

CUMMINS INC
Form 10-Q
October 27, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 27, 2015

Commission File Number 1-4949

CUMMINS INC.

(Exact name of registrant as specified in its charter)

Indiana

(State of Incorporation)

500 Jackson Street

Box 3005

Columbus, Indiana 47202-3005

(Address of principal executive offices)

35-0257090

(IRS Employer Identification No.)

Telephone (812) 377-5000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of September 27, 2015, there were 177,621,278 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.

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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 | | Nine months ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| NET SALES ^(a) | \$4,620 | \$4,890 | \$14,344 | \$14,131 |
| Cost of sales | 3,412 | 3,606 | 10,609 | 10,543 |
| GROSS MARGIN | 1,208 | 1,284 | 3,735 | 3,588 |
| OPERATING EXPENSES AND INCOME | | | | |
| Selling, general and administrative expenses | 530 | 529 | 1,584 | 1,527 |
| Research, development and engineering expenses | 197 | 198 | 558 | 567 |
| Equity, royalty and interest income from investees (Note 5) | 78 | 99 | 240 | 294 |
| Other operating (expense) income, net | (2 |) 3 | (5 |) (4 |
| OPERATING INCOME | 557 | 659 | 1,828 | 1,784 |
| Interest income | 9 | 6 | 20 | 17 |
| Interest expense | 16 | 15 | 47 | 47 |
| Other income, net | 11 | 19 | 12 | 68 |
| INCOME BEFORE INCOME TAXES | 561 | 669 | 1,813 | 1,822 |
| Income tax expense (Note 6) | 169 | 230 | 521 | 553 |
| CONSOLIDATED NET INCOME | 392 | 439 | 1,292 | 1,269 |
| Less: Net income attributable to noncontrolling interests | 12 | 16 | 54 | 62 |
| NET INCOME ATTRIBUTABLE TO CUMMINS INC. | \$380 | \$423 | \$1,238 | \$1,207 |
| EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC. | | | | |
| Basic | \$2.15 | \$2.32 | \$6.92 | \$6.59 |
| Diluted | \$2.14 | \$2.32 | \$6.90 | \$6.58 |
| WEIGHTED AVERAGE SHARES OUTSTANDING | | | | |
| Basic | 177.0 | 182.2 | 178.9 | 183.1 |
| Dilutive effect of stock compensation awards | 0.4 | 0.5 | 0.4 | 0.4 |
| Diluted | 177.4 | 182.7 | 179.3 | 183.5 |
| CASH DIVIDENDS DECLARED PER COMMON SHARE | \$0.975 | \$0.78 | \$2.535 | \$2.03 |

^(a) Includes sales to nonconsolidated equity investees of \$274 million and \$956 million and \$518 million and \$1,656 million for the three and nine month periods ended September 27, 2015 and September 28, 2014, respectively.

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

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CUMMINS INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

| In millions | Three months ended | | Nine months ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| CONSOLIDATED NET INCOME | \$ 392 | \$ 439 | \$ 1,292 | \$ 1,269 |
| Other comprehensive (loss) income, net of tax (Note 12) | | | | |
| Change in pension and other postretirement defined benefit plans | 15 | 14 | 43 | 28 |
| Foreign currency translation adjustments | (221 |) (172 |) (252 |) (62 |
| Unrealized loss on marketable securities | (1 |) (1 |) (1 |) (12 |
| Unrealized gain (loss) on derivatives | 7 | (5 |) 15 | — |
| Total other comprehensive loss, net of tax | (200 |) (164 |) (195 |) (46 |
| COMPREHENSIVE INCOME | 192 | 275 | 1,097 | 1,223 |
| Less: Comprehensive income attributable to noncontrolling interests | (1 |) 10 | 39 | 59 |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO CUMMINS INC. | \$ 193 | \$ 265 | \$ 1,058 | \$ 1,164 |

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

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

| In millions, except par value | September 27, 2015 | December 31, 2014 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$1,688 | \$2,301 |
| Marketable securities (Note 7) | 35 | 93 |
| Total cash, cash equivalents and marketable securities | 1,723 | 2,394 |
| Accounts and notes receivable, net | | |
| Trade and other | 2,915 | 2,744 |
| Nonconsolidated equity investees | 244 | 202 |
| Inventories (Note 8) | 3,059 | 2,866 |
| Prepaid expenses and other current assets | 921 | 849 |
| Total current assets | 8,862 | 9,055 |
| Long-term assets | | |
| Property, plant and equipment | 7,262 | 7,123 |
| Accumulated depreciation | (3,545 |) (3,437 |
| Property, plant and equipment, net | 3,717 | 3,686 |
| Investments and advances related to equity method investees | 959 | 981 |
| Goodwill | 481 | 479 |
| Other intangible assets, net | 337 | 343 |
| Pension assets | 785 | 637 |
| Other assets | 656 | 595 |
| Total assets | \$15,797 | \$15,776 |
| LIABILITIES | | |
| Current liabilities | | |
| Accounts payable (principally trade) | \$1,824 | \$1,881 |
| Loans payable | 27 | 86 |
| Current portion of accrued product warranty (Note 9) | 388 | 363 |
| Accrued compensation, benefits and retirement costs | 505 | 508 |
| Current portion of deferred revenue | 414 | 401 |
| Other accrued expenses | 779 | 759 |
| Current maturities of long-term debt (Note 10) | 31 | 23 |
| Total current liabilities | 3,968 | 4,021 |
| Long-term liabilities | | |
| Long-term debt (Note 10) | 1,595 | 1,589 |
| Postretirement benefits other than pensions | 347 | 369 |
| Pensions | 292 | 289 |
| Other liabilities and deferred revenue | 1,514 | 1,415 |
| Total liabilities | \$7,716 | \$7,683 |
| Commitments and contingencies (Note 11) | | |
| EQUITY | | |
| Cummins Inc. shareholders' equity | \$2,173 | \$2,139 |

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| | | | |
|--|----------|----------|---|
| Common stock, \$2.50 par value, 500 shares authorized, 222.3 and 222.3 shares issued | | | |
| Retained earnings | 10,331 | 9,545 | |
| Treasury stock, at cost, 44.7 and 40.1 shares | (3,486 |) (2,844 |) |
| Common stock held by employee benefits trust, at cost, 1.0 and 1.1 shares | (11 |) (13 |) |
| Accumulated other comprehensive loss (Note 12) | (1,258 |) (1,078 |) |
| Total Cummins Inc. shareholders' equity | 7,749 | 7,749 | |
| Noncontrolling interests | 332 | 344 | |
| Total equity | \$8,081 | \$8,093 | |
| Total liabilities and equity | \$15,797 | \$15,776 | |

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

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

| In millions | Nine months ended | |
|---|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Consolidated net income | \$1,292 | \$1,269 |
| Adjustments to reconcile consolidated net income to net cash provided by operating activities | | |
| Depreciation and amortization | 383 | 330 |
| Gain on fair value adjustment for consolidated investees (Note 3) | (17 |) (38 |
| Deferred income taxes | (120 |) (37 |
| Equity in income of investees, net of dividends | (68 |) (103 |
| Pension contributions in excess of expense | (119 |) (154 |
| Other post-retirement benefits payments in excess of expense | (18 |) (22 |
| Stock-based compensation expense | 24 | 27 |
| Translation and hedging activities | 22 | (19 |
| Changes in current assets and liabilities, net of acquisitions | | |
| Accounts and notes receivable | (163 |) (236 |
| Inventories | (179 |) (302 |
| Other current assets | 133 | (6 |
| Accounts payable | (52 |) 316 |
| Accrued expenses | (153 |) 162 |
| Changes in other liabilities and deferred revenue | 219 | 184 |
| Other, net | (53 |) 17 |
| Net cash provided by operating activities | 1,131 | 1,388 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | (393 |) (409 |
| Investments in internal use software | (38 |) (40 |
| Investments in and advances to equity investees | (9 |) (39 |
| Acquisitions of businesses, net of cash acquired (Note 3) | (102 |) (266 |
| Investments in marketable securities—acquisitions (Note 7) | (175 |) (213 |
| Investments in marketable securities—liquidations (Note 7) | 228 | 316 |
| Cash flows from derivatives not designated as hedges | 17 | — |
| Other, net | (5 |) 11 |
| Net cash used in investing activities | (477 |) (640 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from borrowings | 24 | 39 |
| Payments on borrowings and capital lease obligations | (64 |) (72 |
| Net payments under short-term credit agreements | (38 |) (41 |
| Distributions to noncontrolling interests | (35 |) (52 |
| Dividend payments on common stock | (452 |) (370 |
| Repurchases of common stock | (650 |) (605 |
| Other, net | — | 2 |
| Net cash used in financing activities | (1,215 |) (1,099 |
| | (52 |) (20 |

EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH
EQUIVALENTS

| | | | |
|--|---------|---------|---|
| Net decrease in cash and cash equivalents | (613 |) (371 |) |
| Cash and cash equivalents at beginning of year | 2,301 | 2,699 | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$1,688 | \$2,328 | |

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, 2013 | \$ 556 | \$ 1,543 | \$ 8,406 | \$(2,195) | \$(16) | \$(784) | \$ 7,510 | \$ 360 | \$ 7,870 |
| Net income | | | 1,207 | | | | 1,207 | 62 | 1,269 |
| Other comprehensive income (loss) (Note 12) | | | | | | (43) | (43) | (3) | (46) |
| Issuance of shares | | 8 | | | | | 8 | — | 8 |
| Employee benefits trust activity | | 19 | | | 2 | | 21 | — | 21 |
| Acquisition of shares | | | | (605) | | | (605) | — | (605) |
| Cash dividends on common stock | | | (370) | | | | (370) | — | (370) |
| Distributions to noncontrolling interests | | | | | | | — | (63) | (63) |
| Stock based awards | | (5) | | 21 | | | 16 | — | 16 |
| Other shareholder transactions | | 4 | | | | | 4 | (7) | (3) |
| BALANCE AT SEPTEMBER 28, 2014 | \$ 556 | \$ 1,569 | \$ 9,243 | \$(2,779) | \$(14) | \$(827) | \$ 7,748 | \$ 349 | \$ 8,097 |
| BALANCE AT DECEMBER 31, 2014 | \$ 556 | \$ 1,583 | \$ 9,545 | \$(2,844) | \$(13) | \$(1,078) | \$ 7,749 | \$ 344 | \$ 8,093 |
| Net income | | | 1,238 | | | | 1,238 | 54 | 1,292 |
| Other comprehensive income (loss) (Note 12) | | | | | | (180) | (180) | (15) | (195) |
| Issuance of shares | | 7 | | | | | 7 | — | 7 |
| Employee benefits trust activity | | 21 | | | 2 | | 23 | — | 23 |
| Acquisition of shares | | | | (650) | | | (650) | — | (650) |
| Cash dividends on common stock | | | (452) | | | | (452) | — | (452) |
| Distributions to noncontrolling interests | | | | | | | — | (46) | (46) |
| Stock based awards | | (4) | | 8 | | | 4 | — | 4 |
| Other shareholder transactions | | 10 | | | | | 10 | (5) | 5 |
| | \$ 556 | \$ 1,617 | \$ 10,331 | \$(3,486) | \$(11) | \$(1,258) | \$ 7,749 | \$ 332 | \$ 8,081 |

BALANCE AT
SEPTEMBER 27,
2015

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 a corporation in Columbus, Indiana and as one of the first diesel engine manufacturers. 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 company-owned and independent distributor locations and approximately 7,200 dealer locations in more than 190 countries and territories.

NOTE 2. BASIS OF PRESENTATION

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

Our reporting period usually ends on the Sunday closest to the last day of the quarterly calendar period. The third quarters of 2015 and 2014 ended on September 27 and September 28, respectively. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

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

The weighted-average diluted common shares outstanding exclude the anti-dilutive effect of certain stock options since such options had an exercise price in excess of the monthly average market value of our common stock. The options excluded from diluted earnings per share for the three and nine month periods ended September 27, 2015 and September 28, 2014, were as follows:

| | Three months ended | | Nine months ended | |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Options excluded | 950,345 | 225,773 | 593,436 | 110,488 |

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, 2014. Our interim period financial results for the three and nine month interim periods presented are not necessarily indicative of results to be expected for any other interim period or for the entire year. The year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

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NOTE 3. ACQUISITIONS

In September 2013, we announced our intention to acquire the equity that we do not already own in most of our partially-owned U.S. and Canadian distributors over a three to five year period.

The Distribution segment North American distributor acquisitions for the nine months ended September 27, 2015, versus the comparable period in 2014 were as follows:

| Entity Acquired (Dollars in millions) | Date of Acquisition | Additional Percent Interest Acquired | Payments to Former Owners | Acquisition Related Debt Retirements | Total Purchase Consideration | Type of Acquisition ⁽¹⁾ | Gain Recognized | Goodwill Acquired | Intangible Assets Recognized | Net Sales Previous Fiscal Year Ended ⁽³⁾ |
|--|------------------------|---|------------------------------------|---|------------------------------------|---------------------------------------|--------------------|----------------------|------------------------------------|--|
| 2015 | | | | | | | | | | |
| Cummins Crosspoint LLC ⁽⁴⁾ | 08/03/15 | 50% | \$ 20 | \$ 36 | \$ 65 | ⁽⁵⁾ COMB | \$ 10 | \$ 7 | \$ 2 | \$ 258 |
| Cummins Atlantic LLC ⁽⁴⁾ | 08/03/15 | 51% | 14 | 28 | 48 | ⁽⁵⁾ COMB | 7 | 2 | 6 | 245 |
| Cummins Central Power LLC | 06/29/15 | 20.01% | 8 | — | 8 | EQUITY | — | — | — | — |
| 2014 | | | | | | | | | | |
| Cummins Eastern Canada LP | 08/04/14 | 50% | \$ 30 | \$ 32 | \$ 62 | COMB | \$ 18 | \$ 5 | \$ 4 | \$ 228 |
| Cummins Power Systems LLC | 05/05/14 | 30% | 14 | — | 14 | EQUITY | — | — | — | — |
| Cummins Southern Plains LLC | 03/31/14 | 50% | 44 | 48 | 92 | COMB | 13 | 1 | 11 | 433 |
| Cummins Mid-South LLC | 02/14/14 | 62.2% | 57 | 61 | 118 | COMB | 7 | 4 | 8 | 368 |

All results from acquired entities were included in Distribution segment results subsequent to the acquisition date. Previously consolidated entities were accounted for as equity transactions (EQUITY). Newly consolidated entities

- (1) were accounted for as business combinations (COMB) with gains recognized based on the requirement to remeasure our pre-existing ownership to fair value in accordance with GAAP and are included in the Condensed Consolidated Statements of Income as "Other income, net."
- (2) Intangible assets acquired in business combinations were mostly customer related, the majority of which will be amortized over a period of up to five years from the date of the acquisition.
- (3) Sales amounts are not fully incremental to our consolidated sales as the amount would be reduced by the elimination of sales to the previously unconsolidated entity.
- (4) Purchase accounting for these acquisitions are preliminary, awaiting customary adjustments to purchase price in accordance with the purchase agreements.

The "Total Purchase Consideration" represents the total amount that will or is estimated to be paid to complete the acquisition. In some instances a portion of the acquisition payment has not yet been made and will be paid in future periods in accordance with the purchase contract. The total estimated remaining consideration at September 27, 2015, was \$15 million.

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NOTE 4. PENSION AND OTHER POSTRETIREMENT BENEFITS

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

| In millions | Pension U.S. Plans | | U.K. Plans | | Other Postretirement Benefits | |
|--------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-------------------------------|-----------------------|
| | Three months ended | | | | | |
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Service cost | \$20 | \$ 16 | \$7 | \$ 7 | \$— | \$— |
| Interest cost | 25 | 26 | 14 | 16 | 4 | 4 |
| Expected return on plan assets | (47) | (43) | (23) | (23) | — | — |
| Recognized net actuarial loss | 11 | 8 | 8 | 7 | 1 | — |
| Net periodic benefit cost | \$9 | \$ 7 | \$6 | \$ 7 | \$ 5 | \$ 4 |

| In millions | Pension U.S. Plans | | U.K. Plans | | Other Postretirement Benefits | |
|--------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-------------------------------|-----------------------|
| | Nine months ended | | | | | |
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Service cost | \$60 | \$ 50 | \$20 | \$ 19 | \$— | \$— |
| Interest cost | 76 | 79 | 42 | 49 | 12 | 13 |
| Expected return on plan assets | (142) | (131) | (68) | (66) | — | — |
| Recognized net actuarial loss | 34 | 23 | 25 | 20 | 3 | — |
| Net periodic benefit cost | \$28 | \$ 21 | \$19 | \$ 22 | \$ 15 | \$ 13 |

NOTE 5. EQUITY, ROYALTY AND INTEREST INCOME FROM INVESTEEES

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

| In millions | Three months ended | | Nine months ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Distribution Entities | | | | |
| North American distributors | \$9 | \$27 | \$27 | \$89 |
| Komatsu Cummins Chile, Ltda. | 8 | 8 | 23 | 22 |
| All other distributors | 1 | — | 2 | 2 |
| Manufacturing Entities | | | | |
| Beijing Foton Cummins Engine Co., Ltd | 18 | 5 | 47 | 6 |
| Dongfeng Cummins Engine Company, Ltd. | 11 | 15 | 40 | 51 |
| Chongqing Cummins Engine Company, Ltd. | 9 | 13 | 32 | 39 |
| All other manufacturers | 13 | 20 | 41 | 54 |
| Cummins share of net income | 69 | 88 | 212 | 263 |
| Royalty and interest income | 9 | 11 | 28 | 31 |
| Equity, royalty and interest income from investees | \$78 | \$99 | \$240 | \$294 |

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NOTE 6. INCOME TAXES

Our effective tax rate for the year is expected to approximate 29.5 percent, excluding any one-time items that may arise. The expected tax rate does not include the benefits of the research tax credit, which expired December 31, 2014 and has not yet been renewed by Congress. If the research credit is reinstated during 2015, we anticipate the 2015 effective tax rate will be reduced to 28.5 percent. 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.

The effective tax rate for the three and nine month periods ended September 27, 2015, was 30.1 percent and 28.7 percent, respectively. The tax rate for the nine month period ended September 27, 2015, included a net \$14 million discrete tax benefit primarily to reflect the release of reserves for uncertain tax positions related to a favorable federal audit settlement.

Our effective tax rate for the three and nine month periods ended September 28, 2014, was 34.4 percent and 30.4 percent, respectively. The tax rate for the three months ended September 28, 2014, included a \$19 million discrete tax expense to reflect the reduction in value of state tax credits as a result of a favorable state tax rate change that will lower future taxes. Additionally, the tax rate for the nine month period included a \$2 million discrete tax benefit for the release of reserves for uncertain tax positions related to multiple state audit settlements, a \$12 million discrete tax expense attributable primarily to state deferred tax adjustments, as well as a \$6 million discrete net tax benefit resulting from a \$70 million dividend paid from China earnings generated prior to 2012.

The decrease in the effective tax rate for the three months ended September 27, 2015, versus the comparable period in 2014 was primarily due to favorable changes in the jurisdictional mix of pre-tax income and the 2014 unfavorable discrete tax items.

It is reasonably possible that our existing liabilities for uncertain tax benefits may decrease in an amount ranging from \$0 to \$70 million within the next twelve months for U.S. and non-U.S. audits that are in process.

NOTE 7. MARKETABLE SECURITIES

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

| In millions | September 27, 2015 | | | December 31, 2014 | | |
|---|--------------------|---------------------------------|----------------------|-------------------|---------------------------------|----------------------|
| | Cost | Gross unrealized gains/(losses) | Estimated fair value | Cost | Gross unrealized gains/(losses) | Estimated fair value |
| Available-for-sale Level 2 ⁽¹⁾ | | | | | | |
| Debt mutual funds | \$25 | \$— | \$25 | \$75 | \$1 | \$76 |
| Equity mutual funds | 9 | (1 |) 8 | 9 | — | 9 |
| Bank debentures | — | — | — | 6 | — | 6 |
| Government debt securities | 2 | — | 2 | 2 | — | 2 |
| Total marketable securities | \$36 | \$(1 |) \$35 | \$92 | \$1 | \$93 |

⁽¹⁾ The fair value of Level 2 securities is estimated primarily using actively quoted prices for similar instruments from brokers and observable inputs, including market transactions and third-party pricing services. We do not currently have any Level 3 securities, and there were no transfers between Level 2 or 3 during the first nine months of 2015 and 2014.

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:

| In millions | Three months ended | Nine months ended |
|-------------|--------------------|-------------------|
|-------------|--------------------|-------------------|

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| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| Proceeds from sales and maturities of marketable securities | \$ 73 | \$ 137 | \$ 228 | \$ 316 |
| Gross realized gains from the sale of marketable securities | — | 1 | 1 | 14 |

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At September 27, 2015, the fair value of available-for-sale investments in debt securities that utilize a Level 2 fair value measure by contractual maturity was as follows:

| Maturity date | Fair value (in millions) |
|----------------|-----------------------------|
| 1 year or less | \$25 |
| 1 - 5 years | 1 |
| 5 - 10 years | 1 |
| Total | \$27 |

NOTE 8. INVENTORIES

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

| In millions | September 27, 2015 | December 31, 2014 |
|-----------------------------------|-----------------------|----------------------|
| Finished products | \$2,001 | \$1,859 |
| Work-in-process and raw materials | 1,168 | 1,129 |
| Inventories at FIFO cost | 3,169 | 2,988 |
| Excess of FIFO over LIFO | (110 |) (122 |
| Total inventories | \$3,059 | \$2,866 |

NOTE 9. PRODUCT WARRANTY LIABILITY

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

| In millions | September 27, 2015 | September 28, 2014 |
|---|-----------------------|-----------------------|
| Balance, beginning of year | \$1,283 | \$1,129 |
| Provision for warranties issued | 326 | 307 |
| Deferred revenue on extended warranty contracts sold | 217 | 175 |
| Payments | (282 |) (313 |
| Amortization of deferred revenue on extended warranty contracts | (132 |) (109 |
| Changes in estimates for pre-existing warranties | 18 | 28 |
| Foreign currency translation | (10 |) (4 |
| Balance, end of period | \$1,420 | \$1,213 |

Warranty related deferred revenue, supplier recovery receivables and the long-term portion of the warranty liability on our September 27, 2015, balance sheet were as follows:

| In millions | September 27, 2015 | Balance Sheet Location |
|--|-----------------------|--|
| Deferred revenue related to extended coverage programs | | |
| Current portion | \$183 | Deferred revenue |
| Long-term portion | 508 | Other liabilities and deferred revenue |
| Total | \$691 | |
| Receivables related to estimated supplier recoveries | | |
| Current portion | \$6 | Trade and other receivables |
| Long-term portion | 4 | Other assets |

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| | | |
|---|-------|--|
| Total | \$10 | |
| Long-term portion of warranty liability | \$341 | Other liabilities and deferred revenue |

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NOTE 10. DEBT

A summary of long-term debt was as follows:

| In millions | September 27, 2015 | December 31, 2014 |
|---|-----------------------|----------------------|
| 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 |
| Credit facilities related to consolidated joint ventures | 3 | 3 |
| Other debt | 43 | 31 |
| Unamortized discount | (46 |) (47 |
| Fair value adjustments due to hedge on indebtedness | 68 | 65 |
| Capital leases | 85 | 87 |
| Total long-term debt | 1,626 | 1,612 |
| Less: Current maturities of long-term debt | (31 |) (23 |
| Long-term debt | \$1,595 | \$1,589 |

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

| In millions | Required Principal Payments | | | | |
|--------------------|-----------------------------|------|------|------|------|
| | 2015 | 2016 | 2017 | 2018 | 2019 |
| Principal payments | \$9 | \$40 | \$16 | \$17 | \$11 |

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 value and carrying value of total debt, including current maturities, was as follows:

| In millions | September 27, 2015 | December 31, 2014 |
|---|-----------------------|----------------------|
| Fair value of total debt ⁽¹⁾ | \$1,859 | \$1,993 |
| Carrying value of total debt | 1,653 | 1,698 |

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

NOTE 11. COMMITMENTS AND CONTINGENCIES

We are subject to numerous lawsuits and claims arising out of the ordinary course of our business, including actions related to product liability; personal injury; the use and performance of our products; warranty matters; patent, trademark or other intellectual property infringement; contractual liability; the conduct of our business; tax reporting in foreign jurisdictions; distributor termination; workplace safety; and environmental matters. We also have been identified as a potentially responsible party at multiple waste disposal sites under U.S. federal and related state environmental statutes and regulations and may have joint and several liability for any investigation and remediation costs incurred with respect to such sites. We have denied liability with respect to many of these lawsuits, claims and proceedings and are vigorously defending such lawsuits, claims and proceedings. We carry various forms of commercial, property and casualty, product liability and other forms of insurance; however, such insurance may not be applicable or adequate to cover the costs associated with a judgment against us with respect to these lawsuits, claims and proceedings. We do not believe that these lawsuits are material individually or in the aggregate. While we believe we have also established adequate accruals for our expected future liability with respect to pending lawsuits,

claims and proceedings, where the nature and extent of any such liability can be reasonably estimated based upon then presently available information, there can be no assurance that the final resolution of any existing or future lawsuits, claims or proceedings will not have a material adverse effect on our business, results of operations, financial condition or cash flows.

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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.

Guarantees and Commitments

From time to time 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 third-party obligations. As of September 27, 2015, the maximum potential loss related to these guarantees was \$20 million. We have arrangements with certain suppliers that require us to purchase minimum volumes or be subject to monetary penalties. As of September 27, 2015, if we were to stop purchasing from each of these suppliers, the aggregate amount of the penalty would be approximately \$134 million, of which \$78 million relates to a contract with a components supplier that extends to 2018. These arrangements enable us to secure critical components. We do not currently anticipate paying any penalties under these contracts.

During 2014, we began entering into physical forward contracts with suppliers of platinum and palladium to purchase minimum volumes of the commodities at contractually stated prices for various periods, not to exceed two years. As of September 27, 2015, the total commitments under these contracts were \$38 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 \$69 million at September 27, 2015 and \$76 million at December 31, 2014.

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 counter-party for losses suffered as a result of a misrepresentation in the contract.

We regularly evaluate the probability of having to incur costs associated with these 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 12. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

| In millions | Three months ended | | | | Total attributable to Cummins Inc. | Noncontrolling Interests | Total |
|--|--|--|--|---|--|-----------------------------|---------|
| | Change in pensions and other postretirement defined benefit plans | Foreign currency translation adjustment | Unrealized gain (loss) on marketable securities | Unrealized gain (loss) on derivatives | | | |
| Balance at June 29, 2014 | \$ (597) | \$ (76) | \$ — | \$ 4 | \$ (669) | | |
| Other comprehensive income before reclassifications | | | | | | | |
| Before tax amount | — | (184) | — | (5) | (189) | \$ (6) | \$(195) |
| Tax (expense) benefit | — | 18 | — | 1 | 19 | — | 19 |
| After tax amount | — | (166) | — | (4) | (170) | (6) | (176) |
| Amounts reclassified from accumulated other comprehensive income ⁽¹⁾⁽²⁾ | 14 | — | (1) | (1) | 12 | — | 12 |
| Net current period other comprehensive income (loss) | 14 | (166) | (1) | (5) | (158) | \$ (6) | \$(164) |
| Balance at September 28, 2014 | \$ (583) | \$ (242) | \$ (1) | \$ (1) | \$ (827) | | |
| Balance at June 28, 2015 | \$ (641) | \$ (435) | \$ (1) | \$ 6 | \$ (1,071) | | |
| Other comprehensive income before reclassifications | | | | | | | |
| Before tax amount | — | (239) | (1) | 13 | (227) | \$ (13) | \$(240) |
| Tax (expense) benefit | — | 31 | — | (1) | 30 | — | 30 |
| After tax amount | — | (208) | (1) | 12 | (197) | (13) | (210) |
| Amounts reclassified from accumulated other comprehensive income ⁽¹⁾⁽²⁾ | 15 | — | — | (5) | 10 | — | 10 |
| Net current period other comprehensive income (loss) | 15 | (208) | (1) | 7 | (187) | \$ (13) | \$(200) |
| Balance at September 27, 2015 | \$ (626) | \$ (643) | \$ (2) | \$ 13 | \$ (1,258) | | |

(1) Amounts are net of tax.

(2) See reclassifications out of accumulated other comprehensive income (loss) disclosure below for further details.

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| In millions | Nine months ended | | | | | | |
|--|--|---|--|---|--|-----------------------------|----------|
| | Change in pensions and other postretirement defined benefit plans | Foreign currency translation adjustments | Unrealized gain (loss) on marketable securities | Unrealized gain (loss) on derivatives | Total attributable to Cummins Inc. | Noncontrolling interests | Total |
| Balance at December 31, 2013 | \$ (611) | \$ (179) | \$ 7 | \$ (1) | \$ (784) | | |
| Other comprehensive income before reclassifications | | | | | | | |
| Before tax amount | (7) | (77) | (1) | 5 | (80) | \$ 1 | \$(79) |
| Tax (expense) benefit | 1 | 14 | — | (2) | 13 | — | 13 |
| After tax amount | (6) | (63) | (1) | 3 | (67) | 1 | (66) |
| Amounts reclassified from accumulated other comprehensive income ⁽¹⁾⁽²⁾ | 34 | — | (7) | (3) | 24 | (4) | 20 |
| Net current period other comprehensive income (loss) | 28 | (63) | (8) | — | (43) | \$ (3) | \$(46) |
| Balance at September 28, 2014 | \$ (583) | \$ (242) | \$ (1) | \$ (1) | \$ (827) | | |
| Balance at December 31, 2014 | \$ (669) | \$ (406) | \$ (1) | \$ (2) | \$ (1,078) | | |
| Other comprehensive income before reclassifications | | | | | | | |
| Before tax amount | (3) | (290) | — | 23 | (270) | \$ (15) | \$(285) |
| Tax (expense) benefit | 1 | 53 | — | (3) | 51 | — | 51 |
| After tax amount | (2) | (237) | — | 20 | (219) | (15) | (234) |
| Amounts reclassified from accumulated other comprehensive income ⁽¹⁾⁽²⁾ | 45 | — | (1) | (5) | 39 | — | 39 |
| Net current period other comprehensive income (loss) | 43 | (237) | (1) | 15 | (180) | \$ (15) | \$(195) |
| Balance at September 27, 2015 | \$ (626) | \$ (643) | \$ (2) | \$ 13 | \$ (1,258) | | |

(1) Amounts are net of tax.

(2) See reclassifications out of accumulated other comprehensive income (loss) disclosure below for further details.

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Following are the items reclassified out of accumulated other comprehensive income (loss) and the related tax effects:

| In millions | Three months ended | | Nine months ended | | Statement of Income Location |
|---|--------------------|----------------|--------------------|--------------------|-------------------------------|
| (Gain)/Loss Components | September 2015 | September 2014 | September 27, 2015 | September 28, 2014 | |
| Change in pension and other postretirement defined benefit plans | | | | | |
| Recognized actuarial loss | \$22 | \$ 18 | \$65 | \$47 | (1) |
| Tax effect | (7 |) (4 |) (20 |) (13 |) Income tax expense |
| Net change in pensions and other postretirement defined benefit plans | \$15 | \$ 14 | \$45 | \$34 | |
| Realized (gain) loss on marketable securities | \$— | \$ (1 |) \$(1 |) \$(14 |) Other income (expense), net |
| Tax effect | — | — | — | 3 | Income tax expense |
| Net realized (gain) loss on marketable securities | \$— | \$ (1 |) \$(1 |) \$(11 |) |
| Realized (gain) loss on derivatives | | | | | |
| Foreign currency forward contracts | \$(6 |) \$(1 |) \$(6 |) \$(6 |) Net sales |
| Commodity swap contracts | — | (1 |) — | 2 | Cost of sales |
| Total before taxes | (6 |) (2 |) (6 |) (4 |) |
| Tax effect | 1 | 1 | 1 | 1 | Income tax expense |
| Net realized (gain) loss on derivatives | \$(5 |) \$(1 |) \$(5 |) \$(3 |) |
| Total reclassifications for the period | \$10 | \$ 12 | \$39 | \$20 | |

(1) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see Note 4, "PENSION AND OTHER POSTRETIREMENT BENEFITS").

NOTE 13. OPERATING SEGMENTS

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

Our reportable operating segments consist of the following: Engine, Distribution, Components and Power Generation. This reporting structure is organized according to the products and markets each segment serves. The Engine segment produces engines and parts for sale to customers in on-highway and various industrial markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as in various industrial applications, including construction, mining, agriculture, marine, oil and gas, rail and military equipment. 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 Generation segment is an integrated provider of power systems, which sells engines, generator sets and alternators.

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 have allocated certain common costs and expenses, primarily corporate functions, among segments differently than we would for stand-alone financial information prepared in accordance with GAAP. These include certain costs and expenses of shared services, such as information technology, human resources, legal and finance. We also do not allocate debt-related items, actuarial gains or losses, prior 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 for the three and nine month periods is shown in the table below:

| In millions | Engine | Distribution | Components | Power Generation | Non-segment Items ⁽¹⁾ | Total |
|--|---------|--------------|--------------------|------------------|----------------------------------|----------|
| Three months ended September 27, 2015 | | | | | | |
| External sales | \$1,800 | \$1,543 | \$891 | \$386 | \$— | \$4,620 |
| Intersegment sales | 728 | 8 | 349 | 273 | (1,358) | — |
| Total sales | 2,528 | 1,551 | 1,240 | 659 | (1,358) | 4,620 |
| Depreciation and amortization ⁽²⁾ | 60 | 26 | 28 | 14 | — | 128 |
| Research, development and engineering expenses | 116 | 2 | 65 | 14 | — | 197 |
| Equity, royalty and interest income from investees | 40 | 19 | 9 | 10 | — | 78 |
| Interest income | 6 | 1 | 1 | 1 | — | 9 |
| Segment EBIT | 252 | 123 | ⁽³⁾ 156 | 42 | 4 | 577 |
| Three months ended September 28, 2014 | | | | | | |
| External sales | \$2,181 | \$1,282 | \$946 | \$481 | \$— | \$4,890 |
| Intersegment sales | 635 | 10 | 341 | 273 | (1,259) | — |
| Total sales | 2,816 | 1,292 | 1,287 | 754 | (1,259) | 4,890 |
| Depreciation and amortization ⁽²⁾ | 50 | 22 | 27 | 13 | — | 112 |
| Research, development and engineering expenses | 114 | 2 | 64 | 18 | — | 198 |
| Equity, royalty and interest income from investees | 40 | 37 | 9 | 13 | — | 99 |
| Interest income | 3 | 1 | 1 | 1 | — | 6 |
| Segment EBIT | 330 | 131 | ⁽³⁾ 172 | 60 | (9) | 684 |
| Nine months ended September 27, 2015 | | | | | | |
| External sales | \$5,747 | \$4,499 | \$2,839 | \$1,259 | \$— | \$14,344 |
| Intersegment sales | 2,174 | 23 | 1,097 | 827 | (4,121) | — |
| Total sales | 7,921 | 4,522 | 3,936 | 2,086 | (4,121) | 14,344 |
| Depreciation and amortization ⁽²⁾ | 178 | 78 | 82 | 43 | — | 381 |
| Research, development and engineering expenses | 321 | 8 | 183 | 46 | — | 558 |
| Equity, royalty and interest income from investees | 127 | 60 | 26 | 27 | — | 240 |
| Interest income | 11 | 3 | 3 | 3 | — | 20 |
| Segment EBIT | 846 | 324 | ⁽³⁾ 574 | 148 | (32) | 1,860 |
| Nine months ended September 28, 2014 | | | | | | |
| External sales | \$6,449 | \$3,453 | \$2,821 | \$1,408 | \$— | \$14,131 |
| Intersegment sales | 1,674 | 27 | 976 | 728 | (3,405) | — |
| Total sales | 8,123 | 3,480 | 3,797 | 2,136 | (3,405) | 14,131 |
| Depreciation and amortization ⁽²⁾ | 153 | 58 | 79 | 38 | — | 328 |

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| | | | | | | |
|--|-----|-----|--------------------|-----|-----|---------|
| Research, development and engineering expenses | 335 | 7 | 170 | 55 | — | 567 |
| Equity, royalty and interest income from investees | 117 | 120 | 27 | 30 | — | 294 |
| Interest income | 9 | 2 | 3 | 3 | — | 17 |
| Segment EBIT | 910 | 333 | ⁽³⁾ 524 | 146 | (44 |) 1,869 |

⁽¹⁾ Includes intersegment sales, intersegment profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the three and nine months ended September 27, 2015 and September 28, 2014.

⁽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 \$2 million and \$2 million for the nine months ended September 27, 2015 and September 28, 2014, respectively.

⁽³⁾ Distribution segment EBIT included gains of \$17 million for both the three and nine month periods ended September 27, 2015 and \$18 million and \$38 million for the three and nine month periods ended September 28, 2014, respectively, on the fair value adjustments resulting from the acquisition of the controlling interests in North American distributors. See Note 3, "ACQUISITIONS," 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 | | Nine months ended | |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Total EBIT | \$577 | \$684 | \$1,860 | \$1,869 |
| Less: Interest expense | 16 | 15 | 47 | 47 |
| Income before income taxes | \$561 | \$669 | \$1,813 | \$1,822 |

NOTE 14. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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 standard allows either full or modified retrospective adoption. 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 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 judgments and assets recognized from costs incurred to fulfill a contract. The new rules would have become effective for annual and interim periods beginning January 1, 2017. In July 2015, the FASB approved a one year delay of the effective date of the standard to January 1, 2018, to provide adequate time for implementation. We are in the process of evaluating the impact the amendment will have on our Consolidated Financial Statements, and we are further considering the impact of each method of adoption.

NOTE 15. SUBSEQUENT EVENTS

On October 27, 2015, we announced we will reduce our worldwide professional work force by up to 2,000 employees in response to lower demand for our products in the United States and key markets around the world. The employee reductions will come from all parts of the company. We will incur a pre-tax fourth quarter charge in the range of \$70 million to \$90 million for the headcount reductions. In addition to these reductions, we expect to close or restructure several manufacturing facilities over time which could increase the fourth quarter charge and may result in additional charges in the future.

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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;
- a slowdown in infrastructure development;
- unpredictability in the adoption, implementation and enforcement of emission standards around the world;
- the actions of, and income from, joint ventures and other investees that we do not directly control;
 - changes in the engine outsourcing practices of significant customers;
- a downturn in the North American truck industry or financial distress of a major truck customer;
- a major customer experiencing financial distress;
- any significant problems in our new engine platforms;
- supply shortages and supplier financial risk, particularly from any of our single-sourced suppliers;
- variability in material and commodity costs;
- product recalls;
- competitor pricing activity;
- increasing competition, including increased global competition among our customers in emerging markets;
- exposure to information technology security threats and sophisticated "cyber attacks;"

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;

the development of new technologies;

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obtaining additional customers for our new light-duty diesel engine platform and avoiding any related write-down in our investments in such platform;

increasingly stringent environmental laws and regulations;

foreign currency exchange rate changes;

the price and availability of energy;

the performance of our pension plan assets;

labor relations;

changes in actuarial and accounting standards;

our sales mix of products;

protection and validity of our patent and other intellectual property rights;

technological implementation and cost/financial risks in our increasing use of large, multi-year contracts;

the cyclical nature of some of our markets;

- the outcome of pending and future litigation and governmental proceedings;

continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support our future business;

the consummation and integration of the planned acquisitions of our partially-owned United States and Canadian distributors; and

other risk factors described in our 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 2014 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 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, Chrysler Group, LLC (Chrysler), Volvo AB, Komatsu, Navistar International Corporation, Aggreko plc, Ford Motor Company and MAN Nutzfahrzeuge AG. We serve our customers through a network of approximately 600 company-owned and independent distributor locations and approximately 7,200 dealer locations in more than 190 countries and territories. Our reportable operating segments consist of the following: Engine, Distribution, Components and Power Generation. This reporting structure is organized according to the products and markets each segment serves. The Engine segment produces engines and parts for sale to customers in on-highway and various industrial markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as in various industrial applications, including construction, mining, agriculture, marine, oil and gas, rail and military equipment. 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 Generation segment is an integrated provider of power systems, which sells engines, generator sets and alternators.

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 and 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 decreased 6 percent in the three months ended September 27, 2015, as compared to the same period in 2014, primarily due to unfavorable foreign currency fluctuations, lower global demand in most industrial markets, lower on-highway demand in international markets and weakness in global power generation markets, partially offset by sales increases related to the consolidation of partially-owned North American distributors since December 31, 2013. Continued international economic weakness in the third quarter of 2015 negatively impacted our international revenues (exclude the United States and Canada), which declined by 18 percent, with sales down in most of our markets, primarily in Brazil, as a result of challenging economic conditions and slower growth in China. The decline in international sales was primarily due to unfavorable foreign currency impacts of 4 percent (primarily in Europe, Brazil, Australia, India and the United Kingdom), lower demand in international industrial markets led by declines in the commercial marine market, the construction market (primarily in Europe) and the on-highway markets in Brazil. Revenue in the U.S. and Canada improved by 4 percent primarily due to increased Distribution segment sales related to the consolidation of North American distributors and higher demand in the North American on-highway markets, partially offset by lower demand in the industrial mining and construction markets.

Worldwide revenues increased 2 percent in the first nine months of 2015 as compared to the same period in 2014, primarily due to the consolidation of partially-owned North American distributors since December 31, 2013 and higher demand in North American on-highway markets, partially offset by unfavorable foreign currency fluctuations, lower global demand in many industrial markets and lower on-highway demand in international markets. Revenue in the U.S. and Canada improved by 11 percent primarily due to increased Distribution segment sales related to the consolidation of North American distributors and higher demand in North American on-highway markets, partially

offset by lower demand in mining and construction markets. Continued international economic weakness in the first nine months of 2015 negatively impacted our international revenues, which declined by 10 percent with sales down in most of our markets, especially in Europe and Brazil, as a result of their challenging economic conditions and slower growth in China. The decline in international sales was primarily due to unfavorable foreign currency impacts of 4 percent (primarily in Europe, Brazil, Australia, the U.K. and India), declines in international industrial markets led by declines in the construction market (primarily in Europe) and the commercial marine market and lower demand in on-highway markets (primarily in Brazil and China). These decreases were partially offset by increased international demand in certain power generation markets, especially in the Middle East and Africa.

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The following tables contain sales and earnings before interest expense, income tax expense and noncontrolling interests (EBIT) results by operating segment for the three and nine month periods ended September 27, 2015 and September 28, 2014. Refer to the section titled "Operating Segment Results" for a more detailed discussion of net sales and EBIT by operating segment, including the reconciliation of segment EBIT to income before income taxes.

| Operating Segments | Three months ended | | | September 28, 2014 | | | Percent change | |
|---------------------------|--------------------|------------------|-------|--------------------|------------------|-------|----------------|-------|
| | September 27, 2015 | | | September 28, 2014 | | | 2015 vs. 2014 | |
| In millions | Sales | Percent of Total | EBIT | Sales | Percent of Total | EBIT | Sales | EBIT |
| Engine | \$2,528 | 55 % | \$252 | \$2,816 | 58 % | \$330 | (10)% | (24)% |
| Distribution | 1,551 | 33 % | 123 | 1,292 | 26 % | 131 | 20% | (6)% |
| Components | 1,240 | 27 % | 156 | 1,287 | 26 % | 172 | (4)% | (9)% |
| Power Generation | 659 | 14 % | 42 | 754 | 15 % | 60 | (13)% | (30)% |
| Intersegment eliminations | (1,358) | (29)% | — | (1,259) | (25)% | — | 8% | — |
| Non-segment | — | — | 4 | — | — | (9) | — | NM |
| Total | \$4,620 | 100 % | \$577 | \$4,890 | 100 % | \$684 | (6)% | (16)% |

"NM" - not meaningful information

Net income attributable to Cummins was \$380 million, or \$2.14 per diluted share, on sales of \$4.6 billion for the three months ended September 27, 2015, versus the comparable prior year period net income attributable to Cummins of \$423 million, or \$2.32 per diluted share, on sales of \$4.9 billion. The decrease in net income and earnings per diluted share was driven by lower gross margin, unfavorable foreign currency fluctuations and lower equity, royalty and interest income from investees, partially offset by a lower effective tax rate. The decrease in gross margin was primarily due to lower volumes, unfavorable foreign currency fluctuations (primarily in Australia, Canada, Brazil and Europe), unfavorable pricing and unfavorable mix, partially offset by improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2013, lower material and commodity costs and lower warranty costs. Diluted earnings per share for the three months ended September 27, 2015, benefited \$0.01 from fewer weighted average shares outstanding due to purchases under the stock repurchase programs.

| Operating Segments | Nine months ended | | | September 28, 2014 | | | Percent change | |
|---------------------------|--------------------|------------------|---------|--------------------|------------------|---------|----------------|-------|
| | September 27, 2015 | | | September 28, 2014 | | | 2015 vs. 2014 | |
| In millions | Sales | Percent of Total | EBIT | Sales | Percent of Total | EBIT | Sales | EBIT |
| Engine | \$7,921 | 55 % | \$846 | \$8,123 | 57 % | \$910 | (2)% | (7)% |
| Distribution | 4,522 | 32 % | 324 | 3,480 | 25 % | 333 | 30% | (3)% |
| Components | 3,936 | 27 % | 574 | 3,797 | 27 % | 524 | 4% | 10% |
| Power Generation | 2,086 | 15 % | 148 | 2,136 | 15 % | 146 | (2)% | 1% |
| Intersegment eliminations | (4,121) | (29)% | — | (3,405) | (24)% | — | 21% | — |
| Non-segment | — | — | (32) | — | — | (44) | — | (27)% |
| Total | \$14,344 | 100 % | \$1,860 | \$14,131 | 100 % | \$1,869 | 2% | —% |

Net income attributable to Cummins was \$1,238 million, or \$6.90 per diluted share, on sales of \$14.3 billion for the nine months ended September 27, 2015, versus the comparable prior year period net income attributable to Cummins of \$1,207 million, or \$6.58 per diluted share, on sales of \$14.1 billion. The increase in net income and earnings per diluted share was driven by improved gross margin, a lower effective tax rate and lower research, development and engineering expenses, partially offset by unfavorable foreign currency fluctuations, higher selling, general and administrative expenses, lower other income as a result of larger gains recognized in 2014 from the acquisition of North American distributors and lower equity, royalty and interest income from investees. The increase in gross

margin was primarily due to improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2013 and lower material and commodity costs, partially offset by unfavorable foreign currency fluctuations (primarily in Australia, Canada, Brazil and Europe), unfavorable pricing, unfavorable mix and higher warranty costs. Diluted earnings per share for the nine months ended September 27, 2015, benefited \$0.09 from fewer weighted average shares outstanding, primarily due to purchases under the stock repurchase programs.

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We generated \$1.1 billion of operating cash flows for the nine months ended September 27, 2015, compared to \$1.4 billion for the same period in 2014. Refer to the section titled “Cash Flows” in the “Liquidity and Capital Resources” section for a discussion of items impacting cash flows.

During the first six months of 2015, we repurchased \$174 million of common stock under the 2012 Board of Directors Authorized Plan, completing this program in the second quarter of 2015. In July 2014, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon the completion of the 2012 Plan. We repurchased \$476 million under the new authorization in 2015.

In the third quarter of 2015, we completed the acquisition of the remaining interest in three North American distributors for \$121 million and recognized a total gain of \$17 million on the fair value adjustment resulting from the acquisition of the controlling interests in two of these previously unconsolidated entities.

Our debt to capital ratio (total capital defined as debt plus equity) at September 27, 2015, was 17.0 percent, compared to 17.3 percent at December 31, 2014. At September 27, 2015, we had \$1.7 billion in cash and marketable securities on hand and access to our credit facilities, if necessary, to meet currently anticipated investment and funding needs.

As of the date of filing this Quarterly Report on Form 10-Q, our credit ratings were as follows:

| Credit Rating Agency | Senior L-T Debt Rating | Outlook | Last Updated |
|-----------------------------------|---------------------------|---------|---------------|
| Standard & Poor’s Rating Services | A+ | Stable | August 2014 |
| Fitch Ratings | A | Stable | October 2015 |
| Moody’s Investors Service, Inc. | A2 | Stable | December 2014 |

In July 2015, the Board of Directors authorized an increase to our quarterly dividend of 25 percent from \$0.78 per share to \$0.975 per share.

Our global pension plans, including our unfunded and non-qualified plans, were 108 percent funded at December 31, 2014. Our U.S. qualified plan, which represents approximately 56 percent of the worldwide pension obligation, was 119 percent funded and our U.K. plan was 113 percent funded. We expect to contribute \$175 million to our global pension plans in 2015. Refer to Note 4, "PENSION AND OTHER POSTRETIREMENT BENEFITS" for additional information regarding our pension plans.

We expect our effective tax rate for the full year of 2015 to approximate 29.5 percent, excluding any one-time tax items.

On October 27, 2015, we announced we will reduce our worldwide professional work force by up to 2,000 employees in response to lower demand for our products in the U.S. and key markets around the world. The employee reductions will come from all parts of the company. We will incur a pre-tax fourth quarter charge in the range of \$70 million to \$90 million for the headcount reductions. In addition to these reductions, we expect to close or restructure several manufacturing facilities over time which could increase the fourth quarter charge and may result in additional charges in the future.

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OUTLOOK

Near-Term

Our outlook reflects the following trends for the remainder of 2015:

• We expect demand in the North American medium-duty truck market to remain stable.

• We expect North American light-duty demand to remain stable.

• We expect the new ISG engine, which began production in the second quarter of 2014 with our Beijing Foton Cummins Engine Co., Ltd. joint venture, to continue to gain market share in China in its first full year of production.

• We expect demand in India to improve in some end markets as their economy continues to improve.

Our outlook reflects the following challenges to our business that may reduce our revenue and earnings potential for the remainder of 2015:

• We expect industry production in the North American heavy-duty truck markets to decline.

• Power generation markets are expected to remain weak.

• Weak economic conditions in Brazil will continue to negatively impact demand across our businesses.

• We anticipate end markets in China to remain weak.

• Demand in certain European markets could remain weak due to continued political and economic uncertainty.

• Foreign currency volatility could continue to put pressure on our revenues and earnings.

• We expect market demand to remain weak in the oil and gas markets as the result of low crude oil prices.

• Domestic and international mining markets could continue to deteriorate if commodity prices continue to weaken.

We expect the challenging conditions described above to persist for some time.

Long-Term

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

• tightening emissions controls across the world;

• infrastructure needs in emerging markets;

• energy availability and cost issues; and

• globalization of industries like ours.

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RESULTS OF OPERATIONS

| In millions (except per share amounts) | Three months ended | | Favorable/ | | Nine months ended | | Favorable/ | |
|--|--------------------|--------------------|---------------|---------|--------------------|--------------------|---------------|---------|
| | September 27, 2015 | September 28, 2014 | (Unfavorable) | Percent | September 27, 2015 | September 28, 2014 | (Unfavorable) | Percent |
| NET SALES | \$4,620 | \$ 4,890 | \$(270) | (6)% | \$14,344 | \$ 14,131 | \$213 | 2 % |
| Cost of sales | 3,412 | 3,606 | 194 | 5 % | 10,609 | 10,543 | (66) | (1)% |
| GROSS MARGIN | 1,208 | 1,284 | (76) | (6)% | 3,735 | 3,588 | 147 | 4 % |
| OPERATING EXPENSES AND INCOME | | | | | | | | |
| Selling, general and administrative expenses | 530 | 529 | (1) | — % | 1,584 | 1,527 | (57) | (4)% |
| Research, development and engineering expenses | 197 | 198 | 1 | 1 % | 558 | 567 | 9 | 2 % |
| Equity, royalty and interest income from investees | 78 | 99 | (21) | (21)% | 240 | 294 | (54) | (18)% |
| Other operating (expense) income, net | (2) | 3 | (5) | NM | (5) | (4) | (1) | 25 % |
| OPERATING INCOME | 557 | 659 | (102) | (15)% | 1,828 | 1,784 | 44 | 2 % |
| Interest income | 9 | 6 | 3 | 50 % | 20 | 17 | 3 | 18 % |
| Interest expense | 16 | 15 | (1) | (7)% | 47 | 47 | — | — % |
| Other income, net | 11 | 19 | (8) | (42)% | 12 | 68 | (56) | (82)% |
| INCOME BEFORE INCOME TAXES | 561 | 669 | (108) | (16)% | 1,813 | 1,822 | (9) | — % |
| Income tax expense | 169 | 230 | 61 | 27 % | 521 | 553 | 32 | 6 % |
| CONSOLIDATED NET INCOME | 392 | 439 | (47) | (11)% | 1,292 | 1,269 | 23 | 2 % |
| Less: Net income attributable to noncontrolling interests | 12 | 16 | 4 | 25 % | 54 | 62 | 8 | 13 % |
| NET INCOME ATTRIBUTABLE TO CUMMINS INC. | \$380 | \$ 423 | \$(43) | (10)% | \$1,238 | \$ 1,207 | \$31 | 3 % |
| Diluted earnings per common share attributable to Cummins Inc. | \$2.14 | \$ 2.32 | \$(0.18) | (8)% | \$6.90 | \$ 6.58 | \$0.32 | 5 % |

"NM" - not meaningful information

| Percent of sales | Three months ended | | Favorable/ | | Nine months ended | | Favorable/ | |
|--|--------------------|--------------------|---------------|-------------------|--------------------|--------------------|---------------|-------------------|
| | September 27, 2015 | September 28, 2014 | (Unfavorable) | Percentage Points | September 27, 2015 | September 28, 2014 | (Unfavorable) | Percentage Points |
| Gross margin | 26.1 % | 26.3 % | (0.2) | | 26.0 % | 25.4 % | 0.6 | |
| Selling, general and administrative expenses | 11.5 % | 10.8 % | (0.7) | | 11.0 % | 10.8 % | (0.2) | |
| Research, development and engineering expenses | 4.3 % | 4.0 % | (0.3) | | 3.9 % | 4.0 % | 0.1 | |

Net Sales

Net sales for the three months ended September 27, 2015, decreased versus the comparable period in 2014. The primary drivers by segment were as follows:

-

Engine segment sales decreased by 10 percent primarily due to lower demand in most global industrial markets as well as lower demand in international on-highway markets, partially offset by higher demand in global bus markets and North American medium-duty truck markets.

Foreign currency fluctuations unfavorably impacted sales by approximately 4 percent (primarily in Europe, Brazil, Australia, Canada, India and the U.K.).

Power Generation segment sales decreased by 13 percent due to lower demand in all lines of business.

Components segment sales decreased by 4 percent primarily due to unfavorable foreign currency fluctuations and lower demand in turbo technologies and filtration businesses, partially offset by higher demand in the emission solutions business.

The decreases above were partially offset by increased Distribution segment sales of 20 percent, principally related to the acquisitions of North American distributors since December 31, 2013.

Net sales for the nine months ended September 27, 2015, increased versus the comparable period in 2014. The primary drivers by segment were as follows:

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Distribution segment sales increased by 30 percent, principally related to the acquisitions of North American distributors since December 31, 2013.

Components segment sales increased by 4 percent primarily due to higher demand in the emission solutions and fuel systems businesses, partially offset by lower demand in the filtration and turbo technologies businesses.

The increases above were partially offset by the following:

Foreign currency fluctuations unfavorably impacted sales by approximately 4 percent (primarily in Europe, Brazil, Australia, Canada the U.K. and India).

Engine segment sales decreased by 2 percent primarily due to lower global demand in many industrial markets and lower on-highway demand in international markets, partially offset by higher demand in North American on-highway markets.

Power Generation segment sales decreased by 2 percent primarily due to lower demand in the alternator business, partially offset by higher demand in the power systems business.

Sales to international markets, based on location of customers, for the three and nine months ended September 27, 2015, were 38 percent and 39 percent, respectively, of total net sales compared to 44 percent of total net sales, for both of the comparable periods in 2014. A more detailed discussion of sales by segment is presented in the "OPERATING SEGMENT RESULTS" section.

Gross Margin

Gross margin decreased for the three months ended September 27, 2015, versus the comparable period in 2014, and decreased as a percentage of sales by 0.2 percentage points. The decrease in gross margin was primarily due to lower volumes, unfavorable foreign currency fluctuations (primarily in Australia, Canada, Brazil and Europe), unfavorable pricing and unfavorable mix, partially offset by improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2013, lower material and commodity costs and lower warranty costs.

Gross margin increased for the nine months ended September 27, 2015, versus the comparable period in 2014, and increased as a percentage of sales by 0.6 percentage points. The increase in gross margin was primarily due to improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2013 and lower material and commodity costs, partially offset by unfavorable foreign currency fluctuations (primarily in Australia, Canada, Brazil and Europe), unfavorable pricing, unfavorable mix and higher warranty costs.

The provision for base warranties issued as a percent of sales for the three and nine months ended September 27, 2015, was 1.8 percent and 2.0 percent, respectively, compared to 1.9 percent and 2.0 percent for the comparable periods in 2014. A more detailed discussion of margin by segment is presented in the "OPERATING SEGMENT RESULTS" section.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended September 27, 2015, were relatively flat versus the comparable period in 2014, despite the acquisitions of North American distributors. Higher compensation and related expenses of \$9 million were offset by lower consulting expenses of \$10 million. Overall, selling, general and administrative expenses, as a percentage of sales, increased to 11.5 percent in the three months ended September 27, 2015, from 10.8 percent in the comparable period in 2014. Compensation and related expenses include salaries, fringe benefits and variable compensation.

Selling, general and administrative expenses for the nine months ended September 27, 2015, increased versus the comparable period in 2014, despite the acquisitions of North American distributors, primarily due to higher compensation and related expenses of \$65 million, partially offset by lower consulting expenses of \$28 million. Overall, selling, general and administrative expenses, as a percentage of sales, increased to 11.0 percent in the first nine months of 2015, from 10.8 percent for the comparable period in 2014.

Research, Development and Engineering Expenses

Research, development and engineering expenses for the three months ended September 27, 2015, were relatively flat versus the comparable period in 2014. Higher expense recovery of \$9 million was partially offset by higher consulting expenses of \$5 million. Overall, research, development and engineering expenses, as a percentage of sales, increased

to 4.3 percent in the three months ended September 27, 2015, from 4.0 percent in the comparable period in 2014. Research, development and engineering expenses for the nine months ended September 27, 2015, decreased versus the comparable period in 2014, primarily due to higher expense recovery of \$11 million, partially offset by higher consulting

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expenses of \$3 million. Overall, research, development and engineering expenses, as a percentage of sales, decreased to 3.9 percent in the first nine months of 2015, from 4.0 percent in the comparable period in 2014. Research activities continue to focus on development of new products to meet future emission standards around the world and improvements in fuel economy performance.

Equity, Royalty and Interest Income From Investees

Equity, royalty and interest income from investees decreased \$21 million and \$54 million for the three and nine months ended September 27, 2015, respectively, versus the comparable periods in 2014, primarily due to the consolidation of the partially-owned North American distributors since December 31, 2013, (\$18 million and \$62 million, respectively) and lower earnings at Dongfeng Cummins Engine Company, Ltd. (\$4 million and \$11 million, respectively) and Chongqing Cummins Engine Company, Ltd. (\$4 million and \$7 million, respectively). These decreases were partially offset by higher equity earnings at Beijing Foton Cummins Engine Co., Ltd. (\$13 million and \$41 million, respectively) as the joint venture continues to increase market share with the new heavy-duty engine platform introduced in 2014.

Other Operating (Expense) Income, Net

Other operating (expense) income was as follows:

| In millions | Three months ended | | Nine months ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Amortization of intangible assets | \$(4 |) \$(3 |) \$(15 |) \$(10 |
| Royalty income, net | 4 | 8 | 14 | 16 |
| Other, net | (2 |) (2 |) (4 |) (10 |
| Total other operating (expense) income, net | \$(2 |) \$3 | \$(5 |) \$(4 |

Interest Income

Interest income for the three and nine months ended September 27, 2015, increased versus the comparable periods in 2014, primarily due to interest earned on a favorable tax settlement in Brazil.

Interest Expense

Interest expense for the three and nine months ended September 27, 2015, remained flat versus the comparable periods in 2014.

Other Income, Net

Other income was as follows:

| In millions | Three months ended | | Nine months ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Gain on fair value adjustment for consolidated investees ⁽¹⁾ | \$17 | \$ 18 | \$17 | \$ 38 |
| Foreign currency gains (losses), net | 3 | 1 | (2 |) (2 |
| Dividend income | — | 1 | 2 | 2 |
| Gain on marketable securities, net | — | 1 | 1 | 14 |
| Bank charges | (3 |) (3 |) (7 |) (8 |
| Change in cash surrender value of corporate owned life insurance | (11 |) (2 |) (9 |) 16 |
| Other, net | 5 | 3 | 10 | 8 |
| Total other income, net | \$11 | \$ 19 | \$12 | \$ 68 |

⁽¹⁾ See Note 3, "ACQUISITIONS" for additional information.

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Income Tax Expense

Our effective tax rate for the year is expected to approximate 29.5 percent, excluding any one-time items that may arise. The expected tax rate does not include the benefits of the research tax credit, which expired December 31, 2014 and has not yet been renewed by Congress. If the research credit is reinstated during 2015, we anticipate the 2015 effective tax rate will be reduced to 28.5 percent. 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.

The effective tax rate for the three and nine month periods ended September 27, 2015, was 30.1 percent and 28.7 percent, respectively. The tax rate for the nine month period ended September 27, 2015, included a net \$14 million discrete tax benefit primarily to reflect the release of reserves for uncertain tax positions related to a favorable federal audit settlement.

Our effective tax rate for the three and nine month periods ended September 28, 2014, was 34.4 percent and 30.4 percent, respectively. The tax rate for the three months ended September 28, 2014, included a \$19 million discrete tax expense to reflect the reduction in value of state tax credits as a result of a favorable state tax rate change that will lower future taxes. Additionally, the tax rate for the nine month period included a \$2 million discrete tax benefit for the release of reserves for uncertain tax positions related to multiple state audit settlements, a \$12 million discrete tax expense attributable primarily to state deferred tax adjustments, as well as a \$6 million discrete net tax benefit resulting from a \$70 million dividend paid from China earnings generated prior to 2012.

The decrease in the effective tax rate for the three months ended September 27, 2015, versus the comparable period in 2014 was primarily due to favorable changes in the jurisdictional mix of pre-tax income and the 2014 unfavorable discrete tax items.

It is reasonably possible that our existing liabilities for uncertain tax benefits may decrease in an amount ranging from \$0 to \$70 million within the next twelve months for U.S. and non-U.S. audits that are in process.

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 September 27, 2015, decreased primarily due to lower earnings at Wuxi Cummins Turbo Technologies Co. Ltd. and a decline from the acquisition of the remaining interest in previously consolidated North American distributors since December 31, 2013.

Noncontrolling interests in income of consolidated subsidiaries for the nine months ended September 27, 2015, decreased primarily due to lower earnings at Wuxi Cummins Turbo Technologies Co. Ltd. and a decline from the acquisition of the remaining interest in previously consolidated North American distributors since December 31, 2013, partially offset by higher earnings at Cummins India Ltd.

Net Income Attributable to Cummins Inc. and Diluted Earnings Per Share Attributable to Cummins Inc.

Net income and diluted earnings per share attributable to Cummins Inc. for the three months ended September 27, 2015, decreased versus the comparable period in 2014, primarily due to lower gross margin, unfavorable foreign currency fluctuations and lower equity, royalty and interest income from investees, partially offset by a lower effective tax rate. Diluted earnings per share for the three months ended September 27, 2015, benefited \$0.01 from fewer weighted average shares outstanding due to purchases under the stock repurchase programs.

Net income and diluted earnings per share attributable to Cummins for the nine months ended September 27, 2015, increased versus the comparable period in 2014, primarily due to improved gross margin, a lower effective tax rate and lower research, development and engineering expenses, partially offset by unfavorable foreign currency fluctuations, higher selling, general and administrative expenses, lower other income as a result of larger gains recognized in 2014 from the acquisition of North American distributors and lower equity, royalty and interest income from investees. Diluted earnings per share for the nine months ended September 27, 2015, benefited \$0.09 from fewer weighted average shares outstanding, primarily due to purchases under the stock repurchase programs.

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OPERATING SEGMENT RESULTS

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

Following is a discussion of 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/ (Unfavorable) | | Nine months ended | | Favorable/ (Unfavorable) | |
|--|--------------------------|--------------------------|-----------------------------|----------------------|--------------------------|--------------------------|-----------------------------|----------------------|
| | September 27, 2015 | September 28, 2014 | Amount | Percent | September 27, 2015 | September 28, 2014 | Amount | Percent |
| External sales ⁽¹⁾ | \$1,800 | \$2,181 | \$(381) | (17)% | \$5,747 | \$6,449 | \$(702) | (11)% |
| Intersegment sales ⁽¹⁾ | 728 | 635 | 93 | 15 % | 2,174 | 1,674 | 500 | 30 % |
| Total sales | 2,528 | 2,816 | (288) | (10)% | 7,921 | 8,123 | (202) | (2)% |
| Depreciation and amortization | 60 | 50 | (10) | (20)% | 178 | 153 | (25) | (16)% |
| Research, development and engineering expenses | 116 | 114 | (2) | (2)% | 321 | 335 | 14 | 4 % |
| Equity, royalty and interest income from investees | 40 | 40 | — | — % | 127 | 117 | 10 | 9 % |
| Interest income | 6 | 3 | 3 | 100 % | 11 | 9 | 2 | 22 % |
| Segment EBIT | 252 | 330 | (78) | (24)% | 846 | 910 | (64) | (7)% |
| | | | | Percentage Points | | | | Percentage Points |
| Segment EBIT as a percentage of total sales | 10.0 % | 11.7 % | | (1.7) | 10.7 % | 11.2 % | | (0.5) |

⁽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 2015, our Engine segment reorganized its reporting structure to include the following markets:

• **Heavy-duty truck** - We manufacture diesel engines that range from 310 to 600 horsepower serving global heavy-duty truck customers worldwide and fire trucks, primarily in North America.

• **Medium-duty truck and bus** - We manufacture medium-duty diesel engines ranging from 200 to 450 horsepower serving medium-duty truck and bus customers worldwide, with key markets including North America, Latin America, Europe and Mexico. We provide diesel or natural gas engines for school buses, transit buses and shuttle buses worldwide, with key markets including North America, Europe, Latin America and Asia. We also provide diesel engines for Class A motor homes (RVs), primarily in North America.

• **Light-duty automotive (Pickup and Light Commercial Vehicle (LCV))** - We manufacture 320 to 385 horsepower diesel engines for Chrysler's heavy-duty chassis cab and pickup trucks. We also manufacture 105 to 300 horsepower diesel engines for LCV's worldwide, with key markets in Europe, Latin America and Asia.

• **Industrial** - We provide mid-range, heavy-duty and high-horsepower engines that range from 49 to 5,100 horsepower for a wide variety of equipment in the construction, agricultural, mining, rail, government, oil and gas, and commercial and recreational marine applications throughout the world. Across these markets we have major customers in North America, Europe, Middle East, Africa, China, Korea, Japan, Latin America, India, Russia,

Southeast Asia, South Pacific and Mexico.

Stationary power - We provide mid-range, heavy-duty and high-horsepower engines, that range from 60 to 4,300 horsepower, to our power generation business for standby, mobile and distributed power generation solutions throughout the world.

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Engine segment net sales by market (including 2014 reorganized balances) were as follows:

| In millions | Three months ended | | Favorable/ (Unfavorable) | | Nine months ended | | Favorable/ (Unfavorable) | | Amount | Percent |
|---------------------------|--------------------------|--------------------------|-----------------------------|---------|--------------------------|--------------------------|-----------------------------|---------|--------|---------|
| | September 27, 2015 | September 28, 2014 | Amount | Percent | September 27, 2015 | September 28, 2014 | Amount | Percent | | |
| Heavy-duty truck | \$784 | \$801 | \$(17) | (2)% | \$2,416 | \$2,288 | \$128 | 6 | % | |
| Medium-duty truck and bus | 585 | 599 | (14) | (2)% | 1,867 | 1,779 | 88 | 5 | % | |
| Light-duty automotive | 339 | 396 | (57) | (14)% | 1,074 | 1,179 | (105) | (9)% | | |
| Total on-highway | 1,708 | 1,796 | (88) | (5)% | 5,357 | 5,246 | 111 | 2 | % | |
| Industrial | 617 | 768 | (151) | (20)% | 1,857 | 2,176 | (319) | (15)% | | |
| Stationary power | 203 | 252 | (49) | (19)% | 707 | 701 | 6 | 1 | % | |
| Total sales | \$2,528 | \$2,816 | \$(288) | (10)% | \$7,921 | \$8,123 | \$(202) | (2)% | | |

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

| | Three months ended | | Favorable/ (Unfavorable) | | Nine months ended | | Favorable/ (Unfavorable) | | Amount | Percent |
|----------------------|--------------------------|--------------------------|-----------------------------|---------|--------------------------|--------------------------|-----------------------------|---------|--------|---------|
| | September 27, 2015 | September 28, 2014 | Amount | Percent | September 27, 2015 | September 28, 2014 | Amount | Percent | | |
| Mid-range | 107,400 | 117,700 | (10,300) | (9)% | 339,800 | 355,300 | (15,500) | (4)% | | |
| Heavy-duty | 28,600 | 32,300 | (3,700) | (11)% | 90,100 | 91,400 | (1,300) | (1)% | | |
| High-horsepower | 3,200 | 3,900 | (700) | (18)% | 10,400 | 11,200 | (800) | (7)% | | |
| Total unit shipments | 139,200 | 153,900 | (14,700) | (10)% | 440,300 | 457,900 | (17,600) | (4)% | | |

Sales

Engine segment sales for the three months ended September 27, 2015, decreased versus the comparable period in 2014. The following were the primary drivers by market:

Industrial engine sales decreased primarily due to lower global demand in construction markets with decreased engine shipments of 31 percent, primarily in Europe and North America, reduced demand in global commercial marine markets with decreased engine shipments of 25 percent and reduced demand in North American mining markets with decreased engine shipments of 38 percent.

Light-duty automotive sales decreased due to lower demand, primarily in Brazil.

Stationary power sales decreased due to lower demand in most global power generation markets.

Foreign currency fluctuations unfavorably impacted sales results (primarily in Brazil and Europe).

Heavy-duty truck engine sales decreased due to lower demand in global heavy-duty truck markets with decreased engine shipments of 13 percent, primarily in Korea, North America and China.

Medium-duty truck and bus sales decreased due to lower demand in international medium-duty truck markets with decreased engine shipments of 21 percent, primarily in Brazil, partially offset by higher global bus demand with improved engine shipments of 24 percent and increased North American medium-duty truck demand.

Total on-highway-related sales for the three months ended September 27, 2015, were 68 percent of total engine segment sales, compared to 64 percent for the comparable period in 2014.

Engine segment sales for the nine months ended September 27, 2015, decreased versus the comparable period in 2014. The following were the primary drivers by market:

Industrial engine sales decreased due to lower global demand in construction markets with decreased engine shipments of 25 percent, primarily in Europe, North America and China and reduced demand in international commercial marine markets with decreased engine shipments of 16 percent.

Light-duty automotive sales decreased due to lower demand, primarily in Brazil, and unfavorable pricing.

Foreign currency fluctuations unfavorably impacted sales results (primarily in Brazil, Europe and the U.K.).

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The increases above were partially offset by the following:

• Heavy-duty truck engine sales increased due to improved demand in the North American heavy-duty truck market with increased engine shipments of 5 percent, partially offset by weaker demand in China and Korea.

• Medium-duty truck and bus sales increased due to higher demand in the North American medium-duty truck market with increased engine shipments of 14 percent and higher global bus demand with improved engine shipments of 18 percent. These increases were partially offset by weaker medium-duty truck demand in Brazil.

Total on-highway-related sales for the nine months ended September 27, 2015, were 68 percent of total engine segment sales, compared to 65 percent for the comparable period in 2014.

Segment EBIT

Engine segment EBIT for the three months ended September 27, 2015, decreased versus the comparable period in 2014 primarily due to lower gross margin and slightly higher research, development and engineering expenses, partially offset by lower selling, general and administrative expenses and favorable foreign currency fluctuations (primarily in the U.K., Mexico and Europe).

Engine segment EBIT for the nine months ended September 27, 2015, decreased versus the comparable period in 2014 primarily due to lower gross margin, partially offset by favorable foreign currency fluctuations (primarily in the U.K., Europe and Mexico), lower research, development and engineering expenses, higher equity, royalty and interest income from investees and lower 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 September 27, 2015 vs. September 28, 2014 | | | Nine months ended September 27, 2015 vs. September 28, 2014 | | |
|---|--|---------|---|---|---------|---|
| | Amount | Percent | Percentage point change as a percent of total sales | Amount | Percent | Percentage point change as a percent of total sales |
| Gross margin | \$(89) | (14)% | (1.0) | \$(89) | (5)% | (0.6) |
| Selling, general and administrative expenses | 12 | 6 % | (0.4) | 7 | 1 % | (0.1) |
| Research, development and engineering expenses | (2) | (2)% | (0.6) | 14 | 4 % | — |
| Equity, royalty and interest income from investees | — | — % | 0.2 | 10 | 9 % | 0.2 |

The decrease in gross margin for the three months ended September 27, 2015, versus the comparable period in 2014, was primarily due to lower volumes and unfavorable mix, partially offset by lower material and commodity costs and favorable foreign currency fluctuations. The decrease in selling, general and administrative expenses was primarily due to lower consulting expenses, lower compensation expenses and higher expense recovery.

The decrease in gross margin for the nine months ended September 27, 2015, versus the comparable period in 2014, was primarily due to lower volumes, higher warranty costs and unfavorable mix, partially offset by lower material and commodity costs and favorable foreign currency fluctuations. The decrease in selling, general and administrative expenses was primarily due to lower consulting expenses, partially offset by higher compensation expenses. The decrease in research, development and engineering expenses was primarily due to higher expense recovery and lower consulting expenses, partially offset by increased compensation expenses. The increase in equity, royalty and interest income from investees was primarily due to increased earnings at Beijing Foton Cummins Engine Co., Ltd. as the joint venture continues to increase market share with the new heavy-duty engine platform introduced in 2014, partially offset by an asset impairment of \$12 million.

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Distribution Segment Results

Financial data for the Distribution segment was as follows:

| In millions | Three months ended | | Favorable/ (Unfavorable) | | Nine months ended | | Favorable/ (Unfavorable) | |
|--|--------------------------|--------------------------|-----------------------------|-------------------|--------------------------|--------------------------|-----------------------------|-------------------|
| | September 27, 2015 | September 28, 2014 | Amount | Percent | September 27, 2015 | September 28, 2014 | Amount | Percent |
| External sales | \$1,543 | \$1,282 | \$261 | 20 % | \$4,499 | \$3,453 | \$1,046 | 30 % |
| Intersegment sales | 8 | 10 | (2) | (20)% | 23 | 27 | (4) | (15)% |
| Total sales | 1,551 | 1,292 | 259 | 20 % | 4,522 | 3,480 | 1,042 | 30 % |
| Depreciation and amortization | 26 | 22 | (4) | (18)% | 78 | 58 | (20) | (34)% |
| Research, development and engineering expenses | 2 | 2 | — | — % | 8 | 7 | (1) | (14)% |
| Equity, royalty and interest income from investees | 19 | 37 | (18) | (49)% | 60 | 120 | (60) | (50)% |
| Interest income | 1 | 1 | — | — % | 3 | 2 | 1 | 50 % |
| Segment EBIT ⁽¹⁾ | 123 | 131 | (8) | (6)% | 324 | 333 | (9) | (3)% |
| | | | | | | | | |
| | | | | Percentage Points | | | | Percentage Points |
| Segment EBIT as a percentage of total sales ⁽²⁾ | 7.9 % | 10.1 % | (2.2) | | 7.2 % | 9.6 % | (2.4) | |

⁽¹⁾ Segment EBIT included gains of \$17 million for the three and nine month periods ended September 27, 2015 and \$18 million and \$38 million for the three and nine month periods ended September 28, 2014, respectively, on the fair value adjustments resulting from the acquisition of the controlling interests in North American distributors.

⁽²⁾ North American distributor acquisitions are dilutive to segment EBIT as a percentage of sales.

Sales for our Distribution segment by region were as follows:

| In millions | Three months ended | | Favorable/ (Unfavorable) | | Nine months ended | | Favorable/ (Unfavorable) | |
|-------------------------|--------------------------|--------------------------|-----------------------------|---------|--------------------------|--------------------------|-----------------------------|---------|
| | September 27, 2015 | September 28, 2014 | Amount | Percent | September 27, 2015 | September 28, 2014 | Amount | Percent |
| North & Central America | \$992 | \$678 | \$314 | 46 % | \$2,901 | \$1,763 | \$1,138 | 65 % |
| Europe, CIS and China | 190 | 237 | (47) | (20)% | 543 | 651 | (108) | (17)% |
| Asia Pacific | 186 | 201 | (15) | (7)% | 550 | 564 | (14) | (2)% |
| Africa | 64 | 44 | 20 | 45 % | 169 | 131 | 38 | 29 % |
| Middle East | 48 | 53 | (5) | (9)% | 145 | 144 | 1 | 1 % |
| India | 42 | 40 | 2 | 5 % | 121 | 114 | 7 | 6 % |
| South America | 29 | 39 | (10) | (26)% | 93 | 113 | (20) | (18)% |
| Total sales | \$1,551 | \$1,292 | \$259 | 20 % | \$4,522 | \$3,480 | \$1,042 | 30 % |

Sales for our Distribution segment by product were as follows:

| In millions | Three months ended | | Favorable/ (Unfavorable) | | Nine months ended | | Favorable/ (Unfavorable) | |
|----------------------|--------------------------|--------------------------|-----------------------------|---------|--------------------------|--------------------------|-----------------------------|---------|
| | September 27, 2015 | September 28, 2014 | Amount | Percent | September 27, 2015 | September 28, 2014 | Amount | Percent |
| Parts and filtration | \$604 | \$491 | \$113 | 23 % | \$1,775 | \$1,334 | \$441 | 33 % |
| Engines | 323 | 270 | 53 | 20 % | 962 | 693 | 269 | 39 % |
| Power generation | 323 | 279 | 44 | 16 % | 893 | 750 | 143 | 19 % |

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| | | | | | | | | | | |
|-------------|---------|---------|-------|----|---|---------|---------|---------|----|---|
| Service | 301 | 252 | 49 | 19 | % | 892 | 703 | 189 | 27 | % |
| Total sales | \$1,551 | \$1,292 | \$259 | 20 | % | \$4,522 | \$3,480 | \$1,042 | 30 | % |

Sales

Distribution segment sales for the three months ended September 27, 2015, increased versus the comparable period in 2014, primarily due to \$357 million of segment sales related to the consolidation of partially-owned North American distributors since December 31, 2013, and \$24 million of organic sales growth primarily in Africa, partially offset by unfavorable foreign currency fluctuations (primarily in Australia, Canada, Europe and South Africa) and decreased sales in Western Europe, Asia Pacific, China and Russia.

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Distribution segment sales for the nine months ended September 27, 2015, increased versus the comparable period in 2014, primarily due to \$1.2 billion of segment sales related to the consolidation of partially-owned North American distributors since December 31, 2013, \$19 million of segment sales related to the acquisition of international distributors and \$105 million of organic sales growth primarily in Africa and Asia Pacific, partially offset by unfavorable foreign currency fluctuations (primarily in Australia, Canada, Europe and Brazil) and decreased sales in China, Western Europe, Russia and South America.

Segment EBIT

Distribution segment EBIT for the three months ended September 27, 2015, decreased versus the comparable period in 2014, primarily due to unfavorable foreign currency fluctuations (primarily in Australia and Canada), partially offset by the acquisition of North American distributors. EBIT as a percentage of sales for the three months ended September 27, 2015, was 7.9 percent compared to 10.1 percent for the comparable period in 2014. The decrease was due to the dilutive effect of the 2014 and 2015 acquisitions and unfavorable foreign currency fluctuations.

Distribution segment EBIT for the nine months ended September 27, 2015, decreased versus the comparable period in 2014, primarily due to unfavorable foreign currency fluctuations (primarily in Australia and Canada), partially offset by the acquisition of North American distributors and organic growth, primarily in Africa and Asia Pacific. EBIT as a percentage of sales for the nine months ended September 27, 2015, was 7.2 percent compared to 9.6 percent for the comparable period in 2014. The decrease was due to the dilutive effect of the 2014 and 2015 acquisitions and unfavorable foreign currency fluctuations. 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 September 27, 2015 vs. September 28, 2014 | | | | Nine months ended September 27, 2015 vs. September 28, 2014 | | | |
|--|--|---------|---------------------------------------|--|---|---------|---------------------------------------|--|
| | Favorable/(Unfavorable) Change | | Percentage point | | Favorable/(Unfavorable) Change | | Percentage point | |
| | Amount | Percent | change as a percent of total sales | | Amount | Percent | change as a percent of total sales | |
| Gross margin | \$37 | 16 % | (0.5) | | \$151 | 25 % | (0.7) | |
| Selling, general and administrative expenses | (22) | (14)% | 0.6 | | (74) | (17)% | 1.2 | |
| Equity, royalty and interest income from investees | (18) | (49)% | (1.7) | | (60) | (50)% | (2.1) | |

Components Segment Results

Financial data for the Components segment was as follows:

| In millions | Three months ended | | Favorable/ | | Nine months ended | | Favorable/ | |
|--|--------------------|--------------------|----------------------|---------|--------------------|--------------------|----------------------|---------|
| | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | Percent | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | Percent |
| External sales ⁽¹⁾ | \$891 | \$946 | \$(55) | (6)% | \$2,839 | \$2,821 | \$18 | 1 % |
| Intersegment sales ⁽¹⁾ | 349 | 341 | 8 | 2 % | 1,097 | 976 | 121 | 12 % |
| Total sales | 1,240 | 1,287 | (47) | (4)% | 3,936 | 3,797 | 139 | 4 % |
| Depreciation and amortization | 28 | 27 | (1) | (4)% | 82 | 79 | (3) | (4)% |
| Research, development and engineering expenses | 65 | 64 | (1) | (2)% | 183 | 170 | (13) | (8)% |
| Equity, royalty and interest income from investees | 9 | 9 | — | — % | 26 | 27 | (1) | (4)% |
| Interest income | 1 | 1 | — | — % | 3 | 3 | — | — % |

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| | | | | | | | | | | |
|---|------|-----|-------|-------------------|--------|------|----|-------------------|---|-----|
| Segment EBIT | 156 | 172 | (16) | (9)% | 574 | 524 | 50 | 10 | % | |
| | | | | Percentage Points | | | | Percentage Points | | |
| Segment EBIT as a percentage of total sales | 12.6 | % | 13.4 | % | (0.8) | 14.6 | % | 13.8 | % | 0.8 |

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

Sales for our Components segment by business were as follows:

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| | Three months ended | | Favorable/ | | Nine months ended | | Favorable/ | | |
|--------------------|--------------------|--------------------|----------------------|-----------------------|--------------------|--------------------|----------------------|-----------------------|--|
| | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | (Unfavorable) Percent | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | (Unfavorable) Percent | |
| In millions | | | | | | | | | |
| Emission solutions | \$607 | \$598 | \$9 | 2 % | \$1,899 | \$1,723 | \$176 | 10 % | |
| Turbo technologies | 266 | 297 | (31) | (10)% | 874 | 917 | (43) | (5)% | |
| Filtration | 240 | 268 | (28) | (10)% | 761 | 808 | (47) | (6)% | |
| Fuel systems | 127 | 124 | 3 | 2 % | 402 | 349 | 53 | 15 % | |
| Total sales | \$1,240 | \$1,287 | \$(47) | (4)% | \$3,936 | \$3,797 | \$139 | 4 % | |

Sales
Components segment sales for the three months ended September 27, 2015, decreased versus the comparable period in 2014. The following were the primary drivers by business:

• Foreign currency fluctuations unfavorably impacted sales results (primarily in Europe, Brazil and Australia).

• Turbo technologies sales decreased primarily due to lower demand in China, Europe and Latin America.

• Filtration sales decreased primarily due to lower demand in the North American on-highway markets and lower demand in Europe, North America and Latin America.

The decreases above were partially offset by improved emission solutions sales, primarily due to improved demand in certain North American on-highway markets and higher demand in China, partially offset by lower demand in Brazil.

Components segment sales for the nine months ended September 27, 2015, increased versus the comparable period in 2014. The following were the primary drivers by business:

• Emission solutions sales increased primarily due to improved demand in the North American on-highway markets.

• Fuel systems sales increased due to the new Beijing Foton ISG engine that entered production in the second quarter of 2014 in China and improved demand in certain North American on-highway markets.

The increases above were partially offset by the following:

• Foreign currency fluctuations unfavorably impacted sales results (primarily in Europe and Brazil).

• Filtration sales decreased primarily due to lower demand in Europe and Brazil.

• Turbo technologies sales decreased primarily due to lower demand in China, Europe and Brazil, partially offset by higher demand in the North American on-highway markets.

Segment EBIT

Components segment EBIT for the three months ended September 27, 2015, decreased versus the comparable period in 2014, primarily due to lower gross margin and unfavorable foreign currency fluctuations (primarily in Brazil and Europe).

Components segment EBIT for the nine months ended September 27, 2015, increased versus the comparable period in 2014, primarily due to higher gross margin, partially offset by unfavorable foreign currency fluctuations (primarily in Brazil and Europe), higher research, development and engineering expenses and 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:

| | Three months ended | | | Nine months ended | | | |
|--|---|---------|------------------------------------|---|---------|------------------------------------|------------------------------------|
| | September 27, 2015 vs. September 28, 2014 | | | September 27, 2015 vs. September 28, 2014 | | | |
| In millions | Favorable/(Unfavorable) Change | | Percentage point | Favorable/(Unfavorable) Change | | Percentage point | change as a percent of total sales |
| | Amount | Percent | change as a percent of total sales | Amount | Percent | change as a percent of total sales | |
| Gross margin | \$(14) | (5)% | (0.2) | \$70 | 8% | 0.9 | |
| Selling, general and administrative expenses | — | —% | (0.2) | (4) | (2)% | 0.1 | |
| | (1) | (2)% | (0.2) | (13) | (8)% | (0.1) | |

Research, development and
engineering expenses

Equity, royalty and interest income
from investees

— — % — (1) (4)% —

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The decrease in gross margin for the three months ended September 27, 2015, versus the comparable period in 2014, was primarily due to unfavorable pricing and unfavorable foreign currency fluctuations (primarily in Europe and Brazil), partially offset by lower material costs.

The increase in gross margin for the nine months ended September 27, 2015, versus the comparable period in 2014, was primarily due to higher volumes, mainly in the emission solutions business, and lower material costs, partially offset by unfavorable pricing and unfavorable foreign currency fluctuations (primarily in Europe and Brazil). The increase in selling, general and administrative expenses was primarily due to higher compensation expenses. The increase in research, development and engineering expenses was primarily due to higher consulting expenses and higher compensation expenses.

Power Generation Segment Results

Financial data for the Power Generation segment was as follows:

| | Three months ended | | Favorable/ | | Nine months ended | | Favorable/ | |
|--|--------------------|--------------------|----------------------|-------------------|--------------------|--------------------|----------------------|-------------------|
| | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | Percent | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | Percent |
| In millions | | | | | | | | |
| External sales ⁽¹⁾ | \$386 | \$481 | \$(95) | (20)% | \$1,259 | \$1,408 | \$(149) | (11)% |
| Intersegment sales ⁽¹⁾ | 273 | 273 | — | — % | 827 | 728 | 99 | 14 % |
| Total sales | 659 | 754 | (95) | (13)% | 2,086 | 2,136 | (50) | (2)% |
| Depreciation and amortization | 14 | 13 | (1) | (8)% | 43 | 38 | (5) | (13)% |
| Research, development and engineering expenses | 14 | 18 | 4 | 22 % | 46 | 55 | 9 | 16 % |
| Equity, royalty and interest income from investees | 10 | 13 | (3) | (23)% | 27 | 30 | (3) | (10)% |
| Interest income | 1 | 1 | — | — % | 3 | 3 | — | — % |
| Segment EBIT | 42 | 60 | (18) | (30)% | 148 | 146 | 2 | 1 % |
| | | | | | | | | |
| | | | | Percentage Points | | | | Percentage Points |
| Segment EBIT as a percentage of total sales | 6.4 % | 8.0 % | (1.6) | | 7.1 % | 6.8 % | 0.3 | |

⁽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 2015, our Power Generation segment reorganized its reporting structure to include the following businesses:

Power systems - We manufacture generators for commercial and consumer applications ranging from 2 kilowatts to 3.5 megawatts, as well as paralleling systems and transfer switches for applications such as data centers, health care facilities and waste water treatment plants.

Alternators - We design, manufacture, sell and service A/C generator/alternator products internally as well as to other generator set assemblers. Our products are sold under the Stamford, AVK and Markon brands and range in output from 3 kilovolt-amperes (kVA) to 12,000 kVA.

Power solutions - We provide natural gas fuel-based turnkey solutions for distributed generation and energy management applications using natural or biogas as a fuel. The business also serves a global rental account for diesel and gas generator sets.

Sales for our Power Generation segment by business (including 2014 reorganized balances) were as follows:

| | Three months ended | | Favorable/ | | Nine months ended | | Favorable/ | |
|--|--------------------|--------------------|----------------------|---------|--------------------|--------------------|----------------------|---------|
| | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | Percent | September 27, 2015 | September 28, 2014 | (Unfavorable) Amount | Percent |

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| In millions | 2015 | 2014 | Amount | Percent | 2015 | 2014 | Amount | Percent |
|-----------------|-------|-------|---------|---------|---------|---------|---------|---------|
| Power systems | \$551 | \$598 | \$(47) | (8)% | \$1,705 | \$1,694 | \$11 | 1 % |
| Alternators | 86 | 115 | (29) | (25)% | 276 | 346 | (70) | (20)% |
| Power solutions | 22 | 41 | (19) | (46)% | 105 | 96 | 9 | 9 % |
| Total sales | \$659 | \$754 | \$(95) | (13)% | \$2,086 | \$2,136 | \$(50) | (2)% |

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Sales

Power Generation segment sales for the three months ended September 27, 2015, decreased versus the comparable period in 2014. The following were the primary drivers by business:

Power systems sales decreased primarily due to lower demand in North America, China and Asia, partially offset by higher demand in the Middle East.

Alternator sales decreased primarily due to lower demand in Western Europe, China and the U.K.

Foreign currency fluctuations unfavorably impacted sales results (primarily in Europe, Brazil and India).

Power solutions sales decreased primarily due to lower demand in Russia, the U.K., North America and China, partially offset by higher demand in Asia.

Power Generation segment sales for the nine months ended September 27, 2015, decreased versus the comparable period in 2014. The following were the primary drivers by business:

Alternator sales decreased primarily due to lower demand in Western Europe, China and the U.K.

Foreign currency fluctuations unfavorably impacted sales results (primarily in Europe, Brazil and India).

The decreases above were partially offset by the following:

Power systems sales increased primarily due to higher demand in the Middle East, Africa and China, partially offset by lower demand in North America and Russia.

Power solutions sales increased primarily due to higher demand in the U.K., partially offset by lower demand in North America and Russia.

Segment EBIT

Power Generation segment EBIT for the three months ended September 27, 2015, decreased versus the comparable period in 2014, primarily due to lower gross margin, partially offset by lower selling, general and administrative expenses and lower research, development and engineering expenses.

Power Generation segment EBIT for the nine months ended September 27, 2015, increased slightly versus the comparable period in 2014 primarily due to lower selling, general and administrative expenses and lower research, development and engineering expenses, partially offset by lower gross margin. 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 September 27, 2015 vs. September 28, 2014 | | | Nine months ended September 27, 2015 vs. September 28, 2014 | | |
|--|--|---------|---|---|---------|---|
| | 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 | \$(29) | (20)% | (1.7) | \$(20) | (5)% | (0.5) |
| Selling, general and administrative expenses | 8 | 10 % | (0.3) | 13 | 6 % | 0.3 |
| Research, development and engineering expenses | 4 | 22 % | 0.3 | 9 | 16 % | 0.4 |
| Equity, royalty and interest income from investees | (3) | (23)% | (0.2) | (3) | (10)% | (0.1) |

The decrease in gross margin for the three months ended September 27, 2015, versus the comparable period in 2014, was primarily due to lower volumes and unfavorable pricing, partially offset by savings from operating actions taken in December of 2014. The decrease in selling, general and administrative expenses was primarily due to lower compensation expenses as the result of operating actions taken in December of 2014 and lower consulting expenses. The decrease in research, development and engineering expenses was primarily due to lower compensation expenses as the result of operating actions taken in December of 2014.

The decrease in gross margin for the nine months ended September 27, 2015, versus the comparable period in 2014, was primarily due to unfavorable pricing and lower volumes, partially offset by savings from operating actions taken in December of 2014. The decrease in selling, general and administrative expenses was primarily due to lower consulting expenses and lower compensation expenses as the result of operating actions taken in December of 2014. The decrease in research,

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development and engineering expenses was primarily due to lower compensation expenses as the result of operating actions taken in December of 2014.

Reconciliation of Segment EBIT to Income Before Income Taxes

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

| In millions | Three months ended | | Nine months ended | |
|---------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Total segment EBIT | \$573 | \$693 | \$1,892 | \$1,913 |
| Non-segment EBIT ⁽¹⁾ | 4 | (9 |) (32 |) (44 |
| Total EBIT | 577 | 684 | 1,860 | 1,869 |
| Less: Interest expense | 16 | 15 | 47 | 47 |
| Income before income taxes | \$561 | \$669 | \$1,813 | \$1,822 |

⁽¹⁾ Includes intersegment sales, intersegment profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the three and nine months ended September 27, 2015 and September 28, 2014.

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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 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 | September 27, 2015 | December 31, 2014 | |
|---|-----------------------|----------------------|---|
| Working capital ⁽¹⁾ | \$4,894 | \$5,034 | |
| Current ratio | 2.23 | 2.25 | |
| Accounts and notes receivable, net | \$3,159 | \$2,946 | |
| Days' sales in receivables | 58 | 53 | |
| Inventories | \$3,059 | \$2,866 | |
| Inventory turnover | 4.6 | 5.3 | |
| Accounts payable (principally trade) | \$1,824 | \$1,881 | |
| Days' payable outstanding | 48 | 44 | |
| Total debt | \$1,653 | \$1,698 | |
| Total debt as a percent of total capital ⁽²⁾ | 17.0 | % 17.3 | % |

⁽¹⁾ Working capital includes cash and cash equivalents.

⁽²⁾ Total capital is defined as total debt plus equity.

Cash Flows

Cash and cash equivalents were impacted as follows:

| In millions | Nine months ended | | |
|--|-----------------------|-----------------------|----------|
| | September 27, 2015 | September 28, 2014 | Change |
| Net cash provided by operating activities | \$1,131 | \$1,388 | \$(257) |
| Net cash used in investing activities | (477) | (640) | 163 |
| Net cash used in financing activities | (1,215) | (1,099) | (116) |
| Effect of exchange rate changes on cash and cash equivalents | (52) | (20) | (32) |
| Net decrease in cash and cash equivalents | \$(613) | \$(371) | \$(242) |

Net cash provided by operating activities decreased for the nine months ended September 27, 2015, versus the comparable period in 2014, primarily due to unfavorable working capital fluctuations, partially offset by higher consolidated net income. During the first nine months of 2015, the higher working capital requirements resulted in a cash outflow of \$414 million compared to a cash outflow of \$66 million in the prior period in 2014.

Net cash used in investing activities decreased for the nine months ended September 27, 2015, versus the comparable period in 2014, primarily due to lower cash investment for the acquisitions of businesses of \$164 million.

Net cash used in financing activities increased for the nine months ended September 27, 2015, versus the comparable period in 2014, primarily due to higher dividend payments of \$82 million and higher common stock repurchases of \$45 million.

Sources of Liquidity

We generate significant ongoing cash flow, which has been used, in part, to fund working capital, common stock repurchases, capital expenditures, dividends on our common stock, acquisitions, projected pension obligations and debt service. Cash provided by operations is our principal source of liquidity with \$1.1 billion provided in the nine months ended September 27, 2015.

As of September 27, 2015, our other sources of liquidity included:

cash and cash equivalents of \$1.7 billion, of which approximately 41 percent is located in the U.S. and 59 percent is located outside the U.S., primarily in the U.K., China and Singapore,

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a revolving credit facility with \$1.7 billion available, net of letters of credit and international and other domestic credit facilities with \$197 million available.

Cash, Cash Equivalents and Marketable Securities

A significant portion of our cash flows is generated outside the U.S. At September 27, 2015, the total of cash, cash equivalents and marketable securities held by foreign subsidiaries was \$1.0 billion, the majority of which was located in the U.K., China and Singapore. The geographic location of our cash and marketable securities aligns well with our ongoing investments. We manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct our business and the cost effectiveness with which those funds can be accessed. As a result, we do not anticipate any local liquidity restrictions to preclude us from funding our targeted expansion or operating needs with local resources.

If we distribute our foreign cash balances to the U.S. or to other foreign subsidiaries, we could be required to accrue and pay U.S. taxes. For example, we would be required to accrue and pay additional U.S. taxes if we repatriated cash from certain foreign subsidiaries whose earnings we have asserted are permanently reinvested outside of the U.S. Foreign earnings for which we assert permanent reinvestment outside the U.S. consist primarily of earnings of our China and U.K. domiciled subsidiaries. At present, we do not foresee a need to repatriate any earnings from these subsidiaries for which we have asserted permanent reinvestment. However, to help fund cash needs of the U.S. or other international subsidiaries as they arise, we repatriate available cash from certain foreign subsidiaries whose earnings are not permanently reinvested when it is cost effective to do so. Earnings generated after 2011 from our China operations are considered permanently reinvested, while earnings generated prior to 2012, for which U.S. deferred tax liabilities have been recorded, are expected to be repatriated in future years.

Debt Facilities and Other Sources of Liquidity

We have a \$1.7 billion revolving credit facility, the proceeds of which can be used for general corporate purposes. This facility expires on November 9, 2018. We expect to successfully negotiate an amended and restated revolver agreement at similar terms in the fourth quarter of 2015.

We have a current shelf registration filed with the Securities and Exchange Commission under which 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.

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 \$9 million to \$40 million over the next five years (including the remainder of 2015).

Uses of Cash

Capital Expenditures

Capital expenditures and spending on internal use software for the nine months ended September 27, 2015, were \$431 million compared to \$449 million in the comparable period in 2014. Despite the challenging international economies, we continue to invest in new product lines and targeted capacity expansions. We plan to spend between \$650 million and \$700 million in 2015 as we continue with product launches and facility improvements. Approximately 40 percent of our capital expenditures are expected to be invested outside of the U.S. in 2015.

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Share Repurchases

In July 2014, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon the completion of the 2012 Plan. In 2015, we made the following purchases under the respective stock purchase programs:

| In millions (except per share amounts) For each quarter ended | Shares Purchased | Average Cost Per Share | Total Cost of Repurchases | Remaining Authorized Capacity ⁽¹⁾ |
|--|---------------------|---------------------------|------------------------------|--|
| December 2012, \$1 billion repurchase program | | | | |
| March 29 | 1.0 | \$138.15 | \$137 | \$37 |
| June 28 | 0.3 | 136.68 | 37 | — |
| Subtotal | 1.3 | 137.83 | 174 | — |
| July 2014, \$1 billion repurchase program | | | | |
| June 28 | 2.4 | 140.04 | 340 | 660 |
| September 27 | 1.1 | 127.77 | 136 | 524 |
| Subtotal | 3.5 | 136.30 | 476 | 524 |
| Total | 4.8 | 136.71 | \$650 | |

⁽¹⁾ The remaining authorized capacities under the 2012 and 2014 Plans were calculated based on the cost to purchase the shares, but exclude commission expenses in accordance with the authorized Plans.

We may continue to repurchase outstanding shares from time to time during 2015 to offset the dilutive impact of employee stock based compensation plans and to enhance shareholder value.

Dividends

In July 2015, the Board of Directors authorized an increase to our quarterly dividend of 25 percent from \$0.78 per share to \$0.975 per share. We paid dividends of \$452 million during the nine months ended September 27, 2015.

Pensions

The funded status of our pension plans is dependent upon a variety of variables and assumptions including return on invested assets, market interest rates and levels of voluntary contributions to the plans. In the first nine months of 2015, the investment return on our U.S. pension trust was negative 0.8 percent while our U.K. pension trust return was 0.2 percent. Approximately 77 percent of our pension plan assets are held in highly liquid investments such as fixed income and equity securities. The remaining 23 percent of our plan assets are held in less liquid, but market valued investments, including real estate, private equity and insurance contracts.

We sponsor funded and unfunded domestic and foreign defined benefit pension and other postretirement plans.

Contributions to these plans were as follows:

| In millions | Nine months ended | |
|--|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 |
| Defined benefit pension and other postretirement plans | | |
| Voluntary contribution | \$79 | \$109 |
| Mandatory contribution | 87 | 88 |
| Defined benefit pension contributions | 166 | 197 |
| Other postretirement plans | 33 | 35 |
| Total defined benefit plans | \$199 | \$232 |
| Defined contribution pension plans | \$56 | \$57 |

We anticipate making additional defined benefit pension contributions and other postretirement benefit payments during the remainder of 2015 of \$9 million and \$7 million, respectively. The estimated \$175 million of pension

contributions for the full year include voluntary contributions of approximately \$82 million. These contributions and payments may be made from trusts or company funds either to increase pension assets or to make direct benefit payments to plan participants. Claims and

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premiums for other postretirement benefits are expected to approximate \$40 million in 2015. We expect our 2015 net periodic pension cost to approximate \$63 million.

Restructuring Actions

On October 27, 2015, we announced we will reduce our worldwide professional work force by up to 2,000 employees in response to lower demand for our products in the U.S. and key markets around the world. The employee reductions will come from all parts of the company. We will incur a pre-tax fourth quarter charge in the range of \$70 million to \$90 million for the headcount reductions. In addition to these reductions, we expect to close or restructure several manufacturing facilities over time which could increase the fourth quarter charge and may result in additional charges in the future.

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⁾ | Senior L-T Debt Rating | Outlook | Last Updated |
|-------------------------------------|---------------------------|---------|---------------|
| Standard & Poor's Rating Services | A+ | Stable | August 2014 |
| Fitch Ratings | A | Stable | October 2015 |
| Moody's Investors Service, Inc. | A2 | Stable | December 2014 |

⁽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.

Management's Assessment of Liquidity

Our financial condition and liquidity remain strong. Our solid balance sheet and credit ratings enable 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 liquidity provides us with the financial flexibility needed to fund working capital, capital expenditures, common stock repurchases, dividend payments, acquisitions of our North American distributors, projected pension obligations, restructuring actions and debt service obligations. We continue to generate cash from operations in the U.S. and maintain access to \$1.7 billion of our revolving credit facility.

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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 2014 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 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 2014 Form 10-K under the caption "APPLICATION OF CRITICAL ACCOUNTING ESTIMATES." Within the context of these critical accounting estimates, we are not currently aware of any reasonably likely events or circumstances that would result in different policies or estimates being reported in the first nine months of 2015.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 14, "RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS," in the Notes to Condensed Consolidated Financial Statements.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

A discussion of quantitative and qualitative disclosures about market risk may be found in Item 7A of our 2014 Form 10-K. There have been no material changes in this information since the filing of our 2014 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 September 27, 2015, 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; patent, trademark or other intellectual property infringement; contractual liability; the conduct of our business; tax reporting in foreign jurisdictions; distributor termination; workplace safety; and environmental matters. We also have been identified as a potentially responsible party at multiple waste disposal sites under U.S. federal and related state environmental statutes and regulations and may have joint and several liability for any investigation and remediation costs incurred with respect to such sites. We have denied liability with respect to many of these lawsuits, claims and proceedings and are vigorously defending such lawsuits, claims and proceedings. We carry various forms of commercial, property and casualty, product liability and other forms of insurance; however, such insurance may not be applicable or adequate to cover the costs associated with a judgment against us with respect to these lawsuits, claims and proceedings. We do not believe that these lawsuits are material individually or in the aggregate. While we believe we have also established adequate accruals for our expected future liability with respect to pending lawsuits, claims and proceedings, where the nature and extent of any such liability can be reasonably estimated based upon then presently available information, there can be no assurance that the final resolution of any existing or future lawsuits, claims or proceedings will not have a material adverse effect on our business, results of operations, financial condition or cash flows.

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

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, 2014, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K or the "CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION" in this Quarterly report are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently judge to be immaterial also may materially adversely affect our business, financial condition or operating results.

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

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

| Period | Issuer Purchases of Equity Securities | | | |
|--------------------------------|---|----------------------------------|--|---|
| | (a) Total Number of Shares Purchased ⁽¹⁾ | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs ⁽²⁾ |
| June 29 - August 2, 2015 | 751,522 | \$130.59 | 751,522 | 84,095 |
| August 3 - August 30, 2015 | 156,097 | 128.79 | 155,297 | 102,096 |
| August 31 - September 27, 2015 | 158,109 | 113.54 | 158,109 | 103,967 |
| Total | 1,065,728 | 127.79 | 1,064,928 | |

(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 program.

(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 was excluded from this column.

We repurchased \$136 million of stock under the 2014 Board of Directors authorized stock repurchase plan during the three months ended September 27, 2015.

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During the three months ended September 27, 2015, we repurchased 800 shares from employees in connection with the Key Employee Stock Investment Plan which allows certain employees, other than officers, to purchase shares of common stock on an installment basis up to an established credit limit. Loans are issued for five-year terms at a fixed interest rate established at the date of purchase and may be refinanced after its initial five-year period for an additional five-year period. Participants must hold shares for a minimum of six months from date of purchase and after shares are sold must wait six months before another share purchase may be made. We hold participants' shares as security for the loans and would, in effect repurchase shares if the participant defaulted in repayment of the loan. There is no maximum amount of shares that we may purchase under this plan.

ITEM 3. Defaults Upon Senior Securities

Not applicable.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

Not applicable.

ITEM 6. Exhibits

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

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SIGNATURES

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

Cummins Inc.

Date: October 27, 2015

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

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

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CUMMINS INC.
EXHIBIT INDEX

| Exhibit No. | Description of Exhibit |
|-------------|--|
| 10(c) | Deferred Compensation Plan, as amended (filed herewith). |
| 12 | Calculation of Ratio of Earnings to Fixed Charges. |
| 31(a) | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31(b) | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |