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CUMMINS INC

Form 10-Q

July 31, 2018

false--12-31Q220182018-07-010000026172YesLarge Accelerated

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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 July 1, 2018**

**Commission File Number 1-4949**

## **CUMMINS INC.**

(Exact name of registrant as specified in its charter)

**Indiana 35-0257090**

(State of Incorporation) (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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐  
Smaller reporting company ☐ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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 July 1, 2018, there were 163,311,209 shares of common stock outstanding with a par value of \$2.50 per share.

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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		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
<b>NET SALES</b> <sup>(a)</sup> (Note 3)	<b>\$ 6,132</b>	<b>\$ 5,078</b>	<b>\$ 11,702</b>	<b>\$ 9,667</b>
Cost of sales	<b>4,692</b>	3,827	<b>9,062</b>	7,284
<b>GROSS MARGIN</b>	<b>1,440</b>	1,251	<b>2,640</b>	2,383
<b>OPERATING EXPENSES AND INCOME</b>				
Selling, general and administrative expenses	<b>613</b>	606	<b>1,190</b>	1,153
Research, development and engineering expenses	<b>219</b>	175	<b>429</b>	333
Equity, royalty and interest income from investees (Note 5)	<b>110</b>	98	<b>225</b>	206
Other operating income (expense), net	<b>4</b>	18	<b>6</b>	23
<b>OPERATING INCOME</b>	<b>722</b>	586	<b>1,252</b>	1,126
Interest income	<b>10</b>	5	<b>17</b>	7
Interest expense	<b>28</b>	21	<b>52</b>	39
Other income, net	<b>11</b>	29	<b>21</b>	53
<b>INCOME BEFORE INCOME TAXES</b>	<b>715</b>	599	<b>1,238</b>	1,147
Income tax expense (Note 6)	<b>161</b>	158	<b>359</b>	301
<b>CONSOLIDATED NET INCOME</b>	<b>554</b>	441	<b>879</b>	846
Less: Net income attributable to noncontrolling interests	<b>9</b>	17	<b>9</b>	26
<b>NET INCOME ATTRIBUTABLE TO CUMMINS INC.</b>	<b>\$ 545</b>	\$ 424	<b>\$ 870</b>	\$ 820
<b>EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC.</b>				
Basic	<b>\$ 3.33</b>	\$ 2.53	<b>\$ 5.30</b>	\$ 4.90
Diluted	<b>\$ 3.32</b>	\$ 2.53	<b>\$ 5.27</b>	\$ 4.88
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>				
Basic	<b>163.8</b>	167.3	<b>164.3</b>	167.4
Dilutive effect of stock compensation awards	<b>0.5</b>	0.5	<b>0.7</b>	0.5
Diluted	<b>164.3</b>	167.8	<b>165.0</b>	167.9
<b>CASH DIVIDENDS DECLARED PER COMMON SHARE</b>	<b>\$ 1.08</b>	\$ 1.025	<b>\$ 2.16</b>	\$ 2.05

<sup>(a)</sup> Includes sales to nonconsolidated equity investees of \$340 million and \$637 million and \$283 million and \$550 million for the three and six months ended July 1, 2018 and July 2, 2017, 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		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
<b>CONSOLIDATED NET INCOME</b>	<b>\$ 554</b>	<b>\$ 441</b>	<b>\$ 879</b>	<b>\$ 846</b>
Other comprehensive income (loss), net of tax (Note 13)				
Change in pension and other postretirement defined benefit plans	<b>13</b>	15	<b>21</b>	36
Foreign currency translation adjustments	<b>(299 )</b>	102	<b>(215 )</b>	182
Unrealized gain on marketable securities	—	1	—	1
Unrealized gain on derivatives	—	—	<b>7</b>	1
Total other comprehensive income (loss), net of tax	<b>(286 )</b>	118	<b>(187 )</b>	220
<b>COMPREHENSIVE INCOME</b>	<b>268</b>	559	<b>692</b>	1,066
Less: Comprehensive (loss) income attributable to noncontrolling interests	<b>(7 )</b>	18	<b>(14 )</b>	40
<b>COMPREHENSIVE INCOME ATTRIBUTABLE TO CUMMINS INC.</b>	<b>\$ 275</b>	<b>\$ 541</b>	<b>\$ 706</b>	<b>\$ 1,026</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)**

<b>In millions, except par value</b>	<b>July 1, 2018</b>	<b>December 31, 2017</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	<b>\$1,318</b>	\$ 1,369
Marketable securities (Note 7)	<b>214</b>	198
Total cash, cash equivalents and marketable securities	<b>1,532</b>	1,567
Accounts and notes receivable, net		
Trade and other	<b>3,794</b>	3,311
Nonconsolidated equity investees	<b>301</b>	307
Inventories (Note 8)	<b>3,559</b>	3,166
Prepaid expenses and other current assets	<b>649</b>	577
Total current assets	<b>9,835</b>	8,928
Long-term assets		
Property, plant and equipment	<b>7,982</b>	8,058
Accumulated depreciation	<b>(4,158)</b>	(4,131)
Property, plant and equipment, net	<b>3,824</b>	3,927
Investments and advances related to equity method investees	<b>1,303</b>	1,156
Goodwill	<b>1,079</b>	1,082
Other intangible assets, net	<b>940</b>	973
Pension assets	<b>1,022</b>	1,043
Other assets	<b>912</b>	966
Total assets	<b>\$18,915</b>	\$ 18,075
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable (principally trade)	<b>\$2,981</b>	\$ 2,579
Loans payable (Note 9)	<b>55</b>	57
Commercial paper (Note 9)	<b>802</b>	298
Accrued compensation, benefits and retirement costs	<b>468</b>	811
Current portion of accrued product warranty (Note 10)	<b>464</b>	454
Current portion of deferred revenue	<b>479</b>	500
Other accrued expenses (Note 11)	<b>806</b>	915
Current maturities of long-term debt (Note 9)	<b>49</b>	63
Total current liabilities	<b>6,104</b>	5,677
Long-term liabilities		
Long-term debt (Note 9)	<b>1,556</b>	1,588
Postretirement benefits other than pensions	<b>289</b>	289
Pensions	<b>331</b>	330
Other liabilities and deferred revenue (Note 11)	<b>2,441</b>	2,027
Total liabilities	<b>\$10,721</b>	\$ 9,911

Commitments and contingencies (Note 12)

**EQUITY**

Cummins Inc. shareholders' equity

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Common stock, \$2.50 par value, 500 shares authorized, 222.4 and 222.4 shares issued	<b>\$2,239</b>	\$ 2,210
Retained earnings	<b>12,009</b>	11,464
Treasury stock, at cost, 59.1 and 56.7 shares	<b>(5,276 )</b>	(4,905 )
Common stock held by employee benefits trust, at cost, 0.5 and 0.5 shares	<b>(6 )</b>	(7 )
Accumulated other comprehensive loss (Note 13)	<b>(1,667 )</b>	(1,503 )
Total Cummins Inc. shareholders' equity	<b>7,299</b>	7,259
Noncontrolling interests	<b>895</b>	905
Total equity	<b>\$8,194</b>	\$ 8,164
Total liabilities and equity	<b>\$18,915</b>	\$ 18,075

*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)**

<b>In millions</b>	<b>Six months ended</b>	
	<b>July 1, 2018</b>	<b>July 2, 2017</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Consolidated net income	<b>\$879</b>	\$846
Adjustments to reconcile consolidated net income to net cash provided by operating activities		
Depreciation and amortization	<b>308</b>	284
Deferred income taxes	<b>(21)</b>	—
Equity in income of investees, net of dividends	<b>(163)</b>	(132)
Pension contributions under (in excess of) expense, net (Note 4)	<b>25</b>	(44)
Other post retirement benefits payments in excess of expense, net (Note 4)	<b>—</b>	(8)
Stock-based compensation expense	<b>28</b>	23
Loss contingency payments	<b>(65)</b>	—
Translation and hedging activities	<b>(21)</b>	31
Changes in current assets and liabilities		
Accounts and notes receivable	<b>(555)</b>	(488)
Inventories	<b>(475)</b>	(264)
Other current assets	<b>(42)</b>	21
Accounts payable	<b>442</b>	403
Accrued expenses	<b>94</b>	132
Changes in other liabilities and deferred revenue	<b>5</b>	103
Other, net	<b>34</b>	(81)
Net cash provided by operating activities	<b>473</b>	826
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capital expenditures	<b>(186)</b>	(182)
Investments in internal use software	<b>(35)</b>	(40)
Investments in and advances to equity investees	<b>(15)</b>	(64)
Investments in marketable securities—acquisitions (Note 7)	<b>(143)</b>	(69)
Investments in marketable securities—liquidations (Note 7)	<b>116</b>	162
Cash flows from derivatives not designated as hedges	<b>(9)</b>	19
Other, net	<b>36</b>	14
Net cash used in investing activities	<b>(236)</b>	(160)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net borrowings (payments) of commercial paper (Note 9)	<b>504</b>	(78)
Payments on borrowings and capital lease obligations	<b>(33)</b>	(29)
Distributions to noncontrolling interests	<b>(11)</b>	(10)
Dividend payments on common stock	<b>(355)</b>	(343)
Repurchases of common stock	<b>(379)</b>	(120)
Other, net	<b>21</b>	36
Net cash used in financing activities	<b>(253)</b>	(544)
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	<b>(35)</b>	51
Net (decrease) increase in cash and cash equivalents	<b>(51)</b>	173
Cash and cash equivalents at beginning of year	<b>1,369</b>	1,120
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$1,318</b>	\$1,293

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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**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**  
**(Unaudited)**

In millions	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Common Stock Held in Trust	Accumulated Other Comprehensive Loss	Total Cummins Inc Shareholders Equity	Noncontrolling Interests	Total Equity
<b>BALANCE AT DECEMBER 31, 2016</b>	\$ 556	\$ 1,597	\$ 11,040	\$ (4,489 )	\$ (8 )	\$ (1,821 )	\$ 6,875	\$ 299	\$ 7,174
Net income			820				820	26	846
Other comprehensive income (loss), net of tax (Note 13)						206	206	14	220
Issuance of common stock		3					3	—	3
Employee benefits trust activity		12			1		13	—	13
Repurchases of common stock				(120 )			(120 )	—	(120 )
Cash dividends on common stock			(343 )				(343 )	—	(343 )
Distributions to noncontrolling interests							—	(10 )	(10 )
Stock based awards				23			23	—	23
Other shareholder transactions		16					16	—	16
<b>BALANCE AT JULY 2, 2017</b>	\$ 556	\$ 1,628	\$ 11,517	\$ (4,586 )	\$ (7 )	\$ (1,615 )	\$ 7,493	\$ 329	\$ 7,822
<b>BALANCE AT DECEMBER 31, 2017</b>	\$ 556	\$ 1,654	\$ 11,464	\$ (4,905 )	\$ (7 )	\$ (1,503 )	\$ 7,259	\$ 905	\$ 8,164
Impact of adopting accounting standards (Notes 3 and 14)			30				30	—	30
Net income			870				870	9	879
Other comprehensive income (loss), net of tax (Note 13)						(164 )	(164 )	(23 )	(187 )
Issuance of common stock		8					8	—	8
Employee benefits trust activity		8			1		9	—	9
Repurchases of common stock				(379 )			(379 )	—	(379 )
Cash dividends on common stock			(355 )				(355 )	—	(355 )
Distributions to noncontrolling interests							—	(11 )	(11 )
Stock based awards		(4 )		8			4	—	4
Other shareholder transactions		17					17	15	32
<b>BALANCE AT JULY 1, 2018</b>	\$ 556	\$ 1,683	\$ 12,009	\$ (5,276 )	\$ (6 )	\$ (1,667 )	\$ 7,299	\$ 895	\$ 8,194

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”) was founded in 1919 as Cummins Engine Company, a corporation in Columbus, Indiana, and one of the first diesel engine manufacturers. In 2001, we changed our name to Cummins Inc. We are a global power leader that designs, manufactures, distributes and services diesel and natural gas engines and engine-related component products, including filtration, aftertreatment, turbochargers, fuel systems, controls systems, air handling systems, transmissions, electric power generation systems, batteries and electrified power systems. We sell our products to original equipment manufacturers (OEMs), distributors and other customers worldwide. We serve our customers through a network of approximately 500 wholly-owned and independent distributor locations and over 7,500 dealer locations in more than 190 countries and territories.

**NOTE 2. BASIS OF PRESENTATION**

**Interim Condensed Financial Statements**

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 in accordance with accounting principles in the United States of America (GAAP) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) 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.

These interim condensed financial statements should be read in conjunction with the *Consolidated Financial Statements* included in our Annual Report on Form 10-K for the year ended December 31, 2017. Our interim period financial results for the three and six month 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.

**Reclassifications**

Certain amounts for prior year periods have been reclassified to conform to the presentation of the current year.

**Use of Estimates in Preparation of Financial Statements**

Preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts presented and disclosed in our *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 rate and other assumptions for pension and other postretirement benefit costs, income taxes and deferred tax valuation allowances, lease classification and contingencies. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates.

**Reporting Period**

Our reporting period usually ends on the Sunday closest to the last day of the quarterly calendar period. The second quarters of 2018 and 2017 ended on July 1 and July 2, respectively. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.



Table of Contents**Weighted-Average Diluted Shares Outstanding**

The weighted-average diluted common shares outstanding excludes 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 were as follows:

	Three months ended		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
Options excluded	909,394	6,155	458,130	61,345

**NOTE 3. REVENUE RECOGNITION****Revenue Recognition Accounting Pronouncement Adoption**

In May 2014, the Financial Accounting Standards Board (FASB) amended its standards related to revenue recognition to replace all existing revenue recognition guidance and provide a single, comprehensive model for all contracts with customers. The revised standard contains principles to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that we recognize revenue to depict the transfer of goods or services to customers at an amount that we expect to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of the time value of money in the transaction price and allowing estimation of variable consideration to be recognized before contingencies are resolved in certain circumstances. The amendment also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in those judgments as well as assets recognized from costs incurred to fulfill these contracts.

The standard allows either full or modified retrospective adoption effective for annual and interim periods beginning January 1, 2018. We adopted the standard using the modified retrospective approach. We elected to apply this guidance retrospectively only to contracts that were not completed at January 1, 2018.

We identified a change in the manner in which we account for certain license income. We license certain technology to our unconsolidated joint ventures that meets the definition of functional under the standard, which requires that revenue be recognized at a point in time rather than the previous requirement of recognizing it over the license term. Using the modified retrospective adoption method, we recorded an adjustment to our opening equity balance at January 1, 2018, to account for the differences between existing license income recorded and what would have been recorded under the new standard for contracts for which we started recognizing revenue prior to the adoption date. There was not a material impact on any individual year from this change.

We also identified transactions where revenue recognition was historically limited to the amount of billings not contingent on our future performance. With the allocation provisions of the new model, we accelerated the timing of revenue recognition for amounts related to satisfied performance obligations that would be delayed under the historical guidance. The impact of this change was not material.

On an ongoing basis, this amendment is not expected to have a material impact on our *Condensed Consolidated Financial Statements*, including our internal controls over financial reporting, but will result in expanded disclosures in the Notes to our *Condensed Consolidated Financial Statements*.

We recorded a net increase to opening retained earnings of \$28 million, net of tax, as of January 1, 2018, due to the cumulative impact of adopting the new revenue standard, with the impact primarily related to our technology licenses that now qualify for point in time recognition rather than over time. The impact to any individual financial statement line item as a result of applying the new standard, as compared to the old standard, was not material for the six months ended July 1, 2018.

**Revenue Recognition Policies**

***Revenue Recognition Sales of Products***

We sell to customers either through long-term arrangements or standalone purchase orders. Our long-term arrangements generally do not include committed volumes until underlying purchase orders are issued. Our performance obligations vary by contract, but may include diesel and natural gas engines and engine-related component products, including filtration,

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aftertreatment, turbochargers, fuel systems, controls systems, air handling systems, transmissions, electric power generation systems, batteries, parts, maintenance services and extended coverage.

Typically, we recognize revenue on the products we sell at a point in time, generally in accordance with shipping terms, which reflects the transfer of control to the customer. Since control of construction projects transfer to the customer as the work is performed, revenue on these projects is recognized based on the percentage of inputs incurred to date compared to the total expected cost of inputs, which is reflective of the value transferred to the customer. Revenue is recognized under long-term maintenance and other service agreements over the term of the agreement as underlying services are performed based on the percentage of the cost of services provided to date compared to the total expected cost of services to be provided under the contract. Sales of extended coverage are recognized based on the pattern of expected costs over the extended coverage period or, if such a pattern is unknown, on a straight-line basis over the coverage period as the customer is considered to benefit from our stand ready obligation over the coverage period. In all cases, we believe cost incurred is the most representative depiction of the extent of service performed to date on a particular contract.

Our arrangements may include the act of shipping products to our customers after the performance obligation related to that product has been satisfied. We have elected to account for shipping and handling as activities to fulfill the promise to transfer goods and have not allocated revenue to the shipping activity. All related shipping and handling costs are accrued at the time of shipment.

Our sales arrangements may include the collection of sales and other similar taxes that are then remitted to the related taxing authority. We have elected to present the amounts collected for these taxes net of the related tax expense rather than presenting them as additional revenue.

We grant credit limits and terms to customers based upon traditional practices and competitive conditions. Typical terms vary by market, but payments are generally due in 90 days or less from invoicing for most of our product and service sales, while payments on construction and other similar arrangements may be due on an installment basis.

For contracts where the time between cash collection and performance is less than one year, we have elected to use the practical expedient that allows us to ignore the possible existence of a significant financing component within the contract. For contracts where this time period exceeds one year, generally the timing difference is the result of business concerns other than financing. We do have a limited amount of customer financing for which we charge or impute interest, but such amounts are immaterial to our *Condensed Consolidated Statements of Income*.

## ***Sales Incentives***

We provide various sales incentives to both our distribution network and OEM customers. These programs are designed to promote the sale of our products in the channel or encourage the usage of our products by OEM customers. When there is uncertainty surrounding these sales incentives, we may limit the amount of revenue we recognize under a contract until the uncertainty has been resolved. Sales incentives primarily fall into three categories:

- ♣Volume rebates;
- ♣Market share rebates; and
- ♣Aftermarket rebates.

For volume rebates, we provide certain customers with rebate opportunities for attaining specified volumes during a particular quarter or year. We consider the expected amount of these rebates at the time of the original sale as we determine the overall transaction price. We update our assessment of the amount of rebates that will be earned quarterly based on our best estimate of the volume levels the customer will reach during the measurement period. For

market share rebates, we provide certain customers with rebate opportunities based on the percentage of their production that utilizes our product. These rebates are typically measured either quarterly or annually and we assess them at least quarterly to determine our current estimates of amounts expected to be earned. These estimates are considered in the determination of transaction price at the time of the original sale based on the current market shares, with adjustments made as the level changes. For aftermarket rebates, we provide incentives to promote sales to certain dealers and end-markets. These rebates are typically paid on a quarterly, or more frequent basis. At the time of the sales, we consider the expected amount of these rebates when determining the overall transaction price. Estimates are adjusted at the end of each quarter based on the amounts yet to be paid. These estimates are based on historical experience with the particular program.

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### ***Sales Returns***

The initial determination of the transaction price may also be impacted by expected product returns. Rights of return do not exist for the majority of our sales other than for quality issues. We do offer certain return rights in our aftermarket business, where some aftermarket customers are permitted to return small amounts of parts and filters each year, and in our power generation business, which sells portable generators to retail customers. An estimate of future returns is accounted for at the time of sale as a reduction in the overall contract transaction price based on historical return rates.

### ***Multiple Performance Obligations***

Our sales arrangements may include multiple performance obligations. We identify each of the material performance obligations in these arrangements and allocate the total transaction price to each performance obligation based on its relative selling price. In most cases, the individual performance obligations are also sold separately and we use that price as the basis for allocating revenue to the included performance obligations. When an arrangement includes multiple performance obligations and invoicing to the customer does not match the allocated portion of the transaction price, unbilled revenue or deferred revenue is recorded reflecting that difference. Unbilled and deferred revenue are discussed in more detail below.

### ***Long-term Contracts***

Our long-term maintenance agreements often include a variable component of the transaction price. We are generally compensated under such arrangements on a cost per hour of usage basis. We typically can estimate the expected usage over the life of the contract, but reassess the transaction price each quarter and adjust our recognized revenue accordingly. Certain maintenance agreements apply to generators used to provide standby power, which have limited expectations of usage. These agreements may include monthly minimum payments, providing some certainty to the total transaction price. For these particular contracts that relate to standby power, we limit revenue recognized to date to an amount representing the total minimums earned to date under the contract plus any cumulative billings earned in excess of the minimums. We reassess the estimates of progress and transaction price on a quarterly basis. For prime power arrangements, revenue is not subject to such a constraint and is generally equal to the current estimate on a percentage of completion basis times the total expected revenue under the contract.

Most of our contracts are for a period of less than one year. We have certain long-term maintenance agreements, construction contracts and extended warranty coverage arrangements that span a period in excess of one year. The aggregate amount of the transaction price for long-term maintenance agreements and construction contracts allocated to performance obligations that have not been satisfied as of July 1, 2018, was \$676 million. We expect to recognize the related revenue of \$247 million over the next 12 months and \$429 million over periods up to 10 years. See NOTE 10, "PRODUCT WARRANTY LIABILITY," for additional disclosures on extended warranty coverage arrangements. Our other contracts generally are for a duration of less than one year or include payment terms that correspond to the value we are providing our customers.

### ***Deferred and Unbilled Revenue***

The timing of our billing does not always match the timing of our revenue recognition. We record deferred revenue when we are entitled to bill a customer in advance of when we are permitted to recognize revenue. Deferred revenue may arise in construction contracts, where billings may occur in advance of performance or in accordance with specific milestones. Deferred revenue may also occur in long-term maintenance contracts, where billings are often based on usage of the underlying equipment, which generally follows a predictable pattern that often will result in the accumulation of collections in advance of our performance of the related maintenance services. Finally, deferred

revenue exists in our extended coverage contracts, where the cash is collected prior to the commencement of the coverage period. Deferred revenue is included in our *Condensed Consolidated Balance Sheets* as a component of current liabilities for those expected to be recognized in revenue in a period of less than one year and long-term liabilities for those expected to be recognized as revenue in a period beyond one year. Deferred revenue is recognized as revenue as (or when) control of the underlying product, project or service passes to the customer under the related contract.

We recognize unbilled revenue when the revenue has been earned, but not yet billed. Unbilled revenue is included in our *Condensed Consolidated Balance Sheets* as a component of current assets for those expected to be collected in a period of less than one year and long-term assets for those expected to be collected in a period beyond one year. Unbilled revenue relates to our right to consideration for our completed performance under a contract. Unbilled revenue generally arises from contractual provisions that delay a portion of the billings on genset deliveries until commissioning occurs. Unbilled revenue may also occur when billings trail the provision of service in construction and long-term maintenance contracts. We periodically assess our unbilled revenue for impairment.

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The following is a summary of our unbilled and deferred revenue and related activity:

In millions	July 1, 2018	January 1, 2018
Unbilled revenue	\$56	\$ 6
Deferred revenue, primarily extended warranty	1,101	1,052
Revenue recognized <sup>(1)</sup>	(206)	—

<sup>(1)</sup> Relates to year-to-date revenues recognized from amounts included in contract liabilities at the beginning of the period.

Revenue recognized in the period from performance obligations satisfied in previous periods was immaterial.

We did not record any impairment losses on our unbilled revenues during the three and six months ended July 1, 2018.

***Accounts Receivable and Allowance for Doubtful Accounts***

Trade accounts receivable represent amounts billed to customers and not yet collected or amounts that have been earned, but may not be billed until the passage of time, and are recorded when the right to consideration becomes unconditional. Trade accounts receivable are recorded at the invoiced amount, which approximates net realizable value, and generally do not bear interest. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We determine the allowance based on our historical collection experience and by performing an analysis of our accounts receivable in light of the current economic environment. We review our allowance for doubtful accounts on a regular basis. In addition, when necessary, we provide an allowance for the full amount of specific accounts deemed to be uncollectible. Account balances are charged off against the allowance in the period in which we determine that it is probable the receivable will not be recovered. The allowance for doubtful accounts balances for the periods ended July 1, 2018 and December 31, 2017, were \$16 million and \$16 million, respectively, and bad debt write-offs were not material.

***Contract Costs***

We are required to record an asset for the incremental costs of obtaining a contract with a customer and other costs to fulfill a contract not otherwise required to be immediately expensed when we expect to recover those costs. The only material incremental cost we incur is commission expense, which is generally incurred in the same period as the underlying revenue. Costs to fulfill a contract are generally limited to customer-specific engineering expenses that do not meet the definition of research and development expenses. As a practical expedient, we have elected to recognize these costs of obtaining a contract as an expense when the related contract period is less than one year. When the period exceeds one year, this asset is amortized over the life of the contract. We did not have any material capitalized balances at July 1, 2018.

***Extended Warranty***

In addition, we sell extended warranty coverage on most of our engines and on certain components. We consider a warranty to be extended coverage in any of the following situations:

- When a warranty is sold separately or is optional (extended coverage contracts, for example) or
- When a warranty provides additional services.

The consideration collected is initially deferred and is recognized as revenue in proportion to the costs expected to be incurred in performing services over the contract period. We compare the remaining deferred revenue balance quarterly to the estimated amount of future claims under extended warranty programs and provide an additional accrual when the deferred revenue balance is less than expected future costs.

**Disaggregation of Revenue**

***Consolidated Revenue***

The table below presents our consolidated sales by geographic area. Net sales attributed to geographic areas were based on the location of the customer.

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In millions	Three months ended July 1, 2018	Six months ended July 1, 2018
United States	\$ 3,384	\$6,422
China	644	1,194
India	247	482
Other International	1,857	3,604
Total net sales	\$ 6,132	\$11,702

***Segment Revenue***

Engine segment external sales by market were as follows:

In millions	Three months ended July 1, 2018	Six months ended July 1, 2018
Heavy-duty truck	\$ 730	\$1,344
Medium-duty truck and bus	714	1,341
Light-duty automotive	330	653
Total on-highway	1,774	3,338
Off-highway	276	525
Total sales	\$ 2,050	\$3,863

Distribution segment external sales by region were as follows:

In millions	Three months ended July 1, 2018	Six months ended July 1, 2018
North America	\$ 1,349	\$2,623
Asia Pacific	211	398
Europe	143	274
China	84	161
Africa and Middle East	62	123
India	49	93
Latin America	45	83
Russia	45	80
Total sales	\$ 1,988	\$3,835

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Distribution segment external sales by product line were as follows:

	Three months ended	Six months ended
In millions	July 1, 2018	July 1, 2018
Parts	\$ 815	\$ 1,618
Engines	460	828
Service	368	719
Power generation	345	670
Total sales	\$ 1,988	\$ 3,835

Components segment external sales by business were as follows:

	Three months ended	Six months ended
In millions	July 1, 2018	July 1, 2018
Emission solutions	\$ 735	\$ 1,419
Turbo technologies	201	398
Filtration	257	514
Automated transmissions	141	258
Electronics and fuel systems	68	126
Total sales	\$ 1,402	\$ 2,715

Power Systems segment external sales by product line were as follows:

	Three months ended	Six months ended
In millions	July 1, 2018	July 1, 2018
Power generation	\$ 390	\$ 700
Industrial	208	409
Generator technologies	93	177
Total sales	\$ 691	\$ 1,286

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		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
Defined benefit pension plans				
Voluntary contribution	\$ 4	\$ 41	\$ 7	\$ 84
Mandatory contribution	5	—	11	—
Defined benefit pension contributions	\$ 9	\$ 41	\$ 18	\$ 84
Other postretirement benefit plans				
Benefit payments (rebates), net	\$ (2 )	\$ 3	\$ 5	\$ 18
Defined contribution pension plans	\$ 21	\$ 19	\$ 61	\$ 48

We anticipate making additional defined benefit pension contributions during the remainder of 2018 of \$20 million for our U.S. and U.K. pension plans. Approximately \$14 million of the estimated \$38 million of pension contributions for the full year are voluntary. These contributions may be made from trusts or company funds either to increase pension assets or to make direct benefit payments to plan participants. We expect our 2018 net periodic pension cost to approximate \$86 million.

On January 1, 2018, we adopted the new accounting standard related to the presentation of pension and other postretirement benefit costs. See NOTE 15, "RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS," for detailed information about the adoption of this standard.

The components of net periodic pension and other postretirement benefit costs under our plans were as follows:

	Pension						
	U.S. Plans		U.K. Plans		Other Postretirement Benefits		
	Three months ended						
In millions	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017	July 1, 2018		July 2, 2017
Service cost	\$30	\$26	\$7	\$7	\$	—	\$ —
Interest cost	24	27	10	10	3		4
Expected return on plan assets	(49 )	(52 )	(18)	(17 )	—		—
Recognized net actuarial loss	9	9	8	10	—		1
Net periodic benefit cost	\$14	\$10	\$7	\$10	\$	3	\$ 5
	Pension						
	U.S. Plans		U.K. Plans		Other Postretirement Benefits		
	Six months ended						
In millions	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017	July 1, 2018		July 2, 2017
Service cost	\$60	\$53	\$15	\$13	\$	—	\$ —
Interest cost	49	53	21	20	5		7
Expected return on plan assets	(98 )	(103)	(36 )	(34 )	—		—
Recognized net actuarial loss	17	18	15	20	—		3
Net periodic benefit cost	\$28	\$21	\$15	\$19	\$	5	\$ 10



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 reporting periods was as follows:

In millions	Three months ended		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
<b>Manufacturing entities</b>				
Beijing Foton Cummins Engine Co., Ltd.	\$ 24	\$ 22	\$45	\$55
Dongfeng Cummins Engine Company, Ltd.	17	19	34	41
Chongqing Cummins Engine Company, Ltd.	15	10	32	19
Cummins Westport, Inc.	6	4	12	5
Dongfeng Cummins Emission Solutions Co., Ltd.	4	4	9	7
All other manufacturers	24	19	49	39
<b>Distribution entities</b>				
Komatsu Cummins Chile, Ltda.	6	8	13	15
Cummins share of net income	96	86	194	181
<b>Royalty and interest income</b>	14	12	31	25
Equity, royalty and interest income from investees	\$ 110	\$ 98	\$225	\$206

**NOTE 6. INCOME TAXES**

Our effective tax rate for the year is expected to approximate 23.0 percent, excluding any discrete tax items that may arise.

Our effective tax rates for the three and six months ended July 1, 2018, were 22.5 percent and 29.0 percent, respectively. The three months ended July 1, 2018, contained only immaterial discrete items. The six months ended July 1, 2018, contained \$74 million, or \$0.45 per share, of unfavorable net discrete tax items, primarily due to \$80 million of discrete items related to the 2017 Tax Cuts and Jobs Act (Tax Legislation). This includes \$45 million associated with changes related to the Tax Legislation measurement period adjustment, detailed below, and \$35 million associated with the one-time recognition of deferred tax charges at historical tax rates on intercompany profit in inventory.

Our effective tax rates for the three and six months ended July 2, 2017, were 26.4 percent and 26.2 percent, respectively and contained only immaterial discrete tax items.

The SEC issued guidance which addressed the uncertainty in the application of GAAP to the Tax Legislation where certain income tax effects could not be finalized at December 31, 2017. This guidance allows entities to record provisional amounts based on current estimates that are updated on a quarterly basis. As a result, our accounting for the effects of the Tax Legislation is not considered complete at this time. The final transition impacts of the Tax Legislation may differ from our estimates, possibly materially, due to, among other things, changes in interpretations of the Tax Legislation, any legislative action to address questions that arise because of the Tax Legislation, any changes in accounting standards for income taxes or related interpretations in response to the Tax Legislation, or any updates or changes to estimates we have utilized to calculate the transition impacts. The SEC requires final calculations to be completed within the one-year measurement period ending December 22, 2018, and reflect any additional guidance issued throughout the year. Any adjustments of provisional amounts will be reported in the period in which the estimates change. We have made provisional estimates of the effects of the Tax Legislation in three primary areas: (1) the one-time transition tax; (2) the withholding tax accrued on those earnings no longer considered permanently reinvested at December 31, 2017 and (3) our existing deferred tax balances. The Internal Revenue Service (IRS) continues to issue guidance, which required adjustment of the one-time transition tax as shown in the table below.

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The changes during the one-year measurement period for the six months ended July 1, 2018, for each group consisted of the following:

In millions	Tax Valuation Adjustments as of July 1, 2018
One-time transition tax	\$ 40
Withholding tax accrued	5
Net impact of measurement period changes	\$ 45

**NOTE 7. MARKETABLE SECURITIES**

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

In millions	July 1, 2018			December 31, 2017		
	Cost	Gross unrealized gains/(losses) <sup>(1)</sup>	Estimated fair value	Cost	Gross unrealized gains/(losses) <sup>(1)</sup>	Estimated fair value
Equity securities						
Debt mutual funds	\$163	\$ —	\$ 163	\$170	\$ —	\$ 170
Certificates of deposit	34	—	34	12	—	12
Equity mutual funds	14	2	16	12	3	15
Available-for-sale debt securities	1	—	1	1	—	1
Total marketable securities	\$212	\$ 2	\$ 214	\$195	\$ 3	\$ 198

(1) Unrealized gains and losses for available-for-sale debt securities are recorded in other comprehensive income (See NOTE 13, "ACCUMULATED OTHER COMPREHENSIVE LOSS," to our *Condensed Consolidated Financial Statements* for more information). Effective January 1, 2018, with the adoption of the FASB standard, all unrealized gains and losses for equity securities are recorded in other income, net in the *Condensed Consolidated Statements of Income*. See NOTE 15, "RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS," for detailed information about the adoption of this standard.

All marketable securities are classified as Level 2 securities. The fair value of Level 2 securities is estimated using actively quoted prices for similar instruments from brokers and observable inputs where available, including market transactions and third-party pricing services, or net asset values provided to investors. We do not currently have any Level 3 securities and there were no transfers between Level 2 or 3 during the first half of 2018 and for the year ended December 31, 2017.

A description of the valuation techniques and inputs used for our Level 2 fair value measures is as follows:

*Debt mutual funds*— The fair value measure for the vast majority of 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.

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

*Equity mutual funds*— The fair value measure for these investments is the net asset value published by the issuing brokerage. Daily quoted prices are available from reputable third party pricing services and are used on a test basis to corroborate this Level 2 input measure.

*Available-for-sale debt securities*— The fair value measure for these securities is 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.



The proceeds from sales and maturities of marketable securities were as follows:

In millions	Three months ended		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
Proceeds from sales of marketable securities	\$12	\$12	\$81	\$44
Proceeds from maturities of marketable securities	22	3	35	118
Investments in marketable securities - liquidations	\$34	\$15	\$116	\$162

## NOTE 8. INVENTORIES

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

In millions	July 1, 2018	December 31, 2017
Finished products	\$2,329	\$2,078
Work-in-process and raw materials	1,355	1,216
Inventories at FIFO cost	3,684	3,294
Excess of FIFO over LIFO	(125)	(128)
Total inventories	\$3,559	\$3,166

## NOTE 9. DEBT

### Loans Payable and Commercial Paper

Loans payable, commercial paper and the related weighted-average interest rates were as follows:

In millions	July 1, 2018	December 31, 2017
Loans payable <sup>(1)</sup>	\$55	\$57
Commercial paper <sup>(2)</sup>	802	298

<sup>(1)</sup> Loans payable consist primarily of notes payable to various domestic and international financial institutions. It is not practicable to aggregate these notes and calculate a quarterly weighted-average interest rate.

<sup>(2)</sup> The weighted average interest rate, inclusive of all brokerage fees, was 2.08 percent and 1.56 percent at July 1, 2018 and December 31, 2017, respectively.

We can issue up to \$2.75 billion of unsecured, short-term promissory notes ("commercial paper") pursuant to our board authorized commercial paper programs. The programs facilitate the private placement of unsecured short-term debt through third party brokers. We intend to use the net proceeds from the commercial paper borrowings for general corporate purposes.

### Revolving Credit Facilities

We have access to committed credit facilities that total \$2.75 billion, including a \$1.0 billion, 364-day facility that expires September 14, 2018 and a \$1.75 billion, 5-year facility that expires on November 13, 2020. We intend to maintain credit facilities of a similar aggregate amount by renewing or replacing these facilities before expiration. Revolving credit facilities are maintained primarily to provide backup liquidity for our commercial paper borrowings, letters of credit and general corporate purposes.



Table of Contents**Long-term Debt**

A summary of long-term debt was as follows:

In millions	July 1, 2018	December 31, 2017
Long-term debt		
Senior notes, 3.65%, due 2023	<b>\$500</b>	\$ 500
Debentures, 6.75%, due 2027	<b>58</b>	58
Debentures, 7.125%, due 2028	<b>250</b>	250
Senior notes, 4.875%, due 2043	<b>500</b>	500
Debentures, 5.65%, due 2098 (effective interest rate 7.48%)	<b>165</b>	165
Other debt	<b>55</b>	76
Unamortized discount	<b>(53)</b>	(54)
Fair value adjustments due to hedge on indebtedness	<b>18</b>	35
Capital leases	<b>112</b>	121
Total long-term debt	<b>1,605</b>	1,651
Less: Current maturities of long-term debt	<b>49</b>	63
Long-term debt	<b>\$1,556</b>	\$ 1,588

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

In millions	2018	2019	2020	2021	2022
Principal payments	\$30	\$50	\$12	\$8	\$8

**Fair Value of Debt**

Based on borrowing rates currently available to us for bank loans with similar terms and average maturities, considering our risk premium, the fair values and carrying values of total debt, including current maturities, were as follows:

In millions	July 1, 2018	December 31, 2017
Fair value of total debt <sup>(1)</sup>	<b>\$2,668</b>	\$ 2,301
Carrying values of total debt	<b>2,462</b>	2,006

<sup>(1)</sup> The fair value of debt is derived from Level 2 inputs.

Table of Contents**NOTE 10. PRODUCT WARRANTY LIABILITY**

A tabular reconciliation of the product warranty liability, including the deferred revenue related to our extended warranty coverage and accrued recall programs was as follows:

In millions	July 1, 2018	July 2, 2017
Balance, beginning of year	<b>\$1,687</b>	\$1,414
Provision for warranties issued	<b>222</b>	182
Deferred revenue on extended warranty contracts sold	<b>139</b>	101
Campaigns <sup>(1)</sup>	<b>403</b>	57
Payments	<b>(212)</b>	(199)
Amortization of deferred revenue on extended warranty contracts	<b>(118)</b>	(109)
Changes in estimates for pre-existing warranties	<b>10</b>	74
Foreign currency translation	<b>(6)</b>	1
Other	<b>5</b>	—
Balance, end of period	<b>\$2,130</b>	\$1,521

<sup>(1)</sup> See NOTE 12, "COMMITMENTS AND CONTINGENCIES," for additional information on campaigns.

Warranty related deferred revenues and the long-term portion of the warranty liabilities on our *Condensed Consolidated Balance Sheets* were as follows:

In millions	July 1, 2018	December 31, 2017	Balance Sheet Location
Deferred revenue related to extended coverage programs			
Current portion	<b>\$228</b>	\$ 231	Current portion of deferred revenue
Long-term portion	<b>558</b>	536	Other liabilities and deferred revenue
Total	<b>\$786</b>	\$ 767	
Long-term portion of warranty liability	<b>\$880</b>	\$ 466	Other liabilities and deferred revenue

**NOTE 11. OTHER ACCRUED EXPENSES AND OTHER LIABILITIES AND DEFERRED REVENUE**

Other accrued expenses included the following:

In millions	July 1, 2018	December 31, 2017
Other taxes payable	<b>\$178</b>	\$ 197
Marketing accruals	<b>169</b>	146
Income taxes payable	<b>102</b>	77
Other	<b>357</b>	495
Other accrued expenses	<b>\$806</b>	\$ 915

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Other liabilities and deferred revenue included the following:

In millions	July 1, 2018	December 31, 2017
Accrued warranty	<b>\$880</b>	\$ 466
Deferred revenue	<b>622</b>	604
Deferred income taxes	<b>400</b>	391
Income taxes payable <sup>(1)</sup>	<b>252</b>	281
Accrued compensation	<b>152</b>	151
Other long-term liabilities	<b>135</b>	134
Other liabilities and deferred revenue	<b>\$2,441</b>	\$ 2,027

<sup>(1)</sup> Long-term income taxes payable are the result of the 2017 Tax Legislation and relate to the non-current portion of the one-time transition tax on accumulated foreign earnings.

**NOTE 12. 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; product recalls; 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 pursuant to GAAP 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.

**Engine System Campaign Accrual**

During 2017, the California Air Resources Board (CARB) and the U.S. Environmental Protection Agency (EPA) selected certain of our pre-2013 model year engine systems for additional emissions testing. Some of these engine systems failed CARB and EPA tests as a result of degradation of an aftertreatment component. We recorded charges of \$36 million to cost of sales in our *Consolidated Statements of Income* during 2017 for the then expected cost of field campaigns to repair some of these engine systems. We concluded based upon additional emission testing performed, and further discussions with the EPA and CARB in the first quarter of 2018, that the field campaigns should be expanded to include a larger population of our engine systems that are subject to the aftertreatment component degradation, including our model years 2010 through 2015. As a result, we recorded an additional charge of \$187 million, or \$0.87 per share, to cost of sales in our *Condensed Consolidated Statements of Income* (\$94 million recorded in the Components segment and \$93 million in the Engine segment) in the first quarter of 2018.

In the second quarter of 2018, we reached agreement with the CARB and EPA regarding our plans to address the affected populations. In finalizing our plans, we have increased the number of systems to be addressed through hardware replacement compared to our assumptions last quarter. As a result of this agreement and considering that the hardware replacement solution is a higher cost approach than that previously assumed on some of the engine systems,

we recorded an additional charge of \$181 million, or \$0.85 per share, to cost of sales in our *Condensed Consolidated Statements of Income* (\$91 million recorded in the Engine segment and \$90 million in the Components segment) in the second quarter of 2018. With the additional charge in the second quarter of 2018, the total accrual related to this matter is \$404 million, which represents our best estimate of the cost to execute the campaigns. The campaigns will launch in phases across the affected population and are expected to begin in the third quarter of 2018 with a projection to be substantially completed by December 31, 2020.

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**Guarantees and Commitments**

Periodically, we enter into guarantee arrangements, including guarantees of non-U.S. distributor financings, residual value guarantees on equipment under operating leases and other miscellaneous guarantees of joint ventures or third-party obligations. At July 1, 2018, the maximum potential loss related to these guarantees was \$56 million. We have arrangements with certain suppliers that require us to purchase minimum volumes or be subject to monetary penalties. At July 1, 2018, if we were to stop purchasing from each of these suppliers, the aggregate amount of the penalty would be approximately \$82 million. Most of these arrangements enable us to secure critical components. We do not currently anticipate paying any penalties under these contracts.

We enter into physical forward contracts with suppliers of platinum, palladium and copper to purchase minimum volumes of the commodities at contractually stated prices for various periods, not to exceed two years. At July 1, 2018, the total commitments under these contracts were \$62 million. These arrangements enable us to fix the prices of these commodities, which otherwise are subject to market volatility.

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 \$110 million at July 1, 2018.

**Indemnifications**

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

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Following are the changes in accumulated other comprehensive income (loss) by component for the three months ended:

In millions	Three months ended						
	Change in other pensions and postretirement defined benefit plans	Foreign currency translation adjustment	Unrealized gain (loss) on marketable securities	Unrealized gain (loss) on derivatives	Total attributable to Cummins Inc.	Noncontrolling interests	Total
Balance at April 2, 2017	\$(664 )	\$(1,060 )	\$ (1 )	\$ (7 )	\$(1,732 )		
Other comprehensive income before reclassifications							
Before tax amount	—	105	1	(2 )	104	\$ 1	\$ 105
Tax benefit (expense)	—	(4 )	(1 )	1	(4 )	—	(4 )
After tax amount	—	101	—	(1 )	100	1	101
Amounts reclassified from accumulated other comprehensive loss <sup>(1)</sup>	15	—	1	1	17	—	17
Net current period other comprehensive income (loss)	15	101	1	—	117	\$ 1	\$ 118
Balance at July 2, 2017	\$(649 )	\$(959 )	\$ —	\$ (7 )	\$(1,615 )		
Balance at April 1, 2018	\$(681 )	\$(720 )	\$ —	\$ 4	\$(1,397 )		
Other comprehensive income before reclassifications							
Before tax amount	—	(328 )	—	4	(324 )	\$ (17 )	\$(341 )
Tax benefit (expense)	—	45	—	(2 )	43	—	43
After tax amount	—	(283 )	—	2	(281 )	(17 )	(298 )
Amounts reclassified from accumulated other comprehensive loss <sup>(1)</sup>	13	—	—	(2 )	11	1	12
Net current period other comprehensive income (loss)	13	(283 )	—	—	(270 )	\$ (16 )	\$(286 )
Balance at July 1, 2018	\$(668 )	\$(1,003 )	\$ —	\$ 4	\$(1,667 )		

<sup>(1)</sup> Amounts are net of tax. Reclassifications out of accumulated other comprehensive income (loss) and the related tax effects are immaterial for separate disclosure.

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Following are the changes in accumulated other comprehensive income (loss) by component for the six months ended:

In millions	Six months ended						Noncontrolling interests	Total
	Change in pensions and other postretirement defined benefit plans	Foreign currency translation adjustment	Unrealized gain (loss) on marketable securities <sup>(1)</sup>	Unrealized gain (loss) on derivatives	Unrealized gain (loss) on available-for-sale securities	Total attributable to Cummins Inc.		
Balance at December 31, 2016	\$(685 )	\$(1,127 )	\$ (1 )	\$ (8 )	\$ (1,821 )			
Other comprehensive income before reclassifications								
Before tax amount	8	180	2	(8 )	182	\$ 14		\$ 196
Tax benefit (expense)	(3 )	(12 )	(1 )	3	(13 )	—		(13 )
After tax amount	5	168	1	(5 )	169	14		183
Amounts reclassified from accumulated other comprehensive loss <sup>(2)</sup>	31	—	—	6	37	—		37
Net current period other comprehensive income (loss)	36	168	1	1	206	\$ 14		\$ 220
Balance at July 2, 2017	\$(649 )	\$(959 )	\$ —	\$ (7 )	\$(1,615 )			
Balance at December 31, 2017	\$(689 )	\$(812 )	\$ 1	\$ (3 )	\$(1,503 )			
Other comprehensive income before reclassifications								
Before tax amount	(8 )	(203 )	—	15	(196 )	\$ (24 )		\$(220 )
Tax benefit (expense)	2	12	—	(6 )	8	—		8
After tax amount	(6 )	(191 )	—	9	(188 )	(24 )		(212 )
Amounts reclassified from accumulated other comprehensive loss <sup>(2)</sup>	27	—	(1 )	(2 )	24	1		25
Net current period other comprehensive income (loss)	21	(191 )	(1 )	7	(164 )	\$ (23 )		\$(187 )
Balance at July 1, 2018	\$(668 )	\$(1,003 )	\$ —	\$ 4	\$(1,667 )			

<sup>(1)</sup> We adopted the new accounting pronouncement "Accounting for Certain Financial Instruments" on January 1, 2018, which moved the treatment of unrealized gains and losses for non-debt securities directly to the

*Condensed Consolidated Statements of Income* on a prospective basis. The impact of adopting this standard includes a one-time cumulative effect adjustment to opening retained earnings of \$2 million. See NOTE 15, "RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS," to our *Condensed Consolidated Financial Statements* for more information.

<sup>(2)</sup> Amounts are net of tax. Reclassifications out of accumulated other comprehensive income (loss) and the related tax effects are immaterial for separate disclosure.

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**NOTE 14. 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 (CODM), or decision-making group, in deciding how to allocate resources and in assessing performance. Our CODM is the President and Chief Operating Officer.

Our reportable operating segments consist of Engine, Distribution, Components, Power Systems and Electrified Power. This reporting structure is organized according to the products and markets each segment serves. The Engine segment produces engines (15 liters and less in size) and associated parts for sale to customers in on-highway and various off-highway markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as in various industrial applications, including construction, agriculture, power generation systems and other off-highway applications. 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. The Components segment sells filtration products, aftertreatment systems, turbochargers, fuel systems and transmissions. The Power Systems segment is an integrated power provider, which designs, manufactures and sells engines (16 liters and larger) for industrial applications (including mining, oil and gas, marine and rail), standby and prime power generator sets, alternators and other power components. We formed the Electrified Power segment, effective January 1, 2018, which will provide fully electric and hybrid powertrain solutions along with innovative components and subsystems to serve all our markets as they adopt electrification, meeting the needs of our OEM partners and end customers.

Our Electrified Power segment will design, manufacture, sell and support electrified power systems ranging from fully electric to hybrid. We are currently developing the Cummins Electric Power Battery and the Cummins Hybrid Plug-In systems for urban bus, which are expected to launch in 2019 and 2020, respectively. We also design and manufacture battery modules, packs and systems for commercial, industrial and material handling applications. We use a range of cell chemistries which are suitable for pure electric, hybrid and plug-in hybrid applications. In addition to electrified powertrains for urban bus, we intend to deliver product offerings to future markets, including pick-up and delivery applications and other markets as they adopt electric solutions. We invest in and utilize our internal research and development capabilities, along with strategic acquisitions and partnerships to meet our objectives.

Effective January 1, 2018, we changed our measure to EBITDA (defined as earnings before interest expense, income taxes, noncontrolling interests, depreciation and amortization) as the primary basis for the CODM to evaluate the performance of each of our reportable operating segments. EBITDA assists investors and debt holders in comparing our performance on a consistent basis without regard for depreciation and amortization, which can vary significantly depending upon many factors. Prior periods have been revised to reflect the current presentation. Segment amounts exclude certain expenses not specifically identifiable to segments.

The accounting policies of our operating segments are the same as those applied in our *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 allocate 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, finance and supply chain management. We do not allocate changes in cash surrender value of corporate owned life insurance to individual segments. EBITDA 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 months ended is shown in the table below:

In millions	Engine	Distribution	Components	Power Systems	Electrified Power	Total Segment	Intersegment Eliminations <sup>(1)</sup>	Total
<b>Three months ended July 1, 2018</b>								
External sales	\$ 2,050	\$ 1,988	\$ 1,402	\$ 691	\$ 1	\$ 6,132	\$ —	\$ 6,132
Intersegment sales	646	6	485	555	—	1,692	(1,692 )	—
Total sales	2,696	1,994	1,887	1,246	1	7,824	(1,692 )	6,132
Research, development and engineering expenses	76	5	62	60	16	219	—	219
Equity, royalty and interest income from investees	67	11	14	18	—	110	—	110
Interest income	3	3	2	2	—	10	—	10
Segment EBITDA	362	145	237	186	(21 )	909	(12 )	897
Depreciation and amortization <sup>(2)</sup>	47	27	47	32	1	154	—	154
<b>Three months ended July 2, 2017</b>								
External sales	\$ 1,711	\$ 1,716	\$ 1,064	\$ 587	\$ —	\$ 5,078	\$ —	\$ 5,078
Intersegment sales	596	6	390	430	—	1,422	(1,422 )	—
Total sales	2,307	1,722	1,454	1,017	—	6,500	(1,422 )	5,078
Research, development and engineering expenses	63	4	58	50	—	175	—	175
Equity, royalty and interest income from investees	56	13	15	14	—	98	—	98
Interest income	2	1	1	1	—	5	—	5
Segment EBITDA	323	127	228	90	—	768	(4 )	764
Depreciation and amortization <sup>(2)</sup>	46	31	38	29	—	144	—	144

<sup>(1)</sup> Includes intersegment sales, intersegment profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the three months ended July 1, 2018 and July 2, 2017.

<sup>(2)</sup> Depreciation and amortization, as shown on a segment basis, excludes the amortization of debt discount and deferred costs included in the *Condensed Consolidated Statements of Income* as interest expense. A portion of depreciation expense is included in "Research, development and engineering expenses" above.

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Summarized financial information regarding our reportable operating segments for the six months ended is shown in the table below:

In millions	Engine	Distribution	Components	Power Systems	Electrified Power	Total Segment	Intersegment Eliminations <sup>(1)</sup>	Total
<b>Six months ended July 1, 2018</b>								
External sales	\$ 3,863	\$ 3,835	\$ 2,715	\$ 1,286	\$ 3	\$ 11,702	\$ —	\$ 11,702
Intersegment sales	1,279	12	925	1,034	—	3,250	(3,250 )	—
Total sales	5,142	3,847	3,640	2,320	3	14,952	(3,250 )	11,702
Research, development and engineering expenses	155	10	124	117	23	429	—	429
Equity, royalty and interest income from investees	134	24	30	37	—	225	—	225
Interest income	5	5	3	4	—	17	—	17
Segment EBITDA	648	268	464	328	(31 )	1,677	(80 )	1,597
Depreciation and amortization <sup>(2)</sup>	96	54	93	62	2	307	—	307
<b>Six months ended July 2, 2017</b>								
External sales	\$ 3,168	\$ 3,353	\$ 2,044	\$ 1,102	\$ —	\$ 9,667	\$ —	\$ 9,667
Intersegment sales	1,162	14	754	797	—	2,727	(2,727 )	—
Total sales	4,330	3,367	2,798	1,899	—	12,394	(2,727 )	9,667
Research, development and engineering expenses	117	8	108	100	—	333	—	333
Equity, royalty and interest income from investees	128	24	28	26	—	206	—	206
Interest income	3	2	1	1	—	7	—	7
Segment EBITDA	596	257	444	175	—	1,472	(3 )	1,469
Depreciation and amortization <sup>(2)</sup>	90	61	75	57	—	283	—	283

<sup>(1)</sup> Includes intersegment sales, intersegment profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the six months ended July 1, 2018 and July 2, 2017.

<sup>(2)</sup> Depreciation and amortization, as shown on a segment basis, excludes the amortization of debt discount and deferred costs included in the *Condensed Consolidated Statements of Income* as interest expense. The amortization of debt discount and deferred costs was \$1 million and \$1 million for the six month periods ended July 1, 2018 and July 2, 2017, respectively. A portion of depreciation expense is included in "Research, development and engineering expenses" above.

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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		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
Total EBITDA	\$ 897	\$ 764	\$1,597	\$1,469
Less:				
Depreciation and amortization	154	144	307	283
Interest expense	28	21	52	39
Income before income taxes	\$ 715	\$ 599	\$1,238	\$1,147

**NOTE 15. RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS****Accounting Pronouncements Recently Adopted**

On January 1, 2018, we adopted the new revenue recognition standard in accordance with GAAP. See NOTE 3, "REVENUE RECOGNITION," for detailed information about the adoption of this standard.

In March 2017, the FASB amended its standards related to the presentation of pension and other postretirement benefit costs in the financial statements beginning January 1, 2018. Under the new standard, we are required to separate service costs from all other elements of pension costs and reflect the other elements of pension costs outside of operating income in our *Condensed Consolidated Statements of Income*. In addition, the standard limits the amount eligible for capitalization (into inventory or self-constructed assets) to the amount of service cost. This portion of the standard was applied on a prospective basis. The remainder of the new standard was applied on a retrospective basis using a practical expedient as the estimation basis for the reclassification of prior period non-service cost components of net periodic benefit cost from operating income to non-operating income. As a result, we revised our *Condensed Consolidated Statements of Income* by the following amounts:

In millions	Favorable / (Unfavorable)	
	2017	
	Q1	Q2
Cost of sales	\$ 4	\$ 2
Selling, general and administrative expenses	(10 )	(10 )
Research, development and engineering expenses	—	(1 )
<b>Total change in operating income</b>	(6 )	(9 )
Other non operating income, net	6	9
<b>Total change in income before income taxes</b>	\$ —	\$ —

In August 2016, the FASB amended its standards related to the classification of certain cash receipts and cash payments which became effective for us beginning January 1, 2018. The new standard made eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. Adoption of this standard did not have a material impact on our *Condensed Consolidated Financial Statements*.

In January 2016, the FASB amended its standards related to the accounting for certain financial instruments which became effective for us beginning January 1, 2018. This amendment addresses certain aspects of recognition, measurement, presentation and disclosure. The standard resulted in a cumulative effect increase to opening retained earnings of \$2 million in our *Condensed Consolidated Financial Statements*.

**Accounting Pronouncements Issued But Not Yet Effective**

In August 2017, the FASB amended its standards related to accounting for derivatives and hedging. These amendments allow the initial hedge effectiveness assessment to be performed by the end of the first quarter in which the hedge is designated rather than concurrently with entering into the hedge transaction. The changes also expand the use of a periodic qualitative hedge effectiveness assessment in lieu of an ongoing quantitative assessment performed throughout the life of the hedge. The revision removes the requirement to record ineffectiveness on cash flow hedges

through the income statement when a hedge i

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s considered highly effective, instead deferring all related hedge gains and losses in other comprehensive income until the hedged item impacts earnings. The modifications permit hedging the contractually-specified price of a component of a commodity purchase and revises certain disclosure requirements. The amendments are effective January 1, 2019 and early adoption is permitted in any interim period or fiscal year prior to the effective date. The revised standard is required to be adopted on a modified retrospective basis for any cash flow or net investment hedge relationships that exist on the date of adoption and prospectively for disclosures. We do not expect the amendments to have a material effect on our *Consolidated Financial Statements* and are still evaluating early adoption.

In June 2016, the FASB amended its standards related to accounting for credit losses on financial instruments. This amendment introduces new guidance for accounting for credit losses on instruments including trade receivables and held-to-maturity debt securities. The new rules are effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We do not expect adoption of this standard to have a material impact on our *Consolidated Financial Statements*.

In February 2016, the FASB amended its standards related to the accounting for leases. Under the new standard, lessees will now be required to recognize substantially all leases on the balance sheet as both a right-of-use asset and a liability. The standard will continue to have two types of leases for income statement recognition purposes: operating leases and finance leases. Operating leases will result in the recognition of a single lease expense on a straight-line basis over the lease term similar to the treatment for operating leases under today's standards. Finance leases will result in an accelerated expense similar to the accounting for capital leases under today's standards. The determination of a lease classification as operating or finance will occur in a manner similar to today's standard. The new standard also contains amended guidance regarding the identification of embedded leases in service contracts and the identification of lease and non-lease components of an arrangement. The new standard is effective on January 1, 2019, with early adoption permitted. The standard currently requires adoption on a full retrospective basis; however, the FASB has recently approved an amendment to allow adoption on a modified retrospective basis. While the amendment is not yet published, we would expect to adopt on a modified retrospective basis assuming the amendment is published as approved. We are still evaluating the impact the standard could have on our *Consolidated Financial Statements*, including our internal controls over financial reporting. While we have not yet quantified the amount, we do expect the standard will have a material impact on our *Consolidated Balance Sheets* due to the recognition of additional assets and liabilities for operating leases.

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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:

- a sustained slowdown or significant downturn in our markets;
- changes in the engine outsourcing practices of significant customers;
- the development of new technologies that reduce demand for our current products and services;
- any significant additional problems in our engine platforms or aftertreatment systems;
- product recalls;
- lower than expected acceptance of new or existing products or services;
- a slowdown in infrastructure development and/or depressed commodity prices;
- unpredictability in the adoption, implementation and enforcement of emission standards around the world;
- the actions of, and income from, joint ventures and other investees that we do not directly control;
- changes in taxation;
- exposure to potential security breaches or other disruptions to our information technology systems and data security;
- a major customer experiencing financial distress;
- our plan to reposition our portfolio of product offerings through exploring strategic acquisitions and divestitures and related uncertainties of entering such transactions;
- supply shortages and supplier financial risk, particularly from any of our single-sourced suppliers;
- competitor activity;
- increasing competition, including increased global competition among our customers in emerging markets;
- policy changes in international trade;
- foreign currency exchange rate changes;
- variability in material and commodity costs;
- failure to realize expected results from our investment in Eaton Cummins Automated Transmission Technologies joint venture;
- political, economic and other risks from operations in numerous countries;
- global legal and ethical compliance costs and risks;
- aligning our capacity and production with our demand;
- product liability claims;
- increasingly stringent environmental laws and regulations;
- future bans or limitations on the use of diesel-powered vehicles;

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the price and availability of energy;  
the performance of our pension plan assets and volatility of discount rates;  
labor relations;  
changes in accounting standards;  
our sales mix of products;  
protection and validity of our patent and other intellectual property rights;  
technological implementation and cost/financial risks in our increasing use of large, multi-year contracts;  
• 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 2017 Form 10-K, Part I, Item 1A 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 Management's Discussion and Analysis of Financial Condition and Results of Operations section of our 2017 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 and engine-related component products, including filtration, aftertreatment, turbochargers, fuel systems, controls systems, air handling systems, transmissions, electric power generation systems, batteries and electrified power systems. 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, Daimler Trucks North America, Navistar International Corporation and Fiat Chrysler Automobiles (Chrysler). We serve our customers through a network of approximately 500 wholly-owned and independent distributor locations and over 7,500 dealer locations in more than 190 countries and territories.

Our reportable operating segments consist of Engine, Distribution, Components, Power Systems and Electrified Power. This reporting structure is organized according to the products and markets each segment serves. The Engine segment produces engines (15 liters and less in size) and associated parts for sale to customers in on-highway and various off-highway markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as in various industrial applications, including construction, agriculture, power generation systems and other off-highway applications. 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. The Components segment sells filtration products, aftertreatment systems, turbochargers, fuel systems and transmissions. The Power Systems segment is an integrated power provider, which designs, manufactures and sells engines (16 liters and larger) for industrial applications (including mining, oil and gas, marine and rail), standby and prime power generator sets, alternators and other power components. We formed the Electrified Power segment, effective January 1, 2018, which will provide fully electric and hybrid powertrain solutions along with innovative components and subsystems to serve all our markets as they adopt electrification, meeting the needs of our OEM partners and end customers.

Our Electrified Power segment will design, manufacture, sell and support electrified power systems ranging from fully electric to hybrid. We are currently developing the Cummins Electric Power Battery and the Cummins Hybrid Plug-In systems for urban bus, which are expected to launch in 2019 and 2020, respectively. We also design and manufacture battery modules, packs and systems for commercial, industrial and material handling applications. We use a range of cell chemistries which are suitable for pure electric, hybrid and plug-in hybrid applications. In addition to electrified powertrains for urban bus, we intend to deliver product offerings to future markets, including pick-up and delivery applications and other markets as they adopt electric solutions. We invest in and utilize our internal research and development capabilities, along with strategic acquisitions and partnerships to meet our objectives.

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. Our sales may also be impacted by OEM inventory levels, production schedules and stoppages. Economic downturns in markets we serve generally result in reduced sales of our products and can result in price reductions in certain products and/or markets. 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.

Worldwide net sales increased 21 percent in the three months ended July 1, 2018, as compared to the same period in 2017, with all operating segments reporting higher sales. Net sales in the U.S. and Canada improved by 22 percent primarily due to increased demand in the North American on-highway markets (primarily in the heavy- and medium-duty truck and light commercial vehicle markets)

sales from the automated transmission business acquired during the third quarter of 2017 and

. International demand growth (excludes the U.S. and Canada) improved net sales by 18 percent, with sales up in most of our markets, especially in China, Europe, Latin America, Asia Pacific and

India. The increase in international sales was primarily due to increased on-highway truck demand (especially in Latin America and China), favorable foreign currency impacts of 3 percent of international sales (primarily the Chinese renminbi, Euro and British pound), increased demand in industrial markets (especially construction and mining markets in China and Europe) and increased demand for power generation equipment primarily in China and the Middle East.

Worldwide net sales increased 21 percent in the six months ended July 1, 2018, as compared to the same period in 2017, with all operating segments reporting higher sales. Net sales in the U.S. and Canada improved by 22 percent primarily due to increased demand in the North American on-highway markets (primarily in the heavy- and medium-duty truck and light commercial vehicle markets), sales from the automated transmission

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business acquired during the third quarter of 2017 and

. International demand growth (excludes the U.S. and Canada) improved net sales by 19 percent, with sales up in most of our markets, especially in China, Europe, Latin America, Asia Pacific and India. The increase in international sales was primarily due to increased on-highway truck demand (especially in Latin America and China), favorable foreign currency impacts of 4 percent of international sales (primarily the the Chinese renminbi, Euro and British pound), increased demand in industrial markets (especially construction and mining markets in China and Europe) and increased demand for power generation equipment primarily in China, the Middle East and Australia. Effective January 1, 2018, we changed our measure to EBITDA (defined as earnings before interest expense, income taxes, noncontrolling interests, depreciation and amortization) as a primary basis for the Chief Operating Decision Maker to evaluate the performance of each of our operating segments. EBITDA assists investors and debt holders in comparing our performance on a consistent basis without regard for depreciation and amortization, which can vary significantly depending upon many factors. Prior periods have been revised to reflect the current presentation. The following tables contain sales and EBITDA by operating segment for the three and six months ended July 1, 2018 and July 2, 2017. Refer to the section titled "OPERATING SEGMENT RESULTS" for a more detailed discussion of sales and EBITDA by operating segment, including the reconciliation of segment EBITDA to net income attributable to Cummins Inc.

Operating Segments	Three months ended								
	July 1, 2018			July 2, 2017			Percent change		
	Percent			Percent			2018 vs. 2017		
In millions	Sales	of Total	EBITDA	Sales	of Total	EBITDA	Sales	EBITDA	
Engine	\$2,696	44 %	\$ 362	\$2,307	45 %	\$ 323	17 %	12 %	
Distribution	1,994	33 %	145	1,722	34 %	127	16 %	14 %	
Components	1,887	31 %	237	1,454	29 %	228	30 %	4 %	
Power Systems	1,246	20 %	186	1,017	20 %	90	23 %	NM	
Electrified Power	1	— %	(21 )	—	— %	—	NM	NM	
Intersegment eliminations	(1,692 )	(28 )%	(12 )	(1,422 )	(28 )%	(4 )	19 %	NM	
Total	\$6,132	100 %	\$ 897	\$5,078	100 %	\$ 764	21 %	17 %	

"NM" - not meaningful information

Net income attributable to Cummins was \$545 million, or \$3.32 per diluted share, on sales of \$6.1 billion for the three months ended July 1, 2018, versus the comparable prior year period net income attributable to Cummins of \$424 million, or \$2.53 per diluted share, on sales of \$5.1 billion. The increase in net income and earnings per diluted share was driven by significantly higher net sales, increased gross margin and a lower effective tax rate as the result of the U.S. enacted Tax Cuts and Jobs Act (Tax Legislation), partially offset by higher research, development and engineering expenses. The increase in gross margin was primarily due to higher volumes, improved pricing and lower material costs, partially offset by \$181 million for an Engine System Campaign (a campaign in the Components and Engine segments for engine model years 2010 to 2015 related to degradation of an aftertreatment component) and increased compensation costs. See Note 12, "COMMITMENTS AND CONTINGENCIES," to the *Condensed Consolidated Financial Statements* for additional information on the Engine System Campaign. Diluted earnings per share for the three months ended July 1, 2018, benefited \$0.01 from fewer weighted average shares outstanding due to the stock repurchase program.

Operating Segments	Six months ended								
	July 1, 2018			July 2, 2017			Percent change		
	Percent			Percent			2018 vs. 2017		
In millions	Sales	of Total	EBITDA	Sales	of Total	EBITDA	Sales	EBITDA	
Engine	\$5,142	44 %	\$ 648	\$4,330	45 %	\$ 596	19 %	9 %	
Distribution	3,847	33 %	268	3,367	35 %	257	14 %	4 %	

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Components	<b>3,640</b>	<b>31</b>	<b>%</b>	<b>464</b>	2,798	29	%	444	30	%	5	%
Power Systems	<b>2,320</b>	<b>20</b>	<b>%</b>	<b>328</b>	1,899	19	%	175	22	%	87	%
Electrified Power	<b>3</b>	<b>—</b>	<b>%</b>	<b>(31</b>	) —	<b>—</b>	<b>%</b>	<b>—</b>	<b>NM</b>	<b>NM</b>		
Intersegment eliminations	<b>(3,250</b>	<b>)</b>	<b>(28</b>	<b>)%</b>	<b>(80</b>	<b>)</b>	<b>(2,727</b>	<b>)</b>	<b>(28</b>	<b>)%</b>	<b>(3</b>	<b>)</b>
Total	<b>\$11,702</b>	<b>100</b>	<b>%</b>	<b>\$1,597</b>	\$9,667	100	%	\$1,469	21	%	9	%

"NM" - not meaningful information

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Net income attributable to Cummins was \$870 million, or \$5.27 per diluted share, on sales of \$11.7 billion for the six months ended July 1, 2018, versus the comparable prior year period net income attributable to Cummins of \$820 million, or \$4.88 per diluted share, on sales of \$9.7 billion. The increase in net income and earnings per diluted share was driven by significantly higher net sales and increased gross margin, partially offset by higher research, development and engineering expenses, a higher effective tax rate (\$74 million of unfavorable net discrete tax items primarily due to \$80 million of discrete items for Tax Legislation passed in December 2017) and increased selling, general and administrative expenses. See Note 6, "INCOME TAXES," to the *Condensed Consolidated Financial Statements* for additional information on the tax valuation adjustments. The increase in gross margin was primarily due to higher volumes, improved pricing, lower material costs and favorable mix, partially offset by \$368 million for an Engine System Campaign and increased compensation costs. Diluted earnings per share for the six months ended July 1, 2018, benefited \$0.03 from fewer weighted average shares outstanding, primarily due to the stock repurchase programs.

We generated \$473 million of cash from operations for the six months ended July 1, 2018, compared to \$826 million for the comparable period in 2017. Refer to the section titled "Cash Flows" in the "LIQUIDITY AND CAPITAL RESOURCES" section for a discussion of items impacting cash flows.

During the first half of 2018, we repurchased \$379 million, or 2.5 million shares of common stock.

Our debt to capital ratio (total capital defined as debt plus equity) at July 1, 2018, was 23.1 percent, compared to 19.7 percent at December 31, 2017. The increase was primarily due to the issuance of commercial paper. At July 1, 2018, we had \$1.5 billion in cash and marketable securities on hand and access to our \$2.75 billion credit facilities, if necessary, to meet currently anticipated investment and funding needs.

In July 2018, our Board of Directors authorized an increase to our quarterly dividend of 5.6 percent from \$1.08 per share to \$1.14 per share.

We expect our effective tax rate for the full year of 2018 to approximate 23.0 percent, excluding any discrete tax items.

Our global pension plans, including our unfunded and non-qualified plans, were 116 percent funded at December 31, 2017. Our U.S. qualified plans, which represent approximately 55 percent of the worldwide pension obligation, were 131 percent funded and our U.K. plans were 118 percent funded. We anticipate making additional defined benefit pension contributions during the remainder of 2018 of \$20 million for our U.S. and U.K. pension plans. Approximately \$14 million of the estimated \$38 million of U.K. pension contributions for the full year are voluntary. We expect our 2018 net periodic pension cost to approximate \$86 million.

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**OUTLOOK**

Our outlook reflects the following positive trends and challenges to our business that we expect could impact our revenue and earnings potential for the remainder of 2018.

**Positive Trends**

• We expect North American medium-duty truck and heavy-duty truck demand will remain strong.

• We anticipate demand for pick-up trucks in North America will remain strong.

• We believe demand in global mining markets will remain strong.

• Global construction markets could remain strong.

• We expect power generation markets to remain strong.

**Challenges**

We are experiencing cost increases as a result of trade tariffs recently imposed by the U.S. and some of its trading partners. In the event of prolonged trade disputes, demand for our products could be negatively impacted and we could experience additional cost increases.

• Market demand in truck markets in China is expected to decline.

• Marine markets are expected to remain weak.

In summary, we expect demand to improve or remain strong in many of our most important markets.

Table of Contents**RESULTS OF OPERATIONS**

	Three months ended		Favorable/			Six months ended		Favorable/		
	July 1, 2018	July 2, 2017	(Unfavorable)			July 1, 2018	July 2, 2017	(Unfavorable)		
In millions, except per share amounts			Amount	Percent				Amount	Percent	
<b>NET SALES</b>	<b>\$ 6,132</b>	<b>\$ 5,078</b>	<b>\$ 1,054</b>	<b>21 %</b>		<b>\$ 11,702</b>	<b>\$ 9,667</b>	<b>\$ 2,035</b>	<b>21 %</b>	
Cost of sales	<b>4,692</b>	<b>3,827</b>	<b>(865)</b>	<b>(23)%</b>		<b>9,062</b>	<b>7,284</b>	<b>(1,778)</b>	<b>(24)%</b>	
<b>GROSS MARGIN</b>	<b>1,440</b>	<b>1,251</b>	<b>189</b>	<b>15 %</b>		<b>2,640</b>	<b>2,383</b>	<b>257</b>	<b>11 %</b>	
<b>OPERATING EXPENSES AND INCOME</b>										
Selling, general and administrative expenses	<b>613</b>	<b>606</b>	<b>(7)</b>	<b>(1)%</b>		<b>1,190</b>	<b>1,153</b>	<b>(37)</b>	<b>(3)%</b>	
Research, development and engineering expenses	<b>219</b>	<b>175</b>	<b>(44)</b>	<b>(25)%</b>		<b>429</b>	<b>333</b>	<b>(96)</b>	<b>(29)%</b>	
Equity, royalty and intangible income from investees	<b>110</b>	<b>98</b>	<b>12</b>	<b>12 %</b>		<b>225</b>	<b>206</b>	<b>19</b>	<b>9 %</b>	
Other operating income (expense), net	<b>4</b>	<b>18</b>	<b>(14)</b>	<b>(78)%</b>		<b>6</b>	<b>23</b>	<b>(17)</b>	<b>(74)%</b>	
<b>OPERATING INCOME</b>	<b>722</b>	<b>586</b>	<b>136</b>	<b>23 %</b>		<b>1,252</b>	<b>1,126</b>	<b>126</b>	<b>11 %</b>	
Interest income	<b>10</b>	<b>5</b>	<b>5</b>	<b>100 %</b>		<b>17</b>	<b>7</b>	<b>10</b>	<b>NM</b>	
Interest expense	<b>28</b>	<b>21</b>	<b>(7)</b>	<b>(33)%</b>		<b>52</b>	<b>39</b>	<b>(13)</b>	<b>(33)%</b>	
Other income, net	<b>11</b>	<b>29</b>	<b>(18)</b>	<b>(62)%</b>		<b>21</b>	<b>53</b>	<b>(32)</b>	<b>(60)%</b>	
<b>INCOME BEFORE TAXES</b>	<b>715</b>	<b>599</b>	<b>116</b>	<b>19 %</b>		<b>1,238</b>	<b>1,147</b>	<b>91</b>	<b>8 %</b>	
Income tax expense	<b>161</b>	<b>158</b>	<b>(3)</b>	<b>(2)%</b>		<b>359</b>	<b>301</b>	<b>(58)</b>	<b>(19)%</b>	
<b>CONSOLIDATED INCOME</b>	<b>554</b>	<b>441</b>	<b>113</b>	<b>26 %</b>		<b>879</b>	<b>846</b>	<b>33</b>	<b>4 %</b>	
Less: Net income attributable to noncontrolling interests	<b>9</b>	<b>17</b>	<b>8</b>	<b>47 %</b>		<b>9</b>	<b>26</b>	<b>17</b>	<b>65 %</b>	
<b>NET INCOME</b>	<b>\$ 545</b>	<b>\$ 424</b>	<b>\$ 121</b>	<b>29 %</b>		<b>\$ 870</b>	<b>\$ 820</b>	<b>\$ 50</b>	<b>6 %</b>	

ATTRIBUTABLE  
TO  
CUMMINS  
INC.  
Diluted  
Earnings  
Per  
Common  
Share  
Attributable  
to  
Cummins  
Inc.

\$4.32 \$ 2.53 \$ 0.79 31 % \$5.27 \$ 4.88 \$ 0.39 8 %

	Three months ended				Favorable/ (Unfavorable) Percentage Points	Six months ended				Favorable/ (Unfavorable) Percentage Points
	July 1, 2018	July 2, 2017				July 1, 2018	July 2, 2017			
Percent of sales										
Gross margin	23.5 %	24.6 %			(1.1 )	22.6 %	24.7 %			(2.1 )
Selling, general and administrative expenses	10.0 %	11.9 %			1.9	10.2 %	11.9 %			1.7
Research, development and engineering expenses	3.6 %	3.4 %			(0.2 )	3.7 %	3.4 %			(0.3 )

### Net Sales

Net sales for the three months ended July 1, 2018, increased by \$1.1 billion versus the comparable period in 2017. The primary drivers were as follows:

Components segment sales increased 30 percent primarily due to higher demand across all businesses, especially the emission solutions business, due to stronger market demand for trucks in North America and Europe, and sales from the automated transmission business acquired in the third quarter of 2017.

Engine segment sales increased 17 percent primarily due to higher demand across all markets, especially in North American heavy-duty truck and global construction markets.

Distribution segment sales increased 16 percent primarily due to higher demand in most geographic regions, especially North America, due to increased demand in the engines, parts and service lines of business.

Power Systems segment sales increased 23 percent primarily due to higher demand for all product lines, especially in industrial markets due to higher demand in North American oil and gas markets and international mining markets and increased power generation demand.

Foreign currency fluctuations favorably impacted sales by 1 percent of total sales primarily in the Chinese renminbi, Euro and British pound.

Net sales for the six months ended July 1, 2018, increased by \$2.0 billion versus the comparable period in 2017. The primary drivers were as follows:



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Components segment sales increased 30 percent primarily due to higher demand across all businesses, especially the emission solutions business, due to stronger market demand for trucks in North America, Europe and India, and sales from the automated transmission business acquired in the third quarter of 2017.

Engine segment sales increased 19 percent primarily due to higher demand across most markets, especially in North American heavy-duty truck, medium duty truck and bus markets and increased demand in global construction markets.

Distribution segment sales increased 14 percent primarily due to higher demand in most geographic regions, especially in North America, due to increased demand in the engines, parts and service lines of business.

Power Systems segment sales increased 22 percent primarily due to higher demand for all product lines, especially in industrial markets due to higher demand in global mining markets, North America oil and gas markets and increased power generation demand.

Foreign currency fluctuations favorably impacted sales by 2 percent of total sales primarily in the Chinese renminbi, Euro and British pound.

Sales to international markets (excluding the U.S. and Canada), based on location of customers, for the three and six months ended July 1, 2018, were 41 percent and 41 percent of total net sales, respectively, compared with 42 percent and 42 percent of total net sales for the comparable periods in 2017. A more detailed discussion of sales by segment is presented in the “OPERATING SEGMENT RESULTS” section.

### **Cost of Sales**

The types of expenses included in the cost of sales line item include the following: raw materials consumption, including direct and indirect materials; salaries, wages and benefits; depreciation and amortization; estimated costs of warranty programs and campaigns; production utilities; production-related purchasing; warehousing, including receiving and inspection; engineering support costs; repairs and maintenance; production and warehousing facility property insurance; rent for production facilities and other production overhead.

### **Gross Margin**

Gross margin increased \$189 million for the three months ended July 1, 2018, versus the comparable period in 2017 and decreased 1.1 points as a percentage of sales. The increase in gross margin was primarily due to higher volumes, improved pricing and lower material costs, partially offset by \$181 million for an Engine System Campaign (a campaign in the Components and Engine segments for engine model years 2010 to 2015 related to degradation of an aftertreatment component) and increased compensation costs driven by headcount growth to support increased sales. The decrease in gross margin percentage was primarily due to the Engine System Campaign.

Gross margin increased \$257 million for the six months ended July 1, 2018, versus the comparable period in 2017, and decreased 2.1 points as a percentage of sales. The increase in gross margin was primarily due to higher volumes, improved pricing, lower material costs and favorable mix, partially offset by \$368 million for an Engine System Campaign and increased compensation costs driven by headcount growth to support increased sales. The decrease in gross margin percentage was primarily due to the Engine System Campaign.

The provision for base warranties issued, excluding campaigns, as a percent of sales for the three and six months ended July 1, 2018, was 1.9 percent and 1.9 percent, respectively, compared to 1.8 percent and 1.9 percent for the comparable periods in 2017. A detailed discussion of margin by segment is presented in the “OPERATING SEGMENT RESULTS” section.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased \$7 million for the three months ended July 1, 2018, versus the comparable period in 2017, primarily due to higher compensation expenses driven by headcount growth and higher consulting expenses. Compensation and related expenses include salaries, fringe benefits and variable compensation. Overall, selling, general and administrative expenses, as a percentage of sales, decreased to 10.0 percent in the three months ended July 1, 2018, from 11.9 percent in the comparable period in 2017.

Selling, general and administrative expenses increased \$37 million for the six months ended July 1, 2018, versus the comparable period in 2017, primarily due to higher compensation expenses driven by headcount growth and higher consulting expenses. Overall, selling, general and administrative expenses, as a percentage of sales, decreased to 10.2 percent in the six months ended July 1, 2018, from 11.9 percent in the comparable period in 2017.



Table of Contents**Research, Development and Engineering Expenses**

Research, development and engineering expenses increased \$44 million for the three months ended July 1, 2018, versus the comparable period in 2017, primarily due to investments in the Electrified Power segment, increased compensation expenses driven by headcount growth due to investments in the Electrified Power segment and the automated transmission business acquired in the third quarter of 2017 and higher consulting expenses. Overall, research, development and engineering expenses as a percentage of sales increased to 3.6 percent in the three months ended July 1, 2018, from 3.4 percent in the comparable period in 2017.

Research, development and engineering expenses increased \$96 million for the six months ended July 1, 2018, versus the comparable period in 2017, primarily due to investments in the Electrified Power segment, increased compensation expenses driven by headcount growth due to investments in the Electrified Power segment and the automated transmission business acquired in the third quarter of 2017 higher consulting expenses and lower expense recovery. Overall, research, development and engineering expenses as a percentage of sales increased to 3.7 percent in the six months ended July 1, 2018, from 3.4 percent in the comparable period in 2017. Research activities continue to focus on development of new products to meet future emission standards around the world and improvements in fuel economy performance of diesel and natural gas powered engines.

**Equity, Royalty and Interest Income from Investees**

Equity, royalty and interest income from investees increased \$12 million for the three months ended July 1, 2018, versus the comparable period in 2017, primarily due to higher earnings at Chongqing Cummins Engine Company, Ltd., Tata Cummins Ltd. and Beijing Foton Cummins Engine Company, Ltd.

Equity, royalty and interest income from investees increased \$19 million for the six months ended July 1, 2018, versus the comparable period in 2017, primarily due to higher earnings at Chongqing Cummins Engine Company, Ltd., Tata Cummins Ltd. and Cummins Westport, partially offset by lower earnings at Beijing Foton Cummins Engine Company, Ltd. and Dongfeng Cummins Engine Company, Ltd.

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

Other operating income (expense), net was as follows:

In millions	Three months ended		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
Royalty income, net	\$ 11	\$ 11	\$ 18	\$ 20
Gain on sale of assets, net	3	8	3	5
Loss on write off of assets	(4 )	(1 )	(4 )	(2 )
Amortization of intangible assets	(5 )	(1 )	(10 )	(3 )
Other, net	(1 )	1	(1 )	3
Total other operating income (expense), net	\$ 4	\$ 18	\$ 6	\$ 23

**Interest Income**

Interest income for the three and six months ended July 1, 2018, increased \$5 million and \$10 million, respectively, versus the comparable periods in 2017, primarily due to higher interest rates.

**Interest Expense**

Interest expense for the three and six months ended July 1, 2018, increased \$7 million and \$13 million, respectively, versus the comparable periods in 2017, primarily due to higher weighted-average debt outstanding.

Table of Contents**Other Income, Net**

Other income, net was as follows:

In millions	Three months ended		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
Non-service cost, pension and other postretirement benefits	\$ 15	\$ 9	\$30	\$15
Change in cash surrender value of corporate owned life insurance	1	16	(3 )	29
Dividend income	—	2	2	3
Bank charges	(2 )	(2 )	(5 )	(5 )
Foreign currency (loss) gain, net	(13 )	1	(24 )	3
Other, net	10	3	21	8
Total other income, net	\$ 11	\$ 29	\$21	\$53

**Income Tax Expense**

Our effective tax rate for the year is expected to approximate 23.0 percent, excluding any discrete tax items that may arise.

Our effective tax rates for the three and six months ended July 1, 2018, were 22.5 percent and 29.0 percent, respectively. The three months ended July 1, 2018, contained only immaterial discrete items. The six months ended July 1, 2018, contained \$74 million, or \$0.45 per share, of unfavorable net discrete tax items, primarily due to \$80 million of discrete items related to the 2017 Tax Cuts and Jobs Act (Tax Legislation). This includes \$45 million associated with changes related to the Tax Legislation measurement period adjustment and \$35 million associated with the one-time recognition of deferred tax charges at historical tax rates on intercompany profit in inventory. See Note 6, "INCOME TAXES," for additional information.

Our effective tax rates for the three and six months ended July 2, 2017, were 26.4 percent and 26.2 percent, respectively, and contained only immaterial discrete tax items.

The change in the effective tax rate for the three months ended July 1, 2018, versus the comparable period in 2017, was primarily due to lower U.S. tax rates in the second quarter of 2018 as a result of Tax Legislation. The change in the effective tax rate for the six months ended July 1, 2018, versus the comparable period in 2017, was primarily due to unfavorable discrete changes associated with the Tax Legislation.

**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 and six months ended July 1, 2018, decreased \$8 million and \$17 million, respectively, versus the comparable periods in 2017, primarily due to losses at the automated transmission business acquired in the third quarter of 2017.

**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 July 1, 2018, increased \$121 million and \$0.79 per share, respectively, versus the comparable period in 2017, primarily due to significantly higher net sales, increased gross margin and a lower effective tax rate as the result of Tax Legislation passed in December 2017, partially offset by higher research, development and engineering expenses. Diluted earnings per share for the three months ended July 1, 2018, benefited \$0.01 from fewer weighted average shares outstanding due to the stock repurchase program.

Net income and diluted earnings per share attributable to Cummins Inc. for the six months ended July 1, 2018, increased \$50 million and \$0.39 per share, respectively, versus the comparable period in 2017, primarily due to significantly higher net sales and increased gross margin, partially offset by higher research, development and engineering expenses, a higher effective tax rate (\$74 million of unfavorable net discrete tax items primarily due to \$80 million of discrete items for Tax Legislation passed in December 2017) and increased selling, general and administrative expenses. Diluted earnings per share for the six months ended July 1, 2018, benefited \$0.03 from fewer weighted average shares outstanding, primarily due to the stock repurchase programs.



Table of Contents**Comprehensive Income - Foreign Currency Translation Adjustment**

The foreign currency translation adjustment was a net loss of \$299 million and \$215 million, respectively, for the three months and six months ended July 1, 2018, compared to a net gain of \$102 million and \$182 million, respectively, for the three and six months ended July 2, 2017, and was driven by the following:

In millions	Three months ended		July 2, 2017	
	July 1, 2018	Primary currency driver vs. U.S. dollar	July 2, 2017	Primary currency driver vs. U.S. dollar
	Translation adjustment		Translation adjustment	
Wholly-owned subsidiaries		British pound, Chinese renminbi, Indian rupee, Brazilian real		British pound, Chinese renminbi
	<b>\$(232)</b>		<b>\$90</b>	
Equity method investments	<b>(51)</b>	Chinese renminbi, Indian rupee, British pound	<b>11</b>	Chinese renminbi
Consolidated subsidiaries with a noncontrolling interest	<b>(16)</b>	Indian rupee	<b>1</b>	Indian rupee
Total	<b>\$(299)</b>		<b>\$102</b>	

  

In millions	Six months ended		July 2, 2017	
	July 1, 2018	Primary currency driver vs. U.S. dollar	July 2, 2017	Primary currency driver vs. U.S. dollar
	Translation adjustment		Translation adjustment	
Wholly-owned subsidiaries		British pound, Indian rupee, Brazilian real, Chinese renminbi		British pound, Indian rupee, Chinese renminbi
	<b>\$(162)</b>		<b>\$147</b>	
Equity method investments	<b>(29)</b>	Chinese renminbi, Indian rupee, British pound	<b>21</b>	Chinese renminbi, Indian rupee
Consolidated subsidiaries with a noncontrolling interest	<b>(24)</b>	Indian rupee	<b>14</b>	Indian rupee
Total	<b>\$(215)</b>		<b>\$182</b>	

Table of Contents**OPERATING SEGMENT RESULTS**

Our reportable operating segments consist of the Engine, Distribution, Components, Power Systems and Electrified Power segments. This reporting structure is organized according to the products and markets each segment serves. Effective January 1, 2018, we changed our measure to EBITDA as a primary basis for the Chief Operating Decision Maker to evaluate the performance of each of our reportable operating segments. Segment amounts exclude certain expenses not specifically identifiable to segments. See Note 14, "OPERATING SEGMENTS," to the *Condensed Consolidated Financial Statements* for additional information.

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

**Engine Segment Results**

Financial data for the Engine segment was as follows:

In millions	Three months ended		Favorable/			Six months ended		Favorable/		
	July 1,	July 2,	(Unfavorable)			July 1,	July 2,	(Unfavorable)		
	2018	2017	Amount	Percent		2018	2017	Amount	Percent	
External sales	<b>\$2,050</b>	\$1,711	\$339	20	%	<b>\$3,863</b>	\$3,168	\$695	22	%
Intersegment sales	<b>646</b>	596	50	8	%	<b>1,279</b>	1,162	117	10	%
Total sales	<b>2,696</b>	2,307	389	17	%	<b>5,142</b>	4,330	812	19	%
Research, development and engineering expenses	<b>76</b>	63	(13 )	(21 )	%	<b>155</b>	117	(38 )	(32 )	%
Equity, royalty and interest income from investees	<b>67</b>	56	11	20	%	<b>134</b>	128	6	5	%
Interest income	<b>3</b>	2	1	50	%	<b>5</b>	3	2	67	%
Segment EBITDA	<b>362</b>	323	39	12	%	<b>648</b>	596	52	9	%
Segment EBITDA as a percentage of total sales	<b>13.4</b>	%	14.0	%	(0.6)	<b>12.6</b>	%	13.8	%	(1.2)

Sales for our Engine segment by market were as follows:

In millions	Three months ended		Favorable/		Six months ended		Favorable/	
	July 1,	July 2,	(Unfavorable)		July 1,	July 2,	(Unfavorable)	
	2018	2017	Amount	Percent	2018	2017	Amount	Percent
Heavy-duty truck	<b>\$920</b>	\$714	\$206	29 %	<b>\$1,735</b>	\$1,334	\$401	30 %
Medium-duty truck and bus	<b>777</b>	701	76	11 %	<b>1,469</b>	1,245	224	18 %
Light-duty automotive	<b>444</b>	429	15	3 %	<b>846</b>	852	(6 )	(1 )%
Total on-highway	<b>2,141</b>	1,844	297	16 %	<b>4,050</b>	3,431	619	18 %
Off-highway	<b>555</b>	463	92	20 %	<b>1,092</b>	899	193	21 %
Total sales	<b>\$2,696</b>	\$2,307	\$389	17 %	<b>\$5,142</b>	\$4,330	\$812	19 %

Unit shipments by engine classification (including unit shipments to Power Systems and off-highway engine units included in their respective classification) were as follows:

	Three months ended		Favorable/		Six months ended		Favorable/	
	July 1,	July 2,	(Unfavorable)		July 1,	July 2,	(Unfavorable)	
	2018	2017	Amount	Percent	2018	2017	Amount	Percent
Heavy-duty	<b>32,000</b>	24,100	7,900	33 %	<b>58,600</b>	43,300	15,300	35 %
Medium-duty	<b>83,500</b>	71,600	11,900	17 %	<b>157,500</b>	131,900	25,600	19 %
Light-duty	<b>68,500</b>	65,600	2,900	4 %	<b>130,400</b>	128,700	1,700	1 %
Total unit shipments	<b>184,000</b>	161,300	22,700	14 %	<b>346,500</b>	303,900	42,600	14 %

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### **Sales**

Engine segment sales for the three months ended July 1, 2018, increased \$389 million versus the comparable period in 2017. The following were the primary drivers by market:

- Heavy-duty truck sales increased \$206 million primarily due to higher demand in North American heavy-duty truck markets with increased shipments of 38 percent.

- Off-highway sales increased \$92 million primarily due to improved demand in global construction markets, with increased international unit shipments of 39 percent primarily in China and Europe, and increased unit shipments of 10 percent in North America.

- Medium-duty truck and bus sales increased \$76 million primarily due to higher demand in North American medium-duty truck markets with increased engine shipments of 15 percent.

Total on-highway-related sales for the three months ended July 1, 2018, were 79 percent of total Engine segment sales, versus 80 percent for the comparable period in 2017.

Engine segment sales for the six months ended July 1, 2018, increased \$812 million versus the comparable period in 2017. The following were the primary drivers by market:

- Heavy-duty truck sales increased \$401 million primarily due to higher demand in North American heavy-duty truck markets with increased shipments of 42 percent.

- Medium-duty truck and bus sales increased \$224 million primarily due to higher demand in North American medium-duty truck markets with increased engine shipments of 19 percent.

- Off-highway sales increased \$193 million due to improved demand in global construction markets with increased international unit shipments of 42 percent, primarily in China and Europe, and increased unit shipments of 27 percent in North America.

Total on-highway-related sales for the six months ended July 1, 2018, were 79 percent of total Engine segment sales, versus 79 percent for the comparable period in 2017.

### **Segment EBITDA**

Engine segment EBITDA for the three months ended July 1, 2018, increased \$39 million versus the comparable period in 2017, primarily due to higher gross margin, higher equity, royalty and interest income from investees and lower selling, general and administrative expenses, partially offset by increased research, development and engineering expenses. The increase in gross margin was primarily due to higher volumes and favorable pricing, partially offset by increased Engine System Campaign costs of \$91 million. The increase in research, development and engineering expenses was primarily due to higher compensation expense and lower expense recovery. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Tata Cummins Ltd., Beijing Foton Cummins Engine Co., Ltd. and Cummins Westport, Inc.

Engine segment EBITDA for the six months ended July 1, 2018, increased \$52 million versus the comparable period in 2017, primarily due to higher gross margin, lower selling, general and administrative expenses and higher equity, royalty and interest income from investees, partially offset by increased research, development and engineering expenses. The increase in gross margin was primarily due to higher volumes and favorable pricing, partially offset by increased Engine System Campaign costs of \$184 million. The increase in research, development and engineering expenses was primarily due to higher compensation expense, lower expense recovery and higher consulting expenses. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Tata Cummins Ltd. and Cummins Westport, Inc., partially offset by lower earnings at Beijing Foton Cummins Engine Co.



Table of Contents**Distribution Segment Results**

Financial data for the Distribution segment was as follows:

In millions	Three months ended		Favorable/			Six months ended		Favorable/		
	July 1, 2018	July 2, 2017	(Unfavorable) Amount	Percent		July 1, 2018	July 2, 2017	(Unfavorable) Amount	Percent	
External sales	<b>\$1,988</b>	\$1,716	\$272	16	%	<b>\$3,835</b>	\$3,353	\$482	14	%
Intersegment sales	<b>6</b>	6	—	—	%	<b>12</b>	14	(2)	(14)	%
Total sales	<b>1,994</b>	1,722	272	16	%	<b>3,847</b>	3,367	480	14	%
Research, development and engineering expenses	<b>5</b>	4	(1)	(25)	%	<b>10</b>	8	(2)	(25)	%
Equity, royalty and interest income from investees	<b>11</b>	13	(2)	(15)	%	<b>24</b>	24	—	—	%
Interest income	<b>3</b>	1	2	NM		<b>5</b>	2	3	NM	
Segment EBITDA	<b>145</b>	127	18	14	%	<b>268</b>	257	11	4	%

	Percentage Points				Percentage Points					
Segment EBITDA as a percentage of total sales	7.3	%	7.4	%	(0.1)	7.0	%	7.6	%	(0.6)

"NM" - not meaningful information

Sales for our Distribution segment by region were as follows:

	Three months ended		Favorable/		Six months ended		Favorable/	
	July 1,	July 2,	(Unfavorable)		July 1,	July 2,	(Unfavorable)	
In millions	2018	2017	Amount	Percent	2018	2017	Amount	Percent
North America	\$1,353	\$1,131	\$222	20 %	\$2,629	\$2,244	\$385	17 %
Asia Pacific	212	187	25	13 %	401	357	44	12 %
Europe	143	107	36	34 %	275	204	71	35 %
China	84	75	9	12 %	162	133	29	22 %
Africa and Middle East	62	86	(24 )	(28)%	122	181	(59 )	(33)%
India	50	52	(2 )	(4 )%	95	95	—	— %
Russia	45	41	4	10 %	80	75	5	7 %
Latin America	45	43	2	5 %	83	78	5	6 %
Total sales	\$1,994	\$1,722	\$272	16 %	\$3,847	\$3,367	\$480	14 %

Sales for our Distribution segment by product line were as follows:

	Three months ended				Six months ended			
	July 1,	July 2,	Favorable/		July 1,	July 2,	Favorable/	
In millions	2018	2017	Amount	Percent	2018	2017	Amount	Percent
Parts	\$817	\$759	\$58	8 %	\$1,625	\$1,504	\$121	8 %
Engines	461	314	147	47 %	828	589	239	41 %
Service	370	320	50	16 %	722	639	83	13 %
Power generation	346	329	17	5 %	672	635	37	6 %
Total sales	\$1,994	\$1,722	\$272	16 %	\$3,847	\$3,367	\$480	14 %

**Sales**

Distribution segment sales for the three months ended July 1, 2018, increased \$272 million versus the comparable period in 2017. The following were the primary drivers by region:

• North American sales increased \$222 million, representing 82 percent of the total change in Distribution segment sales, primarily due to increased demand in the engines, parts and service lines of business.

• European sales increased \$36 million primarily due to an increase in demand for whole goods.



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Foreign currency fluctuations favorably impacted sales primarily in the Euro, Chinese renminbi and Canadian dollar. Distribution segment sales for the six months ended July 1, 2018, increased \$480 million versus the comparable period in 2017. The following were the primary drivers by region:

• North American sales increased \$385 million, representing 80 percent of the total change in Distribution segment sales, primarily due to increased demand in the engines, parts and service lines of business.

• European sales increased \$71 million primarily due to an increase in demand for whole goods.

• Foreign currency fluctuations favorably impacted sales primarily in the Euro, Chinese renminbi, Canadian dollar and Australian dollar.

**Segment EBITDA**

Distribution segment EBITDA for the three months ended July 1, 2018, increased \$18 million versus the comparable period in 2017, primarily due to higher gross margin. The increase in gross margin was primarily due to higher volumes, partially offset by increased compensation expenses.

Distribution segment EBITDA for the six months ended July 1, 2018, increased \$11 million versus the comparable period in 2017, primarily due to higher gross margin, partially offset by increased selling, general and administrative expenses and higher research, development and engineering expenses. The increase in gross margin was primarily due to higher volumes and improved pricing, partially offset by increased compensation expenses. The increase in selling, general and administrative expenses was primarily due to higher compensation expenses and increased consulting expenses.

**Components Segment Results**

Financial data for the Components segment was as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	July 1, 2018	July 2, 2017	Amount	Percent	July 1, 2018	July 2, 2017	Amount	Percent
External sales	<b>\$1,402</b>	\$1,064	\$338	32 %	<b>\$2,715</b>	\$2,044	\$671	33 %
Intersegment sales	<b>485</b>	390	95	24 %	<b>925</b>	754	171	23 %
Total sales	<b>1,887</b>	1,454	433	30 %	<b>3,640</b>	2,798	842	30 %
Research, development and engineering expenses	<b>62</b>	58	(4 )	(7 )%	<b>124</b>	108	(16 )	(15 )%
Equity, royalty and interest income from investees	<b>14</b>	15	(1 )	(7 )%	<b>30</b>	28	2	7 %
Interest income	<b>2</b>	1	1	100 %	<b>3</b>	1	2	NM
Segment EBITDA	<b>237</b>	228	9	4 %	<b>464</b>	444	20	5 %

	Percentage Points				Percentage Points					
Segment EBITDA as a percentage of total sales	12.6	%	15.7	%	(3.1)	12.7	%	15.9	%	(3.2)

"NM" - not meaningful information

Sales for our Components segment by business were as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	July 1, 2018	July 2, 2017	Amount	Percent	July 1, 2018	July 2, 2017	Amount	Percent
Emission solutions	<b>\$841</b>	\$674	\$167	25 %	<b>\$1,616</b>	\$1,290	\$326	25 %
Turbo technologies	<b>355</b>	307	48	16 %	<b>695</b>	594	101	17 %
Filtration	<b>324</b>	291	33	11 %	<b>644</b>	568	76	13 %
Electronics and fuel systems	<b>226</b>	182	44	24 %	<b>427</b>	346	81	23 %
Automated transmissions	<b>141</b>	—	141	NM	<b>258</b>	—	258	NM

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Total sales	<b>\$1,887</b>	\$1,454	\$433	30	%	<b>\$3,640</b>	\$2,798	\$842	30	%
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"NM" - not meaningful information

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### **Sales**

Components segment sales for the three months ended July 1, 2018, increased \$433 million, across all lines of business, versus the comparable period in 2017. The following were the primary drivers by business:

- Emission solutions sales increased \$167 million primarily due to stronger market demand for trucks in North America and Europe.

- Automated transmissions, consolidated during the third quarter of 2017, delivered sales of \$141 million in North America.

- Turbo technologies sales increased \$48 million primarily due to higher demand in North America and Western Europe.

- Electronics and fuel systems sales increased \$44 million primarily due to higher demand in North America.

- Filtration sales increased \$33 million primarily due to higher demand in North America and Western Europe.

- Foreign currency fluctuations favorably impacted sales primarily in the Chinese renminbi and Euro.

Components segment sales for the six months ended July 1, 2018, increased \$842 million, across all lines of business, versus the comparable period in 2017. The following were the primary drivers by business:

- Emission solutions sales increased \$326 million primarily due to stronger market demand for trucks in North America, Europe and India, and increased sales of products to meet new emission standards in India.

- Automated transmissions, consolidated during the third quarter of 2017, delivered sales of \$258 million in North America.

- Turbo technologies sales increased \$101 million primarily due to higher demand in North America and Western Europe.

- Electronics and fuel systems sales increased \$81 million primarily due to higher demand in North America.

- Filtration sales increased \$76 million primarily due to higher demand in North America and Western Europe.

- Foreign currency fluctuations favorably impacted sales primarily in the Chinese renminbi, Euro and British pound.

### **Segment EBITDA**

Components segment EBITDA for the three months ended July 1, 2018, increased \$9 million versus the comparable period in 2017, as higher gross margin and favorable foreign currency fluctuations (primarily in the Chinese renminbi) were partially offset by higher selling, general and administrative expenses, increased research, development and engineering expenses and lower equity, royalty and interest income from investees. The increase in gross margin was primarily due to higher volumes, lower material costs and favorable mix, partially offset by increased Engine System Campaign costs of \$90 million and increased compensation expenses driven by the acquisition of the automated transmission business in the third quarter of 2017. The increases in selling, general and administrative expenses and research, development and engineering expenses were primarily due to higher compensation expense due to the addition of the automated transmission business.

Components segment EBITDA for the six months ended July 1, 2018, increased \$20 million versus the comparable period in 2017, as higher gross margin and equity, royalty and interest income from investees was partially offset by increased selling, general and administrative expenses and higher research, development and engineering expenses. The increase in gross margin was primarily due to higher volumes, lower material costs, improved mix and favorable foreign currency fluctuations (primarily the Chinese renminbi), partially offset by increased Engine System Campaign costs of \$184 million. The increase in selling, general and administrative expenses was primarily due to higher consulting expense and increased compensation expense due to the addition of the automated transmission business. The increase in research, development and engineering expenses was primarily due to higher compensation expense due to the addition of the automated transmission business and increased consulting expenses, partially offset by higher expense recovery. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Dongfeng Cummins Emission Solutions Co., Ltd.

Table of Contents**Power Systems Segment Results**

Financial data for the Power Systems segment was as follows:

In millions	Three months ended		Favorable/		Six months ended		Favorable/	
	July 1, 2018	July 2, 2017	(Unfavorable) Amount	Percent	July 1, 2018	July 2, 2017	(Unfavorable) Amount	Percent
External sales	<b>\$691</b>	\$587	\$104	18 %	<b>\$1,286</b>	\$1,102	\$184	17 %
Intersegment sales	<b>555</b>	430	125	29 %	<b>1,034</b>	797	237	30 %
Total sales	<b>1,246</b>	1,017	229	23 %	<b>2,320</b>	1,899	421	22 %
Research, development and engineering expenses	<b>60</b>	50	(10 )	(20 )%	<b>117</b>	100	(17 )	(17 )%
Equity, royalty and interest income from investees	<b>18</b>	14	4	29 %	<b>37</b>	26	11	42 %
Interest income	<b>2</b>	1	1	100 %	<b>4</b>	1	3	NM
Segment EBITDA	<b>186</b>	90	96	NM	<b>328</b>	175	153	87 %

	Percentage Points				Percentage Points			
Segment EBITDA as a percentage of total sales	<b>14.9 %</b>	8.8 %		6.1	<b>14.1 %</b>	9.2 %		4.9

"NM" - not meaningful information

Sales for our Power Systems segment by product line were as follows:

In millions	Three months ended		Favorable/		Six months ended		Favorable/	
	July 1, 2018	July 2, 2017	(Unfavorable) Amount	Percent	July 1, 2018	July 2, 2017	(Unfavorable) Amount	Percent
Power generation	<b>\$666</b>	\$570	\$96	17 %	<b>\$1,237</b>	\$1,096	\$141	13 %
Industrial	<b>483</b>	353	130	37 %	<b>897</b>	628	269	43 %
Generator technologies	<b>97</b>	94	3	3 %	<b>186</b>	175	11	6 %
Total sales	<b>\$1,246</b>	\$1,017	\$229	23 %	<b>\$2,320</b>	\$1,899	\$421	22 %

**Sales**

Power Systems segment sales for the three months ended July 1, 2018, increased \$229 million versus the comparable period in 2017. The following were the primary drivers by product line:

• Industrial sales increased \$130 million primarily due to higher demand in oil and gas markets in North America and global mining markets, especially in China and Eastern Europe.

• Power generation sales increased \$96 million primarily due to higher demand in North America, China and the Middle East.

Power Systems segment sales for the six months ended July 1, 2018, increased \$421 million versus the comparable period in 2017. The following were the primary drivers by product line:

• Industrial sales increased \$269 million primarily due to higher demand in global mining markets, especially in China, Eastern Europe and North America, and in oil and gas markets in North America.

• Power generation sales increased \$141 million primarily due to higher demand in China, North America and Australia.

• Foreign currency fluctuations favorably impacted sales primarily in the British pound, Chinese renminbi and Euro.

Table of Contents**Segment EBITDA**

Power Systems segment EBITDA for the three months ended July 1, 2018, increased \$96 million versus the comparable period in 2017 primarily due to higher gross margin and equity, royalty and interest income from investees, partially offset by increased research, development and engineering expenses and higher selling, general and administrative expenses. The increase in gross margin was primarily due to increased volumes, lower warranty and lower material costs, partially offset by higher compensation expenses driven by volume growth. The increase for both selling, general and administrative expenses and research, development and engineering expenses was primarily due to higher compensation expenses, new product launches and higher consulting expenses. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Chongqing Cummins Engine Company, Ltd.

Power Systems segment EBITDA for the six months ended July 1, 2018, increased \$153 million versus the comparable period in 2017 primarily due to higher gross margin and equity, royalty and interest income from investees, partially offset by increased research, development and engineering expenses and higher selling, general and administrative expenses. The increase in gross margin was primarily due to increased volumes, lower warranty and lower material costs, partially offset by higher compensation expenses driven by volume growth. The increase for both selling, general and administrative expenses and research, development and engineering expenses was primarily due to higher compensation expenses, new product launches and higher consulting expenses. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Chongqing Cummins Engine Company, Ltd.

**Electrified Power Segment Results**

We formed the Electrified Power segment during the first quarter of 2018. The primary focus of the segment is on research and development activities around fully electric and hybrid powertrain solutions. Our intellectual property is developed both in house as well as through acquisitions. As of July 1, 2018, we had completed two acquisitions, which provided us with battery systems intellectual property as well as start-up sales of \$1 million and \$3 million for the three and six months ended July 1, 2018, respectively. In June 2018, we entered into an agreement to purchase Efficient Drivetrains, Inc., which designs and produces hybrid and fully-electric power solutions for commercial markets, and expect the transaction to close in the third quarter of 2018. We invested \$16 million and \$23 million for the three and six months ended July 1, 2018, respectively, in research and development activities, which along with the gross margins generated by our acquisitions and selling, general and administrative expenses resulted in a segment EBITDA loss of \$21 million and \$31 million for three and six months ended July 1, 2018, respectively.

**Reconciliation of Segment EBITDA to Net Income Attributable to Cummins Inc.**

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

In millions	Three months ended		Six months ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
<b>TOTAL SEGMENT EBITDA</b>	<b>\$ 909</b>	<b>\$ 768</b>	<b>\$1,677</b>	<b>\$1,472</b>
Intersegment elimination <sup>(1)</sup>	(12 )	(4 )	(80 )	(3 )
<b>TOTAL EBITDA</b>	<b>897</b>	<b>764</b>	<b>1,597</b>	<b>1,469</b>
Less:				
Interest expense	28	21	52	39
Depreciation and amortization <sup>(2)</sup>	154	144	307	283
<b>INCOME BEFORE INCOME TAXES</b>	<b>715</b>	<b>599</b>	<b>1,238</b>	<b>1,147</b>
Less: Income tax expense	161	158	359	301

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<b>CONSOLIDATED NET INCOME</b>	<b>554</b>	441	<b>879</b>	846
Less: Net income attributable to noncontrolling interest	<b>9</b>	17	<b>9</b>	26
<b>NET INCOME ATTRIBUTABLE TO CUMMINS INC.</b>	<b>\$ 545</b>	\$ 424	<b>\$870</b>	\$ 820

<sup>(1)</sup> Includes intersegment sales, intersegment profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the three and six months ended July 1, 2018 and July 2, 2017.

<sup>(2)</sup> Depreciation and amortization, as shown on a segment basis, excludes the amortization of debt discount and deferred costs included in the *Condensed Consolidated Statements of Income* as interest expense. The amortization of debt discount and deferred costs was \$1 million and \$1 million for the six month periods ended July 1, 2018 and July 2, 2017, respectively.



Table of Contents**LIQUIDITY AND CAPITAL RESOURCES****Key Working Capital and Balance Sheet Data**

We fund our working capital with cash from operations and short-term borrowings, including commercial paper, 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.

Working capital and balance sheet measures are provided in the following table:

Dollars in millions	July 1, 2018	December 31, 2017
Working capital <sup>(1)</sup>	<b>\$3,731</b>	\$ 3,251
Current ratio	<b>1.61</b>	1.57
Accounts and notes receivable, net	<b>\$4,095</b>	\$ 3,618
Days' sales in receivables	<b>60</b>	59
Inventories	<b>\$3,559</b>	\$ 3,166
Inventory turnover	<b>5.0</b>	5.0
Accounts payable (principally trade)	<b>\$2,981</b>	\$ 2,579
Days' payable outstanding	<b>58</b>	53
Total debt	<b>\$2,462</b>	\$ 2,006
Total debt as a percent of total capital	<b>23.1 %</b>	19.7 %

<sup>(1)</sup> Working capital includes cash and cash equivalents.

**Cash Flows**

Cash and cash equivalents were impacted as follows:

In millions	Six months ended		
	July 1, 2018	July 2, 2017	Change
Net cash provided by operating activities	<b>\$473</b>	\$ 826	\$(353)
Net cash used in investing activities	<b>(236)</b>	(160)	(76)
Net cash used in financing activities	<b>(253)</b>	(544)	291
Effect of exchange rate changes on cash and cash equivalents	<b>(35)</b>	51	(86)
Net (decrease) increase in cash and cash equivalents	<b>\$(51)</b>	\$ 173	\$(224)

Net cash provided by operating activities decreased \$353 million for the six months ended July 1, 2018, versus the comparable period in 2017, primarily due to higher working capital levels, partially offset by lower net pension contributions of \$69 million and higher earnings of \$33 million. During the first six months of 2018, the higher working capital requirements resulted in a cash outflow of \$536 million compared to a cash outflow of \$196 million in the comparable period in 2017, primarily due to the payment of higher accrued variable compensation expense in the first quarter of 2018 and business growth.

Net cash used in investing activities increased \$76 million for the six months ended July 1, 2018, versus the comparable period in 2017, primarily due to higher net investments in marketable securities of \$120 million, partially offset by lower investments in and advances to equity investees of \$49 million.

Net cash used in financing activities decreased \$291 million for the six months ended July 1, 2018, versus the comparable period in 2017, primarily due to higher borrowings of commercial paper of \$582 million, partially offset by higher repurchases of common stock of \$259 million.

The effect of exchange rate changes on cash and cash equivalents for the six months ended July 1, 2018, versus the comparable period in 2017, decreased \$86 million primarily due to unfavorable fluctuations in the British pound of \$68 million.

**Sources of Liquidity**

We generate significant ongoing cash flow and cash provided by operations is our principal source of liquidity with \$473 million provided in the six months ended July 1, 2018.



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At July 1, 2018, our sources of liquidity included:

In millions	July 1, 2018			Primary location of international balances
	Total	U.S.	International	
Cash and cash equivalents	\$1,318	\$306	\$ 1,012	U.K., China, Singapore, Mexico, Belgium, Australia, Canada
Marketable securities <sup>(1)</sup>	214	54	160	India
Total	\$1,532	\$360	\$ 1,172	
Available credit capacity				
Revolving credit facilities <sup>(2)</sup>	\$1,948			
International and other uncommitted domestic credit facilities	\$194			

<sup>(1)</sup> The majority of marketable securities could be liquidated into cash within a few days.

<sup>(2)</sup> The five-year credit facility for \$1.75 billion and the 364-day credit facility for \$1.0 billion, maturing November 2020 and September 2018, respectively, are maintained primarily to provide backup liquidity for our commercial paper borrowings and general corporate purposes. At July 1, 2018, we had \$802 million of commercial paper outstanding, which effectively reduced the available capacity under our revolving credit facilities to \$1.95 billion.

***Cash, Cash Equivalents and Marketable Securities***

A significant portion of our cash flow is generated outside the U.S. 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 operating needs with local resources.

***Debt Facilities and Other Sources of Liquidity***

We have access to committed credit facilities that total \$2.75 billion, including a \$1.0 billion, 364-day facility that expires September 14, 2018 and a \$1.75 billion, 5-year facility that expires on November 13, 2020. We intend to maintain credit facilities of a similar aggregate amount by renewing or replacing these facilities before expiration. Revolving credit facilities are maintained primarily to provide backup liquidity for our commercial paper borrowings, letters of credit and general corporate purposes.

We can issue up to \$2.75 billion of unsecured, short-term promissory notes ("commercial paper") pursuant to our board authorized commercial paper programs. The programs facilitate the private placement of unsecured short-term debt through third party brokers. We intend to use the net proceeds from the commercial paper borrowings for general corporate purposes.

As a well-known seasoned issuer, we filed an automatic shelf registration for an undetermined amount of debt and equity securities with the Securities and Exchange Commission on February 16, 2016. Under this shelf registration we may offer, from time to time, debt securities, common stock, preferred and preference stock, depositary shares, warrants, stock purchase contracts and stock purchase units.

***Uses of Cash******Stock Repurchases***

In December 2016, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon completion of the 2015 repurchase plan. In the first six months of 2018, we made the following purchases under the 2015 and 2016 stock repurchase programs:

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In millions, except per share amounts	Shares Purchased	Average Cost Per Share	Total Cost of Repurchases	Remaining Authorized Capacity <sup>(1)</sup>
November 2015, \$1 billion repurchase program				
April 1	0.3	\$ 166.79	\$ 46	\$ —
December 2016, \$1 billion repurchase program				
April 1	0.7	164.48	\$ 117	\$ 883
July 1	1.5	143.69	216	667
Subtotal	2.2	150.38	333	
Total	2.5	\$ 152.20	\$ 379	

<sup>(1)</sup> The remaining authorized capacity under the 2016 plan was calculated based on the cost to purchase the shares but excludes commission expenses in accordance with the authorized plan.

We intend to repurchase outstanding shares from time to time to enhance shareholder value and to offset the dilutive impact of employee stock based compensation plans. These repurchases may be done in the open market or through accelerated share repurchase programs as appropriate based on market conditions.

***Dividends***

In July 2018, our Board of Directors authorized an increase to our quarterly dividend of 5.6 percent from \$1.08 per share to \$1.14 per share. We paid dividends of \$355 million during the six months ended July 1, 2018.

***Capital Expenditures***

Capital expenditures, including spending on internal use software, for the six months ended July 1, 2018, were \$221 million compared to \$222 million in the comparable period in 2017. We continue to invest in new product lines and targeted capacity expansions. We plan to spend between \$730 million and \$760 million in 2018 on capital expenditures as we continue with product launches and facility improvements. Approximately 50 percent of our capital expenditures are expected to be invested outside of the U.S. in 2018.

***Pensions***

Our global pension plans, including our unfunded and non-qualified plans, were 116 percent funded at December 31, 2017. Our U.S. qualified plans, which represent approximately 55 percent of the worldwide pension obligation, were 131 percent funded and our U.K. plans were 118 percent funded. 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. In the first six months of 2018, the investment loss on our U.S. pension trust was 1.2 percent while our U.K. pension trust loss was 0.7 percent. Approximately 76 percent of our pension plan assets are held in highly liquid investments such as fixed income and equity securities. The remaining 24 percent of our plan assets are held in less liquid, but market valued investments, including real estate, private equity, venture capital, opportunistic credit and insurance contracts. We anticipate making additional defined benefit pension contributions during the remainder of 2018 of \$20 million for our U.S. and U.K. pension plans. Approximately \$14 million of the estimated \$38 million of U.S. and U.K. pension contributions for the full year are voluntary. These contributions may be made from trusts or company funds either to increase pension assets or to make direct benefit payments to plan participants. We expect our 2018 net periodic pension cost to approximate \$86 million.

***Current Maturities of Short and Long-Term Debt***

We had \$802 million of commercial paper outstanding at July 1, 2018, that matures in less than one year. The maturity schedule of our existing long-term debt does not require significant cash outflows in the intermediate term. Required annual principal payments range from \$8 million to \$50 million over the next five years (including the remainder of 2018). See Note 9, "DEBT," to the *Condensed Consolidated Financial Statements* for additional information.



Table of Contents**Credit Ratings**

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 <sup>(1)</sup>	Long-Term	Short-Term	Outlook
	Senior Debt Rating	Debt Rating	
Standard & Poor's Rating Services	A+	A1	Stable
Moody's Investors Service, Inc.	A2	P1	Stable

<sup>(1)</sup> 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.

**Management's Assessment of Liquidity**

Our financial condition and liquidity remain strong. Our solid balance sheet and credit ratings enable us to have ready access to credit and the capital markets. We assess our liquidity in terms of our ability to generate adequate cash to fund our operating, investing and financing activities. We believe our operating cash flow and liquidity provide us with the financial flexibility needed to fund working capital, common stock repurchases, acquisitions, capital expenditures, dividend payments, projected pension obligations and debt service obligations. While we expect more efficient access to overseas earnings as a result of Tax Legislation, we will continue to generate cash from operations in the U.S. and maintain access to our revolving credit facility as noted above.

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### **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 2017 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. Our critical accounting estimates disclosed in the Form 10-K address the estimation of liabilities for warranty programs, accounting for income taxes and pension benefits.

A discussion of our critical accounting estimates may be found in the "Management's Discussion and Analysis" section of our 2017 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 six months of 2018.

### **RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

See Note 15, "RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS," in the *Notes to Condensed Consolidated Financial Statements* for additional information.

### **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 2017 Form 10-K. There have been no material changes in this information since the filing of our 2017 Form 10-K.

### **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 (CEO) and Chief Financial Officer (CFO), 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 CEO and our CFO 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 CEO and CFO, 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 July 1, 2018, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**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; product recalls; 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 pursuant to U.S. generally accepted accounting principles 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.

**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, 2017, 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			
	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(2)</sup>
April 2 - May 6	—	\$ —	—	59,353
May 7 - June 3	1,021,676	146.01	1,021,100	64,828
June 4 - July 1	483,114	138.85	482,530	70,427
Total	1,504,790	143.71	1,503,630	

<sup>(1)</sup> Shares purchased represent shares under our Key Employee Stock Investment Plan established in 1969 (there is no maximum repurchase limitation in this plan) and our Board of Directors authorized share repurchase program.

<sup>(2)</sup> 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 were excluded from this column. The dollar value remaining available for future purchases under this program as of July 1, 2018, was \$667 million.

In December 2016, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon completion of the 2015 repurchase plan. During the three months ended July 1, 2018, we repurchased \$216 million of common stock under this authorization.



During the three months ended July 1, 2018, we repurchased 1,160 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

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the date of purchase and may be refinanced after their initial five-year period for an additional five-year period. Participants must hold shares for a minimum of six months from date of purchase. If the shares are sold before the loan is paid off, the employee 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**

The exhibits listed in the following Exhibit Index are filed as part of this Quarterly Report on Form 10-Q.

#### **CUMMINS INC.**

#### **EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
<u>3(a)</u>	<u>Restated Articles of Incorporation, as amended and restated, effective as of May 8, 2018 (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed by Cummins Inc. with the Securities and Exchange Commission on May 9, 2018 (File No. 001-04949)).</u>
<u>3(b)</u>	<u>By-Laws, as amended and restated, effective as of July 10, 2018 (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed by Cummins Inc. with the Securities and Exchange Commission on July 11, 2018 (File No. 001-04949)).</u>
<u>10</u>	<u>2012 Omnibus Incentive Plan, as amended and restated.</u>
<u>12</u>	<u>Calculation of Ratio of Earnings to Fixed Charges.</u>
<u>31(a)</u>	<u>Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>31(b)</u>	<u>Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>32</u>	<u>Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL 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.

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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: July 31, 2018

By: /s/ PATRICK J. WARD

Patrick J. Ward

*Vice President and Chief Financial Officer  
(Principal Financial Officer)*

By: /s/ CHRISTOPHER C. CLULOW

Christopher C. Clulow

*Vice President-Corporate Controller  
(Principal Accounting Officer)*