<br>September 30, 2012 vs. September 25, 2011<br>Favorable/(Unfavorable) Change |         |   | Nine months ended<br>September 30, 2012 vs. September 25, 2011<br>Favorable/(Unfavorable) Change |         |   |
|--|---|---------|---|--|---------|---|
|  | Amount  | Percent | Percentage point<br>change as a percent<br>of sales | Amount   | Percent | Percentage point<br>change as a percent<br>of sales |
| <b>Including acquisition</b>                       |   |         |   |  |         |   |
| Gross margin                                       | \$ (18)   | (8)%    | (0.2)   | \$ 47  | 7%      | 0.8   |
| Selling, general and administrative expenses       | 4   | 6%      | (0.1)   | (9)  | (4)%    |   |
| Research, development and engineering expenses     | (5)   | (11)%   | (0.9)   | (27)   | (21)%   | (0.8)   |
| Equity, royalty and interest income from investees |   |         |   | (1)  | (4)%    | (0.1)   |
| <b>Excluding acquisition</b>                       |   |         |   |  |         |   |
| Gross margin                                       | (19)  | (9)%    | 0.2   | 46   | 7%      | 0.9   |
| Selling, general and administrative expenses       | 5   | 7%      | (0.2)   | (8)  | (4)%    | (0.1)   |
| Research, development and engineering expenses     | (4)   | (9)%    | (0.9)   | (26)   | (21)%   | (0.7)   |

Excluding the acquisition, the decrease in gross margin for the three month period ended September 30, 2012, was primarily due to unfavorable foreign currency fluctuations and lower price realization, partially offset by improved product coverage. Excluding the effects from the acquisition, the decrease in selling, general and administrative expenses for the three month period ended September 30, 2012, was primarily due to decreased variable compensation accruals and lower discretionary spending in the third quarter of 2012. The increase in research, development and engineering expenses was primarily due to new product development spending and increased headcount to support our strategic growth initiatives.

Excluding the acquisition, the increase in gross margin for the nine month period ended September 30, 2012, was primarily due to higher volumes, particularly in the emission solutions business, lower material costs and improved product coverage, partially offset by unfavorable foreign currency fluctuations, lower price realization and the disposition of certain assets and liabilities of our exhaust business and our light-duty filtration business in 2011. Excluding the effects from the acquisition, the increase in selling, general and administrative expenses was primarily due to increased headcount to support our strategic growth initiatives launched prior to a number of markets unexpectedly slowing in mid-2012, partially offset by decreased variable compensation accruals and lower discretionary spending in the third quarter of 2012. The increase in research, development and engineering expenses was primarily due to new product development spending and increased headcount to support our strategic growth initiatives.

**Power Generation Segment Results**

Financial data for the Power Generation segment was as follows:

| In millions    | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|----------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| External sales | \$ 526                | \$ 604                | \$ (78)                     | (13)%   | \$ 1,614              | \$ 1,810              | \$ (196)                    | (11)%   |

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|  |            |     |      |       |              |       |      |       |
|--|------------|-----|------|-------|--------------|-------|------|-------|
| Intersegment sales                                 | <b>288</b> | 270 | 18   | 7%    | <b>889</b>   | 768   | 121  | 16%   |
| Total sales  | <b>814</b> | 874 | (60) | (7)%  | <b>2,503</b> | 2,578 | (75) | (3)%  |
| Depreciation and amortization                      | <b>12</b>  | 11  | (1)  | (9)%  | <b>34</b>    | 32    | (2)  | (6)%  |
| Research, development and engineering expenses     | <b>19</b>  | 14  | (5)  | (36)% | <b>56</b>    | 37    | (19) | (51)% |
| Equity, royalty and interest income from investees | <b>12</b>  | 16  | (4)  | (25)% | <b>32</b>    | 37    | (5)  | (14)% |
| Interest income                                    | <b>2</b>   | 2   |      |       | <b>7</b>     | 6     | 1    | 17%   |
| Segment EBIT                                       | <b>73</b>  | 92  | (19) | (21)% | <b>243</b>   | 286   | (43) | (15)% |

|   |             |                          |  |       |             |                          |  |       |
|---|-------------|--------------------------|--|-------|-------------|--------------------------|--|-------|
|   |             | <b>Percentage Points</b> |  |       |             | <b>Percentage Points</b> |  |       |
| Segment EBIT as a percentage of total sales | <b>9.0%</b> | 10.5%                    |  | (1.5) | <b>9.7%</b> | 11.1%                    |  | (1.4) |

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In the first quarter of 2012, our Power Generation segment reorganized its reporting structure to include the following businesses: power products, power systems, generator technologies and power solutions.

- **Power products** Our power products business manufactures generators for commercial and consumer applications ranging from two kilowatts (kW) to one megawatt (MW) under the Cummins Power Generation and Cummins Onan brands.
  
- **Power systems** Our power systems business manufactures and sells diesel fuel-based generator sets over one MW, paralleling systems and transfer switches for critical protection and distributed generation applications. We also offer integrated systems that consist of generator sets, power transfer and paralleling switchgear for applications such as data centers, health care facilities and waste water treatment plants.
  
- **Generator technologies** Our generator technologies business designs, manufactures, sells and services A/C generator/alternator products internally as well as to other generator set assemblers. Our products are sold under the Stamford, AVK and Markon brands and range in output from 0.6 kilovolt-amperes (kVA) to 30,000 kVA.
  
- **Power solutions** Our power solutions business provides gasoline fuel-based turnkey solutions for distributed generation and energy management applications in the range of 300-2000 kW products. The business also serves the oil and gas segment and a global rental account for diesel and gas generator sets.

Sales for our Power Generation segment by business (including 2011 reorganized balances) were as follows:

| In millions            | Three months ended    |                       | Favorable/<br>(Unfavorable) |             | Nine months ended     |                       | Favorable/<br>(Unfavorable) |             |
|------------------------|-----------------------|-----------------------|-----------------------------|-------------|-----------------------|-----------------------|-----------------------------|-------------|
|                        | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent     | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent     |
| Power products         | \$ 425                | \$ 433                | \$ (8)                      | (2)%        | \$ 1,259              | \$ 1,225              | \$ 34                       | 3%          |
| Power systems          | 174                   | 188                   | (14)                        | (7)%        | 579                   | 587                   | (8)                         | (1)%        |
| Generator technologies | 138                   | 166                   | (28)                        | (17)%       | 439                   | 509                   | (70)                        | (14)%       |
| Power solutions        | 77                    | 87                    | (10)                        | (11)%       | 226                   | 257                   | (31)                        | (12)%       |
| <b>Total sales</b>     | <b>\$ 814</b>         | <b>\$ 874</b>         | <b>\$ (60)</b>              | <b>(7)%</b> | <b>\$ 2,503</b>       | <b>\$ 2,578</b>       | <b>\$ (75)</b>              | <b>(3)%</b> |

### *Sales*

Power Generation segment sales for the three month period ended September 30, 2012, decreased versus the comparable period in 2011. The following were the primary drivers:

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- Generator technologies sales decreased primarily due to demand reductions in Europe and Asia and unfavorable foreign currency fluctuations.
- Power systems sales decreased primarily due to lower volumes in most regions, particularly North America, the Middle East and Africa and unfavorable foreign currency fluctuations, which were partially offset by higher volumes in China.
- Power solutions sales decreased primarily due to lower volumes in Other Asia (which excludes China and India) and Europe.

Power Generation segment sales for the nine month period ended September 30, 2012, decreased versus the comparable period in 2011. The following were the primary drivers:

- Generator technologies sales decreased primarily due to demand reductions in Europe and Asia and unfavorable foreign currency fluctuations.
- Power solutions sales decreased primarily due to lower volumes in the U.K., Africa and Russia, which were partially offset by higher volumes in North America.

These decreases were partially offset by the following:

- Power products sales increased primarily due to higher volumes in North America, which was partially offset by demand reductions in China, Eastern Europe, Latin America and the U.K. and unfavorable foreign currency fluctuations.



Table of Contents**Segment EBIT**

Power Generation segment EBIT for the three months ended September 30, 2012, decreased versus the comparable period in 2011. Lower gross margin, higher research, development and engineering expenses and lower equity, royalty and interest income from investees were partially offset by lower selling, general and administrative expenses. Power Generation segment EBIT for the nine months ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to higher research, development and engineering expenses, lower gross margin, higher selling, general and administrative expenses and lower equity, royalty and interest income from investees. Changes in Power Generation segment EBIT and EBIT as a percentage of sales were as follows:

| In millions  | Three months ended<br>September 30, 2012 vs. September 25, 2011<br>Favorable/(Unfavorable) Change |         |   |  | Nine months ended<br>September 30, 2012 vs. September 25, 2011<br>Favorable/(Unfavorable) Change |         |   |  |
|--|---|---------|---|--|--|---------|---|--|
|  | Amount  | Percent | Percentage point<br>change as a percent<br>of sales |  | Amount   | Percent | Percentage point<br>change as a percent<br>of sales |  |
|  |   |         |   |  |  |         |   |  |
| Gross margin                                       | \$ (14)   | (8)%    | (0.3)   |  | \$ (17)  | (3)%    | (0.1)   |  |
| Selling, general and administrative expenses       | 8   | 10%     | 0.3   |  | (12)   | (5)%    | (0.8)   |  |
| Research, development and engineering expenses     | (5)   | (36)%   | (0.7)   |  | (19)   | (51)%   | (0.8)   |  |
| Equity, royalty and interest income from investees | (4)   | (25)%   | (0.3)   |  | (5)  | (14)%   | (0.1)   |  |

The decrease in gross margin for the three month period ended September 30, 2012, was due to lower volumes and higher material costs, partially offset by improved price realization. The decrease in selling, general and administrative expenses for the three month period ended September 30, 2012, was primarily due to implementation of cost reduction initiatives in the third quarter of 2012 to align with slowing demand in key markets and a favorable foreign currency impact. The increase in research, development and engineering expenses for the three month period ended September 30, 2012, was primarily due to increased headcount to support our strategic growth initiatives and new product development spending. Equity, royalty and interest income from investees decreased primarily due to lower profitability at CCEC and Cummins Olayan.

The decrease in gross margin for the nine month period ended September 30, 2012, was due to higher material costs, lower volumes and increased product coverage, partially offset by improved price realization. The increase in selling, general and administrative expenses was primarily due to increased headcount to support our strategic growth initiatives, partially offset by lower discretionary spending in the third quarter of 2012 to align with slowing demand in key markets. The increase in research, development and engineering expenses was primarily due to increased headcount to support our strategic growth initiatives and new product development spending. Equity, royalty and interest income from investees decreased primarily due to lower profitability at Cummins Olayan and CCEC.

**Distribution Segment Results**

Financial data for the Distribution segment was as follows:



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Sales for our Distribution segment by region were as follows:

| In millions                | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|----------------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                            | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| Asia Pacific               | \$ 332                | \$ 319                | \$ 13                       | 4%      | \$ 967                | \$ 862                | \$ 105                      | 12%     |
| North & Central<br>America | 235                   | 199                   | 36                          | 18%     | 629                   | 567                   | 62                          | 11%     |
| Europe and<br>Middle East  | 168                   | 181                   | (13)                        | (7)%    | 563                   | 578                   | (15)                        | (3)%    |
| Africa                     | 30                    | 53                    | (23)                        | (43)%   | 112                   | 118                   | (6)                         | (5)%    |
| South America              | 36                    | 31                    | 5                           | 16%     | 99                    | 85                    | 14                          | 16%     |
| Total sales                | \$ 801                | \$ 783                | \$ 18                       | 2%      | \$ 2,370              | \$ 2,210              | \$ 160                      | 7%      |

Sales for our Distribution segment by product were as follows:

| In millions             | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|-------------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                         | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| Parts and<br>filtration | \$ 326                | \$ 283                | \$ 43                       | 15%     | \$ 916                | \$ 789                | \$ 127                      | 16%     |
| Power generation        | 178                   | 191                   | (13)                        | (7)%    | 565                   | 531                   | 34                          | 6%      |
| Engines                 | 157                   | 171                   | (14)                        | (8)%    | 470                   | 497                   | (27)                        | (5)%    |
| Service                 | 140                   | 138                   | 2                           | 1%      | 419                   | 393                   | 26                          | 7%      |
| Total sales             | \$ 801                | \$ 783                | \$ 18                       | 2%      | \$ 2,370              | \$ 2,210              | \$ 160                      | 7%      |

*Excluding Acquisitions*

Selected financial information for our Distribution segment excluding the impact of acquisitions was as follows:

| In millions                        | Three months ended    |                       | Favorable/<br>(Unfavorable) |         | Nine months ended     |                       | Favorable/<br>(Unfavorable) |         |
|------------------------------------|-----------------------|-----------------------|-----------------------------|---------|-----------------------|-----------------------|-----------------------------|---------|
|                                    | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent | September 30,<br>2012 | September 25,<br>2011 | Amount                      | Percent |
| Parts and filtration               | \$ 299                | \$ 283                | \$ 16                       | 6%      | \$ 882                | \$ 789                | \$ 93                       | 12%     |
| Power generation                   | 168                   | 191                   | (23)                        | (12)%   | 548                   | 531                   | 17                          | 3%      |
| Engines                            | 131                   | 171                   | (40)                        | (23)%   | 443                   | 497                   | (54)                        | (11)%   |
| Service                            | 132                   | 138                   | (6)                         | (4)%    | 409                   | 393                   | 16                          | 4%      |
| Sales excluding<br>acquisitions    | 730                   | 783                   | (53)                        | (7)%    | 2,282                 | 2,210                 | 72                          | 3%      |
| Acquisitions (1)                   | 71                    |                       | 71                          | 100%    | 88                    |                       | 88                          | 100%    |
| Total sales                        | \$ 801                | \$ 783                | \$ 18                       | 2%      | \$ 2,370              | \$ 2,210              | \$ 160                      | 7%      |
| EBIT excluding<br>acquisitions (2) | \$ 91                 | \$ 104                | \$ (13)                     | (13)%   | \$ 279                | \$ 299                | \$ (20)                     | (7)%    |

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(1) The acquisitions represent the purchase of the majority interest in Cummins Central Power, an equity investee, in the third quarter of 2012, as explained in Note 3, ACQUISITIONS AND DIVESTITURES, to the *Condensed Consolidated Financial Statements*, as well as a few other small acquisitions. The acquisitions increased sales by \$71 million and \$88 million, respectively, and EBIT by \$8 million and \$6 million, respectively, for the three and nine months ended September 30, 2012.

(2) EBIT includes \$2 million of equity earnings, which would have been our share of Cummins Central Power's income for the three and nine months ended September 30, 2012, if we had not consolidated the entity.

### *Sales*

Distribution segment sales, excluding the acquisitions, for the three month period ended September 30, 2012, decreased versus the comparable period in 2011. The following were the primary drivers:

- Foreign currency fluctuations unfavorably impacted sales results.
- Engine product sales decreased primarily due to a significant slowdown in the North American oil and gas markets and lower demand in Europe and Africa.
- Power generation product sales decreased primarily due to a reduction in nonrecurring project-related sales in North and Central America and lower demand in Japan, Africa and the Middle East, partially offset by growth in East Asia.

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These decreases were partially offset by the following:

- Parts and filtration product sales increased primarily due to higher demand in the Middle East, India and North and Central America.

Distribution segment sales, excluding the acquisitions, for the nine month period ended September 30, 2012, increased versus the comparable period in 2011. The following were the primary drivers:

- Parts and filtration product sales increased primarily due to higher demand in North and Central America and the Middle East.
- Power generation product sales increased primarily due to growth in East Asia and improved demand in the South Pacific, which were partially offset by a reduction in nonrecurring project-related sales in the Middle East.
- Service revenue increased primarily due to higher demand from mining customers in the South Pacific, higher demand in Europe and higher volumes in Africa due to the increasing engine population.

These increases were partially offset by the following:

- Foreign currency fluctuations unfavorably impacted sales results.
- Engine product sales decreased primarily due to a significant slowdown in the North American oil and gas markets, partially offset by growth in East Asia.

***Segment EBIT***

Distribution segment EBIT for the three months ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to lower gross margin and higher selling, general and administrative expenses, partially offset by higher equity, royalty and interest income from investees. Distribution segment EBIT for the nine months ended September 30, 2012, decreased versus the comparable period in 2011, primarily due to higher selling, general and administrative expenses and research, development and engineering expenses, partially offset by higher equity, royalty and interest income from investees and higher gross margin. Changes in Distribution segment EBIT and EBIT as a percentage of sales were as follows:

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| In millions   | Three months ended<br>September 30, 2012 vs. September 25, 2011<br>Favorable/(Unfavorable) Change |         |   | Nine months ended<br>September 30, 2012 vs. September 25, 2011<br>Favorable/(Unfavorable) Change |         |   |
|---|---|---------|---|--|---------|---|
|   | Amount  | Percent | Percentage point<br>change as a percent<br>of sales | Amount   | Percent | Percentage point<br>change as a percent<br>of sales |
| <b>Including acquisitions</b>                         |   |         |   |  |         |   |
| Gross margin  | \$ (14)   | (8)%    | (2.2)   | \$ 3   | 1%      | (1.5)   |
| Selling, general and<br>administrative expenses       | (1)   | (1)%    | 0.3   | (35)   | (10)%   | (0.4)   |
| Research, development and<br>engineering expenses     |   |         |   | (2)  | (100)%  | (0.1)   |
| Equity, royalty and interest<br>income from investees | 6   | 14%     | 0.6   | 19   | 15%     | 0.4   |
| <b>Excluding acquisitions</b>                         |   |         |   |  |         |   |
| Gross margin  | \$ (27)   | (15)%   | (2.1)   | \$ (14)  | (3)%    | (1.3)   |
| Selling, general and<br>administrative expenses       | 9   | 7%      | 0.1   | (21)   | (6)%    | (0.4)   |

Excluding the acquisitions, the decrease in gross margin for the three month period ended September 30, 2012, was primarily due to unfavorable variations in geographic mix and unfavorable foreign currency impacts, partially offset by higher parts and filtration volumes. Excluding the effects from the acquisitions, the decrease in selling, general and administrative expenses was mainly due to decreased variable compensation accruals and lower discretionary spending in the third quarter of 2012. The increase in equity, royalty and interest income from investees was primarily due to increased income from North American distributors and Komatsu Cummins Chile, Ltda.

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Excluding the acquisitions, the decrease in gross margin for the nine month period ended September 30, 2012, was primarily due to unfavorable foreign currency impacts and unfavorable variations in geographic mix, partially offset by higher volumes in most products. Excluding the effects from the acquisitions, the increase in selling, general and administrative expenses was primarily due to increased headcount to support our strategic growth initiatives launched prior to a number of markets unexpectedly slowing in mid-2012, partially offset by decreased variable compensation accruals and lower discretionary spending in the third quarter of 2012. The increase in research, development and engineering expenses was mainly due to increased headcount to support our strategic growth initiatives. The increase in equity, royalty and interest income from investees was primarily due to increased income from North American distributors.

**Reconciliation of Segment EBIT to Income Before Income Taxes**

The table below reconciles the segment information to the corresponding amounts in the *Condensed Consolidated Statements of Income*:

| In millions                | Three months ended    |                       | Nine months ended     |                       |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                            | September 30,<br>2012 | September 25,<br>2011 | September 30,<br>2012 | September 25,<br>2011 |
| Total segment EBIT         | \$ 500                | \$ 658                | \$ 1,872              | \$ 1,939              |
| Non-segment EBIT (1)       | (4)                   | (18)                  | (49)                  | 8                     |
| Total EBIT                 | \$ 496                | \$ 640                | \$ 1,823              | \$ 1,947              |
| Less                       |                       |                       |                       |                       |
| Interest expense           | 9                     | 11                    | 25                    | 34                    |
| Income before income taxes | \$ 487                | \$ 629                | \$ 1,798              | \$ 1,913              |

(1) Includes intersegment sales and profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the three months ended September 30, 2012 and September 25, 2011. The nine months ended September 30, 2012, include a \$6 million gain (\$4 million after-tax) related to adjustments from our 2011 divestitures. The nine months ended September 25, 2011, include a \$68 million gain (\$37 million after-tax) related to the sale of certain assets and liabilities of our exhaust business from the Components segment. The gains have been excluded from segment results as they were not considered in our evaluation of operating results for the corresponding periods. There were no other significant unallocated corporate expenses.

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**LIQUIDITY AND CAPITAL RESOURCES**

**Management's Assessment of Liquidity**

Our financial condition and liquidity remain strong. Our solid balance sheet and credit ratings enable us to continue to have ready access to credit.

We assess our liquidity in terms of our ability to generate adequate cash to fund our operating, investing and financing activities. We generate significant ongoing cash flow, which has been used, in part, to fund capital expenditures, pay dividends on our common stock, fund repurchases of common stock and acquisitions. Cash provided by operations is our principal source of liquidity. As of September 30, 2012, other sources of liquidity include:

- cash and cash equivalents of \$ 1.0 billion, of which approximately 13 percent is located in the U.S. and 87 percent is located primarily in the U.K., China, Singapore, India and Brazil,
- marketable securities of \$ 239 million, which are located primarily in India and Brazil and the majority of which could be liquidated into cash within a few days,
- revolving credit facility with \$1.2 billion available, net of outstanding letters of credit,
- international and other domestic credit facilities with \$ 292 million available and
- our accounts receivable sales program with \$ 183 million available, based on eligible receivables.

We believe our liquidity provides us with the financial flexibility needed to fund working capital, capital expenditures, projected pension obligations, dividend payments, common stock repurchases, acquisitions and debt service obligations.

A significant portion of our cash flows is generated outside the U.S. As of September 30, 2012, the total of cash, cash equivalents and marketable securities held by foreign subsidiaries was \$1.1 billion, the vast majority of which was located in the U.K., China, India, Singapore and Brazil. The geographic location of our cash and marketable securities aligns well with our business growth strategy. We manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct our business and the cost



effectiveness with which those funds can be accessed. As a result, we do not anticipate any local liquidity restrictions to preclude us from funding our targeted expansion or operating needs with local resources.

If we distribute our foreign cash balances to the U.S. or to other foreign subsidiaries, we could be required to accrue and pay U.S. taxes. For example, we would be required to accrue and pay additional U.S. taxes if we repatriated cash from certain foreign subsidiaries whose earnings we have asserted are permanently reinvested outside of the U.S. Foreign earnings for which we assert permanent reinvestment outside the U.S. consist primarily of earnings of our U.K. domiciled subsidiaries. At present we do not foresee a need to repatriate any earnings from these subsidiaries for which we have asserted permanent reinvestment. However, to help fund cash needs of the U.S. or other international subsidiaries as they arise, we repatriate available cash from certain foreign subsidiaries whose earnings are not permanently reinvested when it is cost effective to do so. Our 2012 and subsequent earnings from our China operations are considered permanently reinvested, while earnings generated prior to 2012, for which U.S. deferred tax liabilities have been recorded, are expected to be repatriated in future years.

We continuously monitor our pension assets and believe that we have limited exposure to the European debt crisis. No sovereign debt instruments of crisis countries are held in the trusts, while any equities held are with large well-diversified multinational firms or are de minimis amounts in large index funds. Our pension plans have not experienced any significant impact on liquidity or counterparty exposure due to the volatility in the credit markets.

Table of Contents**Working Capital Summary**

We fund our working capital with cash from operations and short-term borrowings when necessary. Various assets and liabilities, including short-term debt, can fluctuate significantly from month to month depending on short-term liquidity needs. As a result, working capital is a prime focus of management attention.

| In millions   | September 30,<br>2012 | December 31,<br>2011 | Change   |
|---|-----------------------|----------------------|----------|
| Cash and cash equivalents                           | \$ 1,033              | \$ 1,484             | \$ (451) |
| Marketable securities                               | 239                   | 277                  | (38)     |
| Accounts and notes receivable                       | 2,503                 | 2,526                | (23)     |
| Inventories   | 2,570                 | 2,141                | 429      |
| Other current assets                                | 770                   | 663                  | 107      |
| Current assets                                      | 7,115                 | 7,091                | 24       |
| Accounts and loans payable                          | 1,514                 | 1,574                | (60)     |
| Current portion of accrued product warranty         | 406                   | 422                  | (16)     |
| Accrued compensation, benefits and retirement costs | 388                   | 511                  | (123)    |
| Taxes payable (including taxes on income)           | 172                   | 282                  | (110)    |
| Other accrued expenses                              | 829                   | 868                  | (39)     |
| Current liabilities                                 | 3,309                 | 3,657                | (348)    |
| Working capital                                     | \$ 3,806              | \$ 3,434             |          |
| Current ratio                                       | 2.15                  | 1.94                 |          |
| Days sales in receivables                           | 53                    | 48                   |          |
| Inventory turnover                                  | 5.3                   | 6.3                  |          |

Current assets remained flat compared to December 31, 2011, as an unanticipated decline in demand resulted in higher inventory levels and an increase in other current assets, primarily refundable income taxes, were offset by a decrease in cash and cash equivalents.

Current liabilities decreased 10 percent compared to December 31, 2011, primarily due to a decrease in accrued compensation, benefits and retirement costs due to 2011 variable compensation payouts and lower variable compensation accruals for 2012 and a decrease in taxes payable as a result of lower earnings and higher tax payments in 2012 compared to 2011.

**Cash Flows**

Cash and cash equivalents decreased \$ 451 million during the nine month period ended September 30, 2012, compared to a \$142 million increase in cash and cash equivalents during the comparable period in 2011. The change in cash and cash equivalents was as follows.



Table of Contents**Operating Activities**

| In millions  | Nine months ended     |                       | Change   |
|--|-----------------------|-----------------------|----------|
|  | September 30,<br>2012 | September 25,<br>2011 |          |
| Consolidated net income  | \$ 1,340              | \$ 1,374              | \$ (34)  |
| Depreciation and amortization  | 262                   | 243                   | 19       |
| Gain on sale of businesses   | (6)                   | (68)                  | 62       |
| Gain on fair value adjustment for consolidated investee                          | (7)                   |                       | (7)      |
| Deferred income taxes  | 91                    | 148                   | (57)     |
| Equity in income of investees, net of dividends                                  | (51)                  | 7                     | (58)     |
| Pension contributions in excess of expense                                       | (74)                  | (71)                  | (3)      |
| Other post-retirement benefits payments in excess of expense                     | (16)                  | (10)                  | (6)      |
| Stock-based compensation expense   | 29                    | 28                    | 1        |
| Excess tax benefits on stock-based awards  | (12)                  | (4)                   | (8)      |
| Translation and hedging activities   | 16                    | (14)                  | 30       |
| Changes in current assets and liabilities, net of acquisitions and divestitures: |                       |                       |          |
| Accounts and notes receivable  | 66                    | (469)                 | 535      |
| Inventories  | (367)                 | (367)                 |          |
| Other current assets   | (54)                  | (5)                   | (49)     |
| Accounts payable   | (145)                 | 317                   | (462)    |
| Accrued expenses   | (398)                 | 173                   | (571)    |
| Changes in other liabilities and deferred revenue                                | 154                   | 93                    | 61       |
| Other, net   | (41)                  | (7)                   | (34)     |
| Net cash provided by operating activities  | \$ 787                | \$ 1,368              | \$ (581) |

Net cash provided by operating activities decreased for the nine months ended September 30, 2012, versus the comparable period in 2011, primarily due to unfavorable working capital fluctuations. During the first nine months of 2012, the net increase in working capital assets resulted in a cash outflow of \$898 million compared to a cash outflow of \$351 million during the first nine months of 2011. This change of \$547 million was primarily driven by lower accrued expenses than the comparable period, a decrease in accounts payable and higher cash tax payments of approximately \$221 million, which were partially offset by a decrease in accounts and notes receivable.

**Pensions**

The funded status of our pension plans is dependent upon a variety of variables and assumptions including return on invested assets, market interest rates and levels of voluntary contributions to the plans. The U.S. trust investments maintained the excellent return trend from the first half of the year into the third quarter. As a result, for the nine months ended September 30, 2012, the return for our U.S. plan was 12 percent while our U.K. plan return was 4 percent. Approximately 89 percent of our pension plan assets are invested in highly liquid investments such as equity and fixed income securities. The remaining 11 percent of our plan assets are invested in less liquid, but market valued investments, including real estate and private equity. We made \$122 million of pension contributions in the nine months ended September 30, 2012, and we anticipate making total contributions of approximately \$130 million to our pension plans in 2012. Expected contributions to our defined benefit pension plans in 2012 will meet or exceed the current funding requirements. Claims and premiums for other postretirement benefits are expected to approximate \$51 million, net of reimbursements, in 2012. The \$122 million of pension contributions in the nine months ended

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September 30, 2012, included voluntary contributions of \$107 million. These contributions and payments include payments from our funds either to increase pension plan assets or to make direct payments to plan participants.

Table of Contents**Investing Activities**

| In millions  | Nine months ended     |                       | Change   |
|--|-----------------------|-----------------------|----------|
|  | September 30,<br>2012 | September 25,<br>2011 |          |
| Capital expenditures                                 | \$ (424)              | \$ (377)              | \$ (47)  |
| Investments in internal use software                 | (62)                  | (31)                  | (31)     |
| Investments in and advances to equity investees      | (92)                  | (104)                 | 12       |
| Proceeds from sale of business, net of cash sold     | 10                    | 111                   | (101)    |
| Acquisition of businesses, net of cash acquired      | (215)                 |                       | (215)    |
| Investments in marketable securities acquisitions    | (433)                 | (538)                 | 105      |
| Investments in marketable securities liquidations    | 475                   | 572                   | (97)     |
| Cash flows from derivatives not designated as hedges | 13                    | 4                     | 9        |
| Other, net   | 9                     | 7                     | 2        |
| Net cash used in investing activities                | \$ (719)              | \$ (356)              | \$ (363) |

Net cash used in investing activities increased for the nine months ended September 30, 2012, versus the comparable period in 2011, primarily due to cash investments for the acquisitions of Hilite and Cummins Central Power, proceeds from the 2011 disposition of certain assets and liabilities of our exhaust business, which did not repeat in 2012, and increased capital expenditures.

Capital expenditures for the nine month period ended September 30, 2012, were \$ 424 million compared to \$ 377 million in the comparable period in 2011. Despite the challenging economies around the world, we continue to invest in new product lines and targeted capacity expansions. However, we now expect to spend approximately \$650 million to \$700 million in 2012. Approximately one-half of our capital expenditures will be invested outside of the U.S.

**Financing Activities**

| In millions  | Nine months ended     |                       | Change  |
|--|-----------------------|-----------------------|---------|
|  | September 30,<br>2012 | September 25,<br>2011 |         |
| Proceeds from borrowings                             | \$ 64                 | \$ 96                 | \$ (32) |
| Payments on borrowings and capital lease obligations | (120)                 | (174)                 | 54      |
| Net borrowings under short-term credit agreements    | 5                     | (5)                   | 10      |
| Distributions to noncontrolling interests            | (50)                  | (50)                  |         |
| Dividend payments on common stock                    | (246)                 | (178)                 | (68)    |
| Repurchases of common stock                          | (231)                 | (546)                 | 315     |
| Excess tax benefits on stock-based awards            | 12                    | 4                     | 8       |
| Other, net   | 16                    | 13                    | 3       |
| Net cash used in financing activities                | \$ (550)              | \$ (840)              | \$ 290  |

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Net cash used in financing activities decreased for the nine months ended September 30, 2012, versus the comparable period in 2011, primarily due to significantly lower repurchases of common stock and debt payments, which were partially offset by higher dividend payments.

In July 2012, the Board of Directors authorized a dividend increase of 25 percent from \$0.40 per share to \$0.50 per share on a quarterly basis.

Our total debt was \$801 million as of September 30, 2012, compared with \$783 million as of December 31, 2011. Total debt as a percent of our total capital, including total long-term debt, was 10.5 percent at September 30, 2012, compared with 11.8 percent at December 31, 2011.

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In February 2011, the Board of Directors approved a new share repurchase program and authorized the acquisition of up to \$1 billion of our common stock. In 2012, we made the following quarterly purchases under this plan:

| In millions (except per share amounts)<br>For each quarter ended | Shares<br>Purchased | Average Cost<br>Per Share | Total Cost of<br>Repurchases | Remaining<br>Authorized<br>Capacity |
|--|---------------------|---------------------------|------------------------------|-------------------------------------|
| April 1  | 0.1                 | \$ 114.97                 | \$ 8                         | \$ 474                              |
| July 1   | 1.8                 | 104.00                    | 188                          | 286                                 |
| September 30   | 0.4                 | 84.95                     | 35                           | 251                                 |
| Total  | 2.3                 | 100.92                    | \$ 231                       | 251                                 |

**Credit Ratings**

A number of our contractual obligations and financing agreements, such as our revolving credit facility have restrictive covenants and/or pricing modifications that may be triggered in the event of downward revisions to our corporate credit rating. There were no downgrades of our credit ratings in the third quarter of 2012 that have impacted these covenants or pricing modifications. In October 2012, Fitch Ratings upgraded our ratings to **A** and changed our outlook to stable.

Credit ratings are not recommendations to buy, are subject to change and each rating should be evaluated independently of any other rating. In addition, we undertake no obligation to update disclosures concerning our credit ratings, whether as a result of new information, future events or otherwise. Our ratings and outlook from each of the credit rating agencies as of the date of filing are shown in the table below.

| Credit Rating Agency              | Senior L-T<br>Debt Rating | Outlook  |
|-----------------------------------|---------------------------|----------|
| Moody's Investors Service, Inc.   | Baa1                      | Positive |
| Standard & Poor's Rating Services | A                         | Stable   |
| Fitch Ratings                     | A                         | Stable   |

**APPLICATION OF CRITICAL ACCOUNTING ESTIMATES**

A summary of our significant accounting policies is included in Note 1, **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**, of the *Notes to the Consolidated Financial Statements* of our 2011 Form 10-K which discusses accounting policies that we have selected from acceptable alternatives.

Our *Condensed Consolidated Financial Statements* are prepared in accordance with generally accepted accounting principles that often require management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts presented and disclosed in the financial statements. Management reviews these estimates and assumptions based on historical experience, changes in business conditions and other relevant factors they believe to be reasonable under the circumstances. In any given reporting period, our actual results may differ from the estimates and assumptions used in preparing our *Condensed Consolidated Financial Statements*.



Critical accounting estimates are defined as follows: the estimate requires management to make assumptions about matters that were highly uncertain at the time the estimate was made; different estimates reasonably could have been used; or if changes in the estimate are reasonably likely to occur from period to period and the change would have a material impact on our financial condition or results of operations. Our senior management has discussed the development and selection of our accounting policies, related accounting estimates and the disclosures set forth below with the Audit Committee of our Board of Directors. We believe our critical accounting estimates include those addressing the estimation of liabilities for warranty programs, recoverability of investment related to new products, accounting for income taxes and pension benefits.

A discussion of all other critical accounting estimates may be found in the Management's Discussion and Analysis section of our 2011 Form 10-K under the caption APPLICATION OF CRITICAL ACCOUNTING ESTIMATES. Within the context of these critical accounting estimates, we are not currently aware of any reasonably likely events or circumstances that would result in different policies or estimates being reported in the first nine months of 2012.

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**RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

See Note 16, **RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**, in the *Notes to Condensed Consolidated Financial Statements*.

**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

A discussion of quantitative and qualitative disclosures about market risk may be found in Item 7A of our 2011 Form 10-K. There have been no material changes in this information since the filing of our 2011 Form 10-K. Further information regarding financial instruments and risk management is discussed in Note 13, **DERIVATIVES**, in the *Notes to the Condensed Consolidated Financial Statements*.

**ITEM 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is (1) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There has been no change in our internal control over financial reporting during the quarter ended September 30, 2012, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

We are subject to numerous lawsuits and claims arising out of the ordinary course of our business, including actions related to product liability; personal injury; the use and performance of our products; warranty matters; patent, trademark or other intellectual property infringement; contractual liability; the conduct of our business; tax reporting in foreign jurisdictions; distributor termination; workplace safety; and environmental matters. We also have been identified as a potentially responsible party at multiple waste disposal sites under U.S. federal and related state environmental statutes and regulations and may have joint and several liability for any investigation and remediation costs incurred with respect to such sites. We have denied liability with respect to many of these lawsuits, claims and proceedings and are vigorously defending such lawsuits, claims and proceedings. We carry various forms of commercial, property and casualty, product liability and other forms of insurance; however, such insurance may not be applicable or adequate to cover the costs associated with a judgment against us with respect to these lawsuits, claims and proceedings. We do not believe that these lawsuits are material individually or in the aggregate. While we believe we have also established adequate accruals for our expected future liability with respect to pending lawsuits, claims and proceedings, where the nature and extent of any such liability can be reasonably estimated based upon then presently available information, there can be no assurance that the final resolution of any existing or future lawsuits, claims or proceedings will not have a material adverse effect on our business, results of operations, financial condition or cash flows.

We conduct significant business operations in Brazil that are subject to the Brazilian federal, state and local labor, social security, tax and customs laws. While we believe we comply with such laws, they are complex, subject to varying interpretations and we are often engaged in litigation regarding the application of these laws to particular circumstances.

Table of Contents**ITEM 1A. Risk Factors**

In addition to other information set forth in this report, you should consider other risk factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K or the CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION in this Quarterly report are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently judge to be immaterial also may materially adversely affect our business, financial condition or operating results.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following information is provided pursuant to Item 703 of Regulation S-K:

| Period                           | Issuer Purchases of Equity Securities   |                                  |  |   |
|----------------------------------|---|----------------------------------|--|---|
|                                  | (a) Total Number of Shares Purchased(1) | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs(2) |
| July 2 - August 5, 2012          | 413,215                                 | \$ 84.99                         | 411,930  | 134,370   |
| August 6 - September 2, 2012     | 5,122                                   | 98.19                            |  | 131,587   |
| September 3 - September 30, 2012 | 1,628                                   | 100.12                           |  | 132,246   |
| Total                            | 419,965                                 | 85.21                            | 411,930  |   |

(1) Shares purchased represent shares under the 2011 Board of Directors authorized \$1 billion repurchase program and our Key Employee Stock Investment Plan established in 1969 (there is no maximum repurchase limitation in this plan).

(2) These values reflect the sum of shares held in loan status under our Key Employee Stock Investment Plan. The repurchase program authorized by the Board of Directors does not limit the number of shares that may be purchased and was excluded from this column.

In February 2011, the Board of Directors approved a new share repurchase program and authorized the acquisition of up to \$1 billion of our common stock. As of September 30, 2012, we have \$ 251 million available for purchase under this authorization.

During the three month period ended September 30, 2012, we repurchased 8,035 shares from employees in connection with the Key Employee Stock Investment Plan which allows certain employees, other than officers, to purchase shares of common stock on an installment basis up to an established credit limit. Loans are issued for five-year terms at a fixed interest rate established at the date of purchase and may be refinanced after its initial five-year period for an additional five-year period. Participants must hold shares for a minimum of six months from date of purchase and after shares are sold must wait six months before another share purchase may be made. We hold participants' shares as security for

the loans and would, in effect repurchase shares if the participant defaulted in repayment of the loan. There is no maximum amount of shares that we may purchase under this plan.

**ITEM 3. Defaults Upon Senior Securities**

Not applicable.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**ITEM 5. Other Information**

Not applicable.

**ITEM 6. Exhibits**

See Exhibit Index at the end of this Quarterly Report on Form 10-Q.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Cummins Inc.

Date: October 31, 2012

By:                   /s/ PATRICK J. WARD  
                          Patrick J. Ward  
                          *Vice President and Chief Financial Officer*  
                          *(Principal Financial Officer)*

By:                   /s/ MARSHA L. HUNT  
                          Marsha L. Hunt  
                          *Vice President-Corporate Controller*  
                          *(Principal Accounting Officer)*

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**CUMMINS INC.**

**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>  |
|--------------------|--|
| 12                 | Calculation of Ratio of Earnings to Fixed Charges.                       |
| 31(a)              | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31(b)              | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32                 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS            | XBRL Instance Document.  |
| 101.SCH            | XBRL Taxonomy Extension Schema Document.                                 |
| 101.CAL            | XBRL Taxonomy Extension Calculation Linkbase Document.                   |
| 101.DEF            | XBRL Taxonomy Extension Definition Linkbase Document.                    |
| 101.LAB            | XBRL Taxonomy Extension Label Linkbase Document.                         |
| 101.PRE            | XBRL Taxonomy Extension Presentation Linkbase Document.                  |