

CUMMINS INC
Form 10-Q
August 01, 2017
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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 2, 2017

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 2, 2017, there were 167,620,608 shares of common stock outstanding with a par value of \$2.50 per share.

Website Access to Company's Reports

Cummins maintains an internet website at www.cummins.com. Investors can obtain copies of our filings from this website free of charge as soon as reasonably practicable after they are electronically filed with, or furnished, to the Securities and Exchange Commission. Cummins is not including the information provided on the website as part of, or incorporating such information by reference into, this Quarterly Report on Form 10-Q.

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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 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
NET SALES ^(a)	\$ 5,078	\$ 4,528	\$9,667	\$8,819
Cost of sales	3,829	3,331	7,290	6,566
GROSS MARGIN	1,249	1,197	2,377	2,253
OPERATING EXPENSES AND INCOME				
Selling, general and administrative expenses	596	524	1,133	1,014
Research, development and engineering expenses	174	155	332	321
Equity, royalty and interest income from investees (Note 4)	98	88	206	160
Loss contingency (Note 9)	—	39	—	39
Other operating income (expense), net	18	—	23	(2)
OPERATING INCOME	595	567	1,141	1,037
Interest income	5	6	7	12
Interest expense (Note 7)	21	16	39	35
Other income (expense), net	20	18	38	26
INCOME BEFORE INCOME TAXES	599	575	1,147	1,040
Income tax expense	158	148	301	280
CONSOLIDATED NET INCOME	441	427	846	760
Less: Net income attributable to noncontrolling interests	17	21	26	33
NET INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 424	\$ 406	\$820	\$727
EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC.				
Basic	\$ 2.53	\$ 2.41	\$4.90	\$4.27
Diluted	\$ 2.53	\$ 2.40	\$4.88	\$4.26
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	167.3	168.8	167.4	170.3
Dilutive effect of stock compensation awards	0.5	0.2	0.5	0.2
Diluted	167.8	169.0	167.9	170.5
CASH DIVIDENDS DECLARED PER COMMON SHARE	\$ 1.025	\$ 0.975	\$2.05	\$1.95

^(a) Includes sales to nonconsolidated equity investees of \$283 million and \$550 million and \$276 million and \$518 million for the three and six months ended July 2, 2017 and July 3, 2016, 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 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
CONSOLIDATED NET INCOME	\$ 441	\$ 427	\$846	\$760
Other comprehensive income (loss), net of tax (Note 10)				
Foreign currency translation adjustments	102	(213)	182	(270)
Unrealized gain (loss) on derivatives	—	(6)	1	(27)
Change in pension and other postretirement defined benefit plans	15	9	36	18
Unrealized gain (loss) on marketable securities	1	1	1	1
Total other comprehensive income (loss), net of tax	118	(209)	220	(278)
COMPREHENSIVE INCOME	559	218	1,066	482
Less: Comprehensive income attributable to noncontrolling interests	18	15	40	27
COMPREHENSIVE INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 541	\$ 203	\$1,026	\$455

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

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CUMMINS INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)

In millions, except par value	July 2, 2017	December 31, 2016
ASSETS		
Current assets		
Cash and cash equivalents	\$1,293	\$ 1,120
Marketable securities (Note 5)	174	260
Total cash, cash equivalents and marketable securities	1,467	1,380
Accounts and notes receivable, net		
Trade and other	3,237	2,803
Nonconsolidated equity investees	316	222
Inventories (Note 6)	2,982	2,675
Prepaid expenses and other current assets	600	627
Total current assets	8,602	7,707
Long-term assets		
Property, plant and equipment	7,804	7,635
Accumulated depreciation	(4,017)	(3,835)
Property, plant and equipment, net	3,787	3,800
Investments and advances related to equity method investees	1,162	946
Goodwill	488	480
Other intangible assets, net	339	332
Pension assets	852	731
Other assets	1,030	1,015
Total assets	\$16,260	\$ 15,011
LIABILITIES		
Current liabilities		
Accounts payable (principally trade)	\$2,300	\$ 1,854
Loans payable (Note 7)	54	41
Commercial paper (Note 7)	134	212
Accrued compensation, benefits and retirement costs	475	412
Current portion of accrued product warranty (Note 8)	392	333
Current portion of deferred revenue	520	468
Other accrued expenses	974	970
Current maturities of long-term debt (Note 7)	45	35
Total current liabilities	4,894	4,325
Long-term liabilities		
Long-term debt (Note 7)	1,564	1,568
Postretirement benefits other than pensions	318	329
Pensions	327	326
Other liabilities and deferred revenue	1,335	1,289
Total liabilities	\$8,438	\$ 7,837
Commitments and contingencies (Note 9)		
EQUITY		
Cummins Inc. shareholders' equity		

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Common stock, \$2.50 par value, 500 shares authorized, 222.3 and 222.4 shares issued	\$2,184	\$ 2,153	
Retained earnings	11,517	11,040	
Treasury stock, at cost, 54.7 and 54.2 shares	(4,586	) (4,489	)
Common stock held by employee benefits trust, at cost, 0.6 and 0.7 shares	(7	) (8	)
Accumulated other comprehensive loss (Note 10)	(1,615	) (1,821	)
Total Cummins Inc. shareholders' equity	7,493	6,875	
Noncontrolling interests	329	299	
Total equity	\$7,822	\$ 7,174	
Total liabilities and equity	\$16,260	\$ 15,011	

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

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CUMMINS INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

In millions	Six months ended	
	July 2, 2017	July 3, 2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	\$ 846	\$ 760
Adjustments to reconcile consolidated net income to net cash provided by operating activities		
Depreciation and amortization	284	259
Deferred income taxes	—	2
Equity in income of investees, net of dividends (Note 4)	(132)	(87)
Pension contributions in excess of expense (Note 3)	(44)	(82)
Other post-retirement benefits payments in excess of expense (Note 3)	(8)	(17)
Stock-based compensation expense	23	20
Restructuring payments	—	(42)
Loss contingency (Note 9)	—	39
Translation and hedging activities	31	(45)
Changes in current assets and liabilities		
Accounts and notes receivable	(488)	(252)
Inventories	(264)	(101)
Other current assets	21	189
Accounts payable	403	143
Accrued expenses	132	(209)
Changes in other liabilities and deferred revenue	103	129
Other, net	(81)	32
Net cash provided by operating activities	826	738
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(182)	(189)
Investments in internal use software	(40)	(27)
Investments in and advances to equity investees	(64)	(17)
Investments in marketable securities—acquisitions (Note 5)	(69)	(379)
Investments in marketable securities—liquidations (Note 5)	162	237
Cash flows from derivatives not designated as hedges	19	(21)
Other, net	14	5
Net cash used in investing activities	(160)	(391)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	2	109
Net (payments) borrowings of commercial paper (Note 7)	(78)	200
Payments on borrowings and capital lease obligations	(29)	(133)
Distributions to noncontrolling interests	(10)	(24)
Dividend payments on common stock	(343)	(333)
Repurchases of common stock (Note 2)	(120)	(695)
Other, net	34	(20)
Net cash used in financing activities	(544)	(896)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	51	(117)

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Net increase (decrease) in cash and cash equivalents	173	(666)
Cash and cash equivalents at beginning of year	1,120	1,711
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$1,293	\$1,045

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 Shareholder Equity	Noncontrolling Interests	Total Equity
BALANCE AT DECEMBER 31, 2015	\$ 556	\$ 1,622	\$ 10,322	\$(3,735)	\$ (11)	\$ (1,348)	\$ 7,406	\$ 344	\$ 7,750
Net income			727				727	33	760
Other comprehensive income (loss), net of tax (Note 10)						(272)	(272)	(6)	(278)
Issuance of common stock		4					4	—	4
Employee benefits trust activity		14			2		16	—	16
Repurchases of common stock (Note 2)				(695)			(695)	—	(695)
Cash dividends on common stock			(333)				(333)	—	(333)
Distributions to noncontrolling interests							—	(31)	(31)
Stock based awards		(6)		8			2	—	2
Other shareholder transactions		6					6	(6)	—
BALANCE AT JULY 3, 2016	\$ 556	\$ 1,640	\$ 10,716	\$(4,422)	\$ (9)	\$ (1,620)	\$ 6,861	\$ 334	\$ 7,195
BALANCE AT DECEMBER 31, 2016	\$ 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 10)						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
BALANCE AT JULY 2, 2017	\$ 556	\$ 1,628	\$ 11,517	\$(4,586)	\$ (7)	\$ (1,615)	\$ 7,493	\$ 329	\$ 7,822

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, as one of the first diesel engine manufacturers. We changed our name to Cummins Inc. in 2001. 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 and electric power generation systems. We sell our products to original equipment manufacturers (OEMs), distributors and other customers worldwide. We serve our customers through a network of approximately 600 wholly-owned and independent distributor locations and over 7,400 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 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, 2016. 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 2017 and 2016 ended on July 2 and July 3, respectively. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

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:

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	Three months ended		Six months ended	
	July 2,	July 3,	July 2,	July 3,
	2017	2016	2017	2016
Options excluded	6,155	1,262,469	61,345	1,475,068

Accelerated Share Repurchase

On February 9, 2016, we entered into an accelerated share repurchase (ASR) agreement with a third party financial institution to repurchase \$500 million of our common stock under our previously announced share repurchase plans. Pursuant to the terms of the agreement, we paid the full \$500 million purchase price and initially received approximately 4.1 million shares representing approximately 80 percent of the shares expected to be repurchased. The unsettled portion of the ASR met the criteria to be accounted for as a forward contract indexed to our stock and qualified as an equity transaction. This resulted in a \$100 million reduction to additional paid-in capital during the first quarter of 2016. In the second quarter of 2016, the ASR was completed, and we received approximately 0.6 million additional shares, based on our volume-weighted average stock price during the term of the transaction, less a discount, for a total of 4.7 million shares purchased under the ASR at an average purchase price of \$105.50 per share. The settlement resulted in the reclassification of the \$100 million reduction of additional paid-in capital recognized in the first quarter of 2016 to treasury stock.

The delivery of shares resulted in a reduction to our common stock outstanding used to calculate earnings per share in the quarter the shares were received and subsequent quarters.

NOTE 3. 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 2,	July 3,	July 2,	July 3,
	2017	2016	2017	2016
Defined benefit pension plans				
Voluntary contribution	\$ 41	\$ 37	\$ 84	\$ 85
Mandatory contribution	—	6	—	18
Defined benefit pension contributions	\$ 41	\$ 43	\$ 84	\$ 103
Other postretirement plans	\$ 3	\$ 15	\$ 18	\$ 28
Defined contribution pension plans	\$ 19	\$ 14	\$ 48	\$ 35

We anticipate making additional defined benefit pension contributions during the remainder of 2017 of \$50 million for our U.S. and U.K. pension plans. Approximately \$133 million of the estimated \$134 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 2017 net periodic pension cost to approximate \$83 million.

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 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016	
Service cost	\$26	\$ 23	\$ 7	\$ 6	\$ —	\$ —	
Interest cost	27	28	10	13	4	4	
Expected return on plan assets	(52)	(51)	(17)	(19)	—	—	

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Recognized net actuarial loss	9	7	10	4	1	2	
Net periodic benefit cost	\$10	\$7	\$10	\$4	\$5	\$6	

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	Pension					
	U.S. Plans		U.K. Plans		Other Postretirement Benefits	
	Six months ended					
In millions	July 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
Service cost	\$53	\$ 46	\$13	\$ 11	\$ —	\$ —
Interest cost	53	56	20	26	7	8
Expected return on plan assets	(103)	(102)	(34)	(38)	—	—
Recognized net actuarial loss	18	14	20	8	3	3
Net periodic benefit cost	\$21	\$ 14	\$19	\$ 7	\$ 10	\$ 11

NOTE 4. 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 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
Distribution entities				
Komatsu Cummins Chile, Ltda.	\$ 8	\$ 8	\$15	\$ 18
North American distributors	—	6	—	11
All other distributors	—	1	—	1
Manufacturing entities				
Beijing Foton Cummins Engine Co., Ltd.	22	22	55	40
Dongfeng Cummins Engine Company, Ltd.	19	15	41	22
Chongqing Cummins Engine Company, Ltd.	10	9	19	17
All other manufacturers	27	16	51	32
Cummins share of net income	86	77	181	141
Royalty and interest income	12	11	25	19
Equity, royalty and interest income from investees	\$ 98	\$ 88	\$206	\$ 160

NOTE 5. MARKETABLE SECURITIES

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

In millions	July 2, 2017			December 31, 2016		
	Cost	Gross unrealized gains/(losses)	Estimated fair value	Cost	Gross unrealized gains/(losses)	Estimated fair value
Available-for-sale ⁽¹⁾						
Debt mutual funds	\$157	\$ —	\$ 157	\$132	\$ —	\$ 132
Bank debentures	3	—	3	114	—	114
Equity mutual funds	12	1	13	12	—	12
Government debt securities	1	—	1	2	—	2
Total marketable securities	\$173	\$ 1	\$ 174	\$260	\$ —	\$ 260

⁽¹⁾ 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 2017 and for the year ended 2016.

A description of the valuation techniques and inputs used for our Level 2 fair value measures was 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.

Bank debentures— 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 institutions' 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.

Government 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 and gross realized gains and losses from the sale of available-for-sale securities were as follows:

	Three months ended July 2, 2017	Six months ended July 3, 2017	July 3, 2016	July 3, 2016
In millions				
Proceeds from sales and maturities of marketable securities ⁽¹⁾	\$ 15	\$ 202	\$ 162	\$ 237

⁽¹⁾ Gross realized gains and losses from the sale of available-for-sale securities were immaterial.

The fair value of available-for-sale investments in debt securities that utilize a Level 2 fair value measure is shown by contractual maturity below:

Contractual Maturity (In millions)	July 2, 2017
1 year or less	\$ 160
1 - 5 years	1
Total	\$ 161

NOTE 6. INVENTORIES

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

In millions	July 2, 2017	December 31, 2016
Finished products	\$1,905	\$ 1,779
Work-in-process and raw materials	1,192	1,005
Inventories at FIFO cost	3,097	2,784
Excess of FIFO over LIFO	(115)	(109)
Total inventories	\$2,982	\$ 2,675

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NOTE 7. DEBT

Loans Payable and Commercial Paper

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

In millions	July 2, December 31,	
	2017	2016
Loans payable ⁽¹⁾	\$ 54	\$ 41
Commercial paper ⁽²⁾	134	212

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

⁽²⁾ The weighted average interest rate, inclusive of all brokerage fees, was 1.20 percent and 0.79 percent at July 2, 2017 and December 31, 2016, respectively.

Long-term Debt

A summary of long-term debt was as follows:

In millions	July 2, 2017	December 31, 2016
Long-term debt		
Senior notes, 3.65%, due 2023	\$500	\$ 500
Debentures, 6.75%, due 2027	58	58
Debentures, 7.125%, due 2028	250	250
Senior notes, 4.875%, due 2043	500	500
Debentures, 5.65%, due 2098 (effective interest rate 7.48%)	165	165
Other debt	56	51
Unamortized discount	(55)	(56)
Fair value adjustments due to hedge on indebtedness	45	47
Capital leases	90	88
Total long-term debt	1,609	1,603
Less: Current maturities of long-term debt	45	35
Long-term debt	\$1,564	\$ 1,568

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

In millions	2017	2018	2019	2020	2021
Principal payments	\$ 18	\$ 45	\$ 36	\$ 10	\$ 4

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 2, December 31,	
	2017	2016
Fair value of total debt ⁽¹⁾	\$2,036	\$ 2,077
Carrying value of total debt	1,797	1,856

⁽¹⁾ The fair value of debt is derived from Level 2 inputs.

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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 2, 2017	July 3, 2016
Balance, beginning of year	\$1,414	\$1,404
Provision for warranties issued	239	181
Deferred revenue on extended warranty contracts sold	101	116
Payments	(199)	(199)
Amortization of deferred revenue on extended warranty contracts	(109)	(98)
Changes in estimates for pre-existing warranties	74	12
Foreign currency translation	1	(5)
Balance, end of period	\$1,521	\$1,411

Warranty related deferred revenues and the long-term portion of the warranty liabilities on our July 2, 2017, balance sheet were as follows:

In millions	July 2, 2017	Balance Sheet Location
Deferred revenue related to extended coverage programs		
Current portion	\$ 232	Current portion of deferred revenue
Long-term portion	505	Other liabilities and deferred revenue
Total	\$ 737	
Long-term portion of warranty liability	\$ 392	Other liabilities and deferred revenue

NOTE 9. 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.

Loss Contingency

Engine systems sold in the U.S. must be certified to comply with the Environmental Protection Agency (EPA) and California Air Resources Board (CARB) emission standards. EPA and CARB regulations require that in-use testing be performed on vehicles by the emission certificate holder and reported to the EPA and CARB in order to ensure

ongoing compliance with these emission standards. We are the holder of this emission certificate for our engines, including engines installed in certain vehicles with one customer on which we did not also manufacture or sell the emission aftertreatment system. During 2015, a

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quality issue in certain of these third party aftertreatment systems caused some of our inter-related engines to fail in-use emission testing. In the fourth quarter of 2015, the vehicle manufacturer made a request that we assist in the design and bear the financial cost of a field campaign (Campaign) to address the technical issue purportedly causing some vehicles to fail the in-use testing.

While we are not responsible for the warranty issues related to a component that we did not manufacture or sell, as the emission compliance certificate holder, we are responsible for proposing a remedy to the EPA and CARB. As a result, we have proposed actions to the agencies that we believe will address the emission failures. As the certificate holder, we expect to participate in the cost of the proposed voluntary Campaign and recorded a charge of \$60 million in 2015. The Campaign design was finalized with our OEM customer, reviewed with the EPA and submitted for final approval in 2016. We concluded based upon additional in-use emission testing performed in 2016, that the Campaign should be expanded to include a larger population of vehicles manufactured by this one OEM. We recorded additional charges of \$39 million and \$99 million in the second and third quarter, respectively, in 2016 to reflect the estimated cost of our participation in the Campaign. We continue to work with our OEM customer to resolve the allocation of costs for the Campaign, including pending litigation between the parties. The Campaign is not expected to be completed for some time and our final cost could differ from the amount we have recorded.

We do not currently expect any fines or penalties from the EPA or CARB related to this matter.

We are funding the Campaign, which began in the fourth quarter of 2016, with a combination of cash and credit memos. The remaining accrual of \$159 million is included in "Other accrued expenses" in our Condensed Consolidated Balance Sheets.

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 2, 2017, the maximum potential loss related to these guarantees was \$43 million. We have arrangements with certain suppliers that require us to purchase minimum volumes or be subject to monetary penalties. At July 2, 2017, if we were to stop purchasing from each of these suppliers, the aggregate amount of the penalty would be approximately \$107 million, of which \$35 million relates to a contract with a components supplier that extends to 2018 and \$28 million relates to a contract with a power systems supplier that extends to 2019. 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 2, 2017, the total commitments under these contracts were \$43 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 \$82 million at July 2, 2017.

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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NOTE 10. ACCUMULATED OTHER COMPREHENSIVE LOSS

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

In millions	Three months ended Change in							Total other comprehensive income (loss)
	pensions and other defined postretirement plans	Foreign currency translation adjustment	Unrealized (loss) on marketable securities	Unrealized gain (loss) on derivatives	Total attributable to Cummins Inc.	Noncontrolling interests		
Balance at April 3, 2016	\$(645)	\$(753)	\$ (2)	\$ (17)	\$(1,417)			
Other comprehensive income before reclassifications								
Before tax amount	—	(207)	1	(10)	(216)	\$ (6)	\$ (222)	
Tax benefit (expense)	—	—	—	2	2	—	2	
After tax amount	—	(207)	1	(8)	(214)	(6)	(220)	
Amounts reclassified from accumulated other comprehensive loss ⁽¹⁾⁽²⁾	9	—	—	2	11	—	11	
Net current period other comprehensive income (loss)	9	(207)	1	(6)	(203)	\$ (6)	\$ (209)	
Balance at July 3, 2016	\$(636)	\$(960)	\$ (1)	\$ (23)	\$(1,620)			
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 ⁽¹⁾⁽²⁾	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)			

(1) Amounts are net of tax.

(2) 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	Change in pensions and other defined postretirement plans	Six months ended Foreign currency translation adjustment	Unrealized (loss) on marketable securities	Unrealized gain (loss) on derivatives	Total attributable to Cummins Inc.	Noncontrolling interests	Total other comprehensive income (loss)
Balance at December 31, 2015	\$(654)	\$(696)	\$ (2)	\$ 4	\$(1,348)		
Other comprehensive income before reclassifications							
Before tax amount	—	(265)	1	(36)	(300)	\$ (6)	\$ (306)
Tax benefit (expense)	—	1	—	6	7	—	7
After tax amount	—	(264)	1	(30)	(293)	(6)	(299)
Amounts reclassified from accumulated other comprehensive loss ⁽¹⁾⁽²⁾	18	—	—	3	21	—	21
Net current period other comprehensive income (loss)	18	(264)	1	(27)	(272)	\$ (6)	\$ (278)
Balance at July 3, 2016	\$(636)	\$(960)	\$ (1)	\$ (23)	\$(1,620)		
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 ⁽¹⁾⁽²⁾	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)		

(1) Amounts are net of tax.

(2) Reclassifications out of accumulated other comprehensive income (loss) and the related tax effects are immaterial for separate disclosure.

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NOTE 11. ACQUISITION

In April 2017, we entered into an agreement to form a joint venture with Eaton Corporation PLC and we closed the transaction on July 31, 2017. We purchased a 50 percent interest in the new venture named Eaton Cummins Automated Transmission Technologies for \$600 million in cash. The joint venture will design, assemble, sell and support medium-duty and heavy-duty automated transmissions for the commercial vehicle market, including new product launches. We will consolidate the results of the joint venture in our Components segment as we have a majority voting interest in the venture by virtue of a tie-breaking vote on the board of directors. We expect to record total assets of approximately \$1.2 billion upon consolidation, the substantial majority of which will be intangible assets and goodwill.

NOTE 12. 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 and Power Systems. 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 and fuel systems. 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 use segment EBIT (defined as earnings before interest expense, income taxes and noncontrolling interests) as a primary basis for the CODM to evaluate the performance of each of our operating segments. Segment amounts exclude certain expenses not specifically identifiable to segments.

The accounting policies of our operating segments are the same as those applied in 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 debt-related items, actuarial gains or losses, prior service costs or credits, changes in cash surrender value of corporate owned life insurance or income taxes to individual segments. Segment EBIT may not be consistent with measures used by other companies.

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Summarized financial information regarding our reportable operating segments is shown in the table below:

In millions	Engine	Distribution	Components	Power Systems	Intersegment Eliminations (1)	Total
Three months ended July 2, 2017						
External sales	\$ 1,711	\$ 1,716	\$ 1,064	\$ 587	\$ —	\$5,078
Intersegment sales	596	6	390	430	(1,422)	—
Total sales	2,307	1,722	1,454	1,017	(1,422)	5,078
Depreciation and amortization (2)	46	31	38	29	—	144
Research, development and engineering expenses	63	4	57	50	—	174
Equity, royalty and interest income from investees	56	13	15	14	—	98
Interest income	2	1	1	1	—	5
Segment EBIT	277	96	190	61	(4)	620
Three months ended July 3, 2016						
External sales	\$ 1,504	\$ 1,538	\$ 933	\$ 553	\$ —	\$4,528
Intersegment sales	498	6	346	368	(1,218)	—
Total sales	2,002	1,544	1,279	921	(1,218)	4,528
Depreciation and amortization (2)	41	29	32	29	—	131
Research, development and engineering expenses	53	3	51	48	—	155
Equity, royalty and interest income from investees	46	19	12	11	—	88
Loss contingency (3)	39	—	—	—	—	39
Interest income	3	1	1	1	—	6
Segment EBIT	206	87	190	90	18	591
Six months ended July 2, 2017						
External sales	\$ 3,168	\$ 3,353	\$ 2,044	\$ 1,102	\$ —	\$9,667
Intersegment sales	1,162	14	754	797	(2,727)	—
Total sales	4,330	3,367	2,798	1,899	(2,727)	9,667
Depreciation and amortization(2)	90	61	75	57	—	283
Research, development and engineering expenses	117	8	107	100	—	332
Equity, royalty and interest income from investees	128	24	28	26	—	206
Interest income	3	2	1	1	—	7
Segment EBIT	506	196	369	118	(3)	1,186
Six months ended July 3, 2016						
External sales	\$ 2,993	\$ 2,996	\$ 1,830	\$ 1,000	\$ —	\$8,819
Intersegment sales	985	11	686	729	(2,411)	—
Total sales	3,978	3,007	2,516	1,729	(2,411)	8,819
Depreciation and amortization(2)	80	57	63	58	—	258
Research, development and engineering expenses	110	7	107	97	—	321
Equity, royalty and interest income from investees	82	37	20	21	—	160
Loss contingency (3)	39	—	—	—	—	39
Interest income	5	2	2	3	—	12
Segment EBIT	403	174	353	136	9	1,075

(1) 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 2, 2017 and July 3, 2016.

⁽²⁾ 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 were \$1 million and \$1 million for the six months ended July 2, 2017 and July 3, 2016, respectively.

⁽³⁾ See Note 9, "COMMITMENTS AND CONTINGENCIES," for additional information.

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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 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
Total segment EBIT	\$ 620	\$ 591	\$1,186	\$1,075
Less: Interest expense	21	16	39	35
Income before income taxes	\$ 599	\$ 575	\$1,147	\$1,040

NOTE 13. RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**Accounting Pronouncements Recently Adopted**

In March 2016, the Financial Accounting Standards Board (FASB) amended its standards related to accounting for stock compensation, which became effective for us beginning January 1, 2017. The amendment replaced the requirement to record excess tax benefits and certain tax deficiencies in additional paid-in capital by recording all excess tax benefits and tax deficiencies as income tax expense / benefit in the Condensed Consolidated Statements of Income and was adopted prospectively. Excess tax benefits and deficiencies are required to be recorded as discrete items in the period in which they occur and were not material for the three and six months ended July 2, 2017. In addition, the standard impacted our Condensed Consolidated Statements of Cash Flows retrospectively, as excess tax benefits are now required to be presented as an operating activity and the cash paid to tax authorities is required to be presented as a financing activity. This resulted in a net reclassification of \$4 million from operating to financing activities for the six months ended July 2, 2017. Finally, in accordance with the standard, we elected to continue our historical approach of estimating forfeitures during the award's vesting period and adjusting our estimate when it is no longer probable that the employee will fulfill the service condition. The adoption of the standard was not material to our diluted earnings per common share.

Accounting Pronouncements Issued But Not Yet Effective

In March 2017, the FASB amended its standards related to the presentation of pension and other postretirement benefit costs in the financial statements. Under the new standard, we will be 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 Consolidated Statements of Income. In addition, the standard will limit the amount eligible for capitalization (into inventory or self-constructed assets) to the amount of service cost. This portion of the standard will be applied on a prospective basis. The remainder of the new standard is effective for us on a retrospective basis beginning January 1, 2018. While we are still evaluating the impact of this standard, the change in presentation will likely result in a decrease in operating income primarily due to the requirement to present the expected return on plan assets outside of operating income.

In August 2016, the FASB amended its standards related to the classification of certain cash receipts and cash payments. The new standard will make eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. The standard is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The new standard will require adoption on a retrospective basis unless it is impracticable to apply, in which case it would be required to apply the amendments prospectively as of the earliest date practicable. We are in the process of evaluating the impact this standard will have on our Consolidated Statements of Cash Flows.

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 are in the process of evaluating the impact the amendment will have 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

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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. 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.

In January 2016, the FASB amended its standards related to the accounting for certain financial instruments. This amendment addresses certain aspects of recognition, measurement, presentation and disclosure. The new rules will become effective for annual and interim periods beginning after December 15, 2017. Early adoption is not permitted. We are in the process of evaluating the impact the amendment will have on our Consolidated Financial Statements. In May 2014, the FASB amended its standards related to revenue recognition. This amendment replaces all existing revenue recognition guidance and provides a single, comprehensive revenue recognition model for all contracts with customers. The standard contains principles that we will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that we will recognize revenue in a manner that depicts 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 estimates 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 and assets recognized from costs incurred to fulfill a contract. The standard allows either full or modified retrospective adoption effective for annual and interim periods beginning January 1, 2018. We are in the process of evaluating the impact the amendment will have on our Consolidated Financial Statements, including our internal controls over financial reporting. We expect to adopt the standard using the modified retrospective approach. While we have not yet completed our evaluation process, we have identified that a change will be required related to our accounting for remanufactured product sales that include an exchange of the used product, referred to as core. Revenue is not currently recognized related to the core component unless the used product is not returned. Under the new standard, the transaction will be accounted for as a gross sale and a purchase of inventory. As a result, the exchange will increase both sales and cost of sales, in equal amounts, related to core. This will not impact gross margin dollars, but will impact the gross margin percentage. We are still quantifying the amount of this change. We have also identified transactions where revenue recognition is currently limited to the amount of billings not contingent on our future performance. With the allocation provisions of the new model, we expect to accelerate the timing of revenue recognition for amounts related to satisfied performance obligations that would have been delayed under the current guidance. We do not expect the impact of this change to be material, but we are still quantifying the impact. Using the modified retrospective adoption method, we will record an adjustment to our opening equity balance at January 1, 2018, to account for the differences between existing revenue recorded and revenue that would have been recorded under the new standard related to contracts for which we have begun to recognize revenue prior to the adoption date. We are still quantifying the potential amount of this adjustment.

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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;
- a major customer experiencing financial distress;
- lower than expected acceptance of new or existing products or services;
- any significant problems in our new engine platforms;
- a further slowdown in infrastructure development and/or continuing depressed commodity prices;
- unpredictability in the adoption, implementation and enforcement of emission standards around the world;
- foreign currency exchange rate changes;
- the actions of, and income from, joint ventures and other investees that we do not directly control;
- the integration of our previously partially-owned United States and Canadian distributors;
- 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;
- variability in material and commodity costs;
- product recalls;
- competitor activity;
- increasing competition, including increased global competition among our customers in emerging markets;
- exposure to potential security breaches or other disruptions to our information technology systems and data security;
- political, economic and other risks from operations in numerous countries;
- changes in taxation;
- 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;
- the price and availability of energy;
- the performance of our pension plan assets and volatility of discount rates;

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labor relations;
changes in accounting standards;
future bans or limitations on the use of diesel-powered vehicles;
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 2016 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 2016 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 and electric power generation 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. We serve our customers through a network of approximately 600 wholly-owned and independent distributor locations and over 7,400 dealer locations in more than 190 countries and territories.

Our reportable operating segments consist of Engine, Distribution, Components and Power Systems. 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 and fuel systems. 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.

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 revenues increased 12 percent in the three months ended July 2, 2017, as compared to the same period in 2016, with all operating segments reporting higher revenue. Revenue in the U.S. and Canada improved by 13 percent primarily due to increased demand in the North American on-highway markets and increased industrial demand (especially in the oil and gas market). International demand growth (excludes the U.S. and Canada) improved revenues by 11 percent, with sales up in most of our markets (especially in China, India and Russia). The increase in international sales was primarily due to increased demand in industrial markets (especially construction markets in China and mining markets in Europe) and increased demand in all Components businesses (especially on-highway truck demand in China and product sales to meet new emission requirements for trucks in India), partially offset by unfavorable foreign currency impacts of 2 percent (primarily in the Chinese renminbi and British pound).

Worldwide revenues increased 10 percent in the six months ended July 2, 2017, as compared to the same period in 2016, with all operating segments reporting higher revenue. International demand growth (excludes the U.S. and Canada) in 2017 improved revenues by 12 percent, with sales up in most of our markets, especially in China, India, Russia and the U.K. The increase in international sales was primarily due to increased demand in industrial markets (especially construction markets in China and mining markets in Europe) and increased demand in all Components businesses (especially on-highway truck demand in China and product sales to meet new emission requirements for trucks in India), partially offset by unfavorable foreign currency impacts of 3 percent (primarily in the British pound and Chinese renminbi). Revenue in the U.S. and Canada improved by 8 percent primarily due to increased demand in the North American on-highway markets and increased industrial demand (especially in the construction, oil and gas

and agriculture markets).

The following tables contain sales and earnings before interest expense, income tax expense and noncontrolling interests (EBIT) by operating segment for the three and six months ended July 2, 2017 and July 3, 2016. Refer to the section titled “OPERATING SEGMENT RESULTS” for a more detailed discussion of sales and EBIT by operating segment, including the reconciliation of segment EBIT to net income attributable to Cummins Inc.

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Operating Segments	Three months ended								
	July 2, 2017			July 3, 2016			Percent change		
	Percent			Percent			2017 vs. 2016		
In millions	Sales	of Total	EBIT	Sales	of Total	EBIT	Sales	EBIT	
Engine	\$2,307	45 %	\$277	\$2,002	44 %	\$206	15 %	34 %	
Distribution	1,722	34 %	96	1,544	34 %	87	12 %	10 %	
Components	1,454	29 %	190	1,279	28 %	190	14 %	— %	
Power Systems	1,017	20 %	61	921	21 %	90	10 %	(32)%	
Intersegment eliminations	(1,422)	(28)%	—	(1,218)	(27)%	—	17 %	—	
Non-segment	—	—	(4)	—	—	18	—	NM	
Total	\$5,078	100 %	\$620	\$4,528	100 %	\$591	12 %	5 %	

"NM" - not meaningful information

Net income attributable to Cummins was \$424 million, or \$2.53 per diluted share, on sales of \$5.1 billion for the three months ended July 2, 2017, versus the comparable prior year period net income attributable to Cummins of \$406 million, or \$2.40 per diluted share, on sales of \$4.5 billion. The increase in net income and earnings per diluted share was driven by significantly higher net sales, higher gross margin, the absence of an accrual for a loss contingency recorded in the second quarter of 2016, higher equity, royalty and interest income from investees, partially offset by increased selling, general and administrative expenses, higher research, development and engineering expenses and a higher effective tax rate. The increase in gross margin was primarily due to higher volumes, improved Distribution segment margins related to the acquisition of North American distributors since December 31, 2015 and lower material costs, partially offset by higher warranty costs (\$87 million primarily due to changes in estimates in the Engine and Component segments and campaigns in the Power Systems segment) and increased variable compensation expense of \$93 million. Diluted earnings per share for the three months ended July 2, 2017, benefited \$0.01 from fewer weighted average shares outstanding due to purchases under the stock repurchase program.

Operating Segments	Six months ended								
	July 2, 2017			July 3, 2016			Percent change		
	Percent			Percent			2017 vs. 2016		
In millions	Sales	of Total	EBIT	Sales	of Total	EBIT	Sales	EBIT	
Engine	\$4,330	45 %	\$506	\$3,978	45 %	\$403	9 %	26 %	
Distribution	3,367	35 %	196	3,007	34 %	174	12 %	13 %	
Components	2,798	29 %	369	2,516	28 %	353	11 %	5 %	
Power Systems	1,899	19 %	118	1,729	20 %	136	10 %	(13)%	
Intersegment eliminations	(2,727)	(28)%	—	(2,411)	(27)%	—	13 %	—	
Non-segment	—	—	(3)	—	—	9	—	NM	
Total	\$9,667	100 %	\$1,186	\$8,819	100 %	\$1,075	10 %	10 %	

"NM" - not meaningful information

Net income attributable to Cummins was \$820 million, or \$4.88 per diluted share, on sales of \$9.7 billion for the six months ended July 2, 2017, versus the comparable prior year period net income attributable to Cummins of \$727 million, or \$4.26 per diluted share, on sales of \$8.8 billion. The increase in net income and earnings per diluted share was driven by significantly higher net sales, higher gross margin, higher equity, royalty and interest income from investees, the absence of an accrual for a loss contingency recorded in the second quarter of 2016 and a lower effective tax rate, 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 Distribution segment margins related to the acquisition of North American distributors since December 31, 2015, favorable pricing and favorable foreign currency fluctuations (primarily the British pound, South

African rand and Brazilian real), partially offset by higher warranty costs (\$120 million primarily due to changes in estimates in the Engine and Component segments and campaigns in the Power Systems segment) and increased variable compensation expense of \$109 million. Diluted earnings per share for the six months ended July 2, 2017, benefited \$0.01 from fewer weighted average shares outstanding, primarily due to purchases under the stock repurchase program.

We generated \$826 million of operating cash flows for the six months ended July 2, 2017, compared to \$738 million for the comparable period in 2016. Refer to the section titled "Cash Flows" in the "LIQUIDITY AND CAPITAL RESOURCES" section for a discussion of items impacting cash flows.

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During the first half of 2017, we repurchased \$120 million, or 0.8 million shares of common stock. Our debt to capital ratio (total capital defined as debt plus equity) at July 2, 2017, was 18.7 percent, compared to 20.6 percent at December 31, 2016. At July 2, 2017, we had \$1.5 billion in cash and marketable securities on hand and access to our \$1.75 billion credit facilities, if necessary, to meet currently anticipated investment and funding needs.

In July 2017, our Board of Directors authorized an increase to our quarterly dividend of 5.4 percent from \$1.025 per share to \$1.08 per share.

We expect our effective tax rate for the full year of 2017 to approximate 26.0 percent, excluding any one-time tax items.

In April 2017, we entered into an agreement to form a joint venture with Eaton Corporation PLC and we closed the transaction on July 31, 2017. We purchased a 50 percent interest in the new venture named Eaton Cummins Automated Transmission Technologies for \$600 million in cash. The joint venture will design, assemble, sell and support medium-duty and heavy-duty automated transmissions for the commercial vehicle market, including new product launches. We will consolidate the results of the joint venture in our Components segment as we have a majority voting interest in the venture by virtue of a tie-breaking vote on the board of directors. We are still in the process of finalizing the purchase accounting and we do not expect this new venture to have a significant impact on our consolidated results in 2017.

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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 2017.

Positive Trends

- Demand for pick-up trucks in North America remains strong.
- Market demand in off-highway markets in China and India remains strong.
- Industry production of medium-duty trucks in North America should remain strong.
- North American construction markets may stabilize.
- Market demand may continue to improve in global mining.
- North American heavy-duty truck demand may stabilize.

Challenges

- Power generation markets may remain soft.
 - Weak economic conditions in Brazil may continue to negatively impact demand across our businesses.
 - Foreign currency could continue to put pressure on our results.
 - Marine markets are expected to remain weak.
- Demand has improved in certain markets and we expect demand will continue to improve over time, as in prior economic cycles. We are well positioned to benefit as market conditions improve.

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RESULTS OF OPERATIONS

	Three months ended			Favorable/ (Unfavorable)			Six months ended			Favorable/ (Unfavorable)		
	July 2, 2017 In millions, except per share amounts	July 3, 2016	Amount	Percent			July 2, 2017	July 3, 2016	Amount	Percent		
NET SALES	\$ 5,078	\$ 4,528	\$ 550	12	%		\$ 9,667	\$ 8,819	\$ 848	10	%	
Cost of sales	3,829	3,331	(498)	(15)	%		7,290	6,566	(724)	(11)	%	
GROSS MARGIN	1,249	1,197	52	4	%		2,377	2,253	124	6	%	
OPERATING EXPENSES AND INCOME												
Selling, general and administrative expenses	596	524	(72)	(14)	%		1,133	1,014	(119)	(12)	%	
Research, development and engineering expenses	174	155	(19)	(12)	%		332	321	(11)	(3)	%	
Equity, royalty and interest income from investees	98	88	10	11	%		206	160	46	29	%	
Loss contingency	39	39	39	100	%		—	39	39	100	%	
Other operating income (expense), net	18	—	18	NM			23	(2)	25	NM		
OPERATING INCOME	595	567	28	5	%		1,141	1,037	104	10	%	
Interest income	5	6	(1)	(17)	%		7	12	(5)	(42)	%	
Interest expense	21	16	(5)	(31)	%		39	35	(4)	(11)	%	
Other income	20	18	2	11	%		38	26	12	46	%	

(expense), net INCOME BEFORE TAXES	599	575	24	4	%	1,147	1,040	107	10	%
Income tax expense	158	148	(10)	(7)	%)	301	280	(21)	(8)	%)
CONSOLIDATED NET INCOME	441	427	14	3	%	846	760	86	11	%
Less: Net income attributable to noncontrolling interests										
NET INCOME ATTRIBUTABLE TO CUMMINS INC.										
Diluted Earnings Per Common Share	2.53	\$ 2.40	\$0.13	5	%	\$4.88	\$4.26	\$0.62	15	%
Attributable to Cummins Inc.										

"NM" - not meaningful information

	Three months ended				Favorable/ (Unfavorable)	Six months ended				Favorable/ (Unfavorable)
	July 2, 2017	July 3, 2016			Percentage Points	July 2, 2017	July 3, 2016			Percentage Points
Percent of sales										
Gross margin	24.6 %	26.4 %			(1.8)	24.6 %	25.5 %			(0.9)
Selling, general and administrative expenses	11.7 %	11.6 %			(0.1)	11.7 %	11.5 %			(0.2)
Research, development and engineering expenses	3.4 %	3.4 %			—	3.4 %	3.6 %			0.2
Net Sales										

Net sales for the three months ended July 2, 2017, increased by \$550 million versus the comparable period in 2016.

The primary drivers were as follows:

• Engine segment sales increased 15 percent primarily due to higher demand in North American medium-duty truck and bus, North American heavy-duty truck markets and improved demand in global off-highway markets.

• Distribution segment sales increased 12 percent primarily due to an increase in organic sales and higher sales related to the acquisition of North American distributors since December 31, 2015.

Components segment sales increased 14 percent primarily due to higher demand across all lines of businesses, primarily in China, North America and India.

Power Systems segment sales increased 10 percent primarily due to higher demand in industrial markets.

These increases were unfavorably impacted by foreign currency fluctuations of approximately 1 percent, primarily in the Chinese renminbi and British pound.

Net sales for the six months ended July 2, 2017, increased \$848 million versus the comparable period in 2016. The primary drivers were as follows:

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• Distribution segment sales increased 12 percent primarily due to an increase in organic sales and higher sales related to the acquisition of North American distributors since December 31, 2015.

• Engine segment sales increased 9 percent primarily due to higher demand in off-highway markets, North American medium-duty truck and bus and North American heavy-duty truck markets.

• Components segment sales increased 11 percent primarily due to higher demand across all lines of businesses, primarily in China and India.

• Power Systems segment sales increased 10 percent primarily due to higher demand in industrial markets, especially global mining, North American oil and gas markets and North American rail markets.

These increases were unfavorably impacted by foreign currency fluctuations of approximately 1 percent, primarily in the British pound and Chinese renminbi.

Sales to international markets (excluding the U.S. and Canada), based on location of customers, for the three and six months months ended July 2, 2017, were 42 percent and 42 percent of total net sales, respectively, compared with 42 percent and 41 percent of total net sales for the comparable periods in 2016. A more detailed discussion of sales by segment is presented in the “OPERATING SEGMENT RESULTS” section.

Gross Margin

Gross margin increased \$52 million for the three months ended July 2, 2017, versus the comparable period in 2016 and decreased 1.8 points as a percentage of sales. The increase in gross margin dollars was primarily due to higher volumes, improved Distribution segment margins related to the acquisition of North American distributors since December 31, 2015 and lower material costs, partially offset by higher warranty costs (\$87 million primarily due to changes in estimates in the Engine and Component segments and campaigns in the Power Systems segment) and increased variable compensation expense of \$93 million.

Gross margin increased \$124 million for the six months ended July 2, 2017, versus the comparable period in 2016 and decreased 0.9 points as a percentage of sales. The increase in gross margin dollars was primarily due to higher volumes, lower material costs, improved Distribution segment margins related to the acquisition of North American distributors since December 31, 2015, favorable pricing and favorable foreign currency fluctuations (primarily the British pound, South African rand and Brazilian real), partially offset by higher warranty costs (\$120 million primarily due to changes in estimates in the Engine and Component segments and campaigns in the Power Systems segment) and increased variable compensation expense of \$109 million.

The provision for base warranties issued, excluding campaigns, as a percent of sales for the three and six months ended July 2, 2017, was 1.8 percent and 1.9 percent, respectively, compared to 1.8 percent and 1.9 percent for the comparable periods in 2016. 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 \$72 million for the three months ended July 2, 2017, versus the comparable period in 2016, primarily due to higher variable compensation expenses (\$49 million) and higher consulting expenses (\$10 million). Compensation and related expenses include salaries, fringe benefits and variable compensation. Overall, selling, general and administrative expenses, as a percentage of sales, increased to 11.7 percent in the three months ended July 2, 2017, from 11.6 percent in the comparable period in 2016.

Selling, general and administrative expenses increased \$119 million for the six months ended July 2, 2017, versus the comparable period in 2016, primarily due to higher variable compensation expenses (\$64 million) and higher consulting expenses (\$30 million). Overall, selling, general and administrative expenses, as a percentage of sales, increased to 11.7 percent in the six months ended July 2, 2017, from 11.5 percent in the comparable period in 2016.

Research, Development and Engineering Expenses

Research, development and engineering expenses increased \$19 million for the three months ended July 2, 2017, versus the comparable period in 2016, primarily due to increased variable compensation expenses (\$13 million) and lower expense recovery from customers (\$5 million). Overall, research, development and engineering expenses remained flat as a percentage of sales, versus the comparable period in 2016 .

Research, development and engineering expenses increased \$11 million for the six months ended July 2, 2017, versus the comparable period in 2016, primarily due to increased variable compensation expense (\$13 million), partially

offset by higher

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expense recovery from customers (\$2 million). Overall, research, development and engineering expenses, as a percentage of sales, decreased to 3.4 percent in the six months ended July 2, 2017, from 3.6 percent in the comparable period in 2016.

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 \$10 million for the three months ended July 2, 2017, versus the comparable period in 2016, primarily due to higher earnings at Dongfeng Cummins Engine Company, Ltd. Equity, royalty and interest income from investees increased \$46 million for the six months ended July 2, 2017, versus the comparable period in 2016, primarily due to higher earnings at Dongfeng Cummins Engine Company, Ltd. and Beijing Foton Cummins Engine Co., Ltd.

Other Operating Income (Expense), Net

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

In millions	Three months ended		Six months ended	
	July 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
Royalty income, net	\$ 11	\$ 6	\$20	\$ 13
Amortization of intangible assets	(1)	(2)	(3)	(5)
Loss on write off of assets	(1)	(4)	(2)	(9)
Other, net	9	—	8	(1)
Total other operating income (expense), net	\$ 18	\$ —	\$23	\$ (2)

Interest Income

Interest income for the three months ended July 2, 2017, remained relatively flat versus the comparable period in 2016. Interest income for the six months ended July 2, 2017, decreased \$5 million versus the comparable period in 2016, primarily due to lower short-term investments.

Interest Expense

Interest expense for the three months ended July 2, 2017, increased \$5 million versus the comparable period in 2016, primarily due to hedge ineffectiveness on our interest rate swap. Interest expense for the six months ended July 2, 2017, increased \$4 million versus the comparable period in 2016, primarily due to hedge ineffectiveness on our interest rate swap.

Other Income (Expense), Net

Other income (expense), net was as follows:

In millions	Three months ended		Six months ended	
	July 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
Change in cash surrender value of corporate owned life insurance	\$ 16	\$ 15	\$29	\$ 23
Dividend income	2	1	3	2
Foreign currency gain (loss), net	1	(8)	3	(11)
Bank charges	(2)	(1)	(5)	(4)
Other, net	3	11	8	16
Total other income (expense), net	\$ 20	\$ 18	\$38	\$ 26

Income Tax Expense

Our effective tax rate for the year is expected to approximate 26.0 percent, excluding any one-time items that may arise. Our tax rate is generally less than the 35 percent U.S. statutory income tax rate primarily due to lower tax rates on foreign income and the research tax credit.

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

Our effective tax rate for the three and six months ended July 3, 2016, was 25.7 percent and 26.9 percent, respectively, and contained only immaterial discrete items.

The changes in the effective tax rate for the three and six months ended July 2, 2017, versus the comparable periods in 2016, were primarily due to differences in the jurisdictional mix of pre-tax income.

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 months ended July 2, 2017, decreased \$4 million versus the comparable period in 2016, primarily due to the acquisition of the remaining interest in Wuxi Cummins Turbo Technologies Co. Ltd, in the fourth quarter of 2016.

Noncontrolling interests in income of consolidated subsidiaries for the six months ended July 2, 2017, decreased \$7 million versus the comparable period in 2016, primarily due to the acquisition of the remaining interest in Wuxi Cummins Turbo Technologies Co. Ltd, in the fourth quarter of 2016.

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 2, 2017, increased \$18 million and \$0.13 per share, respectively versus the comparable period in 2016, primarily due to significantly higher net sales, higher gross margin, the absence of an accrual for a loss contingency recorded in the second quarter of 2016, higher equity, royalty and interest income from investees, partially offset by increased selling, general and administrative expenses, higher research, development and engineering expenses and a higher effective tax rate. Diluted earnings per share for the three months ended July 2, 2017, benefited \$0.01 from fewer weighted average shares outstanding due to purchases under the stock repurchase program.

Net income and diluted earnings per share attributable to Cummins Inc. for the six months ended July 2, 2017, increased \$93 million and \$0.62 per share, respectively versus the comparable period in 2016, primarily due to significantly higher net sales, higher gross margin, higher equity, royalty and interest income from investees, the absence of an accrual for a loss contingency recorded in the second quarter of 2016 and a lower effective tax rate, partially offset by increased selling, general and administrative expenses and higher research, development and engineering expenses. Diluted earnings per share for the six months ended July 2, 2017, benefited \$0.01 from fewer weighted average shares outstanding, primarily due to purchases under the stock repurchase program.

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Comprehensive Income - Foreign Currency Translation Adjustment

The foreign currency translation adjustment was a net gain of \$102 million and \$182 million, respectively, for the three and six months ended July 2, 2017, compared to a net loss of \$213 million and \$270 million for the three and six months ended July 3, 2016, and was driven by the following:

In millions	Three months ended July 2, 2017		July 3, 2016	
	Translation adjustment	Primary currency driver vs. U.S. dollar	Translation adjustment	Primary currency driver vs. U.S. dollar
Wholly-owned subsidiaries	\$90	British pound, Chinese renminbi	\$(193)	British pound, Chinese renminbi offset by Brazilian real
Equity method investments	11	Chinese renminbi	(14)	Chinese renminbi, Indian rupee offset by Japanese yen
Consolidated subsidiaries with a noncontrolling interest	1	Indian rupee	(6)	Indian rupee, Chinese renminbi
Total	\$102		\$(213)	

In millions	Six months ended July 2, 2017		July 3, 2016	
	Translation adjustment	Primary currency driver vs. U.S. dollar	Translation adjustment	Primary currency driver vs. U.S. dollar
Wholly-owned subsidiaries	\$147	British pound, Indian rupee, Chinese renminbi	\$(255)	British pound, Chinese renminbi offset by Brazilian real
Equity method investments	21	Chinese renminbi, Indian rupee	(9)	Chinese renminbi, Indian rupee offset by Japanese yen, Mexican peso
Consolidated subsidiaries with a noncontrolling interest	14	Indian rupee	(6)	Indian rupee, Chinese renminbi
Total	\$182		\$(270)	

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OPERATING SEGMENT RESULTS

Our reportable operating segments consist of the Engine, Distribution, Components and Power Systems segments. This reporting structure is organized according to the products and markets each segment serves. We use segment EBIT as a primary basis for the CODM to evaluate the performance of each of our operating segments. Segment amounts exclude certain expenses not specifically identifiable to segments. See Note 12, "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 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent
External sales ⁽¹⁾	\$ 1,711	\$ 1,504	\$ 207	14 %	\$ 3,168	\$ 2,993	\$ 175	6 %
Intersegment sales ⁽¹⁾	596	498	98	20 %	1,162	985	177	18 %
Total sales	2,307	2,002	305	15 %	4,330	3,978	352	9 %
Depreciation and amortization	46	41	(5)	(12)%	90	80	(10)	(13)%
Research, development and engineering expenses	63	53	(10)	(19)%	117	110	(7)	(6)%
Equity, royalty and interest income from investees	56	46	10	22 %	128	82	46	56 %
Loss contingency	—	39	39	100 %	—	39	39	100 %
Interest income	2	3	(1)	(33)%	3	5	(2)	(40)%
Segment EBIT	277	206	71	34 %	506	403	103	26 %
Percentage Points								
Segment EBIT as a percentage of total sales	12.0 %	10.3 %		1.7	11.7 %	10.1 %		1.6

⁽¹⁾ Due to the acquisitions of North American distributors, sales previously recognized as external sales are now included in intersegment sales.

Sales for our Engine segment by market were as follows:

In millions	Three months ended		Favorable/		Six months ended		Favorable/	
	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent
Heavy-duty truck	\$ 714	\$ 622	\$ 92	15 %	\$ 1,334	\$ 1,253	\$ 81	6 %
Medium-duty truck and bus	701	600	101	17 %	1,245	1,149	96	8 %
Light-duty automotive	429	394	35	9 %	852	827	25	3 %
Total on-highway	1,844	1,616	228	14 %	3,431	3,229	202	6 %
Off-highway	463	386	77	20 %	899	749	150	20 %
Total sales	\$ 2,307	\$ 2,002	\$ 305	15 %	\$ 4,330	\$ 3,978	\$ 352	9 %

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 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent
Heavy-duty	24,100	20,700	3,400	16 %	43,300	40,400	2,900	7 %
Medium-duty	71,600	62,300	9,300	15 %	131,900	117,700	14,200	12 %

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Light-duty	65,600	57,100	8,500	15	%	128,700	118,800	9,900	8	%
Total unit shipments	161,300	140,100	21,200	15	%	303,900	276,900	27,000	10	%

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Sales

Engine segment sales for the three months ended July 2, 2017, increased \$305 million versus the comparable period in 2016, driven by:

• Medium-duty truck and bus sales increased \$101 million primarily due to higher demand in North American medium-duty truck markets with increased engine shipments of 35 percent.

• Heavy-duty truck sales increased \$92 million primarily due to higher demand in North American heavy-duty truck markets with increased shipments of 19 percent.

• Off-highway sales increased \$77 million primarily due to improved demand in global industrial markets, especially in international construction markets, with increased unit shipments of 45 percent in China.

Total on-highway-related sales for the three months ended July 2, 2017, were 80 percent of total engine segment sales, compared to 81 percent for the comparable period in 2016.

Engine segment sales for the six months ended July 2, 2017, increased \$352 million versus the comparable period in 2016. The following were primary drivers:

• Off-highway sales increased \$150 million primarily due to improved demand in global industrial markets, especially in international construction markets, with increased unit shipments of 54 percent in China and Australia.

• Medium-duty truck and bus sales increased \$96 million primarily due to higher demand in North American medium-duty truck markets with increased engine shipments of 12 percent.

• Heavy-duty truck sales increased \$81 million primarily due to higher demand in North American heavy-duty truck markets.

Total on-highway-related sales for the six months ended July 2, 2017, were 79 percent of total engine segment sales, compared to 81 percent for the comparable period in 2016.

Segment EBIT

Engine segment EBIT for the three months ended July 2, 2017, increased \$71 million versus the comparable period in 2016, primarily due to higher gross margin and the absence of a loss contingency recorded in the second quarter of 2016, partially offset by higher selling, general and administrative expenses.

Engine segment EBIT for the six months ended July 2, 2017, increased \$103 million versus the comparable period in 2016 primarily due to higher equity, royalty and interest income from investees, improved gross margin and the absence of a loss contingency recorded in the second quarter of 2016, partially offset by higher selling, general and administrative expenses. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Three months ended July 2, 2017 vs. July 3, 2016				Six months ended July 2, 2017 vs. July 3, 2016			
	Favorable/(Unfavorable) Change		Percentage point change as a percent of total sales		Favorable/(Unfavorable) Change		Percentage point change as a percent of total sales	
	Amount	Percent			Amount	Percent		
Gross margin	\$ 44	11 %	(0.7	)	\$ 44	6 %	(0.5	)
Selling, general and administrative expenses	(19)	(13)%	0.1		(32)	(12)%	(0.2	)
Research, development and engineering expenses	(10)	(19)%	(0.1	)	(7)	(6)%	0.1	
Equity, royalty and interest income from investees	10	22 %	0.1		46	56 %	0.9	
Loss contingency ⁽¹⁾	39	NM	NM		39	NM	NM	

"NM" - not meaningful information

⁽¹⁾ See Note 9, "COMMITMENTS AND CONTINGENCIES," to the Condensed Consolidated Financial Statements for additional information.

The increase in gross margin dollars for the three months ended July 2, 2017, versus the comparable period in 2016, was primarily due to higher volumes and favorable mix, partially offset by increased warranty costs related to claims for certain 2013 and 2014 engines and higher variable compensation expense. The increases in selling, general and administrative expenses and research, development and engineering expenses were primarily due to higher variable compensation expenses. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Dongfeng Cummins Engine Company, Ltd.

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The increase in gross margin dollars for the six months ended July 2, 2017, versus the comparable period in 2016, was primarily due to higher volumes, favorable mix and improved pricing, partially offset by increased warranty costs related to claims for certain 2013 and 2014 engines and higher variable compensation expense. The increase in selling, general and administrative expenses was primarily due to higher variable compensation expense and higher consulting expenses. The increase in research, development and engineering expenses was primarily due to higher variable compensation expense. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Dongfeng Cummins Engine Company, Ltd. and Beijing Foton Cummins Engine Co.

Distribution Segment Results

Financial data for the Distribution segment was as follows:

	Three months ended			Favorable/		Six months ended			Favorable/	
	July 2, 2017	July 3, 2016		(Unfavorable)	Amount Percent	July 2, 2017	July 3, 2016		(Unfavorable)	Amount Percent
In millions										
External sales	\$1,716	\$1,538	\$178	12	%	\$3,353	\$2,996	\$357	12	%
Intersegment sales	6	6	—	—	%	14	11	3	27	%
Total sales	1,722	1,544	178	12	%	3,367	3,007	360	12	%
Depreciation and amortization	31	29	(2)	(7)	%	61	57	(4)	(7)	%
Research, development and engineering expenses	4	3	(1)	(33)	%	8	7	(1)	(14)	%
Equity, royalty and interest income from investees	13	19	(6)	(32)	%	24	37	(13)	(35)	%
Interest income	1	1	—	—	%	2	2	—	—	%
Segment EBIT	96	87	9	10	%	196	174	22	13	%

	Percentage Points					Percentage Points				
Segment EBIT as a percentage of total sales	5.6	%	5.6	%	—	5.8	%	5.8	%	—

In the first quarter of 2017, our Distribution segment reorganized its regions to align with how the segment is managed. All prior year amounts have been reclassified to conform to our new regional structure. Sales for our Distribution segment by region were as follows:

	Three months ended			Favorable/		Six months ended			Favorable/	
	July 2, 2017	July 3, 2016		(Unfavorable)	AmountPercent	July 2, 2017	July 3, 2016		(Unfavorable)	AmountPercent
In millions										
North America	\$1,131	\$975	\$156	16	%	\$2,244	\$1,920	\$324	17	%
Asia Pacific	187	187	—	—	%	357	356	1	—	%
Europe	107	111	(4)	(4)	%	204	212	(8)	(4)	%
Africa and Middle East	86	100	(14)	(14)	%	181	189	(8)	(4)	%
China	75	55	20	36	%	133	114	19	17	%
India	52	46	6	13	%	95	87	8	9	%
Latin America	43	38	5	13	%	78	71	7	10	%
Russia	41	32	9	28	%	75	58	17	29	%
Total sales	\$1,722	\$1,544	\$178	12	%	\$3,367	\$3,007	\$360	12	%

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

	Three months ended		Favorable/			Six months ended		Favorable/	
	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent		July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent
In millions									
Parts	\$ 759	\$ 642	\$ 117	18 %		\$1,504	\$1,290	\$ 214	17 %
Power generation	329	326	3	1 %		635	601	34	6 %
Service	320	297	23	8 %		639	596	43	7 %
Engines	314	279	35	13 %		589	520	69	13 %
Total sales	\$ 1,722	\$ 1,544	\$ 178	12 %		\$3,367	\$3,007	\$ 360	12 %

Sales

Distribution segment sales for the three months ended July 2, 2017, increased \$178 million versus the comparable period in 2016, primarily due to an increase in organic sales of \$113 million (primarily in North America) and \$88 million of sales related to the acquisition of North American distributors since December 31, 2015, partially offset by unfavorable foreign currency fluctuations (primarily in the Chinese renminbi, Canadian dollar and British pound).

Distribution segment sales for the six months ended July 2, 2017, increased \$360 million versus the comparable period in 2016 primarily due to an increase in organic sales of \$214 million (primarily in North America) and \$177 million of segment sales related to the acquisition of North American distributors since December 31, 2015, partially offset by unfavorable foreign currency fluctuations (primarily in the Chinese renminbi and British pound).

Segment EBIT

Distribution segment EBIT for the three months ended July 2, 2017, increased \$9 million versus the comparable period in 2016, primarily due to higher gross margin, partially offset by higher selling, general and administrative expenses (mainly related to the acquisition of North American distributors since December 31, 2015).

Distribution segment EBIT for the six months ended July 2, 2017, increased \$22 million versus the comparable period in 2016, primarily due to higher gross margin, partially offset by higher selling, general and administrative expenses (mainly related to the acquisition of North American distributors since December 31, 2015). Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Three months ended				Six months ended			
	July 2, 2017 vs. July 3, 2016				July 2, 2017 vs. July 3, 2016			
	Favorable/(Unfavorable) Change				Favorable/(Unfavorable) Change			
	Amount	Percent	Percentage point change as a percent of total sales		Amount	Percent	Percentage point change as a percent of total sales	
Gross margin	\$ 35	13 %	0.3		\$ 68	13 %	0.1	
Selling, general and administrative expenses	(27)	(14)%	(0.3)		(42)	(11)%	0.1	
Equity, royalty and interest income from investees	(6)	(32)%	(0.4)		(13)	(35)%	(0.5)	

The increase in gross margin dollars for the three months ended July 2, 2017, versus the comparable period in 2016, was primarily due to higher volumes, the acquisition of North American distributors since December 31, 2015 and improved pricing, partially offset by higher product costs. The increase in selling, general and administrative expenses was primarily due to higher variable compensation expense and increased compensation expenses related to the acquisition of North American distributors. The decrease in equity, royalty and interest income from investees was primarily due to the acquisition of North American distributors.

The increase in gross margin for the six months ended July 2, 2017, versus the comparable period in 2016, was primarily due to improved pricing, the acquisition of North American distributors since December 31, 2015 and higher volumes, partially offset by higher product costs. The increase in selling, general and administrative expenses was primarily due to higher variable compensation expense, increased compensation expenses related to the acquisition of North American distributors and higher consulting expenses. The decrease in equity, royalty and

interest income from investees was primarily due to the acquisition of North American distributors.

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Components Segment Results

Financial data for the Components segment was as follows:

In millions	Three months ended		Favorable/			Six months ended		Favorable/		
	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent		July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	
External sales ⁽¹⁾	\$ 1,064	\$ 933	\$ 131	14 %		\$ 2,044	\$ 1,830	\$ 214	12 %	
Intersegment sales ⁽¹⁾	390	346	44	13 %		754	686	68	10 %	
Total sales	1,454	1,279	175	14 %		2,798	2,516	282	11 %	
Depreciation and amortization	38	32	(6)	(19)%		75	63	(12)	(19)%	
Research, development and engineering expenses	57	51	(6)	(12)%		107	107	—	— %	
Equity, royalty and interest income from investees	15	12	3	25 %		28	20	8	40 %	
Interest income	1	1	—	— %		1	2	(1)	(50)%	
Segment EBIT	190	190	—	— %		369	353	16	5 %	

	Percentage Points				Percentage Points					
Segment EBIT as a percentage of total sales	13.1	%	14.9	%	(1.8)	13.2	%	14.0	%	(0.8)

⁽¹⁾ Due to the acquisitions of North American distributors, sales previously recognized as external sales are now included in intersegment sales.

In the first quarter of 2017, our Components segment reorganized its reporting structure to move an element of the emission solutions business to the fuel systems business to enhance operational, administrative and product development efficiencies. Prior year sales were reclassified to conform with this change.

Sales for our Components segment by business were as follows:

In millions	Three months ended		Favorable/			Six months ended		Favorable/		
	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent		July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	
Emission solutions	\$ 674	\$ 603	\$ 71	12 %		\$ 1,290	\$ 1,192	\$ 98	8 %	
Turbo technologies	307	276	31	11 %		594	541	53	10 %	
Filtration	291	262	29	11 %		568	514	54	11 %	
Fuel systems	182	138	44	32 %		346	269	77	29 %	
Total sales	\$ 1,454	\$ 1,279	\$ 175	14 %		\$ 2,798	\$ 2,516	\$ 282	11 %	

Sales

Components segment sales for the three months ended July 2, 2017, increased \$175 million, across all lines of business, versus the comparable period in 2016. The following were the primary drivers:

• Emission solutions sales increased \$71 million primarily due to higher demand to meet new emission requirements in India and on-highway truck demand in China.

• Fuel systems sales increased \$44 million primarily due to higher demand in China and Mexico.

• Turbo technologies sales increased \$31 million primarily due to higher demand in North America and China.

• Filtration sales increased \$29 million primarily due to higher demand in North America and China.

These increases were partially offset by unfavorable foreign currency fluctuations (primarily in the Chinese renminbi, British pound and euro).

Components segment sales for the six months ended July 2, 2017, increased \$282 million, across all lines of business, versus the comparable period in 2016. The following were the primary drivers:

•

Emission solutions sales increased \$98 million primarily due to higher demand in China on-highway truck markets and higher demand to meet new emission requirements in India, partially offset by unfavorable pricing in North America.

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Fuel systems sales increased \$77 million primarily due to higher demand in China.

- Filtration sales increased \$54 million primarily due to higher demand in North America and China.

Turbo technologies sales increased \$53 million primarily due to higher demand in China and North America.

These increases were partially offset by unfavorable foreign currency fluctuations (primarily in the Chinese renminbi, British pound and euro).

Segment EBIT

Components segment EBIT for the three months ended July 2, 2017, was flat versus the comparable period in 2016, as higher gross margin and higher equity, royalty and interest income from investees were offset by higher selling, general and administrative expenses and higher research, development and engineering expenses.

Components segment EBIT for the six months ended July 2, 2017, increased \$16 million versus the comparable period in 2016 primarily due to higher gross margin and higher equity, royalty and interest income from investees, partially offset by higher selling, general and administrative expenses. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Three months ended July 2, 2017 vs. July 3, 2016				Six months ended July 2, 2017 vs. July 3, 2016			
	Favorable/(Unfavorable) Change				Favorable/(Unfavorable) Change			
	Percentage point				Percentage point			
	Amount	Percent	change as a percent	of total sales	Amount	Percent	change as a percent	of total sales
Gross margin	\$ 10	3 %	(2.3	)	\$ 28	5 %	(1.4	)
Selling, general and administrative expenses	(18	)	(20	)%	(34	)	(20	)%
Research, development and engineering expenses	(6	)	(12	)%	—	—	%	0.5
Equity, royalty and interest income from investees	3	25 %	0.1		8	40 %	0.2	

The increase in gross margin for the three months ended July 2, 2017, versus the comparable period in 2016, was primarily due to higher volumes and lower material costs, partially offset by higher warranty costs driven by changes in estimates and unfavorable pricing in North America. The increase in selling, general and administrative expenses was primarily due to higher variable compensation expense and higher consulting expenses. The increase in research, development and engineering expenses was primarily due to lower expense recovery from customers and higher variable compensation expense.

The increase in gross margin for the six months ended July 2, 2017, versus the comparable period in 2016, was primarily due to higher volumes and lower material costs, partially offset by unfavorable pricing in North America and higher warranty costs driven by changes in estimates. The increase in selling, general and administrative expenses was primarily due to higher variable compensation expense and higher consulting expenses. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Dongfeng Cummins Emission Solutions Co., Ltd., Shanghai Fleetguard Filter Co. and Fleetguard Filtration Systems India Pvt.

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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 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent		July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	
External sales ⁽¹⁾	\$ 587	\$ 553	\$ 34	6 %		\$ 1,102	\$ 1,000	\$ 102	10 %	
Intersegment sales ⁽¹⁾	430	368	62	17 %		797	729	68	9 %	
Total sales	1,017	921	96	10 %		1,899	1,729	170	10 %	
Depreciation and amortization	29	29	—	— %		57	58	1	2 %	
Research, development and engineering expenses	50	48	(2)	(4) %		100	97	(3)	(3) %	
Equity, royalty and interest income from investees	14	11	3	27 %		26	21	5	24 %	
Interest income	1	1	—	— %		1	3	(2)	(67) %	
Segment EBIT	61	90	(29)	(32) %		118	136	(18)	(13) %	
					Percentage Points					
Segment EBIT as a percentage of total sales	6.0 %	9.8 %	(3.8)			6.2 %	7.9 %	(1.7)		

⁽¹⁾ Due to the acquisitions of North American distributors, sales previously recognized as external sales are now included in intersegment sales.

In the first quarter of 2017, our Power Systems segment reorganized its product lines to better reflect how the segment is managed. Prior year sales were reclassified to reflect these changes. Sales for our Power Systems segment by product line were as follows:

In millions	Three months ended		Favorable/			Six months ended		Favorable/		
	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent		July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	
Power generation	\$ 570	\$ 602	\$(32)	(5) %		\$ 1,096	\$ 1,120	\$(24)	(2) %	
Industrial	353	236	117	50 %		628	451	177	39 %	
Generator technologies	94	83	11	13 %		175	158	17	11 %	
Total sales	\$ 1,017	\$ 921	\$ 96	10 %		\$ 1,899	\$ 1,729	\$ 170	10 %	

High-horsepower unit shipments by engine classification were as follows:

Units	Three months ended		Favorable/			Six months ended		Favorable/		
	July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent		July 2, 2017	July 3, 2016	(Unfavorable) Amount	Percent	
Power generation	2,100	2,200	(100)	(5) %		4,000	4,000	—	— %	
Industrial	1,700	1,100	600	55 %		3,000	2,100	900	43 %	
Total engine shipments	3,800	3,300	500	15 %		7,000	6,100	900	15 %	

Power Systems segment sales for the three months ended July 2, 2017, increased \$96 million versus the comparable period in 2016 primarily due to increased industrial sales of \$117 million principally due to higher demand in international mining markets and North American oil and gas markets.

These increases were partially offset by the following:

• Power generation sales decreased \$32 million primarily due to lower demand in the Middle East, China and Africa, partially offset by higher demand in Western Europe.

Foreign currency fluctuations negatively impacted sales, primarily due to the British pound.

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Power Systems segment sales for the six months ended July 2, 2017, increased \$170 million versus the comparable period in 2016. The following were the primary drivers:

- Industrial sales increased \$177 million primarily due to higher demand in global mining markets, North American oil and gas markets and North American rail markets.

- Generator technologies sales increased \$17 million primarily due to higher demand in Western Europe and China.

These increases were partially offset by the following:

- Power generation sales decreased \$24 million primarily due to lower demand in the Middle East, Brazil and Other Asia/Australia, partially offset by higher demand in Western Europe.

Foreign currency fluctuations negatively impacted sales, primarily due to the British pound.

Segment EBIT

Power Systems segment EBIT for the three months ended July 2, 2017, decreased \$29 million versus the comparable period in 2016, primarily due to lower gross margin and higher selling, general and administrative expenses, partially offset by higher equity, royalty and interest income from investees and favorable foreign currency fluctuations (primarily due to the British pound).

Power Systems segment EBIT for the six months ended July 2, 2017, decreased \$18 million versus the comparable period in 2016 primarily due to higher selling, general and administrative expenses and higher research, development and engineering expenses, partially offset by higher equity, royalty and interest income from investees. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Three months ended July 2, 2017 vs. July 3, 2016			Six months ended July 2, 2017 vs. July 3, 2016		
	Favorable/(Unfavorable) Change			Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of total sales	Amount	Percent	Percentage point change as a percent of total sales
Gross margin	\$ (15)	(7)%	(3.7)	\$ —	— %	(2.1)
Selling, general and administrative expenses	(8)	(8)%	0.3	(11)	(6)%	0.4
Research, development and engineering expenses	(2)	(4)%	0.3	(3)	(3)%	0.3
Equity, royalty and interest income from investees	3	27 %	0.2	5	24 %	0.2

The decrease in gross margin for the three months ended July 2, 2017, versus the comparable period in 2016, was primarily due to higher warranty cost related to a campaign accrual, unfavorable mix and increased material costs, partially offset by increased volumes and favorable foreign currency fluctuations (primarily in the British pound). The increase in selling, general and administrative expenses was primarily due to higher variable compensation expense and higher consulting expenses. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Chongqing Cummins Engine Co.

Gross margin was flat for the six months ended July 2, 2017, versus the comparable period in 2016, primarily due to higher warranty cost related to a campaign accrual, unfavorable mix and higher material costs, offset by increased volumes and favorable foreign currency fluctuations (primarily in the British pound). The increase in selling, general and administrative expenses was primarily due to higher variable compensation expense and higher consulting expenses. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Chongqing Cummins Engine Co.

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Reconciliation of Segment EBIT 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 2, 2017	July 3, 2016	July 2, 2017	July 3, 2016
TOTAL SEGMENT EBIT	\$ 624	\$ 573	\$1,189	\$1,066
Non-segment EBIT ⁽¹⁾	(4)	18	(3)	9
TOTAL EBIT	620	591	1,186	1,075
Less: Interest expense	21	16	39	35
INCOME BEFORE INCOME TAXES	599	575	1,147	1,040
Less: Income tax expense	158	148	301	280
CONSOLIDATED NET INCOME	441	427	846	760
Less: Net income attributable to noncontrolling interest	17	21	26	33
NET INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 424	\$ 406	\$820	\$727

⁽¹⁾ 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 2, 2017 and July 3, 2016.

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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 2, 2017	December 31, 2016
Working capital ⁽¹⁾	\$3,708	\$ 3,382
Current ratio	1.76	1.78
Accounts and notes receivable, net	\$3,553	\$ 3,025
Days' sales in receivables	62	61
Inventories	\$2,982	\$ 2,675
Inventory turnover	4.9	4.7
Accounts payable (principally trade)	\$2,300	\$ 1,854
Days' payable outstanding	52	51
Total debt	\$1,797	\$ 1,856
Total debt as a percent of total capital	18.7 %	20.6 %

⁽¹⁾ Working capital includes cash and cash equivalents.

Cash Flows

Cash and cash equivalents were impacted as follows:

In millions	Six months ended July 2, 2017	July 3, 2016	Change
Net cash provided by operating activities	\$826	\$738	\$ 88
Net cash used in investing activities	(160)	(391)	231
Net cash used in financing activities	(544)	(896)	352
Effect of exchange rate changes on cash and cash equivalents	51	(117)	168
Net increase (decrease) in cash and cash equivalents	\$173	\$(666)	\$ 839

Net cash provided by operating activities increased \$88 million for the six months ended July 2, 2017, versus the comparable period in 2016, primarily due to higher consolidated net income, the absence of restructuring payments and lower working capital levels, partially offset by higher equity in income of investees and the absence of loss contingency charges. During the first six months of 2017, the lower working capital requirements resulted in a cash outflow of \$196 million compared to a cash outflow of \$230 million in the comparable period in 2016.

Net cash used in investing activities decreased \$231 million for the six months ended July 2, 2017, versus the comparable period in 2016, primarily due to lower net investments in marketable securities of \$235 million.

Net cash used in financing activities decreased \$352 million for the six months ended July 2, 2017, versus the comparable period in 2016, primarily due to lower repurchases of common stock of \$575 million and lower payments on borrowings and capital lease obligations of \$104 million, partially offset by lower net borrowings of commercial paper of \$278 million and lower proceeds from borrowings of \$107 million.

The effect of exchange rate changes on cash and cash equivalents for the six months ended July 2, 2017, versus the comparable period in 2016, increased \$168 million primarily due to the British pound, which increased cash and cash equivalents by \$150 million.

Sources of Liquidity

We generate significant ongoing cash flow. Cash provided by operations is our principal source of liquidity with \$826 million provided in the six months ended July 2, 2017.

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At July 2, 2017, our other sources of liquidity included:

In millions	July 2, 2017			Primary location of international balances
	Total	U.S.	International	
Cash and cash equivalents	\$ 1,293	\$ 245	\$ 1,048	U.K., Singapore, China, Canada, Australia
Marketable securities ⁽¹⁾	174	41	133	India
Total	\$ 1,467	\$ 286	\$ 1,181	
Available credit capacity				
Revolving credit facility ⁽²⁾	\$ 1,616			
International and other uncommitted domestic credit facilities ⁽³⁾	\$ 170			

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

⁽²⁾ The revolving credit facility is maintained primarily to provide backup liquidity for our commercial paper borrowings and general corporate purposes. At July 2, 2017, we had \$134 million of commercial paper outstanding, which effectively reduced the available capacity under our revolving credit facility to \$1.62 billion.

⁽³⁾ The available capacity is net of letters of credit.

Cash, Cash Equivalents and Marketable Securities

A significant portion of our cash flows 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 can issue up to \$1.75 billion of unsecured short-term promissory notes ("commercial paper") pursuant to a commercial paper program. The program facilitates the private placement of unsecured short-term debt through third party brokers. We intend to use the net proceeds from the commercial paper program for general corporate purposes and acquisitions.

We have a \$1.75 billion revolving credit facility, the proceeds of which can be used for general corporate purposes. This facility expires on November 13, 2020. The revolving credit facility is maintained primarily to provide backup liquidity for our commercial paper borrowings, letters of credit and general corporate purposes. The total combined borrowing capacity under the revolving credit facility and commercial paper program should not exceed \$1.75 billion. 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

Share 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 2017, we made the following purchases under the 2015 stock repurchase program:

In millions, except per share amounts	Shares Purchased	Average Cost Per Share	Total Cost of Repurchases	Remaining Authorized Capacity ⁽¹⁾
April 2	0.3	\$ 151.32	\$ 51	\$ 445
July 2	0.5	153.95	69	376
Total	0.8	\$ 152.82	\$ 120	

⁽¹⁾ The remaining authorized capacity under the 2015 Plan was calculated based on the cost to purchase the shares but excludes commission expenses in accordance with the authorized Plan.

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We may continue to repurchase outstanding shares from time to time during 2017 to enhance shareholder value and to offset the dilutive impact of employee stock based compensation plans.

Dividends

In July 2017, our Board of Directors authorized an increase to our quarterly dividend of 5.4 percent from \$1.025 per share to \$1.08 per share. We paid dividends of \$343 million during the six months ended July 2, 2017.

Agreement to Form a Joint Venture

In April 2017, we entered into an agreement to form a joint venture with Eaton Corporation PLC and we closed the transaction on July 31, 2017. We purchased a 50 percent interest in the new venture named Eaton Cummins Automated Transmission Technologies for \$600 million, which we funded with a combination of cash and short-term debt. We are still in the process of finalizing the purchase accounting and we do not expect this new venture to have a significant impact on our consolidated results in 2017.

Capital Expenditures

Capital expenditures, including spending on internal use software, for the six months ended July 2, 2017, were \$222 million compared to \$216 million in the comparable period in 2016. We continue to invest in new product lines and targeted capacity expansions. We plan to spend between \$500 million and \$530 million in 2017 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 2017.

Pensions

Our global pension plans, including our unfunded and non-qualified plans, were 110 percent funded at December 31, 2016. Our U.S. qualified plans, which represent approximately 56 percent of the worldwide pension obligation, were 118 percent funded and our U.K. plans were 121 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 2017, the investment return on our U.S. pension trust was 7.1 percent while our U.K. pension trust return was 0.8 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 2017 of \$50 million for our U.S. and U.K. pension plans. Approximately \$133 million of the estimated \$134 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 2017 net periodic pension cost to approximate \$83 million.

Current Maturities of Short and Long-Term Debt

We had \$134 million of commercial paper outstanding at July 2, 2017, 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 \$4 million to \$45 million over the next five years (including the remainder of 2017). See Note 7 "DEBT," to the Condensed Consolidated Financial Statements for additional information.

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 ⁽¹⁾	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

⁽¹⁾ 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.

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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 provides 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. We continue to generate cash from operations 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 2016 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 2016 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 2017.

RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 13, "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 2016 Form 10-K. There have been no material changes in this information since the filing of our 2016 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 and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is (1) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended July 2, 2017, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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.

The disclosure set forth under "Loss Contingency" in Note 9, "COMMITMENTS AND CONTINGENCIES," to the Condensed Consolidated Financial Statements is incorporated herein by reference.

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, 2016, 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	Average Price Paid per Share ⁽¹⁾	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 ⁽²⁾
April 3 - May 7	71,242	\$ 145.27	69,028	35,513
May 8 - June 4	349,431	155.49	346,899	35,681
June 5 - July 2	38,124	157.82	33,283	33,273
Total	458,797	154.09	449,210	

⁽¹⁾ 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 programs.

⁽²⁾ These values reflect the sum of shares held in loan status under our Key Employee Stock Investment Plan. The repurchase programs authorized by the Board of Directors do 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 such programs as of July 2, 2017, was \$1.4 billion.

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 November 2015, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon the completion of the 2014 repurchase plan. During the three months ended July 2, 2017, we repurchased \$69 million of common stock under the 2015 Board of Directors authorized plan.

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During the three months ended July 2, 2017, we repurchased 9,587 shares from employees in connection with the Key Employee Stock Investment Plan which allows certain employees, other than officers, to purchase shares of common stock on an installment basis up to an established credit limit. Loans are issued for five-year terms at a fixed interest rate established at the date of purchase and may be refinanced after 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

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

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SIGNATURES

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

Cummins Inc.

Date: August 1, 2017

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)

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CUMMINS INC.
EXHIBIT INDEX

Exhibit No. Description of Exhibit

3.1	By-Laws, as amended and restated effective as of May 9, 2017 (incorporated by reference to Annex B to the Company's definitive proxy statement filed with the Securities and Exchange Commission on Schedule 14A on March 27, 2017 (File No. 001-04949))
10.1	Cummins Inc. 2012 Omnibus Incentive Plan, as amended and restated (incorporated by reference to Annex A to the Company's definitive proxy statement filed with the Securities and Exchange Commission on Schedule 14A on March 27, 2017 (File No. 001-04949))
<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.
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.